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Second Circuit Decertifies Investor Class in Long-Running Class Certification Dispute

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The Second Circuit decertified the class in *Arkansas Teacher Retirement System v. Goldman Sachs Group, Inc.*, concluding that the Defendants rebutted the presumption of reliance with evidence that the generic alleged misstatements had not impacted the company's stock price.

The decision turned on the court's application of the Supreme Court's 2021 decision in the same dispute. There, the Supreme Court observed that where plaintiffs' price impact theory is based on "inflation maintenance"—i.e., the alleged misstatement did not cause the stock price to increase but instead merely prevented it from dropping—any mismatch between generic challenged statements and specific alleged corrective disclosures will be a key consideration in deciding whether defendants have rebutted the presumption. *Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys.*, 141 S. Ct. 1951, 1961 (2021) ("*Goldman*"). Applying this guidance, the Second Circuit held that the "mismatch" between generic statements and a highly specific disclosure was sufficient to "sever the link" between the statements and the stock price drop. *Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc*, --- F.4th ----, 2023 WL 5112157, at *21, 24 (2d Cir. 2023) ("*ATRS*").

Background

Securities class actions can only proceed on a class-wide basis when plaintiffs can avail themselves of the presumption of reliance. *See Basic Inc. v. Levinson*,485 U.S. 224, 242–43, 246–47 (1988). The presumption applies when plaintiffs purchase stock that trades in an efficient market, and the theory is that anyone purchasing the stock implicitly relies on all public, material information incorporated into the current price. *Id.* at 247. Without the presumption of reliance, plaintiffs must prove that each individual class member relied on the alleged misstatements when deciding to purchase stock. In *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014), the Supreme Court held defendants could rebut the presumption with evidence showing the statements did not impact the stock's price.

This dispute spans more than a decade, has been presented to the Second Circuit four times, and reached the Supreme Court. Plaintiffs allege that the Defendants made false and misleading general statements about Goldman Sachs' business principles and conflict-of-interest management procedures and that the "truth" was "revealed" through announcements about regulatory enforcement actions and investigations into certain transactions. Goldman Sachs' stock price did not go up when the challenged statements were made. It did drop following the alleged corrective disclosures.

At class certification, Plaintiffs invoked the presumption of reliance. Defendants presented expert evidence showing that (1) dozens of pre-corrective disclosure statements criticizing the company's conflicts practices did not cause the stock price to drop, and that (2) the stock drops were caused by news of regulatory actions not a correction of the challenged statements. They also argued that the statements were so generic they could not impact

Goldman Sachs' stock price.

In 2021, the Supreme Court held that courts should consider the genericness of challenged statements at the class certification stage. *Goldman,* 141 S. Ct. at 1960–61. The Court also observed that where plaintiffs are proceeding on an "inflation maintenance" theory—meaning they are using a stock drop that occurred when a statement is allegedly corrected rather than an increase when the statement was made to show the statement's price impact—the court should consider whether the statement and the correction sufficiently "match." *Id.* The severity of the mismatch between the two may call into question whether the price movement is attributable to the challenged statement. *Id.*

After the Supreme Court's decision, the Second Circuit remanded the case to the district court, which certified the proposed class again. The Second Circuit has now reversed the class certification order and remanded with instructions to decertify the class.

Issue

Whether the district court erred in rejecting Goldman Sachs' argument that the specific alleged corrections were insufficiently "matched" to the generic challenged statements for the drop accompanying the alleged correction to reflect the statement's "price impact."

Court's Holding

The Second Circuit held the district court misapplied inflation maintenance theory, reasoning that the match between the challenged statements and the corrective disclosure was insufficient. The court concluded when a plaintiff relies on inflation maintenance theory, it cannot simply "identify a specific back-end, price-dropping event" and match it to "a front-end disclosure bearing on the same subject" unless "the front-end disclosure is sufficiently detailed in the first place." *ATRS*, 2023 WL 5112157, at *21. Instead, the specificity of the statement and alleged correction must "stand on equal footing." *Id.* The Second Circuit also noted that in conducting the "mismatch" analysis, other indirect evidence of price impact could be considered, including whether there was "pre- or post-disclosure discussion in the market regarding a generic front-end misstatement." *Id.* at *22.

Applying these principles, the Second Circuit concluded that there was "an insufficient link between the corrective disclosures and the alleged misrepresentations" and that "Defendants have demonstrated, by a preponderance of the evidence, that the misrepresentations did not impact Goldman [Sachs]' stock price, and, by doing so, rebutted *Basic*'s presumption of reliance." *Id.* at *24.

What It Means

- The Second Circuit has confirmed with this opinion that the opportunity to rebut the presumption of reliance to defeat class certification in a securities class action is meaningful. Where the only connection between vague challenged statements and specific, severe alleged corrective disclosures is the general subject matter, the case is not appropriate for class certification because there is no common method of proving shareholders relied on the vague statements.
- The majority also concluded that for purposes of assessing price impact at class certification, there must be a "closer fit (even if not precise) between the front- and back-end statements" than would be required to establish loss causation. *Id.* at *18 n.11.
- The majority considered each of defendants' arguments separately while Judge Richard J. Sullivan, who dissented from the Second Circuit's 2020 decision affirming an earlier certification order, advocated for a more holistic evaluation. *Id.* at *24 (Sullivan, J., concurring).
- We will continue to monitor how courts apply the Supreme Court's guidance in assessing whether defendants have presented sufficient evidence to rebut the

presumption of reliance.

The Second Circuit's opinion is available here.

The following Gibson Dunn attorneys assisted in preparing this client update: Monica Loseman, Lissa Percopo, and Lydia Lulkin.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding developments in Securities Litigation. Please contact the Gibson Dunn lawyer with whom you usually work, or the following leaders of the firm's Securities Litigation practice group:

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