

Supreme Court: Hears Oral Argument on Whether the *Basic* Presumption Can Be Rebutted by Showing There Was No Price Impact Even Though That Evidence Is Also Relevant to Materiality

05.03.21



(Article from *Securities Law Alert*, April 2021)

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On March 29, 2021, the Supreme Court heard oral arguments in [Goldman Sachs Group v. Arkansas Teacher Retirement System, No. 20-222](#). At issue is whether: (1) the *Basic* presumption of classwide stockholder reliance in Section 10(b) claims can be defeated by showing that the alleged misstatements had no impact on the price of the security, even though such evidence is also relevant to the substantive element of materiality; and (2) whether a defendant seeking to rebut the *Basic* presumption has only a burden of production, or a burden of persuasion as well.

Background

In *Basic v. Levinson*, 485 U.S. 224 (1988), the Court created the “rebuttable presumption” of classwide reliance for plaintiffs asserting Section 10(b) claims on behalf of a putative class of stockholders. The *Basic* presumption can be rebutted with “[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.” *Halliburton v. Erica P. John Fund*, 573 U.S. 258 (2014) (*Halliburton II*) held that courts must consider evidence at the class certification stage offered to show that an alleged misrepresentation had no impact on the price of the relevant security, even if that same evidence would also be “highly relevant at the merits stage.” In so-holding, the Court explained that a defendant is entitled to rebut the *Basic* presumption through any evidence showing that “the asserted misrepresentation (or its correction) did not affect the market price of the defendant’s stock.” In *Amgen v. Connecticut Retirement Plans & Trust Funds*, 568 U.S. 455 (2013), the Court held that plaintiffs need not establish the substantive element of materiality to certify a class. The *Amgen* Court explained that while a plaintiff “must prove materiality to prevail on the merits,” “such proof is not a prerequisite to class certification. Rule 23(b)(3) requires a showing that questions common to the class predominate, not that those questions will be answered, on the merits, in favor of the class.”

The case of *Goldman Sachs Group v. Arkansas Teacher Retirement System* centers on certain disclosures made by the defendant bank between 2006 and 2010 about its business practices, including that: “We have extensive procedures and controls that are designed to identify and address conflicts of interest” and “Our clients’ interests always come first.” Stockholders brought a securities fraud lawsuit alleging that

these statements were false because the bank made them while knowing that it had undisclosed conflicts of interest. The crux of the plaintiff stockholders' claim is that the bank's representations about being conflict free artificially maintained an inflated stock price and that the later revelations of conflicts, such as those presented in an SEC complaint, were "corrective disclosures" that caused the market to devalue their shares. Defendants (the bank and certain of its executives) have characterized the statements at issue as aspirational and generic and argue that they were not material and had no impact on the stock price.

The Second Circuit held that a defendant in a securities class action may not rebut the *Basic* presumption by pointing to the generic nature of the alleged misstatements, because that evidence is also relevant to the substantive element of materiality. *Ark. Teacher Ret. Sys. v. Goldman Sachs Grp.*, 955 F.3d 254 (2d Cir. 2020). The court characterized defendants' proposed test as one that would require courts to ask whether the alleged misstatements were "immaterial as a matter of law" and were merely "a means for smuggling materiality into Rule 23." Defendants petitioned the Supreme Court for a writ of certiorari to review the Second Circuit's decision. The Court granted defendants' petition on December 11, 2020.

Justices Grapple With Whether a Court Can Consider Evidence That Is Relevant to Both Price Impact and Materiality

During oral argument, petitioners' counsel argued that the Second Circuit made two errors. First, the court had "refused to consider the generality of the statements as evidence tending to disprove price impact," which respondents agreed were relevant to the underlying inquiry. Second, petitioners' counsel stated that the court had "erred by holding that the *Basic* presumption shifted the ultimate burden of persuasion to a defendant on the issue of price impact." Petitioners warned that if class certification is permitted on these facts, "any stock drop will inevitably result in a reverse-engineered securities class action" based on generic corporate statements.

Citing *Amgen's* holding that a plaintiff is not required to prove materiality at the class certification stage to invoke the *Basic* presumption, Justice Thomas questioned whether *Amgen* precludes a defendant from disproving materiality at the class certification stage. Petitioners' counsel responded that a defendant can "point to evidence that would also be relevant to materiality at the class certification stage in order to negate price impact[]," arguing that "the mere fact that a court at the motion to dismiss stage says that a case shouldn't be dismissed on materiality grounds doesn't mean that that element has been definitively resolved." Petitioners' counsel advocated the Court to adopt a "sliding scale" approach whereby "the more generic a statement is, the less likely it is to have price impact." In advancing this argument, petitioners' counsel asserted that "the nature of the statements is evidence that simply weighs in the preponderance-of-the-evidence inquiry[]" and that the parties can, but are not required to, submit expert testimony on the issue of how generic the statements are and whether they could have a price impact.

Counsel for the United States as *amicus curiae* supporting neither party, stressed that the parties largely agreed that a defendant may rebut the *Basic* presumption by pointing to the generic nature of the alleged misstatements to show a lack of price impact and expressed approval for the sliding scale approach. When asked by Justice Barrett if there could be implications for materiality if the nature of a statement can be considered on the question of price impact, counsel for the United States responded that "the Court had made clear in, I think, *Amgen* and *Halliburton II*, that just because a particular issue might bear on the merits, that's no reason not to allow the defendant or the plaintiff to bring that issue in at class certification." On the question of the defendant's burden of proof, counsel for the United States stated that "every court of appeals to consider the question, including the Seventh Circuit in *Allstate*,^[1] has held that defendants bear the burden [of production and persuasion]. And that's what we think this Court should hold as well."

Respondents' counsel agreed that "the generic nature of the statement as they use the term is relevant evidence to price impact." However, respondents' counsel argued price impact "ought to be addressed in the first instance and principally by expert testimony, but judges can evaluate that testimony on the basis of common sense." Pressed by Justices Alito and Gorsuch on how a judge should analyze the burden shifting issue, respondents' counsel acknowledged that where a defendant comes forward with credible evidence that there is no price impact from an alleged misstatement, and plaintiff does not offer its own direct evidence, a court can find a lack of classwide reliance.

The Court will issue a decision in *Goldman Sachs Group v. Arkansas Teacher Retirement System* later this Term.

[1] *In re Allstate Corp. Sec. Litig.*, 966 F.3d 595 (7th Cir. 2020).

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