Amgen Does Not Mean the Sky is Falling for Defendants in Securities Class Actions

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Although characterized by some as an unexpected blow to defendants, the U.S. Supreme Court's decision in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, No. 11-1085, 568 U.S. __ (2013) ("Amgen") should have little effect on most securities class actions. The Court in Amgen held that plaintiffs need not prove materiality of alleged misrepresentations at the class certification stage. But because class certification decisions in securities fraud class actions rarely turned on considerations of materiality,* Amgen *will have little effect on the status quo in class certification. The Court's decision rests on the fraud-on-the-market presumption of reliance announced in* Basic v. Levinson*, 485 U.S. 224 (1988) ("Basic"). Notably, four justices questioned this theory's ongoing viability. Thus,* Amgen's *most significant take-away is the uncertain future of the theory that serves as securities plaintiffs' gateway to class certification.*

Affirming the Ninth Circuit, Amgen held that class action plaintiffs need not prove materiality at the class certification stage. From reading some headlines, one would think that this decision struck a fatal blow to defendants. Not so. Very few class certifications actually turned on materiality. Thus, for most actions, the decision will have little impact on class certification. But things could change. Four justices express skepticism about the ongoing viability of *Basic*'s fraud-on-the-market theory, established 25 years ago. With four justices being enough to grant certiorari, a proper case could lead to a reexamination and possible rejection or reformulation of the theory. That would be big news.

Factual and Legal Background

After Amgen announced problems with two of its "flagship drugs," the price of its stock declined. Shareholder plaintiffs then filed securities class actions, alleging that Amgen's stock price had been "artificially inflated" during the class period before the announcement because the company had

misrepresented the "safety, efficacy, and marketing of two of its flagship drugs." The plaintiffs, as is typical in actions of this sort, alleged that the stock market was efficient and that Amgen's stock price therefore had reflected the alleged misrepresentations, affecting all market participants.

The centerpiece of this decision is *Basic's* rebuttable presumption of reliance on alleged misrepresentations, known as the "fraud-on-the-market" theory. This theory is essential to class certification, which requires plaintiffs to show that "questions of law or fact common to class members predominate over any questions affecting only individual members." The "fraud-on-the-market" theory allows courts to presume that all plaintiffs relied on alleged misrepresentations, without inquiry into why they individually had decided to buy or sell the stock.

The lead plaintiff invoked the fraud-on-the-market presumption to establish class certification. Amgen argued that materiality should be proven at the class certification stage because *immaterial* misrepresentations do not affect stock prices. Both the district court and the Ninth Circuit rejected Amgen's contention.

The Decision

While the Supreme Court agreed with Amgen's premise that materiality is essential to the fraud-on-the-market theory, it held that materiality need not be proved at the class certification stage. The Court limited its inquiry to the "office of a Rule 23(b)(3) certification ruling," which the Court described as selecting the best method of adjudicating a controversy and not deciding the ultimate merits of the case (all agree that at the merits stage, materiality must be proved).

Here, the Court's "pivotal inquiry" was "whether proof of materiality is needed to ensure that *questions* of law or fact common to the class will predominate over any questions affecting only individual members as the litigation progresses." Because materiality is assessed on an objective basis and therefore "can be proved through evidence common to the class," it is a common question. Additionally, the Court reasoned that individual reliance questions will never predominate over common questions because, if the trier of fact were to find the misrepresentations to be immaterial, the plaintiff would necessarily lose on the merits rather than proceed with the case on an individual (non-class) basis.

Amgen Is Not a Game-Changer

Amgen brought the issue to the Supreme Court on the basis of a Circuit split as to whether materiality should be proved as a prerequisite to class certification. The Ninth and Seventh Circuit Courts of Appeals held that plaintiffs need not prove materiality before class certification. The Third Circuit also held that plaintiffs need not prove materiality for class certification, but if they do, defendants may present rebuttal evidence. But the Second Circuit held that plaintiffs must prove, and defendants may rebut, materiality before class certification. So, *Amgen* arguably only changes the game in the Second Circuit.

Even in the Second Circuit, *Amgen* will not seriously affect most cases. Class certification of securities fraud class actions rarely failed in the Second Circuit pre-*Amgen* because of a failure to prove materiality. Thus, *Amgen* will have little effect on most class certification rulings.

The Future of *Basic's* Fraud-on-the-Market Theory Hangs in Limbo

While *Amgen's* majority bases its decision squarely on *Basic's* fraud-on-the-market presumption, four Justices express serious doubt about the presumption's validity.

The dissent, authored by Justice Thomas, joined by Justices Kennedy and Scalia, includes a footnote highlighting that, although the Court was not asked to "revisit *Basic's* fraud-on-the-market presumption,"

there is disagreement concerning whether *Basic's* assumption that market efficiency is "a binary, yes or no question" or whether it operates differently depending on information type.

Even more interesting is Justice Alito's one paragraph concurrence, made for the sole purpose of expressing his belief that, although Amgen did not ask the Court to revisit *Basic's* fraud-on-the-market theory, "reconsideration of the *Basic* presumption may be appropriate" in light of evidence suggesting it "may rest on a faulty economic premise." Thus, it appears that four Justices may be ready to reconsider the 25-year-old *Basic* decision in the future. Four votes are enough to grant certiorari, but only time will tell whether a majority wishes to wash away or water down the fraud-on-the-market doctrine.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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