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What To Watch For When Goldman Cert. Fight Hits High Court

By **Dean Seal**

Law360 (March 25, 2021, 11:13 PM EDT) -- Goldman Sachs and a class of its shareholders are taking their decade-old securities fraud battle to the U.S. Supreme Court next week for oral arguments that are poised to address more than just the knotty certification issues being put before the justices.

At its core, the case asks the high court to square two of its own precedential decisions regarding defendants' ability to challenge class certification in securities suits, particularly ones like the Goldman suit that proceed on the so-called inflation maintenance theory — the idea that misstatements can fraudulently keep an artificially boosted stock price from dropping.

But advocates for both the investors and the bank are staging the case in more dire terms, warning in amicus briefs that the justices' decision could open the floodgates for either rampant securities fraud or a deluge of securities fraud class actions.

Here, Law360 takes a deep dive into the arguments and areas of law the high court will weigh on Monday morning.

The Case

The long-running litigation stems from a collateralized debt obligation transaction Goldman underwrote in April 2007 that lost CDO investors $1 billion after the bank allegedly helped a client short the CDO while simultaneously selling it elsewhere. The bank settled a 2010 regulatory enforcement action over the allegations for $550 million.

The class action, brought by Goldman's shareholders and not the CDO investors, challenges the bank's assertions in regulatory filings that it had "extensive procedures and controls that are designed to identify and address conflicts of interest" and that its "clients' interests always come first" as misrepresentations used to maintain an artificially inflated stock price that ultimately fell when the regulatory action revealed conflicts of interest in the CDO transaction.

After the class won certification in 2015, lost it in January 2018 and regained it later that year, Goldman launched another appeal over class certification that hit a snag last April. That's when a Second Circuit panel unanimously rejected Goldman's argument that the lower court erroneously extended the narrow scope of the inflation maintenance theory to encompass its general statements about business principles and conflict warnings.

But the panel split over whether Goldman had rebutted the presumption — established under the 1988 Supreme Court case Basic v. Levinson — of classwide reliance on its alleged misstatements by showing that the statements were too generic to have affected the price of Goldman's stock.

According to one dissenting judge, the majority deliberately and erroneously ignored the generic nature of the bank's allegedly misleading representations about being conflict-free on the basis that the class certification stage was too soon to consider whether the statements were material to investors.

After the Second Circuit shot down a request for an en banc review of the ruling, Goldman asked the high court to step in. Despite pushback from the investor class, the justices said in December that they'd take a look, setting the stage for Monday's showdown.

Squaring Two Precedents

Goldman contends that the high court's 2014 Halliburton v. Erica P. John Fund decision allows defendants to rebut the Basic presumption at class certification by showing that alleged misstatements had no effect on stock price, and instructs courts not to artificially limit the evidence they consider when assessing price impact, "even though such proof is also highly relevant at the merits stage."

According to the bank, the Second Circuit contravened the mandate set by the ruling, known as Halliburton II, when it declined to consider the generic nature of the alleged misstatements, and in the process "imposes an impossible burden on defendants" that makes the presumption "effectively irrebuttable."

The investor class has countered that Goldman is effectively trying to defeat certification by claiming the challenged statements were immaterial, which they say flies in the face of the high court's 2013 holding in Amgen Inc. v. Connecticut Retirement Plans & Trust Funds that securities fraud plaintiffs are not required to prove materiality during class certification.

To circumvent the Amgen ruling, Goldman is attempting to relabel its argument as a challenge to price impact rather than materiality, the investors claim.

The disconnect between Amgen's prohibition on certification-stage materiality assessments and Halliburton II's directive to thoroughly analyze price impact has taken a central role in the Goldman case.

Jill Fisch, a professor of business law at the University of Pennsylvania Carey Law School who has supported the investors in amicus briefs, said the Halliburton II decision left "a lot of uncertainty" about exactly how defendants can rebut the Basic presumption by disproving price impact, particularly in cases that involve the inflation maintenance theory. Meanwhile, the Amgen decision drew a "very tenuous" distinction between class certification issues and merits issues, she said.

Todd Cosenza of Willkie Farr & Gallagher LLP, who represents former U.S. Securities and Exchange Commission officials and law professors supporting Goldman in the case, likewise told Law360 that "it would be helpful if the court provided guidance to district courts on what precisely should be done at class certification and how district courts should navigate the Supreme Court's prior decisions in Amgen and Halliburton II."

Considered or Ignored?

Goldman and the investor class unsurprisingly have divergent views on the interplay between the Amgen and Halliburton II decisions and the lower court rulings that brought their case to the Supreme Court.

According to the bank, the Second Circuit majority ignored the generic nature of the alleged misstatements entirely and accused Goldman of trying to "smuggl[e] materiality" into a price impact inquiry in a way that would defy the Amgen holding.

Goldman's amici supporters in the high court — which include pro-business groups and various economists, law professors and former regulators — and even the acting U.S. solicitor general have agreed in their briefs that ignoring the nature of the alleged misstatements cuts against the Halliburton II precedent.

But according to the investors, the district court and Second Circuit considered both Amgen and Halliburton II correctly in rendering their rulings — in accordance with Halliburton II, the lower court considered the "generality" of the alleged misstatements despite the inherent overlap with materiality when weighing Goldman's bid to disprove price impact, they say.

In the end, the investors argue, the lower courts were merely unswayed by the totality of the evidence Goldman put forward.

Whether or not the Second Circuit actually considered the generic nature of the alleged misstatements is therefore a key consideration for the justices' review of the suit. Indeed, both the SEC and the U.S. Department of Justice have asked the high court to remand the case back to the Second Circuit for clarification on its decision-making.

Shifting the Burden?

The second half of the high court's review of the case will focus on Goldman's assertion that the Second Circuit held the bank to too high of a standard for rebutting the Basic presumption.

According to Goldman, federal law only puts the burden of production — or the duty to present evidence to the court — on defendants aiming to rebut the Basic presumption. But the Second Circuit has instead saddled Goldman with the ultimate burden of persuasion, or the duty to convince the court of its side, the bank says.

Goldman specifically points to the Federal Rule of Evidence 301, which states that the "party against whom a presumption is directed has the burden of producing evidence to rebut the presumption," while the burden of persuasion "remains on the party who originally had it."

Given the plain text of the rule and the "silence of the federal securities laws" on the matter, the burden of persuasion therefore remains with the investors, Goldman argues.

But the investors contend that the Second Circuit, the Seventh Circuit and acting U.S. Solicitor General Elizabeth Prelogar, in her own brief supporting neither side in the Goldman case, all agree that both the Halliburton II decision and the Basic ruling put the onus on defendants to rebut the presumption of

classwide reliance "by proving a lack of price impact, not by merely introducing evidence on the issue," as the government said in its brief.

The class's supporters in the high court, which include investor advocates and its own set of economists, law professors and former regulators, likewise argue that defendants should be required to actually prove a lack of price impact at the class certification stage, rather than merely supply "any probative evidence against it," as 16 state attorneys general say in their brief.

Chad Bell, a plaintiff-side attorney for Korein Tillery LLC, similarly pushed back on Goldman's "idea of shifting the burden" and forcing plaintiffs to persuade the court at the certification stage that alleged misstatements kept a stock price inflated.

"Goldman still has the opportunity to prove that at trial, after a class is certified, and so really there's no reason to shift that burden at this early stage," he told Law360.

On the other side of that argument, Willkie Farr's Cosenza said investors "should have the burden at class certification of showing front-end price impact of the alleged misstatement as well as a stock price decline solely attributable to the corrective disclosure at the end of the class period."

Revisiting Inflation Maintenance

Goldman contends that the burden of persuasion, coupled with courts declining to consider the "exceptionally generic" nature of alleged misstatements, would make it virtually impossible to rebut the Basic presumption in securities cases that use the inflation maintenance theory so long as a plaintiff alleges any kind of misstatement and connects it to a later stock drop.

While the theory itself is not technically being adjudicated in the high court case, the bank goes out of its way in its briefs to note that the Supreme Court "has never recognized" the theory. Former SEC officials represented by Cosenza, including former Chairman Christopher Cox and former Commissioner Joseph Grundfest, have said in their brief that the theory was "novel" and "never before sanctioned by this court."

Indeed, Goldman's case will be "the first time the court hears the inflation maintenance theory that plaintiffs in securities class actions increasingly rely on," Columbia Law School professor John Coffee Jr. told Law360.

That fact has plainly provoked some of the amicus briefs filed in recent months. Former SEC officials who've thrown their support behind the investors, including former Chairs William Donaldson and Arthur Levitt, told the high court earlier this month that Goldman is "impliedly ask[ing]" the justices to denounce inflation maintenance claims, which they say are vital to both SEC enforcement actions and private securities litigation, and asked that they refrain from doing so.

The law professors who back the investors also note that Goldman's representations to the high court "suggest that the theory is somehow suspect" and assert that the theory is a "straightforward and unremarkable way" for investor plaintiffs to establish price impact, asking that the justices "disregard Goldman's aspersions to the contrary."

But Goldman and its supporters are clearly hoping for the high court to consider curbing the theory, which has been used to fend off rebuttals of the Basic presumption — with near-universal success — in

more than two-thirds of securities litigations since the Halliburton II decision, according to the Second Circuit's April decision.

The Washington Legal Foundation, a pro-business think tank, in its brief questioned whether the theory is "legally cognizable under the federal securities laws" while acknowledging that such a question was not explicitly before the high court.

Cosenza told Law360 that in an ideal ruling for Goldman, "it would be important for the court to signal that the inflation maintenance should be permitted in the most limited of circumstances."

Coffee said the court's reaction to the theory on Monday "could be the most important consequence of this case."

"To be sure, the dispositive issue is how do you rebut the presumption under Basic v. Levinson, particularly where the misstatements did not move the market and sounded like self-serving puffery," he told Law360. "But the plaintiffs lose more if the court expresses doubt about [the] inflation maintenance theory."

Generic Statements

While the arguments before the high court revolve around procedure and precedent, the underlying allegations of wrongdoing stem from Goldman's representations about being conflict-free, which the bank has long argued were too general or generic to have been relied upon by investors.

A group of financial economists who've thrown their weight behind Goldman contend that price impact "cannot be assumed when a company has merely expressed general business principles, as most public companies do." Other amici have similarly expressed concerns about letting securities suits premised on supposedly run-of-the-mill business statements make it past the certification stage — an occurrence that tends to pressure public companies into settling.

"These concerns are not hypothetical," the Society for Corporate Governance said in its brief supporting Goldman. "On the contrary, plaintiffs have recently filed a flood of securities fraud class actions premised on aspirational public statements."

On the other side of the coin, supporters of the investor class have framed the case and Goldman's many appeals as an attempt to avoid accountability for representations that clearly didn't reflect reality, regardless of how "generic" they may have been.

"No company should be able to claim that the public statements they make about their high standards of conduct are meaningless," a group of 38 individuals and groups, including the Consumer Federation of America and Duke University School of Law professor James D. Cox, said in a joint letter on Wednesday. "Indeed, the statements Goldman Sachs made about managing conflicts and acting in customers' best interest carry specific regulatory meaning and thus cannot be dismissed as mere 'puffery.'"

Korein Tillery's Bell said the alleged misrepresentations in Goldman's regulatory filings were effectively lies to the government and to investors that were "very much central to what happened with their stock," which makes it "somewhat curious" that the Supreme Court took up the case in the first place. He said he is concerned that Goldman's maneuvering could ultimately make it even harder for plaintiffs,

who already face stringent standards for pleading securities claims, to hold defendants liable for misstatements that they wave off as being too "generic" to be material to investors.

"If you weaken the avenue for plaintiffs to pursue securities fraud claims and private litigation, which is the side that really goes and tries to recover for the investors and what they lost, then you're opening up the floodgates to a lot more securities fraud," Bell said.

How the justices engage with the "generic" nature of the alleged misrepresentations could resonate far beyond just the Goldman case, experts told Law360.

In the context of price impact inquiries, Goldman argues that "it is simply intuitive that, the more generic the challenged statement, the less likely it is to affect the price of the stock" and that judges are "not required to set aside common sense in addressing the Basic presumption."

The investor class has countered that Goldman is essentially asking for judges to start using "common sense" rather than actual evidence, like expert reports and analysis, when assessing the nature of alleged misstatements during a price impact inquiry.

That argument has concerned financial economists like Joseph Mason, a Louisiana State University professor and senior adviser at BVA Group who joined with other economists in support of the investor class. Mason said consideration of "whether a statement is too general" in the broader securities context needs to be couched in economic analysis, not judicial intuition.

"I'm hoping that [the justices] will let the financial economists weigh in at whatever stage this is considered at, and allow expert testimony from people in the field to be considered, rather than a mere judicial 'judgement call' as to whether something is too general to be considered actionable," Mason told Law360.

Penn Law's Fisch said any signals the justices give as to whether those kinds of statements are actionable under securities law, even if just for the purposes of a price-impact inquiry, could also be significant as investors increasingly pursue securities claims against companies for their public disclosures concerning workplace safety and sexual harassment policies or environmental, social and corporate governance commitments.

"Whether those disclosure requirements have any bite is going to depend in part on whether the Supreme Court buys the idea that these are material statements to investors," she told Law360.

The case is Goldman Sachs Group Inc. et al. v. Arkansas Teacher Retirement System et al., case number 20-222, in the U.S. Supreme Court.

--Editing by Alanna Weissman and Michael Watanabe.