

Inside the Courts

An Update From Skadden

Securities Litigators

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Jay B. Kasner

Partner / New York
212.735.2628
jay.kasner@skadden.com

Scott D. Musoff

Partner / New York
212.735.7852
scott.musoff@skadden.com

Susan L. Saltzstein

Partner / New York
212.735.4132
susan.saltzstein@skadden.com

Thania Charmani

Associate / New York
212.735.3502
thania.charmani@skadden.com

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One Manhattan West
New York, NY 10001
212.735.3000

Supreme Court To Examine the Presumption of Classwide Reliance

On December 11, 2020, in the first securities class action case to reach the United States Supreme Court in years, the Court agreed to review a decision by the Second Circuit Court of Appeals that refused to allow defendants to rebut the presumption of classwide reliance by pointing to the generic nature of alleged misstatements to show that the statements had no price impact and granted class certification (*Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System (Arkansas Teachers)*, No. 20-222 (petition for *certiorari* granted)). Class certification is an important battleground in defending securities class actions because the potential exposure creates an *in terrorem* effect that often causes defendants to settle disproportionately to the merits. Without this opportunity to clarify the contours of rebutting the presumption of classwide reliance in a so-called price maintenance case, a defendant's ability to challenge class certification would be limited because, as the dissenting judge in the Second Circuit decision noted, that decision made class certification under the price maintenance theory "all but a certainty."

In particular, the issues before the Court are, first, whether a defendant in a securities class action may rebut the presumption of classwide reliance recognized in *Basic Inc. v. Levinson* by pointing to the generic nature of the alleged misstatements in showing that the statements had no impact on the price of the security, even though that evidence is also relevant to the substantive element of materiality; and second, whether a defendant seeking to rebut the *Basic* presumption has only a burden of production or also the ultimate burden of persuasion. The petition for *certiorari* urged the Court to resolve these questions of "enormous legal and practical importance" to public companies, as reflected by the significant amicus support urging for review.

In addressing these issues, the Court will examine the Second Circuit's holding that statements may be actionable when they merely "maintain" a stock price that is inflated for nonfraudulent reasons. The plaintiffs were successful in arguing that although the alleged misleading statements did not cause a decline in stock price, they maintained an inflated price until the truth was revealed. Although the panel was split on whether the *Basic* presumption had been rebutted, the court affirmed the district court's finding that the defendants failed to rebut the *Basic* presumption by a preponderance of the

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evidence. This decision boiled down to whether the absence of stock price movement in response to earlier press reports allegedly exposing the defendants' conflicts of interest severed the connection between the first alleged corrective disclosure and the drop in stock price. The court held that the connection was not severed because the later corrective disclosure contained "new and material" information in the form of "hard evidence" exposed by a government agency, which was different than the news reports that previously disclosed the alleged conflicts issues. The court also rejected the defendants' argument that the later price drops were caused by the announcement of enforcement actions rather than the underlying factual allegations.

The petitioners argued that the Second Circuit's decision contravenes the Supreme Court's previous decision in *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) (*Halliburton II*). In *Halliburton II*, the Court held that defendants could rebut the *Basic* presumption at class certification by disproving price impact. Petitioners asserted that the Second Circuit's characterization of an inquiry into the nature of the alleged misstatements as merely a "means for smuggling materiality into Rule 23" directly conflicts with *Halliburton II*'s mandate that evidence of price impact should not be "artificially limit[ed]" simply because "such proof is also highly relevant at the merits stage." Petitioners contend that had the Second Circuit considered evidence of the

generic nature of the alleged misstatements when assessing price impact, it would have "easily" resolved the case in the defendant's favor because the alleged statements fall into the class of those routinely deemed "too general to cause a reasonable investor to rely upon them." Petitioners characterized this Goldman case as "the most important securities case to come before the Court since [*Halliburton II*]" because if the Second Circuit's holding is allowed to stand, it will effectively "guarantee" plaintiffs the ability to obtain class certification in actions premised on the "inflation maintenance" theory.

Notably, the Second Circuit's decision conflicts with the recent Seventh Circuit decision in *In re Allstate Corp. Securities Litigation*, 966 F.3d 595 (2020), where the court vacated a class certification order that was based, in part, on the district court's refusal to consider price impact evidence relating to the alleged misstatements. In an opinion joined by then-Judge Amy Coney Barrett, the Seventh Circuit recognized that although Allstate's price impact theory "look[ed] very much like the prohibited defenses of no materiality," the court nonetheless concluded that this "close similarity" did not allow the "district court to refuse to consider a price impact defense at the class certification stage." The Seventh Circuit also held, like the Second Circuit did in *Arkansas Teachers*, that defendants bear the burden of persuasion in rebutting *Basic*.