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## SCOTUS Remands Securities Class Action Back to the 2nd Circuit

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### I. Background

On June 21, 2021, the U.S. Supreme Court issued its opinion in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*,[1] vacating the 2nd Circuit's previous decision and remanding for further consideration as to whether Goldman Sachs rebutted the fraud-on-the-market presumption of reliance by a preponderance of the evidence. Relying on the presumption of reliance established in *Basic*,[2] respondent shareholders ("Plaintiffs") had alleged that Goldman Sachs made material misrepresentations that allowed it to maintain an artificially inflated stock price. Plaintiffs' claims arose from generic statements that Goldman Sachs released in which it claimed that it had a system in place to resolve conflicts of interest. After Goldman Sachs issued the generic statements, it became public knowledge that Goldman Sachs did not, in fact, adequately resolve a conflict of interest. Shortly thereafter, Goldman Sachs's stock price dropped.

Plaintiffs asserted an inflation-maintenance theory, which presumes that investors rely on the market price of a company's security. Specifically, under an inflation-maintenance theory, a misstatement causes a stock price to "remain inflated by preventing preexisting inflation from dissipating from the stock price."[3] Here, Plaintiffs relied on this theory to argue that Goldman Sachs's generic statements regarding conflicts of interest artificially inflated the stock price, which harmed Plaintiffs.

Moreover, to certify a class, Plaintiffs relied on the *Basic* presumption, which allows plaintiffs to presume class-wide reliance based on a fraud-on-the-market theory.[4] The fraud-on-the-

market theory assumes that an investor relies on a misrepresentation, so long as it is reflected in the market price at the time of the transaction.[5] In practice, the *Basic* presumption provides a foothold for plaintiffs to prove that class members, at large, relied on defendants' allegedly false statements.

In *Halliburton II*, the Supreme Court held that defendants may rebut the *Basic* presumption by showing that the alleged misrepresentation did not impact the stock price.[6] However, in *Amgen*,[7] the Court held that materiality should be resolved at the merits stage and should not be considered at the class-certification stage.[8]

After Plaintiffs invoked the *Basic* presumption, Goldman Sachs introduced rebuttal evidence showing the generic nature of the statements and attempting to sever "the link between the alleged misrepresentation and either the price received (or paid) by the plaintiffs, or [their] decision to trade at a fair market price."[9]

Initially, the district court granted class certification, and Goldman Sachs appealed. The 2nd Circuit concluded that the district court failed to properly apply the preponderance-of-the-evidence standard. On remand, the district court again granted class certification, and Goldman Sachs again appealed. This time, the 2nd Circuit affirmed the district court's ruling on class certification, holding that the district court properly concluded that Goldman Sachs failed to rebut the *Basic* presumption. Goldman Sachs appealed, and the Supreme Court granted certiorari.

## II. Ruling

Justice Barrett penned the opinion, which was joined by Chief Justice Roberts, Justice Breyer, Justice Kagan, Justice Kavanagh in full, Justice Thomas, Justice Alito, Justice Gorsuch in part and Justice Sotomayor in part. The Court held:

1. Lower courts should consider the generic nature of an alleged misrepresentation at the class-certification stage as evidence that the alleged misrepresentation had no price impact, even in inflation-maintenance cases.
2. Defendants bear the burden of persuasion to prove a lack of price impact by a preponderance of the evidence at the class-certification stage.

*First*, the Court held that lower courts should consider all probative evidence of price impact at the class-certification stage. The Court noted that "the parties' dispute ha[d] largely

evaporated." At Oral Argument, the parties agreed that lower courts could consider evidence of expert testimony and use common sense in assessing whether a generic statement had an impact on the price. The Court agreed, holding that the evidence of the generic nature of a statement should be considered.

The Court largely adopted the 7th Circuit's decision, *In re Allstate Corp. Securities Litigation*, which was decided by then-Judge Barrett.[10] The Court reasoned that *Halliburton II* required courts to consider **all** relevant evidence. The Court also pointed out that it has repeatedly held that lower courts must ensure all elements of Rule 23 are satisfied, even if that requires a consideration of the merits.

The real dispute, the Court explained, was whether the 2nd Circuit properly considered Goldman Sachs's evidence of the generic nature of the statements. Thus, the Court remanded the case to the 2nd Circuit to consider the entire record.

*Second*, the Court held that defendants bear the burden of persuasion. Goldman Sachs argued that based on the *Basic* presumption, a defendant at the class-certification stage holds only the burden of **production**, not the burden of **persuasion**. In other words, Goldman Sachs had argued that once a defendant rebuts the *Basic* presumption, the plaintiff must carry the burden of persuasion under Federal Rule of Evidence 301.[11]

The Court disagreed with Goldman Sachs. Relying on *Basic* and *Halliburton II*, the Court concluded that defendants carry the burden of persuasion. To hold otherwise would negate *Halliburton II*. Under *Halliburton II*, a plaintiff need not provide direct evidence of price impact in order to invoke the *Basic* presumption. But if a defendant supplied evidence of a lack of price impact, then the plaintiff would have to provide direct evidence.

Nonetheless, the Court explained that it did not expect its ruling on the burden of persuasion to be outcome-determinative for the vast majority of cases. Ultimately, the Court instructed the 2nd Circuit on remand to reevaluate the record and consider all the evidence relevant to price impact, regardless of whether the evidence overlaps with materiality or any other merits issues.

Justice Sotomayor concurred, in part, and dissented, in part. She agreed with the Court's answers to the questions presented but did not agree that the Court should vacate and remand the 2nd Circuit's ruling. Justice Sotomayor opined that the 2nd Circuit "properly considered the generic nature of Goldman's alleged misrepresentations."

Justices Gorsuch, Thomas and Alito also concurred, in part, and dissented, in part. They concurred with the majority's decision that the generic nature of a statement should be considered, but dissented with the Court's holding that the defendant bears the burden of persuasion. The three Justices disagreed with the Court's interpretation of *Basic* and *Halliburton II* regarding the burden of persuasion. In their view, the Court "misse[d] the point" by justifying its disposition partly on the idea that the burden of persuasion would rarely make a difference.

### III. Takeaways

Looking ahead, the decision may not change much, if anything, in future securities class actions. If nothing else, this case signifies that class certification will likely remain a point of heated contention in securities class actions. While initially expected to provide needed clarification in this arena, the Court did not provide much guidance to change lower courts' analysis when certifying a class. However, what's clear is that defendants have been given the green light to submit evidence related to the merits at the class-certification stage. With this authorization, lower courts may now place a stronger burden on plaintiffs to actually combat the "generic" characteristics of alleged misstatements. But, even so, defendants must carry the burden and rebut the presumption.

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[1] *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, 141 S. Ct. 1951 (2021).

[2] *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

[3] *FindWhat Investor Grp. v. FindWhat.com*, 658 F. 3d 1282, 1215 (11th Cir. 2011).

[4] *See Basic Inc.*, 485 U.S. at 241-47.

[5] *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 813 (2011).

[6] *See Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 284 (2014) (*Halliburton II*).

[7] *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 568 U.S. 455 (2013).

[8] *Id.* at 474.

[9] *Basic Inc.*, 485 U.S. at 248.

[10] *See In re Allstate Corp. Sec. Litig.*, 966 F. 3d 595 (7th Cir. 2020).

[11] Rule 301 outlines that a party against whom a presumption is directed has the burden of producing evidence to rebut the presumption, but the rule does **not** shift the burden of persuasion. FED. R. EVID. 301.

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