CHOATE

Life Sciences Companies Should Protect Themselves Against Increased Exposure to Costly Securities Fraud Lawsuits After Supreme Court Decision

March 7, 2013

What you need to know:
The Supreme Court recently found that defendants in class action securities fraud lawsuits will not be able to challenge the materiality of allegedly fraudulent misstatements or omissions at the preliminary, class-certification stage. Therefore, the materiality issue will almost always be deferred until summary judgment or trial, necessitating costly and distracting discovery.

What you need to do:
Public life sciences companies must ensure that their public disclosures present an accurate and understandable sense of their business for investors, without relying on third-party information to round out the picture, since the Court's decision means that these statements will be viewed in a vacuum until summary judgment or trial.

The Supreme Court has handed a defeat to life sciences company Amgen, Inc., in a closely-watched decision regarding class action securities fraud lawsuits. As a result of the ruling, defendants in such cases – in which the public disclosures of life sciences companies are often put under a microscope – will not be able to challenge the materiality of allegedly fraudulent misstatements or omissions at the preliminary, class-certification stage. Rebutting materiality is often one of defendants' strongest opportunities for defeating these claims, and the Supreme Court's ruling means the issue will almost always be deferred until summary judgment or trial, necessitating costly and distracting discovery. Nonetheless, a minority on the Court raised questions about a key precedent that has been the lifeblood of securities fraud class actions, holding out the prospect that the Court will curtail such cases in a future decision.

This ruling is a reminder of life sciences companies' vulnerability to securities fraud lawsuits, and the importance of ensuring that public disclosures present an accurate and understandable sense of their business for investors— without relying on third-party information—to help protect against the time-consuming and costly process of addressing these lawsuits.

Case Details and Background

Securities fraud class action suits under section 10(b) of the Securities Exchange Act and Rule 10b-5 are commonly filed against public companies after stock price declines. These are often referred to as "strike suits" because sometimes the aim of the plaintiff and/or its lawyer is to pressure defendants into making a large settlement in lieu of facing the risks of an adverse result at trial.

Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds is the Supreme Court's latest foray into the class certification requirements of Rule 23 of the Federal Rules of Civil Procedure, the implications of which were discussed in Choate's prior Notice on this topic. In *Amgen*, the Court

Choate Notice

was asked to determine whether or not plaintiffs in securities fraud cases must show that alleged misrepresentations were "material" (*i.e.*, whether they would have significantly altered the total mix of information available to investors) in order to win class certification. Materiality is an element of a securities fraud claim that plaintiffs ultimately must prove in order to prevail.

On behalf of investors who purchased Amgen stock during a particular period in time, the Plaintiff filed suit against Amgen and certain individuals alleging that they had committed securities fraud by making misrepresentations about the safety of two anemia treatment products. According to the Plaintiff, Amgen downplayed the FDA's safety concerns about its products in advance of an FDA meeting with a group of oncologists, concealed details about a clinical trial that was canceled over concerns that Amgen's product exacerbated tumor growth in a small number of patients, exaggerated the on-label safety of the products, and claimed that Amgen promoted its products only for on-label uses when, in fact, it promoted significant off-label usage.

After Amgen unsuccessfully moved to dismiss the case at the outset, the Plaintiff sought class certification pursuant to Rule 23, which permits class actions in which one or more plaintiffs sue on behalf of themselves and other, unnamed parties who are alleged to have been injured by similar conduct. To obtain class certification, the plaintiff must show that "questions of law or fact common to class members predominate over any questions affecting only individual members."

The Plaintiff in *Amgen* submitted expert evidence to show that the market for Amgen stock was efficient (a point Amgen conceded), but put forward no evidence as to the materiality of the alleged misrepresentations.

Amgen opposed certification, arguing principally that because the Plaintiff did not (and could not) establish materiality, it could not rely on the "fraud on the market" presumption established by the Supreme Court's 1988 decision in *Basic, Inc. v. Levinson*. Under *Basic*, where an efficient market exists that reflects the available information about the company, members of the class are presumed to have relied on the stock price in making their purchase or sale decision, and thus need not prove that they specifically relied upon the allegedly false or misleading statements by the defendants.

The district court certified the class, holding that the Plaintiff was entitled to the presumption of reliance because it had established the efficiency of the market for Amgen stock (*i.e.*, that the price of Amgen stock reflected the publicly available information about the company). The district court concluded that a finding of materiality was not necessary to the class certification decision because materiality "do[es] not concern the requirements of Rule 23, but instead concern[s] the merits of the case." The district court declined to consider Amgen's rebuttal evidence, holding that its "truth-on-the-market" defense was a method of defeating the claim itself by negating the element of materiality, which the district court considered outside the bounds of the Rule 23 inquiry.

On appeal, the Ninth Circuit affirmed the lower court's ruling. The Supreme Court took the appeal to resolve a circuit split—with some circuits, like the Ninth Circuit, not requiring plaintiffs to prove materiality to win certification, while others either required proof of materiality prior to certification or permitted defendants to rebut materiality.

The Supreme Court's Decision

On appeal to the Supreme Court, Amgen argued that the materiality of the alleged misrepresentations must be shown before plaintiffs can take advantage of the fraud-on-the-market theory, and the corresponding presumption of reliance under *Basic* that makes class action securities fraud suits possible. By definition, Amgen asserted, immaterial misstatements do not affect a stock's price, and therefore there is no basis to presume reliance if the alleged misrepresentations were immaterial.

Justice Ginsburg delivered the opinion of the Court, in which Chief Justice Roberts and Justices Breyer, Alito, Sotomayor and Kagan joined. Justice Alito also wrote a separate concurring

opinion. Justice Scalia filed a dissenting opinion. Justice Thomas filed a dissenting opinion that Justice Kennedy joined and Justice Scalia joined in part.

In the majority opinion, the Court held that because materiality is judged according to an objective standard, the materiality of Amgen's alleged misrepresentations and omissions is a question common to all members of the class. Whether material or immaterial, the statements would be so equally for all investors. In addition, if the plaintiff was unable to prove materiality, that would not result in individual questions predominating. "Instead," the Court wrote, "a failure of proof on the issue of materiality would end the case, given that materiality is an essential element of the class members' securities fraud claims."

Having determined that materiality need not be proved in order for a plaintiff to win class certification, the Court disposed of Amgen's second argument, that it ought to have been permitted to offer evidence rebutting materiality at class certification. "[J]ust as a plaintiff class's inability to prove materiality creates no risk that individual questions will predominate, so even a definitive rebuttal on the issue of materiality would not undermine the predominance of questions common to the class," Justice Ginsburg wrote.

The Court rejected arguments that public policy considerations favored requiring proof of materiality prior to class certification. For example, it brushed aside contentions that deferring materiality until summary judgment or trial can exert substantial settlement pressure on defendants by noting that materiality is no different in this regard than other elements of the claim, including whether the statements at issue were false or misleading or whether the plaintiff suffered an economic loss. Similarly, the Court dismissed claims that airing materiality in the context of class certification would conserve judicial resources, reasoning that, to the contrary, Amgen's position would necessitate "mini-trials" on materiality, which might still be at issue at trial. Moreover, the Court concluded, if materiality were defeated prior to class certification, plaintiffs other than the named plaintiff would not be bound by that determination, raising the specter that those other shareholders could file their own, separate suits.

While the Court has, in recent years, called for a "rigorous" class certification analysis in a variety of contexts, the majority opinion in *Amgen* cautioned that those recent decisions "grant[] courts no license to engage in free-ranging merits inquiries at the certification. Merits questions may be considered to the extent – but only to the extent – that they are relevant to determining whether the Rule 23 prerequisites for class certification are satisfied."

For life sciences companies and other businesses thinking about the "long game," the silver lining in *Amgen* may be the statements in the separate opinions of Justices Alito, Scalia and Thomas (and Justice Kennedy's apparent support for them) that *Basic* – the decision that established the "fraud-on-the-market" presumption undergirding modern securities class actions – may be due for a second look. In his concurring opinion, Justice Alito wrote that "more recent evidence suggests that the presumption may rest on a faulty economic premise" – namely, that markets are either efficient or not, when in fact markets may operate differently depending on the information at issue – and that "[i]n light of this development, reconsideration of the *Basic* presumption may be appropriate." Justice Scalia classified *Basic* as "arguably regrettable," noting that the relevant portion was joined by only four justices. Justice Thomas, meanwhile, described *Basic* as "questionable," raising the same concern as Justice Alito. Justices Scalia and Kennedy joined the portion of Justice Thomas's decision questioning *Basic*.

Justices Alito, Scalia, Thomas and Kennedy, therefore, appear to constitute four votes for revisiting the *Basic* presumption itself. The majority opinion, meanwhile, appears to have sidestepped the issue, responding to Justice Thomas's critique of *Basic* by noting that the Court was not asked, in *Amgen*, to revisit this important precedent, and that because Amgen conceded that the market for its securities was efficient, "this case is a poor vehicle for exploring whatever implications" recent studies may have for *Basic*.

For more information, please contact your lawyer at Choate or one of the following members of our Securities, Life Sciences or Healthcare Groups:

William B. Asher, Jr.	617-248-5087	washer@choate.com
Michael R. Dube	617-248-4077	mdube@choate.com
Michael T. Gass	617-248-4750	mgass@choate.com
Stuart M. Glass	617-248-4804	sglass@choate.com
Brenda H. Jarrell, PhD	617-248-5175	bjarrell@choate.com
Gerald E. Quirk	617-248-4817	gquirk@choate.com
Christine G. Savage	617-248-4084	csavage@choate.com