Amgen Inc. v. Connecticut Retirement Plans and Trust Funds: Proof of Materiality Is Not Required For Class Certification in a Fraud-on-the-Market Action

In a 6-to-3 decision resolving a circuit split between the First, Second and Fifth Circuits and the Third, Seventh and Ninth Circuits, the Supreme Court held in *Amgen Inc*. v. *Connecticut Retirement Plans and Trust Funds* that proof of materiality is not a prerequisite to class certification in a securities fraud action under §10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and SEC Rule 10b-5 ("Rule 10b-5").[1]

I. Background

In order to prevail in a securities fraud action under Rule 10b-5, a plaintiff must prove, among other things, reliance on an alleged misrepresentation. The traditional way a plaintiff demonstrates reliance is through a showing that it was aware of a company's statement and purchased securities based on that specific misrepresentation. Acknowledging that this evidentiary burden would otherwise preclude the predominance of common issues in class actions under Rule 23(b)(3),[2] in *Basic* v. *Levinson*, the Supreme Court established a rebuttable presumption of reliance by every class member in cases where the fraud-on-the-market theory applies.[3]

After *Basic* and its progeny, it is well established that to support certification of a class based on the fraud-on-the-market theory, the plaintiff must demonstrate, at a minimum, that the market for the security is efficient, that the alleged misrepresentation was public and that the plaintiffs traded shares between the time the misrepresentation was made and the time the truth was revealed.[4]

In *Amgen Inc*. v. *Connecticut Retirement Plans and Trust Funds,* the Court considered whether materiality—another element of a Rule 10b-5 violation – must also be proved as a condition of class certification in a fraud-on-the-market action.

II. Procedural History

Plaintiff Connecticut Retirement Plans and Trust Funds brought a securities fraud action under §10(b) of the Exchange Act and Rule 10b-5 against defendants Amgen Incorporated, a biotechnology company, and several of its officers (collectively, "Amgen") arising out of alleged misrepresentations and omission concerning the safety of Amgen's anemia treatment drugs. The District Court granted plaintiff's motion for class-action certification on behalf of all investors who purchased Amgen's stock between the date of the first alleged misrepresentation and the date of the last alleged corrective disclosure by defendants. Defendants appealed, contending that the District Court erred in certifying the class without requiring plaintiff to demonstrate that

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[1] *Amgen Inc*. v. *Connecticut Retirement Plans and Trust Funds*, No. 11-1085 slip Op. at 2 (Feb. 27, 2013) (hereinafter "Slip Opinion").

[2] Rule 23(b)(3) of the Federal Rules of Civil Procedure requires a showing that "the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."

[3] *Basic* v. *Levinson*, 485 U.S. 224, 245-50 (1988); *see also* Slip Opinion at 6. As summarized by the Court, "The fraud-on-the-market premise is that the price of a security traded in an efficient market will reflect all publicly available information about a company; accordingly a buyer of the security may be presumed to have relied on that information in purchasing the security." Slip Opinion at 1.

[4] *See Erica P. John Fund, Inc. v. Halliburton Co.,* 131 S. Ct. 2179, 2185 (2011).

Amgen's alleged misrepresentations and omissions were material and that the District Court should have permitted defendants to present evidence rebutting plaintiff's class certification motion.[5]

The Ninth Circuit Court of Appeals affirmed the decision of the District Court, holding that "plaintiffs need not *prove* materiality to avail themselves of the fraud-on-the-market presumption of reliance at the class certification stage," and that thus "the district court correctly refused to consider" Amgen's rebuttal evidence "at the class certification stage."[6] Defendants appealed and the Supreme Court granted certiorari on two questions:

1. Whether, in a misrepresentation case under Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud on-the-market theory; and

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the element of materiality before certifying a plaintiff class based on that theory.[7]

III. The Supreme Court's Decision

The Court affirmed the decision of the Ninth Circuit Court of Appeals, holding that proof of materiality "is not a prerequisite to class certification" and consequently a trial court need not consider rebuttal evidence concerning materiality at the class action stage.[8]

In rejecting Amgen's argument that plaintiff's class certification required proof of materiality, the Court explained that "[a]lthough we have cautioned that a court's class certification analysis must be 'rigorous' and may 'entail some overlap with the merits of the plaintiff's underlying claim,' Rule 23 grants courts no license to engage in free-ranging merits inquiries at the certification stage."[9] Rather, the Court held, "[m]erits questions may be considered to the extent—but only to the extent—that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied."[10]

Applying Rule 23(3)(b)'s requirement of the predominance of common questions of law or fact in the context of a federal securities-fraud action, the Court concluded that "[b]ecause materiality is judged according to an objective standard . . . [t]he alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class" such that "the plaintiff class' inability to prove materiality would not result in individual questions predominating" but rather "would end the case, given that materiality is an essential element of the class members' securities fraud claims."[11] Given that "failure of proof on the *common* question of materiality ends the litigation and thus will never cause individual questions of reliance or anything else to overwhelm questions common to the class," the Court concluded that "under the plain language of Rule 23(b)(3), plaintiffs are not required to prove materiality at the class-certification stage."[12] Accordingly, the materiality of the alleged misrepresentations or omissions relied upon by plaintiff is "properly addressed at trial or

[5] Slip Opinion at 7.

[6] 660 F.3d 1170, 1177 (9th Cir. 2011) (emphasis in original).

[7] Slip Opinion at 8.

[8] *Id.* at 2, 25.

[9] *Id.* at 9.

[10] *Id.*

[11] *Id.* at 2-3.

[12] *Id.* at 11-12 (emphasis in original).

in a ruling on a summary judgment motion" and "should not be resolved in deciding whether to certify a proposed class."[13]

The Court's decision cautioned that a requirement of proof of materiality at the class action certification stage would "put the cart before the horse" by requiring a plaintiff to "first establish that it will win the fray" in order to gain class certification.[14] The Court rejected this theory, holding that "the office of a Rule 23(b)(3) certification ruling is not to adjudicate the case; rather, it is to select the 'metho[d]' best suited to adjudication of the controversy 'fairly and efficiently.'"[15]

The Court also rejected Amgen's policy arguments for pre-certification proof of materiality. First, the Court addressed Amgen's argument that pre-certification proof of materiality is justified by the substantial pressure that class certification may exert on a defendant to "settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability."[16] In rejecting this argument, the Court concluded that Congress "has addressed settlement pressures associated with securities-fraud class actions through means other than requiring proof of materiality at the class-certification stage," including through the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standards Act of 1998, and consequently the Court found it "[in]appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class-certification in securities-fraud suits."[17] Next, the Court rejected Amgen's argument that "requiring proof of materiality before class certification would conserve judicial resources by sparing judges the task of overseeing large class proceedings in which the essential element of reliance cannot be proved on a classwide basis."[18] Turning Amgen's argument on its head, the Court concluded that "it is Amgen's position, not the judgment of the lower courts in this case, that would waste judicial resources," explaining that a requirement of pre-certification proof of materiality "would necessitate a mini-trial on the issue of materiality at the class-certification stage," which would require "considerable expenditures of judicial time and resources, costs scarcely anticipated by [Rule] 23(c)(1)(A)" and which may be duplicated at trial.[19]

Having concluded that materiality is not a prerequisite to class-certification, the Court affirmed the decision of the lower courts to "disregard[] Amgen's rebuttal evidence in deciding whether plaintiff's proposed class satisfied Rule 23(b)(3)'s predominance requirement."[20] The Court explained that "just as plaintiff class's inability to prove materiality creates no risk that individual questions will predominate, so even a definite rebuttal on the issue of materiality would not undermine the predominance questions common to the class."[21] Accordingly, the Court emphasized that such proof is "correctly reserved . . . for summary judgment or trial."[22]

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[13] *Id.* at 14.

[14] *Id.* at 3.

[15] *Id.*

[16] *Id.* at 18.

[17] *Id.* at 19-20.

[18] *Id.* at 21.

[19] *Id.*

[20] *Id.* at 25.

[21] *Id.*

[22] *Id.* at 26.

IV. Justice Alito's Concurrence

In his concurrence, Justice Alito noted that Amgen's appeal did not ask the Court to "revisit *Basic's* fraud-on-the-market presumption" but cautioned that "more recent evidence suggests that the presumption may rest on a faulty economic premise" such that "reconsideration of the *Basic* presumption may be appropriate."[23]

V. The Dissent[24]

In the principal dissent, the dissenting justices concluded that the Ninth Circuit's decision should have been reversed, arguing that "Rule 23, as well as common sense, requires class certification issues to be addressed first" and concluding that "nothing in logic or precedent justifies ignoring at certification whether reliance is susceptible to Rule 23(b)(3) simply because one predicate of reliance—materiality—will be resolved, if at all, much later in the litigation on an independent merits element."[25] The dissenting justices reasoned that "[w]ithout materiality, there is no fraud-on-the-market presumption, questions of reliance remain individualized, and Rule 23(b)(3) certification is impossible."[26] Thus, the dissent concluded, "[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."[27]

In his separate dissent, Justice Scalia focused on the "unquestionably disastrous" policy implications associated with the majority's decision.[28] Scalia's dissent argues that "the *Basic* rule of fraud-on-the-market . . . governs not only the question of substantive liability, but also the question of whether certification is proper. All of the elements of that rule, including materiality, must be established if and when it is relied upon to justify certification."[29] Noting that "[c]ertification of the class is often, if not usually, the prelude to a substantial settlement by the defendant because the costs and risks of litigating further are so high," Justice Scalia argued that the majority's opinion "does an injustice to the *Basic* Court" to allow all market class-action suits to pass beyond the "crucial certification stage . . . no matter what the alleged misrepresentation."[30]

VI. Significance of the Decision

The Court's decision resolved a significant circuit split between the First, Second and Fifth Circuits and the Third, Seventh and Ninth Circuits. As a result of this decision, the issue of materiality is regarded as a class-wide merits issue that must await the summary judgment stage or trial. This may be regarded as a strategic advantage for securities plaintiffs, whose burden of demonstrating materiality will now be postponed until after class-certification.

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[23] Slip Opinion at 1 (Alito, J. concurring).

[24] Justice Thomas wrote the principal dissent, joined by Justice Kennedy and by Justice Scalia in part. Slip Opinion at 1 (Thomas, J. dissenting). Justice Scalia wrote a separate dissent as to the portion of the principal dissent from which he departed. Slip Opinion at 1 (Scalia, J. dissenting).

[25] Slip Opinion at 10 (Thomas, J. dissenting).

[26] *Id.*

[27] *Id.*

[28] Slip Opinion at 4 (Scalia, J. dissenting).

[29] *Id.* at 1-2.

[30] *Id.* at 4.

In addition to the impact of the majority's decision, the opinions of the concurring and dissenting justices are of particular significance, as they suggest that the fraud-on-the-market presumption may be subjected to critical examination by the Court in the future.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Christine Mott at 212.701.3015 or cmott@cahill.com.