

SANGRA MOLLER LLP*Barristers & Solicitors***LEGAL CURRENCY***A Client Communication****Supreme Court Issues Ruling in Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System***

On June 21, 2021, the United States Supreme Court (the "**Court**" or "**Supreme Court**") issued its decision in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, providing clearer mechanisms for defendants to rebut the *Basic Inc. v. Levinson* ("**Basic**") presumption of reliance and thus defeat class certification in securities-fraud class actions. In the case, Goldman Sachs ("**Goldman**") shareholders filed a class-action lawsuit alleging that it committed securities fraud by misrepresenting its management of conflicts of interest. Goldman argued that the United States Court of Appeals for the Second Circuit ("**Second Circuit**") erred twice: first, by holding that the generic nature of Goldman's alleged misrepresentations is irrelevant to the price impact inquiry at the class certification stage in securities-fraud class actions; and second, by assigning Goldman the burden of persuasion to prove a lack of price impact. Addressing the first issue, the Court held that the generic nature of a misrepresentation is often important evidence of price impact that courts should consider at the class certification stage, even where the same evidence may be relevant to materiality. Secondly, the Court noted that where defendants seek to rebut *Basic Inc. v. Levinson*'s fraud-on-the-market presumption, they bear the burden of production as well as the ultimate burden of persuasion to prove a lack of price impact by a preponderance of the evidence. In concluding that the Second Circuit may not have properly considered the generic nature of Goldman's alleged misrepresentations, the Court remanded the case for reassessment.

I. Background

The case is concerned with whether statements made by Goldman in its SEC filings and annual reports were misrepresentations that violated the anti-fraud provisions of the Securities Exchange Act of 1934

(the "**SEA**"), allegedly allowing Goldman to maintain an inflated stock price. Goldman represented that it had "extensive procedures and controls that are designed to identify and address conflicts of interest," that "its clients' interests always come first," and that "integrity and honesty are at the heart of our business." The plaintiffs allege, however, that while publishing these assurances, Goldman was involved in underwriting certain securities for one client while assisting another client to short those same securities. When the SEC filed a complaint alleging that Goldman misstated and omitted key facts regarding the foregoing securities, Goldman's stock prices fell significantly.

In suing Goldman under Section 10(b) of the SEA, the investor plaintiffs sought to certify a class of Goldman shareholders by invoking the *Basic* presumption that the price of stock traded in an efficient market reflects all public material information. In *Basic*, the Court held that plaintiffs can, at the certification stage, establish a classwide, rebuttable presumption of reliance if they prove three elements: (i) that the defendant's misrepresentations were publicly known, (ii) that the stock was traded in an efficient market and (iii) that the plaintiffs purchased the stock at market price after the alleged misstatements were made and before the truth was revealed. In addition to providing expert testimony attesting to a lack of price impact, Goldman attempted to rebut the presumption by arguing that the alleged misrepresentations were too generic to have had any significant price impact on its securities.

The district court held that Goldman bore the burden of persuasion with respect to the price impact of the alleged misrepresentations, and in applying the preponderance of evidence standard, found that Goldman had failed to establish that its alleged

misrepresentations had no price impact. The Second Circuit ultimately affirmed this holding. The Second Circuit's majority opinion held that considering a statement's generic nature would risk importing materiality into the class certification stage. However, Judge Richard Sullivan's dissent suggests that once a defendant has presented sufficient evidence to challenge the *Basic* presumption and demonstrate that no price impact occurred, the court should be permitted to consider the nature of the misrepresentations, regardless of whether such an inquiry is similar to a materiality assessment.

II. The Supreme Court's Decision

In arguing that the Second Circuit erred in its decision, Goldman presented two questions for review by the Supreme Court:

1. Whether a defendant in a securities class action may rebut the presumption of classwide reliance recognized in *Basic* by pointing to the generic nature of the alleged misstatements in showing that the statements had no impact on the price of the security, even though that evidence is also relevant to the substantive element of materiality; and
2. Whether a defendant seeking to rebut the *Basic* presumption has only a burden of production or also the ultimate burden of persuasion.

Responding to the first question, the Court rejected the Second Circuit's conclusion, holding that "in 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.'" This openness should exist, "regardless [of] whether the evidence is also relevant to a merits question like materiality." The Court noted that "the generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory." The inference that a "back-end price drop equals front-end inflation" begins to break down when the contents of the misrepresentation and the corrective disclosure are mismatched. For example, where an 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"), the specific disclosure does not necessarily correct the generic misrepresentation. As a result, it becomes less reasonable to infer front-end price inflation from the back-end price drop and important for courts to consider the generic nature of alleged misrepresentations in determining whether the *Basic* presumption has been rebutted.

In addressing the second question, the Court affirmed the Second Circuit's holding that a defendant seeking to rebut the *Basic* presumption has both a burden of production and the ultimate burden of persuasion, rejecting Goldman's argument that Rule 301 of the Federal Rules of Evidence shifts the burden of persuasion to the plaintiffs. The Court noted that its decisions in *Basic* and *Halliburton II* had already allocated the burden of persuasion of price impact to the defendants. By demonstrating that the link between the alleged misrepresentation and the price paid by the plaintiff was severed, defendants can show that "the misrepresentation *in fact* did not lead to a distortion of price," thereby rebutting the presumption.

Regardless, the Court noted that the manner in which the burden of persuasion is allocated "is unlikely to make much difference on the ground," since the district court is only required to assess all the evidence of price impact and "determine whether it is more likely than not that the alleged misrepresentations had a price impact." The defendant's burden of persuasion will only be of significance in rare cases where the evidence is in equipoise.

III. Outcome

Although the decision maintains the defendant's burden of persuasion in proving price impact, its holding that district courts need only weigh all evidence of price impact under a preponderance of evidence standard provides a mechanism of resistance for defendants challenging class certification in cases premised on allegations of a generic nature. The

ruling is likely to result in class certification remaining a contentious issue in many securities cases.