Supreme Court Makes Securities Fraud Class Certification Easier

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The United States Supreme Court on February 27, 2013 ruled in *Amgen v. Connecticut Retirement* that plaintiffs in a securities fraud case relying on a "fraud on the market theory" need not prove the materiality of the allegedly incorrect statement in order to obtain class certification.

Securities fraud grew out of direct communications between buyers and sellers. With the rise of impersonal exchanges in which buyers almost never dealt with the company selling the securities, the Supreme Court in its 1988 decision, *Basic, Inc. v. Levinson*, announced a new rule that allowed such plaintiffs to satisfy the requirement that they relied on the allegedly incorrect statement. That new rule was the fraud on the market theory, which assumes that in an efficient market, the false statement is calibrated into the price of the stock and anyone who trades in the open market before the statement is corrected has "indirectly relied" on that statement.

The elements that plaintiffs must ultimately prove to avail themselves of this fraud on the market theory are:

- that the market was generally efficient;
- that the alleged misstatement was public;
- that the stock transaction took placed between the time the statement was made and the time its falsity became known; and
- that the statement was material, i.e., that a reasonable investor would consider the information important in the trade.

The question the *Amgen* Court faced was whether the plaintiffs must prove the elements of the fraud on the market theory in order to obtain class certification, or may the plaintiffs simply allege those elements in their complaint, leaving proof until later on summary judgment or trial.

The distinction is critical, since most cases settle if the class is certified, which is a practical reflection of the substantial liability a certified class poses; or what the courts call, "in terrorem settlements."

The *Amgen* Court decided that the first four elements must be proven at the certification stage, i.e., efficient market, public statement, and timing of the stock transaction, but not the fourth one. The Court held that the plaintiffs need not prove, at the certification stage, that the statement was material. Likewise, the Court also held that defense evidence of non-materiality is irrelevant for the class certification issue.

The dissent points out that the decision allows for classes to be certified that never should have been. That is, if the plaintiffs later on summary judgment or at trial are unable to prove materiality, then they should not have been allowed to rely on the fraud on the market theory, and each separate plaintiff would have needed to show reliance the traditional way, i.e., giving testimony that they read or heard the allegedly fraudulent statement, and acted on that statement. In that instance, the individual questions would predominate, and class certification would be improper. As the dissent says, "we will learn *ex post* that certification was inappropriate because reliance was not, in fact, a common question."

The facts in the *Amgen* case were simple. An executive publically and incorrectly stated that an upcoming meeting with the Food and Drug Administration would not focus on one of Amgen's leading drugs. The FDA, however, publicly published the agenda a month before the meeting, stating that the drug would be discussed. "Truth on the market" is a defense against the presumed reliance of the fraud on the market theory. That is, the market calibrated the correct

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statement from the FDA into the price of the stock, and therefore the Amgen statement, while incorrect, was not material to those who never heard it or read it.

Before *Amgen*, courts across the country went in different directions on these questions of whether plaintiffs needed to prove materiality and whether the defense could counter the theory at the class certification stage.

In a post *Amgen* setting, there is now a clear rule, and that rule makes it substantially easier for plaintiffs to obtain securities fraud class certification for statements that they never knew about.

The U.S. Supreme Court makes it easier to certify securities fraud class actions for those who never heard or read the allegedly false statement.