On Monday, June 21, 2021, the U.S. Supreme Court issued its much-awaited decision on the federal securities laws in *Goldman Sachs Grp. v. Arkansas Teachers*’
Retirement Sys., No. 20-222. For the past several years, the Court has addressed important issues affecting the securities bar, and this year was no different. The Court’s decision addressed two important questions that often affect parties at the class-certification stage: (1) whether a court may consider the generic nature of an alleged misrepresentation for purposes of rebutting Basic’s presumption of reliance (i.e., consider whether the statement was so generic that it did not actually affect the issuer’s stock price, which price impact would raise a presumption of indirect market-wide reliance on the statement); and (2) which party carries the burden of persuasion with respect to the presumption of reliance afforded to plaintiffs. The Supreme Court answered the first question in the affirmative, an outcome actually agreed with by both parties to the appeal. With respect to the second question, the Supreme Court found that precedent was clear: defendants “bear the burden of persuasion . . . by a preponderance of evidence.” Although the Supreme Court’s decision addressed both issues head-on, it declined to address other topics, such as the viability of price maintenance theory for establishing loss causation or the continuing viability of its ruling in Amgen Inc. v. Connecticut Retirement Plans and Trust Funds, 568 U. S. 455, 468 (2013), which held that the issue of materiality may not be considered at the class certification stage.

Case Background

The underlying case at issue is a securities class action alleging claims pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, brought by shareholders of Goldman Sachs (“Goldman”) against the bank and several of its executives. The case stems from a collateralized debt obligation (“CDO”) transaction for which Goldman served as the underwriter. According to plaintiffs, Goldman had reason to believe many investors would lose money on the CDO. Shareholders alleged that Goldman materially misled them by stating, inter alia, that the Company had “extensive procedures and controls that are designed to identify and address conflicts of interest” and that its “clients’ interests always come first.” Although the alleged misstatements did not inflate Goldman’s share price at the time the statements were made, plaintiffs alleged that they helped Goldman’s stock maintain an inflated price, which dropped following a series of “corrective” disclosures. This theory of damages has become known as “price maintenance theory” and is increasingly employed by the plaintiffs’ bar.

The issues before the Supreme Court stem from whether a class was properly certified in the case, despite defendants’ arguments that their alleged statements had no effect on Goldman’s stock price. Notably, the case made its way to the Second Circuit Court of Appeals twice before reaching the Supreme Court. On its first trip, the Second Circuit found the district court applied too high a burden to defendants opposing class certification and remanded the case for consideration applying a “preponderance of evidence” not “conclusive proof” standard in showing an absence of price impact / presumption of reliance. On its second trip to the Second Circuit, the panel found that, after remand, the district court had correctly applied a preponderance of evidence standard and, in doing so, appropriately granted class certification because, in the panel’s view, defendants failed to make a sufficient showing of no price impact.

The petition for certiorari followed the Second Circuit’s affirmation of class
Somewhat unusually, by the time the case reached oral argument this spring, the parties were in agreement that a court could consider the generic nature of an alleged misstatement in evaluating whether it impacted a stock’s price, even though that analysis would also be relevant to the merits of the “materiality” element of a federal securities claim addressed at a later stage of the litigation. And so, by March 2021, parties were left to contest which party carries the ultimate burden of persuasion in overcoming Basic’s presumption of reliance.

**Relevant Precedent**

The Supreme Court’s decision, authored by Justice Amy Coney Barrett, focuses on the fraud-on-the-market presumption of reliance, a doctrine established in the seminal 1988 case Basic v. Levinson, 485 U.S. 224, 246-47 (1988). The underlying rationale for the presumption—which affords plaintiffs in federal securities actions a presumption of the element of reliance—is that “an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction.” Erica P. John Fund, Inc. v. Halliburton Co., 563 U.S. 804, 813 (2011). In a series of decisions, the Supreme Court has clarified that defendants may rebut the fraud-on-the-market presumption with (a) “[a]ny showing 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,” Basic, 485 U.S. at 248, or (b) a showing that “an alleged misrepresentation did not actually affect the market price of the stock[,]” Halliburton Co. v. Erica P. John Fund, Inc. (Halliburton II), 573 U.S. 258, 284 (2014).

**The Court’s Decision**

**Courts may consider the generic nature of an alleged misrepresentation at the class certification stage.** In a 8-1 decision on the first question, the Supreme Court’s majority finding was consistent with both parties’ understanding of the law: “[i]n 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.’” Slip Op. at 7 (citation omitted). Notably, the Supreme Court found such analysis to be appropriate even if it “overlaps with materiality or any other merits issue,” id. at 9, which many had believed the Court previously deemed to be improper for consideration during class certification. See Amgen Inc. v. Conn. Ret. Plans & Tr. Funds, 568 U.S. 455, 466-68 (2013) (holding materiality should not be assessed at class certification as it does not bear on Federal Rule of Civil Procedure 23’s class certification predominance requirement). During oral argument at least one of the Justices suggested that it would be nearly impossible for judges to check their common sense at the door. The Supreme Court went on to explain that “[t]he generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the [price]-maintenance theory.” Slip Op. at 8. Ultimately, the issue was remanded for further consideration before the Second Circuit. In her dissent on this issue, Justice Sonia Sotomayor found this particular question was improperly before the Court, believing not only that the Second Circuit had actually considered the generic nature of the statements at issue; but also, that the issue was not properly raised on appeal.
Defendants carry the burden of persuasion in overcoming the fraud-on-the-market presumption of reliance. In finding that defendants “bear[] the burden of persuasion” to rebut the Basic presumption of reliance, Slip Op. at 11, the 6-3 majority on this issue rejected Goldman’s argument that Federal Rule of Evidence 301 applies to the Basic presumption of reliance at class certification and, pursuant to that rule, defendants only carry a burden of producing evidence to rebut the presumption but once that burden of production is satisfied, the burden of persuasion goes back to plaintiffs. According to the Supreme Court, “Rule 301 ‘in no way restricts the authority of a court . . . to change the customary burdens of persuasion’ pursuant to a federal statute.” Slip Op. at 10 (quoting NLRB v. Transp. Mgmt. Corp., 462 U.S. 393, 404 n. 7 (1983)). In this case, the Supreme Court found that Basic and its progeny had in fact changed the customary burdens and made clear that defendants may rebut the presumption only by “show[ing] that the misrepresentation in fact did not lead to a distortion of price[,]” Slip Op. at 10 (quoting Basic, 485 U.S. at 248) (emphasis in original), or by “showing . . . that the particular misrepresentation at issue did not affect the stock’s market price.” Id. (quoting Halliburton II, 573 U.S. at 279) (emphasis in original). Critically, in footnote 4 to the decision, the majority addresses Justice Neil Gorsuch’s dissent, joined by Justices Clarence Thomas and Samuel Alito, and recognizes that “as a general rule, presumptions shift only the burden of production[.]” Slip. Op. at 11 n. 4. The footnote continues, nonetheless, that the majority “read[s the text of] Basic and Haliburton II as a clear departure from that general rule.” Id.

Although defense counsel may be somewhat disappointed by the Supreme Court’s opinion, ultimately the Court cautioned that its holding is “unlikely to make much difference on the ground” (Slip. Op. at 11), explaining that:

In most securities-fraud class actions, as in this one, the plaintiffs and defendants submit competing expert evidence on price impact. The district court’s task is simply to assess all the evidence of price impact—direct and indirect—and determine whether it is more likely than not that the alleged misrepresentations had a price impact. The defendant’s burden of persuasion will have bite only when the court finds the evidence in equipoise—a situation that should rarely arise.

Slip Op. at 12 (citation omitted).

Limitations to the Supreme Court’s Decision

- Parties appear to be in agreement that courts may consider the generic nature of an alleged misstatement at the class certification stage. Nonetheless, in practice it may be somewhat unusual for a defendant to prevail on such an argument, because to do so would suggest that a defendant’s immateriality argument failed on a motion to dismiss, but prevailed at class certification.

- While the Supreme Court found that defendants carry the burden of persuasion in overcoming the fraud-on-the-market presumption of reliance, the Supreme Court itself acknowledged that “the allocation of the burden is unlikely to make much difference on the ground” and “[t]he defendant’s burden of persuasion will have a bite only when the court finds the evidence in equipoise—a situation that should rarely arise.”
The Supreme Court did not address the appropriateness of price maintenance theory, leaving in place a circuit split on the viability of the theory.

The Supreme Court also appears to have pulled back a bit from Amgen’s holding that materiality may not be considered at the class certification stage, to the extent it has now made clear that courts may consider the “generic nature” of a statement (a common materiality issue) on class certification. The Court, however, made no effort to square the possible inconsistency of its previous jurisprudence that the fraud on the market presumption may be rebutted by “[a]ny showing 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[,]” or a showing that “an alleged misrepresentation did not actually affect the market price of the stock[,]” but at the same time may not consider the immateriality of a statement that would sever the link.

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