# 18-3667-cv

## United States Court of Appeals

*for the*

## Second Circuit

ARKANSAS TEACHER RETIREMENT SYSTEM,
WEST VIRGINIA INVESTMENT MANAGEMENT BOARD,
PLUMBERS AND PIPEFITTERS PENSION GROUP,

*Plaintiffs-Appellees,*

PENSION FUNDS, ILENE RICHMAN, Individually
and on behalf of all others similarly situated,

*Plaintiffs,*

*(For Continuation of Caption See Inside Cover)*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

**BRIEF OF FORMER SEC OFFICIALS AND LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF APPELLANTS' PETITION FOR PANEL REHEARING OR REHEARING *EN BANC***

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*Consolidated-Plaintiffs,*

– v. –

GOLDMAN SACHS GROUP, INC., LLOYD C. BLANKFEIN, DAVID A. VINIAR, GARY D. COHN,

*Defendants-Appellants,*

SARAH E. SMITH,

*Consolidated-Defendant.*

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## INTRODUCTION AND INTEREST OF *AMICI CURIAE*[1]

This case presents the exceptionally important question of whether, in this Circuit, defendants can rebut the fraud-on-the-market presumption created in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) ("*Basic*"), in opposing class certification, as required by both *Basic* and *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) ("*Halliburton II*"). In his vigorous dissent, Judge Sullivan explained that the Panel majority's decision has made *Basic* "truly irrebuttable," and class certification "all but inevitable in every case" in this Circuit. (Dissent 8.) As detailed below, this result eliminates the careful balance struck in *Halliburton II* when the Supreme Court did not reverse the judge-made *Basic* presumption, but held that defendants must be afforded the opportunity to show at class certification that alleged misstatements did not have price impact—the premise of the efficient market theory underlying *Basic*. The Panel should either rehear this appeal or the full court should review the Panel majority's decision. And if the majority of this Court denies *en banc* review, members of this Court should, at a minimum, dissent from that denial to signal to the Supreme Court the significant consequences of the Panel's interpretation of *Halliburton II* in

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than amici curiae or their counsel, contributed money to fund its preparation or submission. Amici submit this brief with a motion for leave to file, as to which petitioners have consented and respondents have taken no position.

the leading Circuit for securities cases and the center of the nation's financial markets.

While this case arises from the 2008 financial crisis, the decision below gains heightened importance because of the ongoing COVID-19 crisis. For example, companies in the airline, hospitality, and related industries that make generic disclosures about mitigating risk (e.g., "Customer safety always comes first," "We meet the highest standards of cleanliness," or "We value the safety of all our employees") now face the prospect of *investor* securities class action lawsuits after a stock price drop in the event of a new COVID-19 outbreak or another pandemic effect. Simply put, if the Panel's decision stands, companies will be defenseless against plaintiffs' class certification arguments that are *de facto* irrebuttable.

The *amici curiae* are a group of individuals who have a strong interest in these issues: former officials of the United States Securities and Exchange Commission and law professors whose scholarship and teaching focuses on the federal securities laws. Although each individual amicus may not endorse every statement herein,[2] this brief reflects the consensus of the amici that the Petition presents exceptionally important questions on the *Basic* presumption and a

[2] In addition, the views expressed by amici here do not necessarily reflect the views of the institutions with which they are or have been associated.

defendant's right to rebut the same, the district court's resolution of these issues was incorrect and threatens to eviscerate that right, and therefore, judicial review by this Court is necessary. In alphabetical order, the *amici curiae* are:

- Brian G. Cartwright – former General Counsel of the U.S. Securities and Exchange Commission from 2006 to 2009;
- Ronald J. Colombo – Professor of Law and Dean for Distance Education at the Maurice A. Deane School of Law at Hofstra University;
- Elizabeth Cosenza – Associate Professor and Area Chair, Law and Ethics, at Fordham University;
- The Honorable Joseph A. Grundfest – William A. Franke Professor of Law and Business at Stanford Law School, and Commissioner of the U.S. Securities and Exchange Commission from 1985 to 1990;
- Paul G. Mahoney – David and Mary Harrison Distinguished Professor of Law, at the University of Virginia School of Law, and Dean of the same from 2008 to 2016;
- Richard W. Painter – the S. Walter Richey Professor of Corporate Law at the University of Minnesota Law School;
- Adam C. Pritchard – the Frances and George Skestos Professor of Law at the University of Michigan Law School;

- Matthew Turk – Assistant Professor of Business Law and Ethics at Indiana University's Kelley School of Business; and
- Karen E. Woody – Assistant Professor of Law at Washington & Lee University School of Law.

## ARGUMENT

### I. THE PANEL'S PRICE IMPACT ANALYSIS VIOLATES *HALLIBURTON II*.

#### *A. The Panel's Holding Nullifies the Supreme Court's Compromise in* Halliburton II *Regarding the Basic Presumption.*

In affirming the district court's legally and factually flawed class certification order, the Panel majority rendered the Supreme Court's decision in *Halliburton II* a *de facto* nullity in this Circuit. *Halliburton II* reflected a compromise between the two diametrically opposed arguments represented in that case: securities class action defendants urged that *Basic*'s fraud-on-the-market presumption be overruled, while securities class action plaintiffs urged that defendants not have any opportunity to rebut the fraud-on-the-market presumption at class certification.

Since the Supreme Court's creation of the fraud-on-the-market presumption in *Basic*, courts have struggled with the presumption's practical application. In *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011) ("*Halliburton I*") and *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455

(2013), the Supreme Court appeared to be lowering the bar for securities fraud class action plaintiffs, holding in two consecutive cases that plaintiffs need not establish loss causation and materiality, respectively, prior to class certification. Notably, in *Amgen*, three justices dissented from the majority, challenging *Basic*'s fraud-on-the-market presumption. *See Amgen*, 568 U.S. at 490-502.

Then, in *Halliburton II*, the Supreme Court reaffirmed the viability of the fraud-on-the-market presumption and attempted to clarify ***how*** to apply the presumption in practice. The middle ground established in *Halliburton II* provides that defendants in securities class actions ***must*** be afforded an opportunity to rebut the fraud-on-the-market presumption of reliance "with evidence of a lack of price impact . . . before class certification." 573 U.S. at 277. Although the majority opinion did not overturn *Basic*, and held that plaintiffs need not prove price impact to first *invoke* the fraud-on-the-market presumption, the Court also made clear that defendants can rebut the *Basic* presumption at class certification through "*any* showing that severs the link between the alleged misrepresentation and . . . the price received (or paid) by the plaintiff" for the shares in question. *Id.* at 281 (citing *Basic*, 485 U.S. at 248) (emphasis added). To adopt the rationale of the Panel's ruling would undermine the Supreme Court's delicate compromise and nullify defendants' ability to rebut the *Basic* presumption at class certification.

### *B. The Panel Improperly Refused to Consider the Nature of the Challenged Statements as Price Impact Evidence.*

The Panel incorrectly viewed evidence about the generic nature of Defendants' challenged statements as "a means for smuggling materiality into Rule 23" in violation of *Amgen*. (Slip op. at 28 & n.11, 29.) But nothing in *Amgen* prohibits a court from considering at class certification the generality or specificity of the alleged misstatements, which directly bears on price impact. (*See* Dissent at 9.) In imposing a blanket prohibition against such evidence, the Panel majority misconstrued *Amgen* in the same manner as the Fifth Circuit in *Halliburton II*, which prompted the Supreme Court's reversal.

In *Amgen*, the Supreme Court held that proof of materiality is not a prerequisite to certification of a securities fraud class action. *See* 568 U.S. 455 at 459. Even though materiality is a precondition to *Basic*'s fraud-on-the-market presumption, the Court reasoned, "As to materiality . . ., the class is entirely cohesive. It will prevail or fail in unison." *Id.* at 460. In so ruling, the *Amgen* majority also affirmed the district court's refusal to consider Amgen's "truth-on-the-market" rebuttal evidence at the class certification stage. *Id.* at 481.

On this basis, between *Halliburton I* and *Halliburton II*, the Fifth Circuit concluded that defendants could not offer evidence of a lack of price impact at class certification. *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d

423 (5th Cir. 2013), vacated and remanded by 573 U.S. 258 (2014). Applying *Amgen*, the Fifth Circuit reasoned that price impact evidence may ***not*** be considered because, like materiality, price impact does not bear on common question predominance under Federal Rule of Civil Procedure 23. *Id.* at 432.

The Fifth Circuit made the same error as the Panel majority did here: because "[t]he price impact evidence considered here is both similar to and offered for much the same reason as the materiality evidence" that the Supreme Court in *Amgen* held should not be considered at class certification, the Fifth Circuit refused to credit Halliburton's contention that it was challenging reliance, not materiality, through its truth-on-the-market defense. *Id.* at 434 n.10. The Supreme Court rejected the Fifth Circuit's analysis in *Halliburton II*.

There, the Supreme Court explained that, even though the same issues counseling against considering materiality evidence could also apply to weighing price impact evidence at class certification, "[p]rice impact is different. The fact that a misrepresentation 'was reflected in the market price at the time of the transaction'—that it had price impact—'is *Basic*'s fundamental premise.' It thus has everything to do with the issue of predominance at the class certification stage." *Halliburton II*, 573 U.S. 258, 281, 283 (internal citation omitted).

Even though the same evidence often bears on price impact and materiality, *Halliburton II* holds that, notwithstanding *Amgen*, price impact

evidence may be considered at class certification, not for the purpose of rebutting materiality or rearguing a court's decision on the sufficiency of the complaint's pleading of materiality, but to demonstrate a lack of price impact and thereby to rebut the *Basic* presumption.

Any other reading creates a conflict between the Supreme Court's *Amgen* and *Halliburton II* rulings, requiring district courts to undertake the impossible task of parsing permissible price impact evidence from impermissible materiality evidence. As Judge Sullivan persuasively observed, "I don't believe that such rigid compartmentalization is possible." (Dissent at 9.)

### *C. If Left Uncorrected, the Panel's Decision Will Adversely Impact Public Companies.*

The Panel's decision impermissibly limits the price impact evidence that district courts can consider at class certification. The majority held the generic nature of alleged misstatements should be dealt with at the pleading stage. (Slip op. at 27 n.10.) But that is often not what happens in practice. At the pleading stage, Plaintiffs regularly argue that materiality is a mixed question of law and fact, and cases dealing with generic statements sometimes are not resolved on materiality grounds at the pleading stage. Indeed, this Circuit recently granted a Rule 23(f) petition in another case to address this very issue. *See Signet Jewelers Ltd. v. Pub. Emps. Ret. Sys. of Miss.*, Order Granting Rule 23(f) Petition (2d Cir.

Dec. 18, 2019). The Panel should clarify that district courts must consider all relevant price impact evidence (even if it overlaps with materiality) at the Rule 23 stage.

The Panel majority's decision here also risks draconian practical consequences because publicly traded companies *routinely* include generic statements of corporate principle similar to those at issue here in their public filings. The publication of these anodyne statements combined with a later stock price drop is not necessarily evidence of fraud, even if shareholders happen to lose money.

As noted, these risks are particularly heightened during the ongoing COVID-19 crisis, where aspirational statements about best practices amid a fast-moving global pandemic can be weaponized by plaintiffs and turned into a predicate for a securities fraud class action, as securities markets around the world are extremely volatile. Granting class certification in such cases is contrary to Supreme Court precedent and Congressional intent as reflected in the Private Securities Litigation Reform Act. *See Halliburton II*, 573 U.S. at 285-87; *see also Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345 (2005). The private right of action under the securities law is not intended to function as a guarantee against stock price declines, especially in times of crisis.

## II. THE PANEL ERRED AND CREATED A CIRCUIT SPLIT OVER APPLICATION OF THE PRICE MAINTENANCE THEORY.

The price maintenance theory permits plaintiffs to argue that statements can be actionable if they merely *maintained* an already inflated stock price. *See In re Pfizer Inc. Sec. Litig.*, 819 F.3d 642, 659 (2d Cir. 2016). The Panel's decision puts the Second Circuit out of sync with other circuits over the application of the price maintenance theory because it (1) directly conflicts with the Eighth Circuit's decision in *IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775 (8th Cir. 2016), and (2) incorrectly applies the theory to general statements, in conflict with prior decisions of this Court and courts in every other circuit.

First, the Panel decision creates a circuit split with the Eighth Circuit in *Best Buy*, in which the Court held that the price maintenance theory did not apply because defendants had shown "overwhelming evidence of no 'front-end' price impact," and thus no price inflation despite a back-end stock drop. *Id.* at 782. Here, Plaintiffs likewise failed in demonstrating inflation caused by Defendants' alleged misstatements, because Goldman's stock price did not move on any of the 36 dates on which the falsity of the alleged misstatements was revealed to investors through press reports, including on the front pages of the Wall Street Journal and New York Times. This evidence "clearly compels the conclusion that the stock

drop . . . was attributable to something other than the misstatements alleged in the complaint." (Dissent at 9.)

Second, the Panel majority incorrectly applied the price maintenance theory to Defendants' general statements—an unwarranted expansion of the theory, for which no court in any circuit has advocated before. The only two circumstances in which any court has applied the price maintenance theory involve alleged misstatements that (1) were unduly optimistic statements about specific, material financial or operational information made to stop a stock price from declining;[3] or (2) falsely conveyed that the company had met market expectations about a specific, material financial metric, product, or event.[4]

In reaching its decision, the Panel mischaracterized the Defendants' argument here as a "proposed revision" of the doctrine, claiming that "Goldman . . . surveyed nationwide inflation-maintenance cases . . . , claimed that each case fits one of its special circumstances, and thereby concluded that these are the *only* permissible applications of the theory." (Slip op. at 26.)

But the Defendants' survey confirmed that the district court's application of the price maintenance theory was unprecedented. No court until

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[3] *See, e.g., In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223 (2d Cir. 2016); *Schleicher v. Wendt*, 618 F.3d 679 (7th Cir. 2010).

[4] *See, e.g., FindWhat Inv'r Grp. v. FindWhat.com*, 658 F.3d 1282 (11th Cir. 2011); *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342 (3d Cir. 2009).

now has applied the theory to such general statements. It is this expansion that Judge Sullivan took issue with in his Dissent. Rather than disputing the viability of the price maintenance theory, Judge Sullivan rightfully refused to endorse the idea that general statements can maintain inflated prices. (Dissent at 1.) If this ruling stands, it would not only create a clear conflict between this Circuit and others, but would effectively eliminate the price impact requirement altogether. Doing so would allow the price maintenance theory to become a catch-all for securities fraud plaintiffs to certify investor classes based simply on a stock drop, even when the challenged statements were too general to cause any price impact, in direct contradiction to Supreme Court precedent. *See Halliburton II*, 573 U.S. 258.

## CONCLUSION

For the foregoing reasons, the *amici curiae* believe that the Court should grant Defendants-Petitioners' petition for rehearing or rehearing *en banc*.

Dated: New York, New York
May 19, 2020

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