

Alert | Financial Services Litigation/Securities Litigation



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Rebutting the Presumption of Class-Wide Reliance at the Class Certification Stage (Part II): Key Takeaways From the Supreme Court’s Decision in *Goldman Sachs Grp., Inc. v. Arkansas Teacher Ret. Sys.* (2021)

The U.S. Supreme Court has given Goldman Sachs a partial victory in a securities fraud class action, vacating the lower courts’ grant of class certification and remanding for further proceedings. *See Goldman Sachs Grp., Inc. et al. v. Arkansas Teacher Ret. Sys. et al.*, No. 20-222 (U.S. June 21, 2021). The **ruling** will need to be reviewed carefully by defendants and their counsel in putative class actions in which the plaintiffs can be expected to invoke the presumption of class-wide reliance first articulated by the Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). The *Goldman Sachs Group* decision clarifies important issues relating to the types of evidence that may be considered, and the evidentiary burden that must be satisfied, when a defendant attempts to rebut the *Basic* presumption at the class certification stage.

This article follows a **December 2020 GT Alert** published by these authors when the Court first granted Goldman’s petition for *certiorari*, which discusses the potential ramifications of the Court’s ruling on class certification in future securities fraud litigation.

Overview of the *Basic* Presumption of Class-Wide Reliance

The *Basic* presumption, when successfully invoked, permits class action plaintiffs to avoid issues regarding differing degrees of individual reliance, which may preclude class certification under Federal Rule of Civil Procedure 23. The presumption is based on the theory that, in an efficient securities market, a material misstatement or omission about a company will have an impact on the company's stock price. Under *Basic*, an investor "presumptively relies" on a misstatement when that misstatement is reflected in the market price at the time the investor trades the stock. *Goldman Sachs Grp.*, Slip Op. at 3.

To invoke the *Basic* presumption, plaintiffs must prove four elements: (1) that the alleged misstatement was publicly known; (2) that it was material; (3) that the stock traded in an efficient market; and (4) that the plaintiff traded the stock between the time the misrepresentation was made and when the truth was revealed. At the certification stage, however, plaintiffs need only show that the publicity, market efficiency, and market timing prerequisites are satisfied—the materiality element is reserved for the merits stage, on the theory that it does not bear on Rule 23's predominance requirement.

A defendant is entitled to rebut the *Basic* presumption at the class certification stage by showing that an alleged misstatement did not, in fact, affect the market price of the stock (i.e., that it had no "price impact"). The Court held in *Basic* that "[a]ny 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" suffices to rebut the presumption. *Id.* (emphasis added) (quoting *Basic*, 485 U.S. at 248).

Notwithstanding the above language from *Basic*, courts have disagreed as to the types of evidence that can be used to rebut the presumption, and, in particular, whether evidence relevant to the materiality element may also be used to show a lack of price impact at the certification stage. It has also been unclear who has the burden of persuasion as to the applicability (or non-applicability) of the presumption.

The Underlying Litigation

The plaintiffs in *Goldman Sachs Group* are Goldman shareholders. They allege that from 2006-2010, the company made misstatements in public filings about its conflict-of-interest policies. These misstatements were generic in nature, but plaintiffs nonetheless allege that these misstatements had the effect of artificially inflating the value of Goldman's stock. Plaintiffs further allege that when the existence of certain Goldman conflicts eventually came to light, that inflation purportedly dissipated, causing them to suffer losses.

The plaintiffs moved for class certification, invoking the *Basic* presumption. In response, Goldman sought to rebut the presumption by showing a lack of price impact. The District Court certified the class, but the Second Circuit vacated that order. Specifically, the Second Circuit held that although Goldman bore the burden of persuasion (and thus was required to show a lack of price impact by a preponderance of the evidence), the District Court had erred by holding Goldman to an even higher standard and refusing to consider some of its price impact evidence.

On remand, the District Court again granted class certification, finding that Goldman had failed to meet its burden of persuasion. This time, the Second Circuit affirmed. The Supreme Court granted *certiorari*.

The Supreme Court's Decision and Potential Ramifications

The Supreme Court's June 21 opinion addresses two issues of significance to the *Basic* presumption and future securities fraud class action litigation: first, whether the generic nature of alleged misstatements can be used to rebut the *Basic* presumption by showing a lack of price impact; and second, whether a defendant bears the burden of persuasion to prove a lack of price impact (as opposed to a mere burden of production).

In its opinion, the Court unanimously confirmed that the generic nature of a misstatement is not only *relevant* to price impact, but “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.’” Slip Op. at 6-7 (emphasis added). The Court also stated that, in considering whether a generic misstatement had a price impact, courts may consider both expert testimony and “common sense.” *Id.* at 7. Indeed, the Court repeatedly emphasized that courts must consider “*all*” evidence probative of the price impact issue, “regardless of whether that evidence is also relevant to a merits question like materiality.” *Id.* (emphasis in original). Finding “sufficient doubt” that the Second Circuit had appropriately considered Goldman’s evidence—in particular, expert testimony regarding the generic nature of the alleged misstatements—the Court vacated the decision below and remanded with an instruction for the Second Circuit to “take into account *all* record evidence relevant to price impact.” *Id.* at 9 (emphasis in original).

The Court’s important ruling on this issue should quash any lingering misapprehension among lower courts that they can reject, dismiss, or understate certain categories of evidence submitted by securities fraud defendants to show a lack of price impact purely on the ground that such evidence is also relevant (or even purportedly *more* relevant) to materiality. The opinion makes clear that courts have an obligation to consider all such evidence at the class certification stage or risk potential reversal on appeal.

With respect to the burden issue, a 6-3 majority of the Court rejected the argument that a defendant bears only a burden of production to rebut the *Basic* presumption. The Court disagreed that a defendant need only produce “any competent evidence of a lack of price impact” to rebut the *Basic* presumption at the class certification stage, interpreting its prior opinions on the presumption as having assigned to the defendant the burden of persuasion with respect to price impact, too. *See id.* at 9-12. Accordingly, under the Court’s ruling, once plaintiffs successfully invoke the *Basic* presumption, the burden lies with the defendant to show that there was not in fact any price impact by a preponderance of the evidence.

Justice Gorsuch, in an opinion joined by Justices Thomas and Alito, dissented on this point, notably characterizing the majority’s ruling as the first time the Court had ever placed a burden of persuasion on the defendant with respect to an element of a plaintiff’s case. In the majority’s view, however, “the allocation of the burden is unlikely to make much difference on the ground,” insofar as it should only be determinative “when the court finds the evidence in equipoise” (i.e., that it favors neither side). *Id.* at 12.

The Court’s resolution of the burden applicable to a defendant’s effort to rebut the *Basic* presumption should be of interest to companies sued in putative securities fraud class actions and their counsel, insofar as it will (and should) inform litigation strategy. In particular, defense counsel will need to consider seeking targeted discovery, retaining critical experts, and otherwise developing and preparing the record early in a case so that their clients are able to make persuasive evidentiary showings of a lack of price impact at the class certification stage.

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