KING & SPALDING

Client Alert

Business Litigation Practice Group

March 4, 2013

Supreme Court's *Amgen* Ruling Creates Wide-Ranging Implications for Securities Suits and Other Business Litigation

On February 27, 2013, the Supreme Court issued its decision in *Amgen, Inc. v. Connecticut Retirement Plans*. Justice Ginsburg authored the 6-3 majority opinion affirming the Ninth Circuit's holding that a securities fraud plaintiff need only plausibly allege—not prove—that the alleged misrepresentations or omissions at issue are material to obtain certification of an investor class. Justice Alito wrote a short concurrence. Justice Thomas wrote the principal dissent, joined by Justice Kennedy and (in large part) Justice Scalia. Justice Scalia also wrote a separate dissent. While the Court removed yet another lower-court-created barrier to class certification, *Amgen* signals other important defenses to class certification in securities class actions. Although the opinion is limited to the securities fraud context, it highlights the precarious balance at the Supreme Court regarding how stringently to apply Rule 23 in all class actions.

Plaintiff Connecticut Retirement Plans brought a putative class action against Amgen and its officers under §10(b) of the Securities Exchange Act of 1934 and Securities Exchange Commission Rule 10b-5. It alleged that defendants misled investors about the safety, efficacy, and marketing of two of its flagship drugs, causing investors losses when the truth about these drugs came to light. After defendants' motion to dismiss was denied, plaintiff moved for class certification. Defendants opposed class certification, arguing that a plaintiff must prove the materiality of the alleged misrepresentations to qualify for the class-wide presumption of reliance under the fraud-on-the-market theory to avoid the predominance of individual issues. The district court disagreed, granted plaintiff's motion, and the Ninth Circuit affirmed.

In defendants' appeal to the Supreme Court, Justice Ginsburg distilled the issues presented in the case into one succinct question: "whether proof of materiality is needed to ensure that the questions of law or fact common to the class 'predominate over any questions affecting only individual members,'" a requirement for class certification under Federal Rule of Civil Procedure 23(b)(3). The Court answered "no" for two reasons.

For more information, contact:

Michael R. Smith
+1 404 572 4824
mrsmith@kslaw.com

Paul R. Bessette
+1 512 457 2050
pbessette@kslaw.com

Jeffrey S. Bucholtz
+1 202 626 2907
jbucholtz@kslaw.com

Elizabeth V. Tanis
+1 404 572 4660
etanis@kslaw.com

King & Spalding
Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600
Fax: +1 404 572 5100

Washington, D.C.
1700 Pennsylvania Avenue, NW
Suite 200
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

Austin
401 Congress Avenue
Suite 3200
Austin, Texas 78701
Tel: +1 512 457 2000
Fax: +1 512 457 2100

www.kslaw.com

First, materiality is a "common question" among investors. It is an objective inquiry based on the significance of a misrepresentation or omission to the *reasonable* investor; it can be proved through evidence common to the class. Second, if the plaintiff fails to carry its materiality burden, then individual questions will not predominate over common ones. Instead, since materiality is an essential merits element of a § 10(b) claim, the failure to prove materiality causes the claim to fail for all investors in the class on a common basis. Rather than defeating class certification, a loss on materiality defeats the class action as a whole on the merits; the case remains a class action, but the defendant defeats the claims of the entire class in one stroke. Since Rule 23(b)(3) requires only that common questions predominate, and not that these questions will ultimately be answered in favor of the class, proof of materiality is not required to certify an investor class.

Although the majority's holding rests on the plain language of Rule 23(b)(3), the Court explained why it found defendants' arguments based on the fraud-on-the-market theory unpersuasive. Defendants argued that because courts have required proof of other predicates of the fraud-on-the-market theory at the class-certification stage, such as proof that (1) the stock trades in an efficient market, and (2) that the relevant transaction took place while the stock price was inflated by the alleged fraud, the Court should similarly require proof of materiality at class certification. But the Court explained that the transaction timing requirement relates primarily to the Rule 23(a) requirements of typicality and adequacy of the proposed lead plaintiff, not to whether common issues predominate. Further, while a plaintiff's failure to establish an efficient market would preclude a presumption of reliance, individual investors would still be free to establish actual, individual reliance, although not as a class. In other words, in the absence of an efficient market, individual issues would predominate. In the absence of materiality, on the other hand, common issues remain predominant, as all investors would be equally unable to establish their § 10(b) claims.

While taking materiality off the table at class certification, *Amgen* gives securities class action defendants important cues for other potential defenses.

Amgen *takes another factor, materiality, out of the class certification equation*

Following the Supreme Court's 2005 decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, the defense bar began opposing class certification based on loss causation and materiality challenges to the fraud-on-the-market presumption of reliance. Defendants obtained several favorable circuit court decisions holding that loss causation and materiality were necessary predicates to triggering the fraud-on-the-market presumption of reliance (and thus to showing that common issues predominate). *See e.g., Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton*, 597 F.3d 330 (5th Cir. 2010) (loss causation); *In re Salomon Analyst Metromedia Litigation*, 544 F.3d 474 (2d Cir. 2008) (plaintiff must prove, and defendant may present evidence rebutting, materiality before class certification). However, in the 2011 decision in *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. ___, the Supreme Court rejected the Fifth Circuit's requirement that a plaintiff invoking the fraud-on-the-market presumption of reliance demonstrate that the alleged misstatements caused the stock price decline to obtain class certification. Now in *Amgen*, the Supreme Court has reiterated that while a plaintiff still must demonstrate the market for a stock timely processes material information in the market efficiency analysis, it need not prove that the alleged misstatements or omissions were material to obtain class certification.

***Following* Amgen *and* Halliburton*, the battleground will shift to market efficiency*.**

With the Supreme Court now having taken loss causation and materiality off the table at the class-certification stage, companies should take a close look at whether there is a basis to dispute market efficiency, including through the lens of materiality.

Although courts commonly examine a number of factors to assess whether a market is efficient, the most important factor is the how the market price responds to new information. *Cammer v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989). This factor is the essence of an efficient market, and requires evidence showing a cause and effect relationship between unexpected news and an immediate response in the stock price. Immaterial information of course should not move the stock price, but material information should, at least in an efficient market. If the information was or is assumed to be material, then its failure to move the stock price means that the market was not efficient.

Thus, notwithstanding *Amgen*, defendants may be able to defeat a fraud-on-the-market class by showing that the market was not efficient with evidence that the subject misstatements did not have an impact on the company's stock price. The Fifth Circuit endorsed this defense in *Bell v. Ascendant Solutions, Inc.*, 422 F.3d 307 (5th Cir. 2005). Other courts have similarly been receptive to arguments about the inefficiency of the market for a stock based on lack of price movement following unexpected news. *See In re Federal Home Loan Mortgage Corp. (Freddie Mac) Sec. Litig.*, 281 F.R.D. 174 (S.D.N.Y. 2012). Following *Halliburton* and *Amgen*, however, defendants must be careful to couch these arguments in terms market efficiency rather than "loss causation" or "materiality."

The Court signaled a broader attack on class certification may be coming.

In their concurring and dissenting opinions, Justices Thomas, Alito and Scalia raised doubt about the continued validity of the efficient market hypothesis, the foundation of the fraud-on-the-market presumption. The hypothesis was first endorsed by the Supreme Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), in unusual circumstances where only six Justices participated in the case and a majority of four spoke for the Court. Recent economic research, however (some of which the *Amgen* defendants raised in their briefing) casts doubt on the theory, and none of the current Members of the Court participated in the decision in *Basic*. While Justice Ginsburg noted that *Amgen* "is a poor vehicle" for considering the continued validity of the efficient market theory because Amgen did not ask the Court to revisit *Basic*, she acknowledged that the foundations of the theory have been questioned.

Defendants may see Justice Alito's and the dissenting Justices' opinions in *Amgen* as an opportunity to begin attacking the efficient market hypothesis in lower courts and present an appropriate vehicle for the Supreme Court to consider the issue. Should the fraud-on-the-market theory be overturned in whole or in part, it would create a significant barrier to class certification. Without the presumption of reliance, the element would be individual to each investor, causing individual questions to predominate and making certification of a class difficult at best.

Defendants should also consider moving early for summary judgment on materiality.

Now that *Amgen* is the law of the land, defendants will have to wait until summary judgment to raise most challenges to the materiality of the alleged misstatements or omissions at issue. The exception involves cases where immateriality is clear from the pleadings or documents subject to judicial notice that can be used in a motion to dismiss under Rule 12(b)(6)—for example, where the alleged misstatements are mere puffery, matters of opinion, or forward-looking statements.

Even if a defendant's materiality arguments are not appropriate for a motion to dismiss, a defendant may still be able to avoid most of the costly discovery that follows denial of a motion to dismiss and granting of class certification. Where the evidence establishing immateriality is strong and plaintiffs' claim to need additional discovery on materiality is weak, defendants should consider filing a motion for summary judgment early in the case. This would appear particularly appropriate where a "truth-on-the-market" defense can be established via readily available public documents or analysts' reports rather than requiring extensive discovery.

Defendants also should keep in mind the possibility of requesting phased discovery in appropriate cases: Where the plaintiff seems vulnerable on materiality and discovery on the issue can be conducted in a discrete fashion, some district courts may be willing to order an initial phase of discovery limited to materiality to avoid the burdens imposed by costly full-blown discovery regarding the accuracy of representations, scienter, and damages.

What does *Amgen* mean for Rule 23 outside the securities fraud context?

The *Amgen* decision may seem surprising in light of the Court's recent defendant-friendly class certification rulings outside of the securities fraud context. Indeed, the dissenting Justices argued that certain aspects of the majority opinion break from recent precedent construing Rule 23, primarily the Court's landmark ruling in *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. __ (2011). Nonetheless, *Amgen* appears to be limited to the securities fraud context and likely does not portend a broader shift in the Court's class action jurisprudence.

First, the *Amgen* opinion is largely an exercise in interpreting the Court's prior opinion in *Basic* that adopted the fraud-on-the-market presumption in securities fraud cases. Attempts to extend that presumption to other contexts have generally failed, so the Court's clarification in *Amgen* of how that presumption applies in the securities context is unlikely to spill over to other contexts. Second, the *Amgen* Court did not loosen *Wal-Mart*'s requirement that a classwide proceeding must be capable of generating "common answers" and not merely raising common questions. Rather, *Amgen* simply held that materiality is a common question that is capable of being answered in one stroke as *Wal-Mart* requires, because the materiality standard is objective. The presence of an as-yet unanswered materiality question at class certification thus does not prevent common issues from predominating. Nor did the Court back away from *Wal-Mart*'s admonition that the district court conduct a "rigorous analysis" to ensure that Rule 23's requirements are satisfied before certifying a class. The Court held that whether the alleged misstatements or omissions at issue were material is not relevant to Rule 23. As a result, the Court had no occasion to consider what kind of showing the plaintiff must make at the certification stage on the issues that are relevant to Rule 23's requirements.

The *Amgen* opinion thus does not address the important question whether plaintiffs seeking class certification must rely on evidence that would be admissible under the rules of evidence, including expert testimony that complies with Federal Rule of Evidence 702 and the *Daubert* standard. That question is implicated by another case currently pending before the Court, *Comcast v. Behrend*. While the dissenting Justices appeared to question whether the Court had honored *Wal-Mart*'s holding that Rule 23 requires a plaintiff to prove, not just plead, that class certification is appropriate, the majority opinion did not purport to modify *Wal-Mart* in that respect. As a result, it is unlikely that *Amgen* will significantly weaken *Wal-Mart*'s constraints on class certification outside of the securities fraud context.

Michael J. Biles, Jeffrey S. Bucholtz, Jonathan R. Chally, Royale Price, Matthew S. Owen, and Michael R. Smith contributed to this client alert.