June 21, 2021

Skadden

Supreme Court Clarifies *Basic* Presumption Burden and Holds Courts Should Consider All Price Impact Evidence

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

One Manhattan West
New York, NY 10001
212.735.3000

On June 21, 2021, the U.S. Supreme Court held in *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System*, No. 20-222 (2021), that courts may consider at the class certification stage the generic nature of alleged misrepresentations as evidence of the lack of price impact in determining whether a defendant has rebutted the presumption of classwide reliance recognized in *Basic Inc. v. Levinson*, even though this may entail overlap with the merits question of materiality. The Court further held that defendants seeking to rebut the *Basic* presumption bear not only the burden of production, but also the ultimate burden of persuasion to prove lack of price impact by a preponderance of the evidence.

Justice Barrett delivered the opinion of the Court, in which Chief Justice Roberts and Justices Breyer, Kagan and Kavanaugh joined in full, and Justices Thomas, Alito, Gorsuch and Sotomayor joined in part. Justice Sotomayor also filed an opinion concurring in part and dissenting in part, and Justice Gorsuch filed an opinion concurring in part and dissenting in part, in which Justices Thomas and Alito joined.

Background

The case arises from a putative securities class action in the Southern District of New York under Section 10(b) and Rule 10b-5 of the Exchange Act, in which the plaintiffs alleged that petitioner Goldman Sachs made material misstatements concerning its procedures for managing conflicts of interest. The alleged misstatements included generic, aspirational statements that are common among issuers (*e.g.*, "[o]ur clients' interests always come first" and "integrity and honesty are at the heart of our business."). The Court previously held in *Basic Inc. v. Levinson* that investor plaintiffs can establish a classwide, rebuttable presumption of reliance if they show that (i) the defendant's misstatements were publicly known, (ii) their shares were traded in an efficient market and (iii) the plaintiffs purchased the shares at market price after the alleged misstatements were made and before the truth was revealed. To invoke *Basic*'s presumption of reliance, the shareholders in *Goldman* relied on the "inflation maintenance" or "price maintenance" theory, which posits that misstatements can artificially maintain an already inflated stock price. Respondents argued that the statements fraudulently inflated the company's stock price, which then dropped when reports of alleged conflicted trans-

Supreme Court Clarifies Basic Presumption Burden and Holds Courts Should Consider All Price Impact Evidence

actions became public. In addition to presenting expert testimony to demonstrate the absence of price impact, Goldman Sachs countered that the *Basic* presumption was rebutted because the alleged misstatements were, by their nature, too general to have any significant impact on a security's price.

In a divided opinion, the U.S. Court of Appeals for the Second Circuit held that considering a statement's generic nature at the class certification stage would "really be a means for smuggling materiality into Rule 23," which is "irrelevant at the [certification] stage" and is unrelated to the issue of whether common questions predominate over individual ones.[1] The court affirmed the certification of the shareholder class, holding that the company failed to satisfy its burden of persuasion to show, by a preponderance of the evidence, that the price decline was due to something other than the alleged misstatements.[2] In a dissenting opinion, Judge Richard Sullivan reasoned that "[o]nce a defendant has challenged the *Basic* presumption and put forth evidence demonstrating that the misrepresentation did not affect share price, a reviewing court is free to consider the alleged misrepresentations in order to assess their impact on price. The mere fact that such an inquiry 'resembles' an assessment of materiality does not make it improper."[3]

The Supreme Court's Decision

The Supreme Court rejected the Second Circuit's approach, holding that although a court cannot consider materiality and loss causation directly at the class certification stage, it can consider the nature of the alleged misrepresentations to the extent that review relates to an analysis of price impact. Reconciling its prior decisions in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds* — in which the Court held that "materiality should be left to the merits stage" — and *Halliburton II* — in which the Court held that defendants may rebut the Basic presumption at the class certification stage, the Court held that in assessing price impact at class certification, courts should be open to all probative evidence on that question "regardless [of] whether the evidence is also relevant to a merits question like materiality."[4] The Court noted the particular importance of the generic nature of an alleged misrepresentation to the price impact inquiry in cases resting on a price inflation maintenance theory, observing that the inference "that [a] 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." In those circumstances, "there is less reason to infer front-end price inflation — that is price impact — from the back-end price drop."[5] The Court concluded that because the Second Circuit's opinion did not make clear whether it had, in fact, considered the nature of the alleged misrepresentations as to price impact, the case should be remanded for further consideration.

While the Court's resolution of the price impact question can be viewed as a win for defendants, the Court also held that defendants bear not only the burden of production in rebutting the *Basic* presumption, but also the ultimate burden of persuasion on that question, rejecting the argument that the burden shifting structure of Rule 301 of the Federal Rules of Evidence applies to the *Basic* presumption. Instead, pointing to language in those precedents requiring defendants to "show" a lack of price impact and to "sever the link" between a misrepresentation and the price paid by a plaintiff, the Court concluded that its decisions in *Basic* and *Halliburton II* had already "assign[ed] to defendants the burden of persuasion to prove a lack of price impact,"[6] Finally, the Court observed that the allocation of the burden of persuasion "is unlikely to make much difference on the ground," because a district court's task is to assess all evidence and decide "whether it is more likely than not that the alleged misrepresentations had a price impact." Accordingly,"[t]he defendants' burden of persuasion will have bite only when the Court finds the evidence in equipoise — a situation that should rarely arise."

Justice Sotomayor concurred in the Court's analysis of both legal questions, but noted in dissent that she would not have remanded the case because, in her view, the Second Circuit did not reject the notion of considering the generic nature of alleged misstatements in evaluating price impact. Justice Gorsuch, in a partial dissent joined by Justices Thomas and Alito, joined the Court's decision as to the use of materiality evidence to rebut price impact, but would have held that Rule 301 applied to the *Basic* presumption and left the burden of persuasion with plaintiffs.

[1] *Arkansas Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254, 267 (2d Cir.), cert. granted, 141 S. Ct. 950, 208 L. Ed. 2d 488 (2020).

[2] *Id.*at 274.

[3] *Id.* at 278.

[4] *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System*, No. 20-222 (2021) at 7.

[5] *Id.* at 8.

[6] *Id.* at 10.

Supreme Court Clarifies Basic Presumption Burden and Holds Courts Should Consider All Price Impact Evidence

The *Goldman* decision adds some constraints to plaintiffs' ability to use the combined impact of the *Basic* presumption and the price inflation maintenance theory to meet their class certification burden. The decision could also serve as a broader mandate to the lower courts to consider all relevant evidence at the class certification stage, even if the same evidence is also relevant to a merits question such as materiality. And although the placement of the burden of persuasion as to price impact on defendants might initially seem to temper that effect, the Court's clarification that district courts need only weigh all evidence of price impact under a preponderance of evidence standard can be viewed as a win for defendants on the whole and reinforces that class certification will continue to be an active battleground in many securities cases.

Contacts

Shay Dvoretzky
Partner / Washington, D.C.
202.371.7370
shay.dvoretzky@skadden.com

Jay B. Kasner
Partner / New York
212.735.2628
jay.kasner@skadden.com

Peter B. Morrison
Partner / Los Angeles
213.687.5304
peter.morrison@skadden.com

Scott D. Musoff
Partner / New York
212.735.7852
scott.musoff@skadden.com

Noelle M. Reed
Partner / Houston
713.655.5122
noelle.reed@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