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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 FORMER SEC COMMISSIONERS AND OFFICIALS AND LAW AND FINANCE PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICI CURIAE*

The *amici curiae* are former Commissioners and officials of the United States Securities and Exchange Commission (SEC), as well as prominent law and finance professors whose fields of academic inquiry include securities regulation and litigation, class-action practice, and law and economics.[1] *Amici* have devoted substantial parts of their professional careers to drafting, implementing, and/or studying the federal securities laws, including how those laws should be interpreted to ensure the protection of investors and the promotion of efficiency, competition, and capital formation. *Amici* previously filed an *amicus* brief in support of petitioners at the certiorari stage of this case.

This brief reflects the consensus view of the *amici* that this Court should reverse the Ninth Circuit's decision. *Amici* observe that the logic and purposes of the fraud on the market doctrine and of the Rule 23 class action device require that, in order to obtain class certification, Section 10(b) plaintiffs seeking money damages must establish by a preponderance of the evidence that defendants' alleged misrepresentations were material in the sense that they affected the price of the stock at issue. Each individual *ami-*

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[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. The parties' letters consenting to the filing of this brief have been filed with the Clerk's office.

cus may not endorse every argument presented in this brief, however. The former SEC Commissioners, former SEC officials, and professors joining this brief as *amici* are listed alphabetically below:

The Honorable Paul S. Atkins served as a Commissioner of the SEC from 2002 to 2008.

Brian G. Cartwright served as General Counsel of the SEC from 2006 to 2009.

The Honorable Charles C. Cox served as a Commissioner of the SEC from 1983 to 1989, and as Chief Economist of the SEC from 1982 to 1983.

Professor Richard A. Epstein is the Laurence A. Tisch Professor of Law at New York University School of Law, the James Parker Hall Distinguished Service Professor of Law Emeritus and Senior Lecturer at the University of Chicago Law School, and the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution.

Professor Allen Ferrell is the Greenfield Professor of Securities Law at Harvard University.

The Honorable Stephen J. Friedman is the President of Pace University and served as a Commissioner of the SEC from 1980 to 1981.

The Honorable Joseph A. Grundfest is the William A. Franke Professor of Law and Business at Stanford Law School and served as a Commissioner of the SEC from 1985 to 1990.

The Honorable Philip R. Lochner, Jr. served as a Commissioner of the SEC from 1990 through 1991.

The Honorable Aulana L. Peters served as a Commissioner of the SEC from 1984 through 1988.

Professor Amanda Rose is an Associate Professor of Law at Vanderbilt University.

Professor Kenneth E. Scott is the Ralph M. Parsons Professor of Law and Business Emeritus at Stanford Law School and Senior Research Fellow Emeritus at the Hoover Institute.

SUMMARY OF ARGUMENT

I.A. The Ninth Circuit's decision strikes at the heart of this Court's holding in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988). *Basic* recognized that in order to benefit from a presumption of class-wide reliance, a private securities fraud plaintiff seeking money damages must show at the class certification stage that the essential predicates to the fraud-on-the-market theory are satisfied. The crux of the fraud-on-the-market theory is that, in an efficient market, all public *material* information is reflected in the price of a security. An investor who purchases a security relying on the integrity of the market price thus relies on any *material* misrepresentations that have been made to the market, not because the investor is actually aware of any of these misrepresentations, but because the effect of the material misrepresentation is incorporated into the stock price, and not for any other reason.

Materiality in the form of information that is incorporated into securities prices is thus a necessary condition precedent to the very theory that makes class certification of private Section 10(b) money damages claims possible. *Basic* recognized that whenever the link between an alleged misrepresentation and the market price of a security is severed, the presumption of reliance is inapplicable and class certification is improper. The Ninth Circuit failed to

follow these important principles when it held that a Section 10(b) plaintiff need not demonstrate materiality in any form whatsoever in order to obtain class certification in an action for money damages.

I.B. That materiality is a necessary predicate in establishing the presumption of reliance means that it is also a necessary predicate in determining whether a suit may be certified as a class action under Federal Rule of Civil Procedure 23. *Basic* explained that a Section 10(b) case can *only* be tried in a class action format if the presumption of reliance applies. Otherwise, individual reliance issues predominate over common issues and Rule 23(b)(3) cannot be satisfied. See *Basic*, 485 U.S. at 242 (the need for "proof of individualized reliance from each member of the proposed plaintiff class" would have "prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones").

If a representation was not material in the sense of influencing the security's price then there is no basis for concluding that investors acted "in reliance on the integrity of the [market] price" that was at all affected by the alleged misrepresentation. See *Basic*, 485 U.S. at 247. Accordingly, plaintiffs must establish that an alleged misrepresentation was both material and impounded into the market price of shares in order to show that reliance on the misrepresentation is an issue common to all class members.

The Ninth Circuit's misunderstanding of *Basic* and the role of materiality in the Rule 23 inquiry has significant implications. Because securities class actions are nearly always settled if a class is certified, the materiality and price impact of an alleged misstatement will never be tested unless the question is

examined as part of the Rule 23 inquiry. Plaintiffs' allegations of reliance therefore will therefore never be tested either. The Ninth Circuit's decision unleashes the *in terrorem* power of class certification to compel settlement of even questionable claims without any meaningful inquiry into materiality or price impact and, therefore, into an important aspect of the propriety of presuming reliance. *Basic*, however, establishes that these are critical issues that must be tested at the class certification stage.

I.C.1. The rule proposed by *amici* would not impair the ability of the SEC to enforce the federal securities laws. The SEC in civil enforcement actions is not required to establish reliance or causation. The SEC therefore need not depend on the fraud-on-the-market theory, and need not prove materiality by way of price impact. In this federal enforcement context, a statement may be shown to be material if there is a "substantial likelihood" that a "reasonable investor" would view it "as having significantly altered the 'total mix'" of available information, even if it has no price impact. *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). And, while proof of price impact would definitively satisfy that standard, the absence of a reliance or causation element or need to rely on the fraud-on-the-market theory means that other evidence may also satisfy the standard in a particular case.

I.C.2 The Ninth Circuit's expansive interpretation of the fraud-on-the-market doctrine untethers the class certification determination from even the most cursory consideration of materiality. The decision below is therefore directly contrary to this Court's recent admonitions that the Section 10(b) implied private right of action is to be interpreted

narrowly. See*, e.g.*, *Janus Capital Group, Inc.* v. *First Derivative Traders*, 131 S. Ct. 2296, 2303 (2011); *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008).

I.D. Nothing in this Court's decision in *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179 (2011), casts any doubt on the rule of decision urged by *amici*. *Halliburton* explains that the fraud-on-the market theory depends on the principle that material information is impounded in the price of a security, but that loss causation requires more: a showing "that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." 131 S. Ct. at 2186; see also *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336, 342 (2005). "Loss causation" therefore "has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." 131 S. Ct. at 2186. Materiality, by contrast, is central to that inquiry, and therefore must be shown in order to obtain class certification.

II. The Court should take the opportunity afforded by this case to define the burden of proof a plaintiff bears to establish the prerequisites for class certification in a Section 10(b) suit. Although the courts of appeals are trending towards the recognition that the usual standard that applies in civil cases—proof by a preponderance of the evidence—also governs at the class certification stage, some confusion remains about that question. To guide the courts and parties below, and to avoid the inefficiency of having eventually to resolve this matter after the expenditure of further judicial and private party resources, *amici* believe it appropriate for this Court

to hold in this case that the normal civil burden applies.

ARGUMENT

I. PLAINTIFFS MUST DEMONSTRATE MATERIALITY BY SHOWING PRICE IMPACT BEFORE A CLASS MAY BE CERTIFIED IN A SECTION 10(b) SUIT FOR DAMAGES.

A. *Basic* Establishes That The Presumption Of Reliance Applies Only When It Is Shown That Material Information Is Incorporated Into The Price Of A Stock.

1. In *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), this Court explained that "[t]he paradigm of a fraud on the market litigation [was] a class action brought by purchasers of stock alleging that over a period of time the stock prices were artificially inflated due to material misstatements contained in publicly available corporate documents." Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. REV. 435, 435-437 (1984) (cited in *Basic*, 485 U.S. at 247 n.26). Thus, the artificial inflation or deflation of a stock price was clearly perceived as central to the notion of materiality that lies at the core of a class action claim for money damages.

Basic itself involved a claim that a corporation had misled investors by artificially depressing the price of its stock through false representations about the material question of whether there was a plan for the corporation to be acquired. The plaintiffs' complaint was thus of a material misrepresentation with a clear price impact, and the *Basic* court never had occasion even to consider whether a material misrepresentation without a price impact could support a

fraud on the market claim. Indeed, the entire logic of the Court's plurality decision in *Basic* is inconsistent with the notion that materiality absent a price impact could support the fraud on the market presumption.[2]

From the start, therefore, the essential link between materiality and price impact has been clear. There is no question that *Basic*'s core premise is "that an investor presumptively relies on a misrepresentation *so long as it was reflected in the market price at the time of his transaction*." *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 131 S. Ct. 2179, 2186 (2011) (emphasis added). *Basic* thus stands firmly for the proposition that the fraud-on-the-market theory does not apply—and that plaintiffs are not entitled to a presumption of reliance—unless they can demonstrate that the alleged misrepresentations were material in the sense that they had an impact on the price of the shares they traded.

This Court's recognition that price impact is an essential predicate to the application of the fraud on the market theory is evident in every facet of *Basic*'s discussion of the fraud-on-the-market theory. Indeed, the rebuttable presumption of reliance recognized in *Basic* makes no sense if the alleged misrepresentations did not impact the price of the plaintiffs' shares.

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[2] We do not suggest that materiality always requires price impact. See pp. 17-19, *infra*. But in a private cause of action under Section 10(b) for damages, where reliance is to be proved by presumption, price impact is necessary to establish that the fraud-on-the-market theory applies and that reliance may therefore be presumed.

"Reliance by the plaintiff upon the defendant's deceptive acts * * * ensures that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008), quoting *Basic*, 485 U.S. at 243. And reliance may be presumed under the fraud-on-the-market theory only when the misrepresentation is *material* and "is reflected in the market price of the security." *Ibid.* Only then can it "be assumed that an investor who buys or sells stock at the market price relies upon the statement." *Ibid.* Unless a misstatement is material because it affects the market price, "the basis for finding that the fraud had been transmitted through market price would be gone." *Basic*, 485 U.S. at 248.[3]

Some courts of appeals have understood this relationship between materiality and price impact in fraud-on-the-market cases. The Third Circuit, for example, correctly explained in *Oran* v. *Stafford*, 226 F.3d 275, 282 (3d Cir. 2000), that the concept of materiality must be "shaped by the basic economic insight that in an open and developed securities market," the "price of a company's stock is determined by all available material information regarding the company and its business." The court observed that "[i]n such an efficient market, 'information important to reasonable investors * * * is immediately incorporated into the stock price,'" and explained that be-

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[3] *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-154 (1972), which establishes a presumption of reliance in omissions cases, also requires that the omission be "material." The omissions in *Affiliated Ute* had a price impact, and thus were material. See *id.* at 147 & n.14.

cause "'*the concept of materiality translates into information that alters the price of the firm's stock*,' if a company's disclosure of information has no effect on stock prices, 'it follows that the information disclosed * * * was immaterial as a matter of law.'" *Ibid.* (emphasis added). See also, *e.g.*, *Shaw* v. *Digital Equip. Corp.*, 82 F.3d 1194, 1218 (1st Cir. 1996) ("by its underlying rationale, the presumption [of reliance under the fraud-on-the-market theory] shifts the critical focus of the materiality inquiry" to "'whether the market as a whole was fooled,'" "because it is the market, not any single investor, that determines the price of a publicly traded security").

Considerations of "common sense and probability," this Court explained in *Basic*, support a presumption of reliance when—but only when—plaintiffs traded shares "after the issuance of a materially misleading statement by the corporation" that was "reflected in [the] market price" of those shares. 485 U.S. at 226, 246-247. Where a stock price is not moved by a misstatement of fact, that misstatement either is immaterial or the market is inefficient—and in either case "common sense" and "probability" would not support a presumption of reliance. See, *e.g.*, ANDREI SHLEIFER, INEFFICIENT MARKETS: AN INTRODUCTION TO BEHAVIORAL FINANCE 5 (2000) (a key prediction of efficient market theory is that "prices should not move without any news about the value of the security"); Frederick C. Dunbar & Dana Heller, *Fraud on the Market Meets Behavioral Finance*, 31 DEL. J. CORP. L. 455, 509 (2006) ("The definition of immaterial information * * * is that it is already known or * * * does not have a statistically significant effect on stock price in an efficient market"); Allen Ferrell & Atanu Saha, *The Loss Causation Requirement for Rule 10b-5 Causes of Action:*

The Implications of Dura Pharmaceuticals, Inc. *v.* Broudo, 63 BUS. LAW. 163, 166 (2007) ("actionable misconduct must *cause* economic losses to shareholders who purchased shares at an inflated price").[4]

2. Significantly, this Court's discussion in *Basic* of the circumstances in which the fraud-on-the-market presumption of reliance does *not* apply further confirms that a material misstatement that fails to impact stock price cannot support the application of the fraud on the market presumption.

First, as this Court explained, plaintiffs are not entitled to a presumption of reliance if the defendant demonstrates that the alleged misrepresentations did not impact the price of the plaintiffs' securities. "Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance." 485 U.S. at 248.

By way of example, the Court explained that "if [defendants] could show that the 'market makers' were privy to the truth * * * and thus that *the market price would not have been affected* by their misrepresentations, the causal connection could be broken: the basis for finding that the fraud had been transmitted through market price would be gone." 485 U.S. at 248 (emphasis added). But that is precisely the showing—*i.e.*, the absence of price impact—that the Ninth Circuit would prevent any defendant from

[4] Price impact is also critical to materiality in the case of a confirmatory misstatement. Plaintiffs, to establish materiality and establish the presumption of reliance, must prove that a confirmatory misstatement maintained the price impact of the misstatement it confirmed.

making at the class certification stage in any class action securities fraud litigation.

Similarly, this Court explained that "if, despite * * * allegedly fraudulent attempt[s] to manipulate market price, news * * * credibly entered the market and dissipated the effects of the misstatements, those who traded * * * after the corrective statements would have no direct or indirect connection with the fraud." 485 U.S. at 248-249. To say that the "effects of the misstatements" were "dissipated" is precisely to say that the misstatements did not affect the price of the securities at the time plaintiff purchased them. Here too, *Basic* makes clear that price impact is essential to a showing of materiality.

In sum, *Basic* establishes that unless plaintiffs can show that the alleged "fraud had been transmitted through market price," and is thus material because it affected the market price, they are not entitled to a presumption of reliance. 485 U.S. at 248. It follows from *Basic*'s core holding that in an action for money damages, plaintiffs must show not merely that representations in general contained "material" misinformation in the sense that there is a "substantial likelihood" that the information "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976); accord *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1318 (2011). Instead, to support the application of the fraud-on-the-market rebuttable presumption, plaintiffs must demonstrate that the material information was "reflected in," and "[led] to a distortion of," the "market price" of the plaintiffs' securities. *Basic*, 485 U.S. at 247-248.

B. A Class May Not Be Certified Under Rule 23 Unless Plaintiffs Establish That A Material Misrepresentation Affected The Price Of The Stock.

1. That materiality through the price impact of an alleged misstatement is a necessary predicate for establishing the presumption of reliance logically implies that it is also a necessary predicate for determining whether a suit may be certified as a class action. As the drafters of Rule 23 explained, the "critical need" at the class certification stage is to determine "the nature of the issues that actually will be presented at trial"—"how the case will be tried." Fed. R. Civ. P. 23, Advisory Comm. Notes to the 2003 Amendments. As *Basic* held, a Section 10(b) case can *only* be tried as a class action if the presumption of reliance apples. Otherwise, individual issues of reliance predominate over common issues and Rule 23(b)(3) is not satisfied. See *Basic*, 485 U.S. at 242 (the need for "proof of individualized reliance from each member of the proposed plaintiff class" would have "*prevented respondents from proceeding with a class action*, since individual issues then would have overwhelmed the common ones") (emphasis added); see also *Halliburton*, 131 S. Ct. at 2184 ("[w]hether common questions of law or fact predominate in a securities fraud action often turns on the element of reliance").

If a representation was not material in the sense that it was not reflected in the price of a security then there is no basis for concluding that any investor relied on it by virtue of trading "in reliance on the integrity of the [market] price." See *Basic*, 485 U.S. at 247. Thus, if plaintiffs fail to establish prior to class certification that an alleged misrepresentation

was impounded in the market price of their shares, they also fail to show that reliance is a common issue that binds together their claims. Individual reliance issues then predominate and are an absolute bar to class certification.

2. Postponing inquiry into the materiality of an alleged misrepresentation until after the class certification stage, as the Ninth Circuit held should be done, would "[a]llo[w] plaintiffs to circumvent the reliance requirement" altogether and thereby to "disregard the careful limits on 10b-5 recovery mandated by [this Court's] earlier cases." *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994). "A district court's ruling on the certification issue is often the most significant decision rendered in * * * class-action proceedings." *Deposit Guarantee Nat'l Bank* v. *Roper*, 445 U.S. 326, 339 (1980). If a class action seeking substantial damages is certified, the case is almost always then settled before any trial on the merits. Indeed, the data suggest that only 8 percent of all federal class action securities fraud claims ever result in a ruling on a motion for summary judgment. Of the 92% of cases resolved prior to issuance of a ruling on summary judgment, 41% are dismissed, and 51% are settled.[5] Thus, unless the materiality of an alleged misstatement is tested at the Rule 23 stage, there is only an 8 percent chance that the average class action securities fraud complaint will ever be tested at all beyond the application of liberal pleading requirements pursuant to which plaintiffs' allegations are accepted as

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[5] Stanford Law School and Cornerstone Research, *Securities Class Action Filings, 2011 Year in Review* 18 & Figure 16, http://securities.stanford.edu.

true. *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544, 555-556 (2007) (plaintiffs' allegations accepted as true at pleading stage).

It is well understood that, if a class is certified in a securities fraud case, the risks of trial to the defendant are so significant that settlement is usually the defendant's only option. *E.g.*, Fed. R. Civ. P. 23(f), 1998 Advisory Comm. Note ("An order granting certification" may "force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability"). This Court has recognized that "[e]ven weak cases brought under [Rule 10b-5] may have substantial settlement value." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Dabit*, 547 U.S. 71, 80 (2006). The "*in terrorem*" prospect of "extensive discovery," "disruption of normal business activities," and the risk of a potentially massive adverse jury verdict gives even an insubstantial claim "a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740-743 (1975). And these large settlements are "'payable in the last analysis by innocent investors'"—the defendant company's current shareholders. *Id.* at 739, quoting *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 867 (2d Cir. 1968).

It is commonly appreciated that "'blackmail settlements,'" "induced by a small probability of an immense judgment," are a serious problem with the class action device in large securities fraud cases. *In re Rhone-Poulenc Rohrer, Inc.*, 51 F.3d 1293, 1298 (7th Cir. 1995), quoting HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973); see THOMAS E. WILLGING, ET AL., EMPIRICAL STUDY OF CLASS ACTIONS IN FOUR FEDERAL DISTRICT COURTS: FINAL

REPORT TO THE ADVISORY COMMITTEE ON CIVIL RULES 179, Tables 39 & 40 (Federal Judicial Center 1996). The costs and risks of litigation can make the merits of such claims largely irrelevant. *E.g.*, Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 516-517 (1991); Joseph A. Grundfest, *Why Disimply?*, 108 HARV. L. REV. 727, 742-743 (1995). Once a class is certified the risks of the suit are magnified and settlement becomes the predictable outcome.

Securities fraud actions are not intended "to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause"—*i.e.*, losses caused by misrepresentations of *material* fact that, at a minimum, have an impact on the price paid or received for securities. *Dura Pharm.*, 544 U.S. at 345, citing *Basic*, 485 U.S. at 252. But taking materiality and price impact out of the equation at the class certification stage means in practice that materiality and price impact need only be adequately pled, never proved, even though materiality and price impact are essential ingredients of the presumption needed to establish reliance on a common, class-wide basis. Courts must "be especially alert" to prevent this sort of "class-action harassment." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 345 (1979). But as the Ninth Circuit's decision shows, such "harassment" will persist without a clear ruling from this Court that in a Section 10(b) case for money damages, plaintiffs seeking class certification must demonstrate that the alleged misstatements actually moved the market price of their shares.

C. Requiring Proof of Materiality At The Class Certification Stage of Private Damages Actions Furthers Investor Protection and Economic Efficiency.

1. Requiring proof of materiality at the class certification stage also comports with this Court's efforts to confine the judge-made implied private right of action under Section 10(b). This Court has consistently resisted expansive readings of the implied right, recognizing that private securities litigation is susceptible to abuse. *Janus Capital Group, Inc.* v. *First Derivative Traders*, 131 S. Ct. 2296, 2303 (2011) (giving the implied private right of action a "narrow scope"); *Stoneridge Inv. Partners* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008) (private right of action must be given "narrow dimensions"); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 736 (1975); *Dura*, 544 U.S. at 347 (expressing concerns about "'abusive' practices"); see David S. Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision Of Legislative Intent?*, 57 NW. U.L. REV. 627, 660 (1962) (because it is implied, the private right under Rule 10b-5 "should be interpreted with caution").

This Court has invoked "policy considerations" in repeatedly rejecting "expansive imposition of civil liability" under Section 10(b). *Blue Chip Stamps*, 421 U.S. at 737, 739, 748. In particular, the Court has limited the scope of Section 10(b) actions to curtail their coercive potential and make meritless claims easier "'to dispose of before trial.'" *Id.* at 742-743; see *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) (requiring proof of scienter, not mere negligence); *TSC Indus.*, 426 U.S. at 449 (rejecting lax definition of materiality); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462 (1977) (limiting Section 10(b) to manipulative or

deceptive conduct); *Central Bank*, 511 U.S. at 189 (rejecting aiding and abetting claims because they would engender "uncertainty and excessive litigation"); *Dura*, 544 U.S. at 346 (requiring that loss causation be pled). Addressing at the class certification stage whether plaintiffs are able to demonstrate materiality is fully in keeping with these policy considerations.

2. Securities fraud class action plaintiffs routinely argue that requiring them to satisfy any threshold requirement serves as a disincentive to filing those suits, the threat of which they say is necessary to deter fraud. But that contention has no merit in this case, and it is flatly inconsistent with a long line of decisions from this Court imposing limits on the judge-made Section 10(b) implied private right of action.

The rule proposed by *amici* would not at all impair the ability of the Securities and Exchange Commission to enforce the federal securities laws. "The United States has the toughest administrative enforcement of securities laws in the world." INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 11 (2006). The SEC employs a broad range of statutory and administrative tools to combat fraud, including civil actions in which it *is not required to establish either reliance or causation*, and which are therefore likely to be much more effective in deterring fraud than the judicially implied private right of action for damages. The SEC, in addition to having the power to seek large civil penalties and the disgorgement of any gains, may obtain injunctive relief and orders barring or suspending individuals from serving as an officer or director of an issuer of securities. See 15 U.S.C. §§ 78u, 78u-3. And the pe-

nalties and disgorgements it obtains may be used as "Fair Funds" to provide compensation to defrauded investors. See 15 U.S.C. § 7246. Securities fraud is also a criminal violation punishable by fines and imprisonment. See, *e.g.*, 15 U.S.C. § 78ff.

Rule 10b-5(b) requires the SEC to show in an enforcement action that an "untrue statement" was one of "material fact." But the SEC's burden is far lighter than that of a private plaintiff class seeking Rule 23 certification of a damages claim. A private plaintiff's burden to show at the class certification stage that an alleged misstatement had a price impact derives, as we have explained, from *Basic*'s holding that Rule 23 class certification is appropriate only if reliance may be presumed under the fraud-on-the-market theory. By contrast, in the public enforcement context, the SEC need not prove reliance or causation and the fraud-on-the-market theory is unnecessary to the SEC's success. Accordingly, there is no reason for courts to insist that the SEC make a showing of price impact as part of the materiality inquiry.

In this federal enforcement context, a statement may be shown to be material if there is a "substantial likelihood" that a "reasonable investor" would view it "as having significantly altered the 'total mix'" of available information, even if it has no price impact. *TSC Indus.*, 426 U.S. at 449. And while proof of price impact would definitively satisfy that standard, the absence of a reliance or causation element or need to rely on the fraud-on-the-market theory means that other evidence may also satisfy the standard in a particular case.

"Materiality" naturally is a context-driven concept, so it should be no surprise that it may be satisfied in different ways in the case of implied private

damages actions and express SEC enforcement actions. *E.g.*, *Earl v. Nielsen Media Research, Inc.*, 658 F.3d 1108, 1114 (9th Cir. 2011) ("Materiality depends on the context and is a question of fact that 'cannot be mechanically resolved'"); *Hawn v. Executive Jet Mgmt., Inc.*, 615 F.3d 1151, 1157 (9th Cir. 2010) ("Materiality will depend on context and the facts of the case"). Indeed, the Third Circuit has recognized that while *TSC* supplies the general rule of materiality in securities fraud cases, in those private actions for money damages where an efficient market is involved, price impact is the appropriate test of materiality. See *In re Constar Int'l Inc. Sec. Litig.*, 585 F.3d 774, 783 (3d Cir. 2009) ("We have * * * 'fashioned a special Rule for measuring materiality in the context of an efficient securities market.' * * * In that context, 'the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock'"); see also *supra* pp. 9-10 (discussing similar cases).

D. Nothing In This Court's Ruling In *Halliburton* Relieves Section 10(b) Plaintiffs Of The Burden To Establish Materiality At The Class Certification Stage.

In *Erica P. John Fund* v. *Halliburton* this Court held that plaintiffs in private securities fraud actions need not prove loss causation in order to obtain class certification. Loss causation, however, is an entirely "distinct concept" from materiality and price impact. 131 S. Ct. at 2187; see, *e.g.*, *Matrixx Initiatives, Inc.* v. *Siracusano*, 131 S. Ct. 1309, 1317 (2011). And, as this Court was at pains to explain in *Halliburton*, proving loss causation is not "a precondition for invoking *Basic*'s rebuttable presumption of reliance,"

but "addresses a matter different from" reliance. Indeed, "[t]he term 'loss causation' does not even appear in our *Basic* opinion." 131 S. Ct at 2186.

This Court explained that while the fraud-on-the-market theory depends on the principle that material information is impounded in the price of a security in an efficient market, loss causation requires "a plaintiff to show that a misrepresentation that affected the integrity of the market price *also* caused a subsequent economic loss." *Id.* at 2186 (emphasis added); see also *Dura Pharm*. v. *Broudo*, 544 U.S. 336, 342 (2005) (that a material misrepresentation inflated the price of a stock does not mean that the misstatement is also the cause of a later price decline). As *Halliburton* held, "[l]oss causation" therefore "has no logical connection to the facts necessary to establish the efficient market predicate to the fraud-on-the-market theory." 131 S. Ct. at 2186. Price impact can occur either with or without loss causation; these are separate inquiries.

By contrast, as we have explained above, proof that a misstatement was material, in that it moved the price of the stock, is essential under *Basic* to invoke the presumption of reliance, which is in turn necessary to satisfy Rule 23's predominance requirement. Although proof of loss causation is not necessary to obtain class certification, absent proof of materiality and of price impact, the fraud-on-the-market theory is not available to plaintiffs and the need for individualized proof of reliance defeats Rule 23 predominance and thus bars class certification. *Halliburton*, therefore, is not controlling here.

II. TO OBTAIN CLASS CERTIFICATION, SECTION 10(b) PLAINTIFFS MUST ESTABLISH MATERIALITY BY A PREPONDERANCE OF THE EVIDENCE.

The Court should require plaintiffs to prove materiality through price impact and all other prerequisites of Rule 23 certification by a preponderance of the evidence. This Court has not yet explicitly established the standard of proof for Rule 23 requirements, though in *Wal-Mart* it made clear that a plaintiff must meet more than "a mere pleading standard." *Wal-Mart Stores, Inc.* v. *Dukes*, 131 S. Ct. 2541, 2551 (2011). The issue of the applicable standard is fairly encompassed in the questions presented as to whether Section 10(b) plaintiffs must prove materiality to obtain class certification, and what such proof entails. Resolving that issue here, rather than requiring parties and courts to devote resources to litigating the issue in the future, would be an efficient allocation of judicial resources and would appropriately guide the courts below in any remand in this case.

This Court left no doubt in *Wal-Mart* that a plaintiff "seeking class certification must *affirmatively demonstrate* his compliance with the Rule—that is, he must be prepared *to prove* that there are in fact sufficiently numerous parties, common questions of law or fact, etc." 131 S. Ct. at 2551. This Court also reaffirmed, as it had held in *Falcon*, that "certification is proper only if 'the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied.'" *Ibid.* (citing *Gen. Tel. Co.* v. *Falcon*, 457 U.S. 147, 161 (1982)). A court considering whether to certify a class action must "'probe behind the pleadings'" because "'actual, not pre-

sumed conformance with Rule 23(a)'" is "'indispensable.'" *Ibid.*, quoting *Falcon*, 457 U.S. at 160. This emphasis on the need for rigorous inquiry into whether plaintiffs have proved that Rule 23 is satisfied is impossible to reconcile with a lesser standard than proof by a preponderance of the evidence.

Indeed, this Court in *Wal-Mart* specifically addressed, in the course of its analysis, the fraud-on-the-market presumption in "class-action suits for securities fraud," stating unequivocally that "plaintiffs seeking 23(b)(3) certification must *prove* that their shares were traded on an efficient market," even though "they will surely have to prove" that issue "*again* at trial in order to make out their case on the merits." 131 S. Ct. at 2552 n.6 (first emphasis added). That the Court equated plaintiffs' burden of proof on the merits with their burden of proof at the class certification stage to establish that the Rule 23 requirements are satisfied surely means that the preponderance standard that governs on the merits also governs at the certification stage.

The 2003 amendments to Rule 23 confirm that the preponderance standard is appropriate. Those amendments call for a court to make "findings" that Rule 23 prerequisites are met based on a developed record. Fed. R. Civ. P. 23(b)(3); Fed. R. Civ. P. 23, 2003 Advisory Comm. Note. And when amended Rule 23(c)(1)(A) altered the timing of the class certification decision, from "as soon as practicable" to "at an early practicable time," it did so according to the Committee Notes to allow time for class-certification-related discovery necessary to facilitate "prob[ing] behind the pleadings." These changes, with their focus on discovery and fact-findings, strongly suggest

that the usual preponderance standard for proof of facts should apply.

Since the 2003 amendments, the Second, Third, and Fifth Circuits have expressly held that Rule 23 prerequisites must be proved by a preponderance of evidence. The Second Circuit was the first to reject the weaker "some showing" standard in favor of the preponderance standard. *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 39-42 (2d Cir. 2006) (*IPO*). In doing so the court analogized the class certification decision to a trial court resolving personal or subject matter jurisdiction, which often involves "resolv[ing] underlying factual disputes, and, as to these disputes, the judge must be persuaded that the fact at issue has been established." *Id.* at 40. The Second Circuit directed district courts "to assess all of the relevant evidence admitted at the class certification stage" to "resolv[e] factual disputes relevant to each Rule 23 requirement," and "[to] fin[d] that whatever underlying facts are relevant to a particular Rule 23 requirement have been established," notwithstanding an issue's overlap with the merits. *Id.* at 41-42. The Second Circuit later reiterated that *IPO* requires district courts to apply the preponderance standard to establish Rule 23 requirements. *Teamsters Local 445 Freight Div. Pension Fund* v. *Bombardier Inc.*, 546 F.3d 196, 202-203 (2d Cir. 2008).

The Third and Fifth Circuits subsequently joined the Second in adopting a preponderance of evidence standard. The Third Circuit held unequivocally that "[f]actual determinations necessary to make Rule 23 findings must be made by a preponderance of the evidence." *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 320 (3d Cir. 2008). The Fifth Circuit also adopted the preponderance standard. See

Alaska Elec. Pension Fund v. *Flowserve Corp.*, 572 F.3d 221, 228-229 (5th Cir. 2009). In so doing, it observed that "a district court's certification order often bestows upon plaintiffs extraordinary leverage, and its bite should dictate the process that precedes it." *Oscar Private Equity Invs.* v. *Allegiance Telecom, Inc.*, 487 F.3d 261, 267 (5th Cir. 2007), abrogated in other respects by *Halliburton*, 131 S. Ct. 2179. Given the enormous settlement leverage that comes from certification of a class action, certification should be ordered only when the evidence shows it is warranted—not merely when Rule 23 factors have been alleged, or some showing has been made that they are satisfied. There is no reason to depart from the usual standard of proof when facts are in dispute and when so much turns on the court's ruling.

Here, the Ninth Circuit held that the plaintiff must merely plausibly allege—but need not prove—materiality at the class certification stage. *Amgen*, 660 F.3d at 1172. Although the court acknowledged that the plaintiff must prove the other elements of Rule 23, the Ninth Circuit did not describe the evidentiary standard that applies to Rule 23. Nor has the Ninth Circuit done so elsewhere. See *Cholakyan* v. *Mercedes-Benz, USA, LLC*, 2012 WL 1066755, at *11 n.88. (C.D. Cal. Mar. 28, 2012) (finding no Ninth Circuit case that establishes the applicable standard of proof). This Court should embrace the reasoning of the Second, Third, and Fifth Circuits and, consistent with the rigorous analysis it required in *Wal-Mart*, adopt the preponderance of the evidence standard for Rule 23 class certification.

CONCLUSION

The judgment of the Ninth Circuit should be reversed.

Respectfully submitted.

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