



SCOTUS Hears Oral Argument in Goldman Sachs Securities Class Action

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The “fraud on the market” theory, recognized by the Supreme Court in *Basic Inc. v. Levinson*,² allows a class action plaintiff to satisfy the reliance requirement of a securities fraud claim through a rebuttable presumption that the price of a stock traded in an efficient market reflects all material public information. The Supreme Court later held in *Halliburton II*³ that a defendant must have the opportunity to rebut this presumption by demonstrating that the statements at issue did not impact the stock price. However, lower courts have struggled to apply these decisions due to the lack of guidance on the showing required to rebut the presumption.

Goldman challenges the Second Circuit’s decision to uphold class certification in an inflation-maintenance theory securities fraud class action. Under the inflation-maintenance theory, plaintiffs can claim that misstatements kept a company’s stock price artificially high, rather than causing the price to decrease. Importantly, under this theory, defendants likely cannot look to evidence that the price did not increase initially after the misstatement, but rather may need to rely on evidence that the statement was too generic to impact the price. In oral argument, Goldman asserted that the Second Circuit committed two legal errors. First, Goldman argued that “the court refused to consider the generality of the statements as evidence tending to disprove price impact.” Second, Goldman claimed that the court “erred by holding that the Basic presumption shifted the ultimate burden of persuasion to a defendant on the issue of price impact.”

Despite the wide gap between plaintiffs and defendants in the lower courts on whether general statements could be considered when assessing price impact, in oral argument, both

sides came to near agreement on the first issue regarding materiality. Goldman conceded that courts could consider the generic statements when deciding whether investors relied on them, while the shareholders acknowledged that the generic nature of the statement is a relevant consideration. The Justices overwhelmingly noted that both sides had converged, which caused the Justices to question the need for the Court's ruling on this issue.

The second issue—which party bears the burden of persuasion once the *Basic* presumption has shifted—was a central issue in the oral argument. The Justices questioned the parties on who should have the ultimate burden and sought guidance on how its ruling would impact district judges' consideration of the evidence at the class certification stage. The parties noted that the current precedent places the burden on defendants, yet Goldman urged the Court to rule that the *Basic* presumption only shifts the burden of production—not the burden of persuasion.

Underlying Legal Framework.—Rule 10b-5(b) forbids entities from “mak[ing] any untrue statement of a material fact” or “omit[ting] to state a material fact necessary in order to make the statements made . . . not misleading.”⁴ When asserting a private right of action under this section, plaintiffs can seek class certification under Federal Rule of Civil Procedure 23, but plaintiffs must show that “the questions of law or fact common to class members predominate over any questions affecting only individual members.”⁵

In order to achieve class certification in these contexts, plaintiffs must look to Court-created doctrine. In *Basic*, the Supreme Court created a “rebuttable presumption” of class-wide reliance.⁶ This presumption is rooted in a “fraud on the market theory,” which presumes that a company's stock price reflects the rapid incorporation of all new and value relevant public information, and any investor who bought or sold stock relied on the integrity of the market price.⁷

In *Basic*, the Court explained that defendants can rebut this presumption by providing evidence 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.”⁸

After this decision, the Court continued to interpret the presumptions' application in Section 10(b) claims, providing direction in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*⁹ that plaintiffs need not show materiality to certify a class.¹⁰ Then, in 2014, in

Halliburton II, the Supreme Court clarified the *Basic* presumption and explicitly ruled that lower courts must consider evidence that the misrepresentation had no impact on the price of the security, even if the evidence is also “highly relevant at the merits stage.”¹¹

Procedural History.—Plaintiff shareholders originally filed this securities class action in 2011 in the Southern District of New York. Plaintiffs alleged that Goldman and certain directors and officers made misstatements concerning Goldman’s conflicts of interest. Specifically, plaintiffs relied on the inflation-maintenance theory (or price-maintenance theory), which allows plaintiffs to claim that a company’s misstatements affected its stock price, not by artificially inflating the price, but by preventing the stock from decreasing from its artificially high price. Here, plaintiffs allege that Goldman’s allegedly general public misstatements were misleading and maintained an artificially high stock price.

Initially, the district court granted class certification, and Goldman appealed. The Second Circuit vacated and remanded back to the district court because it did not properly apply the preponderance-of-the-evidence standard when evaluating evidence in rebuttal to the *Basic* presumption.

After returning to the district court, Goldman opposed class certification and attempted to offer evidence that the alleged misstatements had no impact on the later drop in stock price. However, the district court again granted class certification, and Goldman appealed. In April 2020, the Second Circuit, in a split decision, affirmed the lower court’s ruling and held that the district court properly applied the inflation-maintenance theory and that Goldman failed to rebut the *Basic* presumption.¹² In the Second Circuit opinion, Judge Sullivan dissented, noting that the Second Circuit’s ruling makes the *Basic* presumption irrefutable.

Oral Argument.—During oral argument, the Justices questioned the parties about both the materiality and burden issues asserted in Goldman’s questions presented. Prior to oral argument, Goldman held an unwavering position that the lower court erred in refusing to assess whether the statements were too generic. Conversely, the shareholders were unwilling to admit that the court should engage in any analysis of the generic nature of the statement at the class certification stage.

Yet, from the start of oral argument, both sides were quick to concede important points regarding the materiality issue. During oral argument, many of the Justices commented that the parties’ positions had converged since arguing at the Circuit level. Despite Goldman’s

stalwart stance regarding generality at the Circuit level, Goldman dropped its position that generic statements could never be the basis of a securities fraud suit. And the shareholders immediately conceded at oral argument that the “generic nature of the statement as [the Petitioners] use the term is relevant evidence to price impact.”

Justice Barrett expressed this sentiment and noted that “it seems to me that [they’ve] both moved towards the middle. . . . [T]hey’ve backed off on how important they think generality is and whether it can be decided categorically.”

Goldman further admitted that they “largely agree with the [G]overnment,” who also independently argued to the Court. But Goldman noted that the parties diverge on the suggested ruling of the Court. Goldman ultimately asked the Court to reverse the lower court’s judgment and provide “desperately need[ed] guidance on how to navigate this Court’s decisions on the Basic presumption.”

The Government, who also sought clarity from the Court, did not side with either party; instead, the Government urged the Court to vacate the lower court’s ruling in order to provide guidance as to whether a company could argue that its statements were too generic to have an impact on its share price.

In the same vein, Justice Stephen G. Breyer suggested that it might be best if the Supreme Court was not involved at all, commenting that “[t]his seems like an area that the more that I read about it, the less that we write, the better.” However, the shareholders emphasized that an opinion outlining that the lower court should not ask the materiality question at the class certification stage but should still maintain a common sense analysis would be valuable.

Yet the parties did not converge on the burden issue. Prior to oral argument, Goldman urged the Court to rule that the ultimate burden of persuasion remains with the plaintiff, as consistent with Federal Rule of Evidence 301. But the shareholders argued that the burden remained with the defendant, as held in previous precedent. Once at oral argument, Goldman remained consistent and argued that the federal rules should apply to the *Basic* presumption. Justice Gorsuch pressed Goldman as to how the Court could rule for Goldman without effectively overruling *Halliburton II*. Yet, Goldman distinguished *Halliburton II* and did not concede that this ruling would overrule previous precedent. Nevertheless, both Goldman and the shareholders noted that the Court’s precedent places the burden on the defendant. The Justices, in turn, asked the Government extensively about the implications of deciding the burden issue.

Following, Judge Gorsuch pressed the shareholders on the burden issue, asking how a district judge should analyze a case when the defendant presents credible evidence showing a lack of a direct impact, and the plaintiff provides nothing in response. The shareholders responded simply that the judge could find the defendant prevailed.

Interestingly, Justice Barrett specifically questioned the Government and the shareholders about a contrasting Seventh Circuit's opinion, *In re Allstate Corp. Securities Litigation*,¹³ an opinion authored by Justice Hamilton and joined by then-Judge Barrett. The Government noted that it agrees with the Seventh Circuit's outcome on both issues, specifically highlighting that the Seventh Circuit held that the defendant bears the burden.

Now, the Court must decide whether to provide clarity on the materiality issue and despite clear precedent in the Circuit courts, the Court must determine how to rule on the burden question. While the parties' positions have converged, this case has potential to be outcome-determinative for defendants facing the possibility of class certification in securities litigation. The Court is expected to issue its awaited opinion in June 2021. We are closely monitoring the developments in the case, so please check back for an update when the Court issues its opinion.

¹ *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, No. 20-222 (*petition for cert. filed Aug. 21, 2020*).

² 485 U.S. 224 (1988).

³ *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 283 (2014) (*Halliburton II*).

⁴ 17 C.F.R. § 240.100b-5(b).

⁵ Fed. R. Civ. P. 23(b)(3).

⁶ 485 U.S. at 242.

⁷ *Id.* at 247.

⁸ *Id.* at 248.

⁹ 568 U.S. 455 (2013).

¹⁰ *See id.* at 474.

¹¹ *Halliburton II*, 573 U.S. at 283.

¹² *Ark. Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254 (2d Cir. 2020).

¹³ 966 F.3d 595 (7th Cir. 2020).

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