CLIENT ALERT

Finally!: Second Circuit Reverses Class Certification Decision Seemingly Resolving the Longstanding Goldman Sachs CDO Securities Class Action Litigation Saga

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Yesterday, the Second Circuit issued its much-anticipated ruling in *Arkansas Teacher Retirement System v. Goldman Sachs Group, Inc.*, No. 22-484, reversing the district court's order certifying a class of investors. The decision reinforces the Supreme Court's 2021 decision (issued in this same case), which instructed district courts to carefully consider the degree of "mismatch" between the alleged misstatements and the corrective disclosures in inflation-maintenance cases. *See Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys.*, 141 S. Ct. 1951 (2021) (*Goldman*). Following remand from the Supreme Court, the district court again certified the class based on a strained reading of *Goldman*. The Second Circuit has now reversed the district court. In doing so, it emphasized that the district court "fail[ed] to heed *Goldman*'s cautionary guidance that the back-end—front-end inference starts to 'break down' when there is a mismatch in genericness at the front and back ends." *Id.* (internal citation omitted).

This case has been the subject of a class certification fight for nearly a decade, and Willkie has served as counsel for an amicus group of law professors and former SEC officials whose scholarship and professional practice focus on issues of securities class action litigation practice. Most recently, Willkie submitted both merits and Rule 23(f) amicus briefs to the Second Circuit in support of Goldman's positions, and prior to that, an amicus brief to the Supreme Court. Given that the Second Circuit decertified the class, rather than remanding to the district court for further consideration, this decision likely ends the class certification dispute in the case, subject to any attempts by the plaintiffs to pursue further appellate review.

The Opinion

Most importantly, the Second Circuit ruled that the district court's price impact analysis was based on an overly expansive application of the inflation-maintenance theory as set forth in *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223 (2d Cir. 2016). In *Vivendi*, the Second Circuit held that the proper "inquiry into price impact is not what might have happened had a company remained silent, but what would have happened if it had spoken *truthfully*." 838 F.3d at 258.

The Second Circuit explained that *Vivendi's* analysis is straightforward in cases where the alleged misstatement is directly implicated by the corrective disclosure—the strong link between the two "provide[s] sturdy ground to use the back-end price drop as a proxy for front-end inflation." Op. at 52. However, where the corrective disclosure does not directly implicate the alleged misrepresentation, *Vivendi* provides that the "truthful substitute" should align in detail with the alleged misrepresentation. Op. at 53–54. And even then, the Court made clear that *Goldman* requires not only that the subject matter of the misstatement and the corrective disclosure match, but that the gap in genericness between the two is limited. Op. at 55, 58.

Applying this framework, the Court found that the alleged misstatements about conflicts (for example, "we have extensive procedures and controls that are designed to identify and address conflicts of interest") and the corrective disclosures (for example, an SEC enforcement action involving a failure to disclose a conflict of interest) bore on the same subject: conflicts of interest management. Crucially, however, none of the corrective disclosures directly implicated the alleged misstatements given the considerable gap in specificity between the two. Op. at 55–56. Because of this, the district court should have asked what would have happened had Goldman spoken truthfully at an equally generic level. Op. at 56. Instead, when asking what would have happened had Goldman spoken truthfully—"in what amounts to the crux of [its] misstep"—the district court substituted the details and severity of the corrective disclosure in place of the generic statements, notwithstanding the district court's own finding that the front-end statements are much more generic than the back-end disclosures. Op. at 56. The Court found that "requiring only a general front-end—back-end subject matter match" to effectively "concoct a highly specific truthful substitute does not meaningfully account for the Supreme Court's guidance in *Goldman*." Op. at 59.

The Court's Guidance for Inflation Maintenance Cases Moving Forward

The Court concluded its opinion by providing much needed guidance for courts moving forward when faced with class certification motions in securities fraud cases proceeding under the inflation maintenance theory. Specifically, the Court stated that courts must conduct "a searching price impact analysis" in cases "where (1) there is a considerable gap in front-end–back-end genericness . . ., (2) the corrective disclosure does not directly refer . . . to the alleged misstatement, and (3) the plaintiff claims . . . that a company's generic risk-disclosure was misleading by omission." Op. at 63. In those cases, courts can look to "case law bearing on materiality" for guidance "in considering, as a factual matter, the generic nature of the alleged misrepresentation." *Id*. If the court determines that a gap in genericness exists between the alleged

misstatement and the corrective disclosure, "court should ask, under *Vivendi*, whether a truthful—but equally generic—substitute for the alleged misrepresentation would have impacted the stock price." *Id*. In doing so, "courts should consider other indirect evidence of price impact" and ultimately determine "whether the defendant spoke on topics generally important to investment decision-making," and also "whether the defendant's statements on that topic were important in the regard." *Id*. at 64.

Conclusion

This decision is a significant win for Goldman Sachs, as well as other underwriters, issuers, and securities defense practitioners in general. Most notably, this decision makes it substantially more difficult for plaintiffs to certify securities classes based on generic misstatements. In this regard, the decision limits the application of the inflation maintenance theory by preventing plaintiffs from achieving near automatic class certification in such cases. Under the approach embraced by the district court, plaintiffs could argue that a generic statement had price impact as evidenced by the stock market reaction when that generic statement was "corrected" later by a much more specific and detailed disclosure. That approach has now been squarely rejected by the Second Circuit. Moreover, the court's crucial guidance provides a real path forward for defendants to rebut the *Basic* presumption at the class certification stage. The breadth of the decision remains to be determined, but the Court's application of the materiality case law when considering the price impact of generic misstatements will also arm defendants with new and additional arguments when moving to dismiss complaints alleging generic misstatements.

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If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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