No. 11-1085

IN THE
Supreme Court of the United States

AMGEN INC., KEVIN W. SHARER, RICHARD D. NANULA, ROGER M. PERLMUTTER, GEORGE J. MORROW,
Petitioners,

v.

CONNECTICUT RETIREMENT PLANS AND TRUST FUNDS,
Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONERS

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QUESTIONS PRESENTED

1. Whether, in a misrepresentation case under SEC Rule 10b-5, the district court must require proof of materiality before certifying a plaintiff class based on the fraud-on-the-market theory.

2. Whether, in such a case, the district court must allow the defendant to present evidence rebutting the applicability of the fraud-on-the-market theory before certifying a plaintiff class based on that theory.

CORPORATE DISCLOSURE STATEMENT

There are no changes to the disclosure statement included in the petition for a writ of certiorari in this case.

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INTRODUCTION

To prevail in a private action alleging a misrepresentation in violation of section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, a plaintiff must prove reliance on the alleged misrepresentation. In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court recognized that securities-fraud plaintiffs could not proceed with a class action if they were required to prove each class member's direct individual reliance on the misrepresentation, because individual questions would overwhelm common ones, thereby precluding certification, *see* Fed. R. Civ. P. 23(b)(3). The Court, however, endorsed a rebuttable presumption of reliance by every

class member for cases in which the "fraud-on-the-market" theory applies. That theory states that if a security trades in an efficient market, all public *material* information is reflected in the price of the security. Purchasers or sellers who rely on the integrity of the market price therefore also rely, indirectly, on any material misrepresentation, which would be reflected in that price. The Court also held that the presumption of class-wide reliance can be rebutted by "[a]ny showing that severs the link between the alleged misrepresentation" and "the price received (or paid) by the plaintiff." *Basic*, 485 U.S. at 248.

This Court's decisions since *Basic* make clear that securities-fraud plaintiffs seeking to proceed as a class must demonstrate at the class-certification stage that certain predicates to the fraud-on-the-market theory—and thus to *Basic*'s presumption of reliance—have been satisfied. These predicates include that the market for the security is efficient, that the alleged misrepresentation was public, and that the plaintiff traded the shares "'between the time the misrepresentations were made and the time the truth was revealed.'" *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2185 (2011) (hereafter *Halliburton*) (quoting *Basic*, 485 U.S. at 248 n.27). The first question presented here is whether another fraud-on-the-market predicate, the materiality of the alleged misrepresentation, must similarly be proved at class certification. The second question is whether defendants must have an opportunity, before class certification, to offer evidence rebutting the applicability of the fraud-on-the-market theory (and thus the presumption of reliance). Under Federal Rule of Civil Procedure 23 and this Court's precedent, the answer to both questions is yes.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 660 F.3d 1170. The court's order denying rehearing en banc (Pet. App. 51a-52a) is unreported, as is the opinion of the district court granting respondent's motion for class certification (Pet. App. 15a-50a).

JURISDICTION

The judgment of the court of appeals was entered on November 8, 2011. *See* Pet. App. 1a. A timely petition for rehearing en banc was denied on December 28, 2011. Pet. App. 51a-52a. The petition for a writ of certiorari was filed on March 1, 2012, and granted on June 11, 2012. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES, REGULATIONS, AND RULES INVOLVED

Pertinent portions of the following provisions are reproduced in the appendix to the petition for a writ of certiorari: Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a) (Pet. App. 53a-54a); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (Pet. App. 55a); and Federal Rule of Civil Procedure 23 (Pet. App. 56a-57a).

STATEMENT

1. Respondent Connecticut Retirement Plans and Trust Funds is the named plaintiff in this putative securities-fraud class action. Connecticut Retirement alleges that Petitioner Amgen Inc. artificially inflated the market price for Amgen stock by making misrepresentations regarding the safety of two Amgen products,

Aranesp® and Epogen®. Pet. App. 16a. Those products are erythropoiesis-stimulating agents (ESAs), which stimulate the production of red blood cells and thus reduce the need for patient transfusions. Pet. C.A. Br. 6. Connecticut Retirement alleges that Amgen made misrepresentations about: (1) the subject matter of a May 2004 advisory committee meeting of the Food and Drug Administration, (2) clinical trials involving Aranesp, (3) the safety of on-label uses of both drugs, and (4) their marketing. Pet. App. 17a-20a.

Connecticut Retirement moved to certify a class of persons who purchased Amgen stock from April 22, 2004, through May 10, 2007. Pet. App. 16a. The start of this period corresponds to a public statement by Amgen regarding the May 2004 FDA advisory committee meeting. Connecticut Retirement alleges that Amgen misrepresented that the meeting would not focus on the safety of Aranesp. Pet. App. 17a. The end of the class period corresponds with a later meeting of the same committee. Connecticut Retirement alleges that this meeting constituted a corrective disclosure, revealing information about the safety of ESAs, including Aranesp and Epogen. Pet. App. 19a.

Connecticut Retirement sought class certification pursuant to Federal Rule of Civil Procedure 23(b)(3). Pet. App. 22a. That rule conditions certification on, among other things, a finding by the district court that "questions of law or fact common to class members predominate over any questions affecting only individual members." As with most misrepresentation claims under Rule 10b-5, the predominance inquiry in this case "turn[ed] on the element of reliance." *Halliburton*, 131 S. Ct. at 2184; *see also* Pet. App. 31a-40a. Connecticut Retirement asserted that the putative class members were entitled to *Basic*'s fraud-on-the-market-based

presumption of class-wide reliance. Pet. App. 31a. In support, it submitted expert evidence to establish the efficiency of the market for Amgen stock. Pet. App. 40a. It made no evidentiary showing, however, about the materiality of Amgen's alleged misstatements. Pet. App. 33a-34a.

Amgen opposed class certification principally on the ground that Connecticut Retirement did not, and could not, establish that the alleged misrepresentations were material. Pet. App. 8a. To the contrary, Amgen showed through analyst reports and public documents that the market was aware of all the information that Connecticut Retirement claimed Amgen had concealed through alleged misrepresentations during the class period. Pet. C.A. Br. 2, 8-9. Proof of market efficiency alone, Amgen argued, without any corresponding proof of the materiality of the alleged misrepresentations, was not sufficient to invoke a presumption of class-wide reliance based on the fraud-on-the-market theory. Pet. App. 32a.

Amgen also sought to affirmatively rebut any such presumption, again by showing that the market already was "privy to the truth," *Basic*, 485 U.S. at 248, and accordingly that no alleged misrepresentation had any impact on the price of Amgen stock. Pet. App. 41a. For example, Connecticut Retirement claimed that the class period started when an Amgen executive purportedly stated, before the May 2004 FDA advisory committee meeting, that the meeting would not focus on the safety of Aranesp. Pet. App. 17a. Amgen demonstrated, however, through numerous analyst reports and public documents dated both before and after the advisory committee meeting, that analysts were well aware that the committee would discuss possible safety concerns associated with all ESAs, including Aranesp.

Pet. C.A. Br. 9-10. Those public documents included the agenda of the meeting itself, which was published in the Federal Register more than a month in advance of the meeting. Pet. App. 41a-42a. Amgen made similar showings regarding the other alleged misrepresentations. Pet. App. 42a-43a. Based on this rebuttal evidence, Amgen argued that Connecticut Retirement was not entitled to a class-wide presumption of reliance based on the fraud-on-the-market theory, and therefore could not satisfy the Rule 23(b)(3) predominance requirement. Pet. App. 32a.

2. The district court rejected Amgen's arguments and granted Connecticut Retirement's class-certification motion. Pet. App. 15a. The court held that Connecticut Retirement could invoke *Basic*'s presumption of reliance because, "to trigger" the presumption, Connecticut Retirement "need only establish that an efficient market exists." Pet. App. 40a. The court therefore refused to consider whether Connecticut Retirement had proved the materiality predicate of the fraud-on-the-market theory, *i.e.*, whether the alleged misrepresentations were in fact material. "[T]he inquiries Defendants urge the Court to make do not concern the requirements of Rule 23, but instead concern the merits of the case," the court reasoned, holding that those inquiries should be deferred until "a later stage in this proceeding." Pet. App. 38a, 40a. For the same reason, the court also refused to consider Amgen's evidence rebutting the applicability of the fraud-on-the-market theory to this case, holding that class certification "is an inappropriate time to consider [Amgen's] contentions." Pet. App. 44a.

3. The Ninth Circuit granted Amgen leave to appeal the district court's certification order, *see* Fed. R. Civ. P. 23(f), and affirmed the district court's order.

Pet. App. 6a, 13a. The court of appeals rejected Amgen's contention that Connecticut Retirement had to prove materiality at the class-certification stage. While acknowledging that Connecticut Retirement was required "to prove at the class certification stage [1] that the market for Amgen's stock was efficient and [2] that Amgen's supposed misstatements were public," the Ninth Circuit held that Connecticut Retirement did not need to "prove [3] materiality to avail [itself and the class] of the fraud-on-the-market presumption of reliance at the class certification stage." Pet. App. 9a, 12a (emphasis omitted). Rather, Connecticut Retirement had only to "allege materiality with sufficient plausibility to withstand a 12(b)(6) motion." Pet. App. 12a.

The reason for this, the Ninth Circuit stated, is that materiality is an "element of the merits of [a] securities fraud claim," Pet. App. 8a, whereas the efficient-market and public-statement predicates to the fraud-on-the-market theory, the court asserted, are not, *see* Pet. App. 9a. As a "merits issue," the court reasoned, materiality should be addressed only "at trial or by summary judgment motion." Pet. App. 13a. The court also grounded its distinction of the materiality predicate from the efficient-market and public-statement predicates on its view that, as to materiality, the arguments of Connecticut Retirement and the class "stand or fall together," rendering "the reliance issue common to the class." Pet. App. 8a, 9a. Finally, because the court of appeals concluded that materiality need not be proven for class certification, it also approved the district court's refusal to consider Amgen's rebuttal evidence on that issue. Pet. App. 12a-13a.

SUMMARY OF ARGUMENT

I. Private plaintiffs who seek to litigate securities-fraud claims on a class basis by invoking the presumption of class-wide reliance that this Court approved in *Basic Inc.* v. *Levinson* must prove—prior to class certification—that the alleged misstatement underlying their claims was material.

A. This Court in *Basic* endorsed a rebuttable presumption of class-wide reliance after recognizing that without it, private securities-fraud plaintiffs would typically be unable to proceed as a class because individual issues would predominate as to the essential element of reliance. The *Basic* presumption rests on the fraud-on-the-market theory, which states that the price of a security traded in an efficient market reflects all material information available to the market, including any material misrepresentation. Since investors may be presumed to rely on market price, class members who buy or sell during the relevant period can all be presumed to have relied indirectly on the alleged material misrepresentation.

The materiality of the alleged misstatements is a key predicate to the fraud-on-the-market theory that is central to the presumption of class-wide reliance. Because immaterial misstatements do not—by definition—affect a stock's price, there is no basis to presume that investors relied in common on immaterial misstatements when they bought or sold the stock. The *Basic* Court's repeated references to materiality in discussing the presumption, and the clear link between materiality and an effect on stock price, confirm that materiality is an essential predicate to the presumption of class-wide reliance. This Court's subsequent decisions provide further confirmation.

B. Because materiality is a predicate to the *Basic* presumption—a presumption that is needed to satisfy Rule 23's prerequisites—the rule requires that materiality be proved prior to class certification: Until materiality has been shown, class-wide issues do not "predominate."

Rule 23 created a significant exception to the traditional American model of bilateral litigation, allowing plaintiffs who satisfy the rule's requirements to transform their lawsuit by dramatically increasing the number of parties, the resources required to resolve the case, and the defendants' potential liability. Recognizing the stark and immediate consequences that flow from class certification, this Court has repeatedly held that Rule 23 requires district courts to closely scrutinize certification requests—especially requests under Rule 23(b)(3)—and to grant them only if a searching analysis reveals that all of the rule's requirements have been met.

The requirement at issue here is that common issues of law or fact predominate over individual ones. This Court has explained that in securities-fraud cases, the answer to the predominance question frequently turns on the reliance element. But the required predominance finding can be made as to reliance (and hence overall) only through the fraud-on-the-market theory. Unless that theory can properly be invoked, therefore, certification cannot be granted. The theory cannot properly be invoked, however, unless all of its predicates—including the materiality of the alleged misstatements—have first been established. This Court and others (including the court of appeals here) have recognized this logic in regard to other predicates of the *Basic* presumption, and thus concluded that they must be proved before Rule 23 will permit certification.

The same approach should be followed with the materiality predicate.

C. Allowing district courts to certify securities-fraud classes without first ensuring that all of the predicates to the fraud-on-the-market theory have been proved—and hence that the *Basic* presumption can properly be used to make the required Rule 23 predominance finding—would have harmful practical consequences. As this Court has observed, certification of a class immediately places enormous settlement pressure on defendants, often without regard to the actual merit of the plaintiffs' claims. As the Court has also observed, such settlement pressure is particularly acute in securities-fraud cases. If materiality is not tested before certification, then, it frequently never will be; the risks and costs to defendants of continuing to litigate a case will simply be too high. Defendants will thus be forced to settle many class claims without plaintiffs ever having proved one of the predicates to the theory that allows for a class action in the first place. Moreover, such a regime would waste judicial resources, forcing district courts to expend the substantial resources required to conduct class litigation before determining whether class litigation is even properly available.

D. Recent economic research provides an additional reason why the Ninth Circuit's ruling here should be reversed. The decision below allows certification of a securities-fraud class based almost entirely on a showing of market efficiency. Contrary to the *Basic* Court's apparent assumption, however, the efficiency of a market is generally not a yes-or-no question. How efficiently a market processes information—such as an alleged misstatement—depends in part on the nature of that information. Markets are typically less ef-

ficient as to abstruse information or information that has not been widely disseminated, and more efficient as to well-publicized and easy-to-understand information. Merely concluding that a market is efficient in some overall sense therefore does not demonstrate that invocation of *Basic*'s fraud-on-the-market-based presumption is appropriate as to specific statements, because overall market efficiency does not mean that the market is efficient as to that specific type of statement. The statements themselves, including their materiality, must be examined in order to make an informed decision regarding the efficiency of the market, and thus the appropriateness of invoking *Basic*'s presumption.

E. The Ninth Circuit's two grounds for refusing to require proof of materiality before certification were, first, that materiality is an element of a securities-fraud claim, and thus not suitable to examination at the certification stage, and second, that the arguments for or against the materiality of a statement are common to the class. Both of these lack merit.

To begin with, both fail to distinguish materiality from the other fraud-on-the-market predicates that concededly do have to be established before class certification. Those other predicates are equally part of the merits of a securities-fraud claim because they must be proved at trial—typically through evidence common to the class—in order for the class to prove the required element of reliance. The Ninth Circuit's first reason is also directly contrary to this Court's decision in *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541 (2011), which reaffirmed that all matters relevant to certification must be examined at the certification stage, including those that are related (even integral) to the merits of the underlying claim. The question is not whether an issue will be considered again later but whether a class

action should be allowed to proceed at all before Rule 23 has been satisfied.

II. The Court in *Basic* expressly stated that the presumption it was adopting for securities-fraud plaintiffs was rebuttable. Defendants must have an opportunity to provide such rebuttal before certification.

As the *Basic* Court explained, a successful rebuttal demonstrates that on the particular facts of a case there is no sound basis to presume common reliance by the plaintiff class. Without that presumption, plaintiffs could not proceed as a class; individual issues would predominate as to the essential element of reliance, and thus predominate overall. In other words, a successful rebuttal defeats certification. Logically, then, the appropriate time to first address whether the presumption can be rebutted is at the certification stage. It makes no sense to say that defendants must wait until after a class is certified to show that it should not have been certified to begin with. Fairness suggests the same answer: Because of the settlement pressure created by class certification, refusing to allow rebuttal evidence before certification will often deprive defendants of *any* opportunity to rebut the presumption. That would tip the scales too far in favor of securities-fraud plaintiffs, to whom the *Basic* presumption already provides a notable advantage.

Allowing defendants to challenge the presumption before certification occurs is also consistent with this Court's Rule 23 decisions. Those decisions underscore the need for district courts to conduct a rigorous inquiry before permitting certification. American courts do not conduct such inquiries through independent investigation; they hear from both sides. There is no basis to create an exception to that approach here, par-

ticularly considering the profoundly consequential nature of the certification decision.

ARGUMENT

I. SECURITIES-FRAUD PLAINTIFFS WHO SEEK TO OBTAIN CLASS CERTIFICATION BY INVOKING *BASIC*'S PRESUMPTION OF CLASS-WIDE RELIANCE MUST PROVE MATERIALITY AT THE CLASS-CERTIFICATION STAGE

A. Materiality Is An Essential Predicate To The Fraud-On-The-Market Theory And Hence To *Basic*'s Presumption Of Reliance

1. Section 10(b) of the Securities Exchange Act of 1934 prohibits the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). SEC Rule 10b-5 implements section 10(b) by prohibiting, among other things, any "untrue statement of a material fact … in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5(b)-(c).[1]

The Securities Exchange Act does not, however, "provide an express civil remedy" to private plaintiffs for violations of these provisions. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 729 (1975). In fact, this Court has repeatedly explained that Congress, in enacting the Act, did not intend to establish a private

[1] Last year, this Court reaffirmed that a fact is material "when there is a substantial likelihood that the disclosure of the … fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1318 (2011) (internal quotation marks omitted).

right of action. *See Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008); *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 359 (1991) (citing *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 196 (1976)). Private plaintiffs instead proceed under a "judicially crafted" right of action, *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Dabit*, 547 U.S. 71, 80 (2006), first recognized by this Court in *Superintendent of Insurance of New York* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

The elements of such a private securities-fraud claim are: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1317 (2011) (internal quotation marks omitted). The fourth element, reliance, is "transaction causation," *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336, 341 (2005), meaning that the alleged misstatement caused the plaintiff to enter into the securities transaction, *see id.* at 341-342; *see also Halliburton*, 131 S. Ct. at 2186 (reliance concerns the "facts surrounding the investor's decision to engage in the transaction").

This Court has stated that reliance is an "essential" component of a 10b-5 claim because it guarantees "the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury.'" *Stoneridge*, 552 U.S. at 159 (quoting *Basic*, 485 U.S. at 243). "Requiring the plaintiff to show that he reasonably relied on the defendants' misrepresentations is [thus] a means of … ensuring that the federal securities laws do not expose defendants to limitless liability or become trans-

formed into merely private enforcement mechanisms." *Lipton* v. *Documation, Inc.*, 734 F.2d 740, 742 (11th Cir. 1984); *accord, e.g.*, *Wilson* v. *Comtech Telecomms. Corp.*, 648 F.2d 88, 92 (2d Cir. 1981) ("The element of reliance serves to restrict the potentially limitless thrust of rule 10b-5[.]"), *cited in Basic*, 485 U.S. at 243.

Traditionally, a plaintiff proved reliance by "showing that he was aware of a company's statement and engaged in a relevant transaction … based on that specific misrepresentation." *Halliburton*, 131 S. Ct. at 2185. Such individual proof, however, is inconsistent with the requirements for a class action seeking to recover damages for securities fraud. Federal Rule of Civil Procedure 23(b)(3), under which Connecticut Retirement sought certification here, permits class certification only if "questions of law or fact common to class members predominate over any questions affecting only individual members." As this Court recently observed, "[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance." *Halliburton*, 131 S. Ct. at 2184. But "[r]equiring proof of individualized reliance from each member of the proposed plaintiff class effectively would" prevent certification under Rule 23(b)(3), "since individual issues then would … overwhelm[] the common ones." *Basic*, 485 U.S. at 242.

2. To address that perceived difficulty, this Court, in *Basic Inc.* v. *Levinson*, approved a rebuttable presumption of class-wide reliance based on the fraud-on-the-market theory. As the Court explained, according to that theory, "in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business." 485 U.S. at 241 (internal quotation marks omitted). The "available material information,"

the Court continued, includes any material public misrepresentations. *See id.* at 246. Hence, the Court concluded, because "[a]n investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price[,] … an investor's reliance on any public material misrepresentations … may be presumed for purposes of a Rule 10b-5 action." *Id.* at 247. *Basic*'s presumption, in other words, is that all investors who traded a security in an open and developed market during the relevant period *indirectly* relied on any material public misstatements, through the investors' common reliance on the integrity of a market price that was distorted by those material misstatements. *See id.*

The Court also made clear in *Basic*, however, that the presumption was "just that," *Halliburton*, 131 S. Ct. at 2185, and that defendants may rebut the presumption by showing that *Basic*'s chain of inferences does not apply in a particular case. As the Court explained, "[a]ny showing that severs the link between the alleged misrepresentation" and "the price received (or paid) by the plaintiff" would serve to rebut the presumption. *Basic*, 485 U.S. at 248. Such rebuttal would eliminate the logical basis for presuming class-wide reliance.[2]

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[2] Three members of the Court did not participate in *Basic*. *See* 485 U.S. at 250. Thus, while Justice Blackmun's entire opinion in the case constituted "the opinion of the Court," *id.* at 226, the portion of it that addressed the presumption of reliance was joined by only three other Justices. Justice White's dissent from that portion rested on concern about the Court's foray into economic analysis, and in particular its endorsement of an untested economic theory. *See, e.g.*, *id.* at 252 (opinion concurring in part and dissenting in part) (objecting to "economic theorization by the federal courts"); *id.* at 254 ("[T]heories which underpin the fraud-on-the-market presumption … are—in the end—nothing more than theories."); *id.* at 254-255 (similar).

3. As a review of *Basic* demonstrates, a critical link in the chain of reasoning that led to the rebuttable presumption of class-wide reliance was a showing of materiality, *i.e.*, that the alleged misrepresentations underlying the plaintiff's claim were material. The Court explained that the presumption is that persons trade "in reliance on the integrity of the price set by the market, but because of … material misrepresentations that price [is] fraudulently depressed." *Basic*, 485 U.S. at 245. The fraud is therefore "transmitted through market price." *Id.* at 248. Without materiality, however, there is no basis to presume an effect on the market price—and therefore to presume class-wide reliance on a distorted price—even if the other fraud-on-the-market predicates are met.

The materiality of an alleged misstatement is the connection between the fraud and class-wide reliance because materiality *means* that the statement was important to the market as a whole—that is, to reasonable investors—and therefore moved the price of the stock up or down. Immaterial misrepresentations, by definition, do not affect the price of a security. *See, e.g.*, *Oran* v. *Stafford*, 226 F.3d 275, 282 (3d Cir. 2000) (Alito, J.) ("[I]n an efficient market the concept of materiality translates into information that alters the price of the firm's stock." (internal quotation marks omitted)); Dunbar & Heller, *Fraud on the Market Meets Behavioral Finance*, 31 Del. J. Corp. L. 455, 509 (2006) ("The definition of immaterial information … is that it is already known or … does not have a statistically significant effect on stock price in an efficient market."). Thus, the making of an immaterial misrepresentation cannot constitute a fraud on the market—or, consequently, a common fraud on investors who are presumed to rely on the integrity of the stock price set by

the market. *See, e.g.*, *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.) ("[T]o the extent that information is not important to reasonable investors, it follows that its release will have a negligible effect on the stock price."). It is only the materiality of a misstatement, in other words, that allows a court to presume an effect on the "integrity" of the market price, on which investors are presumed to rely in common.

Materiality, then, in addition to being an element of a securities-fraud claim, is critical to application of the fraud-on-the-market theory, and therefore to *Basic*'s presumption of reliance. The Court in *Basic* made this link between materiality and reliance clear, stating that "[f]or purposes of accepting the presumption of reliance …, we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices." 485 U.S. at 246 n.24; *see also id.* at 244-245 (quoting court of appeals decisions that linked reliance to materiality). The Court reinforced the point in discussing ways that the presumption could be rebutted in a particular case. "For example," the Court stated, "if [defendants] could show that the 'market makers' were privy to the truth …, and thus that the market price would not have been affected by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone." *Id.* at 248. That example speaks directly to materiality: When the market is "privy to the truth," *id.*, a misstatement is immaterial and thus does not affect the market price.

Subsequent decisions by this Court confirm materiality's status as an essential predicate of the fraud-on-

the-market theory, and consequently of *Basic*'s presumption of class-wide reliance. For example, the Court has unanimously cited *Basic* as having approved a "presum[ption] that the price of a publicly traded share reflects a *material* misrepresentation and that plaintiffs have relied upon that [material] misrepresentation." *Dura Pharm.*, 544 U.S. at 341-342 (emphasis added). Similarly, just last year the Court unanimously described "*Basic*'s fundamental premise" as being "that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction"—*i.e.*, so long as it was material (and the other fraud-on-the-market predicates are met). *Halliburton*, 131 S. Ct. at 2186.

B. Rule 23 Requires Plaintiffs To Prove Materiality At Class Certification Along With The Other Fraud-On-The-Market Predicates

Because materiality is an indispensable predicate of the fraud-on-the-market theory, and thus of *Basic*'s presumption of indirect class-wide reliance, Rule 23 requires that it—like the other fraud-on-the-market predicates—be proved before class certification.

1. "The class-action device was designed as 'an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.'" *General Tel. Co. of Sw.* v. *Falcon*, 457 U.S. 147, 155 (1982) (quoting *Califano* v. *Yamasaki*, 442 U.S. 682, 700-701 (1979)). "In order to justify a departure from that [usual] rule," a party seeking class certification must "prove" that the requirements of Rule 23 are "*in fact*" satisfied. *Wal-Mart*, 131 S. Ct. at 2550, 2551. A district court may therefore certify a class only if it concludes, "after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *Id.* at 2551 (internal

quotation marks omitted). In other words, "actual, not presumed, conformance with Rule 23(a) remains … indispensable." *General Tel. Co.*, 457 U.S. at 160. "That is equally true of Rule 23(b)." *Szabo* v. *Bridgeport Machs., Inc.*, 249 F.3d 672, 677 (7th Cir. 2001); *accord In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 33 & n.3 (2d Cir. 2006); *Newton* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 167 (3d Cir. 2001). Indeed, it is particularly important in cases—like this one—in which certification is sought under Rule 23(b)(3): This Court has noted that Rule 23(b)(3) covers "situations in which class-action treatment is not as clearly called for," and thus requires the district court to take "a close look at the case before it is accepted as a class action." *Amchem Prods., Inc.* v. *Windsor*, 521 U.S. 591, 615 (1997) (internal quotation marks omitted).

Among the reasons for requiring a "rigorous analysis" and "close look" before class certification is that a class action is orders of magnitude different from a traditional bilateral or multi-lateral lawsuit. Immediately upon the certification of a class, the scope of the litigation expands dramatically—the number of affected parties, the time and cost required, the amount at stake, and the very dynamics of the litigation. *See AT&T Mobility LLC* v. *Concepcion*, 131 S. Ct. 1740, 1752 (2011) (noting "the higher stakes of class litigation"); *cf. Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1776 (2010) (noting "the fundamental changes brought about by the shift from bilateral arbitration to class-action arbitration"). Moreover, the claims of the hundreds or even thousands of class members, and the correspondingly enormous potential liability of the defendant, are placed in the hands of a single jury (possibly consisting of as few as six people). *See AT&T Mobility*, 131 S. Ct. at 1752 (observing that "when dam-

ages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable"). While such a large-scale transformation is authorized by Rule 23 when its requirements are met, district courts must ensure that these stark and immediate effects are imposed on the parties only when all of the enumerated requirements have indeed been established.

2. The Rule 23 requirement in dispute here is predominance, *i.e.*, whether "questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Rule 23 does not permit certification until the district court affirmatively "finds" such predominance. *Id.* But because predominance in a private securities-fraud case "often turns" on reliance, *Halliburton*, 131 S. Ct. at 2184, no predominance finding would normally be possible unless that "essential" element, *Stoneridge*, 552 U.S. at 159, is susceptible to class-wide proof. A private securities-fraud claim is inappropriate for class certification, then, absent some means of proving reliance on behalf of the class of investors.

The presumption of class-wide reliance endorsed by this Court in *Basic* provides that means, allowing a court to make the required predominance finding as to the reliance element (and thus the claims overall). But for that to occur, the predicates of the presumption must first be established. One of those is materiality, without which there can be no fraud on the market. Until materiality is proved, therefore, no sound basis exists to allow plaintiffs to invoke the presumption. And without the presumption, the class members would have to prove reliance individually, rendering it impossible for the district court to make the required predominance finding. *See Basic*, 485 U.S. at 242. That

finding cannot simply be deferred until later in the litigation. To the contrary, "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been." Fed. R. Civ. P. 23(c)(1) advisory committee notes (2003 amendments).

Although this Court's decision last year in *Erica P. John Fund, Inc.* v. *Halliburton* is not directly on point, its reasoning fully supports requiring proof of materiality before class certification. In that case, the court of appeals had held that proof of loss causation, another element of a private 10b-5 claim, was required before certification. *See Archdiocese of Milwaukee Supporting Fund, Inc.* v. *Halliburton Co.*, 597 F.3d 330, 334 (5th Cir. 2010) (subsequent history omitted). This Court unanimously rejected that view. *See Halliburton*, 131 S. Ct. at 2186. The reason it did, the Court made clear, was that loss causation is not connected to the element of reliance, and hence not logically connected to *Basic*'s rebuttable presumption of class-wide reliance. *See id.* ("Loss causation addresses a matter different from whether an investor relied on a misrepresentation[.]"). By contrast, matters that *are* logically connected to reliance—including materiality—do have to be proven at class certification. The Court also noted, in rejecting the court of appeals' view, that "[t]he term 'loss causation' does not even appear in our *Basic* opinion." *Id.* The term materiality, on the other hand, pervades *Basic*'s discussion of the presumption of reliance. *See* 485 U.S. at 241-248.

3. Requiring proof of materiality before class certification is consistent with the treatment of the other predicates of the fraud-on-the-market theory. As this Court said in *Halliburton*, "[i]t is undisputed that … in order to invoke *Basic*'s rebuttable presumption of reli-

ance," plaintiffs must prove—before certification—(1) an efficient market, (2) a public misstatement, and (3) that the plaintiff traded between the time of the alleged misrepresentation and the time the truth was revealed. 131 S. Ct. at 2185 (citing *Basic*, 485 U.S. at 248 n.27), *cited in Wal-Mart*, 131 S. Ct. at 2552 n.6; *accord* Br. in Opp. 15. As with materiality, the need to show each of these predicates before certification is evident from the logic of *Basic*. The market must be efficient because efficiency provides the basis for "presuming that the price of a publicly traded share reflects a material misrepresentation." *Dura Pharm.*, 544 U.S. at 341-342. Similarly, the class members must have traded between the time of the misrepresentations and the time the truth was revealed, for otherwise there is no basis to assume that they relied on the market price at a time when, "because of petitioners' material misrepresentations[,] that price had been fraudulently depressed" or inflated. *Basic*, 485 U.S. at 245. Finally, the misstatements must be public because "how [else] would the market [price] take them into account?" *Halliburton*, 131 S. Ct. at 2185.

The same reasoning applies to the materiality predicate. If a misstatement is not material, there is no basis for presuming a market-price distortion upon which plaintiffs could have commonly relied, and thus the reliance question cannot be resolved for all class members "in one stroke." *Wal-Mart*, 131 S. Ct. at 2551. As with the other predicates, therefore, plaintiffs must prove that a misstatement is material before class certification.

C. If Materiality Is Not Determined Before Class Certification, It Frequently Will Not Be Considered At All

1. A long-recognized consequence of class certification is that defendants may suddenly face enormous potential liability that they cannot afford to risk. *See* Fed. R. Civ. P. 23(f) advisory committee notes (1998 amendments) ("An order granting certification ... may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability."). Indeed, this Court and others have often noted the "risk of in terrorem settlements that class actions entail." *AT&T Mobility*, 131 S. Ct. at 1752 (internal quotation marks omitted); *see also, e.g.*, *Newton*, 259 F.3d at 192 ("[C]lass certification would place hydraulic pressure on defendants to settle."); *West* v. *Prudential Sec., Inc.*, 282 F.3d 935, 937 (7th Cir. 2002) (noting "[t]he effect of a class certification in inducing settlement to curtail the risk of large awards"); Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 99 (2009) ("With vanishingly rare exception, class certification sets the litigation on a path toward resolution by way of settlement, not full-fledged testing of the plaintiffs' case by trial."). This Court has further observed that the pressure to settle in the wake of class certification is not limited to claims that have merit. To the contrary, "[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a *meritorious* defense." *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 476 (1978) (emphasis added); *see also Shady Grove Orthopedic Assocs.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1465 n.3 (2010) (dissenting opinion) ("A

court's decision to certify a class … places pressure on the defendant to settle even unmeritorious claims.").

The danger of undue settlement pressure that class actions inevitably entail is particularly acute in private securities-fraud cases. As this Court noted decades ago, there is "widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739; *see also Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) ("Private securities fraud actions, … if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law."). That special concern "is founded in something more substantial than the common complaint of the many defendants who would prefer avoiding lawsuits entirely to either settling them or trying them." *Blue Chip Stamps*, 421 U.S. at 740. In securities-fraud cases, "even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Id.* That is because "[t]he very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* It is also because the "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge*, 552 U.S. at 163.

Empirical evidence confirms that the power of *Basic*'s presumption of reliance to "facilitate[] an extraordinary aggregation of claims" means that the "*in terrorem* power of certification" generally forces even the least risk-averse defendants to settle once a class is

certified. *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 267 (5th Cir. 2007), *abrogated on other grounds by Halliburton*, 131 S. Ct. 2179. According to one recent study, a verdict is reached in only about one-third of one percent of securities-fraud class actions. *See* Cornerstone Research, *Securities Class Action Filings: 2010 Year in Review* at 14 (2011). In practice, then, failing to evaluate materiality at the certification stage will usually mean that defendants are forced to settle without any testing of the materiality of the alleged misstatements—that is, without any showing that class certification was warranted in the first place.[3]

Moreover, in every case in which the alleged misstatement is not material, refusing to evaluate materiality before class certification wastes judicial resources. If the alleged misstatements underlying a plaintiff's class claim are immaterial, then the class will not be able to prove class-wide reliance in the litigation and all the costs to the legal system of proceeding on a class-wide basis are wasted. This waste is significant: According to a study by the Federal Judicial Center, "[c]ertified class action cases consume[] considerably more judge time than cases filed as class actions but

[3] The possibility of summary judgment does not meaningfully reduce the settlement pressure created by class certification. First, materiality is an "'an inherently fact-specific finding,'" *Matrixx*, 131 S. Ct. at 1318 (quoting *Basic*, 485 U.S. at 236), involving "inferences" and "assessments [that] are peculiarly ones for the trier of fact," *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 (1976). Second, once a class has been certified, the risks associated with litigating a summary judgment motion to decision are also increased, and they themselves constitute a part of the settlement pressure recognized by this Court and others.

never certified." Willging et al., Fed. Judicial Ctr., *Empirical Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* 23 (1996), *available at* http://www.fjc.gov/public/pdf.nsf/lookup/rule23.pdf/$File/rule23.pdf. In fact, the judges who were studied spent over five times as many hours on certified class actions as on putative class actions that were never certified. *Id.* at 169 tbl. 19.

2. At the petition stage, Connecticut Retirement objected (Br. in Opp. 29) that the forgoing are "naked public policy arguments" rather than "a coherent legal argument." But the very purpose of Rule 23(b)(3) is to serve such considerations as fairness. The rule itself states that before certifying a class under subparagraph (b)(3), the district court must find "that a class action is superior to other available methods for *fairly* and efficiently adjudicating the controversy." Fed. R. Civ. P. 23(b)(3) (emphasis added). Fairness of course runs to defendants as well as plaintiffs. *See Unger* v. *Amedisys Inc.*, 401 F.3d 316, 320 (5th Cir. 2005) (recognizing "the important due process concerns of both plaintiffs and defendants inherent in the certification decision"); *In re Am. Med. Sys., Inc.*, 75 F.3d 1069, 1086 (6th Cir. 1996) (vacating a certification order in part because the defendant's "due process rights were violated by the district judge's precipitous certification of the class"). It is unfair to certify a class where the likely practical result of that step is that the materiality predicate of the essential element of reliance—the element on which the requirement of predominance "often turns," *Halliburton*, 131 S. Ct. at 2184—will never be examined.

By contrast, requiring proof of materiality before class certification creates no unfairness to plaintiffs. If

such proof exists, it can be offered as readily at the certification stage as later, given district courts' authority to allow appropriate pre-certification discovery. *See* Fed. R. Civ. P. 23(c)(1) advisory committee notes (2003 amendments) ("[I]n aid of the certification decision, … it is appropriate to conduct controlled discovery …, limited to those aspects relevant to making the certification decision on an informed basis."); *In re Initial Pub. Offerings*, 471 F.3d at 41 (authorizing discovery at the certification stage because "the district judge must receive enough evidence, by affidavits, documents, or testimony, to be satisfied that each Rule 23 requirement has been met"). Hence, when materiality is at issue, requiring proof of it before class certification imposes no undue burden on plaintiffs. Connecticut Retirement has never contended otherwise.

This Court's precedent makes clear, moreover, that fairness and other policy considerations are particularly pertinent in the context of private securities-fraud claims. The Court has repeatedly explained that such considerations "are entitled to a good deal of weight" in identifying the boundaries of the judicially created private cause of action under the Securities Exchange Act and Rule 10b-5. *Blue Chip Stamps*, 421 U.S. at 749; *see also supra* pp. 13-14. As the Court stated nearly 40 years ago:

> [W]e are not dealing here with any private right created by the express language of § 10 (b) or of Rule 10b-5. No language in either of those provisions speaks at all to the contours of a private cause of action for their violation. … We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one

> way or another unless and until Congress addresses the question.

Id. at 748-749; *see also id.* at 737 ("It is … proper that we consider … what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance."). *See generally Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1104 (1991) ("[W]here a legal structure of private statutory rights has developed without clear indications of congressional intent, the contours of that structure need not be frozen absolutely when the result would be demonstrably inequitable."). Indeed, in the same case the Court cited the settlement pressure created by securities-fraud lawsuits in rejecting the plaintiff's theory of liability. *See Blue Chip Stamps*, 421 U.S. at 740.

More recently, this Court similarly noted that it was "appropriate to examine" "[t]he practical consequences of" securities-fraud plaintiffs' proposed rule regarding liability under 10b-5. *Stoneridge*, 552 U.S. at 163. The Court reasoned that the "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies," and cited that rationale as "further reason to reject [the plaintiff's] approach." *Id.* Under this Court's relevant precedent, then, it is entirely appropriate to accord significant weight to judicial economy and to the "hydraulic pressure" to settle created by class certification—and in particular to ensure that such pressure is not brought to bear, and substantial judicial resources needlessly expended, unless the district court has made the findings required by Rule 23.

Consideration of practical and equitable factors is all the more warranted given that what is at issue here are the contours of not only a "judicially crafted" cause of action, *Merrill Lynch*, 547 U.S. at 80, but also the judicially crafted doctrine that enables securities-fraud plaintiffs to obtain class certification in appropriate cases. Rule 23 does not, of course, provide that the required predominance finding can be made via a fraud-on-the-market-based presumption of class-wide reliance. It was only the Court's approval of that presumption in *Basic* that allowed securities plaintiffs to proceed as a class in this context. There is no reason why plaintiffs should enjoy that significant judicially created advantage without satisfying the judicially stated requirements for its application. As the Fifth Circuit put it, a certification order's "bite should dictate the process that precedes it." *Oscar Private Equity*, 487 F.3d at 267.

D. Modern Economic Research Further Demonstrates Why The Ninth Circuit Should Not Have Expanded The *Basic* Presumption

Under the rule adopted by the Ninth Circuit, a court may certify a securities-fraud class based almost exclusively on a general showing of the efficiency of the trading market for the security. But proof that a market is generally efficient does not make it appropriate to apply the fraud-on-the market theory in every case involving a security in that market. Economic research, much of it post-*Basic*, demonstrates that efficiency cannot be analyzed in the abstract; whether a market is efficiently processing specific information depends on a host of factors, including the nature of the information, its source, and the other information available to investors. Proof of the materiality of an alleged

misstatement is required because it provides much of this necessary context.

The Court in *Basic* relied in part on "[then-r]ecent empirical studies" that tended to confirm the efficient-market hypothesis. 485 U.S. at 246. According to the Court, that hypothesis was straightforward: "the market price of shares traded on well-developed [*i.e.*, efficient] markets reflects all publicly available information." *Id.* The Court thus found it reasonable to presume that, so long as the market is efficient, any material misrepresentation would have an effect on the market price on which investors would rely in common. Lower courts applying *Basic* have developed various multi-factor tests to determine whether a particular market is efficient. *See, e.g.*, *Cammer* v. *Bloom*, 711 F. Supp. 1264, 1286-1287 (D.N.J. 1989) (articulating five factors); *Krogman* v. *Sterritt*, 202 F.R.D. 467, 478 (N.D. Tex. 2001) (adding three more factors); *see also Unger*, 401 F.3d at 323 (noting that the *Cammer*/*Krogman* factors "have been used by many courts throughout the country").

Modern economic research shows, however, that these efficiency tests do not reliably predict whether a particular piece of information will be incorporated into a security's market price. *See, e.g.*, Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?*, 54 Emory L.J. 843, 863-868 (2005).[4]

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[4] *Accord* Erenburg et al., *The Paradox of "Fraud-on-the-Market Theory": Who Relies on the Efficiency of Market Prices?*, 8 J. Empirical Legal Stud. 260, 292 (2011) ("Overall, the *Cammer* and *Krogman* factors that we examine exhibit little relation to weak-form market efficiency."); Barber et al., *The Fraud-on-the-Market Theory and the Indicators of Common Stocks' Efficiency*, 19 J. Corp. L. 285, 305-307 (1994) (finding that three factors—the

The research casts serious doubt on a key premise underlying the *Basic* Court's endorsement of the presumption of reliance, namely that market efficiency is "a binary, yes or no question," Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 167; *see also* Cornell & Rutten, *Market Efficiency, Crashes, and Securities Litigation*, 81 Tul. L. Rev. 443, 448 (2006). That premise ignores the reality that there are differences in efficiency *within* a market. As studies have shown, a market can be efficient in some respects but not in others—efficient as to some types or sources of information but not others, for example, or efficient over some periods of time but not others. *See, e.g.*, Macey & Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1079-1091 (1990).[5]

Markets are most likely to be efficient as to information that is both widely disseminated and relatively easy to understand, such as merger announcements and public reports of stock splits. Stock prices often respond to this type of information very soon after it be-

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size of an issuer, the bid-ask spread, and institutional holdings—were not independently important efficiency indicators); Bernard et al., *Challenges to the Efficient Market Hypothesis: Limits to the Applicability of Fraud-on-the-Market Theory*, 73 Neb. L. Rev. 781, 796 (1994) (similarly finding that firm size, analyst following, and percentage of outstanding shares held by institutions did not significantly and independently predict efficiency).

[5] *See also* Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* 2 (2000); Fox, *The Myth of the Rational Market* 200-206, 250-255, 259-262, 295-300, 312-318 (2009); Brown et al., *Analyst Recommendations, Mutual Fund Herding, and Overreaction in Stock Prices* 33-34 (Feb. 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1363837.

comes public. *See* Brealey & Myers, *Principles of Corporate Finance* 358-360 (6th ed. 2000) (describing studies); Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. Corp. L. 635, 653 (2003). In contrast, markets are less efficient when investors must expend substantial time and resources to acquire or understand the information. *See* Brealey & Myers at 363-365 (describing studies). For example, "news of a change in quarterly earnings will require a large investment in information-gathering to decode," and studies show that markets do not "respond particularly quickly to" such news. Macey & Miller, 42 Stan. L. Rev. at 1083, 1084. Even "[o]ne of the most common types of material disclosures—an earnings surprise—actually takes a while to be fully impounded, even for large-cap stocks, and even varies depending on whether it is good news or bad." Langevoort, 2009 Wis. L. Rev. at 170. Studies also have found that information already known to the market through SEC filings, like insider-trading disclosures, can have a delayed but significant price impact once publicized through prominent media outlets, probably as a result of the high costs of obtaining and processing such information earlier, before its dissemination by the media. *See* Chang & Suk, *Stock Prices and the Secondary Dissemination of Information: The Wall Street Journal's "Insider Trading Spotlight" Column*, 33 Fin. Rev. 115, 116-117 (1998).

A striking example of this phenomenon occurred in *In re Merck & Co. Securities Litigation*, 432 F.3d 261 (3d Cir. 2005). In that case, Merck, one of the largest pharmaceutical companies in the world, disclosed through a public SEC filing an accounting interpretation that had significant adverse implications for its revenues. Initially, the disclosure appeared to have no negative effect on Merck's stock price—indeed, the

price increased on each of the next five days, including the day of the filing. *Id.* at 264, 269. Two months later, however, *The Wall Street Journal* published an article analyzing the disclosure and estimating its potential significance, causing an immediate and significant decline in the market price. *See id.* at 265. In short, although "it is hard to imagine any stock more likely traded in an efficient market than Merck," Langevoort, 2009 Wis. L. Rev. at 174, a public disclosure with important revenue implications nonetheless had no meaningful price impact for more than two months—a period that might have been even longer had the media report not called attention to the disclosure.

Because market-wide efficiency tests fail to account for these common issues regarding the assimilation of information into the price of a security, it would be improvident for courts to expand the *Basic* presumption by allowing class certification under the fraud-on-the-market theory based on a finding of general market efficiency alone. A court cannot reliably conclude, based on that proof alone, that the theory will in fact apply to a particular case. Market efficiency and materiality are both essential predicates, and often are intertwined, when determining whether a presumption of class-wide reliance is appropriate. The misrepresentation at issue must have been material, and the market must have been efficient as to that misrepresentation, such that the court considering class certification can reliably say—before transforming the case into a class proceeding—that the market price incorporated the alleged misrepresentation. Allowing a presumption of reliance at class certification without any examination of the materiality of the statement itself is thus supported by neither "common sense" nor "probability." *Basic*, 485 U.S. at 246.

E. The Ninth Circuit's Grounds For Refusing To Require Proof Of Materiality Before Certification Lack Merit

The court of appeals offered two reasons for refusing to examine materiality (or to permit any rebuttal on the issue) at the class-certification stage. Neither has merit.

1. The court first noted that materiality is "an element of the merits of [a] securities fraud claim." Pet. App. 8a (emphasis omitted). Hence, the court reasoned, it should "be reached at trial or by summary judgment motion." Pet. App. 13a. By contrast, the court stated, two other predicates of the fraud-on-the-market theory—market efficiency and the public nature of the alleged misstatements—"are not elements of the merits of a securities fraud claim," and therefore are appropriately examined at the class-certification stage. Pet. App. 9a. This reasoning is flawed for at least two reasons.

First, it is contrary to this Court's decision last year in *Wal-Mart Stores, Inc.* v. *Dukes*. *Wal-Mart* held that at the certification stage, district courts must examine all issues relevant to the Rule 23 inquiry, regardless of whether those issues overlap with or are even identical to issues that must later be considered on a summary judgment motion or at trial. As the Court explained, "certification is proper only if 'the trial court is satisfied, after a rigorous analysis,'" that Rule 23's prerequisites are met. 131 S. Ct. at 2551 (quoting *General Tel. Co.*, 457 U.S. at 161). "Frequently," this Court recognized, "that 'rigorous analysis' will entail some overlap with the merits of the plaintiff's underlying claim." *Id.* But "[t]hat cannot be helped." *Id.* Class certification "'generally involves considerations

that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action.'" *Id.* at 2551 (quoting *General Tel. Co.*, 457 U.S. at 160). A Rule 23 determination, in other words, must be made before, and independently of, any merits determination. The rule provides no exception for subjects that, if litigated at class certification, might reveal that the plaintiff's and the class's claims lack merit.[6]

This principle is especially relevant here, where the reason for the Rule 23 inquiry into materiality is distinct from the reason for the merits inquiry into the same issue. Rule 23 requires courts to examine materiality as a predicate to the fraud-on-the-market theory because only the applicability of that theory allows for class-wide proof on the reliance element. That a plaintiff's failure to prove materiality, a distinct element of a Rule 10b-5 claim, would defeat every plaintiff on the merits is irrelevant to whether individualized issues predominate on the distinct element of reliance.

The Court's application of the Rule 23 principles in *Wal-Mart* itself confirms the error of the Ninth Circuit's analysis here. In order to meet the Rule 23 commonality requirement, the plaintiffs in *Wal-Mart* had to show that Wal-Mart "'operated under a general policy of discrimination.'" 131 S. Ct. at 2553 (quoting *General Tel. Co.*, 457 U.S. at 159 n.15). To establish the merits element of a "pattern or practice of discrimination," they similarly had to show that "discrimination was the

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[6] Although *Wal-Mart* interpreted the commonality requirement of Rule 23(a)(2), its holdings also apply to the predominance requirement of Rule 23(b)(3), which "subsume[s]" and is "more stringent"—indeed, "far more demanding"—than Rule 23(a)(2). *Amchem*, 521 U.S. at 609, 624.

company's standard operating procedure." *Id.* at 2552 & n.7 (emphasis and internal quotation marks omitted). Notwithstanding this substantial overlap, the Court held that before certification the plaintiffs had to submit "significant proof" of a "general policy of discrimination," because of its relevance to the Rule 23 inquiry. *Id.* at 2553 (internal quotation marks omitted). The Court in *Wal-Mart* thus refused to excuse compliance with Rule 23's requirements simply because the "proof of commonality [required for class certification] necessarily overlaps with [plaintiffs'] merits contention that Wal-Mart engages in a pattern or practice of discrimination." *Id.* at 2552 (emphasis omitted). The Ninth Circuit's ruling in this case is entirely inconsistent with the lesson of *Wal-Mart*.

Second, the Ninth Circuit's logic does not distinguish materiality from the efficient-market, public-statement, and trade-timing predicates that *do* have to be proved before class certification. *See Halliburton*, 131 S. Ct. at 2185. The court of appeals asserted that these other predicates "are not elements of the merits of a securities fraud claim." Pet. App. 9a. But in a case (like this one) in which the plaintiff class proceeds on a fraud-on-the-market theory of reliance, that assertion is wrong: The other predicates are necessary components of the required element of reliance because they are essential to the fraud-on-the-market theory by which the plaintiff will prove that required element. For a securities-fraud class to prevail at trial using a fraud-on-the-market theory, in other words, it must prove—at trial—not only that the alleged misrepresentations were material but also that they were public, that the market was efficient, and that the class members traded during the relevant period. *See Wal-Mart*, 131 S. Ct. at 2552 n.6 ("To invoke [the fraud-on-the-

market] presumption, the plaintiffs seeking 23(b)(3) certification must prove that their shares were traded on an efficient market, *an issue they will surely have to prove again at trial in order to make out their case on the merits*." (emphasis added) (citation omitted)). A failure to prove any one of these predicates at trial—like a failure to prove materiality—would therefore doom the entire class's claim.

2. The Ninth Circuit's second reason for refusing to examine materiality (or permit any rebuttal evidence on the issue) before certification was that the arguments for and against a misstatement's materiality are common to the class, and therefore consideration of materiality could be deferred until summary judgment or trial. *See* Pet. App. 8a-10a; *id.* at 10a (noting that materiality "affect[s] investors alike").

At best, this puts the cart before the horse. The *first* question is whether to certify a class; a district court cannot properly answer that question "yes" without making the necessary Rule 23 findings merely because the process of answering it implicates common evidence or arguments.

And again, the Ninth Circuit's reasoning fails to distinguish materiality from the efficient-market and public-statement predicates. The arguments for and against market efficiency are also common across a putative class. Nevertheless, because of the importance of the fraud-on-the-market theory to overcoming an otherwise insuperable bar to class certification in securities-fraud cases, *see Basic*, 485 U.S. at 242, this Court and the courts of appeals (including the Ninth Circuit in this case) have made clear that market efficiency and a public statement must be proved at the certification stage. *See Halliburton*, 131 S. Ct. at 2185 (quoting *Ba-*

sic, 485 U.S. at 248); *Wal-Mart*, 131 S. Ct. at 2552 n.6; *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 631, 633 (3d Cir. 2011); *Schleicher* v. *Wendt*, 618 F.3d 679, 682, 688 (7th Cir. 2010); *Unger*, 401 F.3d at 322; Pet. App. 9a ("[T]he district court was correct to require Connecticut Retirement to prove at the class certification stage that the market for Amgen's stock was efficient and that Amgen's supposed misstatements were public."). This is so even though a successful class certification motion under Rule 23(b)(3) necessarily will prove the market-efficiency and public-statement predicates through evidence common to the class. The same approach is warranted for the materiality predicate.

The Ninth Circuit's two flawed rationales led it to conclude that at the certification stage plaintiffs merely need to "allege materiality with sufficient plausibility to withstand a 12(b)(6) motion." Pet. App. 12a. Rule 23, however, "does not set forth a mere pleading standard." *Wal-Mart*, 131 S. Ct. at 2551. It requires "[a] party seeking class certification" to "affirmatively demonstrate his compliance with" the rule by proving "in fact" that its requirements are satisfied. *Id.* (emphasis omitted). An allegation of materiality establishes at most the *possibility* that reliance will be a common issue if materiality can later be established. *See Ashcroft* v. *Iqbal*, 556 U.S. 662, 678 (2009) ("The plausibility standard is not akin to a 'probability requirement[.]'"), *cited in* Pet. App. 12a. But if the statements are actually immaterial, the fraud-on-the-market theory will be unavailable "in fact" as a method of class-wide proof. *Wal-Mart*, 131 S. Ct. at 2551 (emphasis omitted). Until the district court makes a finding as to whether the statement is material, it simply cannot determine whether the predominance requirement is satisfied. *See Halliburton*, 131 S. Ct. at 2184

(predominance in a securities-fraud case "often turns" on reliance).

II. Defendants Must Be Permitted To Rebut The Fraud-On-The-Market Theory At Class Certification

When the Court in *Basic* adopted the presumption of class-wide reliance for cases in which the fraud-on-the-market theory applies, it expressly labeled that presumption "rebuttable." 485 U.S. at 250. Last year, this Court confirmed that "the presumption was just that, and could be rebutted by appropriate evidence." *Halliburton*, 131 S. Ct. at 2185. As a matter, again, of logic, fairness, and judicial economy, defendants must be allowed to offer such "appropriate [rebuttal] evidence" at the class-certification stage.

1. The very purpose of the presumption is to enable the required Rule 23 finding of predominance, and thus certification of a class, where such a finding (and hence certification) would otherwise be impossible. *See Basic*, 485 U.S. at 242. Logically, then, "a successful rebuttal defeats certification by defeating the Rule 23(b)(3) predominance requirement." *In re Salomon Analyst Metromedia Litig.*, 544 F.3d 474, 485 (2d Cir. 2008) (emphasis omitted). It makes no sense to say that defendants must wait until summary judgment or trial in order to show that a class should not have been certified in the first place. The time to consider evidence regarding the certification question is the certification stage.

This case provides a good example. In the district court, Amgen sought to show that in light of all the information available to the market, the alleged Amgen misstatements could not be presumed to have altered the market price because they would not have "'signifi-

cantly altered the total mix of information made available,'" *Basic*, 485 U.S. at 232 (quoting *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976)) (other internal quotation marks omitted); *see also supra* pp. 5-6 (detailing Amgen's rebuttal evidence). As explained in *Basic*, a showing of this type breaks "the causal connection" inherent in the fraud-on-the-market-theory: "[t]he basis for finding that the fraud had been transmitted through market price [is] gone." 485 U.S. at 248.

The effect of a successful rebuttal, therefore, is the same as a plaintiff's failure to establish the efficient-market, public-statement, or materiality predicates: It eliminates the basis for presuming the existence of a price distortion on which the plaintiffs could have commonly relied. Because it defeats the possibility of class-wide reliance, it is a matter on which defendants should be allowed to introduce evidence at the class-certification stage.

Denying defendants any such opportunity would be fundamentally inequitable. Again, when this Court endorsed the presumption of class-wide reliance in *Basic*, it added a powerful weapon to plaintiffs' arsenal in securities-fraud litigation. The Court did so, however, with the express understanding that defendants would have a meaningful opportunity to rebut the presumption and thereby show that the plaintiffs in any particular case are not entitled to this advantage. *See* 485 U.S. at 248. That opportunity would not be meaningful if rebuttal were postponed until after class certification. Given the settlement pressure created by class certification in securities-fraud cases, defendants would rarely have any actual chance to present rebuttal evidence. Considerations of judicial economy reinforce the point: Requiring courts to initially hear evidence re-

garding class certification from only one side would inevitably lead to certification in some cases in which it is improper. Courts would then have to spend resources managing those large cases until evidence from both sides was finally allowed (or, of course, the case settled). Permitting prompt adversarial resolution of the certification issue would avoid such a waste of resources.

2. The Court's opinion in *Basic* does not support deferring the consideration of rebuttal evidence until after class certification. Responding in a footnote to Justice White's partial dissent, the Court in *Basic* stated in dictum that certain proof regarding market efficiency "is a matter for trial, throughout which the District Court retains the authority to amend the certification order as may be appropriate." 485 U.S. at 249 n.29 (citing Fed. R. Civ. P. 23(c)), *cited in* Pet. App. 44a. As the end of that sentence and the accompanying citation to Rule 23(c) indicate, this statement was made at a time when Rule 23 authorized "conditional" class-certification orders, allowing courts to defer difficult or complex questions until a later stage of the litigation. *See* Fed. R. Civ. P. 23(c)(1)(C) (1998). That authority was eliminated in 2003; now, "[a] court that is not satisfied that the requirements of Rule 23 have been met should refuse certification until they have been met." *Id.* advisory committee note (2003 amendments). This significant change counsels against giving any weight to *Basic*'s "for trial" observation.

In any event, a strict application of that dictum would prove too much. It would mean, for example, that issues like materiality could not be adjudicated at summary judgment—a position that, to Amgen's knowledge, no court has embraced. *See Rand* v. *Cullinet Software, Inc.*, 847 F. Supp. 200, 206 (D. Mass. 1994)

(*Basic*'s footnote "does not mean that it is always necessary or appropriate to have a trial to establish a truth on the market defense"); *see also In re DVI*, 639 F.3d at 637 n.20 ("Taken literally, note 29 may even appear to preclude a court from evaluating evidence presented by a defendant at class certification to demonstrate the market is inefficient. But this widespread practice is permitted even in circuits that do not allow the examination of rebuttal evidence at the class certification stage."). There is, in short, no basis to overread the footnoted dictum in *Basic*.

3. This Court's recent Rule 23 precedent reinforces the need to allow rebuttal at the class-certification stage. The Court has held that Rule 23 requires district courts to conduct a "rigorous analysis" of whether the rule's requirements are "in fact" satisfied before certifying a class. *Wal-Mart*, 131 S. Ct. at 2551 (emphasis omitted). It has also held that certification under Rule 23(b)(3) in particular requires a "close look" by district courts. *Amchem*, 521 U.S. at 615. District courts cannot comply with these mandates without giving both sides an opportunity to introduce and challenge evidence relevant to the Rule 23 requirements. *See In re Initial Pub. Offerings*, 471 F.3d at 27 (determining whether "each Rule 23 requirement is met" requires "that *all* of the evidence … be assessed as with any other threshold issue" (emphasis added)).[7]

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[7] *See also In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 324 (3d Cir. 2008) ("Genuine disputes with respect to the Rule 23 requirements must be resolved, after considering all relevant evidence submitted by the parties."); *Weathers* v. *Peters Realty Corp.*, 499 F.2d 1197, 1200 (6th Cir. 1974) (at the certification stage, "[t]he parties should be afforded an opportunity to present evidence on the maintainability of the class action").

American courts, after all, are not independent investigators. Rather, "in Anglo-American legal practice, courts rely on the rigors of the adversarial process to reveal the true facts of a case." *Snead* v. *Barnhart*, 360 F.3d 834, 838 (8th Cir. 2004); *cf. Maryland* v. *Craig*, 497 U.S. 836, 845 (1990) ("reliability of the evidence" is ensured "by subjecting it to rigorous testing in the context of an adversary proceeding"); *Carroll* v. *President & Comm'rs of Princess Anne*, 393 U.S. 175, 183 (1968) ("The value of a judicial proceeding … is substantially diluted where the process is ex parte, because the Court does not have available the fundamental instrument for judicial judgment: an adversary proceeding in which both parties may participate."). The notion of allowing plaintiffs to adduce evidence regarding the fraud-on-the-market predicates, while barring defendants from offering contrary evidence, is contrary to fundamental tenets of our adversarial system of justice.[8]

Recognizing this, the courts of appeals have permitted defendants to introduce evidence rebutting plaintiffs' showings on various issues critical to class certification. *See, e.g.*, *Teamsters Local 445 Freight Div. Pension Fund* v. *Bombardier, Inc.*, 546 F.3d 196, 205-206 (2d Cir. 2008) (relying on defense expert's testimony on lack of market efficiency in fraud-on-the-market case to uphold denial of class certification); *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 322 (3d Cir. 2008) (vacating class certification order because the district court "did not confront [the defense

[8] The rare exceptions to the adversarial approach—an ex parte temporary restraining order, for example—simply prove the rule. Class certification is not like any of those exceptions, which typically involve extreme time sensitivity.

expert's] analysis or his substantive rebuttal of [the plaintiff expert's] points"); *West*, 282 F.3d at 938 (reversing grant of class certification where the district court failed to resolve a dispute between competing experts, because failing to "choos[e] between competing perspectives" "amounts to a delegation of judicial power to the plaintiffs, who can obtain class certification just by hiring a competent expert"); *Bennett* v. *Nucor Corp.*, 656 F.3d 802, 814-815 (8th Cir. 2011) (crediting defendant employer's evidence showing absence of a general policy of discrimination in affirming denial of class certification), *cert. denied*, 132 S. Ct. 1807 & 1861 (2012). This Court itself has likewise underscored the importance of adversarial testing of Rule 23 requirements, albeit in the context of a limited-fund, mandatory-settlement class action. *See Ortiz* v. *Fibreboard Corp.*, 527 U.S. 815, 849 (1999) (certification in that context requires "findings of fact following a proceeding in which the evidence is subject to challenge"); *id.* at 849-850 ("'[T]he district court, as a matter of law, must have a fact-finding inquiry … and allow the opponents of class certification to present evidence that a limited fund does not exist.'" (quoting *In re Bendectin Prods. Liab. Litig.*, 749 F.2d 300, 306 (6th Cir. 1984))). In contrast, neither Connecticut Retirement nor the Ninth Circuit has identified any circumstance where such a high-stakes litigation issue is resolved based on the unilateral presentation of evidence from one side, without affording the opposing party any chance to respond. There is no sound basis to create such a unique exception.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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AUGUST 2012