

Litigation Alert:

Amgen: A Pyrrhic Victory For Plaintiffs in Securities Class Actions?

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In a 6-3 decision issued last week, the Supreme Court ruled in *Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 568 U.S. ___, 2013 WL 691001 (Feb. 27, 2013), that shareholders bringing class actions under Section 10(b) of the Securities Exchange Act of 1934 need not prove that alleged misstatements are material in order to invoke the fraud-on-the-market presumption. Several lower courts had held that the fraud-on-the-market theory – long used by plaintiffs to justify class certification – was not applicable absent a threshold showing of materiality. In rejecting that approach, the *Amgen* decision removes one potential weapon from companies defending shareholder class actions. However, after reading the various opinions by the members of the Court, plaintiffs may conclude that modest victory is outweighed by a far more significant threat: the possibility of a challenge to the fraud-on-the market presumption itself.

THE ISSUES RAISED IN AMGEN

The *Amgen* decision pivots on the interplay between the requirements for class certification and the substantive elements of a Section 10(b) claim – and, in particular, the element of reliance.¹ To certify a class action, a plaintiff must not only satisfy the requirements of numerosity, commonality, typicality, and adequacy of representation, but must also establish that “the questions of law or fact common to class members predominate over any questions affecting only individual members.” Fed. R. Civ. P. 23(b)(3).

Securities fraud traditionally required a showing of direct reliance – *i.e.*, that a plaintiff was aware of a defendant’s statement and relied on that statement in his or her purchase or sale of a security. Applied strictly, however, the reliance element would present enormous challenges to shareholders seeking to show that common issues predominate over

individual ones: after all, direct reliance is almost always an inherently individualized inquiry (*i.e.*, one requiring an analysis of the circumstances of particular shareholders and what they may or may not have relied upon in buying or selling securities). Consequently, courts have held that reliance in Section 10(b) cases may be presumed in certain circumstances – a judicial gloss on the statute that has permitted hundreds of shareholder class actions to be filed every year. In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Supreme Court endorsed the “fraud-on-the-market” presumption of reliance. The fraud-on-the-market presumption allows courts to “presume that investors trading in efficient markets indirectly rely on public, material misrepresentations through their ‘reliance on the integrity of the price set by the market.’” *Amgen*, 2013 WL 691001, at *5 (citing *Basic*, 485 U.S. at 245). The fraud-on-the-market presumption is based on the premise that “the market price of shares traded on well-developed markets reflects all publicly available information, and hence, any material misrepresentations.” *Basic*, 485 U.S. at 246. To invoke the presumption, plaintiffs must show (1) an efficient market, (2) a public statement, (3) that the stock was traded after the statement was made but before the truth was revealed, and (4) the materiality of the statement. *Id.* at 248 n.27.

Thus, under *Basic* and its progeny, materiality of alleged misstatements is one of the “essential predicates” to the invocation of the fraud-on-the-market presumption. *Amgen*, 2013 WL 691001, at *7. Notwithstanding that, courts have generally been willing to certify classes without any real examination of materiality.² In recent years, though, a number of courts – most notably the Second Circuit – have undertaken an analysis of materiality, permitted evidence on that issue, and have held that

¹ The elements of a Section 10(b) claim are: “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.” *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317 (2011).

² See, e.g., *Connecticut Ret. Plans & Trust Funds v. Amgen Inc.*, 660 F.3d 1170, 1175-77 (9th Cir. 2011) (plaintiffs need not prove materiality in order to invoke the fraud on the market presumption of reliance for purposes of class certification; refusing to consider evidence rebutting materiality at class certification stage); *Schleicher v. Wendt*, 618 F.3d 679, 687 (7th Cir. 2010) (materiality need not be proved at class certification stage).

a presumption of reliance is inapplicable where the allegedly actionable statements are not shown to be material.³

THE AMGEN OPINION: FRAUD-ON-THE-MARKET MAY BE APPLIED AT THE CLASS CERTIFICATION STAGE WITHOUT A SHOWING OF MATERIALITY

In *Amgen*, Connecticut Retirement Plans and Trust Funds (“plaintiff”) brought a putative securities class action for money damages against the Company and several of its officers alleging that, by misstating and failing to disclose safety information about two Amgen products used to treat anemia, they violated Sections 10(b) and 20(a) of the 1934 Act. The District Court granted plaintiff’s motion to certify a class under Rule 23(b)(3). Amgen appealed, arguing that the District Court erred by not requiring plaintiff to prove that Amgen’s alleged misrepresentations were material in order to invoke the fraud-on-the-market presumption at class certification, and, by refusing to consider evidence rebutting the materiality of the alleged misrepresentations. The Ninth Circuit affirmed. The Supreme Court then granted certiorari in order to resolve the split that had arisen among the Circuit Courts on that issue.

Although Justice Ginsburg (writing for the majority) conceded that materiality is “indisputably” a predicate to the fraud-on-the-market presumption, *Amgen*, 2013 WL 691001, at *8, she noted that any suggestion that plaintiffs must first prove that they will prevail on the merits of the case (*e.g.*, on the substantive element of materiality) before a class is certified, was tantamount to putting the “cart before the horse.” *Id.* at *4. That is so because “the office of a Rule 23(b)(3) certification ruling is not to adjudicate the case; rather, it is to select the method best suited to adjudication of the controversy.” *Id.* To that end, the question before the Court was whether proof of materiality is necessary “to ensure that the *questions* of law or fact common to the class will ‘predominate over any questions affecting only individual members.’” *Id.* at *8 (citing Fed. R. Civ. P. 23(b)(3)). The majority found the answer to this question was “clearly no.” *Id.*

³ See, *e.g.*, *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 483-84 (2d Cir. 2008) (plaintiff must prove materiality before class certification; defendant may present evidence rebutting materiality at class certification). See also *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631-32, 637-38 (3d Cir. 2011) (although plaintiff need not prove materiality at class certification, defendant may present rebuttal evidence on that issue at class certification).

First, because materiality can be proved based on objective evidence, whether a statement is or is not material can be proven using evidence common to the class – thus making it a “common question” for purposes of Rule 23(b)(3). *Id.* *Second*, because materiality is itself a substantive element of a claim under Section 10(b), failure to prove the materiality of a statement at a later stage in the litigation would end the litigation for the entire class. For that reason, individual issues of reliance would never threaten to overwhelm common issues to the class should materiality be lacking – the entire class would sink or swim together as to materiality. *Id.*⁴

In addition to holding that plaintiffs need not prove materiality at class certification in order to invoke the fraud-on-the-market presumption of reliance, the Court also held that defendants cannot submit evidence rebutting materiality at the class certification stage. The Court found such merits-based evidence is better saved for summary judgment or trial. *Id.* at *15.

Notably, in making its ruling, the majority rejected several of Amgen’s policy-based arguments. Amgen asserted that because certification of a class placed enormous *in terrorem* settlement pressures on defendants, if materiality were not required to be proved at class certification, it may never be adjudicated. The Court, however, pointed out that the same was true for any other substantive element of a Section 10(b) claim. *Id.* at *12. Moreover, the majority noted that in enacting the Private Securities Litigation Reform Act of 1995, Congress had considered these settlement pressures and put into place a number of protections for defendants, including, *inter alia*, heightened pleading standards, a discovery stay, and a safe harbor for forward-looking statements. Congress did not, however, require proof of materiality at the class certification stage as

⁴ Justice Thomas’ dissent points out the fallacy in this logic and urges that it is the Court, not Amgen, who is attempting to “put the cart before the horse.” *Id.* at *22 (Thomas, J., dissenting). Justice Thomas explains that “[t]he materiality of a specific statement, is . . . essential to the fraud-on-the market presumption, which in turn enables a plaintiff to prove reliance.” *Id.* at *20. “Without materiality, there is no fraud-on-the market presumption, questions of reliance remain individualized, and Rule 23(b)(3) certification is impossible.” *Id.* at *22. Thus, “[a] plaintiff who cannot prove materiality does not simply have a claim that is ‘dead on arrival’ at the merits, he has a class that should never have arrived at the merits at all because it failed Rule 23(b)(3) certification from the outset.” *Id.* Justice Thomas goes on to argue that “[t]he Court reverses that inquiry, effectively saying that certification may be put off until later because an adverse merits determination will retroactively wipe out the entire class.” *Id.*

an antidote to *in terrorem* settlements. *Id.* Nor did the Court accept Amgen's argument that requiring proof of materiality at class certification would result in judicial efficiencies. To the contrary, the Court found that a requirement that materiality be proved at class certification would waste judicial resources, necessitating a "mini-trial" on the issue of materiality. *Id.* at *13.

Putting aside the fact that the majority opinion removes a potential argument from defendants' arsenal at class certification, the most significant issue to arise out of *Amgen* comes not out of the majority opinion itself, but rather out of Justice Alito's concurrence and several statements made by the dissenters regarding the continuing viability of the fraud-on-the-market presumption. In his concurrence, Justice Alito suggests that, in light of recent evidence suggesting that the fraud-on-the-market presumption might rest on a faulty economic premise, "reconsideration of the *Basic* [fraud-on-the-market] presumption may be appropriate." *Id.* at *16. Similarly, Justice Thomas' dissent (which was joined by Justices Scalia and Kennedy) asserts that "[t]he *Basic* decision itself is questionable" given that "the Court 'is not well equipped to embrace novel constructions of a statute based on contemporary microeconomic theory.'" *Id.* at *19 n.4 (quoting *Basic*, 485 U.S. at 252-53 (White, J., concurring in part and dissenting in part)).

WHAT AMGEN MEANS FOR SECURITIES CLASS ACTIONS

Although *Amgen* does remove one potential obstacle facing plaintiffs seeking to establish class certification, its holding does not substantially change the realities of defending a securities class action. That is especially true in California and elsewhere in the Ninth Circuit, where even before *Amgen* plaintiffs were not required to prove materiality at the class certification stage. Defendants can still attack application of the fraud-on-the-market presumption at class certification on various grounds, including showing that the stock was not traded in an efficient market (an argument that has been successful in a number of cases). Moreover, defendants can

still challenge materiality on motion to dismiss, at summary judgment, and at trial.

Indeed, the majority's holding in *Amgen* may ultimately be much less significant than the concurring and dissenting opinions of Justices Alito and Thomas, which invite a challenge to the fraud-on-the-market presumption. As noted above, without the fraud-on-the-market presumption, class certification becomes highly problematic for shareholders bringing suit under Section 10(b). Thus, while plaintiffs may be able to claim a minor victory in *Amgen*, that victory may eventually prove to be Pyrrhic.

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