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The "Fraud-on-the-Market" Presumption of Reliance Revisited: Supreme Court Hears Oral Argument in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds

BY SECURITIES LITIGATION AND ENFORCEMENT PRACTICE

On November 5, 2012, the Supreme Court heard arguments in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*[1] ("*Amgen*"), a matter that will decide whether plaintiffs in federal securities fraud actions must establish materiality before obtaining class certification. At issue is the "fraud-on-the-market" presumption of reliance adopted by the Supreme Court in *Basic Inc. v. Levinson*[2] ("*Basic*") and left open last year in the Supreme Court's holding that plaintiffs need not show loss causation at class certification in *Erica P. John Fund Inc. v. Halliburton Co.*[3] ("*Halliburton*"). *Amgen* has the potential to significantly alter the class certification process in securities actions by tightening certification standards in those cases.

The Rebuttable Presumption of Reliance and Rule 23(b)(3)

In securities actions under Section 10(b) of the Securities Exchange Act of 1934[4] and SEC Rule 10b-5,[5] plaintiffs must show they relied upon material misrepresentations in buying or selling a security. The fraud-on-the-market theory posits that defendants' material misrepresentations can defraud market participants by distorting the market price of the security at issue. Hypothesizing that investors generally rely on market prices in trading securities, the Supreme Court in *Basic* created a rebuttable presumption of reliance that can be used by plaintiffs both at class certification and trial to satisfy the reliance requirements of Section 10(b) and Rule 10b-5.[6] Using this presumption, class proponents may indirectly establish the reliance requirements on defendants' misrepresentation through reliance on the market price of the security.

Invocation of this rebuttable presumption at class certification is of special significance because most securities class actions are sought under Federal Rule of Civil Procedure 23(b)(3). Under that rule, a class may be certified only if "questions of law or fact common to class members predominate over any questions affecting only individual members."[7] Because evidence of reliance traditionally requires individualized proof, this rule acts as a bar to class certification unless a presumption of reliance can be invoked.[8] In other words, if the *Basic* presumption is found inapplicable, reliance will usually have to be established individually and the class will fail.

The fraud-on-the-market presumption is predicated on the hypothesis that the market price of a security trading in an "efficient market" incorporates all publicly available material information. Courts have thus held that before invoking the fraud-on-the-market presumption, a plaintiff must first show that certain predicates have been satisfied, including that the security traded in an efficient market and that the alleged misrepresentations were public.[9] The Supreme Court granted *certiorari* in *Amgen* to address an established circuit split as to whether the class proponent must also establish the alleged misrepresentations were material.

Factual and Procedural Background

In the district court, the plaintiffs alleged that Amgen had artificially inflated its stock price by misrepresenting the safety of two of its products. Seeking class certification under Rule 23(b)(3), the plaintiffs presented expert testimony purporting to show that Amgen's stock traded in an efficient market and that the alleged misrepresentations were public. Amgen responded that the plaintiffs were not entitled to use of the fraud-on-the-market presumption of reliance because they had failed to show also that the alleged misrepresentations were material. Amgen additionally sought to affirmatively rebut the presumption of reliance by showing that the market was already "privy to the truth."[10] The district court rejected Amgen's arguments and granted the plaintiffs' motion for class certification.

On appeal, the Ninth Circuit affirmed, joining the Seventh Circuit in holding that plaintiffs need only plausibly allege, but not establish materiality to invoke the fraud-on-the-market presumption at class certification.[11] The Ninth Circuit further concluded that because no proof of materiality is required, defendants cannot present rebuttal evidence on the issue.[12] The decision deepened a split with the First, Second, and Fifth Circuits which require proof of materiality at the class certification stage.

Much of the Ninth Circuit's decision rested on the premise that materiality is a distinct element of Section 10(b) and Rule 10b-5 claims that must be proved at trial.[13] For the Ninth Circuit, this means materiality should be evaluated only by motion to dismiss, motion for summary judgment, or at trial.

The Parties' Arguments

To a large degree, arguments put forth in *Amgen* are a direct outgrowth of the Supreme Court's recent opinion in *Halliburton*. In that case, the Supreme Court held that proof of loss causation is not required to invoke the fraud-on-the-market presumption of reliance at class certification.[14] The Supreme Court's narrow holding, however, left open the issue of whether a plaintiff seeking class certification must establish price impact, *i.e.* materiality.[15]

Amgen contends that *Halliburton*'s discussion of market price recognized materiality as predicate to use of the fraud-on-the-market presumption: "[A]n investor presumptively relies on a misrepresentation *so long as* it was reflected in the market price at the time of his relevant transaction."[16] Amgen argues that because materiality is a key predicate to this presumption of reliance, and because that presumption is necessary to satisfy the requirements of Rule 23(b)(3) under plaintiff's theory of the case, materiality must be established prior to class certification.[17] In support of this argument, *amicus curiae* in support of Amgen submitted a brief pointing to the enormous settlement pressures that securities class actions defendants face, arguing that such practical pressures may preclude materiality from ever being tested.[18] By way of contrast, the *amicus curiae* pointed to the ways by which plaintiffs might establish materiality using an event study or analysis of the total mix of information with readily available, public information.[19]

Arguments Before the Supreme Court

During oral argument, the Justices probed key issues which may provide insight into the Supreme Court's eventual opinion. First, without distinction between proof of materiality as an element of the securities claim and as a prerequisite to invoking the fraud-on-the-market presumption of reliance, the Supreme Court debated whether a decision in favor of Amgen improperly requires a "mini-trial" on the merits at class certification. Justice Kagan questioned whether requiring proof of a plaintiff's claim of materiality would impermissibly allow for a merits determination of a question common to all class members.[20] Focusing upon the class certification emphasis on "common issues," Respondents seized on Justice Kagan's point, arguing that materiality should not be decided at class certification because the class members' claims on this point would "rise or fall" together.[21]

Justice Scalia highlighted, however, that the fraud-on-the-market presumption is a "shortcut" to establishing predominance under Rule 23(b)(3) and *proof* of materiality is merely a prerequisite to obtaining that shortcut.[22]

Importantly, when pushed by the Justices, Respondent conceded that indirect reliance "devolves down to the core merits question of materiality."[23] Expanding on this point, Justice Scalia posited that only material statements move the market price of a security trading in an efficient market, and therefore materiality is a predicate to invoking the *Basic* rebuttable presumption.[24] Justices Scalia and Kennedy also questioned the economic theory behind *Basic*, indicating some willingness to overturn the decision altogether.[25]

Somewhat surprisingly, apart from two questions from Justice Sotomayor, the Supreme Court did not focus on the right of Amgen to *rebut* materiality at class certification. That right to rebut the presumption has been recognized by both the Second and Third Circuits.[26] The Supreme Court, however, seemed intent on considering whether materiality is properly an issue at class certification at all.

Conclusion

Amgen represents an attempt by securities fraud defendants to combat plaintiffs' potential abuse of class action claims. To the extent the Supreme Court rules in favor of Amgen, the decision may reshape the fundamental contours of securities fraud class actions by allowing for a rigorous analysis of materiality at class certification through event studies and/or analysis of the total mix of information through readily accessible public information.

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Contributors to this alert were partners William F. Sullivan, Peter M. Stone, and Howard M. Privette, and associates John S. Durrant, Scott D. Carlton, Timothy D. Reynolds, and Sarah Kelly-Kilgore.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Securities Litigation Enforcement Practice lawyers:

Chicago

Mark D. Pollack
1.312.499.6050
markpollack@paulhastings.com

Los Angeles

John S. Durrant
1.213.683.6144
johndurrant@paulhastings.com

Joshua G. Hamilton
1.213.683. 186
joshuahamilton@paulhastings.com

Thomas P. O'Brien
1.213. 683. 6146
thomasobrien@paulhastings.com

Howard M. Privette
1.213. 683. 6229
howardprivette@paulhastings.com

William F. Sullivan
1.213.683.6252
williamsullivan@paulhastings.com

Thomas A. Zaccaro
1.213. 683. 6285
thomaszaccaro@paulhastings.com

New York

Kenneth M. Breen
1.212.318.6344
kennethbreen@paulhastings.com

Alan J. Brudner
1.212.318.6262
alanbrudner@paulhastings.com

Maria E. Douvas
1.212.318.6072
mariadouvas@paulhastings.com

Douglas Koff
1.212.318.6772
douglaskoff@paulhastings.com

Kevin Logue
1.212.318.6039
kevinlogue@paulhastings.com

Barry G. Sher
1.212.318.6085
barrysher@paulhastings.com

Carla R. Walworth
1.212.318.6466
carlawalworth@paulhastings.com

Palo Alto

Peter M. Stone
1.650.320.1843
peterstone@paulhastings.com

Edward Han
1.415.856.7013
edwardhan@paulhastings.com

San Diego

Christopher H. McGrath
1.858.458.3027
chrismcgrath@paulhastings.com

San Francisco

Grace Carter
1.415.856.7015
gracecarter@paulhastings.com

Washington, D.C.

Kirby D. Behre
1.202.551.1719
kirbybehre@paulhastings.com

Morgan J. Miller
1.202.551.1861
morganmiller@paulhastings.com

[1]No. 11-1085 (U.S. Aug. 8, 2012). This firm represented the Securities Industry and Financial Markets Association on the *amicus* brief it submitted to the Supreme Court in this matter.

[2]485 U.S. 224 (1988).

[3]131 S. Ct. 2179 (2011).

[4]15 U.S.C. § 78j (2006 & Supp. 2010).

[5]17 C.F.R. § 240.10b-5 (2012).

[6]485 U.S. at 226.

[7]FED. R. CIV. P. 23(b)(3).

[8]*Basic*, 485 U.S. at 242.

[9]*Id.* at 248.

[10]*Conn. Ret. Plans & Trust Funds v. Amgen, Inc.*, 660 F.3d 1170, 1174 (9th Cir. 2011). In *Basic*, the Supreme Court recognized that the presumption of reliance may be rebutted by evidence that "market makers" were privy to the truth, and the market price was thus unaffected. 485 U.S. at 248.

[11]*Conn. Ret. Plans & Trust Funds*, 660 F.3d at 1177.

[12]*Id.*

[13]*Id.* at 1175.

[14]In *Halliburton*, the Supreme Court distinguished between "loss causation" and "price impact" explaining that the former is the causal connection between alleged material misrepresentations and the investors' loss, while the latter establishes that alleged misrepresentations distorted the market price of the security at issue. 131 S. Ct. 2179, 2186 (2011).

[15]*Id.* at 2183.

[16]Brief for Petitioners at 19, *Amgen*, No. 11-1085 (U.S. Aug. 8, 2012) (quoting *Halliburton*, 131 S. Ct. at 2186) (emphasis added).

[17]In its merits brief, Amgen also argued that defendants should be able to present rebuttal evidence at class certification on the issue of materiality. *Id.* at 8. This issue went largely unaddressed at oral argument.

[18]Brief of *Amicus Curiae* of Securities Industry and Financial Markets Association in Support of the Petitioners at 8, *Amgen*, No. 11-1085 (U.S. Aug. 8, 2012).

[19]*Id.* at 14.

[20]Transcript of Oral Argument at 6, *Amgen*, No. 11-1085 (U.S. Aug. 8, 2012) (Kagan, J.) ("[I]sn't it correct that if the Court holds that a statement is immaterial, it's immaterial for all members of the class, and the suit has to be dismissed?").

[21]*Id.* at 33.

[22]*Id.* at 50 (Scalia, J.).

[23]*Id.* at 26.

[24]*Id.* at 45 (Scalia, J.).

[25]*Id.* at 40 ("[M]aybe we should overrule *Basic* because it was certainly based upon a theory that—that simply collapses once you remove the materiality element."); *id.* at 42 (Kennedy, J.) ("[T]hat imparts the question of 24 years of economic scholarship—I think that's how long it's been since Basic was decided—has shown that the efficient market theory is—is really an overgeneralization.").

[26]Brief of *Amicus Curiae* of Securities Industry and Financial Markets Association in Support of the Petitioners at 19–20, *Amgen*, No. 11-1085 (U.S. Aug. 8, 2012).