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Recent Developments in Securities Class Actions: 'Goldman', Market Speculation and Loss Causation, and Triggering the Exchange Act's Statute of Repose

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Recent federal case law has seen a number of important developments in securities class actions, including the Supreme Court's grant of certiorari in *Pivotal Software v. Tran* on the issue of whether the PSLRA's discovery stay applies to state court actions under the Securities Act of 1933. While securities litigators will be closely watching *Pivotal Software*, this article discusses three other key developments: (1) the Supreme Court's decision in *Goldman Sachs Group v. Arkansas Teacher Retirement System* clarifying that courts should consider the generic nature of a misrepresentation as part of price impact disputes at the class certification stage; (2) cases addressing whether stock drops resulting from market speculation are recoverable as securities fraud damages under *Dura Pharmaceuticals v. Broudo* and progeny; and (3) a growing consensus among district courts in the Second Circuit that the Exchange Act's statute of repose is measured from the date of each alleged misrepresentation, rather than the last one. Each of these developments presents risks and opportunities that defendants in §10(b) cases should take into account as they craft their litigation strategy.

The Supreme Court Addresses Class Certification Standards in Securities Fraud Class Actions in 'Goldman Sachs Group v. Arkansas Teacher Retirement System'. The standards for class certification in a securities fraud suit brought under §10(b) of the Exchange Act recently came before the Supreme Court in *Goldman*. In holding that (1) the generic nature of a misrepresentation is potentially important evidence bearing on the price impact analysis at the class certification stage, and (2) the defendant bears the burden of persuasion to prove a lack of price impact by a preponderance of the evidence, the Supreme Court left these standards largely undisturbed. Nonetheless, there is language in the decision that may prove helpful to defendants not only

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in price impact disputes, but also on merits issues of loss causation and damages.

The plaintiffs alleged that Goldman maintained an inflated stock price through arguably innocuous statements concerning its conflict-of-interest policies. After surviving a motion to dismiss, the plaintiffs moved to certify a class of shareholders by invoking the *Basic* presumption of reliance. Goldman attempted to rebut that presumption by proving a lack of price impact, introducing expert testimony and highlighting the generic nature of the alleged misstatements. The district court certified the class and the Second Circuit affirmed.

At oral argument before the Supreme Court, plaintiffs' counsel

conceded that the generic nature of an alleged misrepresentation is potentially relevant evidence of a lack of price impact that should be considered at the class certification stage, even though such evidence is also relevant to merits issues (notably materiality). Thus, the result was unsurprising, and indeed the court weighed in on the matter apparently to dispel ambiguity as to whether the Second Circuit had held otherwise.

The court's analysis of this issue may be helpful, however, on matters relating both to price impact and loss causation and damages in inflation-maintenance cases. According to that theory—the validity of which was not before the court—alleged misstatements that do not cause the stock price to rise nonetheless cause securities fraud damages by "maintaining" preexisting inflation in the defendant's stock price. Therefore, plaintiffs reason, damages should correspond to the stock price drop following a negative disclosure that purportedly corrected the alleged misstatements. However, the court noted, "that inference—that the back-end price drop equals front-end inflation—starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure." The court indicated that the mismatch may occur when the "earlier misrepresentation is generic (e.g., 'we have faith in our business model') and the later corrective disclosure is specific (e.g., 'our fourth quarter earnings did not meet expectations')." The court noted that "[u]nder those circumstances, it is less likely that the specific disclosure actually corrected the generic misrepresentation, which means that there is less reason to infer front-end price inflation—that is, price impact—from the back-end price drop." The court's discussion, while arguably dicta, may support arguments that generic misrepresentations did not in fact inflate the stock price, bolstering a lack of price impact presentation at the class certification stage. It may also support more fundamental merits arguments that a sharp stock price decline following a corrective disclosure is not attributable to—or is at most *partially* attributable to—the alleged fraud.

On the second issue presented—who bears the burden of persuasion on the price impact question—the court rejected Goldman's argument that the burden-shifting framework in the context of price impact disputes should function like any other under Federal Rule of Evidence 301, requiring the defendant only to meet the burden of production to swing the burden of proving price impact back to the plaintiffs. In so holding, the court wrapped itself in the cloak of *Basic* and *Halliburton II*, which requires defendants to "sever the link between a misrepresentation and the price paid by the plaintiff" in order to rebut the presumption of reliance.

The court commented that the burden of persuasion is unlikely to make any practical difference "on the ground" of securities class actions, because the question of burden will only have an effect in the rare case where a court finds the evidence in complete equipoise. While this may be true, the court failed to acknowledge that it is not only "equipoise" cases that are rare, but also cases where any defendant has been successful in rebutting the presumption of reliance, raising more fundamental questions as to whether the price impact mechanism established by *Halliburton II* is an illusory defense to the *Basic* presumption. Thus, while *Goldman* provides little by way of practical guidance to litigants in §10(b) cases, it will also do little to quell ongoing challenges to *Basic* itself (such as in the pending cert petition discussed below).

In Light of a Circuit Split, the Relationship Between Market Conjecture and Loss Causation Is Potentially Teed Up for Supreme Court Review. In §10(b) actions, plaintiffs typically prove loss causation by showing a price decline following a corrective disclosure. But what happens when the market overreacts to uncorroborated allegations or the simple fact of an internal investigation? And what if that overreaction proves to be unwarranted? Depending on the facts and circumstances, defendants may have persuasive arguments to mitigate liability in these situations.

Whether loss causation can be established by stock price drops resulting from market conjecture has been teed up for Supreme Court review in the recent petition for a writ of certiorari in *BofI Holding v. Houston Municipal Employees Retirement Pension System*, No. 18-55415 (cert. petition filed March 26, 2021). There, the defendants seek review of a Ninth Circuit judgment holding that an employee lawsuit containing

purportedly unproven and speculative allegations could constitute a corrective disclosure. At the motion to dismiss stage, the Ninth Circuit held, "the relevant question for loss causation purposes is whether the market reasonably believed [the employee's] allegations as true and acted upon them accordingly." Among the questions to the court was "[w]hether disputed public allegations about an issuer or its business, without any additional corroborating disclosure or event, reveal to an efficient market the "truth" for the purposes of establishing loss causation under *Dura*."

While the cert petition is pending, lower courts continue to issue conflicting decisions on the issue of market speculation. For example, a recent Ninth Circuit memorandum opinion lies in some tension with *BofI Holding*. In *New York Hotel Trades Council & Hotel Association of New York City, Inc. Pension Fund v. Impax Laboratories*, 843 F. App'x 27, 31 (9th Cir. 2021), the Ninth Circuit ruled that the plaintiffs failed to plead loss causation stemming from media reports that "consisted of speculation about whether the defendants would be indicted as part of the [DOJ's] investigation into price-fixing on the generic drug market." The Ninth Circuit held, "[b]ecause 'the market [could not] possibly know' whether defendants would be indicted, the decrease in [the defendant corporation's] share price following these media reports could be attributed only to market speculation about the accuracy of the media speculation concerning potential criminal liability."

Although the makers and nature of the purported corrective disclosures differ, at bottom, the stock price drops in *BofI Holding* and *Impax Labs* were both caused by uncorroborated market speculation. However, only the *Impax Labs* defendants successfully moved to dismiss these allegations.

The Ninth Circuit's decision in *BofI Holding* also conflicts with case law issued by its sister circuits. In *Meyer v. Greene*, 710 F.3d, 1189, 1201 (11th Cir. 2013), the Eleventh Circuit held that the announcement of an investigation, without any subsequent disclosure of wrongdoing, cannot constitute a corrective disclosure for the purposes of establishing loss causation. The Eleventh Circuit reasoned that, absent a disclosure of wrongdoing, the announcement of an investigation indicated no more than an "added *risk* of future corrective action," not underlying conduct that revealed prior statements to be false or misleading. Accordingly, the Eleventh Circuit held that there could be no liability based on these announcements. *BofI Holdings* and *Meyer* ultimately rely on similar factual bases: unproven allegations caused the defendant corporation's stock price to drop and these allegations were never found to be true. Yet the Ninth and the Eleventh Circuits reached opposite conclusions regarding loss causation. The Ninth Circuit's decision in *BofI Holdings* also conflicts with the Second Circuit's decision in *In re Omnicom Securities Litigation*, 597 F.3d 501, 513-14 (2d Cir. 2010), in which the court found that the market's speculation as to what a director's resignation portended concerning suspected accounting improprieties did not establish loss causation.

Arguing that losses stemmed from market speculation—rather than from the disclosure of the truth—may be a promising defense for §10(b) defendants in appropriate circumstances. This issue recently arose in Milbank's representation of the defendant in *Villella v. Chemical and Mining Company of Chile*, Case No. 15-cv-2106 (S.D.N.Y.), where the plaintiffs sought damages stemming from a stock price drop that followed the resignation of a block of corporate directors. Although the entity that nominated the directors issued a press release shortly after the resignations, it was non-descript, and the reasoning it offered was distinct from the fraud alleged by the plaintiffs. Milbank argued that the stock price drop following the resignations was not a result of the revelation of any previously concealed truth, but rather the effect of market speculation that the director resignations augured more negative news. The issue was contested throughout expert discovery and presented to the court in dueling summary judgment motions. Although the case was settled prior to the court's adjudication of the issue, the parties agreed that it was central to the court's resolution of whether plaintiffs could establish loss causation and damages.

District Courts Within Second Circuit Build Consensus on Repose Clock Trigger in §10(b) Cases. Under the Exchange Act's statute

of repose, a private right of action involving fraud must be brought within five years of the alleged violation. 28 U.S.C. §1658(b)(2). Although it was intended to provide certainty to defendants, district courts in the Second Circuit applying the Exchange Act's statute of repose have reached "diametrically opposite conclusions" when it comes to continuing violations. *In re Teva Sec. Litig.*, 2021 WL 231130, at *5, 6 (D. Ct. Jan. 22, 2021). Specifically, when plaintiffs allege a series of misrepresentations, courts have diverged on whether the statute of repose analysis applies to *each* alleged misstatement, or whether the statute of repose clock only starts on the date of the *last* alleged misstatement.

However, two recent decisions by courts in the District of Connecticut and the Southern District of New York have contributed to a building consensus within the Second Circuit that, when a plaintiff alleges continuing violations, each alleged misstatement or omission may be time-barred by the Exchange Act's statute of repose.

In *In re Teva Securities Litigation*, the defendants moved to dismiss the plaintiffs' §10(b) claims to the extent they were based on misstatements or omissions that occurred more than five years prior to the date the plaintiffs filed their first complaint. The plaintiffs argued "that the Supreme Court and other lower courts have repeatedly stated that the Repose Clock in analogous circumstances begins running at a defendant's 'last culpable act or omission.'" The court acknowledged that "when the Repose Clock begins to tick in a Section 10(b) case is a relatively open issue."

The plaintiffs relied primarily on two Supreme Court cases: *California Public Employees' Retirement System v. ANZ Securities*, 137 S. Ct. 2042 (2017), and *CTS Corporation v. Waldburger*, 573 U.S. 1 (2014). The plaintiffs identified language from *ANZ Securities* in which the court wrote, "statutes of repose begin to run on 'the date of the last culpable act or omission of the defendant.'" Similarly, the plaintiffs highlighted language in *Waldburger* suggesting that a statute of repose is "measured not from the date on which the claim accrues but instead from the date of the last culpable act or omission of the defendant." The court was not persuaded, as neither of these cases arose under the Exchange Act. Further, it held, "in both cases, the Court was simply emphasizing that a repose period begins to run at the conclusion of a Defendant's culpable behavior, rather than when a claim accrues."

The parties advanced similar arguments in *Abu Dhabi Investment Authority v. Mylan N.V.*, 2021 WL 516310, at *2 (S.D.N.Y. Feb. 10, 2021). Like the court in *In re Teva*, however, the court in *Abu Dhabi* found that these cases did not support the plaintiff's position. Instead, the court held that *ANZ Securities* and *Waldburger* suggested "that the specific language of a statute of repose … matters for determining the relevant 'last culpable act or omission.'" The Exchange Act's statute of repose foreclosed claims "five years after [a] violation" and thus there was "no indication in the statutory language that Congress intended the statute of repose to run from the *last* violation." The court held that its conclusion was actually supported by *ANZ Securities* and *Waldburger*, which "confirm the Court's strong caution regarding equitable tolling of statutes of repose."

As suggested by *In re Teva* and *Abu Dhabi*, courts in the Second Circuit have begun to close the open question of the triggering event for the Exchange Act's statute of repose. Exchange Act defendants should be cognizant of this growing body of case law in evaluating the timeliness of plaintiffs' allegations. See, e.g., *Seagrape Invs. v. Tuzman*, 2020 WL 5751232, at *14 (S.D.N.Y. Sept. 25. 2020); *Sjunde AP-Fonden v. Gen. Elec. Co.*, 417 F. Supp. 3d 379, 391 (S.D.N.Y. 2019); *Freihofer v. Vermont Country Foods*, 2019 WL 2995949, at *4 (D. Vt. July 9, 2019); *Kuwait Inv. Off. v. Am. Int'l Grp.*, 128 F. Supp. 3d 792, 807 (S.D.N.Y. 2015); *Marini v. Adamo*, 995 F. Supp. 2d 155, 183-84 (E.D.N.Y. 2014).

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