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The Supreme Court Clarifies Standards for Rebutting Presumption of Reliance at Class Certification Stage in Securities Litigation

To establish a securities fraud claim, plaintiffs must show they relied on the alleged misrepresentations or omissions that are the subject of the lawsuit. The individualized nature of that inquiry had the potential to pose a crippling hurdle to plaintiffs' efforts to certify a securities fraud class, because a plaintiff seeking to certify such a class typically must show that "questions of law or fact common to class members predominate over any questions affecting only individual members."[1]

The Supreme Court of the United States addressed that issue in *Basic Inc.* v. *Levinson* and adopted the "fraud-on-the-market" theory. Under that theory, so long as the securities at issue trade in an efficient market, plaintiffs are entitled to a class-wide presumption of reliance.[2] Defendants can rebut the presumption by "sever[ing] 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."[3] In practice, however, courts tend to defer consideration of those issues until after class certification, because they also are relevant to merits issues such as materiality and loss causation, which the Supreme Court has held were not appropriately considered at class certification.[4]

On June 21, 2021, the Supreme Court decided *Goldman Sachs Grp., Inc.* v. *Arkansas Tchr. Ret. Sys.*, 141 S. Ct. 1951 (2021) ("*Goldman* v. *Arkansas*"),[5] which addressed questions about the standards for rebutting the *Basic* presumption. The Court held that (i) whether an alleged misrepresentation is generic, and therefore unlikely to affect price, is relevant at the class certification stage, even though it is also relevant to the merits issue of materiality and (ii) defendants seeking to rebut the *Basic* presumption have the ultimate burden of proof to show a lack of price impact at the class certification stage. While the Court clarified the standards for rebutting the *Basic* presumption, it did not substantially alter those standards, as some commentators had expected.

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[1] Fed. R. Civ. P. 23(b)(3).

[2] *Basic* v. *Levinson*, U.S. 224, 246-247 (1988) ("*Basic*").

[3] *Halliburton Co.* v. *Erica P. John Fund, Inc*. ("*Halliburton II*"), 573 U.S. 258, 268 (2014).

[4] *See*, *e.g.*, *Erica P. John Fund, Inc.* v. *Halliburton Co.* ("*Halliburton I*"), 563 U.S. 804 (2011); *Amgen Inc.* v. *Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 (2013).

[5] Unless otherwise stated, all quotations in this memorandum are taken from this opinion.

I. Factual and Procedural Background

In *Arkansas Teacher Ret. Sys.* v. *Goldman Sachs Group, Inc.*, 955 F.3d 254 (2d Cir. 2020), plaintiffs, a group of shareholder pension funds, filed a putative class action against Goldman Sachs and certain of its executives, alleging that defendants made misrepresentations in Goldman Sachs' Securities and Exchange Commission ("SEC") filings and annual reports about conflicts of interest, which artificially inflated the company's stock price. The alleged misrepresentations included generic statements, such as "[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest" and "[o]ur clients' interests always come first." However, in a settlement agreement with the SEC related to Goldman Sachs' involvement in several collateralized debt obligations ("CDOs"), the company settled with the SEC for failing to disclose a conflict of interest in connection with the creation of its CDOs (*e.g.*, the role of Paulson & Co. in the selection of mortgages that constituted the CDOs and Paulson & Co.'s position as a short seller). Plaintiffs alleged that this settlement rendered Goldman Sachs' disclosures about its policies and procedures regarding conflicts of interest inaccurate.

Plaintiffs moved for class certification under Rule 23 of the Federal Rules of Civil Procedure, which in a claim for money damages requires that the "court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Under *Basic*, courts may presume reliance on a class-wide basis if plaintiffs demonstrate that (i) defendants' alleged misstatements were publicly known, (ii) defendants' shares were traded in an efficient market, and (iii) plaintiffs purchased their shares in the period between when the misstatements were made and when more accurate or corrective disclosure came out.[6]

The *Basic* presumption can be rebutted. "Any showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff . . . will be sufficient to rebut the presumption of reliance" because "the basis for finding that the fraud had been transmitted through market price would be gone."[7] Defendants attempted to rebut the *Basic* presumption by arguing that its statements regarding conflicts of interest were only "general" and would be incapable of "maintaining inflation in a stock price as a matter of law."[8] Defendants also argued that they should bear only a burden of production to rebut the *Basic* presumption, and not the burden of persuasion.[9]

The Court of Appeals for the Second Circuit rejected both of defendants' arguments, holding the question of whether the alleged generic statement impacted price is really one of materiality, and "materiality . . . is not an appropriate consideration at the class certification stage."[10] "Goldman's authority for what constitutes an impermissibly 'general statement' provides further evidence that its 'special circumstances' test is really a means for smuggling materiality into Rule 23."[11] The Second Circuit concluded that, whether the alleged misstatements are too general to demonstrate price impact "has nothing to do with the issue of whether common questions predominate

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[6] *Arkansas Teacher Ret. Sys.* v. *Goldman Sachs Group, Inc.*, 955 F.3d 254 (2d Cir. 2020) ("*Arkansas* v. *Goldman*").

[7] *Basic*, 485 U.S. at 248; *see also Halliburton II*. In *Halliburton II*, the Supreme Court affirmed that defendants have the right to rebut the presumption of reliance established in *Basic* prior to class certification by showing a lack of price impact. There, the Court held there is "no reason to artificially limit the inquiry. . .by excluding direct evidence of price impact." 573 U.S. 258, 283. Such evidence may be considered "even though such proof is also highly relevant at the merits stage." *Id*.

[8] *Arkansas* v. *Goldman*, 955 F.3d at 266.

[9] There was a split among the circuit courts as to the second argument. *Compare Waggoner* v. *Barclays PLC*, 875 F.3d 79, 99-103 (2d Cir. 2017) and *In re Allstate Corp. Securities Litigation*, 966 F.3d 595 (7th Cir. 2020) *with IBEW Local 98 Pension Fund* v. *Best Buy Co.*, 818 F.3d 775, 782 (8th Cir. 2016).

[10] *Arkansas* v. *Goldman*, 955 F.3d at 266.

[11] *Id*.

over individual ones" and is "irrelevant at the Rule 23 stage."[12] As to whether plaintiffs submitted sufficient evidence of price inflation caused by defendants' alleged fraud, the court specified that defendants, not plaintiffs, bear the burden of persuasion at the class certification stage. The question is not "which side has better evidence, but whether the defendant has rebutted the presumption."[13]

On December 11, 2020, the Supreme Court granted certiorari to address: (i) whether a defendant in a securities class action may rebut the presumption of class-wide reliance recognized in *Basic* by showing the alleged misstatements were general and did not affect the price of the security and (ii) whether a defendant seeking to rebut the *Basic* presumption has a burden of production or the ultimate burden of persuasion.

In an *amicus curiae* brief, both the Department of Justice ("DOJ") and the SEC urged the Court to reverse the Second Circuit's holding affirming the grant of class certification.[14] The government argued that, under *Halliburton II*, a court may not ignore evidence about the nature of an alleged misstatement "in assessing price impact at the class-certification stage merely because the evidence would also be relevant to the question of materiality, which would be resolved at the merits stage."[15] On the burden issue, the Government urged the Court to uphold the decision of the Second Circuit that a defendant bears the burden of persuasion to show that an alleged misstatement had no impact on price. Citing *Halliburton II*, the government argued that defendants must prove a lack of price impact and not merely introduce evidence on the issue.

II. Supreme Court Vacates the Second Circuit's Decision

On the first question, Justice Barrett, writing for the Court in a six-to-three decision, held "that the generic nature of a misrepresentation often is important evidence of price impact that courts should consider at class certification." In briefing, both parties agreed that the "generic nature of an alleged misrepresentation often will be important evidence of price impact because, as a rule of thumb, a more-general statement will affect a security's price less than a more-specific statement on the same question." Furthermore, the parties agreed that courts may consider the generic nature of an alleged misstatement at the class certification stage, even though the question also goes to materiality—an issue generally reserved for the merits phase.

The Supreme Court agreed with the parties and took an expansive approach as to what evidence may be considered at the class certification stage:

> [i]n assessing price impact at class certification, courts should be open to all probative evidence on that question—qualitative as well as quantitative—aided by a good dose of common sense. ***That is so regardless whether the evidence is also relevant to a merits question like materiality***. As we have repeatedly explained, a court has an obligation before certifying a class to determine that Rule 23 is satisfied, even when that requires inquiry into the merits.[16]

In a case like this one—under a price inflation maintenance theory wherein in the generic statement allegedly held the stock price up—the Court found that considering the generic nature of a misrepresentation may be especially important when trying to link a corrective disclosure and subsequent price drop.

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[12] *Id*.

[13] *Id.* at 272 n.19.

[14] Brief for the United States as Amicus Curiae Supporting Neither Party, *Arkansas Tchr. Ret. Sys.* v. *Goldman Sachs Group, Inc.*, 955 F.3d 254 (2d Cir. 2020), *cert. granted*, 2020 WL 7296815 (U.S. Dec. 11, 2020) (No.20-222).

[15] *Id*. at 13.

[16] (emphasis added)

Specifically, the Court observed that the "inference—that the back-end price drop equals front-end inflation—starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure." The Court stated that such a mismatch may be likely to occur when the "earlier misrepresentation is generic (e.g., 'we have faith in our business model') and the later corrective disclosure is specific (e.g., 'our fourth quarter earnings did not meet expectations')." "Under those circumstances," the Court explained, "it is less likely that the specific disclosure actually corrected the generic misrepresentation, which means that there is less reason to infer front-end price inflation—that is, price impact—from the back-end price drop." The Court remanded the case back to the Second Circuit to "take into account *all* record evidence relevant to price impact, regardless whether that evidence overlaps with materiality or any other merits issue."

On the second question, regarding whether the plaintiff or defendant has the burden of persuasion at the class certification stage, the Court held that defendants bear the burden of persuasion to prove a lack of price impact by a preponderance of the evidence. The Court rejected defendants' reliance on the Federal Rule of Evidence 301, explaining that the Court has at times "exercised that authority to reassign the burden of persuasion to the defendant upon a *prima facie* showing by the plaintiff." The Court stated that the authority to assign the burden of persuasion to defendants has already been exercised in *Basic* and *Halliburton II*. Despite the Court's holding, it indicated that "the allocation of the burden is unlikely to make much difference on the ground" given that, in most securities fraud class actions, courts are tasked with assessing both plaintiffs' and defendants' competing evidence of price impact. "The defendant's burden of persuasion will have bite only when the court finds the evidence in equipoise—a situation that should rarely arise."

Justice Gorsuch, joined by Justices Thomas and Alito, dissented as to the second question presented and concluded that plaintiffs, rather than defendants, should "bear the burden of persuasion on price impact." Citing precedent,[17] Justice Gorsuch indicated that the "plaintiff at all times bears the ultimate burden of persuasion" to prove all aspects of its cause of action, and that the Supreme Court has "explained that nearly all presumptions operate in this way." Federal Rule of Evidence 301, which states that "burden of production may shift to the defendant, but never the burden of persuasion," confirms this interpretation. According to the dissent, the burden framework, both rooted in Supreme Court precedent and codified in Federal Rule of Evidence 301, was not then reassigned by the Court in *Basic* or *Halliburton II*. Such an interpretation, Justice Gorsuch wrote, is flatly incorrect and a departure from long established principles.

Justice Gorsuch's dissent also took issue with the Court's argument that burden of persuasion will rarely matter because the evidence is rarely "in equipoise," concluding that "[t]he whole reason we allocate the burden of persuasion is to resolve close cases by providing a tie breaker where the burden does make a difference. That close cases may not be common ones is no justification for indifference about how the law resolves them."

III. Implications

Goldman v. *Arkansas* clarifies that defendants can, in certain circumstances, rebut the *Basic* presumption at the class certification stage by relying on evidence that goes to the merits of the case. Some of the Court's dicta (quoted above) about the reasons why generic misrepresentations may not, in fact, inflate stock prices, may bolster arguments by defendants about a lack of price impact at the class certification stage and about loss causation arguments at the merits stage. The decision also confirms that defendants bear the burden of persuasion at the

[17] *Texas Dept. of Community Affairs* v. *Burdine*, 450 U.S. 248, 255, n. 8 (1981); *St. Mary's Honor Center* v. *Hicks*, 509 U.S. 502, 506 (1993).

class certification stage. However, it remains to be seen in future cases what impact the decision will have on analyses by the lower courts of defendants' challenges to class certification.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email authors Bradley J. Bondi (partner) at 202.862.8910 or bbondi@cahill.com; Joel Kurtzberg (partner) at 212.701.3120 or jkurtzberg@cahill.com; Adam Mintz (counsel) at 212.701.3981 or amintz@cahill.com; or Grace McAllister (associate) at 212.701.3343 or gmcallister@cahill.com; or email publications@cahill.com.