Solving a Circuit Splitter: Amgen in the High Court

Must a plaintiff in a securities fraud class action prove that the alleged misrepresentations or omissions are material in order to obtain class certification? That is the issue the U.S. Supreme Court agreed to consider when it granted certiorari in *Connecticut Retirement Plans and Trust Funds v. Amgen*, 660 F.3d 1170 (9th Cir. 2011), cert. granted, ___ U.S. ___, (June 11, 2012).

In Amgen, the Ninth Circuit held that materiality is not an issue at the class certification stage — a plaintiff can rely on the fraud-on-the-market presumption to demonstrate that reliance is a common issue simply by proving that there is an efficient market for the security at issue and the misrepresentation was public. The court observed that materiality is a merits issue to be addressed in a motion for summary judgment or at trial, not at the class certification stage. Amgen, 660 F.3d at 1177.

In light of this holding, the court also rejected Amgen's argument that it should be permitted an opportunity to rebut the fraud-on-the-market presumption to defeat class certification by pointing to evidence that the truth already was published to the market so the alleged misrepresentations could not have affected the stock price because this so called "truth-on-the-market" defense is a method of refuting an alleged misrepresentation's materiality. Id.

With this holding, the Ninth Circuit joined the Seventh Circuit (*Schleicher v. Wendt*, 618 F.3d 679, 685 (7th Cir. 2010)) and the Third Circuit (*In re DVI, Inc. Sec. Lit.*, 639 F.3d 623, 631 (3d Cir. 2011)). Three circuits disagree: the Second Circuit (*In re SalomonAnalyst Metromedia Litig.*, 544 F.3d 474, 481 (2d Cir. 2008)), the Fifth Circuit (*OscarPrivate Equity Invs. v. Allegiance Telecom Inc.*, 487 F.3d 261, 264 (5th Cir. 2007)), and the First Circuit (*In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 8 n. 11 (1st Cir. 2005).

The Ninth Circuit noted that its conclusion (and that of the Seventh Circuit) "enjoys support from the Supreme Court's more recent formulations of the presumption in Erica P. John Fund and Dukes, which require the plaintiff to show that the stock was traded in an efficient market but do not mention materiality as a requirement." Amgen at 1176.

However, *Erica P. John Fund Inc. v. Halliburton*, 563 U.S. ___, 131 S. Ct. 1179 (2011), does not support the Ninth Circuit's conclusion and, in fact, suggests a contrary conclusion. In Halliburton, the Supreme Court held that a plaintiff need not prove loss causation to obtain class certification in a securities fraud class action. It noted that reliance is a common element if the plaintiff can rely on the fraud-on-the-market presumption and the presumption does not require a showing of loss causation. "Loss causation addresses a matter different from whether an investor relied on a misrepresentation presumptively or otherwise, when buying or selling a stock." Id. at 2186.

However, the court reiterated that the fraud-on-the-market theory applies only with regard to "material misrepresentations." Quoting from its opinion in *Basic v. Levinson*, 485 U.S. 224, the Supreme Court stated in Halliburton: "According to [the fraud-on-the-market theory], 'the market price of shares reflects all publicly available information, and, hence, any material misrepresentations." Id. at 2185.

The court described as "Basic's fundamental premise" "that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction." Id. at 2186. As Basic made clear, the market price reflects all material representations. Thus, for the fraud-on-the-market presumption to apply, a plaintiff should be required to prove that the alleged misrepresentation is material.

In Halliburton, the defendant argued that while the Fifth Circuit in Amgen held that plaintiff was required to prove loss causation to obtain class certification, what the Fifth Circuit really meant was that plaintiff was required to prove that the alleged misrepresentation affected the market price, i.e., that the misrepresentation was material.

The Supreme Court elected not to address the issue: "While the opinion below may include some language consistent with a 'price impact' approach ..., we simply cannot ignore the Court of Appeals' repeated and explicit references to 'loss causation,' [citations omitted]. Whatever Halliburton thinks the Court of Appeals meant to say, what it said was loss causation ... We take the Court of Appeals at its word. Based on those words, the decision cannot stand." Id. at 2187.

Thus, while the Supreme Court in Halliburton agreed with the Second Circuit's holding in Salomon Analyst Metromedia that the plaintiff is not required to prove loss causation at the class certification stage, it did not address the Second Circuit's holding that the plaintiff has the burden to establish that the alleged misrepresentations were material in order to invoke the fraud-on-the-market presumption.

In *Salomon Analyst Metromedia*, the Second Circuit held that the plaintiff seeking class certification could satisfy its burden to prove materiality without showing a market price reaction by demonstrating under the test first enunciated in *TSC Indus. Inc. v. Northway Inc.*, 426 U.S. 438, 449 (1976), "a substantial likelihood that the alleged misrepresentations and omissions would have been viewed by a reasonable investor as having significantly altered the 'total mix' of information available."

The Second Circuit held this was sufficient to make a threshold showing that the misrepresentations were material, but that defendants would have to be afforded an opportunity before class certification to demonstrate that the misrepresentations were not material, which the defendants could do by showing that "the allegedly false or misleading material statements did not measurably impact the market price of the security." Id. at 486 n.9.

In *Oscar v. Allegiance*, 487 F.3d 262, 264 (5th Cir. 2007), the Fifth Circuit went further, holding that plaintiff has the burden to prove that the alleged misrepresentation "actually moved the market." However, the Oscar court's holding was based on its requirement that the plaintiff must prove loss causation to invoke the fraud-on-the-market presumption. Id. at 265. As discussed above, that rationale was undermined by the Supreme Court's rejection of the loss causation requirement in Halliburton.

Conclusion

The fraud-on-the-market presumption applies where the defendant publicly makes a material misrepresentation about a stock traded in an efficient market. Therefore, to take advantage of the fraud-on-the-market presumption to obtain class certification, a plaintiff should be required to prove that the alleged misrepresentation is material.

Moreover, although not required to prove loss causation, a plaintiff should be required to show that the alleged misrepresentation actually impacted the stock price. Requiring a plaintiff to demonstrate an impact on the stock price would provide a much needed bright line test as to whether the alleged misrepresentation is in fact material, and therefore whether the case should proceed as a class action.

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This *GT Alert* was prepared by **Robert A. Horowitz**. Questions about this information can be directed to Mr. Horowitz at 212.801.2194 (horowitzr@gtlaw.com) or to your Greenberg Traurig attorney.

Albany 518.689.1400	**Delaware** 302.661.7000	**Mexico City+** +52 55 5029.0000	**Palm Beach County S.** 561.955.7600	**Tallahassee** 850.222.6891
Amsterdam + 31 20 301 7300	**Denver** 303.572.6500	**Miami** 305.579.0500	**Philadelphia** 215.988.7800	**Tampa** 813.318.5700
Atlanta 678.553.2100	**Fort Lauderdale** 954.765.0500	**New Jersey** 973.360.7900	**Phoenix** 602.445.8000	**Tel Aviv^** +03.636.6000
Austin 512.320.7200	**Houston** 713.374.3500	**New York** 212.801.9200	**Sacramento** 916.442.1111	**Tysons Corner** 703.749.1300
Boston 617.310.6000	**Las Vegas** 702.792.3773	**Orange County** 949.732.6500	**San Francisco** 415.655.1300	**Warsaw~** +48 22 690 6100
Chicago 312.456.8400	**London*** +44 (0)203 349 8700	**Orlando** 407.420.1000	**Shanghai** +86 21 6391 6633	**Washington, D.C.** 202.331.3100
Dallas 214.665.3600	**Los Angeles** 310.586.7700	**Palm Beach County N.** 561.650.7900	**Silicon Valley** 650.328.8500	**White Plains** 914.286.2900