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.

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

BRIEF OF AMERICAN INTERNATIONAL GROUP, INC. AND CHUBB GROUP HOLDINGS INC., AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*[1]

American International Group, Inc. ("AIG") and Chubb Group Holdings Inc., through its licensed insurance subsidiaries ("Chubb"), are two of the world's leading providers of insurance products. These include directors and officers liability policies ("D&O"), which, subject to various terms and conditions, provide coverage for the costs of defending and resolving lawsuits alleging certain wrongdoing by directors, officers, or their organizations. AIG and Chubb extend D&O policies to thousands of companies, organizations, and individuals in the United States—from multinational public companies to privately held businesses to nonprofits and their board members.[2]

In this role, *Amici* have repeatedly witnessed what this Court and many commentators have observed: the certification of a plaintiff class creates massive litigation risk—especially in securities-fraud cases, where class-wide damages often run into the billions of dollars. And as this risk intensifies, insureds can face intense pressure to settle the litigation before they have an opportunity to test the merits of the underlying claims. That pressure impacts not only securities defendants, but also their insurers, and the D&O insurance market as a whole. *Amici* therefore have a strong interest in ensuring that courts considering class certification undertake

[1] Pursuant to S. Ct. Rule 37.6, counsel for all parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part and no person or entity other than *Amici*, their members, or counsel made a monetary contribution to its preparation or submission.

[2] AIG and Chubb provide D&O insurance to Goldman Sachs, among many other clients. While it is possible that *Amici* could have a direct financial interest in the outcome of this litigation, neither is aware of any such interest at this time.

the rigorous analysis required by this Court's precedents and Federal Rule of Civil Procedure 23. This means the presumption of reliance in securities class actions must be—not just in name but in fact—a true presumption that can be rebutted by relevant evidence.

SUMMARY OF ARGUMENT

1. *Amici* are repeat players in, and regular observers of, a wide array of securities cases. From this vantage point, *Amici* have witnessed a troubling, recent trend: the steady rise of "event-driven securities litigation." In these event-driven cases, investors and their attorneys reverse-engineer a securities fraud to fit a corporate controversy that coincides with a decline in stock price—an approach that is directly contrary to this Court's admonition against transforming allegations of corporate mismanagement into securities fraud.

The playbook is now familiar: plaintiffs in event-driven cases invoke the "price maintenance" or "inflation maintenance" theory of securities fraud. Under this theory, which this Court has never approved, plaintiffs contend that a company's prior statements "maintained" an inflated stock price until the controversy surfaced, revealing the purported truth. These statements supposedly "impacted" the company's stock price by preventing it from declining.

Frequently, event-driven claims allege that generic or aspirational statements, similar to ones made by virtually every public company, maintained inflation in a company's stock price. Allegations of wrongdoing nearly always conflict, at some level of generality, with a company's code of conduct or other statements of corporate policy. So it is not difficult for plaintiffs to allege that negative reporting or disclosures "corrected" a prior, generic policy statement (*e.g.*, "We strive to comply with all applicable laws."). The result is that just about any corporate controversy that coincides with a drop in stock price can be re-characterized as a securities fraud. Examples abound. COVID-19 exposure on cruise ships, wildfires, data breaches, and sexual-harassment allegations have all served as grounds for event-driven claims of securities fraud supposedly tied to generalized statements.

Event-driven securities suits are also a double-punishment of the target company and its stakeholders. In many of these cases, the parties directly injured by the company's alleged misconduct have already brought a separate litigation (individually or as a class) under laws directly governing that conduct (*e.g.*, negligence or anti-discrimination laws). The event-driven securities claims are follow-on litigations by investors seeking to hold the company *doubly* liable for the alleged wrongdoing, which they allege shows the falsity of a company's code of conduct, annual reports, or other generic statements.

These event-driven securities cases routinely proceed to class certification without any proof that the alleged, generalized statements in fact impacted (by maintaining supposed inflation of) the stock price, as required for the presumption of reliance established in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), to apply.

2. This Court has long recognized the *in terrorem* effect that class certification has on defendants, pressuring them to settle even the most questionable claims. *See, e.g.*, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 350 (2011). That pressure is even more pronounced

in securities-fraud class actions, which, because of the potential for outsized damages, pose "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975).

The emergence of event-driven securities litigation has only increased the well-recognized "hydraulic pressure" to settle that class certification imposes on defendants. *See, e.g., Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 164-65 (3d Cir. 2001), as amended (Oct. 16, 2001). Securities-fraud cases in general are rarely adjudicated on the merits: only 14 cases filed since 2001 have been tried.[3] During that time period, only around 5% of securities-fraud class action settlements took place after a ruling on summary judgment.[4] The rest—the vast majority—were settled before the summary-judgment phase was completed. The impetus to settle event-driven cases is even greater. Compared to traditional securities-fraud cases, event-driven securities litigation involves increasingly long class periods. This leads to even greater exposure to damages, often in the many billions of dollars, and—accordingly—increased settlement pressure.

All public companies and their insurers are at risk. The stock-exchange rules *require* public companies to keep and publish aspirational codes of conduct, which

[3] Stanford Law School Securities Class Action Clearinghouse and Cornerstone Research, *Securities Class Action Filings: 2020 Year in Review*, (forthcoming Feb. 2, 2021).

[4] Based on analysis by Cornerstone Research of securities class action settlements from 2001 to 2020 and data from Stanford Securities Litigation Analytics (SSLA), available via subscription at https://sla.law.stanford.edu/.

companies often incorporate by reference into their annual reports. These codes invariably state the company's desire to avoid conflicts of interest and maintain workplace environments free of discrimination and unlawful conduct. And public filings often include generic statements about their commitments to safety, equal-opportunity employment, and compliance with applicable laws. So with each new controversy, enterprising plaintiffs' attorneys can easily locate generalized policies to serve as the purported misleading statements that supposedly maintained stock inflation. This Court has long rejected the practice of converting allegations of corporate mismanagement into securities fraud. *See Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977). But that is precisely what the court of appeals' decision encourages.

3. Class certification in securities actions typically depends on the presumption of reliance afforded under the fraud-on-the-market theory accepted in *Basic*. Given the importance of class certification, this Court confirmed in *Halliburton II* that only statements that truly had "price impact" should be sufficient to invoke *Basic*'s presumption of reliance. *See Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) ("*Halliburton II*"). If a statement did not affect the company's stock price, there is no basis to presume investors relied on the statement by relying on the integrity of price in an efficient market.

Generic or aspirational statements similar to those made by every public company are unlikely to affect a company's stock price. Allowing defendants to point to the statements themselves as evidence of a lack of price impact does not, as the lower court believed, "smuggl[e] materiality" into class-certification proceedings. It simply permits defendants to adduce evidence directly relevant to class certification. Artificially excluding this evidence, as the lower courts have done, renders the *Basic* presumption effectively irrebuttable, especially in event-driven litigations. Rule 23 and this Court's cases require more. The court of appeals' decision to the contrary should be reversed.

ARGUMENT

I. Event-Driven Securities Litigation Has Increased Substantially in the Past Few Years

1. Event-driven securities litigation can transform nearly every allegation of corporate negligence or misconduct into securities fraud.[5] It was not always this way. For decades, fraud allegations focused on *financial* disclosures, where the "biggest disaster was an accounting restatement." John C. Coffee, Jr., *The Changing Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions*, CLS Blue Sky Blog (Jan. 22, 2019), tinyurl.com/clschanging. Now, as Professor Coffee explained, "the biggest disaster may be a literal disaster: an airplane crash, a major fire, or a medical calamity that is attributed to your product." *Id.*

This sea change began in the late 2010s, following the *Halliburton II* decision. In 2017, the number of securities filings doubled the average for the prior 20 years.[6] Since then, the number of event-driven cases has

[5] *See* Matt Levine, *Everything Everywhere Is Securities Fraud*, Bloomberg (June 26, 2019), tinyurl.com/EverythingSecFraud.

[6] Stanford Law School Securities Class Action Clearinghouse and Cornerstone Research, *Securities Class Action Filings: 2017 Year in Review*, at 1 (Jan. 30, 2018), tinyurl.com/CR2017YIR.

skyrocketed—growing 40% since 2018.[7] These securities-fraud cases cover nearly every type of corporate misconduct or negligence making headlines, including data breaches, workplace sexual harassment, opioid labeling, and more than two dozen cases related to the COVID-19 pandemic.

2. The inflation-maintenance theory has fueled this litigation boom. Under this theory, "statements that merely maintain inflation already extant in a company's stock price, but do not add to that inflation, nonetheless affect a company's stock price." *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 256 (2d Cir. 2016). In other words, the alleged misstatements in such cases are presumed to have "price impact"—not because they increase the company's stock price, but because the price supposedly would have fallen had the company told the purported truth.

It is one thing to invoke the inflation-maintenance theory for statements that confirm earlier price-moving representations. For example, a company's stock price might rise on reports of anticipated earnings increases or improved financial results. A later company statement confirming those positive reports—especially in response to skepticism by analysts—could indeed maintain an artificially inflated stock price, if the company knew the reports to be false. Early inflation-maintenance cases were based on either statements confirming the market's existing expectations or omitting negative financial information. *See, e.g.*, *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342 (3d Cir. 2009); *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010);

[7] *See* Harvard Law School Forum on Corporate Governance, *Event Driven Securities Litigation* (Dec. 18, 2020), tinyurl.com/harvevent/.

FindWhat Inv'r Grp. v. FindWhat.com, 658 F.3d 1282 (11th Cir. 2011).

But it is another thing altogether to apply the inflation-maintenance theory as it is typically used in event-driven litigations. The plaintiffs in event-driven cases ordinarily do not identify any prior misrepresentation that allegedly inflated the defendant company's stock price. The only alleged misrepresentations are ones that supposedly maintained price inflation, often through generic or aspirational statements of corporate policy. And the only evidence of inflation is the stock-price decline when the alleged misconduct comes to light. But allegations of corporate misconduct are often accompanied by other events that drag on the company's stock price (like government investigations or other civil litigations related to previously publicized events). So the price drop that prompts the securities-fraud suit may not reveal any prior inflation or cast doubt on the integrity of the securities markets. This is especially likely if the alleged misrepresentations are generic statements similar to those made by virtually every public company.

Often, plaintiffs locate these statements in corporate codes of conduct or other sources that investors would not realistically rely on when making investment decisions. Stock exchange rules and SEC regulations require companies to keep codes of conduct and publish them on company websites. *See* NYSE Listed Company Manual § 303A.10; 17 C.F.R. § 229.406. Pursuant to the Sarbanes-Oxley Act of 2002, the U.S. Sentencing Commission has also implemented guidelines that strongly encourage companies to take affirmative efforts to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law," such as the maintenance of codes of conduct. U.S.S.G. Manual § 8B2.1(a)(2).

The policies articulated in these codes are generic and aspirational. They express, for example, a company's commitment to "operating in compliance with all laws and policies" or to "protect the environment" or to "provide a fair workplace for all." Even where the policies are more specific, they define standards of conduct; they are not factual reports of specific events. Codes of conduct are undoubtedly important elements of a company's "corporate culture," but it is fanciful to suggest that investors read and rely on such statements as they would press releases about company developments and earnings reports. And the codes exist—often unchanged—throughout the class period. These statements are often repeated year after year in company annual reports. Treating codes of conduct and other generic statements as inflation-maintaining frauds is not just unrealistic—it creates perverse incentives. It tells companies they should dilute standards of conduct or fill them with caveats to avoid claims of securities fraud.

Consider the statements purporting to support securities-fraud claims against cruise companies in the wake of the COVID-19 pandemic. Norwegian Cruise Lines' code of ethics states: "You shall comply with all applicable laws and regulations and are expected to deal honestly, ethically and fairly with customers . . . ." Carnival Corporation's annual report proclaims: "We are committed to operating a safe and reliable fleet and protecting the health, safety and security of our guests." Both are generic statements similar to those made by many companies. Yet, according to these event-driven suits, both statements defrauded the cruise lines' stockholders, and the truth was revealed when news broke of alleged COVID-19 exposure onboard.[8] No one should be exposed to COVID-19 unnecessarily, and if any negligence or other violations of law occurred, there are laws designed to hold companies accountable for those errors. But the specific facts concerning the alleged COVID-19 exposure are not discussed in the companies' ethical codes or anodyne commitments to public safety. Those aspirational statements did not "maintain" an inflated stock price and they were not "corrected" by reports of infected passengers.

These lawsuits are among the latest in a series of event-driven class actions that retrofit allegations of securities fraud to match all manners of corporate malfeasance. The inflation-maintenance securities cases related to the pandemic were preceded by a wave of inflation-maintenance cases focusing on workplace sexual harassment. There, generic, aspirational statements in codes of conduct expressing a commitment to providing a fair workplace and treating all employees with respect were repurposed as inflation-maintaining frauds after company executives were accused of sexual harassment.[9] The securities-fraud allegations against Goldman Sachs in this case are the residue of a yet earlier era of alleged misconduct—the global financial crisis of the late 2000s.

Not every bad act defrauds investors. Section 10(b) was never designed to be a roving commission for

[8] *See* Complaint ¶¶ 46, 221, *In re Carnival Corp. Sec. Litig.* No. 20-cv-22202-KMM (S.D. Fla. Dec. 17, 2020) (Dkt. 52); Complaint ¶ 113, *Douglas v. Norwegian Cruise Lines, et al.*, No. 20-cv-21107-RNS (S.D. Fla. July 31, 2020) (Dkt. 56).

[9] *See supra*, n.7.

stockowners and their lawyers to police all forms of corporate misconduct. *See Green*, 430 U.S. at 479. Yet, through event-driven securities lawsuits, lower courts have permitted plaintiffs to do just that.

3. As the above discussion demonstrates, event-driven securities cases also create the potential for duplicative liability—and the ancillary securities liability risk may be much larger than the alleged damages in the primary case targeting the alleged misconduct. For example, if a company's executives allegedly engage in sexual discrimination, the company may owe damages to the injured parties. And, encouraged by the court of appeals' decision, it may also face an event-driven lawsuit by investors who claim they were defrauded by a statement that the company is an equal-opportunity employer. The investor plaintiffs are not directly harmed by the underlying wrongdoing. But if reports of discrimination are accompanied by a stock drop, investors may recover large damages—or, far more likely, a large settlement—in addition to whatever payments are due to the victims of discrimination.

This form of securities litigation can therefore significantly amplify damages and settlement costs for alleged misconduct regulated by other laws and remedied by other lawsuits. The secondary securities suit may also reach class certification before the merits are adjudicated in the primary suit—setting up the bizarre, yet all-too-common result that defendants settle the securities case before their culpability for the underlying misconduct is determined. Or, if it is one of the rare securities-fraud cases that proceeds to the merits, the results may be even more bizarre. To adjudicate the falsity of the alleged misstatements, the parties must try a "case within a case"—*e.g.*, a discrimination case within a securities-fraud trial—to determine whether the misconduct allegations that revealed the so-called truth were actually true.

II. Event-Driven Litigation Has Intensified the Already Immense Hydraulic Settlement Pressure Imposed by Class Certification

1. The class-certification decision is a critical inflection point in securities litigation, as the "certification decision is typically make-or-break for everyone involved." Margaret V. Sachs, *Superstar Judges As Entrepreneurs: The Untold Story of Fraud-on-the-Market*, 48 U.C. Davis L. Rev. 1207, 1219 (2015). Indeed, it is "well known that [class actions] can unfairly 'plac[e] pressure on the defendant to settle even unmeritorious claims.'" *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1632 (2018) (citation omitted).

This is particularly true in securities cases. After a class is certified, nearly all securities cases settle. Indeed, among cases filed after *Halliburton II*, only one has gone to trial. *See supra*, n.3. Most cases settle even before a ruling on summary judgment: during the same period, only 5% of cases awaited a ruling on summary judgement before settling. *See supra*, n.4. Class certification also meaningfully affects the settlement amount. Since *Halliburton II*, the median settlement amount for cases settling after the grant of class certification was more than 85% higher than the settlement amount for cases resolved before a ruling on the motion. *See id*.

The outsized damages available in securities-fraud class actions—especially after class certification—can make even weak claims too risky to litigate on the merits. Facing "large potential damages," defendants are "eager to avoid a trial even if advised that their chances of winning are 'excellent.'" Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 531 (1991). Indeed, alleged damages routinely exceed billions of dollars, and individual defendants face liability for the entire amount given the Private Securities Litigation Reform Act of 1995's joint-and-several liability provision. *See* 15 U.S.C. § 78u-4(f)(2)(A). This Court has accordingly recognized that the "potential for uncertainty" in a securities lawsuit "allow[s] plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 163-64 (2008).

2. Event-driven securities lawsuits intensify this settlement pressure because the potential damages awards are often greater than in traditional securities cases. This is because the "misstatements" undergirding event-driven securities litigation (*e.g.*, corporate codes of conduct) are present over an extended period of time, leading to longer class periods and, in turn, greater potential damages. *Cf. FindWhat*, 658 F.3d at 1316 ("[A] falsehood that endures within the marketplace for a longer period of time, all else being equal, will cause greater harm than one that endures for a shorter period of time."). And, under the inflation-maintenance theory, lower courts have not required plaintiffs to show that any of these generic statements ever caused the stock price to increase.

3. This settlement pressure comes with real costs—not only for the defendants in the suits themselves, but also for the public at large. Some of these costs are straightforward and easy to understand. For example, a company facing an event-driven securities lawsuit will

shoulder direct litigation costs, a portion of which will inevitably be passed on to consumers. Other costs are less obvious—but no less important. Insurers such as *Amici* take on the risk of their clients' corporate liability—for a price that is reflected in the premiums paid by those clients and by the overall market of purchasers of D&O insurance. Accurate, fair, efficient pricing depends on the insurers' ability to measure the potential risk properly. It is one thing to evaluate risk based on the nature of a company's business or its record of compliance; it is a very different thing to assess the risk that a generalized, wholly anodyne statement of organizational values made many years earlier will form the basis for a multi-billion-dollar securities class action premised on the notion that the statement of values was never publicly withdrawn. In the latter situation, it becomes harder to evaluate and price the risk of litigation and the risk (and scope) of liability.

III. Given the Immense Settlement Pressure Created by Event-Driven Litigation, This Court Should Require the Rigorous Analysis Rule 23 Commands

1. *Basic*'s presumption of reliance was supposed to be just that—a presumption. In event-driven securities cases, it has become a guarantee. In Section 10(b) litigation overall, it is a near certainty: since *Halliburton II*, defendants successfully rebutted the presumption in just one case, and at least partially rebutted price impact in a mere four cases. *See* Br. of Petitioners at 35. As the dissenting judge below observed, the lower courts have made the *Basic* presumption "truly irrebuttable," such that "class certification is all but a certainty in every case." Pet. App. 44a (Sullivan, J., dissenting). This state of affairs is incompatible with *Basic*'s promise—

reaffirmed in *Halliburton II*—that the presumption may be rebutted by "*[a]ny showing* that severs the link" between the alleged misrepresentation and the price received or paid for the security. *See Basic*, 485 U.S. at 248 (emphasis added).

In all other circumstances, "[a] party seeking to maintain a class action 'must affirmatively demonstrate his compliance' with Rule 23." *Comcast Corp. v. Behrend*, 569 U.S. 27, 33 (2013) (citation omitted). Neither this Court's precedents nor the federal rules of procedure suggest that putative class plaintiffs asserting securities-fraud claims should be any different. Consistent with the rigorous analysis required by Rule 23, courts must scrutinize the alleged misstatements among defendants' other price-impact evidence (which cannot be presented at the Rule 12(b)(6) stage). Misplaced concerns about materiality should not be used for foreclose defendants from rebutting the *Basic* presumption. *See* Br. of Petitioners at 30-33.

Left uncorrected, the decisions below will continue to subject defendants to claims of "fraud" based on anodyne statements that do not realistically affect the integrity of the securities markets. And because class certification will be a foregone conclusion, even more event-driven lawsuits will be encouraged and defendants will be unable to avoid the hydraulic pressure to settle even meritless claims.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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