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# Supreme Court to Consider Securities Class Action Issue

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On December 11, 2020, the United States Supreme Court granted certiorari in a shareholder securities litigation against Goldman Sachs.[1] On appeal, Goldman argues that federal securities law permits issuer defendants in purported class actions to rebut the presumption of reliance where the alleged misstatements are of such a generic nature that they could not be expected to have impacted the stock price. The Supreme Court could decide a split between the Second and Seventh Circuits on whether corporations may challenge materiality of the alleged misstatements at the class certification phase of litigation.

The complaint, which was initially filed in 2011, alleges Goldman privately allowed its hedge fund clients to select mortgages that were packaged as collateralized debt obligations, to the detriment of other CDO investors. According to the plaintiffs, this conduct rendered Goldman's public statements about its procedures concerning conflicts of interest materially misleading and artificially maintained the company's inflated stock price, in violation of § 10(b) of the Securities Exchange Act of 1934. Plaintiffs allege that after an SEC enforcement action revealed these issues, Goldman's stock price declined and shareholders lost about $1 billion.

A critical issue in this litigation has been whether Goldman rebutted the "fraud on the market" presumption of reliance set forth by the Supreme Court in *Basic v. Levinson*,[2] which presumes that the market price of a company's shares takes into account all publicly available information about the company – including material misrepresentations.  In challenging the district court's grant of class certification, Goldman argued that its alleged misstatements generally describing its conflicts of interest policies did not sufficiently inflate the company's stock price.  The Second Circuit, however, accepted the plaintiffs' argument that although such statements may not have initially inflated Goldman's stock price, they artificially maintained that inflation.[3]  The Second Circuit also held that evaluating the effect the bank's statements had on its shareholders would impermissibly institute a materiality requirement for class certification under Federal Rule of Civil Procedure 23.  Generally, defendants challenge materiality in motions to dismiss or for summary judgment.  Because it presents a common question for all shareholders, class certification under Rule 23 does not evaluate materiality.[4]

The effect of the Supreme Court's decision in this case could be wide-ranging.  Goldman, along with other critics of the inflation-maintenance theory, have argued that accepting generalized statements at the class certification stage would render it impossible to rebut the fraud-on-the-market presumption of reliance before a class is certified. Notably, this argument was accepted in the Seventh Circuit's recent decision in *In re Allstate Corp. Securities Litigation*, which vacated a class certification order wherein the district court had refused to consider whether the defendant-company's public statements impacted its stock price.[5]  The *Allstate* decision (which was joined by then-Judge Amy Coney Barrett) acknowledged that such evidence "looks very much like the prohibited defenses [at the class certification stage] of no materiality or truth on the market," but nevertheless held that this "close similarity" does not mean a district court can disregard such evidence.[6]  The plaintiffs' bar, on the other hand, has argued that Supreme Court and Second Circuit precedent does not allow materiality determinations at the class certification stage, and allowing price-impact defenses to be made in class certification arguments would effectively amend Rule 23.

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[1] *Goldman Sachs Grp. Inc. v. Ark. Teacher Ret. Sys.*, Dkt. No. 20-222.

[2] 485 U.S. 224 (1988).

[3] *Ark. Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254, 264 (2d Cir. 2020).

[4] *See Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 568 U.S. 455, 468 (2013).

[5] 966 F.3d 595 (7th Cir. 2020).

[6] *Id.* at 602.

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