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Goldman Sachs Secures Class Decertification

By Robert Finkel & Sasha Marseille

Summary

Pension funds that serve as Lead Plaintiffs in a class action securities lawsuit should understand that the class certification stage is a hurdle to jump over. The recent Second Circuit decision: Ark. Teacher Ret. Sys. v. Goldman Sachs Grp., Inc., 2023 U.S. App. LEXIS 20815 (2d Cir. Aug. 10, 2023), is an illustration on how a class can become decertified.

For securities class actions that survive a motion to dismiss, the class certification motion stage is typically the next opportunity for defendants to defeat the class claims. A recent Second Circuit decision shows how a defendant's price impact defense can rebut a presumption of reliance and defeat class certification.

To prevail on a claim under Section 10(b) of the Securities Exchange Act of 1934, a plaintiff must prove, among other things, a material misrepresentation or omission by the defendant and the plaintiff's reliance on that misrepresentation or omission. As to reliance, plaintiffs may invoke the "fraud on the market theory."

The fraud on the market theory is based on the principle that "stock trading on theoretically efficient markets like the New York Stock Exchange or Nasdaq incorporates all public, material information, including material misrepresentations, into its share price." A market is considered "efficient," generally, if the shares are actively traded in the market. Defendants can rebut the presumption of an efficient market by severing the link between the misrepresentation and the price paid by plaintiffs for publicly traded securities.[1]

On August 10, 2023, the Second Circuit Court of Appeals issued an order to decertify a class action securities lawsuit against Goldman Sachs.[2] The lawsuit has been ongoing for over a decade and stems from allegations of conflicts of interest related to collateralized debt obligations (CDOs) and an enforcement action by the U.S. Securities and Exchange Commission (SEC) against Goldman Sachs.

The Plaintiffs in the lawsuit alleged that Goldman Sachs maintained an inflated share price caused by misrepresentations and omissions concerning Goldman Sachs' business principles and conflict-of-interest policies. The Plaintiffs further alleged that the true facts were revealed to the market when the SEC sued Goldman Sachs on April 16, 2010 "for making material misleading statements and discussions in connection with" ABACUS 2007 AC-1. The next day, Goldman Sachs' stock price declined 12.79% from $184.27 to $160.70 per share.[3]

In addition, on April 30, 2010, Goldman Sachs' stock price dropped another 9.39% following a report from The Wall Street Journal that Goldman was under investigation by the Department of Justice for its purported role in unspecified CDOs.[4]

Because Goldman Sachs' stock price had not risen contemporaneously with the false statements concerning Goldman's business principles and conflict-of-interest policies, the Plaintiffs were proceeding under the theory that Goldman Sachs' false statements enabled Goldman Sachs to "maintain" the inflation in its shares. Under the "inflation-maintenance theory," price impact is the amount of price inflation maintained by an alleged misrepresentation—in other words, the amount that the stock's price would have fallen if Goldman had spoken the truth about its principles and policies.[5]

In Goldman, the District Court had on June 12, 2012 denied in part Goldman Sachs' motion to dismiss the complaint and subsequently certified on September 24, 2015 the class action. Although interlocutory appeals from the denial of a motion to dismiss are not generally allowed, a defendant pursuant to Fed. R. Civ. P. 23(f) may seek to appeal to a circuit court a district court order granting class certification. On January 26, 2016, the Second Circuit granted Goldman Sachs' request to appeal the September 24, 2015 District Court order granting class certification, and subsequently affirmed the District Court's certification. However, the Supreme Court granted certiorari and in 2021 vacated the Second Circuit's decision and remanded with instructions to consider the "generic" nature of the alleged misrepresentations.

The Supreme Court held in 2021 that district courts should consider all probative evidence in assessing price impact and clarified that courts may consider the generic nature of misrepresentations at class certification "regardless whether the evidence is also relevant to a merits question like materiality."[6] Courts were directed to compare, at the class certification stage, the relative genericness of a misrepresentation with its corrective disclosure.[7]

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1 Ark. Teacher Ret. Sys. v. Goldman Sachs Grp., Inc., 2023 U.S. App. LEXIS 20815, at *18 (2d Cir. Aug. 10, 2023) ("ATRS III") (citing Basic Inc. v. Levinson, 108 S. Ct. 978, 991 (1988)).
2 ATRS III at *18.
3 ATRS III at *13-14.
4 Id. at *14.
5 Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys. (Goldman), 141 S. Ct. 1951, 1961 (2021).
6 Id. at 1959.
7 ATRS III at *8.

> [T]hat final inference—that the back-end price drop [at the end of the class period] equals front-end inflation [at the beginning and during the class period] —starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure. That 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"). Under those circumstances, it is less likely that the specific disclosure actually corrected the generic misrepresentation, which means that there is less reason to infer front-end price inflation—that is, price impact—from the back-end price drop.[8]

Although the Supreme Court in an earlier opinion held that district courts should not consider the materiality of a false statement or omission in deciding class certification[9], it determined in the 2021 Goldman decision that in assessing price impact a district court could consider the “generic” nature of the allegedly misleading statement. The Supreme Court explained, 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" and that is true "regardless whether that evidence is also relevant to a merits question like materiality."[10]

On remand, the District Court certified the class. On appeal, the Second Circuit had to assess the generic nature of Goldman Sachs’ business principles statements, consistent with the Supreme Court’s 2021 guidance on the “fraud-on-the-market” theory, and whether a reasonable investor would have relied on the truth of those statements.[11]

The Second Circuit agreed with Goldman Sachs that the District Court failed to meaningfully apply the inflation-theory framework established by the Supreme Court because there was no evidence that investors relied on Goldman Sachs’ generic statements of its business principles and conflict management. Among other things, Goldman Sachs demonstrated that during the alleged period of price inflation, 880 analyst research reports were issued and not one referenced Goldman Sachs’ business principles or conflict management.[12]

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8 Goldman, 141 S. Ct. at 1961 (2021).
9 Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 133 S. Ct. 1184 (2013).
10 Goldman, 141 S. Ct. at 1960-61.
11 ATRS III at *32.
12 Id. at *68.

The Second Circuit further indicated that the District Court erred in construing Goldman Sachs' generic statements of business principles along with the challenged statements about conflicts controls. It reasoned those statements were disseminated to shareholders "in separate reports at separate times" with no evidence the statements "piggybacked" off each other.[13]

The Second Circuit decision provides guidance for future cases. The Second Circuit states that a searching price analysis must be conducted when "1) there is a considerable gap in front-end-back-end genericness, as the district court found here, (2) the corrective disclosure does not directly refer…to the alleged misstatement, and (3) the plaintiff claims, as plaintiffs claim here, that a company's generic risk-disclosure was misleading by omission."[14]

It will be interesting to see how this Second Circuit opinion will impact securities litigation cases moving forward. As indicated above, the decision adds important guardrails to the "inflation-maintenance" theory of securities fraud.

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13 Id. at *41-42.
14 Id. at *62-63.


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About the Authors

Robert C. Finkel is a senior partner and member of the executive committee at Wolf Popper LLP.

Robert is a graduate of the Columbia Law School, Class of 1981 (where he was a Harlan Fiske Stone Scholar), and the University of Pennsylvania, Class of 1978, where he obtained a B.S. in accounting from the Wharton School of Business and a B.A. in history from the College of Arts and Sciences. Robert began his employment in the 1980s with two large New York City defense firms. Robert became a partner at Wolf Popper LLP effective January 1, 1992. He has been repeatedly designated a Super Lawyer® in Securities Litigation.

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While in law school Sasha was a student attorney in the Public Justice Advocacy clinic, where she represented low-income clients in wage and hour cases.

After law school, Sasha served as an attorney advisor at The U.S. Department of Health and Human Services, Departmental Appeals Board, where she assisted the administrative appeals judges in adjudicating Medicare related exclusions imposed by Medicare providers or suppliers.

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