Securities Regulation Daily Wrap Up, SUPREME COURT DOCKET—U.S.: October Term 2020: The Court clarifies the approach to analyzing evidence of price impact, (Jul. 2, 2021)

Securities Regulation Daily Wrap Up

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The *Basic* analysis received a small clarification, and the Court will take up the application of the discovery stay in Securities Act cases brought in state court.

With the release of the last of 66 opinions on July 1, 2021, the Supreme Court has acted on all of the cases submitted for its October 2020 Term. Of these opinions, two are of interest to the securities community. Hanging by a hair over the term has been the possibility of the Court revisiting *Basic* in a petition brought by Goldman Sachs. While there was no sea change in the law, the Court took the opportunity to clarify that appellate courts should consider *all* evidence relevant to price impact. In the other case, the court overturned a Third Circuit holding that Delaware's judicial-selection requirements violated the First Amendment. Finally, the final order list contains a grant of certiorari for a petition addressing the PSLRA discovery stay. The court is in summer recess until Monday, October 4, 2021, when the October 2021 Term will begin.

Discovery stay: state or federal? In its final order list of the term, the Court granted certiorari for a case asking whether the PSLRA discovery-stay provision applies to a private action under the Securities Act in state or federal court, or solely to a private action in federal court. *Pivotal Software, Inc. v. Tran*, concerns the discovery stay found in Section 27(b)(1), which states that it applies to "any private action" arising under the Securities Act.

The action at issue was filed in the California Superior Court, challenging statements made in a software company's IPO registration statement and bringing claims under Securities Act Sections 11 12(a)(2), and 15. The trial court denied a motion to stay discovery after concluding that the provision only applies in federal courts, in part due to the lack of express references to state courts in the text. The California appellate and Supreme Court both summarily denied relief.

The petition argued that the plain language of the provision applies to any private action, just like it says, no matter if brought in state or federal court. The state trial courts, however, are split on the issue, with some insisting that the provision only applies in the federal courts. This divide has deepened since the 2018 *Cyan* decision holding that state courts have concurrent jurisdiction over Securities Act claims and the subsequent increase in those claims being filed in state courts. The issue, however, has consistently evaded appellate review since it arises during a stage not reviewable after final judgment and, moreover, the disputes and orders are often unreported. The petition said that since there is no viable path for appellate review of this question, the Court should take the opportunity to clarify the matter.

In their brief in opposition, the respondents argued that the issue is now moot because they have irrevocably committed to adhering to the stay and because the motion to dismiss will have been decided before the Court can take up this case (on August 2, 2021, according to the brief). The respondents offered several other reasons for denial, pointing out that, at the very least, this "minor procedural question" should be allowed to percolate through the lower courts. In reply, the petitioners' brief remarked that the respondents' "eleventh-hour" efforts to moot the petition and downplay its significance as confirmation of the need for review. The issue has percolated for two decades, the arguments have been fully-aired, and there is no textual ambiguity, the petitioners said. In addition, the controversy is justiciable because the question presented is capable of repetition, yet evades review. Finally, the brief notes that many Securities Act suits—like this one—are filed in San Francisco, and the Superior Court will likely confront the issue again, including in cases involving the very same petitioners.

Goldman Sachs. On June 21, 2021, the Court confirmed that the generic nature of an alleged misrepresentation is important evidence of price impact. At issue in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System* was the rebuttal of the *Basic* presumption in class actions premised on the inflation-maintenance theory. The stakes were high in the beginning: the petition refers to the issue as "the most important securities case" since *Halliburton II*, presenting "recurring questions of huge practical significance." By the time the parties made their cases before the court, however, the arguments narrowed, and the dispute "largely evaporated."

In this case, the plaintiffs relied on the "inflation maintenance" theory, alleging that Goldman's repeated misrepresentations in SEC filings and annual reports about its business practices prevented the inflation from dissipating. For its part, Goldman asserted that the statements at issue were generic and aspirational and sought to rebut the *Basic* presumption by showing a lack of price impact. The district court again certified the class, and a divided panel of the Second Circuit affirmed that Goldman had failed to carry the burden of proving a lack of price impact.

Oral argument was heard on March 29, 2021. By this time, the parties had narrowed their arguments to the point that both agreed that a court may consider the nature of a statement in determining price impact (as opposed to Goldman's argument below in its petition that generic statements cannot have price impact as a matter of law). As a result, the justices at times seemed to struggle to determine whether there was, as the Chief Justice put it: "any daylight on the substantive question between the two of you concerning the generic statements?"

Justice Barrett delivered the opinion, in which Justices Roberts, Breyer, Kagan and Kavanaugh joined in full. Without opining on the validity of the inflation maintenance theory, the opinion clarified the assessment of price impact at class certification. All evidence relevant to price impact should be considered, the Court said, even if it is also relevant to the merits. And, the generic nature of a misrepresentation can be important evidence of a lack of price impact.

Since the parties no longer disputed whether the generic nature of the alleged misrepresentations was relevant to price impact, the only disagreement was whether the nature of Goldman Sachs's statements had been properly considered by the Second Circuit. It was unclear to the Court whether the Second Circuit did so; as a result, the judgment was vacated and the case remanded for the appellate court to consider all record evidence relevant to price impact. With the exception of Justice Sotomayor, who would have affirmed the Second Circuit, all of the justices joined in this holding.

The second question presented in this case concerned the burden of persuasion on price impact at class certification. Goldman argued that Federal Rule of Evidence 301 applies to the *Basic* presumption at class certification, meaning that once a defendant discharges its burden of production and rebuts the presumption, the plaintiff must carry the burden of persuasion to show price impact. The majority disagreed with Goldman's interpretation of the rule, stating that the Court has the authority to assign defendants the burden of persuasion to prove a lack of price impact. The best reading of the Court's precedents is that the defendant bears the burden of persuasion to prove a lack of price impact—Justice Barrett acknowledged that this allocation "is unlikely to make much difference on the ground."

Justice Gorsuch, joined by Justices Thomas and Alito, vigorously dissented from this portion of the opinion. In *Basic* and in the 30 years since, Justice Gorsuch wrote, the Court has never even suggested that plaintiffs are relieved from carrying the burden of persuasion: "It is incumbent on the plaintiff to prove reliance, not the defendant to disprove it." In the majority opinion, Justice Barrett replied that if the presumption could be defeated by introducing any competent evidence of a lack of price impact, the plaintiff would end up with the burden of directly proving price impact in almost every case.

Delaware judge bar. Another opinion issued this term had the potential to have a wide-ranging impact on Delaware's courts, including the Chancery Court, which has tremendous influence on questions of corporate governance. On December 10, 2020, the Court held in *Carney v. Adams* that a judicial aspirant lacked standing to challenge how Delaware picks judges. The Court concluded that a would-be judge failed to show that he was "able and ready" to apply for a judicial vacancy and thus lacked standing to bring a constitutional challenge against Delaware's party-membership requirements for its judiciary.

The case involved a longstanding provision in Delaware's state constitution that sets out a system by which the benches of the state courts must be balanced between the major political parties. In practice, a provision requiring members to be in a "major party" effectively excludes all candidates who are not members of the Republican or Democratic parties from the Supreme Court, Superior Court, or Chancery Court. The case was brought by a Delaware resident, James Adams, who wished to be considered for a judicial position open to Republicans, but, being an Independent, believed that applying would be futile. Adams successfully argued in the district court and in the Third Circuit that the Delaware constitution's political balance provisions violated his associational rights under the First Amendment.

Delaware's petition for certiorari asked if the First Amendment invalidated political balance provisions and whether the major-party provision was severable. The petition argued that the Court should resolve a circuit split regarding the application to judges of a line of Supreme Court decisions prohibiting the government from making party affiliation a condition of employment if that employee is not in a policymaking position. Certiorari was granted in December 2019, and in addition to the questions presented by the petition, the Court asked the parties to brief and argue the threshold issue of whether Adams had demonstrated Article III standing.

In an 8-0 decision by Justice Breyer (Justice Barrett took no part in this case), the Court reversed the Third Circuit's decision with respect to standing, vacated the judgment, and remanded with instructions to dismiss the case. As Justice Breyer put it: "This case begins and ends with standing." Unfortunately for Adams, the Court concluded that he suffered only a "generalized grievance" to which all citizens of Delaware are subject and was unable to show that he was "able and ready" to apply to be a judge in the reasonably foreseeable future. The holding in this case, then, follows from a straightforward application of precedent to the record: Adams failed to show that he was "able and ready" to apply and consequently lacked a personal, concrete, and imminent injury.

Olan. Finally, the Court took up a case concerning the Dirks personal benefit question in the Title 18 context, but the question must await a better vehicle. In its first order list of the year, the Court granted certiorari in *Olan v. U.S.*, but then vacated and remanded for further consideration. In this case, the Second Circuit upheld the convictions of hedge fund analysts on criminal charges arising from their misappropriation of confidential information. The appellate court held that the Dirks v. SEC (1983) personal-benefit test does not apply in criminal prosecutions under the wire fraud and securities fraud provisions of Title 18 of the U.S. Code.

The case was remanded for further consideration in light of the holding in Kelly v. U.S., which was decided after the Second Circuit issued its opinion. In Kelly, the Court held that a scheme to alter a regulatory decision that did not aim to obtain money or property could not have violated the federal-program fraud or wire fraud laws. While Kelly was discussed in the petition for certiorari, it was previously mentioned only in supplemental letters addressing the petitioners' motions to stay the court of appeals' mandate. The GVR order also embraced the petition in *Blaszczak v. U.S.*, in which the petitioner was a codefendant below with the Olan petitioners and which asked the same questions as the petition in Olan.

Pending case. While the Goldman case did not have the potentially seismic effect it could have had as originally presented, the Court will have another opportunity to address the Basic presumption in the coming term. In *Bofl Holding, Inc. v. Houston Municipal Employees Pension System* the court is asked to address whether, for the purposes of establishing loss causation, the "truth" entered the market through unsubstantiated allegations in lawsuit. In this case, the Ninth Circuit held that a whistleblower complaint served as a corrective disclosure where the market perceived the allegations as credible. The petition argues that the court should have demanded additional confirmation before allowing this claim to proceed, especially where, as in this case, the whistleblower's allegations did not pan out.

The petition also takes issue with the Ninth Circuit's use of the market reaction to infer that the truth became known, which, the petitioner maintains is misapplies Dura and conflicts with Basic. Since the loss causation theory in this case rests on the efficient capital markets hypothesis endorsed in Basic, the petition asks the Court to consider whether it should overrule Basic to the extent it recognizes that hypothesis, because it sows confusion in the lower courts with respect to the proper analysis of loss causation. The petition also noted the shift toward "informationless" passive investing seen in indexes and ETFs as well as the recent GameStop

trading, which had little or nothing to do with the company's expected economic performance. As well as being anachronistic, the petition argues, the Basic presumption allows "event-driven" litigation and other abusive trends. In its brief in opposition, the respondent avers that this argument was considered and rejected in *Halliburton II*, so there is no need to reconsider this recently reaffirmed precedent.

Certiorari denied. Finally, the court denied certiorari in nearly a dozen other securities-related cases, which may be referenced in the final version of the Supreme Court Docket for this term. Issued opinions, granted petitions, pending petitions, and denied petitions are listed separately, along with a summary of the questions presented and the current status of each appeal.

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