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REPORT FROM WASHINGTON

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The Supreme Court Holds That Class Certification of Rule 10b-5 Claims Does Not Require Proof of Materiality

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Yesterday, in *Amgen Inc., et al. v. Connecticut Retirement Plans*, No. 11-1085, the Supreme Court held that a plaintiff class bringing suit under SEC Rule 10b-5 and relying on the fraud-on-the-market theory need not prove at the class certification stage that a defendant's alleged misrepresentations were material. Requiring a plaintiff to prove materiality at the class certification stage "would have us put the cart before the horse," wrote Justice Ginsburg for the 6-3 majority. Under Rule 23(b)(3), a plaintiff seeking class certification is required to show only that common questions predominate among the class such that plaintiffs' claims stand or fall together—not that questions will be resolved on the merits in favor of the class. The decision resolved a split among the circuits.

BACKGROUND AND CIRCUIT SPLIT

The element of "reliance" in a claim pursuant to Section 10(b) of the Securities Exchange Act and Rule 10b-5 historically raised thorny problems for class action plaintiffs – if they had to plead and show proof of class members' individual reliance, they would face problems in demonstrating that common questions of law or fact predominated over individual ones, a necessary predicate to achieving class certification. To address this challenge, the U.S. Supreme Court in *Basic v. Levinson, Inc.* recognized the "fraud-on-the-market" theory, a rebuttable presumption which permits courts to presume reliance where plaintiffs show that any misstatements were public and made in a well-developed, efficient market. 485 U.S. 224 (1988).

Since *Basic*, however, the lower courts had differed whether plaintiffs seeking to certify a class in reliance on the fraud-on-the-market presumption also bear the burden of showing that any misrepresentation was material and whether a defendant was entitled to rebut such evidence. In *Amgen*, the Ninth Circuit had joined the Third and Seventh Circuits in holding that plaintiffs need not prove materiality to obtain class certification; further, the Ninth Circuit held that defendants were not entitled to present evidence to rebut materiality at class certification. By contrast, the Second and Fifth Circuits had required plaintiffs to prove materiality at class certification; the Second Circuit also permitted defendants to rebut evidence of materiality at class certification. The First Circuit had joined the Second and Fifth in dicta.

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THE AMGEN CASE

In 2007, Connecticut Retirement Plans and Trust Funds ("Connecticut Retirement") brought suit against biotechnology company Amgen Inc. and several of its officers, alleging that they knowingly and recklessly made materially misleading statements and omissions regarding the safety of two Amgen products in violation of Sections 10(b) and 20(a) and Rule 10b-5. Among other things, Connecticut Retirement alleged that Amgen had downplayed FDA safety concerns about the products prior to an FDA meeting; concealed details about a clinical trial that was canceled because of safety concerns; and exaggerated the safety of the products for approved FDA uses.

The district court observed that Connecticut Retirement had met its fraud-on-the-market burden at the class certification stage by showing that (1) Amgen's stock was traded in an efficient market, and (2) the alleged misstatements were public. Notably, the district court held that Connecticut Retirement need not prove the materiality of Amgen's misstatements and that Amgen could not rebut the presumption of materiality at this stage.

The Ninth Circuit affirmed, ruling that the question of materiality went solely to the merits of the plaintiff's Rule 10b-5 claim—not to whether common questions of law or fact predominate among class members under Rule 23. The Ninth Circuit held that the "critical question in the Rule 23 inquiry" to permit class certification was whether plaintiffs' claims would "stand or fall together." 660 F. 3d 1170, 1775 (9th Cir. 2011).

Amgen and its senior officers sought reversal, arguing that materiality was a "key predicate" to plaintiff's successful invocation of the fraud-on-the-market theory. Amgen argued that (i) proof of market efficiency alone, without corresponding proof of the materiality of the alleged misrepresentations, was not sufficient to invoke a presumption of class-wide reliance, and (ii) permitting class certification without evidence of materiality would impose overwhelming settlement pressure on companies in meritless suits. Connecticut Retirement urged that materiality was irrelevant at the class certification stage because a showing of immateriality did not show dissimilarity among the class members that would cause individual questions to predominate. Connecticut Retirement also argued that requiring proof of materiality at the class certification stage would saddle judges with burdensome, fact-intensive inquiries before full discovery.

SUMMARY OF THE DECISION

"Rule 23 grants courts no license to engage in free-ranging merits inquiries at the certification stage."

-Opinion of The Court

In a 6-3 opinion written by Justice Ginsburg and joined by Chief Justice Roberts and Justices Breyer, Kagan, Sotomayor, and Alito, the Court held that a 10b-5 plaintiff relying on the fraud-on-the-market theory need not prove at the class certification stage that a defendant's misrepresentations were material and that defendants have the right to rebut materiality at the summary judgment stage or trial, not the class certification stage. While reaffirming that a court's class certification analysis must be "rigorous" and may "entail some overlap with the merits of the plaintiff's underlying claim," the Court observed that "Rule 23 grants courts no license to engage in free-ranging merits inquiries at the certification stage." Under Rule 23, the district court was obligated to only consider whether the question of materiality predominated among all class members.

Here, materiality predominated among class members for two reasons. First, as a question considered under the objective standard, materiality would be resolved based on evidence common to the class. Second, there was no risk that failing to show the materiality of defendants' alleged misrepresentations would cause individual questions to predominate. The Court held that "[a]s to materiality, therefore, the class is entirely cohesive: It will prevail or fail in unison." As the Court further explained, materiality would remain a common *question* at the merits determination, and failure to prove materiality on the merits "would end the case for one and for all." The Court observed that public policy concerns mitigated against requiring materiality at the class certification stage because such a requirement would "necessitate a mini-trial on the issue of materiality . . . [and] entail considerable expenditures of judicial time and resources."

"I join the opinion of the Court with the understanding that petitioners did not ask us to revisit Basic's fraud-on-the-market presumption . . . [M]ore recent evidence suggests that the presumption may rest on a faulty economic premise."

-Justice Alito

Justice Alito concurred with the majority, but wrote separately to question the economic logic underlying *Basic*: "I join the opinion of the Court with the understanding that petitioners did not ask us to revisit *Basic*'s fraud-on-the-market presumption . . . [M]ore recent evidence suggests that the presumption may rest on a faulty economic premise."

Justices Thomas, Kennedy, and Scalia dissented, arguing that by applying Rule 23 to the fraud-on-the-market presumption, the Court had misinterpreted *Basic*. *Basic* outlined not only the elements required to prevail on the merits in a fraud-on-the-market action, but also the requirements necessary to survive class certification. Materiality, at the time of certification, "was central to the development, analysis, and adoption of the fraud-on-the-market theory both before *Basic* and in *Basic* itself," wrote Justice Thomas. Justice Scalia warned that the Court's decision could impose unfair settlement pressure on defendants, noting that "[c]ertification of the class [is often] . . . the prelude to a substantial settlement by the defendant because the costs and risks of litigating further are so high."

IMPLICATIONS

In *Amgen*, the Supreme Court abrogated case law in the First, Second, and Fifth Circuits, which had previously required plaintiffs relying on the fraud-on-the-market presumption to prove materiality in order to obtain class certification. The Court also abrogated Second Circuit case law that had previously given defendants the right to rebut materiality at the class certification stage. This decision reduces the burden for plaintiffs to obtain certification in reliance on the fraud-on-the-market presumption, although plaintiffs will still need to prove materiality to prevail on the merits. The dissenting opinion and certain questions at oral argument suggest that some members of the Court may be willing to revisit the economic rationale underlying *Basic* when presented with the right facts in the future.

The decision does not prevent the defendant from making a Rule 12(b)(6) dismissal motion or a Rule 56 summary judgment motion seeking dismissal of a class action on the merits based on the plaintiff's failure to establish the materiality of the alleged misstatements or omissions. The Supreme Court's recent *Matrixx* decision, however, makes Rule 12(b) motions to dismiss at the pleading stage more difficult with its holding that adverse events reports need not be statistically significant to support a plaintiff's allegation of materiality at the pleading stage.

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