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In Terrorem Impact of Securities Class Actions May Increase After *Amgen*

On June 11, 2012, the Supreme Court agreed to answer two critical class certification questions in a securities fraud case that could increase the *in terrorem* settlement value of these actions dramatically. The case, *Amgen Inc., et al. v. Connecticut Retirement Plans*, Docket No. 11-1085, is before the Court on appeal from the Ninth Circuit. The questions presented bear directly on the standards plaintiffs must satisfy to obtain class certification. The lower the standards, the easier it is for plaintiffs to obtain class certification, and it is certification of a class that raises the damages stakes for defendants to levels that typically exceed even the tallest towers of insurance coverage.

Summary of the Issues

The two questions *Amgen* raises pertain to a technical prerequisite to class certification, i.e., securities fraud plaintiffs must establish that questions of law or fact affecting all class members will "predominate" over questions that impact individuals only. In all securities cases asserting §10(b) violations, the "reliance" element of the cause of action presents a predominance obstacle to class certification—if each class member must individually prove its actual reliance on alleged misstatements, no class will be certified.

Plaintiffs could not overcome this obstacle to class certification until the courts adopted the "fraud-on-the-market" presumption of reliance, which is founded on the "Efficient Market Hypothesis" (EMH) developed by an economist in the 1960s. The EMH holds that the price of a stock traded in an "efficient market" rapidly and fully reflects all publicly available material information about the issuer, including any material false statement of fact or misleading omission. Thus, if a company's stock trades in an efficient market, investors who heard, read and knew nothing about a company can nevertheless be presumed to have relied on representations made about the company when they invested.

The Supreme Court accepted the EMH and approved the fraud-on-the-market presumption of reliance in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). *Basic*, however, also held that this presumption is rebuttable and that defendants can rebut it by severing the link between an alleged misstatement and the company's stock price. Experience has shown that this link can be severed in several ways, e.g., by demonstrating that the alleged misstatement was not material (and therefore did not impact the stock price), or that a decline in the stock price (which plaintiffs attribute to the revelation of a prior fraud) was actually caused by other material information entering the marketplace. The *Basic* opinion did not, however, address the standards or burdens of proof the lower courts should apply when plaintiffs seek to invoke the presumption at the class certification stage or when defendants may rebut the reliance presumption. In the 24 years since *Basic* was decided, the lower courts have developed their own procedures and standards and the differences among them conflict.

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Questions Presented to the Supreme Court

The *Amgen* appeal asks the Supreme Court to clarify: (i) what plaintiffs must prove to invoke the fraud-on-the-market presumption of reliance when seeking class certification, and specifically whether plaintiffs must demonstrate the materiality of alleged misstatements, and (ii) whether defendants may rebut this presumption of reliance *before* a class is certified, and specifically if such rebuttal may include proof that the alleged misstatements were not material.

Amgen Procedural History

Before the district court, the *Amgen* defendants argued that to raise the fraud-on-the-market presumption, plaintiffs must prove, *inter alia*, that during the class period defendants made material public misstatements and the market for Amgen's stock was efficient. Defendants further argued that even if plaintiffs are not required to prove the materiality of misstatements to raise the presumption, *Basic* permits the defendants to rebut it by proving the alleged misstatements were not material.

Under the securities laws, information is not material unless an objectively "reasonable investor would have viewed" it "as having significantly altered the total mix of information made available." An economist might offer a similar yet more direct definition—material information is new, value-relevant information about a company that impacts a company's stock price. The *Amgen* defendants introduced evidence to prove their alleged misstatements were not material. They argued that even if the court assumed their statements were false or misleading, the evidence demonstrated their statements did not alter the total mix of information available to the market. That evidence established the truth had been previously disclosed repeatedly—by the company, the analysts covering the company, the FDA, *The New York Times*, and various other third parties.

The district court rejected defendants' arguments without examining their evidence. Relying on precedent or a lack thereof, the court ruled that when plaintiffs move for class certification in a securities case, (i) they only need to establish that the defendant company's stock traded in an efficient market to raise the fraud-on-the-market presumption, and (ii) defendants may not rebut the presumption. The court characterized defendants' rebuttal evidence as defendants' attempt to raise a "truth-on-the-market" defense and ruled that Ninth Circuit precedent prohibits this "non-reliance" defense as a basis for denying class certification. According to the district court, defendants may first assert this defense in summary judgment motions. Because any party opposing summary judgment can obtain discovery before filing their opposition, these motions are generally not filed before discovery has been completed. Discovery in securities class actions is a long, extraordinarily expensive process and is chief among the drivers to settle these cases, even the most defensible of them. As a result, most securities cases that survive a motion to dismiss settle long before summary judgment motions are filed. Therefore, denying defendants the right to rebut the fraud-on-the-market presumption at the class certification stage, in effect, permanently denies defendants the opportunity to exercise this right.

The Ninth Circuit affirmed the district court's ruling in *Amgen*, although the Ninth Circuit did modify the plaintiffs' burden slightly. It held that to invoke the fraud-on-the-market presumption, plaintiffs need to demonstrate both (i) the efficiency of the market, *and* (ii) the public nature of the alleged misrepresentations. 660 F.3d 1170 (9th Cir. Nov. 8, 2011).

A Split Among the Circuits

The Ninth Circuit's *Amgen* decision deepened a preexisting split among the Courts of Appeals. The Ninth Circuit joined the Seventh Circuit by barring any evaluation of materiality at the class certification stage. The Second and Fifth Circuits both (i) require plaintiffs to prove the materiality of alleged misstatements to invoke the presumption of reliance and obtain certification, and (ii) permit defendants to present evidence rebutting the fraud-on-the-market presumption at the class certification stage. Standing alone, the Third Circuit does not require plaintiffs to demonstrate materiality to invoke the presumption, but it does allow defendants to offer evidence to rebut the presumption of reliance at the class certification stage.

Analysis of Ninth Circuit's Ruling and Amgen's Petition

The Ninth Circuit recognized that Supreme Court precedent directs the lower courts to "rigorously" analyze an element of plaintiffs' cause of action when it overlaps with the class certification requirements. And the *Amgen* defendants argued that this overlap existed because, if the alleged misrepresentations were immaterial, they would not impact the company's stock price and therefore no investor could have relied on them when purchasing Amgen's stock. Without analysis, the Ninth Circuit simply disagreed, labeling "materiality" a stand-alone element of plaintiffs' cause of action. The Ninth Circuit further characterized

defendants' argument as proving too much, explaining that if, as defendants contended, the alleged misrepresentations were immaterial, plaintiffs' entire case fails, not merely their motion for class certification. While the Ninth Circuit's explanation possesses superficial appeal, it is at odds with the Supreme Court's most recent class certification decision, *Wal-Mart v. Dukes*, 131 S. Ct. 2541 (June 20, 2011) (employment discrimination). In *Wal-Mart*, plaintiffs' failure to "provide convincing proof" of an element of their cause of action that overlapped with class certification was no bar to the Court's consideration of the evidence or its holding that certification was erroneous.

Under *Wal-Mart*, the lower courts should focus on whether the overlap between an element of the cause of action and a certification requirement exists. If it does, the court should carefully analyze the evidence before ruling on any motion for class certification. As the *Amgen* Supreme Court petition demonstrates, in the 24 years since *Basic* was decided, additional empirical studies have shown that the EMH is far more complex than the approach the Ninth and Seventh Circuits recognize. These studies demonstrate the overlap between the materiality of alleged statements and the market efficiency determination. Economists now generally recognize that if the price of a stock is impacted by immaterial information, or is impacted in the wrong direction (e.g., declining on material positive news), or that the impact of material information takes several days to be reflected in the price, the market for that stock was not efficient. Conversely, if the market for a stock is efficient and information does not impact the stock's price rapidly, then (i) the information either is not new, i.e., the market was previously aware of the information, or (ii) the information is not material, e.g., the market viewed the information as insignificant puffery.

Furthermore, *Basic* held that defendants have the right to rebut the fraud-on-the-market presumption by "severing the link" between the alleged misstatement and the stock's price. If, at a minimum, defendants are not permitted to exercise this rebuttal right before a class is certified, the right itself is illusory. Although *Basic* did not specify *when* defendants can present such rebuttal evidence, a rebuttal is offered to refute an opponent's argument or evidence. By its nature, a rebuttal right logically must be exercised *before* a court issues a ruling—not after. Denying defendants the timely opportunity to exercise this basic procedural right creates an even greater injustice in securities class actions. As the *Amgen* defendants' petition to the Supreme Court argues, the Ninth Circuit's decision makes class certification in federal securities cases extremely easy for plaintiffs to obtain and nearly impossible for defendants to defeat. Such certification "may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability" even in actions that lack merit.

Conclusion

As soon as the Supreme Court agreed to accept the *Amgen* petition, predictions about the outcome surfaced. There appears, however, to be at least some support in prior Supreme Court decisions for each side in *Amgen*. Court dicta in recent cases, including *Wal-Mart* and *Halliburton*, reference the fraud-on-the-market presumption in a manner that appears to favor the *Amgen* plaintiffs. In contrast, the Court's analysis and ruling in *Wal-Mart* strongly suggest that if the *Amgen* defendants can convince the Court that materiality and the presumption of reliance overlap, defendants will prevail. If defendants are successful in demonstrating this overlap, the Supreme Court could adopt the Third Circuit's approach, holding (i) plaintiffs do not need to establish the materiality of misstatements to raise the presumption of reliance, but (ii) defendants are entitled to rebut the presumption, before class certification, with any proof that severs the link between the statement and the stock price. Indeed, this approach is supported by *Basic* and maintains a balance of leverage between the parties.