21-3105-CV

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

IN RE GOLDMAN SACHS GROUP, INC. SECURITIES LITIGATION

FROM AN ORDER GRANTING CERTIFICATION OF CLASS ENTERED ON DECEMBER 8, 2021 BY THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK MASTER FILE NO. 1:10 CIV. 03461 (PAC)
THE HONORABLE PAUL A. CROTTY

BRIEF OF *AMICUS CURIAE* WASHINGTON LEGAL FOUNDATION IN SUPPORT OF THE PETITION OF DEFENDANTS-PETITIONERS FOR PERMISSION TO APPEAL UNDER FEDERAL RULE OF CIVIL PROCEDURE 23(f)

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INTEREST OF *AMICUS CURIAE*

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

To that end, WLF often appears as *amicus curiae* in cases raising the proper scope of the federal securities laws. *See, e.g.*, *Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys.*, 141 S. Ct. 1951 (2021); *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 regularly publishes 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), https://bit.ly/2Ylugdm.

WLF is concerned that, left undisturbed, the district court's application of *Goldman* threatens to erode important litigation protections for generic statements about corporate values and internal controls common to the securities filings of nearly every public company. WLF believes that, given its potential impact, the district court's opinion warrants immediate appellate scrutiny.[1]

[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.

SUMMARY OF ARGUMENT

Goldman's "mismatch" test ensures the free flow of useful information in the securities market by providing an important litigation protection for generic corporate statements made by nearly every public company. As applied below, however, the "mismatch" test has the potential to convert nearly any generic corporate statement of aspiration, commitment, or risk into a valid basis for a securities-fraud class action. If the district court's application of *Goldman* is left unaddressed, it would leave defendants without the meaningful ability to defeat class certification for failure to prove price impact, undermining Supreme Court precedent and congressional policy aimed at limiting meritless securities class actions and coercive settlements.

The Supreme Court could not have meant for the "mismatch" test to be applied in the manner applied by the district court below. *First*, the district court's decision renders the "mismatch" test virtually meaningless, as a practical matter, by endorsing a very loose connection between the types of generic, front-end statements at issue and the purported back-end corrective disclosures. *Second*, the district court's decision defeats the underlying legal principles and public policy considerations underlying the "mismatch" test. In both respects, this Court should not permit the application of the "mismatch" test to stray so far from its first principles.

ARGUMENT

I. The Petition should be granted because the district court's application of the "mismatch" test renders it virtually meaningless.

Price impact is a critical component in any securities fraud class action. It forms the basis for a rebuttable presumption of reliance under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), which allows these 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), this circuit has allowed the *Basic* presumption to be invoked 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 ("inflation maintenance"). *See In re Vivendi, S.A. Secs. Litig.*, 838 F.3d 223, 255 (2d Cir. 2016). But the Supreme Court has repeatedly affirmed that no matter the underlying price-impact theory, "[i]f a misrepresentation had no price impact, then *Basic*'s fundamental premise 'completely collapses, rendering class certification inappropriate.'" *Goldman*, 141 S. Ct. at 1959 (quoting *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 283 (2014)).

Goldman supplemented existing case law on price-impact determinations with "new ideas" to aid parties and courts in assessing the appropriateness of class certification in securities fraud class actions. *Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 11 F.4th 138, 143 (2d Cir. 2021) (citing *Goldman*, 141 S. Ct. at 1960).

One of these "new ideas" is that an inference of price impact falls apart when "there is a mismatch between the contents of the misrepresentation and the corrective disclosure." *Goldman*, 141 S. Ct. at 1961. The Supreme Court specifically warned that this "may occur when the earlier misrepresentation is generic (e.g., 'we have faith in our business model') and the later corrective disclosure is specific (e.g., 'our fourth quarter earnings did not meet expectations')." *Id.*

Goldman's "mismatch" test thus provides a viable path for defendants to rebut the *Basic* presumption for inflation-maintenance claims premised on generic alleged misrepresentations. *See* 141 S. Ct. at 1961 ("[A mismatch] may occur when the earlier misrepresentation is generic[.]"); *id.* ("The generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory."). But if a corrective disclosure need only "implicate" the same subject as a prior generic statement to satisfy the "mismatch" test, as the district court held below (A-27), then the test is virtually meaningless.

Relying on the district court's interpretation of *Goldman*, creative plaintiffs' counsel will work their way backwards. After news reveals a meaningful decrease in a security's price, counsel will identify past generic corporate statements (e.g., risk factors or aspirational goals) that generally "implicate" the same subject as the

purported corrective disclosure that led to the price decrease. Then, they will allege the generic statements were rendered false or misleading by the company's failure to disclose either the existence of the circumstances lowering the security's price or the company's vulnerability to such an event.

Absent a requirement that the content and specificity of the alleged front-end misrepresentation mirror the purported back-end corrective disclosure, class certification will pose no real challenge for two reasons. *First*, plaintiffs will have a long menu of purported front-end misrepresentations at their disposal given the volume of generic statements that "implicate" the same subject matter as news that typically leads to a decrease in a security's price. *See infra* § II. *Second*, under an inflation-maintenance theory, plaintiffs can proceed without showing the generic front-end statement caused an increase to the security's price. Instead, the price decrease resulting from the bad news serves as the benchmark for alleged front-end inflation. The Supreme Court introduced the "mismatch" framework to counter this very scenario. *See Goldman*, 141 S. Ct. at 1961 ("But that final inference—that the back-end price drop equals front-end inflation—starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure.").

Under the district court's decision, however, *Goldman* effectively (but silently) will have nullified the Court's repeated reaffirmation of a defendant's

right to rebut the *Basic* presumption through "[a]ny showing that severs the link between the alleged misrepresentation" and the alleged impact on the security's price. *Goldman*, 141 S. Ct. at 1962 (quoting *Basic*, 485 U.S. at 248). That was not the Supreme Court's intent and the district court's decision demands immediate appellate review.

II. The Petition should be granted because the district court applied the "mismatch" test in a manner that defeats the underlying public policy considerations it serves.

The district court's application of *Goldman*'s "mismatch" test has far-reaching policy implications. The types of disclosures at issue are ubiquitous among public companies. For example, Plaintiffs have challenged aspirational statements about "Business Principles," such as "[o]ur clients' interests always come first," "[i]ntegrity and honesty are at the heart of our business," and "[w]e are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us." A-233. A recent study by scholars from several universities found that all 249 publicly traded companies they studied made these types of "value statements," and approximately 85 percent published generic statements about commitments to corporate integrity and legal compliance. Mussie Tessema et al., *Analysis of Corporate Value Statements: An Empirical Study*, 10 Int. J. Corp. Governance 149, 161 (2019), https://bit.ly/34c69nB. Likewise, Petitioners' expert, Dr. Laura Starks, conducted a comprehensive study and found

analogous statements in securities filings and other public communications from every S&P 500 company she examined. *In re Goldman Sachs Grp., Inc. Secs. Litig.*, No. 10-cv-3461 (S.D.N.Y. Nov. 6, 2015) ECF 170-3, ¶ 45 ("Starks Report").

Generic statements like these do not have the specificity needed to impact the price of a security. *See Goldman*, 141 S. Ct. at 1961 ("The generic nature of a misrepresentation often will be important evidence of a lack of price impact"). Companies issue these types of statements because they serve other beneficial functions unrelated to a security's price. *See* Starks Report, ¶ 30 ("These types of aspirational statements are used for a variety of purposes, including creation and promotion of organizational culture, employee motivation, and corporate brand formation."); Tessema, at 154 ("A publicly accessible and authentic corporate value statement can positively impact employee recruitment and retention . . . form an ethical foundation for the company . . . [and] improve employee engagement"). Empirical evidence has shown a "link between corporate rhetoric and conduct," suggesting that public statements of commitment or aspiration, even generic ones like those here, "can have a powerful impact on corporate behavior." Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing Social Responsibility Rhetoric*, 59 Fla. L. Rev. 771, 817-18 (2007).

Moreover, use of these types of generic corporate statements is likely to increase. Investors increasingly are calling on companies to make more public disclosures about "ESG" (environmental, social, and governance) issues.[2] ESG disclosures often include company commitments on topics like sustainability, diversity and inclusion, socially responsible behavior, and effective monitoring and oversight, among other things. *See*, *e.g.*, *ESG Trends and Practices in the BioPharma Industry*, PharmExec.com (June 14, 2021), https://bit.ly/3JLAsSu.

The Supreme Court's adoption of the "mismatch" test in *Goldman* buttressed protections at the class certification stage for generic statements of aspiration, commitment, and risk that have no impact on price. But as applied by the district court, the "mismatch" test would make these statements a potential basis for a securities-fraud class action anytime the company falls short of its aims. This creates uncertainty and increases the perceived risk of liability for issuing generic statements about corporate values, business principles, and ESG commitments, even if they do not impact the price of a security. The perception of increased risk for innocuous statements of aspiration could chill the very types of beneficial, voluntary disclosures that the federal securities laws should facilitate, not hinder. *See* Kevin S. Haeberle & M. Todd Henderson, *A New Market-Based*

[2] *See* Caitlin Reilly, *Securities Exchanges Report Growing Investor Demand for ESG Disclosure*, CQ Roll Call (July 17, 2020) (Reporting that "[a]lmost 90 percent of the exchanges said they perceived some investor demand for more disclosure of ESG factors, up from 70 percent two years ago").

Approach to Securities Law, 85 U. Chi. L. Rev. 1313, 1334 (2018) (explaining why "legal uncertainty" creates "little upside" for "disclosing more than that which is required" and chills disclosure).

Indeed, liability concerns for these types of disclosures already loom large in ongoing debates over calls for SEC-mandated ESG disclosures, where commentators have been closely monitoring developments in this case. *See, e.g.*, Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 Wash. U. L. Rev. 1821, 1853-54 (2021) (discussing concerns about developments in this case on the potential for securities fraud class actions relating to generic ESG disclosures and asserting that "[a]ny serious discussion regarding the adoption of a broad SEC-mandated ESG disclosure regime cannot ignore these concerns").

By lowering the bar to class certification, the district court's application of *Goldman* also will accelerate a growing trend of "event-driven" securities lawsuits that hinge on "tenuous" arguments. Elisa Mendoza & Jeffrey Lubitz, *Event-Driven Securities Litigation: The New Driver in Class Action Growth*, Institutional Shareholder Services (December 2020), at 2-3, https://bit.ly/3mFv9dl ("[T]he new trend of event-driven securities class action litigation is on the rise . . . despite more tenuous arguments being the basis of the lawsuits.").[3] These are cases based

[3] Event-driven securities class actions increased from 34 cases filed in 2018

on external events, such as data security breaches, sexual harassment allegations, and regulatory investigations or enforcement actions, which have begun displacing traditional securities-fraud claims based on corporate financial disclosures. While event-driven securities-fraud claims typically rest on shaky ground, the nature of these claims can exert undue settlement pressure, particularly if a defendant believes it lacks a viable means to rebut the *Basic* presumption and defeat class certification. *See* Rose, at 1852-53 ("The difficulties associated with terminating event-driven securities litigation at the motion to dismiss or class certification stage, coupled with the costs of discovery and extremely large potential damage awards typical in this sort of litigation, means that the risk of vexatious litigation is high."); Emily Strauss, *Is Everything Securities Fraud?* U.C. Irvine L. Rev. (forthcoming) (manuscript at 18), https://bit.ly/3pEusmr (explaining why "the pressure to settle even claims with a low probability of success is compounded in event-driven cases for several reasons," including that "the application of 10b-5 jurisprudence in event-driven securities cases has been inconsistent, leading to great uncertainty for defendants.").[4] The district court's application of the

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to 47 cases filed in 2020. Mendoza & Lubitz, at 3.

[4] *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 v. Wendt*, 618 F.3d 679, 683-84 (7th Cir. 2010) ("[C]ertification substantially increases the settlement value of a securities suit.").

"mismatch" test makes generic statements about aspirations, commitments, or risks easy targets for vexatious event-driven securities fraud class actions.

In sum, *Goldman*'s "mismatch" test was designed to support Congress's intent to restrain the proliferation and *in terrorem* effect of meritless securities class actions. *See Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 276 (2010) (Section 10(b) "area of law is replete with judge-made rules, which give concrete meaning to Congress' general commands") (quotation omitted); *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").[5] The district court's application of the "mismatch" test will have the opposite effect.

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[5] Indeed, Congress passed the Private Securities Litigation Reform Act of 1995 "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).

CONCLUSION

The district court's interpretation of *Goldman* is untenable. Given its potential far-reaching impact beyond this case, the Court should exercise oversight and grant the petition of Defendants-Petitioners to ensure that the application of *Goldman* does not stray from the Supreme Court's intent or the public policy goals of the federal securities laws that *Goldman* supports.

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rules of Appellate Procedure 5(c), 29(d) and 32(a)(7)(B)-(C), the undersigned counsel certifies as follows:

1. This brief complies with the type-volume limitation under Fed. R. App. 29 because this brief contains, according to the word count of the word processing system used to prepare this brief, 2,534 words, excluding those portions of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Office Word in 14-point Times New Roman font.

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