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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 *AMICUS CURIAE* OF NATIONAL ASSOCIATION OF SHAREHOLDER AND CONSUMER ATTORNEYS IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE[1]

The National Association of Shareholder and Consumer Attorneys ("NASCAT") is a trade organization and public policy voice for lawyers interested in a strong system of legal protections for investors and consumers. NASCAT and its members are committed to representing victims of corporate abuse, fraud, and white collar crime in cases having the potential to advance the state of the law, educate the public, modify corporate behavior, and improve access to justice and compensation for those who have been injured by corporate wrongdoers.

NASCAT has a deeply-rooted interest in the issue this case presents: whether securities plaintiffs attempting to invoke a presumption of reliance premised on the fraud-on-the-market doctrine must demonstrate materiality at the class certification stage. NASCAT agrees with Respondent's arguments against such a requirement, and writes separately to address the serious practical difficulties inherent in Amgen's position.

SUMMARY OF ARGUMENT

There are many different kinds of issues that arise when one examines the materiality of a misstatement or omission. For example, even small errors may be critical if they concern an important area of the business.

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1. Pursuant to Rule 37.6, amicus affirms that no counsel for a party authored this brief in whole or in part, and that no person other than amicus and its counsel made a monetary contribution to the preparation or submission of this brief. The parties have filed letters giving blanket consent to the filing of amicus briefs in this case.

Investors may expect, and discount, a certain amount of sales puffery; but they may also highly value the opinions and judgments of management. Contingent events may be of greater or lesser importance depending on both their likelihood and their potential impact on the business. These questions are all part of the materiality inquiry, and in many cases they cannot be answered prior to the completion of both fact and expert discovery. This is particularly true for class actions, where there are usually multiple false statements and material omissions that continue over a prolonged period.

This is not to say that defendants have no meaningful opportunity to contest materiality before the completion of discovery. In fact, courts commonly dismiss claims under Rule 12(b)(6) on materiality grounds, frequently taking judicial notice of materials outside the complaint to evaluate the materiality of an alleged misstatement or omission in its full context. However, this means that for complaints that survive a motion to dismiss, the only remaining materiality questions are the ones that, by definition, require a full record to evaluate properly.

For this reason, requiring an assessment of materiality at class certification would dramatically extend proceedings that are already quite prolonged, thus wasting judicial resources and forcing the parties to bear unnecessary expenses. Section 10(b) actions in particular take a long time to advance past the motion to dismiss; it may be years before discovery begins, and additional years before class certification is decided. Introducing materiality into the mix would delay resolution of class certification even further, creating additional inefficiencies.

Nor can these problems be solved by using "price impact" as a proxy for materiality. Most defendants commit fraud to conceal "bad news." These frauds do not result in a measurable "uptick" in stock price; instead, they keep prices level when the truth would have caused them to fall. Thus, the only measurable price impact occurs when the truth concealed by the fraud is fully or partially disclosed. But an inquiry into the price effects of disclosures is indistinguishable from an assessment of *loss causation* (and Amgen and its amici do not argue otherwise). This Court has already recognized that plaintiffs need not prove loss causation to satisfy the requirements of Rule 23. *See Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011).

The problems with assessing materiality at class certification are illustrated by the very cases cited by Amgen's *amici* as examples of how the inquiry could proceed. In several of these cases, the district courts dramatically misinterpreted the stock price evidence on which they purported to rely, reaching conclusions that are fundamentally at odds with basic principles of economics. In others, the courts dealt with unusually simple records, or went with their own "common sense" – an inquiry facially more suited for a jury determination.

Finally, it is not necessary to prove materiality at class certification to protect defendants from "blackmail settlements." In the PSLRA, Congress instituted several measures to curb abusive lawsuits and reduce such pressures. The evidence shows that defendants are not being coerced into settling meritless lawsuits, and that securities class action litigation serves as a valuable tool

for improving corporate governance and strengthening financial markets.

ARGUMENT

I. MATERIALITY IS A COMPLEX QUESTION THAT USUALLY REQUIRES A FULL RECORD FOR ACCURATE RESOLUTION

A fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). By definition, materiality is fact-specific and context-dependent, requiring "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences." *Id.* at 236 (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U. S. 438, 450 (1976)). Nor is precedent a clear guide because "[m]ateriality determinations in individual cases tend to be so fact-specific that the accumulated body of published case law provides limited guidance for decision-making." Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 Bus. Law. 317, 319 (2007) (quotations omitted). Even stock price reaction to a disclosure, though *evidence* of materiality, is not dispositive: facts may be immaterial even if their disclosure causes a large price drop. *See, e.g.*, *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650, 655 (4th Cir. 2004).

For example, there may be a dispute about whether an omitted fact concerns such a small matter that it is

immaterial. In such cases, the factfinder must identify the proper basis for comparison: should materiality be assessed against the relevant operating segment of a diversified company, or against the corporation as a whole? *See, e.g.*, *Litwin v. Blackstone Group, L.P.*, 634 F.3d 706, 713 (2d Cir. 2011). And what if the fact relates to a small but rapidly growing business line? Some metrics, such as revenue, may be more significant for new companies than for established ones – and others (*e.g.* cashflow) may be more or less important depending on the company's overall capitalization. *See* Sauer, *supra*, at 321. Such delicate judgments require a full examination of the facts.

Some corporate statements concern not "hard" facts, but "soft" opinions, characterizations, or predictions, which defendants may challenge as too indefinite to matter to investors. A certain amount of sales "puffery" may be immaterial, *see ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 206 (2d Cir. 2009), but merely because a statement is imprecise does not render it "puffery." *See Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1092-95 (1991) ("conclusory" terms like "high" or "fair" may be material); *Novak v. Kasaks,* 216 F.3d 300, 315 (2d Cir. 2000) (statements such as "in good shape" or "under control" may be actionable under §10(b)); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 281-282 (3d Cir. 1992) ("adequate," "conservative," "cautious"). Distinguishing "puffing" statements from material (though imprecise) ones requires an evaluation of the context in which the statement was made and the aspects of the business at issue. *See Casella v. Webb*, 883 F.2d 805, 808 (9th Cir. 1989) ("What might be innocuous 'puffery' or mere statement of opinion standing alone may be actionable as an integral part of a representation

of material fact ….”); *City of Monroe Empls. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 672 (6th Cir. 2005) (“a company’s statements that it is ‘premier,’ ‘dominant,’ or ‘leading’ must not be assessed in a vacuum…” (quotations omitted)).

Materiality may also depend on whether the statement carried with it qualifiers that rendered any undisclosed facts immaterial to the reasonable investor.[2] For example, a corporation may temper optimistic statements with specific warnings or other hedges that neutralize any misleading impression that the statement, standing alone, may have given. *See, e.g.*, *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 377 (3d Cir. 1993). But such warnings must be closely examined to determine whether they match in intensity and specificity any undisclosed risks. *See, e.g.*, *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 247-48 (5th Cir. 2009). Again, this is a fact-specific inquiry that often depends on the conditions that existed at the time of the statement, and the degree to which any warnings encompassed those conditions.

When it comes to contingent events, materiality depends on the *magnitude* of the event in light of the company’s overall activity, and its *likelihood* of occurring. *See Basic*, 485 U.S. at 238-39. In *Basic*, this issue arose in the context of a potential merger, *see id.*; *see also Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 181-82, 185-86 (2d Cir. 2001); *McCormick v. Fund Am. Cos.*,

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2. This is known as the “bespeaks caution” doctrine, which was codified in the PSLRA as the “safe harbor” for forward-looking statements. *See* 15 U.S.C. §78u-5; *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194 n.23 (1st Cir. 1996).

26 F.3d 869, 876-77 (9th Cir. 1994), but it can arise in other contingent contexts, such as pharmaceutical trials, *e.g.*, *In re Transkaryotic Therapies*, 319 F. Supp. 2d 152, 160-61 (D. Mass. 2004), and new business plans, *e.g.*, *Lormand*, 565 F.3d at 248-49.

Finally, materiality may be assessed in light of other information known to the market, as Amgen argues here. But this also raises complicated questions, because whether general market information completely neutralized a false statement depends on a case-by-case assessment of the facts, such as the source and credibility of the offsetting information and how directly it challenged defendants' false statements. *See, e.g.*, *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 167-68 (2d Cir. 2000); *Provenz v. Miller*, 102 F.3d 1478, 1493 (9th Cir. 1996); *In re Massey Energy Co. Sec. Litig.*, 2012 WL 3156765, at *11 (S.D. W. Va. Mar. 27, 2012).

As is evident from such precedents, a proper examination of materiality often cannot be accomplished without considerable discovery. It may, for example, be necessary to assess precisely what the "true" conditions were when a statement was made to determine whether a defendant's "cautionary language" adequately disclosed the relevant risks, *see Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 734-35 (7th Cir. 2004) (interpreting PSLRA's safe harbor), or expert evidence may be required to explain the significance of a fact within the context of all fraud-related facts.

Discovery will often be particularly important when the fraud allegedly occurred over a prolonged period. Most securities class actions do not involve a single false

statement, but instead involve multiple misstatements and material omissions over a class period that may span several years. *See, e.g.*, *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 269-72, 275-92 (S.D.N.Y. 2011); *In re Wash. Mut., Inc. Sec.*, 694 F. Supp. 2d 1192, 1205-20 (W.D. Wash. 2009). The undisclosed truth may change over time – for example, where problems grow progressively worse, or the number of fraudulent transactions grows larger. *See, e.g.*, *In re Vivendi Universal, S.A., Sec. Litig.*, 634 F. Supp. 2d 352, 354-56 (S.D.N.Y. 2009); *In re NTL Inc. Sec. Litig.*, 347 F. Supp. 2d 15, 25-26 (S.D.N.Y. 2004). Under such circumstances, the cumulative effects of the fraud may be revealed at the end of the class period, but the size of the misstatements at earlier points may not be evident (particularly when the fraud was just beginning). As a result, prior to discovery, it may be impossible for plaintiffs to quantify the impact of the fraud at a given time. Thus, the only way for courts to evaluate the materiality of the omitted information for the *whole* class period is to first have merits discovery.[3] And because defendants can be expected to dispute whether there was any fraud to begin with, questions about the *size* of the fraud (and thus its *materiality*) are necessarily entangled with issues of *falsity*.

Discovery will also likely be necessary to determine how the defendants themselves viewed the relevant facts.

3. A similar dilemma arises when a company's warnings and qualifiers remain the same over time, but the undisclosed facts grow increasingly dire. *See, e.g.*, *Baxter*, 377 F.3d at 734; *Slayton v. Am. Express Co.*, 604 F.3d 758, 772-73 (2d Cir. 2010). Without full discovery, it may be impossible to pinpoint when the undisclosed facts reached the point that the company's warnings were no longer sufficient to "neutralize" the falsity of its statements.

"A major factor in determining whether information was material is the importance attached to it by those who knew about it." *Media Gen., Inc. v. Tomlin,* 387 F.3d 865, 870 (D.C. Cir. 2004) (quotations and alterations omitted)). Or, as former SEC Chair Arthur Levitt put it, "Some companies … intentionally record errors within a defined percentage ceiling. They then try to excuse that fib by arguing that the effect on the bottom line is too small to matter. If that's the case, why do they work so hard to create these errors?" Arthur Levitt, *The "Numbers Game," Remarks at NYU Center for Law and Business* (Sept. 28, 1998), *available at* http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.[4] Indeed, in *Basic* itself, this Court held that the materiality of a potential merger turned on "indicia of interest in the transaction at the highest corporate levels," as evidenced by "board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest," 485 U.S. at 239 – information that is only be available after discovery.

II. IN THE SIMPLEST CASES, MATERIALITY IS DECIDED ON THE PLEADINGS

Despite the complexity of the materiality inquiry, in the simplest cases, defendants often successfully challenge materiality on the pleadings. Thus, by the time a case reaches class certification, any easy materiality issues will likely have already been addressed, leaving only

4. This is not to say that the mere fact that an error is intentional renders it material, or that corporate insiders are a proxy for the reasonable shareholder. Nonetheless, the company's internal attitude toward the information may provide powerful *evidence* of materiality.

the more difficult ones – which are most in need of full discovery – remaining.

The PSLRA imposes heightened pleading standards and stays discovery during the pendency of a motion to dismiss. *See* 15 U.S.C. §78u-4(b)(1-3). Virtually all Section 10(b) complaints are therefore subject to at least one motion to dismiss under Rule 12(b)(6), at which time defendants often argue that at least some of the alleged misstatements were immaterial, as Amgen did here. *See In re Amgen Inc. Sec. Litig.*, 544 F. Supp. 2d 1009, 1025-27 (C.D. Cal. 2008). Contrary to the argument of Amgen's amici that such motions apply "liberal" pleading standards, *see* Former SEC Commissioners Brief at 15-16, in fact courts conduct a thorough materiality analysis on the pleadings and frequently dismiss claims on materiality grounds. *See* David A. Hoffman, *The "Duty" To Be a Rational Shareholder*, 90 Minn. L. Rev. 537, 542 (2006) (of all Rule 12(b)(6) opinions addressing materiality, half dismissed claims for lack of materiality); Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does--Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 Emory L.J. 83, 116 n.94 (2002) (in one survey, 70% of securities dismissals held that at least one alleged misstatement was immaterial).

Nor are courts required to confine their analysis to the complaint when evaluating materiality on the pleadings. On a motion to dismiss, courts may also consider "documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007). Typically, courts review any SEC filings in which the statement appeared, as well as any other SEC filings in

which related disclosures were made. *See In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1331 (3d Cir. 2002). Courts also consider stock prices, news articles, analyst reports, accounting standards, government reports and findings, filings in other cases and other documents deemed to be judicially noticeable.[5]

Thus, it is commonplace for defendants to file literally hundreds of pages of exhibits in connection with motions to dismiss.[6] Though these documents are not submitted for the truth of the matters asserted, *see, e.g.*,

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5. *See Wolfe v. Aspenbio Pharma*, 2012 WL 4040344, at *2 (D. Colo. Sept. 13, 2012) (taking judicial notice of "documents publicly filed with the SEC and/or the courts, and publications of federal agencies"); *Carlucci v. Han*, 2012 WL 3242618, at *15 (E.D. Va. Aug. 7, 2012) (judicially noticing a patent application); *Phillips v. Triad Guar., Inc.*, 2012 WL 259951, at *4 (M.D.N.C. Jan. 27, 2012) (judicial notice of marketwide disruptions); *In re XenoPort, Inc. Sec. Litig.*, 2011 WL 6153134, at *3 (N.D. Cal. Dec. 12, 2011) (judicial notice of "documents quoted or referenced in the [complaint], XenoPort's stock prices, FDA guidance, and SEC filings"); *In re MBIA, Inc. Sec. Litig.*, 700 F. Supp. 2d 566, 575 n.7 (S.D.N.Y. 2010) (reviewing analyst reports to "determin[e] what the market knew"); *Wilamowsky v. Take-Two Interactive Software, Inc.*, 818 F. Supp. 2d 744, 756 n.8 (S.D.N.Y. 2011) (press coverage and regulatory filings); *In re American Apparel, Inc. S'holder Litig.*, 2012 WL 1131684, at *14 (C.D. Cal. Jan. 13, 2012) (SEC investor bulletin); *In re Seracare Life Sciences, Inc.*, 2007 WL 935583, *4 (S.D. Cal. Mar. 19, 2007) (accounting standards and bankruptcy court brief); *In re White Elec. Designs Corp. Sec. Litig.*, 416 F. Supp. 2d 754, 760 (D. Ariz. 2006) (SEC filings, press releases, and accounting rules).

6. Here, the district court took judicial notice of several exhibits submitted by Amgen, including printouts of FDA websites and an analyst report. *See Amgen*, 544 F. Supp. 2d at 1023-24.

In re Merrill Lynch Auction Rate Sec. Litig., 2012 WL 1994707, at *2 (S.D.N.Y. June 4, 2012); *Salomon Analyst Winstar Litig.*, 2006 WL 510526, at *4 n.6 (S.D.N.Y. Feb. 28, 2006), courts may use them to evaluate the context in which defendants' statements were made, other information then available to the market, and the relationship of the false statement to defendants' business. Defendants therefore have ample opportunity at the outset to weed out facially immaterial statements. *See, e.g.*, *Garber v. Legg Mason Inc.,* 347 Fed. Appx. 665, 669 (2d Cir. 2009) (deciding on the pleadings that press coverage rendered omissions immaterial); *In re Bank of Am. Corp. Securities, Derivative, & ERISA Litig.*, 2012 WL 1353523, at *7-8 (S.D.N.Y. Apr. 12, 2012) (truth was disclosed in news articles).[7] Indeed, scholars have criticized judges as too quick to dismiss claims on materiality grounds, arguing that in so doing "federal judges are claiming - at least implicitly - a level of expertise about the workings of markets and organizations that, in some areas, not even

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7. *See also In re Yukos Oil Co. Sec. Litig*, 2006 WL 3026024, at *21 (S.D.N.Y. Oct. 25, 2006) (omission immaterial "in light of the wealth of publicly available information"); *In re UBS Auction Rate Sec. Litig.*, 2010 WL 2541166, at *23 (S.D.N.Y. June 10, 2010) (omission immaterial/reliance unreasonable in light of "the company-specific disclosures in the prospectuses combined with the publicly available information…"); *White v. H&R Block, Inc.*, 2004 WL 1698628, at *12 (S.D.N.Y. July 27, 2004) (false statements rendered immaterial by court filings and press coverage); *Smith v. Circuit City Stores, Inc.*, 286 F. Supp. 2d 707, 721 (E.D. Va. 2003) (omissions rendered immaterial by disclosures in analyst reports); *In re Merrill Lynch Auction Rate Sec. Litig.*, 704 F. Supp. 2d 378, 396 (S.D.N.Y. 2010) (truth adequately disclosed by, *inter alia*, press coverage of SEC investigation and order); *Iron Workers Local 16 Pension Fund v. Hilb Rogal & Hobbs Co.*, 432 F. Supp. 2d 571, 581-82 (E.D. Va. 2006) (truth adequately disclosed in various analyst reports).

the most sophisticated researchers in financial economics and organizational theory have reached." Bainbridge & Gulati, *supra*, at 84; *see id.* at 120-21, 134 (criticizing courts that invoke market theories of materiality without consulting financial literature).[8]

This means that by the class certification stage any "low hanging fruit" has been eliminated, leaving only the more difficult materiality questions – i.e., precisely the ones that most require full discovery and expert analysis. For these questions, resolution at class certification (as opposed to summary judgment upon a full factual record) is neither practical nor desirable.

III. MATERIALITY DETERMINATIONS AT CLASS CERTIFICATION ARE IMPRACTICAL AND WOULD WASTE JUDICIAL RESOURCES

A. The Initial Stages of Section 10(b) Litigation Are Already Unusually Prolonged

After a Section 10(b) class action is filed, the court must first select a "lead plaintiff." The PLSRA contains special procedures for the selection of lead plaintiffs, due to Congress's belief that institutional investors, in particular, are well-suited to that role. *See In re Cendant Corp. Litig.*, 264 F.3d 201, 261-62 (3d Cir. 2001). The first plaintiff to file a complaint must issue a notice within 20 days. 15 U.S.C. § 78u-4(a)(3)(A)(i). All affected investors then have 60 days to file a lead plaintiff application. 15 U.S.C. § 78u-4(a)(3)(A)(i)(II). If there is more than one

8. *See also* Stefan J. Padfield, *Is Puffery Material to Investors? Maybe We Should Ask Them*, 10 U. Pa. J. Bus. & Emp. L. 339 (2008).

applicant, the PSLRA sets forth procedures for evaluating competing applications. *See generally In re Cavanaugh*, 306 F.3d 726, 729-31 (9th Cir. 2002). There may be several rounds of briefing before a lead plaintiff is selected.[9]

Next, courts typically give the lead plaintiff 30-60 days to file an amended complaint,[10] after which time defendants file their motions to dismiss. *See, e.g.*, *Eastwood Enters., LLC v. Farha*, 2008 WL 687351, at *4 (M.D. Fla. Mar. 11, 2008); *In re XM Satellite Radio Holdings Sec. Litig.*, 237 F.R.D. 13, 21 (D.D.C. 2006). Full briefing can easily take 5-6 months, with oral argument to follow. It routinely takes over a year from the date that the case was first filed until motions to dismiss are decided – with all discovery stayed by the PSLRA in the interim. Often, the case is dismissed on the pleadings – indeed, 46% of resolved cases in 2009 were dismissed prior to summary judgment.[11] If plaintiffs are permitted to replead, further dismissal motions will take additional months (and often much longer) to resolve. *See, e.g.*, *Curry v. Hansen Med., Inc.*, 2012 WL 3242447 (N.D. Cal. Aug. 10, 2012) (sustaining, in part, second amended complaint after prior dismissal); *In re SunPower Sec. Litig.*, 2011 WL 7404238 (N.D. Cal. Dec. 19, 2011) (same). "[T]he net

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9. The PSLRA requires lead plaintiffs to be appointed within 90 days of issuance of the notice, but permits courts more time when multiple complaints are filed that require consolidation. *See* 15 U.S.C. § 78u-4(a)(3)(B).

10. Because the lead plaintiff need not have filed its own complaint, *see* 15 U.S.C. § 78u-4(a)(3)(B)(i), it may have had no role in drafting the initially-filed complaints.

11. *See* Stanford Law School and Cornerstone Research, *Securities Class Action Filings: 2011 Year in Review* 31 Appendix 2 (2012) (hereinafter "Cornerstone Report").

result can be that many months or even years pass before discovery begins in earnest." Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 Iowa J. Corp. L. 551, 553 (2011).

Assuming the case reaches the class certification stage, further complex proceedings await. Most obviously, plaintiffs must establish that the relevant security traded efficiently, which involves analysis of the multiple factors identified in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989) and *Krogman v. Sterritt*, 202 F.R.D. 467 (N.D. Tex. 2001). These include: (1) the causal relationship between unexpected company-specific disclosures and stock price reaction, as evidenced by an "event study"; (2) average weekly trading volume; (3) the number of "market makers" and arbitrageurs; (4) eligibility to file a Form S-3 registration statement; (5) the number of analysts following the issuer; (6) market capitalization; (7) "bid-ask spread"; and (8) the percentage of shares not owned by company insiders. Market efficiency is often hotly contested, resulting in a "battle of experts." *See, e.g.*, *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1 (1st Cir. 2005). And in addition to establishing market efficiency, plaintiffs must satisfy Rule 23's other requirements, such as "adequacy" and "typicality" – criteria that defendants routinely challenge by delving into the proposed representatives' knowledge of the litigation, background and myriad other subjects. *See, e.g.*, *In re Wash. Mut., Inc.*, 2010 WL 4272567 (W.D. Wash. Oct. 12, 2010).[12] As a result, even in cases that meet the PSLRA's heightened

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12. There may also be significant discovery disputes regarding the typicality and adequacy of the proposed representatives. *See, e.g.*, *In re Qwest Commc'ns Int'l, Inc., Sec. Litig.*, 2005 U.S Dist. LEXIS 11618, at *15 (D. Colo. June 7, 2005); *In re Priceline.com Inc. Sec. Litig.*, 2005 WL 1366450, at *3 (D. Conn. June 7, 2005).

pleading standards, class certification decisions will often not issue until 3 or 4 years after the case was first filed.[13]

However, if materiality were added into the class certification equation, the need to conduct extensive additional fact and expert discovery in all but the simplest fraud cases would necessitate further delays. Such delays would create additional *inefficiency*, making a mockery of Rule 23's command that classes be certified "[a]t an early practicable time," Fed. R. Civ. P. 23(c)(1)(A), not to mention Rule 1's command that the rules "be construed … to secure the just, speedy, and inexpensive determination of every action…." Fed. R. Civ. P. 1.

B. Materiality is Difficult to Evaluate at Class Certification

Most securities cases involve *multiple* false statements over the course of a potentially multi-year class period, often on different (though usually related) subjects. There may also be multiple *disclosures* over the course of a class period – each of which only reveals a portion of the truth concealed by the defendants. *See, e.g.*, *Lormand*, 565 F.3d at 261; *Steiner v. MedQuist Inc.*, 2006 WL 2827740, at *12 (D.N.J. Sept. 29, 2006); *Norfolk County Ret. Sys. v. Ustian*, 2009 WL 2386156, at *6 (N.D. Ill. July 28, 2009); *In re Bradley Pharms., Inc. Secs. Litig.*, 421 F. Supp. 2d 822, 828-29 (D.N.J. 2006). Those partial disclosures may be accompanied by additional false statements as

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13. A Westlaw search of district court rulings on motions for class certification in §10(b) actions, issued within the last three years, revealed that those rulings issued, on average, 3.8 years after the case was first filed.

the company seeks to conceal the full extent of its fraud. *Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 202-03 (S.D.N.Y. 2010). This makes a statement-by-statement materiality analysis an exceptionally complex undertaking, particularly where – as in most cases – defendants have already eliminated any clearly immaterial statements at the pleading stage.

For example, *Amici* Chamber of Commerce et al. cite *In re American International Group Sec. Litig.*, 265 F.R.D. 157 (S.D.N.Y. 2010) ("*AIG*"), as an example of a case where the court effectively examined materiality at the class certification stage. Chamber Br. 23. As detailed at Part III.D below, *AIG*'s analysis is deeply flawed, but for present purposes one need only consider the complexity of its fact pattern. There, the plaintiffs alleged that AIG, over a six-year class period: (1) concealed that it bribed insurance brokers to steer business its way, (2) concealed its involvement in a bid-rigging scheme, (3) engaged in several different types of accounting fraud, including improper off-balance sheet transactions, reporting of false revenues on intra-company transactions, and understating its reserves, and (4) concealed the extent of certain investigations by the SEC, the New York Attorney General, and the Department of Justice. 265 F.R.D. at 162-63. The truth was not disclosed in a single neat announcement, but in a stream of announcements over prolonged period. *See id.* at 162-63. It is facially obvious that with such a fact pattern any attempt to parse materiality statement by statement at *class certification* (and *prior* to the completion of discovery) would ensnare the court in a tangle of highly complex issues – which is exactly what occurred. *See* Part III.D, *infra* (further discussing *AIG*).

Fact patterns like *AIG*'s are not uncommon. *See, e.g.*, *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 551, 556-57 (S.D.N.Y. 2011) (57 false statements and 9 disclosure dates proved at trial, including dates disclosing credit ratings downgrades and sudden asset sales that revealed liquidity problems)[14]; *Lehman Bros.*, 799 F. Supp. 2d at 269-72, 275-92, 305-07 (multiple false statements alleged over 15 months; alleged partial disclosures over four months); *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1201 (C.D. Cal. 2008) (multiple misstatements over a 4-year class period; "Countrywide's corrective disclosures were made over an extended period of time and often in combination with alleged further misrepresentations that dampened the disclosures' price effects.").

In sum, Amgen's proposal to have a court evaluate the materiality of each individual statement at class certification would introduce a nightmare of subsidiary issues, especially in more complex cases, resulting in either idiosyncratic, standardless and unreliable "early" decisions (as exemplified by the cases cited by Amgen's amici that are further discussed below), or lengthy delays for the development of an appropriately full record.

C. "Price Impact" Evidence is Not a Workable Proxy for Materiality

Several *amici* suggest that instead of assessing materiality per se, courts should assess whether a

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14. *See also Vivendi*, 634 F. Supp. 2d at 356-59 (summary judgment opinion detailing alleged partial disclosures, which overlapped with additional false statements).

particular false statement "moved the market" (i.e., had a measurable effect on stock prices). *See* Chamber Br. at 19; Petitioners' Law Professors Br. at 26-34. But this suggestion is even less practical than a requirement that courts decide materiality at class certification under *Basic*'s "total mix" standard.

First, most cases will not involve a "front end" uptick in prices when the false statement is made. This is because most frauds do not involve the concoction of good news, but the concealment of bad news – such as the "last period problem." *See, e.g.*, Sean J. Griffith, *Towards an Ethical Duty to Market Investors*, 35 Conn. L. Rev. 1223, 1241-42 (2003). Typically, defendants determine that corporate results will not meet market expectations, and commit fraud to hide that fact. As a result, defendants' false statements – rather than introducing new positive information to the market – falsely confirm pre-existing information or expectations. Such "confirmatory" statements do not move market prices *upward*, but instead hold them steady. *See, e.g.*, *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342, 352 (3d Cir. 2009); *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282, 1314-15 (11th Cir. 2011); *see also* Sanjai Bhagat & Roberta Romano, *Event Studies and the Law, Part I*, 4 Am. L. & Econ. Rev. 141, 143 (2002); Frank Torchio, *Proper Event Study Analysis in Securities Litigation*, 35 J. Corp. Law 159, 164 (Fall 2009); Donald C. Langevoort, *Compared to What? Econometric Evidence and the Counterfactual Difficulty*, 35 J. Corp. L. 183, 185 (2009).[15] In other cases, defendants may gradually reveal

15. *Cf. Vivendi*, 765 F. Supp. 2d at 562-63 ("To hold, as Vivendi argues, that inflation must rise each time a misstatement

some problems but fraudulently downplay their severity, thereby causing prices to fall more slowly than they would have absent the fraud. *See Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010). Notably, in neither scenario do the defendants' statements have no impact; rather, their impact is to *maintain* prices. Had defendants told the truth – or even had they remained silent when new statements were expected – prices would have fallen. *See* Torchio, *supra* at 165; Langevoort, *supra* at 185.[16]

Thus, if plaintiffs are required to prove that false information "moved the market," they will typically try to demonstrate "at the back end" that the market price dropped in response to a disclosure of the true state of affairs. This is, of course, an inquiry that is indistinguishable from "loss causation," and neither Amgen nor its amici argue otherwise. But as this Court has recently recognized, there are many reasons why the plaintiff's failure to prove that there was a stock price drop in reaction to a truthful disclosure does not indicate that the price was never inflated in the first place. It may be that any price drops were due to intervening events rather than the fraud. *See Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011). Or, defendants may disclose confounding

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is reiterated … would produce a perverse result: it would make it harder for plaintiffs to prove loss causation when a company makes numerous similar misstatements over a long time period than when a company makes a single, isolated fraudulent statement, even though the former situation involves a more pervasive and widespread fraud." (citing cases)).

16. Amgen's *amici* concede this. *See* Petitioners' Law Professors Br. at 28 n.11.

information that makes it difficult to isolate the effect of the truthful revelation – a danger that scholars have warned against, fearful that bright-line price drop rules may hand defendants a roadmap for insulating themselves from liability.[17] Or, the truth may have become stale, so that it no longer influences prices as strongly as newer market and company-specific information (*see In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137, 145 (S.D.N.Y. 2008)), or the truth may have leaked to the market, resulting in a gradual price decline that is difficult to measure (*see Schleicher*, 619 F.3d at 686-87). As Professor Langevoort observes, "the problem of information leakage, or professionals figuring out the problem before being told officially, or corrective disclosure bundled with positive news, all very plausible even in markets characterized by a high degree of efficiency. Event studies and similar analyses do not do well in assessing these other possibilities…." *Basic at Twenty*, *supra*, at 190.

Tellingly, this Court has already recognized that in such circumstances plaintiffs are still entitled to class certification, even though they may not be able to prove *loss causation* on the merits. *See Halliburton*, 131 S. Ct. at 2186. At minimum, none of the foregoing illustrative scenarios has anything to do with whether the initial false statement was material – which is precisely why a price-impact proxy serves as a wholly inadequate substitute for the Court's highly contextual "reasonable investor"

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17. *See* Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 Iowa L. Rev. 811, 852 (2009); Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 Wis. L. Rev. 151, 187 (hereinafter "*Basic at Twenty*").

test of materiality. Indeed, it is precisely because of such concerns that *Basic* held that the question of whether inflation dissipated over the class period is best left for trial. *See Basic*, 485 U.S. at 249 n.29; *cf. Greenhouse*, 392 F.3d at 661 ("We note only the commonsense proposition that judges are not stockbrokers, and that, even with the corrective lenses of hindsight, they must be chary of theories that purport to discern precisely what caused stock prices to rise or fall.").

Moreover, using a stock price drop upon revelation of the truth as a proxy for initial price impact is highly problematic when the materiality disputes concern the size of the alleged fraud. For example, defendants may admit that they misstated corporate revenues – but only by a small amount. If the market fails to react, this hardly suggests that defendants' earlier statements about their revenues were immaterial, or that their revenue reports did not influence the stock price, which is the only potentially relevant question at class certification (as Amgen concedes, Pet. Br. 17). Instead, the only possible materiality inference (if any) is that the size of the discrepancy that defendants confessed to was not material. But *that* question has nothing to do with whether the stock price was impacted by the initial statements themselves, the fraud-on-the-market presumption, or class certification. Thus, even if there was a materiality dispute, it would present a quintessential merits question that is entirely divorced from the requirements of Rule 23.

Finally, in many cases, there are disputes about whether the particular disclosure that caused a price drop was, or was not, related to the fraud. *See, e.g.*, *Vivendi*, 765 F. Supp. 2d at 556-60. As explained in the brief filed by

Amici Financial Economists, these disputes – like other materiality questions – also will often require merits discovery to resolve.

D. Cases Cited by Petitioners' *Amici* Illustrate the Perils Of Having Courts Evaluate Materiality at Class Certification

Amgen's *amici* cite certain decisions within the Second Circuit as examples of cases where courts were able to assess materiality at class certification. See Chamber Br. at 20-24. In fact, a closer look demonstrates that those courts have had serious trouble with the inquiry, and even adopted approaches that conflict with the fraud-on-the-market theory. Therefore, far from establishing the appropriateness of requiring materiality to be evaluated at class certification, these decisions illustrate why it should not be. It should also be noted that, in *every* case cited, the only price impact evidence came from drops upon disclosure of the fraud, and not upticks upon the initial false statements.

First, two of the cited cases plainly erred by rejecting the proposition that material information that confirms existing expectations will not cause stock prices to move. This fundamental misunderstanding caused both courts to incorrectly interpret the lack of price movement at the time of the initial misstatements as affirmative evidence that the statements had no effect. *See Credit Suisse*, 250 F.R.D. at 144-45; *In re Moody's Corp. Sec. Litig.*, 274 F.R.D. 480, 492-93 (S.D.N.Y. 2011). However, as discussed above, it is a fundamental economic principle that only *unexpected* information will result in a price change.

The implications of such patently flawed reasoning are illustrated by examining the facts of *Moody's*. There, many of the allegedly false statements appeared in annual reports on Form 10-K (which all public companies must file with the SEC). *See In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 501 (S.D.N.Y. 2009). Forms 10-K are the single most comprehensive source of information about an issuer, as they contain (inter alia) complete financial statements as well as management's detailed discussion and analysis of the company's operations. *See* SEC Regulation S-K, 17 C.F.R. § 229.101 et seq. Yet, according to *Moody's*, because there was no measurable *uptick* when the 10-Ks issued, the false statements contained therein – and, by the same logic, *every other piece of information in the 10-K* – had no impact on prices. This is an extraordinary conclusion: it would mean that had Moody's subsequently announced that every word in the 10-K was false, investors would have had no claim.

Next, *Moody's* considered whether there had been price *drops* upon disclosures of the truth, agreeing that such drops occurred on two separate dates. 274 F.R.D. at 492-93. Nonetheless, the court refused to accept the drops as evidence that the misstatements affected prices because the plaintiffs had chosen an earlier class period end date. *Id.* at 493. But this is a non sequitur: if a price drop upon disclosure of the truth indicates that the price was previously inflated, it hardly matters whether the plaintiffs artificially cut their class period short; the drop alone would still mean that investors within the class period bought at inflated prices.

Credit Suisse offers an equally flawed analysis. There, the court rejected price drop evidence because the court believed there had been intervening factors, including

economic developments prior to the price drop, that erased the effects of the initial false statements. 250 F.R.D. at 146-49. But as this Court recognized, intervening factors should not be used a basis for denying certification. *See Halliburton*, 131 S. Ct at 2186; *see also In re Alstom SA Sec. Litig.*, 253 F.R.D. 266, 281 (S.D.N.Y. 2008) (criticizing *Credit Suisse* for improperly requiring plaintiffs to demonstrate loss causation at class certification). Indeed, *Credit Suisse* itself acknowledged that "Plaintiff has proffered evidence which, if credited, would constitute a modest showing of market impact" – but still decertified the class. *Id.* at 142 n.11.

AIG presents another example of illogical stock price analysis. As discussed above, the *AIG* plaintiffs alleged a series of false statements concerning AIG's accounting and business methods. Defendants attempted to rebut the fraud-on-the-market presumption by arguing that there had been no market movements in response to any alleged partial disclosures of the truth, and thus no artificial inflation initially. *See* 265 F.R.D. at 181 & n.20. In response, plaintiffs introduced expert evidence showing that there *had* been a stock price drop on four dates when new facts emerged concerning the extent of the fraud: March 17, 30 and 31, and April 1. *Id.* at 184-88. However, on March 30 and March 31, the price drops were not established at the 95% confidence level typically required for statistical significance. *Id.* at 187. As a result, the court held that the fraud-on-the-market presumption was rebutted for March 30 and March 31, but not for March 17 and April 1, and defined the class accordingly. *Id.* at 188.

This was facially nonsensical. The false statements had issued much earlier – so by March 30 either the stock price was inflated, or it was not. Apparently, in the court's

view, the stock was inflated until March 17, then deflated to its unmanipulated level by March 30, and then – without any intervening false statements[18] – suddenly re-inflated after the disclosures on March 31, only to drop one day later on April 1. Obviously, such reasoning has nothing to do with *Basic*, fraud-on-the-market, or any other recognizable economic theory.

More importantly, *AIG*'s entire evaluation of stock price drops was divorced from the allegations in the case. The plaintiffs claimed that AIG had extensively manipulated its financial performance for *six years*. Whether the market reacted – or not – to one of a long series of disclosures calling its financial statements into question hardly suggests that the market ignored AIG's financial statements throughout the class period. That the court engaged in this inquiry at all demonstrates how disconnected the "price impact" approach was from the actual issue that was purportedly under consideration – namely, whether AIG's false statements inflated the price of its stock.[19]

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18. The plaintiffs did not allege that AIG made additional false statements between March 17 and March 31. *See* Third Amended Complaint, *In re AIG Sec. Litig.*, No. 04-8141 (S.D.N.Y. Dec. 15, 2006), ECF No. 308.

19. *Berks County Emples. Ret. Fund v. First Am. Corp.*, 734 F. Supp. 2d 533 (S.D.N.Y. 2010) similarly does not support an argument that materiality is a simple matter at class certification. In that case, the plaintiffs did not submit any evidence regarding how a reasonable shareholder would have interpreted the statements, or evidence of how the fraud impacted the total mix of information – leaving the district court with an unusually bare record. *See id.* at 538-39. Indeed, the plaintiff's only expert conceded that he had not been retained to evaluate materiality. *See id.* at 539 n.35.

In two further cases cited by amici (Chamber Br. 22-23), the stock price drop upon disclosures of the truth was indisputable, and therefore the decisions focused solely on *Basic*'s "total mix" standard. But even these cases did not suggest that materiality is a simple matter at class certification. In the first, *In re Monster Worldwide Securities Litigation*, 251 F.R.D. 132 (S.D.N.Y. 2008), the plaintiff had previously moved for summary judgment on materiality – thus, there was an unusually clear record, including defendants' own implicit admissions of materiality. *Id.* at 137-38. In the second, *In re Sadia, S.A. Securities Litigation*, 269 F.R.D. 298 (S.D.N.Y. 2010), to assess materiality the court relied on a stock price drop when the truth was disclosed, on class representative and expert testimony, and on the court's own "common sense" to find that the misstatements were material. *Id.* at 315. Although Amicus NASCAT has no quarrel with the *outcome* in *Sadia*, its reasoning was ultimately standardless, as the court's "common sense" in one case is no guide to what a court's "common sense" will be in another – and is an inquiry facially more suited for a jury. This is particularly true given that, as discussed above, cases that present simple materiality issues will be disposed of on the pleadings.

In sum, Petitioner's *amici*'s cases confirm that requiring an evaluation of materiality at class certification – let alone one premised on "price impact" evidence – is impractical and unworkable, as it would force courts to make premature determinations on matters that cannot be reliably assessed before the completion of merits discovery. Nor is their proposal necessary, as weak materiality cases are dismissed under Rule 12(b)(6). Indeed, in most cases, the rule proposed by Amgen and its amici flies in face of *Halliburton* by requiring courts to perform the same

kind of loss causation analysis (albeit under the rubric of "materiality") that *Halliburton* rejected as unnecessary at class certification.

IV. SECURITIES CLASS ACTIONS CONTRIBUTE TO STRONGER MARKETS AND GOOD CORPORATE GOVERNANCE

The practical problems inherent in requiring plaintiffs to prove materiality at class certification are not unknown to Amgen and their amici, which likely explains why they devoted so much of their briefing to the perceived evils of securities litigation and the supposed need to protect corporations from "blackmail settlements."

The most obvious response is that Congress disagrees. Faced with precisely these arguments in 1995, Congress passed the PSLRA, which instituted several measures to curb abusive lawsuits and reduce undue pressures to settle. In addition to imposing heightened pleading standards and staying discovery until the complaint has survived motions to dismiss, the PSLRA also limits defendants' joint and several liability, thus significantly reducing their exposure to damages. *See* 15 U.S.C. §78u-4(f)). It also requires plaintiffs to prove loss causation, so that defendants will not be liable for price declines unrelated to the fraud, and limits damages in cases where the market quickly rebounds after a negative disclosure. 15 U.S.C. §§78u-4(b)(4); 78u-4(e). It also provides special protections for "forward-looking statements." 15 U.S.C. §78u-5. And, to strengthen the role of institutional investors, it adds new procedures for selecting lead plaintiffs. 15 U.S.C. §78u-4(a)(3). These provisions have succeeded both in increasing the number of weak cases that are

dismissed, as discussed below, and in increasing recoveries for investors in meritorious cases that survive the PSLRA's new hurdles.[20]

What Congress did *not* do, however, is change the standards for class certification. To the contrary, "[Congress] incorporated Rule 23 explicitly in one portion of the statute, and enacted language that is identical to Rule 23's typicality and adequacy requirements in a nearby provision. Given the many other changes Congress did make, we must infer that its decision to leave the standards of Rule 23 intact was deliberate." *Cavanaugh*, 306 F.3d at 739. Thus, if Amgen and its amici believe that, despite the PSLRA, investor-plaintiffs still hold too much power over corporate defendants, their complaints are better directed to Congress.

More fundamentally, the notion of class certification being used to "blackmail" defendants into settling frivolous claims has been thoroughly debunked. For example, Amgen's *amici* cite Janet Cooper Alexander's *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991) as evidence of the prevalence of blackmail settlements. *See* Former SEC Commissioners Br. at 16. But this article – written before

20. The rate of institutional participation as lead plaintiffs has been climbing since the PSLRA was passed, and institutional plaintiffs are associated with larger recoveries for class members and lower attorneys' fees. *See* NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2011 Year-End Review* 19 (2011); C.S. Agnes Cheng et al., *Institutional Monitoring Through Shareholder Litigation,* 95 J. Fin. Econ. 356, 358-60 (2010); Jill E. Fisch, *The Overstated Promise of Corporate Governance*, 77 U. Chi. L. Rev. 923, 938 (2010).

the PSLRA's enactment – has been seriously undermined by subsequent research. *See, e.g.*, Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*," 108 Harv. L. Rev. 438, 448-455 (1994); Geoffrey Miller, *Access to Justice: Investor Suits in the Era of the Roberts Court: A Modest Proposal for Securities Fraud Pleading after Tellabs*, 75 Law & Contemp. Probs. 93, 99 (2012).[21] Amici argue that a 1996 study concluded that blackmail settlements are a problem. *See* Former SEC Commissioners Br. at 16. In fact, that study found that "there were *no* objective indications that settlement was coerced by class certification," Thomas E. Willging, et al., *Empiral Study of Class Actions in Four Federal District Courts: Final Report to the Advisory Committee on Civil Rules* 90 (Federal Judicial Center 1996) (emphasis added), and that attempted strike suits were adequately addressed via dismissals on the pleadings or at summary judgment, *without* settlement. *Id*.

In any event, whatever concerns one might have had about frivolous securities litigation in the past, these have been addressed by the PSLRA. Since then, securities claims have been dismissed at much higher rates, and

21. *See also* James D. Cox, *Making Securities Fraud Class Actions Virtuous*, 39 Ariz. L. Rev. 497, 503-04 (1997); Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 Yale L.J. 2053, 2080-84 (1995); Leonard B. Simon & William S. Dato, *Legislating on a False Foundation: The Erroneous Academic Underpinnings of the Private Securities Litigation Reform Act of 1995*, 33 San Diego L. Rev. 959, 990-93 (1996).

those rates climb year after year. *See* Cornerstone Report 31 Appendix 2[22]; *see also* Stephen J. Choi at al., *The Screening Effect of the Private Securities Litigation Reform Act*, 6 J. Empirical Legal Stud. 35, 48 (2009) (comparing dismissal rates pre- and post-PSLRA); Christine Hurt, *The Undercivilization of Corporate Law*, 33 Iowa J. Corp. L. 361, 389 (2008) (same). As the Fifth Circuit put it, with former Justice O'Connor sitting by designation, "to be successful, a securities class-action plaintiff must thread the eye of a needle made smaller and smaller over the years by judicial decree and congressional action." *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 235 (5th Cir. 2009) (per curiam).[23]

There is every reason to believe the PSLRA's heightened pleading standards will continue to be enforced, as the increasing dismissal rates identified in the Cornerstone Report confirm. Indeed, a study of how "motive" allegations are used to meet the PSLRA's heightened scienter pleading standard shows that courts have continually narrowed the types of "motive" evidence that they will accept. *See* Hillary A. Sale, *Judging Heuristics*, 35 U.C. Davis L. Rev. 903, 923-46 (2002).

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22. These figures include claims filed under Section 11 of the Securities Act of 1933, which does not have scienter, loss causation, or reliance requirements. The rate of dismissal for Section 10(b) claims is likely much higher.

23. *See also* Hurt, *supra*, at 402, 387 ("the pleading and evidentiary burdens on plaintiffs in [securities fraud] civil cases is quite high, and a large number of cases are dismissed prior to discovery at the pleading stage… To increase the level of specificity that plaintiffs must know and plead but to block the same plaintiffs from any information-producing discovery creates a catch-22 situation that few can surmount….").

At the same time, scholars have documented how securities class action litigation improves corporate governance. Class action lawsuits deter aggressive financial reporting both at the targeted firm and – more interestingly – even at peer firms in the same industry. *See* Jared N. Jennings, Simi Kedia, and Shivaram Rajgopal, *The Deterrent Effects of SEC Enforcement and Class Action Litigation* (December 2011), http://ssrn.com/abstract=1868578. One study found that "these lawsuits appear to change firm behavior towards better governance, greater focus, and lower overinvestment." Brian Carson McTier & John K. Wald, *The Causes and Consequences of Securities Class Action Litigation*, 17 J. Corp. Fin. 649, 663 (2011), while another concluded that "institutional investors' involvement in securities litigation enhances … the quality of the defendant firms' corporate governance. In light of the ineffectiveness of traditional institutional monitoring channels (e.g., private communication and filing proposals, etc.) and the increasing number of securities litigations, institutional investors could use litigation as a mechanism to discipline management and to secure the long-term health of the firms." Cheng, *supra*, at 381; *see also* Geraldine Szott Moohr, *The Balance Among Corporate Criminal Liability, Private Civil Suits, and Regulatory Enforcement*, 46 Am. Crim. L. Rev. 1459, 1470 (2009) ("Studies show that private civil suits may also be more effective in regulating financial markets than public enforcement…..").

Private securities fraud class actions also serve as a necessary complement to public enforcement by the SEC. As Professor Samuel Issacharoff observes, the SEC relies on ex post enforcement actions – both private and public – to regulate the markets, rather than directly regulating business transactions themselves ex ante. Samuel

Issacharoff, *Regulating After the Fact*, 56 Depaul L. Rev. 375, 379 (2007). An ex post model is particularly suited to private enforcement, *see id.* at 381-82, and – compared to countries that use ex ante regulation – contributes to freer, better developed markets, *see id.* at 376-77, 385. Given that "'[t]he resources of the [SEC] are adequate to prosecute only the most flagrant abuses,' private litigation mechanisms ... may often be needed to prevent a noninsignificant amount of misconduct from escaping regulation." J. Maria Glover, *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 Wm. & Mary L. Rev. 1137, 1159-60 (2012) (quotations omitted). Securities class actions, subject to the limitations already placed by the PSLRA, thus continue to play a critical role in the enforcement of the securities laws.

CONCLUSION

For the foregoing reasons, this Court should not require courts to determine whether the alleged misstatements were material as part of the class certification inquiry in a fraud-on-the-market action. The decision of the Ninth Circuit should be affirmed.

Respectfully submitted,

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