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 AMICUS CURIAE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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RULES

INTEREST OF AMICUS CURIAE[1]

Washington Legal Foundation ("WLF") is a nonprofit, public-interest law firm and policy center with supporters in all 50 States. Founded in 1977, WLF promotes and defends free enterprise, individual rights, limited government, and the rule of law.

To that end, WLF often appears before this and other federal courts in cases raising the proper scope of the federal securities laws. *See, e.g., China Agritech, Inc. v. Resh,* 138 S. Ct. 1800 (2018)*; Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.,* 137 S. Ct. 2042 (2017). And WLF's Legal Studies Division has published many articles on the faithful interpretation of the federal securities laws and related topics. *See, e.g.*, Doug Greene, *et al., Private Securities Litigation: Making the 1995 Reform Act's "Safe Harbor" Safer*, WLF Working Paper (Nov. 16, 2018).

WLF is concerned that the decision below effectively strips defendants of any ability to rebut the *Basic* presumption of reliance in securities class actions premised on the inflation-maintenance theory and will encourage meritless suits and coercive settlements that harm current investors. The Second Circuit's holding is an unwarranted drag

[1] No counsel for a party authored any part of this brief, in whole or in part, and no person other than *amicus curiae* or its counsel made any monetary contribution to the preparation or submission of this brief. All parties consent to the filing of WLF's brief.

on the U.S. economy at a time of financial turmoil and should be overturned.

REASONS FOR GRANTING THE PETITION

Price impact is key to any securities fraud claim. In class actions alleging securities fraud, it forms the basis for a rebuttable presumption of reliance (recognized in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988)) that allows those cases to proceed on a class-wide basis. Although *Basic* contemplated a situation where a misstatement caused a stock's price to be fraudulently inflated or depressed (*id.* at 244-45), courts have not limited the presumption to cases where a plaintiff alleges that misstatements moved the price of the security. Instead, courts also have found that the *Basic* presumption can be used in cases where a plaintiff alleges that a misstatement affected a security's price by preventing the price from decreasing from a previously inflated level (the "inflation-maintenance theory").

As applied by the Second Circuit in this case, however, the inflation-maintenance theory makes class certification in securities class actions a near certainty. The petitioners correctly argue that (a) they were improperly prevented from rebutting the *Basic* presumption by pointing to the generic nature of the alleged misstatements to show that the statements had no impact on the price of the security, and (b) in seeking to rebut the *Basic* presumption, they only had a burden of production, not the ultimate burden of persuasion.[2]

The important issues raised by the petitioners, however, also highlight more broadly that the Second Circuit's application of the inflation-maintenance theory in this case contravenes this Court's (and other circuit courts') precedents because it wrongly prohibits a full inquiry into price impact at class certification. Moreover, the Second Circuit's approach undermines Congress's intent – in passing the Private Securities Litigation Reform Act of 1995 (PSLRA) – to limit the ability of plaintiffs to bring meritless securities class actions for the purpose of forcing coercive settlements.

ARGUMENT

I. The Petition Should be Granted Because the Second Circuit's Decision Is Inconsistent with Supreme Court (and Other Circuit Court) Precedent on Assessing Price Impact

Price impact is "an essential precondition for any Rule 10b-5 class action" (*Halliburton Co. v. Erica P. John Fund Inc.* ("*Halliburton II*") 573 U.S. 258, 282 (2014)) because it is almost always the basis for asserting class-wide reliance. *See also Basic Inc. v. Levinson ("Basic")*, 485 U.S. 224, 245

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[2] WLF agrees with the positions taken by petitioners on whether a defendant seeking to rebut the *Basic* presumption bears only a burden of production or also the ultimate burden of persuasion, Pet. App. at 21-24, but this brief largely addresses the first question presented.

(1988) (the "presumption, created by the fraud-on-the-market theory and subject to rebuttal by petitioners, [is] that persons who had traded Basic shares had done so in reliance on the integrity of the price set by the market"). Most securities class action plaintiffs rely on the rebuttable presumption recognized in *Basic* to satisfy the predominance requirement of Fed. R. Civ. P. 23(b)(3). *See Halliburton II*, 573 U.S. at 281-22 ("without the presumption of reliance . . . [e]ach plaintiff would have to prove reliance individually, so common issues would not 'predominate' over individual ones."). To establish the *Basic* presumption, plaintiffs must show "(1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the plaintiff traded the stock between the time that the misrepresentations were made and when the truth was revealed." *Id*. at 268 (citing *Basic*, 485 U.S. at 248, n.27). These showings, however, are merely an "indirect proxy for price impact," which is "*Basic*'s fundamental premise." *Id*. at 281, 283. Therefore, this Court has recognized that if a defendant rebuts an inference of price impact with "[a]ny showing that severs the link" between the alleged misstatement and the security's price, the element of class-wide reliance is not met and class certification must be denied. *Id.* at 281.

Establishing price impact may be straightforward in a situation where a false statement "causes a stock's price to rise, [and] the price [falls] when the truth comes to light." *Schleicher v. Wendt*, 618 F.3d 679, 683 (7th Cir. 2010). Courts also have recognized, however, that a misstatement can "stop[] a price from declining" or maintain preexisting inflation if it prevents a decline that would have occurred "had the statement not been made." *Id.* But this inflation-maintenance theory only makes sense in limited circumstances, *i.e.*, where an affirmative misstatement, on the topic at issue, prevents the market from learning the truth that would cause the preexisting inflation to dissipate. *See, e.g., id.* (for example, when "a firm says that it lost $100 million, when it actually lost $200 million"); *In re Vivendi SA Sec. Litig.*, 838 F.3d 223, 259 (2d Cir. 2016) (describing example where a car company with a record for safety affirmatively, but falsely, states that its new car has passed all of its safety tests). It is *not* enough for a plaintiff to simply point to a stock price drop and assert that earlier alleged misstatements must have caused the drop. *In re Allstate Corp. Sec. Litig.* ("*Allstate*"), 966 F. 3d 595, 605 (7th Cir. 2020) ("A sharp drop in share price alone is not enough for a class to be certified.")

The Second Circuit's application of the inflation-maintenance theory in this case fails to recognize that distinction. The required connection for purposes of the *Basic* presumption is "between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at fair market price." *Basic*, 485 U.S. at 248. Although evidence that "a [corrective] disclosure caused a reduction in a defendant's share price" can be the basis for an inference that "the price was inflated by the amount of the reduction" (Pet. App. at 18a), this is indirect evidence, and it does not establish price impact. *Halliburton II*, 573 U.S. at 281 ("an indirect proxy should not preclude direct evidence when such evidence is available"). On the contrary, *any* showing by a defendant that rebuts the price impact of the statements, such as if "the market price would not have been affected by the[] misrepresentations," will suffice to "sever[] the link." *Basic*, 485 U.S. at 248.

The *Basic* presumption therefore is subject to prudential limitations. For example, while a plaintiff may be able to invoke the inflation-maintenance theory where the alleged misstatements relate to concrete financial or product information about a company, generic or aspirational statements cannot have the necessary price impact. *See, e.g., In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.) (if "information is not important to reasonable investors, it follows that its release will have a negligible effect on the stock price"); *Raab v. General Physics Corp.,* 4 F.3d 286, 289 (4th Cir. 1993) ("the market price of a share is not inflated by vague statements predicting growth").

Here, petitioners established, with little or no opposition, that (a) before the stock price decline, the market knew of the alleged conflicts of interest, (*see* Pet. App. at 51a-53a); (b) Goldman's stock price did not move in response to repeated reports about these alleged conflicts of interest before the alleged corrective disclosures, (*see id.* at 54a-55a ("Dr. Gompers claims, and Dr. Finnerty concedes, that Goldman's stock price did not move on any of the 36 dates on which the falsity of the alleged misstatements was revealed to the public")); (c) the stock price did not rise when the challenged statements were made;[3] and (d) the challenged statements were not the type of statements that investors generally rely on. *Id*. at 59a. This showing sufficed to sever the link between the alleged misstatements and the price paid by respondents. *Halliburton II*, 573 U.S. at 281-282; *see also IBEW Local 98 Pension Fund v. Best Buy Co., Inc.*, 818 F.3d 775, 782 (8th Cir. 2016) (reversing grant of class certification because "what the district court ignored, in our view, is that defendants did present strong evidence on [the absence of price impact]—*the opinion of plaintiffs' own expert*").

Yet, in this case, the Second Circuit upheld the use of the *Basic* presumption merely because the stock price declined after reports of government enforcement activity, including the SEC's enforcement action against Goldman. The Second Circuit reasoned that a court could rely on the unsupported assertion of respondents' expert that the stock price decline must have been the result of artificial inflation that had been prevented from dissipating. Pet. App. at 33a–35a. In so doing, the Second Circuit incorrectly failed to credit petitioners' evidence directly rebutting the inference of price impact, which should have negated a finding of class-wide reliance. *See* Pet. App. at 44a (Sullivan, J., dissenting) ("Goldman introduced hard evidence that 'sever[ed] the link between the alleged misrepresentation and . . . the price . . . paid by the plaintiff.'") (citing *Waggoner v. Barclays PLC*, 875 F.3d 79, 95 (2d Cir. 2017)); *see also Schleicher*, 618

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[3] *See* Gompers Report at Joint Appendix at A-4820, *Arkansas Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254 (2d Cir. 2020) (No. 18-3667).

F.3d at 684 ("Fraud depends on the state of events when a statement is made, not on what happens later.").

Moreover, this Court never has held that the price-impact inquiry is limited to a quantitative analysis. *Halliburton II*, 573 U.S. at 281, 284 (at class certification, defendants may make "any showing" that "an alleged misrepresentation did not actually affect the market price of the stock."). In *Halliburton II*, this Court directed lower courts not to "artificially limit the inquiry at the certification stage to indirect evidence of price impact." *Id.* at 283. *Halliburton II* thus encourages defendants to test price impact at the certification stage, and the Court did not hold that defendants are limited to any single type of evidence.

The proper scope of evidence when assessing price impact includes evidence that (a) no change in stock price occurred when the alleged falsity was revealed to the market; (b) no change in stock price occurred when the alleged misstatements were made; and (c) the statements are insufficiently connected to the alleged fraud (because they are too generic, would not be relied on by investors, or otherwise). *Id.*, *see also Basic*, 485 U.S. at 248-249 (describing ways that the presumption of reliance can be rebutted); *Allstate*, 966 F.3d at 609 ("*Basic* line of cases imposes few if any limits" on the scope of evidence that defendants may use to rebut price impact). That these inquiries may overlap with materiality or loss causation is no reason to proscribe them at the class certification stage. *Halliburton II,* 573 U.S. at 283 ("[W]e see no reason to artificially limit" defendants' evidence of price impact "even [if] such proof is also highly relevant at the merit stage."); *Allstate,* 966 F.3d at 608 (even though such "evidence is likely to have obvious implications for the off-limits merits issues of materiality and loss causation . . . a district court may not use the overlap to refuse to consider the evidence."); *Grae v. Corr. Corp. of Am.*, 330 F.R.D. 481, 498 (M.D. Tenn. 2019) ("At the heart of this confusing area of the case law is the fact that all three concepts addressed—loss causation, materiality, and price impact—are, in essence, slightly different takes on the same fundamental question: Did a statement matter?").

In sum, a court must be able to determine whether the statement indeed mattered—*i.e.*, whether it "stop[ped] a price from declining." *Schleicher*, 618 F.3d at 683. A court cannot do so if it artificially limits itself solely to evidence that a later stock price decline occurred without analyzing the statement itself and any other relevant evidence. Pet. App. at 44a–45a (*dissent*) ("Candidly, I don't see how a reviewing court can ignore the alleged misrepresentations when assessing price impact.").

II. The Petition Should be Granted Because Limiting the Scope of the Inflation-Maintenance Theory Will Have Important Public Policy Benefits

Granting review and allowing petitioners to fully rebut price impact at the class certification stage will have important public policy benefits far beyond this case

The private right of action under § 10(b) is a judicial creation and is subject to prudential judicial limitations. *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 276 (2010) (§ 10(b) "area of law is replete with judge-made rules, which give concrete meaning to Congress' general commands . . . we deal with a judicial oak which has grown from little more than a legislative acorn.") (quotation omitted). A key judicial limitation is ensuring that prohibited conduct is limited to what Congress intended both through the individual statute and the overall statutory scheme. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) (declining to extend the scope of § 10(b) to cover negligent conduct given Congress's clear intent to proscribe intentional wrongdoing); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473 (1977) (declining to extend scope of § 10(b) to cover breach of fiduciary duty because there is "no indication that Congress meant to prohibit any conduct not involving manipulation or deception").

The decision below, if left to stand, would undermine the intention of Congress to limit the proliferation and *in terrorem* effect of meritless securities class actions. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975) (warning against "permit[ting] a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope"). Indeed, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA) "to restrict abuses in securities class-action litigation, including . . . the practice of filing lawsuits against issuers of securities in response to any change in stock price, regardless of defendants' culpability." *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 531 (3d Cir. 1999) (citing H.R. Conf. Rep.

No. 104-369, at 28 (1995), reprinted in 1995 U.S.C.A.A.N. 679, 748).

Even after the passage of the PSLRA, however, many securities class actions are lawyer-driven exercises lacking clear merit. Several related statistical trends, which began in 2013 and have continued through 2019, support this conclusion.

First, the annual number of securities class action filings continues to increase, with a record 5.5% of all U.S. exchange-listed companies sued in 2019 alone (268 total cases). Cornerstone Research, *Securities Class Action Filings: 2019 Year in Review*, 5, 11 (Jan. 2019) (all cited numbers from this report are for "core filings," which exclude merger and acquisition related cases). Second, just three plaintiffs' law firms have filed more than 50% of all securities class actions over this time. *Id.* at 39. Third, the percentage of cases in which individual investors (rather than the institutional investors favored by the PSLRA) have been appointed sole lead plaintiff has increased to over 50% of all securities class actions. *Id.* at 18. Finally, the dismissal rate for securities class actions has risen from about 40% to nearly 50%, with cases led by these three plaintiffs' firms appearing to have largely caused the increase. *Id.* at 16, 40 (for example, 60% of the cases filed in 2017 and led by these three firms have been dismissed).

Taken together, these trends strongly suggest that a small group of plaintiffs' firms are bringing a host of securities class actions of questionable merit (based on the decline in institutional investor support and rise in dismissal rates). What is the nature of these cases?

Securities class actions based on corporate financial disclosures, which used to form the backbone of securities litigation, have been declining. Indeed, the number of public company financial restatements, and associated cases based on accounting allegations, have fallen sharply over the past few years, even as the overall number of securities class action filings has increased. *See* Don Whalen, Derryck Coleman, & Dennis Tanona, *2019 Financial Restatements: A Nineteen Year Comparison*, AUDIT ANALYTICS (July 2020), Table 1 at 5 (showing a decline in the annual number of financial restatements from 1,869 restatements in 2006 to 484 restatements in 2019), https://tinyurl.com/y2xunvhy, C*ornerstone* at 10 (the number of federal securities class action filings alleging accounting violations has fallen from 38% in 2015 to 23% in 2019).

The plaintiffs' bar instead has turned its focus to "event-driven" securities litigation, bringing securities class actions based on *external events* that drive down a company's stock price. These external events have included data security breaches, sexual harassment allegations, commercial litigation, allegations that a drug or product has side effects or caused injury, and regulatory investigations or enforcement actions.[4]

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[4] "Once, securities class actions were largely about financial disclosures (e.g., earnings, revenues, liabilities, etc.). In this world, the biggest disaster was an accounting restatement. Now, the biggest disaster may be a literal disaster: an airplane crash, a major fire, or a medical calamity that is attributed to your product." John C. Coffee, Jr., *The Changing*

In the typical scenario (as in this case, where the company's stock price declined after reports of government enforcement activity), the plaintiffs' bar works their way backwards. First, they identify the event and associated stock price drop. Second, they look for generic statements (*e.g.*, risk factors or aspirational goals) by the company that they allege were rendered false or misleading by failing to disclose either the existence of the underlying alleged conduct (no matter whether it actually happened) or the company's vulnerability to the external event. As in this case, the plaintiff only needs to establish that the stock traded in an efficient market to stand a strong chance of achieving class certification. If that requirement is met, the plaintiff may be able to merely allege price inflation or inflation maintenance. *See* Pet. App. at 51a.

Adding to the burden on companies facing event-driven securities litigation is that courts often decline to rule on the materiality of the generic statements (*i.e.*, would the statements have been important to a reasonable investor in making an investment decision) at the motion to dismiss stage. Coffee, *The Changing Character of Securities Litigation in 2019*. A survey of recent cases suggests that these decisions are highly judge-dependent,

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Character of Securities Litigation in 2019: Why It's Time to Draw Some Distinctions (Jan. 22, 2019), http://clsbluesky.law.columbia.edu/2019/01/22/thechanging-character-of-securities-litigation-in2019-why-its-time-to-draw-some-distinctions/.

with many courts unwilling (given the materiality standards of this Court's decision in *Matrixx*[5]) to assess materiality without factual discovery. *See, e.g., In re Petrobras Sec. Litig.*, 116 F. Supp. 3d 368, 381 (S.D.N.Y. 2015) (declining to find that statements "regarding [defendant's] general integrity and ethical soundness" were immaterial); *In re Electrobras Sec. Litig.*, 245 F. Supp. 3d 450, 463-64 (S.D.N.Y. 2017) (declining to find that statements of the defendant's "commitment to transparency and ethical conduct" were immaterial); *In re Signet Jewelers Ltd. Sec. Litig.*, No. 16-cv-6728, 2018 WL 6167889, at *17 (S.D.N.Y. Nov. 26, 2018) (declining to find that statements that disciplinary action would be taken against those who violated the company's Code of Conduct and Code of Ethics were immaterial).

Given this background, it is no surprise that the plaintiffs' bar has come to rely heavily on the inflation-maintenance theory. Generic or aspirational statements will not increase a company's stock price, so the plaintiffs' bar has eagerly turned to pleading a theory that hinges solely on a later stock price decline. Indeed, a recent study states that in 71% of cases where defendants have attempted to rebut the *Basic* presumption, plaintiffs have asserted that the statements merely maintained the company's stock price at inflated levels and that the price then dropped when the alleged fraud became public. And in every one of those cases the plaintiff succeeded in certifying a

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[5] *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 43 (2011) (assessing materiality "is fact-specific inquiry") (quotations omitted).

class. Pet. App. at 26; *cf. In Re Finisar Corp. Sec. Litig.*, 2017 WL 6026244 (N.D. Cal. Dec. 5, 2017) (denying class certification where defendants' expert showed that alleged misstatements failed to inflate stock price and plaintiffs did not specifically allege existence of price maintenance).

The decision below, if unaddressed by the Court, would ensure the proliferation of event-driven securities litigation by virtually guaranteeing class certification in any securities class action that invokes the inflation-maintenance theory (which is nearly all of them). The Second Circuit's holding also creates undue settlement pressure by improperly removing class certification as a potential roadblock to litigation success. Pet. Br. at 27-29; *see also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 163-64 (2008) ("[E]xtensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies."); *Schleicher*, 618 F.3d at 683-84 ("[C]ertification substantially increases the settlement value of a securities suit."); *Hevesi v. Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2004) ("Moreover, numerous courts and scholars have warned that settlements in large class actions can be divorced from the parties' underlying legal positions.").

In sum, the Second Circuit's application of the inflation-maintenance theory in this case undermines Congress's statutory scheme for private securities litigation, which includes express measures to limit the ability of plaintiffs to bring meritless cases and extort settlements. Accordingly, this case is an ideal and opportune vehicle for this

Court to prune the ever-growing judicial oak of Section 10(b) liability.

CONCLUSION

Left unaddressed, the *Goldman* decision will permit the certification of classes of Section 10(b) plaintiffs in ways that are inconsistent with this Court's prior rulings and contrary to good public policy. The petition should be granted.

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