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Practice Update

Supreme Court Clarifies the Presumptions and Burdens of Proof for Class Certification in Securities Fraud Cases

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The Supreme Court's recent decision in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System* vacated the Second Circuit's class certification in a securities fraud case and gave Goldman a partial win, but it is unclear whether it provides the framework to extend that win to other defendants. A copy of the decision can be found here.

The Court ruled, in the context of certifying a securities fraud class action lawsuit under Section 10(b) of the Exchange Act, that whether an alleged misrepresentation is generic can be probative evidence to rebut a claim that it impacted a corporation's stock price, and to rebut a claim that shareholders relied on the truthfulness of the generic statement when buying or selling stock. The Court also confirmed that to defeat class certification, defendant corporations still bear the burden of proof that a misrepresentation did not impact the stock price.

Background

This case involves the 2008 financial crisis and Goldman's role in the Abacus CDO transaction, its settlement with the SEC, and a consolidated shareholder complaint filed in 2011. Shareholders

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alleged that Goldman violated securities laws by making repeated misrepresentations, which included generic statements about Goldman's conflict of interest policies and business practices.

The Court previously held in *Basic Inc. v. Levinson*, 485 U. S. 224 (1988), that a plaintiff could invoke the "fraud on the market" theory, which is based on the premise that an investor relies on a misrepresentation or omission if it was reflected in the stock's market price at the time of the purchase or sale. The *Basic* presumption is triggered if the shareholders can show (1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the shareholders traded the stock between the time the misrepresentations were made and when the truth was revealed. Defendants, in turn, may rebut the presumption by showing, among other things, that the alleged misrepresentation had no impact on the stock's price.

Plaintiffs in *Goldman* claimed that the stock price was artificially inflated by generic misrepresentations about Goldman's ability to avert risk related to conflicts of interest. The shareholders pointed to generic statements in public filings with the SEC, including, "Our clients' interests always come first," and "[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest." Shareholders claimed that these statements were false and misleading because Goldman was engaging in undisclosed transactions that were tainted by conflicts of interest. They argued that once the market discovered these conflicted transactions, the stock price dropped.

When the Goldman shareholders sought class certification in the Second Circuit, Goldman argued that the representations at issue were generic statements commonly found in SEC filings that did not impact stock price. Goldman also argued that the *Basic* presumption is one of *production* of evidence rather than one of *persuasion*; in other words, Goldman need only produce evidence that the supposed misrepresentations did not impact Goldman's stock price in order to shift the burden to the shareholder plaintiffs, who then must prove that the supposed misrepresentations actually did impact the stock price. The U.S. Court of Appeals for the Second Circuit rejected Goldman's arguments, and certified the Goldman shareholders' class action suit. The Supreme Court remanded the case for further consideration.

Supreme Court Clarifies Basic Presumption Burden

A. Courts should be open to *all* probative evidence in assessing price impact at class certification.

The Supreme Court ruled that all probative evidence should be considered in determining whether a representation impacts stock price, including whether a statement in an SEC filing is generic. The Court held 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" like the one advanced by the Goldman shareholders.

According to the Court, the argument that a certain generic statement impacts stock price "starts to break down," for example, "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')." In this circumstance, it is less likely that the stock price was inflated by generic statements, rather than that the stock price dropping due to later, more specific disclosures. Thus, "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." Based on this reasoning, the Supreme Court reversed the Second Circuit's decision.

B. The *Basic* Presumption Requires a Defendant to *Prove* Lack of Price Impact And Not Merely *Produce Evidence* Showing a Lack of Price Impact

Goldman found less success in its argument that it lacked any burden to show that generic statements did not impact Goldman's stock price. The Court ruled that producing some evidence rebutting price impact is not enough, and that defendants looking to overcome the *Basic* presumption must affirmatively prove a lack of price impact by a preponderance of the evidence. This means defendants must show that it is more likely than not that the claimed misrepresentation had no impact on stock price.

The Court observed that although the defendant bears the burden of persuasion, this burden is unlikely to make much practical difference because in most securities fraud cases, plaintiffs and defendants submit competing expert evidence on price impact.

Will This Decision Significantly Change How Securities Fraud Cases Are Litigated?

Probably not. As the Supreme Court noted, in most cases, plaintiffs and defendants have dueling experts, and it is rare that a defendant might lose simply because it has the burden of persuasion. Similarly, it is also rare—given the prevalence of expert testimony and other evidence of price impact—that a court will rely heavily on whether a misrepresentation is specific or generic when determining impact on stock price.

However, securities fraud cases based on generic misrepresentations may be more likely to be viewed with skepticism by courts after this case. Defendants have more legal authority to defeat class certification in shareholder suits where the plaintiffs' arguments are based on boilerplate disclosures in SEC filings.

Shareholders, on the other hand, will know to look for more specific misrepresentations to claim securities fraud, or to find other compelling evidence of price impact. Akerman is ready to assist with questions about the impact of this ruling. Please feel free to contact any of the authors if you have questions.