



Supreme Court Clarifies Evidentiary Burden for Rebutting “Fraud on the Market” Presumption of Reliance at Class Certification Stage in Securities Fraud Class Actions

by James J. Boland

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On June 21, 2021, the United States Supreme Court held a defendant in a “fraud on the market” securities fraud class action seeking to rebut the presumption of reliance at the class certification stage must prove that the alleged misrepresentations or omissions did not impact the price of the stock at issue by a preponderance of evidence. *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, --- U.S. --- (2021). The Court also held that a district court must consider all evidence relating to the lack of impact, even if that evidence goes to the merits of the claim.

To recover damages in a securities fraud action under Section 10(b) of the Securities and Exchange Act, 17 U.S.C. 78(j)(b), and Securities and Exchange Commission Rule 10b-5, a plaintiff must prove, among other things, that the plaintiff relied on a defendant’s material misrepresentation or omission when the plaintiff purchased or sold stock. In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the Supreme Court held that a plaintiff could prove reliance by invoking the “fraud on the market” theory, which is based on the premise that an investor relies on a misrepresentation or omission provided that it was reflected in the stock’s market price at the time of his transaction. *Erica P. John Fund, Inc. v. Halliburton Co.*, U.S. 804, 813 (2011). To invoke the presumption, a plaintiff must prove that the misrepresentation or omission was publicly known and material, that the stock traded in an efficient market, and that the plaintiff purchased or sold the stock after the misrepresentation or omission was made but before the truth was known.

The fraud on the market theory has traditionally been key to obtaining class certification in securities fraud cases. It allows class action plaintiffs to prove the normally individual issue of reliance on a class-wide basis with common proof, which in turn allows plaintiffs to satisfy a key requirement for class certification that “questions of law or fact common to class members predominate over any questions affecting only individual members.” Fed. R. Civ. P. 23(b)(3).

Absent such a presumption, individual issues of reliance would make class certification inappropriate. As a result, class action plaintiffs must prove that the prerequisites for the presumption exist – save for materiality, which is traditionally considered an issue for the merits – to obtain class certification. Defendants, in turn, may rebut the presumption by showing, among other things, that lack of the impact of any alleged misrepresentation or omission on the stock’s price.



In *Goldman Sachs*, the Court was confronted with two evidentiary issues relating to *Basic's* presumption. First, the Court was confronted with the issue of whether the nature of the alleged misrepresentation or omission, typically a matter of its materiality, is relevant and should be considered. The Court held that the nature of the misrepresentation or omission is relevant and should be considered, even if that presents issues of materiality that overlap with the merits of the case.

Second, the Court was confronted with the issue of whether a defendant need to merely produce evidence of a lack of price impact to rebut the presumption of reliance as provided by Federal Rule of Evidence 301, or whether the defendant must, in fact, prove the lack of impact – i.e. the burden of “persuasion” (proof) on this issue. The Court held that defendants bear the burden of persuasion. The Court held that Rule 301 does not bar courts from changing the burdens of persuasion under federal statutes, and that the Court’s prior decision on the price impact element did so.

As a result, a defendant in a securities fraud class action seeking to rebut the presumption of reliance under *Basic* must now prove, by a preponderance of evidence, the lack of any price impact by the statement or omissions at issue in order to defeat class certification. However, the evidence that the defendant may use to do so may include evidence relating to the materiality or immateriality of the alleged misrepresentations or omissions, even though that is traditionally considered evidence relating to the merits of the claim.

As *Goldman Sachs* shows, that can prove significant. In *Goldman Sachs*, a case brought under an “inflation maintenance” theory (not recognized to date by the Court), the alleged misrepresentations were generic statements about Goldman Sachs’ general business approach and policies. Plaintiffs alleged that these statements were inconsistent with Goldman Sachs’ operations, based on certain specific later disclosures of individual issues. Recognizing that the inference that a later stock drop was the result of prior inflation tied to such statements “starts to break down” when there is a mismatch between a specific corrective disclosure and a prior generic statement, the Court vacated and remanded the lower decision in *Goldman Sachs*, specifically directing the Court of Appeals to consider the nature of the misrepresentations.

To learn more about how this decision could impact you, contact James J. Boland at jboland@freeborn.com or 312-360-6548.

ABOUT THE AUTHOR



James J. Boland

Partner

Chicago Office
(312) 360-6548

jboland@freeborn.com

Jim has extensive experience and has represented a variety of corporations, businesses and professional firms in matters involving securities fraud, reinsurance (life & health, property & casualty), antitrust, accountant liability, consumer protection, shareholder and derivative disputes, mergers and acquisitions disputes, including post-closing disputes, and a variety of other commercial matters. He also has extensive experience in class action litigation, representing corporations and businesses in matters involving securities fraud, antitrust, residential and commercial mortgage practices, commercial leasing and other retail sales and marketing practices, and has experience in SEC and other governmental investigations.



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CHICAGO

311 South Wacker Drive
Suite 3000
Chicago, IL 60606
(312) 360-6000
(312) 360-6520 fax

NEW YORK

1155 Avenue of the Americas
26th Floor
New York, NY 10036
(212) 218-8760
(212) 218-8761 fax

SPRINGFIELD

217 East Monroe Street
Suite 202
Springfield, IL 62701
(217) 535-1060
(217) 535-1069 fax

RICHMOND

901 East Byrd Street
Suite 950
Richmond, VA 23219
(804) 644-1300
(804) 644-1354 fax

TAMPA

1 Tampa City Center
201 North Franklin Street
Suite 3550
Tampa, FL 33602
(813) 488-2920

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