

Supreme Court Lowers Plaintiffs' Hurdle at Class Certification

On February 27, 2013, the Supreme Court of the United States issued a decision in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds* holding that in a securities class action under Section 10(b), a plaintiff need not prove that the alleged misrepresentation or omission is material in order to certify a class.

Yesterday's *Amgen* decision follows a number of recent Supreme Court decisions addressing the showing required by a plaintiff for class certification. These opinions clarify that while plaintiffs must prove the elements of Rule 23 for class certification, they need not prove the underlying elements of the cause of action at the class certification stage. This issue has important practical implications. Once a class has been certified, a plaintiff has significant leverage, regardless of the merits of the case, to obtain a large settlement from defendants who wish to avoid costly discovery.

Rule 23 of the Federal Rules of Civil Procedure sets forth the requirements for class certification, which include: numerosity, typicality, adequacy of representation and commonality. Pursuant to Rule 23(b)(3), questions of law or fact common to class members must predominate over any questions affecting only individual members.

The elements required to sustain a private securities-fraud action to recover damages under Section 10(b) of the Securities and Exchange Act of 1934 are: (1) materiality; (2) scienter; (3) a connection between the alleged misrepresentation or omission and the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation. While these elements need not be proven at the class certification stage, the predominance of commonality as to these issues must be established for class certification.

Until the Supreme Court endorsed the fraud-on-the-market presumption of reliance in *Basic v. Levinson*, proof of reliance required an individualized inquiry into the information that each investor relied on, one that by definition would preclude class certification. The fraud-on-the-market theory allows class-wide proof of the Section 10(b) element of reliance when the security is traded on a well-developed and efficient market, presuming that the market has absorbed any public information into the security's price.

In *Amgen*, the Supreme Court was asked to address whether a plaintiff is required to prove that the public information was *material* to the reasonable investor in order to obtain class certification. Justice Ginsburg delivered the 6-3 majority opinion, holding that materiality is not a prerequisite to certification of a securities fraud class action under 10(b) because it is not necessary to ensure that questions of law or fact common to the class predominate. The Court explained that this is so for two reasons:

- First, "because materiality is judged according to an objective standard, it can be proved through evidence common to the class."
- Second, "Rule 23(b)(3) requires a showing that *questions* common to the class predominate, not that those questions will be answered, on the merits, in favor of the class ... The alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class." As a result, a failure of proof of materiality would not result in individual questions predominating, but rather would end the case for all parties.

The Supreme Court further held that rebuttal of the fraud-on-the-market presumption of reliance is appropriate at the class certification stage if it would disprove commonality of the class members' reliance, but that rebuttal of materiality would not disprove commonality and thus would not be appropriate at the class certification stage.

The Supreme Court's holding affirmed the Ninth Circuit, resolving an existing split between the First, Second and Fifth Circuits and the Third, Seventh and Ninth Circuits.

The Supreme Court's decision in *Amgen* follows a series of recent Supreme Court decisions emphasizing that while plaintiffs must prove the elements of Rule 23 for class certification, they need not prove the underlying elements of the cause of action.

In *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011), the Supreme Court reversed the Ninth Circuit's holding that sufficient common issues were present to certify a class of both current and former female employees in a gender discrimination suit against Wal-Mart. The Supreme Court emphasized the importance that there be common issues of fact in order to certify a class and that a class certification inquiry must be "rigorous" and may "entail some overlap with the merits of the plaintiff's underlying claim." The Court in *Amgen* clarified that such "[m]erits 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."

In *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), the Supreme Court acknowledged that for class certification "securities fraud plaintiffs must prove certain things in order to invoke *Basic*'s rebuttable presumption of reliance" including that the alleged misrepresentations were publicly known and that the stock traded in an efficient market, but need not prove loss causation in order to get the benefit of the presumption at the class certification stage. In *Amgen*, the Court distinguished materiality from the other two elements of the fraud-on-the-market presumption, noting that a finding of immateriality, unlike a finding that the market is not efficient or that the information was not public, requires not only a denial of class certification but also dismissal of the case.

The Supreme Court will likely again address the required showing for class certification in *Comcast Corp. v. Behrend*, where it has been presented with the question of whether a plaintiff, at the class certification stage, must submit evidence in admissible form to show that the case is susceptible to the award of damages on a class-wide basis. While *Comcast* addresses class certification in the antitrust context, it will have implications for securities litigation, because at issue in *Comcast* is the application of the "rigorous" inquiry into issues surrounding class certification endorsed by the Supreme Court in *Dukes*. The parties are disputing whether the lower courts took a close enough look at plaintiffs' model for damages. Oral arguments were heard in November 2012.

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