No. 11-1085

IN THE

Supreme Court of the United States

AMGEN INC., ET AL.,

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 OF *AMICI CURIAE* CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM AND CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM IN SUPPORT OF RESPONDENT

JAY W. EISENHOFER
Counsel of Record
DAVID M. HAENDLER
GRANT & EISENHOFER P.A.
123 Justison Street
Wilmington, Delaware 19801
(302) 622-7000
jeisenhofer@gelaw.com

JAMES J. SABELLA
GRANT & EISENHOFER P.A.
485 Lexington Avenue
New York, New York 10017
(646) 722-8500

Attorneys for Amici Curiae California Public Employees' Retirement System and California State Teachers' Retirement System

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases PAGE

Statutes and Rules

Other Authorities

INTEREST OF THE *AMICI CURIAE*

This brief is filed on behalf of public pension systems that serve as fiduciaries to public employees who rely on them to prudently manage their retirement funds.[1] These public funds have a special responsibility to help ensure the accountability of participants in the securities markets, and therefore a strong interest in the integrity of, and eliminating fraud in, such markets.

The California Public Employees' Retirement System ("CalPERS") is the largest state public pension fund in the United States. CalPERS manages approximately $205 billion on behalf of 1.6 million California public employees, retirees and their families. The California State Teachers' Retirement System ("CalSTRS") manages an approximately $138.5 billion fund to administer retirement, disability, and survivor benefits for California's 845,000 public school educators and their families.[2]

The *amici* believe that Rule 23 of the Federal Rules of Civil Procedure should be applied to cases

---

[1] Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part and that no person other than *amici* and their counsel made a monetary contribution to its preparation or submission. Blanket consent to the filing of *amicus* briefs was given by the parties and filed with the Clerk's office.

[2] According to the U.S. Census Bureau's 2010 Statistical Abstract, state and local retirement funds had $2.311 trillion in assets in 2008 ($1.238 trillion in corporate equities). U.S. Census Bureau, Assets of Private and Public Pension Funds (2009), available at http://www.census.gov/compendia/statab/2010/tables/10s1180.xls.

involving claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), in a manner that will help to promote Congress's intent to provide redress for misrepresentations and deceptive practices in the purchases and sales of securities. The *amici's* overriding responsibility is to provide for the payment of benefits to their members and, in doing so, to invest for the long-term security of their millions of active and retired members. As major investors with long-term outlooks, the *amici* are vitally concerned with the proper and efficient functioning of U.S. capital markets and are concerned that investors not be harmed by fraudulent conduct. Many state and local governments are constitutionally obligated to guarantee defined benefit retirement plans. Therefore, investment losses due to securities fraud fall directly on state and local governments, and ultimately on taxpayers. If the ability of public pension funds to recover money lost to securities fraud is impaired, the public will suffer.

In recent years, public pension funds have become increasingly concerned about the integrity of U.S. securities markets. Scandals at Enron, WorldCom, Global Crossing, Tyco, Refco, Fannie Mae, Freddie Mac, Adelphia, Xerox, and numerous other public companies have caused hundreds of billions of dollars in losses to innocent investors. As investors who have been materially harmed by corporate fraud, the *amici* have a strong interest in ensuring that the law allows injured investors to recover from perpetrators of fraud.

The *amici* strongly believe that investors' ability to redress corporate wrongdoing through private

actions—including in particular through class actions—under the Securities Exchange Act of 1934 is essential to deter improper conduct and to recoup losses caused by fraud. As this Court noted in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 320-21 n.4 (2007) (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)), "private securities litigation is an indispensable tool with which defrauded investors can recover their losses—a matter crucial to the integrity of domestic capital markets." Indeed, with the enactment of Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) ("PSLRA"), Congress sought "to increase the likelihood that institutional investors will serve as lead plaintiffs," based on its belief "that increasing the role of institutional investors in class actions will ultimately benefit shareholders and assist courts by improving the quality of representation in securities class actions." H.R. Rep. No. 104-369, at 34 (1995) (Conf. Rep.).

SUMMARY OF ARGUMENT

The Court of Appeals' decision that Respondents, having established the existence of an efficient market, need not also prove at the class certification stage the materiality of Petitioners' alleged misstatements is wholly consistent with this Court's precedent, the logic of the fraud-on-the-market presumption and the structure of the Rule 23 class action. As this Court held in *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974), and *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011), the question that must be resolved at the class certification stage is not

whether the plaintiffs' claims should prevail, but rather, whether those claims are susceptible to classwide proof. Provided that the plaintiff has met all applicable pleading burdens under the PSLRA, Rule 9(b) and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), any merits issues that involve common issues that predominate as to all class members—such as whether defendants' statements in a fraud case are "material"—should be considered only insofar as necessary to meet the expressly delimited criteria for resolving class certification issues under Rule 23, and must otherwise be resolved only at summary judgment or trial. To do otherwise would be to improperly conflate resolution of *procedural* Rule 23 issues with well-established means for addressing merits issues that already exist at both the early pleading and later summary judgment and trial stages of litigation.

In a securities fraud case, the materiality of the alleged misstatements and omissions is a fact-intensive merits question. The answer depends upon a broad array of factors, both quantitative and qualitative, including the magnitude of the issues in the context of the company's overall operations and management's state of mind in making the alleged misstatements or omissions. *See Basic Inc. v. Levinson*, 485 U.S. 224, 238-39 (1988). This Court, Congress, the Securities and Exchange Commission ("SEC"), and the accounting profession have all recognized that the materiality test must be flexible if it is to be effective, and that a more rigid rule would be underinclusive, overinclusive, or both. However, because the test for materiality is objective, and looks to what

the hypothetical "reasonable investor" would have thought, it is a test particularly well-suited to classwide proof.

The broad factual inquiry that is frequently necessary to resolve materiality disputes is simply not suitable for resolution at the class certification stage. As Judge Easterbrook, one of the leading exponents of the fraud-on-the-market presumption, has stated, once the plaintiffs have proven the existence of an efficient market, the defense argument that their alleged misrepresentations were inconsequential goes to whether plaintiffs have a *claim* on the merits, and not whether they have a claim that can be brought as a *class action* under Rule 23. *See Schleicher v. Wendt*, 618 F.3d 679, 685-87 (7th Cir. 2010). Similarly, this Court held only last year that the question of what actually caused the plaintiffs' losses is not a matter to be resolved at class certification, as the answer to that question (like questions about materiality) will be the same for all class members so long as the market is efficient. *See Erica P. John Fund. v. Halliburton Co.*, 131 S. Ct. 2179, 2185-86 (2011). Although Defendants and their *amici* now try to couch some of their materiality concepts in terms of requiring proof of "price impact," whether such questions are framed in terms of "loss causation" or "materiality" makes no difference, since the outcome of such merits inquiries will necessarily be the *same* for all class members.

Finally, it should be stressed that Petitioners' legally misguided efforts to make class certification decisions more closely resemble merits decisions will inevitably deter institutional investors such as *amici* from seeking to assert claims on a

classwide basis. If obtaining class certification not only involves the traditional Rule 23 inquiries of commonality, typicality, adequacy, and superiority, but *also* requires largely the same proofs and burdens as obtaining individual relief, any investors with a sufficient stake to pursue individual claims will have an incentive to cut to the chase and avoid the class certification inquiry entirely. This would have the practical effect of atomizing securities fraud litigation into a multiplicity of solo actions asserted by institutional investors, with class actions being led by smaller investors who could not economically bring individual claims. This is exactly what Congress sought to avoid when it passed the PSLRA.

ARGUMENT

MATERIALITY IS A FACT-INTENSIVE INQUIRY THAT SHOULD NOT BE RESOLVED AT THE CLASS CERTIFICATION STAGE

A. The Class Certification Inquiry Is Limited To The Question Of Whether Plaintiffs Will Prove Their Case Using Common, Classwide Evidence

In conducting a certification analysis, the district court's role is not to assess the merits of the case, but only to determine whether questions of law or fact capable of resolution through common evidence predominate over individual questions. *See Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974). The focus of class certification is "the capacity of a classwide proceeding to generate

common *answers* apt to drive the resolution of the litigation." *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. at 2551 (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009)) (emphasis in original). As the Ninth Circuit Court of Appeals correctly noted in the decision on appeal herein, "the critical question in the Rule 23 inquiry" is not whether the plaintiffs' claims would survive a motion to dismiss, but rather, whether "the plaintiffs' claims stand or fall together." 660 F.3d 1170, 1175 (9th Cir. 2012). "The chance, even the certainty, that a class will lose on the merits does not prevent its certification." *Schleicher*, 618 F.3d at 685.

Because the class certification inquiry is circumscribed to determining the *types* of evidence that would ultimately be used to determine the plaintiffs' claims, as opposed to the *contents* of that evidence—and because Rule 23(c)(1)(A) mandates that class certification decisions be made "[a]t an early practicable time"—the scope of class certification discovery is appropriately limited to examining the types of information that will be integral to any later adjudication of the case at summary judgment and trial. As the Advisory Committee Notes to Rule 23 state,

> Although an evaluation of the probable outcome on the merits is not properly part of the certification decision, discovery in aid of the certification decision often includes information required to identify the nature of the issues that actually will be presented at trial. In this sense it is appropriate to conduct controlled discov-

> ery into the "merits," limited to those aspects relevant to making the certification decision on an informed basis. . . . A critical need is to determine how the case will be tried. An increasing number of courts require a party requesting class certification to present a "trial plan" that describes the issues likely to be presented at trial *and tests whether they are susceptible of class-wide proof*.

Advisory Committee Notes to the 2003 amendments to Rule 23(c)(1)(A) (emphasis added); *see also* MANUAL FOR COMPLEX LITIGATION, FOURTH ED., § 21.14 ("Generally, discovery into certification issues pertains to the requirements of Rule 23 and whether the claims and defenses are susceptible to class-wide proof[.]"); *In re Zurn Pex Plumbing Products Liability Litig.*, 644 F.3d 604, 613 (8th Cir. 2011) ("As class certification decisions are generally made before the close of merits discovery, the court's analysis is necessarily prospective and subject to change, and there is bound to be some evidentiary uncertainty."); *Messner v. Northshore University Health System*, 669 F.3d 802, 823 (7th Cir. 2012) ("[I]t is unlikely that discovery regarding the merits of a claim will be complete by the time the court is called upon to certify a class."). In other words, while the preliminary inquiry at the class certification stage

> may overlap the merits of the case . . . such disputes may be resolved only insofar as resolution is necessary to determine the nature of the evidence that would be sufficient, if the plaintiff's general allegations were true, to make out a prima facie

> case for the class. The closer any dispute at the class certification stage comes to the heart of the claim, the more cautious the court should be in ensuring that it must be resolved in order to determine the nature of the evidence the plaintiff would require.

Blades v. Monsanto Co., 400 F.3d 562, 562 (8th Cir. 2005); *see also In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1, 16 (1st Cir. 2005) (noting that courts must not turn the class-certification proceeding "into a mini-trial on the merits"); *Unger v. Amedisys, Inc.*, 401 F.3d 316, 321 (5th Cir. 2005) ("Class certification hearings should not be mini-trials on the merits of the class or individual claims"). Accordingly, as the Seventh Circuit has held with respect to materiality, "whether statements were false, or whether the effects were large enough to be called material, are questions on the merits." *Schleicher*, 618 F.3d at 685 (internal citations omitted). While a court "may take a peek at the merits before certifying a class", this peek must "be limited to those aspects of the merits that affect the decisions essential under Rule 23." *Id.*

For these and other reasons, recent scholarship has expressed concern over the trend towards converting certification decisions into mini-trials. *See* Joshua P. Davis & Eric L. Cramer, *Antitrust, Class Certification, and the Politics of Procedure*, 17 Geo. Mason L. Rev. 969, 969 (2010) (arguing that the resolution of merits questions at the certification stage could "wreak havoc with the orderly administration of litigation" by requiring premature resolution of merits issues or belated

certification rulings, and also risks violating the Seventh Amendment); Michael J. Kaufman & John M. Wunderlich, *The Unjustified Judicial Creation of Class Certification Merits Trials in Securities Fraud Actions*, 43 U. Mich. J. L. Reform 323, 323 (2010) (judicial resolution of merits at the certification stage is inconsistent with federal securities laws and Supreme Court precedent, infringes on the Seventh Amendment, and causes significant harm to plaintiffs while serving no legitimate policy concerns); Steig D. Olson, *"Chipping Away": The Misguided Trend Toward Resolving Merits Disputes as Part of the Class Certification Calculus*, 43 U.S.F. L. Rev. 935, 936 (2009) (those courts making summary judgment-like decisions at the class certification stage "fundamentally misapprehend the proper role of the certification decision, which is to shape the litigation based on an evaluation of how the plaintiffs intend to prove their case.").

It is also worth noting that Congress has long had the ability to add a merits inquiry to the Rule 23 certification analysis, but has declined to do so. *See* Olson, 43 U.S.F. L. Rev. at 938 ("Following *Eisen*, various parties have made proposals (formally and informally) to revise Rule 23 to allow for preliminary evaluation of the merits of the plaintiffs' claims, but these efforts never succeeded."). Instead, when Congress chose to reform the securities class action through the passage of the PSLRA and Securities Litigation Uniform Standards Act,[3] it chose to do so primarily by establishing heightened pleading standards and

[3] Pub. L. No. 105–353, 112 Stat. 3227 (1998).

controlling the forums in which class actions may be brought, and not by enacting additional barriers to class certification. *See Schleicher*, 618 F.3d at 686 ("[T]he means that Congress chose to deal with settlement pressure were to require more at the pleading stage. . . . We do not think it appropriate for the judiciary to make its own further adjustments by reinterpreting Rule 23 to make likely success on the merits essential to class certification in securities-fraud suits."); Kaufman & Wunderlich, 43 U. Mich. J. L. Reform at 344-50 (discussing how, at the time Congress enacted the PSLRA to address concerns over securities litigation, it did not establish heightened class certification standards).

Indeed, the PSLRA expressly provides an avenue by which defendants can seek to have meritless materiality allegations dismissed. Specifically, the PSLRA contains a safe harbor provision which applies to forward-looking statements that are not material. *See* 15 U.S.C. § 78u-5(c)(1)(A)(ii). Accordingly, courts can and do dismiss securities cases where plaintiffs have alleged nothing more than mere puffery or general statements of corporate optimism. *See, e.g., Indiana State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. OmniCare, Inc.*, 583 F.3d 935, 944 (6th Cir. 2009); *In re Lincoln Educational Services Corp. Sec. Litig.*, No. 10-cv-460, 2011 WL 3912832, at *8 (D.N.J. Sept. 6, 2011); *In re Impac Mortg. Holdings, Inc. Sec. Litig.*, 554 F. Supp. 2d 1083, 1096-98 (C.D. Cal. 2008). In the context of their motion to dismiss, Petitioners have already had an opportunity to contest the materiality of their alleged misstate-

ments and omissions. *See In re Amgen, Inc. Sec. Litig.*, 544 F. Supp. 2d 1009, 1027 (C.D. Cal. 2008). For them to claim a second bite at the apple in the class certification hearing would disrupt the balance between investor rights and issuer protections that Congress has deliberately set.

B. Materiality Is A Contextual, Fact-Intensive Merits Inquiry

This Court, Congress, the SEC and even the accounting profession have all recognized that whether a particular misrepresentation or omission is "material" is not a question that can be adequately resolved through any simple, bright-line tests. Rather, assessing materiality involves a highly contextual inquiry that must take all surrounding facts and circumstances into account—thus making it particularly inappropriate for resolution before full discovery.

Significantly, however, materiality is also an objective inquiry that looks to what the hypothetical "reasonable investor" would have thought based on all relevant facts and circumstances, such that if a statement is material as to one investor, it is material to *all* investors. Accordingly, the materiality inquiry is well-suited to resolution on a class basis, because the merits of each class member's materiality claims will involve exactly the same evidence. Petitioners do not and cannot dispute that the materiality of the misstatements and omissions alleged in the Complaint are susceptible to class-wide proof. *See Schleicher*, 618 F.3d at 685. ("Falsehood and materiality affect investors alike.").

In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), this Court explained that within the context of the Securities Exchange Act of 1934, proving materiality requires "a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable investor." *Id.* at 449. For the disclosure of an omitted fact to be material, it must have been a fact that the reasonable investor would have viewed as significantly altering the "total mix" of information made available. *Id.*[4] This determination is a mixed question of law and fact, requiring "delicate assessments" of the inferences to be drawn from a given set of facts and the significance of those inferences, and as such, the assessment of whether a particular omission or misrepresentation is material is usually one for the trier of fact. *Id.* at 450.

This Court adopted the *TSC Industries* materiality standard for § 10(b) claims in *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988). In doing so, the Court rejected the use of mechanical, bright-line tests to assess materiality, noting that, "[a]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive." *Id.* at 236. The Court further noted that its construction of the word "material" aligned with Congress's intent, citing the Congressional Advisory

---

[4] It is not, however, necessary to allege or prove that the investor would have acted differently if an accurate disclosure was made. *See id.* at 449.

Committee on Corporate Disclosure's statement that:

> Although the Committee believes that ideally it would be desirable to have absolute certainty in the application of the materiality concept, it is its view that such a goal is illusory and unrealistic. The materiality concept is judgmental in nature and it is not possible to translate this into a numerical formula. The Committee's advice to the [SEC] is to avoid this quest for certainty and to continue consideration of materiality on a case-by-case basis as disclosure problems are identified.

Id. at 236 n.14 (quoting House Committee on Interstate and Foreign Commerce, Report of the Advisory Committee on Corporate Disclosure to the SEC, 95th Cong., 1st Sess., 327 (Comm. Print 1977)).

Basic held that with respect to contingent or uncertain information or events (such as the clinical trial results at issue in this case), materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in the light of the totality of the company activity," a question it described as "highly fact-dependent." *Id.* at 238-39 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968)). "Materiality depends on the facts and thus is to be determined on a case-by-case basis." *Id.* at 250.

Following *Basic*, courts "have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation." *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 162

(2d Cir. 2000); *see, e.g., United States v. Smith*, 155 F.3d 1051, 1064-66 (9th Cir. 1998) (under *Basic*, even "soft" statements regarding forward-looking data and projections may be material). In particular, reliance on a "numerical or percentage benchmark to determine materiality" is "error." *Ganino*, 228 F.3d at 162.

This Court's recent decision in *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011), reaffirmed *Basic*'s holding that materiality cannot be adequately assessed through a bright-line test. *See id.* at 1318-19. The Court again noted that materiality is a fact-specific inquiry, holding that determining the materiality of adverse event reports "requires consideration of the source, content, and context of the reports," and that "[t]his contextual inquiry may reveal in some cases that reasonable investors would have viewed reports of adverse events as material even though the reports did not provide statistically significant evidence of a causal link." *Id.* at 1321.

The SEC has also formally agreed that the materiality inquiry is complex and contextual. For example, in the accounting context, the SEC has stated:

> Materiality concerns the significance of an item to users of a registrant's financial statements. The omission or misstatement of an item in a financial report is material if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.

Staff Accounting Bulletin No. 99, 17 C.F.R. § 211, 64 F.R. 45150 (Aug. 19, 1999) ("SAB 99").[5] Under SAB 99, "[m]ateriality has both a quantitative and a qualitative component, and it is error to rely exclusively on a single numerical or percentage benchmark to determine materiality." *SEC v. Escala Group, Inc.*, No. 09-cv-2646, 2009 WL 2365548, at *9 (S.D.N.Y. 2009).

It is necessary that the standard be flexible and open-ended because, "the authoritative accounting literature cannot specifically address all of the novel and complex business transactions and events that may occur." *Id.*[6] Some of the factors that the SEC has identified as being relevant to

---

[5] Materiality is defined in a similar manner throughout SEC regulations. *See, e.g.,* Rule 1-02(o) of Regulation S-X, 17 CFR § 210.1-02(o) ("The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an average prudent investor ought reasonably to be informed."); Rule 405 of Regulation C, 17 CFR § 230.405 ("The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."); Rule 12b-2, 17 CFR § 240.12b-2 ("The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.").

[6] *See also* Arthur Levitt, Chairman, Sec. & Exch. Comm., Remarks at the NYU Center for Law and Business (Sept. 28, 1998), available at http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt ("Materiality is another way we build flexibility into financial reporting.").

the materiality analysis in the accounting context include whether the misstatement is an estimate or an item capable of precise measurement, whether the misstatement masks a change in earnings or other trends, whether the misstatement concerns an especially important segment of the registrant's business, and whether the misstatement affects the registrant's compliance with regulatory requirements. *See id.* As SAB 99 states, "quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations." *Id.*

Lower courts have found SAB 99 to provide "persuasive guidance for evaluating the materiality of an alleged misrepresentation" in the financial disclosure context. *Ganino*, 228 F.3d at 163; *see also ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase & Co.*, 553 F.3d 187, 197-98 (2d Cir. 2009) ("[A]ccording to SAB 99, both quantitative and qualitative factors should be considered in assessing a statement's materiality."); *In re SLM Corp. Sec. Litig.*, No. 08-cv-1029, 2012 WL 209095, at *7 (S.D.N.Y. Jan. 24, 2012) (under SAB 99 and Supreme Court precedent, courts must apply "a common-sense and holistic approach" to materiality); *SEC v. Kovzan*, 807 F. Supp. 2d 1024, 1045 (D. Kan. 2011) (SAB 99 "indicates that *any factors* relating to a misstatement's materiality should also be considered.") (emphasis added).

The accounting profession also recognizes that materiality depends on context and resists bright-line rules. *See* Financial Accounting Standards

Board ("FASB") Statement of Financial Accounting Concepts No. 8, Conceptual Framework for Financial Reporting ("Concepts Statement No. 8"), QC11 (Sept. 2010) ("Information is material if omitting it or misstating it could influence decisions that users make . . . . In other words, materiality is . . . based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity's financial report.") Accordingly, like the SEC, the FASB directs financial management and auditors to assess both "quantitative" and "qualitative" factors in assessing an item's materiality. *Compare* SAB 99 *with* Concepts Statement No. 8 QC11.

The qualitative factors necessary to make materiality determinations may include inquiries into the mental states of executives and management. For example, when a plaintiff alleges that a statement of opinion or belief constituted a material misrepresentation, the finder of fact may need to examine the subjective opinions held by management. *See, e.g., Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 n.6 (10th Cir. 1997) (noting that it is "quite clear" that statements of opinion may be material "if the opinion is known by the speaker at the time it is expressed to be untrue or to have no reasonable basis in fact."); *In re Computer Sciences Corp. Sec. Litig.*, No. 11-cv-610, 2012 WL 3779349, at *13 (E.D. Va. Aug. 29, 2012) ("[A] reasonable investor surely would have considered it important that CSC's own on-the-ground analysts did not believe CSC could meet critical contractual deadlines . . . ."); *United States v. Causey*, No. 04-cv-25, 2005 WL 2647976, at *12 (S.D. Tex. Oct. 17,

2005) (examining defendant's knowledge that a statement regarding Enron's auditing was false in determining that the statement was material).

A further example of the type of non-quantitative considerations that enter into the materiality analysis may be seen in the cases that consistently hold that the integrity of management "is always a material factor." *In re Franchard Corp.*, 42 S.E.C. 163, 172 (1964); *see also, e.g., Siemers v. Wells Fargo & Co.*, No. 05-cv-04518 WHA, 2007 WL 1140660, at *8 (N.D. Cal. Apr. 17, 2007) ("The integrity of management is always of importance to investors."); *SEC v. Jos. Schlitz Brewing Co.*, 452 F. Supp. 824, 830 (E.D. Wisc. 1978) ("[T]he question of the integrity of management gives materiality to the matters the [SEC] claims should have been disclosed."); *Ross v. Warner*, No. 77-cv-243, 1980 WL 1474, at *8, (S.D.N.Y. Dec. 12, 1980) ("nondisclosure of . . . questionable payments was material" because it is "pertinent to the integrity of management."). The SEC has also stated that "[w]hile the intent of management does not render a misstatement material, *it may provide significant evidence of materiality*." SAB 99 (emphasis added). The facts relevant to an analysis of the integrity of management often will be complex and will rarely be susceptible to thorough analysis at class certification (not least because the depositions of a corporate defendant's most senior officers invariably occur at the end, rather than towards the beginning, of discovery).

Finally, materiality cannot be boiled down to a simple analysis of whether the stock price moved in reaction to the announcement. *Amici* argue that "[t]he only important question is whether the

price was distorted." Brief of Law Professors as *Amici Curiae* In Support Of Petitioners at 9 (quoting Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 898-99 (1992)). As pointed out in *SLM Corp.*, 2012 WL 209095, at *5 (internal citations omitted), this argument

> . . . confuses "economic materiality" with the meaning of materiality under the securities laws. . . . "[M]ateriality has a specific meaning for economists, who use scientific methods to determine whether a misrepresentation or omission impact[ed] the stock price in a significant fashion. A legal assessment of materiality is different—it is not determined by a single factor, such as price impact, but must take into account all the relevant circumstances in a particular case.

Similarly, the SEC has appropriately rejected the idea that the market reaction to a corrective disclosure is, in and of itself, an adequate test for materiality, stating: "Consideration of potential market reaction to disclosure of a misstatement is by itself too blunt an instrument to be depended on in considering whether a fact is material." SAB 99 (internal quotations omitted).

Moreover, the very scholar upon whom *amici* rely squarely *opposes* their suggested focus on "price impact." Professor Langevoort has acknowledged that event studies "simply do not produce clean results when there are two or more simultaneous issuer-specific events being measured over a short time horizon." Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009

Wisc. L. Rev. 151, 187 (2009).[7] As such, "one could imagine a truly dastardly fraud where the class certification is denied simply because the company announced additional bad news along with its acknowledgment of wrongdoing," thereby confounding easy efforts to disentangle the extent to which any "price impact" was due to factors relating to disclosures of the fraud as opposed to "unrelated" disclosures. *Id.* at 195.[8] This problem is likely to be especially acute in instances where a significant amount of time has passed between the misstatement or omission and the corrective disclosure, such that the company's overall position has changed. For example, if a company releases false information regarding one of its products in 2011, and then corrects the misinformation a year later when it announces the release of a new and improved version of the product, it will be very difficult to determine how the stock price would have moved differently had the company been truthful all along.[9]

---

[7] *Amici* cite to Professor Langevoort only to put his views into proper context, and not to endorse every aspect of his analysis of Rule 23 or *Basic*.

[8] Alternately, the issuer could reveal its fraud on a day where it announces generally positive news, such that at the time of class certification, the district court would be faced with the extremely difficult task of determining how much the stock price would have otherwise risen.

[9] In the damages context, Judge Easterbrook and Professor Daniel Fischel have discussed some of the limitations that may confound event studies, including that event studies lose accuracy as the interval over which they are performed increases, that intervening events "may be hard to untangle," that information may trickle out over a long period of time, and that "[t]he method assumes a particular form of relation

Indeed, the Court addressed this evidentiary problem in *Basic* itself, stating that, "[r]equiring a plaintiff to show a speculative state of facts . . . would place an unnecessarily unrealistic evidentiary burden on the Rule 10b-5 plaintiff who has traded on an impersonal market." 485 U.S. at 245. The *Basic* Court emphasized that in adopting its presumption of reliance, it did not intend to "determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory." *Id.* at 246 n.24. Rather, the presumption arises "out of considerations of fairness, public policy, and probability, as well as judicial economy." *Id.* at 245. This Court recently reaffirmed *Basic* in *Erica P. John Fund v. Halliburton*, 131 S. Ct. at 2186, holding that a plaintiff need not prove what caused its losses "to establish the efficient market predicate to the fraud-on-the-market theory."

A retrospective materiality test at the class certification stage that is focused wholly on market reaction would invite abuse by unscrupulous issuers. On the front end, since many frauds involve issuers who seek to fraudulently maintain prior market expectations, the false statements in such cases would not be expected to "surprise" the market or result in a noticeable price impact when made.[10] On the back end, artful issuers could con-

---

between the market and individual stocks that is necessarily an oversimplification." Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages In Securities Cases*, 52 U. Chi. L. Rev. 611, 628 (Summer 1985).

[10] *See, e.g.*, *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 561-62 (S.D.N.Y. 2011); *Credit Suisse-AOL*, *In re Credit Suisse-AOL Sec. Litig.*, 465 F. Supp. 2d 34, 44, 54-56 (D.

found event studies by slowly leaking bad news over time, or strategically timing their corrective disclosures alongside other important news. A test that renders market price reaction the *sine qua non* of materiality would provide no comfort to honest issuers, and would be so one-dimensional and mechanical that the dishonest could easily manipulate it.

Given these considerations, courts have rejected arguments that asserted misrepresentations "were not material because the price of the [defendant's] securities did not suffer a statistically significant market reaction as a result of the Corrective Disclosures." *In re Alstom SA Sec. Litig.*, 253 F.R.D. 266, 279 (S.D.N.Y. 2008) (citing *Basic*, 485 U.S. at 231-32). Under *Basic,* "[t]here is no requirement that stock prices fluctuate as a result of a defendant's misstatements or omissions in order for them to be material." *SEC v. DCI Telecommunications, Inc.*, 122 F. Supp. 2d 495, 499 (S.D.N.Y. 2000). *See also No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 934 (9th Cir. 2003); *In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 291-92 (S.D.N.Y. 2008); *SEC v. Penthouse Int'l, Inc.*, 390 F. Supp. 2d 344, 353 (S.D.N.Y. 2005).[11]

Mass 2006);); *In re Bristol-Myers Squibb Sec. Litig.*, No. 00-cv-1990, 2005 U.S. Dist. LEXIS 18448, at *47-48 (D.N.J. Aug. 17, 2005).

[11] *But see In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (information is immaterial if the disclosure of that information has no effect on the company's stock price). *Burlington* dealt with a motion to dismiss and so is not directly applicable here. In all events, as one commentator has observed, "the [*Burlington*] court is

Some kind of "price impact" will be evident in almost every securities fraud case, since plaintiffs will rarely initiate suit if the price of the company has remained stable. The distinction between "price impact" and materiality primarily comes into play in cases (such as this one) where there has been a noticeable drop in the company's stock price, but the parties contest what was responsible for that drop. In this context, stock price movements and event studies are an important component of the materiality analysis, but they do not and cannot substitute for a more nuanced and contextual analysis that also takes other considerations relevant to materiality into account. "Evidence of stock price movement may be relevant to the issue of materiality but it is not determinative." *Geiger v. Solomon-Page Group,* 933 F. Supp. 1180, 1188 (S.D.N.Y. 1996). Since no bright-line test could adequately capture the "delicate assessments" that the materiality inquiry demands, materiality is (and must be) a broad and fact-intensive issue, such that the contours of the inquiry and the relevant proofs will vary considerably from case to case. *See Basic*, 485 U.S. at 250.

---

invoking a questionable heuristic in a number of respects . . . if the court is willing to look at nothing more than market reaction, plaintiffs probably lose what could be an otherwise strong case." Langevoort, 2009 Wisc. L. Rev. at 190; *see also No. 84 Employer-Teamster Joint Council*, 320 F.3d at 934 (declining to adopt a per se rule that if there has been no immediate change in the stock price, the alleged misrepresentations or omissions must have been immaterial).

C. Materiality Determinations Depend On Information Outside The Ordinary Scope Of Class Certification Discovery

As discussed above, merits discovery usually is incomplete at the class certification stage. *See* Point A, *supra.* Therefore, if Petitioners' position is adopted and materiality becomes a question that must be addressed and decided at the class certification stage, courts will be required to decide this issue before all of the discovery needed for an informed decision on this question has been conducted.

Examining the types of evidence that may be relevant to materiality determinations shows how dramatically Petitioners' proposed rule would broaden and transform the class certification decision. As discussed above, *see* Point B, *supra,* the materiality of a particular statement or omission may depend upon management's subjective state of mind when they made that statement or omission. For example, in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), this Court found that testimony from directors as to their motivations for supporting a proposal were relevant to the materiality analysis, and would have formed a proper basis for the jury to find that the defendants' disclosures did not neutralize the materiality of prior misstatements regarding the proposal. *See id.* at 1098. In such cases, materiality determinations will revolve around the factual question of what corporate officers knew and when they knew it. This is a classic "merits" question, and is totally unsuitable for resolution at the class certification stage. It is impossible to effectively liti-

gate such an issue without wide-ranging discovery, and it is impossible for courts to decide such an issue without conducting mini-trials of the merits of the case.

To give another example, in *Freudenberg v. E*Trade Corp*, No. 07-cv-8538, 2010 WL 1904315 (S.D.N.Y. May 11, 2010), plaintiffs alleged that defendants had made material misrepresentations about their "strict discipline" in respect to risk mitigation. *Id.* at *11-12. At the motion to dismiss stage, the court held that "[b]ecause the statements Plaintiffs allege were misleading related to the fundamental nature of E*TRADE's most important business sector and are belied by detailed allegations directly contradicting the assertions of 'discipline' . . . these statements are actionable and material." *Id.* at *12. This is a relatively straightforward issue to resolve on the pleadings, but to *prove* it would require a court to conduct a mini-trial on, *inter alia*, the inner workings of defendants' business, whether defendants were undisciplined, and the importance of the sector in question to the defendants' overall business.

Indeed, the type of causation evidence that Petitioners seek to introduce in this case is exactly the type of evidence that this Court has recently held need *not* be considered at the time of class certification. While Petitioners cloak their argument in the language of materiality, the crux of their case against class certification is actually a loss causation argument fundamentally analogous to that raised by the defendants and rejected in *Erica P. John Fund v. Halliburton*, 131 S. Ct. 2179. In *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, No. 02-cv-1152,

2008 WL 4791492 (N.D. Tex. Nov. 4, 2008), *aff'd*, 597 F.3d 330, 335-36 (5th Cir. 2010), *rev'd sub nom. Erica P. John Fund v. Halliburton Co.*, 131 S. Ct. 2179, 2185-86 (2011), the district court, operating under the mistaken belief that plaintiffs could not make use of the fraud-on-the-market theory without first establishing loss causation, held that the plaintiffs were required to show "that it is more probable than not that it was [the alleged] corrective disclosure, and not any other unrelated negative statement, that caused the stock price decline." *Id.* at *3-4. The district court then carefully examined the information that was known to the market at the time of the alleged corrective disclosures, including press releases, SEC filings, and analyst reports, to determine what actually caused the price decline. *See id.* at *4-20. It concluded that the price decline was not caused by the correction of any fraudulent misstatements, and accordingly refused to certify the class. *See id.* at *20. On appeal, the Fifth Circuit affirmed, finding that "[t]he district court explicitly recognized the need for Plaintiff to establish a causal link between the alleged falsehoods and its losses in order to invoke the fraud-on-the market presumption" and that "[w]e must bear in mind that the main concern when addressing the fraud-on-the-market presumption of reliance is whether allegedly false statements actually inflated the company's stock price." *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330, 335-36 (2010). However, this Court reversed, holding that at class certification a plaintiff is *not* required to establish loss causation to trigger the fraud-on-the-market presumption. *Erica P. John Fund. v. Halliburton*, 131 S. Ct. at 2185-86 (reject-

ing defendants' position as "not justified by *Basic* or its logic." *Id.* at 2185.

Petitioners' position here is substantially similar to the position that this Court rejected in *Halliburton*. In the courts below, Petitioners argued that their alleged omissions regarding safety concerns were immaterial because the market was already aware of those safety issues during the class period. *See Connecticut Ret. Plans & Trust Funds v. Amgen, Inc.*, No. 07-cv-2536, 2009 WL 2633743, at *12 (C.D. Cal. Aug. 12, 2009). As in *Halliburton*, Petitioners sought to bring to the court's attention analyst reports purportedly showing that the marketplace was already aware of the matters that Respondents alleged to have been concealed. *Compare Connecticut Ret. Plans*, 2009 WL 2633743, at *12 ("As evidence of the market's awareness, Defendants point to a sample of analyst reports issued on May 5, 2004, in which the analysts discuss the ODAC Meeting") *with Archdiocese of Milwaukee*, 2008 WL 4791492, at *20 (holding that plaintiffs had not established loss causation with respect to a disclosure, because the announcement "[did] not appear to have been a surprise or concern to analysts as some charge was expected") As such, Petitioners assert that any decline in stock price could not have been caused by corrective disclosures remedying the alleged omissions, since "[i]f the market has become aware of the allegedly concealed information, the facts allegedly omitted by the defendant would already be reflected in the stock's price and the market [would] not be misled." *Connecticut Ret. Plans*, 2009 WL 2633743, at *12 (internal quotations omitted). Essentially, Petitioners seek to advance an intensely fact-

based, truth-on-the-market defense at the class certification stage. *See id.* Whether this is cast as a matter of "materiality" or "loss causation," the substance is the same—Petitioners want to use the class certification hearing as a vehicle for determining whether a factor other than their alleged misrepresentations was responsible for the drop in stock price. Since this determination "has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory," Petitioners' request should be denied. *Erica P. John Fund* v. *Halliburton,* 131 S. Ct. at 2186. *See also Schleicher*, 618 F.3d at 686-87 (requiring proof of why stock price declined as a prerequisite for certification "would make certification impossible in many securities suits, because when true and false statements are made together it is often impossible to disentangle the effects with any confidence.").

To gratuitously combine the merits and procedural aspects of the Rule 23 class action as Petitioners advocate would not only transform the certification hearing, it would also have a significant effect on the incentives of institutional investors such as *amici*. Requiring lead plaintiffs to prove the validity of their claims at the class certification stage, and then again at summary judgment and trial, would inevitably increase the costs and delays of class litigation in comparison to individual litigation, leading some potential lead plaintiffs to forego class treatment of their claims and file solo actions. This would be efficient for the individual litigants (since they would bypass the certification stage entirely and proceed directly to proving their claims), but not for the

judicial system generally or even for defendants. Moreover, implicitly discouraging institutional investors from serving as class representatives by needlessly raising the barriers to class certification is directly contrary to the intent of the PSLRA. *See Tellabs*, 551 U.S. at 320-21.

In short, requiring a contextual, fact-intensive matter such as materiality to be litigated and decided at the class certification stage is not consistent with the class certification hearing's proper focus and purpose. The rule that Petitioners advocate would prejudice plaintiffs by forcing decision on the materiality issue prior to completion of the discovery needed properly to evaluate the issue.

CONCLUSION

For the reasons stated herein and in the Respondent's Brief, the Court of Appeals' decision upholding the District Court's grant of class certification should be affirmed.

Dated: September 27, 2012

Respectfully submitted,

JAY W. EISENHOFER
Counsel of Record
DAVID M. HAENDLER
GRANT & EISENHOFER P.A.
123 Justison Street
Wilmington, Delaware 19801
(302) 622-7000
jeisenhofer@gelaw.com

JAMES J. SABELLA
GRANT & EISENHOFER P.A.
485 Lexington Avenue
New York, New York 10017
(646) 722-8500

Attorneys for Amici Curiae California Public Employees' Retirement System and California State Teachers' Retirement System