Supreme Court: securities fraud plaintiffs need not prove materiality to certify a class

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The Supreme Court recently issued a much-anticipated decision in *Amgen Inc v Connecticut Retirement Plans and Trust Funds*,(1) affirming the Ninth Circuit and holding that securities class action plaintiffs do not have to prove that alleged misrepresentations or omissions were material at the class certification stage. The ruling has substantial implications for future securities fraud class actions, where materiality could otherwise have proven a significant hurdle for plaintiffs.

Facts

The case involved purportedly fraudulent statements concerning "the safety, efficacy, and marketing of two of [Amgen's] flagship drugs" alleged to have artificially inflated its stock price.(2) Amgen argued that the market was well aware of the truth during the class period based on other public information, thus rendering the allegedly fraudulent statements immaterial.(3)

The focus in *Amgen* was the requirement for class certification under Federal Rule of Civil Procedure 23(b)(3) that "questions of law or fact common to class members predominate over any questions affecting only individual members".(4) The question before the court was whether plaintiffs were required to prove that the alleged misstatements were material in order to demonstrate that the element of reliance would involve common issues of fact and law.

Securities class action plaintiffs typically rely on the 'fraud-on-the-market' presumption to establish reliance – a cornerstone of securities fraud litigation established in a four-to-two decision in *Basic Inc v Levinson*.(5) The fraud-on-the-market presumption allows courts to presume "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".(6)

In *Amgen* there was no dispute that the market was efficient and the alleged statements were public. However, the fraud-on-the-market presumption recognises that in an efficient market, only a "material misrepresentation will be reflected in the security's price".(7) Amgen therefore argued that plaintiffs could not rely on the fraud-on-the-market presumption to overcome individual reliance issues, unless they first established that the misrepresentations at issue were 'material' and thus presumed to be reflected in the stock price.(8)

Decision

The court agreed with that premise, but disagreed that class certification must be denied on that basis:

> "*[T]he key question in this case is not whether materiality is an essential predicate of the fraud-on-the-market theory; indisputably it is. Instead, the pivotal inquiry is whether proof of materiality is needed to ensure that the questions of law or fact common to the class will predominate over any questions affecting only individual members as the litigation progresses*."(9)

The court's analysis was driven by a concern that requiring plaintiffs to prove materiality to certify a class would "put the cart before the horse" by making plaintiffs establish that they "will win the fray" in order to proceed.(10) The court went on to state that:

> "*Rule 23 grants courts no license to engage in free-ranging merits inquiries at*

> *the certification stage. Merits 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*."(11)

Crucially, the court was of the view that:

> "*the plaintiff class's inability to prove materiality would not result in individual questions predominating. 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*."(12)

The court also found it important that "materiality is judged according to an objective standard" and thus "is a question common to all members of the class." Thus, the court did not perceive a risk that the case would devolve into individualised issues at a later stage.

The court took note of Amgen's policy argument that, in practice, granting class certification "can exert substantial pressure on a defendant to settle".(13) However, the court dismissed the argument, noting that Congress had enacted certain limitations on class actions in recognition of such concerns, but had declined to require plaintiffs to prove materiality at the class certification stage, as well as to undo the fraud-on-the-market presumption.(14)

Comment

In dissent, Justice Thomas argued that it was the majority, not Amgen, which put the cart before the horse by allowing the plaintiffs to proceed without demonstrating that they were entitled to rely on the fraud-on-the-market presumption. Perhaps equally noteworthy was Justice Alito's one-paragraph concurrence. Picking up one theme from the dissent, Alito noted that the court was not asked to directly reconsider the fraud-on-the-market presumption itself, but that "more recent evidence suggests that the presumption may rest on a faulty economic premise".

It will be interesting to see how lower courts react as defendants take up that invitation to challenge directly the validity of the court-created, fraud-on-the-market presumption.

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Endnotes

(1) 11-1085, 568 US __ (2013). Justice Ginsburg wrote for the majority, joined by Chief Justice Roberts and Justices Breyer, Alito, Kagan and Sotomayor. Thomas filed a dissenting opinion joined by Justice Kennedy and joined in part by Justice Scalia, who also filed a separate dissenting opinion. As noted, Alito also filed a brief but intriguing concurrence.

(2) Slip op at 6.

(3) *Id* at 7.

(4) *Id* at 2.

(5) 485 US 224 (1988).

(6) *Id* at 1.

(7) *Id* at 5 (emphasis added).

(8) *Id* at 2.

(9) *Id* at 10 (emphasis in original, quotation marks and citation omitted).

(10) *Id* at 3.

(11) *Id* at 9.

(12) *Id* at 2.

(13) *Id* at 18.

(14) *Id* at 19-20.

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