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U.S. Supreme Court Rejects Need to Prove Materiality at Class-Certification Stage in Securities Class Actions

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The U.S. Supreme Court ruled on February 27, 2013 that a plaintiff need not prove materiality as a prerequisite to obtaining class certification in a securities class action. The Court's ruling in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds* resolves a split among the federal Courts of Appeals, some of which had required proof of materiality (or had allowed evidence rebutting materiality) at the class-certification stage, and others of which had not.

Of equal interest is what the Court did *not* decide: the Court did *not* revisit the principle that class-action plaintiffs can invoke a rebuttable *presumption* of reliance if the defendant issuer's securities traded in an efficient market. However, four Justices appear willing to reconsider and perhaps even overturn the fraud-on-the-market presumption of reliance in a future case.

Factual Background

Amgen is a securities class action alleging that Amgen's stock price was inflated during the class period because the company had purportedly misled the market about the safety, efficacy, and marketing of two of its "flagship drugs." When the supposed "truth came to light," Amgen's stock price declined, and shareholder class actions were filed.

Plaintiffs sought to establish class certification by invoking the "fraud on the market" presumption of reliance under the Supreme Court's 1988 decision in *Basic Inc. v. Levinson*. The Court had held in *Basic* that reliance – a necessary element of a securities-fraud claim – can be rebuttably *presumed*, and need not be individually established, where the defendant's securities trade in an efficient market (as Amgen had conceded its stock did). Without such a presumption of reliance, securities class actions would "ordinarily" be impossible to certify, because "individual reliance issues would overwhelm questions common to the class."

Amgen opposed class certification by arguing that plaintiffs had failed to establish the materiality of its alleged misrepresentations – and that immaterial misrepresentations could not have affected Amgen's stock price. Accordingly, Amgen argued, plaintiffs could not rely on the fraud-on-the-market presumption of reliance, and the class thus could not be certified. The district court and the Court of Appeals for the Ninth Circuit rejected Amgen's position and held that proof of materiality was not required at the class-certification stage.

The Supreme Court agreed to review the case because of a split among the federal Circuits. For example, the Seventh Circuit – like the Ninth Circuit – had held that materiality need not be proven at the class-certification stage. But the Second Circuit had ruled that a plaintiff must prove, and a defendant may attempt to rebut, materiality before class certification. And the Third Circuit had allowed defendants to present rebuttal evidence on materiality at the class-certification stage, although it had not required plaintiffs to prove materiality before class certification.

The Supreme Court's Decision

The Supreme Court held that a plaintiff need not prove, and a defendant is not entitled to rebut, materiality at the class-certification stage. The Court reasoned that materiality is judged according to an objective, reasonable-person standard; it does not depend on an individual investor's subjective view of what is or is not significant. Accordingly, the question whether the alleged misrepresentations or omissions were material "is a question common to all members of the class."

Because materiality is a question common to all class members, "the plaintiff class's inability to prove materiality would not result in individual questions predominating" – a result that would preclude class certification. "Instead, a failure of proof on the issue of materiality would end the case, given that materiality is an essential element of the class members' securities-fraud claims. As to materiality, therefore, the class is entirely cohesive: It will prevail or fail in unison. In no event will the individual circumstances of particular class members bear on the inquiry."

The Court contrasted materiality with issues such as market efficiency and publicity of the alleged misrepresentations, which must be established at the class-certification stage if the plaintiffs wish to rely on the presumption of reliance. The Court noted that a failure of proof on those issues would defeat the fraud-on-the-market presumption, but could still leave investors with their *individual* claims. But a failure of proof on materiality would end the case for *all* class members.

Amgen's Implications

The Supreme Court's ruling could make certification of securities class actions easier in federal Circuits (such as the Second and Third) that had required or allowed materiality issues to be litigated during the class-certification stage. As Amgen argued, anything that makes class certification easier to obtain could put more pressure on defendants to settle a case rather than to continue litigating.

But perhaps the more interesting aspect of *Amgen* is what the Court did *not* decide, and what could happen in the future: *Amgen* suggests that the fraud-on-the-market doctrine itself might be subject to question by perhaps as many as four Justices.

Justice Alito wrote a one-paragraph opinion concurring in the majority's opinion "with the understanding that [Amgen] did not ask us to revisit *Basic*'s fraud-on-the-market presumption. . . . As the dissent observes, more recent evidence suggests that the presumption may rest on a faulty economic premise. . . . In light of this development, reconsideration of the *Basic* presumption may be appropriate."

The dissent – by Justice Thomas, joined by Justices Kennedy and Scalia – contains a footnote stating that "[t]he *Basic* decision itself is questionable. . . . [B]ut the Court has not been asked to revisit *Basic*'s fraud-on-the-market presumption. I thus limit my dissent to demonstrating that the Court is not following *Basic*'s dictates. Moreover, the Court acknowledges there is disagreement as to whether market efficiency is 'a binary, yes or no question,' or instead operates differently depending on the information at issue."

If a majority of the Court were to overrule *Basic*'s fraud-on-the-market presumption of reliance, securities class actions as we know them could be doomed, because a requirement that each class member prove his or her own reliance on the alleged misrepresentations or omissions would make class certification virtually impossible – as *Basic* and *Amgen* acknowledge. In light of these statements by four Justices, we can probably expect to see frontal assaults on *Basic* in subsequent securities class actions.