

Supreme Court issues long-awaited ruling on 'Basic' presumption at class certification

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The briefing in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System et al.* teed up two significant issues for the Supreme Court — first, whether and how a court should consider the materiality (or lack thereof) of an alleged misrepresentation at the class certification stage in deciding whether a class plaintiff may invoke the rebuttable presumption of reliance established in *Basic v. Levinson*, 485 U.S. 224, 246-47 (1988); and second, which party bears the burden of persuasion in connection with that rebuttable presumption. Both questions had the potential to tilt the class certification playing field in favor of either side of the “v.”

On June 23, 2021, the Court held that the generality of an alleged misstatement is relevant to whether that misstatement impacted the price of a security, and courts should therefore consider the materiality of the statement when deciding whether a plaintiff may invoke the *Basic* presumption of reliance at the class certification stage, even if that exercise overlaps with merits issues.

The Court placed the burden of persuasion to rebut the *Basic* presumption on defendants, although it characterized its own decision as “unlikely to make much difference on the ground.” *Goldman* at 12. Now that the dust has settled, it is worth revisiting *Goldman* for a closer look at the impact of the Court’s decision and analysis.

Merits issues are fair game at class certification

At the heart of the *Goldman* case was an apparent tension between two lines of precedent — one governing securities class actions specifically, and the other class actions generally. Before *Basic*, putative class plaintiffs seeking class certification under Rule 23(b)(3) of the Federal Rules of Civil Procedure had to show that issues common to the proposed class predominated over individual issues.

This showing was difficult in securities fraud cases where plaintiffs must prove that each member of a class actually relied on a particular misrepresentation or omission — a requirement that often gave rise to individualized issues that defeated the “predominance” requirement.

In *Basic*, the Supreme Court made this task easier, holding that a plaintiff could invoke a rebuttable presumption of classwide reliance on an alleged misstatement if she could show (1) that the alleged

misrepresentation or omission was public and (2) the security in question traded in an efficient market incorporating the alleged public misstatement.

The rationale for the *Basic* presumption is that when a security trades in an efficient market, its price should reflect the effects of any public misstatements about the security. Under this theory, investors who purchase that security at the artificially inflated price necessarily relied on the alleged misstatement.

A defendant could defeat the presumption by showing the absence of “price impact” — that is, that the alleged misstatement did not affect the price of the security.

Two cases decided 25 years after *Basic* created the conflict resolved in *Goldman*. The Supreme Court held in *Halliburton II*, 573 U.S. 258 (2014), that a defendant is entitled to rebut the *Basic* presumption at class certification. In *Amgen Inc. v. Connecticut Ret. Plans & Tr. Funds*, 568 U.S. 455 (2013), however, the Court held that plaintiffs did not have to prove — and defendants were not entitled to disprove — materiality at class certification because it was a merits issue.

The combined effect of *Halliburton II* and *AmGen* created the dilemma in *Goldman*: Is the immateriality of an alleged misstatement a permissible basis for a defendant exercising its right under *Halliburton II* to attempt to rebut the price impact underpinning the *Basic* presumption at the class certification stage, or is it forbidden territory under *AmGen*’s bar against requiring a plaintiff to prove materiality at the same stage?

The Court itself noted that the parties’ dispute on this issue “ha[d] largely evaporated” by the time the case was argued. The Court agreed with the parties that courts may assess the generic nature of an alleged misrepresentation at class certification even if that inquiry overlaps with the merits question of materiality.

But ultimately, this resolution was grounded less in securities precedents and more in the general class certification principles established in *Comcast Corp. v. Behrend*, 569 U.S. (2013) and *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338 (2011). With perhaps a slight note of exasperation, the Court held that *Comcast* and *Wal-Mart* readily resolved the issue: “[a]s we have repeatedly explained, a court has an obligation before certifying a class to

“determine that Rule 23 is satisfied, even where that requires inquiry into the merits.” *Goldman* at 7.

Accordingly, while the Court’s explicit holding that courts must consider the lack of materiality of a misstatement at class certification is undoubtedly helpful to securities defendants, the impact of the decision should be broader. Read together with *Comcast* and *Wal-Mart*, *Goldman* leaves no room for doubt that courts must consider any and all arguments and evidence concerning whether a plaintiff satisfies Rule 23’s class certification prerequisites, regardless of any overlap with the merits of the case.

Is the *Basic* burden lighter than it once seemed?

Although the Court’s decision that defendants bear the burden of persuasion to overcome the *Basic* presumption appears on its face to favor plaintiffs, the combined effect of the Court’s statements about materiality and the application of the burden shifting structure suggest that plaintiffs may have won the battle but lost the war.

First, the Court clarified that a defendant need only disprove price impact by a preponderance of the evidence. Although this appears to have been the governing standard before *Goldman*, courts sometimes described the defendant’s rebuttal task with phrases like defendant must “conclusively sever the link” between the misstatement and any price impact. This framing appeared to impose a higher burden.

Second, the Court endorsed the notion that the generic nature of an alleged misstatement “often will be important evidence of price impact, particularly in cases proceeding under the inflation-maintenance theory.” *Goldman* at 8.

Third, the Court held that courts “should be open to all probative evidence” on the question of price impact, “qualitative as well as quantitative — aided by a good dose of common sense,” rejecting the idea that price impact is the exclusive terrain of experts. *Goldman* at 7.

Pulling each of these pieces together, the Court described how a court should approach the price impact inquiry. “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.” *Goldman* at 12. Once the test is framed this way, making clear the latitude courts have under the preponderance burden, it is no surprise that the Court played down the impact of placing the burden of persuasion on defendants — “The defendant’s burden of persuasion will

have bite only when the court finds the evidence in equipoise — a situation that should rarely arise.”

When is a statement material under Rule 12(b)(6) but immaterial under *Basic*?

A number of commentators have opined that there is some contradiction between the notion that an alleged misstatement or omission that a court had found sufficiently material to survive a motion to dismiss could nevertheless be too immaterial to support a finding of price impact. But the Court’s analysis actually explains precisely how to thread this hypothetical materiality needle.

The plaintiff in *Goldman* relied on the “inflation maintenance” or “price maintenance” theory, which is itself a means of circumventing the ordinary route to proving price impact and thereby benefitting from the *Basic* presumption. Typically, a shareholder plaintiff alleges a misrepresentation that actually increases the price of a security at the time the statement is made — a price impact link that is easy to discern.

Under the price maintenance theory, however, plaintiffs do not allege that the alleged misstatement increased the price of the stock. Instead, they attempt to show price impact by matching a statement that moved a stock price down with an earlier statement that did not affect the stock price and ask a court to infer that the earlier statement artificially maintained the price of the security, and the downward movement in response to the later statement revealed that artificial inflation.

At the motion to dismiss stage, an alleged misrepresentation is material if there is a likelihood that a reasonable investor would consider it important in making an investment decision. But to take advantage of the *Basic* presumption, the question is not only whether the original statement (which did not move the stock price) was material, but whether it is reasonable to infer from a later drop in the stock price that the alleged misstatement had actually artificially maintained an inflated price.

The key, as the *Goldman* Court recognized, is not solely in the materiality of the first statement, but in the “mismatch” between the original, generic representation and a later, specific alleged corrective disclosure — a mismatch that makes the inference of price impact less reasonable.

There is no inconsistency — or unfairness — in denying plaintiffs the advantage of the shortcut around predominance afforded by *Basic* in the context of cases that are already premised on a shortcut around the price impact foundation of that presumption.

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