

US Supreme Court Reverses Class Certification in 10b-5 Action

Securities Litigation Quick Read

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On June 21, the U.S. Supreme Court issued a decision in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, a closely watched case involving the standards for class certification in securities class actions.^[1]

In *Goldman*, a group of shareholders brought an action against the company, alleging violations of Section 10(b) and Rule 10b-5. The plaintiffs premised their action on a theory of “inflation maintenance,” alleging Goldman maintained an artificially inflated stock price “by making repeated misrepresentations about its conflict-of-interest policies and business practices.”^[2] The alleged misstatements were generic in nature, including statements such as “integrity and honesty are at the heart of our business” and “our clients’ interests always come first.”^[3] The plaintiffs claimed these statements were false and misleading because Goldman failed to disclose that it had participated in conflicted transactions. When those conflicted transactions were publicly revealed, Goldman’s stock price dropped.

After surviving a motion to dismiss, the plaintiffs moved to certify a class. At the certification stage, the plaintiffs sought to invoke the presumption of reliance established in *Basic, Inc. v. Levinson*.^[4] The *Basic* presumption assumes that investors rely on the integrity of the market price for a company’s stock and that an efficient market incorporates all of a company’s material public misrepresentations into the market price. Investors who purchase securities at the market price, therefore, are presumed to have relied on material misrepresentations. In *Goldman*, the company sought to rebut the *Basic* presumption by arguing that its alleged misrepresentations were so broad and generic in nature that they could not have adversely impacted Goldman’s stock price. The district court certified the class, and the Second Circuit eventually affirmed the class certification.^[5]

The company argued the Second Circuit erred in two ways. First, the company argued the Second Circuit erred by concluding that the generic nature of its alleged misrepresentations was irrelevant to determining whether the misrepresentation had an impact on its stock price. Second, the company argued that the Second Circuit erred by placing the burden of persuasion on the company to prove a lack of price impact.

Addressing the company’s first argument, the Court affirmed that the generic nature of misrepresentations is a proper factor to consider in evaluating price impact. The Court noted that generic misrepresentations are less likely to support a plaintiff’s allegations that a company’s stock price was artificially inflated, especially when corrective disclosures are specific in nature. “[T]hat final inference — that the back-end price drop equals front-end

inflation — starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure.”^[6] The Court found the Second Circuit had improperly refused to consider the generic nature of the alleged misstatements.

Addressing the company’s second argument, the Court affirmed the Second Circuit’s ruling that Goldman had the burden of production and persuasion in rebutting the *Basic* presumption. The Court concluded that, after plaintiffs meet their initial burden of establishing the prerequisites for invoking the *Basic* presumption, *Basic* and subsequent cases shift the burden of persuasion to defendants when they seek to rebut that presumption. The Court noted, however, that:

Although the defendant bears the burden of persuasion, the allocation of the burden is unlikely to make much of a difference The defendant’s burden of persuasion will have bite only when the court finds the evidence in equipoise — a situation that should rarely arise.^[7]

The Court held that while the Second Circuit had properly “placed the burden of proving a lack of price impact on Goldman,” the record was not sufficient for the Court to conclude that the Second Circuit had fully considered the generic nature of the alleged misrepresentations.^[8] The Court vacated the Second Circuit’s ruling and remanded the case for further proceedings. The Court’s opinion was narrower than some commentators expected, as the Court did not address issues, such as the validity of the plaintiffs’ underlying “inflation-maintenance theory” or fundamentally alter the *Basic* presumption. Part of the reason for this narrowness is the convergence of arguments over the course of the litigation before the Supreme Court. At oral argument, Justice Barrett observed that, with respect to the parties’ respective positions, “[i]t seems to me that you’ve both moved toward the middle.”^[9] The plaintiffs conceded that the generic nature of Goldman’s statements could be a relevant factor in determining price impact, and Goldman abandoned its earlier contention that generic statements categorically could not impact a company’s stock price.

Despite the relatively narrow opinion, however, the Court’s ruling has important ramifications for defendants in securities class actions, especially at the class certification stage. The Court clarified that, under existing precedent, the generic nature of a company’s alleged misrepresentations is a factor the trial court must consider in evaluating whether defendants can rebut the *Basic* presumption, even when the generic nature of the statements is something that could also be addressed at the merits stage. And, while the Court rejected Goldman’s arguments that plaintiffs should bear the burden of persuasion when the *Basic* presumption is challenged, the Court’s statements suggest that this burden will rarely — if ever — substantively prevent a defendant from rebutting the *Basic* presumption. The Court’s opinion provides important and useful guidance for defendants in future cases, especially where plaintiffs premise their theories of misrepresentation on highly generic statements of corporate policy.

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[1] 594 U.S. ___, 2021 WL 2519035 (June 21, 2021).

[2] *Id.* at *4.

[3] *Id.*

[4] 485 U.S. 224 (1998).

[5] See *Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254, 273-74 (2d. Cir. 2020), *vacated*, 594 U.S. ___, 2021 WL 2519035 (June 21, 2021) (finding the district court had not abused its discretion in certifying the class over Goldman's objections).

[6] 2021 WL 2519035, at *6.

[7] *Id.* at *7.

[8] *Id.*

[9] Oral argument at 1:16:15, *Goldman Sachs Grp., Inc. v. Ark. Tchrs. Ret. Sys.*, No. 20-222 (U.S. Mar. 29, 2021), available at <https://www.oyez.org/cases/2020/20-222> (last visited June 23, 2021).

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