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CLASS ACTION

ALERT

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2ND CIRCUIT REINFORCES STANDARD OF PROOF TO REBUT CLASS CERTIFICATION

By Samantha Banks and Ira Neil Richards

When a plaintiff in a securities fraud class action seeks to support a motion for class certification using a presumption of reliance where the stock trades in an efficient market, what burden does a defendant have to rebut the presumption to defeat class certification? That is, does the defendant bear the burden of persuasion on the issue, or is the defendant's burden only to produce evidence going to the issue, with the burden of persuasion remaining on the plaintiff? The Second Circuit recently issued an opinion in *Arkansas Teachers Retirement System. v. Goldman Sachs Group Inc.* reinforcing that the defendant bears the burden of persuasion of showing that a market was not efficient so that a presumption of reliance does not apply. The Second Circuit explained that a defendant in a securities fraud action must rebut the application of a presumption of reliance in an efficient market by a preponderance of the evidence. The Second Circuit's decision shows that a defendant can seek to satisfy its burden with evidence going to the market's awareness of the alleged misrepresented information.

The underlying securities fraud claims were filed against The Goldman Sachs Group, Inc. ("Goldman") and several of its directors after the 2008 housing bubble burst. Investors alleged that they lost more than $13 billion because the defendants' regulatory filings and public comments misstated their ability to avoid conflicts of interest. Federal enforcement, including 2010 civil fraud charges brought by the Securities Exchange Commission, caused Goldman's stock values to decline.

The plaintiffs moved to certify the class, setting forth evidence that they met all four elements as required under Fed. R. Civ. P. 23 (a) and arguing that they established predominance under Fed. R. Civ. P. 23 (b)(3) because they could take advantage of a presumption that all investors relied on the price of the stock in an efficient market. In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), the United States Supreme Court permitted plaintiffs in securities fraud cases to satisfy the requirement under Fed. R. Civ. P. 23(b)(3) that individual issues not predominate over common issues by invoking this rebuttable presumption of reliance. When the presumption of reliance applies, a plaintiff can avoid the need to prove that each potential class member relied on the alleged misrepresentation. If the presumption does not apply, then the need to prove individual reliance will preclude class certification because individual issues of proof will predominate over issues common to all class members.

The logic underlying the *Basic* presumption is that the market prices of shares traded on a well-developed market reflect all publicly available information, including material mis-representations. *Id.* at 246. Therefore, class members need not prove that they actually relied on the misstatement; under the *Basic* presumption, if an investor purchases stock after a misstatement is made, but before the truth is revealed, the investor is entitled to a presumption that the misstatement affected the stock price and that they purchased the stock in reliance on the integrity of that price.

The *Basic* presumption provides an alternative means for individual class members to meet class requirements under Fed. R. Civ. P. 23(b)(3) where claims arise under the federal securities laws. Defendants can rebut the *Basic* presumption of reliance and defeat class certification by "any showing that severs the link" between the misstatement and the market price. To rebut the presumption, defendants' evidence can include proof that the misrepresentation did not affect the stock price, that the misrepresentation was not public, or that the shares were not traded in an efficient market.

Relying on *Basic,* the plaintiffs in *Arkansas Teachers Retirement System* argued that they were entitled to a presumption that all class members relied on defendants' misstatements in choosing to buy Goldman stock. The defendants opposed class certification, putting forth evidence to rebut the assertion that the presumption of reliance could be applied under the facts of the case. Specifically, the defendants presented evidence of 34 dates before the plaintiffs purchased the stock in which various news sources reported Goldman's alleged conflict of interest that the plaintiffs had alleged were not disclosed. The defendants also offered evidence that there was no accompanying decline in the market price of the stock when the alleged undisclosed information became available to the market. In deciding whether the defendants had rebutted the plaintiffs' presumption of reliance, the district court held that defendants' proofs provided no "conclusive evidence" of a separation between the misrepresentation and the market action. The district court also considered the defendants' rebuttal evidence not relevant at the class certification stage, concluding that the evidence went to a "truth on the market" defense, and not to market efficiency. The district court thus found that the defendants had not rebutted the presumption of reliance and certified the class.

On appeal, the Second Circuit vacated the class certification order and remanded the case to the district court. The Second Circuit relied on its recent decision from another panel from the same Circuit, *Waggoner v. Barclays PLC*, 875 F.3d 79, 99 (2d Cir. 2017). Under *Barclays*, defendants have a burden of persuasion, not a burden of production, to overcome the *Basic* presumption, a burden of proof that defendants can satisfy by a preponderance of the evidence, the same evidentiary burden that applies to plaintiffs who are required to prove that class certification is appropriate. In *Arkansas Teachers Retirement System,* the district court appeared to have held the defendants to a higher standard, requiring "conclusive evidence" that the market was inefficient to rebut the *Basic* presumption.

Based on the district court's "conclusive evidence" analysis, it was unclear to the Second Circuit whether the district court was requiring more of the defendants than a preponderance of the evidence to rebut the *Basic* presumption. The Second Circuit also explained that on remand, the district court should consider the defendants' rebuttal evidence in assessing whether the defendants met their burden of persuasion. The Second Circuit explained that the defendants' evidence attempting to show the lack of an effect of a misrepresentation on the stock price because the information about the alleged conflicts of interests that the plaintiffs claimed were misrepresented was already disclosed was not relevant only to a "truth on the market" defense. Rather, the evidence was relevant to determining market efficiency in reacting to the alleged misrepresentation.

The Second Circuit's *Arkansas Teachers Retirement System* decision reinforces that class certification must be decided on an evidentiary record, applying a preponderance of the evidence standard even when the burden of persuasion on a class certification issue falls on a defendant. Moreover, both sides' evidence must be considered when the evidence goes to an issue of class certification, even where the evidence might also be relevant to non-class certification issues. ◆

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