Outside Counsel

'Goldman Sachs': SCOTUS, Aspirational Statements and Inflation-Maintenance

By **Anthony Michael Sabino**

It is now a commonplace for publicly traded corporations to include in their regulatory filings, annual reports, and assorted communiques so-called "aspirational statements," proclamations memorializing the company's deep commitment to transacting business with honesty and integrity, while observing the highest ethics. While critics deride the practice as, at best, merely stating the obvious, and, at worse, disingenuous self-congratulation (and they might have a point), most do no more than mildly applaud such public declarations of fealty to good corporate citizenship.

But such utterances are not without a cost. As previously exposited by this writer, see Sabino, "*#MeToo and Securities Fraud: Lessons from the CBS Case*," 263 *New York Law Journal* p.4, cl.4 (June 3, 2020), any revelations that the corporation has failed to live up to its high minded ideals is typically accompanied by harsh consequences, ranging from the reshuffling of upper management to reputational harm to an ensuing loss of business. The last mentioned almost inevitably leads to class action lawsuits brought by aggrieved shareholders who, in truth, suffer the most when, as a consequence of such duplicity, the corporation's share price declines. This is especially so when it is alleged that the malefactor promulgated these aspirational statements as a means to maintain its share price at artificially high levels, a species of federal securities fraud known as "inflation-maintenance."

Which brings us to a notable pairing of the newest landmarks on these precise subjects, the U.S. Supreme Court's very recent holding in *Goldman Sachs Group v. Arkansas Teacher Retirement System*, 594 U.S. ___ (June 21, 2021) (*Arkansas Teacher*), and the even more recent decision of the district court on remand, *In re Goldman Sachs Group, Inc. Securities Litigation*, ___ F. Supp. 3d ___ (No. 10 Civ. 3461) (S.D.N.Y. Dec. 8, 2021) (*Goldman*). Destined to influence federal securities cases yet to come, they are worthy of examination.

In this, our first installment, we shall begin with a review of the fundamentals of reliance and "fraud on the market," and then set forth the high court's latest views of same, as elucidated in *Arkansas Teacher*. Our second writing will then exposit *Goldman*, and the trial court's application of that fresh guidance to the controversy at hand.

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Reliance and 'Fraud on the Market'

It is beyond cavil that §10 of the Securities Exchange Act of 1934, working in conjunction with its boon companion, Rule 10b-5, is the preeminent anti-fraud provision of the federal securities laws. See 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5, respectively. And it is equally true that pleading securities fraud thereunder is a formidable task. In order to survive dismissal, any claim of wrongdoing in securities transactions must set forth with specificity allegations of: (1) material misrepresentations or omissions; (2) made with scienter; (3) in connection with the purchase or sale of a security; (4) reliance upon same by the plaintiff; (5) economic loss; and (6) loss causation. See *Amgen v. Connecticut Retirement Plans and Trust Funds*, 568 U.S. 455 (2013).

In the nearly nine decades that §10 has held sway, it is the fourth element, reliance, which has proven to be one of the more difficult obstacles for plaintiffs to overcome, particularly in representative litigation. After all, how does one prove reliance by a diverse group of plaintiff/stockowners, some or possibly all of whom lack personal knowledge of the alleged misstatements?

To surmount that impediment, years ago the Supreme Court crafted the "fraud on the market" theorem, also known in the lexicon as the "*Basic* presumption." In oversimplified terms, this rebuttable assumption presupposes that investors everywhere rely upon an efficient, impersonal market that absorbs every publicly available iota of material information about a security, even misrepresentations, and then immediately and coolly reflects those inputs in a trustworthy share price. See *Basic v. Levinson*, 485 U.S. 224 (1988). The device is especially useful to putative representatives seeking class certification for disgruntled shareholders, as it embraces evidence common to the group as proof of reliance, with the further salutary benefit of satisfying Rule 23's requirement that common questions of fact or law predominate throughout the proposed class. See Fed. R. Civ. P. 23(b)(3).

Yet a defendant can successfully rebut the *Basic* presumption by delinking the purported misstatement from any movement in the security's market price. Put another way, if the alleged falsehood has no "price impact," then *Basic*'s underpinnings collapse, blocking class certification. See *Halliburton Co. v. Erica P. John Fund*, 573 U.S. 258 (2014). All this being established, we may now proceed to our discussion of *Arkansas Teacher*.

'Arkansas Teacher'

The case at bar pitted Goldman Sachs, which needs no introduction, against certain pension funds invested in the » Page 7

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Statements

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financial titan's stock. The latter accused the global powerhouse of inflation-maintenance, supposedly rooted in the investment bank's aspirational statements lauding safeguards against conflicts of interest, yet said to be a mere cloak for malfeasance against its clients' best interests. After failing to secure dismissal of the litigation, Goldman petitioned for high court review on the following question: Can allegations of inflation-maintenance be defeated by showing that the defendant's purported misrepresentations were so generic that they could never be correlated with any subsequent corrective disclosures, and therefore lacked any price impact? See *Petition for a Writ of Certiorari*, at I (Aug. 21, 2020).

Near the outset, *Arkansas Teacher* stipulates that "[t]his case concerns the element of reliance," where individualized proof is the "'traditional (and most direct) way'" of satisfying that fourth prong of the six-point test for securities fraud, in contradistinction to proving same by means of the alternative modality of "fraud on the market."

The Justices were unified (more or less) in confirming that the requirements for invoking the *Basic* presumption remain unchanged; a plaintiff must demonstrate: (1) the alleged misrepresentation was publicly made; (2) was material; (3) the stock traded in an efficient market; and (4) the plaintiff transacted her shares in the period between the issuance of the misstatement and revelations of its falsity. Likewise, the high bench reiterated the maxim that an assumption of "fraud on the market" can be rebutted by demonstrating that the alleged falsity "'*in fact* did not lead to a distortion of price.'"

Writing for the court, Justice Barrett opined that the *Basic* presumption "has particular significance in securities-fraud class actions." The supreme tribunal's newest member observed that the presumption empowers litigants "to prove reliance through evidence common to the class," while at the same time conforming to the strictures regulating representative litigation. Furthermore, were it not for the aegis of the *Basic* presumption, class certification would be defeated in most cases.

Arkansas Teacher then expounded the Supreme Court's current perspective on the inflation-maintenance theory, declaring that the sustainability of such a claim pivots upon, first, the existence of an alleged misrepresentation which "'prevent[s] preexisting inflation from dissipating from the stock price,'" and, second, its price impact, "the amount that the stock's price would have fallen 'without the false statement.'"

Announcing a rule that is certain to resonate beyond the confines of the controversy at bar, the Supreme Court proclaimed that "[t]he 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." *Arkansas Teacher* admonishes that any inference that a subsequent drop in market value equates with earlier price inflation "starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure."

Striking a precautionary note, the Justices warned that, the more generalized the catalytic alleged misrepresentation is when contrasted to a subsequent and more precise remedial statement, then the "less likely that the specific disclosure actually corrected the generic misrepresentation." To be sure, Justice Barrett illustrated the point by comparing a typical aspirational statement with a more definitive correction.

But *Arkansas Teacher* does not end there. In two significant parentheticals, the Supreme Court may very well set the stage for further proceedings in this case, and others like it.

In the first, Justice Barrett explicitly declared that, while a number of circuit courts have expressed a variety of views on the inflation-maintenance theory, "this Court has expressed no view on is validity or its contours. We need not and do not do so in this case." And in the second footnote, the high bench catalogues, without approbation, certain conflicting appellate holdings as to whether the relative generality or specificity of alleged misstatements bolsters or defeats a claim of inflation-maintenance.

The paramount question remained: In the proceedings below, had the lower courts properly considered the generic aspect of the investment bank's alleged falsehoods? Since the majority admitted to "sufficient doubt on this score," the controversy was remanded.

In closing today, we contend *Arkansas Teacher*'s most telling points are these: that reliance remains one of most crucial elements of federal securities fraud; that the "fraud on the market" theory first articulated in *Basic*, and its attendant presumption, retain their full vigor; and, as Justice Barrett warns in what may prove to be a prescient footnote, the Justices have yet to opine on the validity and contours of the inflation-maintenance theory, especially in relation to aspirational statements and their impact on price.

While the high court's final word of such matters may be in distant future, we do have the immediacy of the district court's decision on remand, applying this recent wisdom from the supreme tribunal. Those particulars shall be examined in detail in our next installment.