Reading Tea Leaves After the Supreme Court's Amgen Securities Litigation Decision

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On February 27, 2013, the Supreme Court issued its ruling in *Amgen Inc. v. Connecticut Retirement Plans and Trust Fund*. In the decision, the Court held that plaintiffs in 10b-5 securities litigation need not prove materiality of the alleged misrepresentation in order to obtain class certification.

While commentators are heralding the decision as landmark, its importance may lie less in the line it draws for parties battling class certification and more in what it signals for a much broader issue in securities regulation. The fascinating aspect of the case is that four of the justices questioned the continued vitality of the "fraud-on-the-market" presumption, recognized in *Basic Inc. v. Levinson* (1988), without which securities fraud class actions cannot proceed.

Background of the Case

The *Amgen* case was brought in 2007 against pharmaceutical company Amgen Inc. by a state pension fund shareholder. The plaintiff complained that Amgen engaged in public market securities fraud by allegedly concealing the safety risks of two of its drugs used to treat anemia. The suit survived a motion to dismiss and arrived at the class certification stage where the shareholder plaintiff seeks to have a class certified of all those who purchased company shares during the specified time period.

The foundation of every securities fraud class action is *Basic*, decided by the Supreme Court in 1988. Prior to *Basic*, securities fraud actions could not proceed as class actions but rather only as individual actions because the fundamental inquiry in such fraud cases is whether each shareholder received and was misled by the alleged misstatements. With the inquiry at the individual shareholder level, common issues do not predominate and class treatment is inappropriate.

In *Basic*, the plurality of the Court adopted the fraud-on-the-market presumption, which relieves the individual shareholder of the need to establish receipt and reliance upon the alleged misstatements, and instead presumes that in an efficient market, the price of a publicly-traded stock reflects all material public information about the stock. Thus, by buying at the market price, the stockholder is presumed to rely on all such information.

After the Court decided *Basic*, plaintiffs' lawyers developed a cottage industry in bringing lucrative class actions alleging securities fraud by public companies. The Private Securities Litigation Reform Act was enacted in 1995 to curtail perceived excesses of securities fraud litigation by imposing higher pleading standards and limitations on professional plaintiffs bringing cases. Since 1995, the Supreme Court has issued a series of decisions, generally favorable to registrants, giving effect to the 1995 legislation.

In *Amgen*, the defendant registrant argued that before a class may be certified and before the *Basic* presumption may be applied on a class-wide basis, the plaintiff must prove, at the class certification hearing, that the alleged misstatements were "material." After all, Amgen argued, the fraud-on-the-market presumption only applies if there are **material** misrepresentations made in an efficient market.

The Supreme Court stated in the 2011 *Halliburton* case that plaintiffs must prove at class certification that the market is efficient with respect to the particular stock at issue, so why would the materiality inquiry be any different? Amgen then argued that the alleged misrepresentations were not material because the market already knew the information.

Prior to the Supreme Court's decision, the Second and Fifth Circuits had already adopted the rule Amgen advanced. The First Circuit seemed to agree, and the Seventh and Ninth Circuits went the other way. The Third Circuit took an intermediate approach.

The Court's Decision

In *Amgen*, the Supreme Court, by a 6-3 majority that included Justices Ginsberg, writing for the Court, Breyer, Alito, Sotomayor and Kagan and Chief Justice Roberts, held that the question of whether the alleged misrepresentation is material is one on the merits that must wait until the merits phase of summary judgment and perhaps trial. Justices Thomas, Kennedy and Scalia dissented, arguing that materiality should be proved by a plaintiff at the class certification stage before the fraud-on-the-market presumption may come into play. Justice Scalia also raised a policy consideration by noting that once a class is certified, there is added pressure on a company to settle so as to avoid the costs and risks of further class action litigation.

The *Amgen* decision is obviously favorable to plaintiffs. Certain defendants would have retained a valuable defense to class certification if materiality could be invoked. In many cases, however, the materiality of the alleged misrepresentation is not the central issue. And even in those cases in which materiality is at issue, the cases will either be extinguished on that basis at the outset on a motion to dismiss or the defense will survive, although it will have to wait until the next phase after class certification.

Is the Fraud-on-the-Market Theory Vulnerable?

What we find most interesting about the *Amgen* decision is the hostility demonstrated towards *Basic* itself by four of the justices. Justice Scalia, raised eyebrows during oral argument in November 2012 by remarking "maybe we shouldn't have this fraud-on-the-market theory . . . . So maybe we should overrule Basic." In his dissent, Justice Scalia criticized *Basic* as regrettable and as appearing nowhere in any statute or the common law but rather as having been "invented" by four members of the Court.

Justice Thomas in his dissent, joined by Justice Kennedy, characterized *Basic* as a "judicially invented doctrine based on an economic theory adopted to ease the burden on plaintiffs bringing claims under an implied cause of action" while highlighting the dissent of Justices White and O'Connor in *Basic*.

Justice Alito noted in his one-paragraph concurrence that Amgen had not asked the Court to revisit Basic but that it may be high time to do so.

In the end, while *Amgen* is a win for plaintiffs on the specific issue before the Court, it could be the catalyst for a reconsideration of fraud-on-the-market as a fundamental presumption for securities fraud class actions.

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