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SECOND CIRCUIT VACATES CLASS CERTIFICATION ORDER ON PRICE IMPACT GROUNDS

To Our Clients and Friends:

On January 12, 2018, the Second Circuit issued its second substantive opinion applying *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014) ("*Halliburton II*"), only the third issued by any federal circuit court since the Supreme Court's landmark decision in June 2014. *Ark. Teachers Ret. Sys. v. Goldman Sachs*, -- F.3d --, Case No. 16-250, 2018 WL 385215 (S.D.N.Y. Jan. 12, 2018). The Second Circuit vacated the district court's order certifying a class and remanded for further proceedings to determine whether the defendants had presented sufficient evidence that the alleged misstatements did not impact Goldman Sachs' stock price. The Second Circuit encouraged the district court to hold any evidentiary hearing or oral argument it finds appropriate to address this issue on remand.

In *Halliburton II*, the Supreme Court preserved the "fraud-on-the-market" presumption—a presumption enabling plaintiffs to maintain the common proof of reliance that is essential to class certification in a Rule 10b-5 case—but the Court made room for defendants to rebut that presumption at the class certification stage with evidence that the alleged misrepresentations had no impact on the price of the issuer's stock. Although the Supreme Court ruled that direct and indirect evidence of price impact must be considered at the class certification stage, *Halliburton II*, 123 S. Ct. at 2417, courts throughout the country have struggled to reconcile that holding with the Supreme Court's previous decisions holding that plaintiffs need not prove loss causation or materiality until the merits stage, *see Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011) ("*Halliburton I*"); *Amgen Inc. v. Conn. Ret. Plans & Trust Funds*, 133 S. Ct. 1184 (2013).

In *Goldman Sachs*, defendants attempted to rebut the presumption of reliance by presenting evidence that the alleged misstatements had no impact on Goldman's stock price. They offered evidence that (1) the stock price did not increase on the days when the alleged misstatements were made and (2) the stock price did not decrease when those statements were "corrected" by news that was publicly revealed on thirty-four separate occasions before the alleged corrective disclosure dates. *Goldman Sachs*, 2018 WL 385215, *7. If the prior disclosures "correcting" the alleged misstatements did not negatively impact the company's stock price, defendants reasoned, then the misstatements themselves "did not affect the price of Goldman stock and plaintiffs could not have relied on them in choosing to buy shares at that price." *Id*. at *4. The district court rejected defendants' evidence regarding the lack of price impact based on these earlier "corrective" press reports, labeling the argument a premature "materiality" argument.

The Second Circuit acknowledged that price impact "touches on materiality," but nonetheless instructed the trial court, on remand, to consider defendants' price impact evidence. *Goldman Sachs*, 2018 WL

385215, at *8. The court explained that price impact and materiality are distinct, and that price impact "refers to the effect of a misrepresentation on a stock price." *Id.* (quoting *Halliburton I*, 563 U.S. at 814). "Whether a misrepresentation was reflected in the market price at the time of the transaction—whether it had price impact—" the court explained, "'is *Basic*'s fundamental premise.'" *Id.* (quoting *Halliburton II*, 134 S Ct. at 2416) Therefore, a defendant's evidence of a lack of price impact must be fully considered at the class certification stage. *Id.*

This decision marks the circuit's second decision in the last three months on the mechanics of rebutting the presumption of reliance. On November 6, 2017, a Second Circuit panel held that once a plaintiff establishes that the presumption of reliance applies, the defendant bears the burden of *persuasion* to rebut the presumption by a preponderance of the evidence. *See Waggoner v. Barclays PLC*, 875 F.3d 79, 99 (2d Cir. 2017). This opinion follows suit. *Goldman Sachs*, 2018 WL 385215, at *6-7.

These Second Circuit rulings are at odds with the Eighth Circuit's 2016 decision in *IBEW Local 98 Pension Fund v. Best Buy Co.*, which cited Rule 301 of the Federal Rules of Evidence ("Rule 301") when reversing that trial court's certification order. 818 F.3d 775, 782 (8th Cir. 2016). Rule 301 assigns only the burden of *production*—i.e., producing *some* evidence—to the party seeking to rebut a presumption, but "does not shift the burden of persuasion, which remains on the party who had it originally." By its own terms, Rule 301 applies in all civil cases "unless a federal statute or these rules provide otherwise." Both Second Circuit panels reasoned that "the *Basic* presumption is a substantive doctrine of federal law that derives from the securities fraud statutes" in departing from the standard burden-shifting paradigm of Rule 301. *Goldman Sachs*, 2018 WL 385215, at *6-7 (citing *Barclays*, 875 F.3d at 102–03).

Despite its reasoning regarding the burden of proof, the Second Circuit's decision in *Goldman Sachs* provides needed clarification on the standard for rebutting the presumption of reliance and promises to serve as a valuable tool for defendants seeking to defeat the certification of improper classes in securities litigation. The decision demands analysis of price-impact evidence at the class certification stage, even when that evidence overlaps with other factual issues that need not be decided before trial. Moreover, the Second Circuit strongly suggested that it expects a comprehensive examination of price impact evidence, including through evidentiary hearings when appropriate. The decision also illustrates that defendants have multiple avenues for disproving price impact, including showing that a company's stock price did not decline in response to corrective information that was revealed before the "corrective disclosures" alleged by plaintiffs. These clarifications are critically important for the future of securities litigation because, in reality, the certification of a class results in a settlement in the vast majority of cases, and the defendants' best chance of avoiding overwhelming pressure to settle is defeating class certification. Defendants should, therefore, carefully consider all means of "severing the link" between the alleged misstatements and any stock price movement, including employing both factual and expert evidence and requesting evidentiary hearings or oral argument to best position themselves to disprove price impact.

We will continue to monitor developments in this and other cases.

The following Gibson Dunn lawyers assisted in the preparation of this client update: Monica Loseman, Jason Mendro, Lissa Percopo and Christopher White.

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