No. 20-222

IN THE

Supreme Court of the United States

GOLDMAN SACHS GROUP, INC., *et al.*,

Petitioners,

v.

ARKANSAS TEACHER RETIREMENT SYSTEM, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF FORMER SEC OFFICIALS AND LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICI CURIAE*[1]

The *amici curiae* are a group of individuals who have a strong interest in these issues: former officials of the United States Securities and Exchange Commission and law professors whose scholarship and teaching focuses on the federal securities laws. Although each individual amicus may not endorse every statement herein,[2] this brief reflects the consensus of the amici that the petition for certiorari presents exceptionally important questions on the *Basic* presumption and a defendant's right to rebut the same, the lower courts' resolution of these issues was incorrect and threatens to eviscerate that right, and therefore, judicial review by this Court is necessary. In alphabetical order, the *amici curiae* are:

- Brian G. Cartwright – former General Counsel of the U.S. Securities and Exchange Commission from 2006 to 2009;

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amici curiae* or their counsel, contributed money to fund its preparation or submission. All parties were given proper notice and have consented to the filing of this brief pursuant to this Court's Rule 37.2(a).

[2] In addition, the views expressed by *amici* here do not necessarily reflect the views of the institutions with which they are or have been associated whose names are included solely for purposes of identification.

- Ronald J. Colombo – Professor of Law and Dean for Distance Education at the Maurice A. Deane School of Law at Hofstra University;
- Elizabeth Cosenza – Associate Professor and Area Chair, Law and Ethics, at Fordham University;
- The Honorable Joseph A. Grundfest – William A. Franke Professor of Law and Business at Stanford Law School, and Commissioner of the U.S. Securities and Exchange Commission from 1985 to 1990;
- Paul G. Mahoney – David and Mary Harrison Distinguished Professor of Law at the University of Virginia School of Law, and Dean of the same from 2008 to 2016;
- Adam C. Pritchard – the Frances and George Skestos Professor of Law at the University of Michigan Law School;
- Matthew Turk – Assistant Professor of Business Law and Ethics at Indiana University's Kelley School of Business;
- Andrew N. Vollmer – Senior Affiliated Scholar, Mercatus Center at George Mason University; former Professor of Law, General Faculty, University of Virginia School of Law; former Deputy General Counsel of the SEC; and
- Karen E. Woody – Associate Professor of Law at Washington & Lee University School of Law.

SUMMARY OF ARGUMENT

The questions presented in this appeal are extremely important to securities class actions. At stake is whether defendants can rebut the fraud-on-the-market presumption created in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), in opposing class certification, as squarely required by this Court in *Halliburton Co.* v. *Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) ("*Halliburton II*"). In his vigorous dissent from the Second Circuit Panel decision affirming the district court's granting of class certification, Judge Sullivan explained that the Second Circuit's decision has made *Basic* "truly irrebuttable," and class certification "all but a certainty in every case." (Petitioners' App. at 44a.) As detailed below, this result eliminates the careful balance struck in *Halliburton II*. There, this Court did not reverse the judge-made *Basic* presumption, but held that defendants must be afforded the opportunity to show at class certification that alleged misstatements did not have price impact—the premise of the efficient market theory underlying *Basic*. The petition for a writ of certiorari should be granted to make clear to lower courts the proper approach that should be taken in securities cases, and to remediate the significant consequences of the Second Circuit's nullification of *Halliburton II* in the leading circuit for securities cases and the center of the nation's financial markets. In short, lower courts (like the Second Circuit in its decision below) are frustrating the objectives of *Halliburton II*, and this Court should put an end to it.

These questions take on heightened importance amid the emerging trend of securities class action

plaintiffs relying on the novel "inflation maintenance" theory. This theory, never before sanctioned by this Court, posits that a class may be certified where an alleged misstatement does not itself introduce inflation into the stock price, but simply *maintains* inflation previously introduced through some other, even nonfraudulent, means. Coupling such an expansive view of price impact with such a restrictive view of the right to rebutting price impact recognized in *Halliburton II* all but ensures near-automatic class certification in inflation maintenance cases. That is, a class will almost always be certified any time a public company makes generic or aspirational disclosures about mitigating risk or engaging in best practices (as nearly all public companies do) and then suffers a stock price drop. That cannot be consistent with the aim and holding of *Halliburton II*. Simply put, if the Second Circuit's decision stands, companies will be almost defenseless against plaintiffs' class certification arguments that will become *de facto* irrebuttable.

ARGUMENT

I. THE SECOND CIRCUIT'S PRICE IMPACT ANALYSIS VIOLATES *HALLIBURTON II*.

A. The Second Circuit's Holding Nullifies This Court's Compromise in *Halliburton II* Regarding the *Basic* Presumption.

In affirming the district court's legally and factually flawed class certification order, the Second Circuit rendered this Court's decision in *Halliburton II* a *de facto* nullity. *Halliburton II* reflected a compromise between the two diametrically opposed arguments represented in that case: securities class action defendants urged that *Basic*'s fraud-on-the-market presumption be overruled, while securities class action plaintiffs urged that defendants not have any opportunity to rebut the fraud-on-the-market presumption at class certification.[3]

Since this Court's creation of the fraud-on-the-market presumption in *Basic*, courts have struggled with the presumption's practical application. In *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011) ("*Halliburton I*"), this Court addressed some of the ambiguity surrounding *Basic* by rejecting the argument that plaintiffs must affirmatively show loss causation to invoke the fraud-on-the-market presumption. The Court reasoned that loss causation did not relate to whether an investor had *relied* on a misrepresentation "either directly or presumptively through the fraud-on-the-market theory." *Id.* at 813. Two years later, in *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455 (2013), this Court seemingly leaned further in the direction of securities fraud class action plaintiffs, holding that plaintiffs need not establish materiality prior to class certification.

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[3] *See* Donald C. Langevoort, *Judgment Day for Fraud-on-the-Market: Reflections on Amgen and the Second Coming of Halliburton*, 57 ARIZ. L. REV. 37, 46-47 (2015).

With *Halliburton I* and *Amgen* handed down two years apart, this Court appeared to be steadily lowering the bar for securities fraud class action plaintiffs to advance their cases. In *Halliburton II*, Chief Justice Roberts (joined by Justices Kennedy, Ginsburg, Breyer, Sotomayor and Kagan) reaffirmed the viability of the fraud-on-the-market presumption. Importantly, while reaffirming *Basic*, the Court in *Halliburton II* provided much-needed clarity on ***how*** to apply the fraud-on-the-market presumption in practice. The middle ground established by the Supreme Court in *Halliburton II* provides that defendants in securities fraud class actions ***must*** be afforded an opportunity to rebut the fraud-on-the-market presumption of reliance "with evidence of a lack of price impact . . . before class certification." 573 U.S. at 277. Although the majority opinion failed to overturn *Basic* and held that plaintiffs need not prove price impact to first *invoke* the fraud-on-the-market presumption, the Court also made clear that defendants are entitled to an opportunity to rebut the *Basic* presumption at class certification by presenting evidence that severs the link between the alleged misrepresentations and the stock price. *Id.* at 279–80. Significantly, in so holding, the *Halliburton II* Court cited *Basic*'s own lenient expression of the standard for securities fraud class action defendants to break that link: "[*a*]*ny* showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff" for the shares in question. *Id.* at 281 (citing *Basic*, 485 U.S. at 248) (emphasis added).

This Court's decision in *Halliburton II* reflects a carefully constructed compromise between the apparently plaintiff-friendly trend in *Halliburton I* and *Amgen*, and the defendants' contention in *Halliburton II* that *Basic* be overruled entirely. In many ways, this compromise represents a recognition of what was implicit in *Basic*: (i) the presumption of fraud-on-the-market is exactly that, only a presumption, and as such, is rebuttable; and (ii) evidence introduced by defendants demonstrating the absence of price impact before class certification will break the link between the challenged statements and the stock price, thereby defeating that presumption. *See* 573 U.S. at 268–69. The Second Circuit here has nullified defendants' opportunity to rebut the *Basic* presumption at the class certification stage, undermining this Court's work in crafting this delicate compromise.

B. The Second Circuit Defied *Halliburton II* by Refusing to Consider the Nature of the Challenged Statements as Price Impact Evidence.

The Second Circuit incorrectly viewed evidence about the generic nature of challenged statements as "a means for smuggling materiality into Rule 23" in violation of *Amgen*. (Petitioners' App. at 21a, n.11 & 22a.) But nothing in *Amgen* prohibits a court from considering at class certification the generality or specificity of the alleged misstatements, which directly bears on price impact. (*See id.* at 45a.) In imposing a blanket prohibition against such evidence,

the Second Circuit misconstrued *Amgen* in much the same manner as the Fifth Circuit in *Halliburton II*, which prompted this Court's reversal in that case.

In *Amgen*, this Court held that proof of materiality is not a prerequisite to certification of a securities fraud class action. *See* 568 U.S. at 459. Even though materiality is a precondition to *Basic*'s fraud-on-the-market presumption, the Court reasoned, "As to materiality . . ., the class is entirely cohesive. It will prevail or fail in unison." *Id.* at 460. In so ruling, the *Amgen* majority also affirmed the district court's refusal to consider Amgen's "truth-on-the-market" rebuttal evidence at the class certification stage. *Id.* at 481.

On this basis, between *Halliburton I* and *Halliburton II*, the Fifth Circuit concluded that defendants could not offer evidence of a lack of price impact at class certification. *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423 (5th Cir. 2013), vacated and remanded by 573 U.S. 258 (2014). Applying *Amgen*, the Fifth Circuit reasoned that price impact evidence may ***not*** be considered because, like materiality, price impact does not bear on common question predominance under Federal Rule of Civil Procedure 23. *Id.* at 432.

The Fifth Circuit made the same error as the Second Circuit did here: because "[t]he price impact evidence considered here is both similar to and offered for much the same reason as the materiality evidence" that this Court in *Amgen* held should not be considered at class certification, the Fifth Circuit refused to credit Halliburton's contention that it was challenging reliance, not materiality, through its

truth-on-the-market defense. *Id.* at 434 n.10. This Court rejected the Fifth Circuit's analysis in *Halliburton II*.

There, this Court explained that, even though the same issues counseling against considering materiality evidence could also apply to weighing price impact evidence at class certification, "[p]rice impact is different. The fact that a misrepresentation 'was reflected in the market price at the time of the transaction'—that it had price impact—is '*Basic*'s fundamental premise.' It thus has everything to do with the issue of predominance at the class certification stage." *Halliburton II*, 573 U.S. 258, 281, 283 (internal citation omitted).

Even though the same evidence often bears on price impact and materiality, *Halliburton II* holds that, notwithstanding *Amgen*, price impact evidence may be considered at class certification, not for the purpose of rebutting materiality or rearguing a court's decision on the sufficiency of the complaint's pleading of materiality, but to demonstrate a lack of price impact and thereby to rebut the *Basic* presumption.

Indeed, the Second Circuit's decision is inconsistent with the Seventh Circuit's recent decision in *In re Allstate Corp. Securities Litigation*, 966 F.3d 595 (7th Cir. 2020), which properly held that the district court violated *Halliburton II* by failing to consider permissible price impact evidence at class

certification.[4] The Seventh Circuit vacated the district court's class certification order based on *Halliburton II*'s holding that a court may not ignore price impact evidence because it implicates merits-stage elements of the claim. In its opinion, the Seventh Circuit underscored the "challenge" courts face in reconciling *Halliburton I*, *Amgen*, and *Halliburton II* because they must "(a) decide whether reliance can be proven by common evidence without (b) delving too far into the merits of the materiality or falsity of the representations at issue, while still (c) reserving loss causation entirely for the merits phase[.]" *Id.* at 608. Consistent with these principles, the Seventh Circuit permitted defendants to introduce an expert report at class certification showing that (1) there was "no statistically significant increase in Allstate's stock price following any of the alleged misrepresentations" and (2) "the alleged misrepresentations could not [*i.e.*, as matter of logic]

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[4] The Second Circuit decision also deepened a circuit split between the Second and Seventh Circuits on the one hand, which each held that the burden of persuasion rests with a defendant attempting to rebut the *Basic* presumption, *see Ark. Teachers Ret. Sys. v. Goldman Sachs Grp., Inc.*, 879 F.3d 474, 484-85 (2d Cir. 2018), *Waggoner v. Barclays PLC*, 875 F.3d 79, 104 (2d Cir. 2017), *In re Allstate Corp. Securities Litigation*, 966 F.3d 595, and the Eighth Circuit on the other hand, which held that under Federal Rule of Evidence 301, the burden of production shifts to the defendant when the plaintiff makes a prima facie showing of market efficiency, but the burden of persuasion always rests with the plaintiff. *See IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775 (8th Cir. 2016).

have had price impact because Allstate's growth strategy . . . was publicly disclosed in the Company's conference calls prior to the alleged Class Period, was covered in analyst reports on the Company prior to and at the beginning of the alleged Class Period and, in an efficient market, would have already been impounded into Allstate's stock price." *Id.* at 611. Such evidence—similar to the evidence profferred by Petitioners here—should have been considered by the district court as price-impact rebuttal evidence, the Seventh Circuit held, even though it undoubtedly implicated the separate element of materiality. *Id.*

The Seventh Circuit's approach is more consistent with *Halliburton II*. Any other reading of these cases creates a conflict between this Court's *Amgen* and *Halliburton II* rulings, requiring district courts to undertake the impossible task of parsing permissible price impact evidence from impermissible materiality evidence. As Judge Sullivan persuasively observed, "I don't believe that such rigid compartmentalization is possible[.]" (Petitioners' App. at 45a.) Without an affirmation from this Court that, under *Halliburton II*, price impact evidence may be presented at the class certification stage to rebut the *Basic* presumption, even if the evidence also implicates materiality, lower courts will continue to violate *Halliburton II* and deny defendants the opportunity to rebut the *Basic* presumption with permissible evidence. That is, although price impact resembles materiality, it would be "fair" for courts "to consider the nature of the alleged misstatements in assessing whether and why" there was no price impact. (*Id.* at 44a.)

C. If Left Uncorrected, the Second Circuit's Decision Will Adversely Impact Public Companies.

The Second Circuit's decision impermissibly limits the price impact evidence that district courts can consider at class certification. Here, the Second Circuit barred consideration of the generic nature of the alleged misstatements, reasoning that the issue should be dealt with at the pleading stage. (Petitioners' App. at 20a n.10.) But that is often not what happens in practice. At the pleading stage, plaintiffs regularly argue that materiality is a mixed question of law and fact, and accordingly cases dealing with generic statements oftentimes are not resolved on materiality grounds at the pleading stage. This Court should make clear that district courts must consider all relevant price impact evidence (even if it overlaps with materiality) at the Rule 23 stage.

The Second Circuit's decision here risks draconian practical consequences because publicly traded companies *routinely* include generic statements of corporate principle similar to those at issue here in their public filings. The publication of these anodyne statements combined with a later stock price drop should not give rise to automatic class certification, even if shareholders happen to lose money.

These risks are particularly heightened during the ongoing COVID-19 crisis, where aspirational statements about best practices amid a fast-moving global pandemic can be weaponized by plaintiffs and turned into a predicate for a securities fraud class action, as securities markets around the world are

extremely volatile. For example, companies in the airline, hospitality, and related industries that make generic disclosures about business principles (*e.g.*, "Customer safety always comes first," "We meet the highest standards of cleanliness," or "We value the safety of all our employees") now face the prospect of *investor* securities class action lawsuits after a stock price drop in the event of a new COVID-19 outbreak or another pandemic effect. Granting class certification in such cases is contrary to this Court's precedent and Congressional intent as reflected in the Private Securities Litigation Reform Act. *See Halliburton II*, 573 U.S. at 277 (explaining that the PSLRA was enacted "to combat perceived abuses in securities litigation with heightened pleading requirements, limits on damages and attorney's fees, a 'safe harbor' for certain kinds of statements, restrictions on the selection of lead plaintiffs in securities class actions, sanctions for frivolous litigation, and stays of discovery pending motions to dismiss"); *see also Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005) ("The securities statutes seek to maintain public confidence in the marketplace . . . by deterring fraud, in part, through the availability of private securities fraud actions. . . . But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause."). The private right of action under the securities law is not intended to function as a guarantee against stock price declines, especially in times of crisis.

II. THE COURT SHOULD PROVIDE CLARITY ON REBUTTING THE *BASIC* PRESUMPTION GIVEN THE RISING PREVALENCE OF INFLATION MAINTENANCE CASES NATIONWIDE.

The inflation maintenance theory permits plaintiffs to argue that certain statements can be actionable if they merely *maintained* an already inflated stock price. *See In re Pfizer Inc. Sec. Litig.*, 819 F.3d 642, 659 (2d Cir. 2016). Here, the Second Circuit applied the inflation maintenance theory to generalized statements of corporate principle, an unprecedented expansion of an already expansive theory.

The only two circumstances in which any court had previously applied the price maintenance theory involved alleged misstatements that (1) were unduly optimistic statements about specific, material financial or operational information made to stop a stock price from declining;[5] or (2) falsely conveyed that the company had met market expectations about a specific, material financial metric, product, or event.[6] In any event, whatever the merits of this theory, general statements that companies routinely make in

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[5] *See, e.g.*, *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223 (2d Cir. 2016); *Schleicher v. Wendt,* 618 F.3d 679 (7th Cir. 2010).

[6] *See, e.g.*, *FindWhat Inv'r Grp. v. FindWhat.com*, 658 F.3d 1282 (11th Cir. 2011); *Alaska Elec. Pension Fund v. Pharmacia Corp.,* 554 F.3d 342 (3d Cir. 2009).

corporate disclosures, like the ones at issue in this case, cannot "maintain" an inflated stock price.

Plaintiffs' reliance on the theory comes as no surprise given the recent surge in inflation maintenance cases filed by securities class action plaintiffs across the country, and defendants' extraordinarily low success rates in rebutting the *Basic* presumption in such cases. (Petitioners' App. at 19a n.9.) This trend makes the inflation maintenance theory susceptible to abuse at class certification, especially if it is transformed into a catch-all for securities fraud plaintiffs to certify investor classes based simply on a stock drop, even when the challenged statements were too general to cause any price impact. If allowed to become a catch-all in this way, it would be in direct contradiction to this Court's precedent, *see Halliburton II*, 573 U.S. 258, and would result in effectively eliminating the price impact requirement altogether.

Given the risk of abuse of the inflation maintenance theory at class certification, it is particularly important that this Court provide clarity on what evidence courts can consider in determining whether a defendant has rebutted the fraud-on-the-market presumption. Otherwise, plaintiffs nationwide will continue to benefit from the *Basic* presumption, which depends on price impact, even in cases like this where, under the inflation maintenance theory, there is no evidence of price impact.

CONCLUSION

For the foregoing reasons, the *amici curiae* believe that this Court should grant petitioners' petition for a writ of certiorari.

Respectfully submitted,

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