Supreme Court Will Review Holding that Proof of Materiality Is Not Required For Class Certification in a Fraud-on-the-Market Action

On June 11, 2012, the Supreme Court granted certiorari with respect to the unanimous decision of the Court of Appeals for the Ninth Circuit in *Connecticut Retirement Plans and Trust Funds v. Amgen, Inc., et al.*[1] The Court certified two questions for review:

1. Whether, in a misrepresentation case under Securities and Exchange Commission 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 applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

The Court of Appeals held in *Amgen* 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 the district court had "correctly refused to consider Amgen's truth-on-the-market defense" during the class certification process.[2] It therefore affirmed the certification of the class under Rule 23(b)(3) of the Federal Rules of Civil Procedure.[3]

Amgen had argued in its petition for certiorari that there is a deep and mature split among circuit courts as to whether proof of materiality is a necessary predicate for class certification where a plaintiff invokes the presumption of reliance[4] recognized by the Supreme Court in *Basic, Inc. v. Levinson*.[5] It urged that a proper reading of *Basic* requires such a showing in addition to a demonstration of an efficient market, an alleged public misrepresentation and trading during the alleged period of fraud.[6] It also argued that the *in terrorem* effect of class certification in modern securities fraud litigation would be exacerbated if rebuttal evidence were disallowed at the class certification stage and reserved for a trial that (in view of the pressure to settle) may never come.[7] Respondent countered that there is no entrenched circuit split, that any prior differences have been resolved by recent Supreme Court rulings on related subjects and that the Ninth Circuit's ruling was in accord with those precedents.[8]

I. Background

In order to prevail in a securities fraud action under Rule 10b-5, a plaintiff must prove, *inter alia,* 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 common stock based on that specific misrepresentation. Acknowledging that this evidentiary burden would otherwise preclude the predominance of common issues in

---

[1] 660 F.3d 1170 (9th Cir. 2011) (hereinafter *Amgen*).

[2] *Id.* at 1177 (emphasis in original).

[3] *Id.*

[4] *See* Petition for a Writ of Certiorari at 8.

[5] 485 U.S. 224, 250 (1988) (hereinafter *Basic*).

[6] *See* Petition for a Writ of Certiorari at 19-20.

[7] *Id.* at 3.

[8] *See* Brief for Respondent in Opposition at 10.

class actions under Rule 23(b)(3), the *Basic* plurality recognized a rebuttable presumption of reliance by every class member in cases where the fraud-on-the-market theory applies.[9]

The fraud-on-the-market theory assumes that if a security trades in an efficient market, *all* public material information is reflected in the price of the security. Therefore, misleading statements will "defraud purchasers of stock even if the purchasers do not directly rely on the misstatements."[10] 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.[11]

However, Amgen asserted in its petition that circuit courts are split as to 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. Amgen cited *In Re Salomon Analyst Metromedia Litigation*[12] and *Oscar Private Equity Investors v. Allegiance Telecom, Inc.*[13] as cases in which Courts of Appeal for the Second and Fifth Circuits, respectively, held that plaintiffs must offer proof of a material misstatement in order to invoke the presumption of reliance based on the fraud-on-the-market theory. In contrast, like the Ninth Circuit in *Amgen*, the Court of Appeals for the Seventh Circuit held in *Schleicher v. Wendt*[14] that materiality is a merits question that may not be considered at the class certification stage. The Third Circuit has taken a middle ground, not requiring proof of materiality as a condition of class certification, but allowing defendants to rebut the applicability of the fraud-on-the-market theory by disproving the materiality of the alleged misrepresentation.[15]

The Supreme Court's consideration of this issue may be informed by two significant decisions it issued in 2011. The Court held in *Erica P. John Fund* that proof of loss causation is *not* required at the class-certification stage and must be deferred until consideration of the merits.[16] It ruled in *Wal-Mart Stores, Inc. v. Dukes* that "[a] party seeking class certification" must be prepared to prove "*in fact*" that the requirements of Rule 23 have been met, and that in conducting the required "rigorous analysis," a court may probe behind the pleadings, notwithstanding overlap with the merits of the underlying claim.[17] Both parties find support in these cases for their respective positions.

II. Positions of the Parties

In *Amgen*, the plaintiff class brought securities fraud claims against Amgen regarding alleged product safety misrepresentations of two of the company's flagship products. The class period began on April 22, 2004 when Amgen reassured investors that the products Aranesp and Epogen were safe and ended on May 10, 2007 when an FDA official stated that no trial had tested the safety of the drugs. On motion for class certification,

[9] 485 U.S. at 250.

[10] *Id.* at 241-42 (*quoting Piel v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).

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

[12] 544 F.3d 474 (2d Cir. 2008).

[13] 487 F.3d 261 (5th Cir. 2007).

[14] 618 F.3d 679 (7th Cir. 2010).

[15] *See In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 639 (3d Cir. 2011).

[16] 131 S. Ct. at 2187.

[17] 131 S. Ct. 2541, 2551 (2011).

Amgen argued that the "truth" regarding the products was already known on the market before May 10, 2007 such that the allegedly concealed information was not material. The class maintains that until May 10, 2007 the truth had not been conveyed to the public.

In its petition for certiorari, Amgen argued that materiality cannot be separated from the required showing of efficiency in a fraud-on-the-market analysis because *Basic* assumed that an investor's reliance would be on "public material misrepresentations."[18] Amgen noted that this issue had not been addressed in *Erica P. John Fund,* which was expressly limited to whether a showing of loss causation was essential at the class certification stage. It also emphasized the practical ramifications disallowing rebuttal of the presumption of reliance at the class certification stage: "The Ninth Circuit's error . . . will have the harmful effect of depriving many defendants of any real opportunity to challenge the class-wide reliance, given the immense and immediate settlement pressure created by a class certification order in securities litigation."[19]

The plaintiff class argued that the Ninth Circuit had "correctly recognized 'that proof of materiality is not necessary to ensure that the question of reliance is common among all prospective class members' securities fraud claims."[20] Because Amgen admitted that its securities were traded in an efficient market, "the class action mechanism has 'the capacity . . . . to generate' a common answer on whether Amgen's misrepresentations were material" under *Wal-Mart*'s Rule 23 standard.[21] The class also argued that Amgen's demand to present rebuttal evidence at the certification stage was not a "coherent legal argument" but a "naked public policy argument[] about the perceived unfairness [of settlement pressure for] securities fraud defendants having to face the prospect of defending against claims brought by a certified class."[22]

Amici curiae for the petitioner, including the U.S. Chamber of Commerce, and certain law professors and former SEC commissioners, urged in their respective briefs that "the materiality of the alleged misrepresentations was essential to *Basic*'s holding that reliance on misrepresentations may be presumed under the fraud-on-the-market theory when the market is efficient."[23] They also argued that if allowed to stand, the Ninth Circuit's position will unfairly burden companies such as Amgen, which will be forced to litigate or settle meritless claims if a determination of materiality is not required or allowed at the class certification stage.[24]

III. Importance of the Grant of Certification

In *Erica P. John Fund,* the Supreme Court expressly declined to reach the defendant's argument that class certification analysis in a fraud-on-the-market case should include a determination of whether the alleged misrepresentation impacted the price of the subject stock. As summarized by the Court: "Halliburton's theory is that if a misrepresentation does not affect market price, an investor cannot be said to have relied on the misrepresentation merely because he purchased stock at that price. If the price is unaffected by the fraud, the price does not reflect the fraud."[25] Although the Court did not regard that issue to be within the scope of the opinion under review, the *Amgen* matter will provide a new opportunity for it to consider whether a district court

[18] 485 U.S. at 247.

[19] *See* Petition for a Writ of Certiorari at 8-9.

[20] *See* Brief for Respondent in Opposition at 13 (*citing Amgen*, 660 F.3d at 1177).

[21] *See* Brief for Respondent in Opposition at 14 (*citing Wal-Mart,* 131 S. Ct. at 2551).

[22] *Id.* at 29.

[23] *See* Brief of Former SEC Commissioners et al. as Amici Curiae Supporting Petitioners at 11.

[24] *See id.* at 3-4.

[25] 131 S. Ct. at 2187.

should consider -- as an affirmative element of a class certification showing, or as rebuttal evidence at the class certification stage -- whether an alleged misrepresentation had a price impact. Even if it should hold that materiality is a class-wide merits issue that must await the summary judgment stage or trial, the Court's certification of the question of admissibility of rebuttal evidence at the class certification stage may yield further clarification of the extent to which a district court should look behind the pleadings before certifying a class.

The Court is expected to hear oral arguments in the fall.

* * *

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 Patricia Farren at 212.701.3257 or pfarren@cahill.com; 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.