

2nd Circ. Clarifies Cert. Standard For Stock-Drop Actions

By **Dunstan Prial**

Law360, New York (January 16, 2018, 10:11 PM EST) -- A Second Circuit ruling that a judge applied the wrong standard of proof when certifying a class of shareholders accusing Goldman Sachs of fraud should help clarify the standard needed to rebut allegations that a company's misstatements directly impacted its stock price, legal experts said Tuesday.

A panel of judges found that Goldman Sachs Group Inc. should get another opportunity to rebut claims that alleged misrepresentations by the bank impacted its stock price and led to \$1 billion in shareholder losses in the Abacus collateralized debt obligation.

The Abacus transaction was underwritten by Goldman, which had allowed its favored client, hedge fund Paulson & Co. Inc., to select assets that it knew would fail so it could profit by betting against them, according to the investors pressing the consolidated class action.

The panel said an earlier ruling by U.S. District Judge Paul A. Crotty of the Southern District of New York certifying the class of investors may have held Goldman to a standard of proof that was too high.

Class action experts said the Second Circuit decision should help lower courts determine the proper standard of proof for rebutting those claims, an essential step in the certification process. Specifically, the ruling instructed the lower court to allow Goldman to offer a preponderance of evidence rather than conclusive evidence in its rebuttal.

"At least in the Second Circuit, that does provide the district judges with guidance that they need," said Victor E. Schwartz, a partner at Shook Hardy & Bacon. "The Second Circuit is over many district courts, and some key ones. Those district judges have to look to Second Circuit opinions for the clarity they need in complex class action litigations."

Schwartz said clarification for standards of proof is vital at the certification process because once a securities fraud suit is certified as a class action, most are settled since few companies have the time or the resources to pursue it to the end.

"Everyone knows this fact even though you'll not find it in any opinion of law. Once a judge certifies these things, it's over. The checkbooks come out. They don't fight class actions once they're certified," Schwartz explained. "So that certification decision is so paramount, and the judges need guidance as to when to make a certification with these presumptions, which are very tricky."

In his September 2015 ruling certifying a class of investors who bought Goldman stock between Feb. 5, 2007, and June 10, 2010, Judge Crotty wrote that a link between Goldman's misstatements and a drop in its stock was "obvious, and defendants have failed to conclusively sever this link."

But Circuit Judge Richard C. Wesley wrote that Goldman only had to offer a preponderance of evidence that the alleged misrepresentations had no impact on the stock, which is a lower standard of evidence.

He cited as precedent a Second Circuit ruling in *Waggoner v. Barclays PLC*, which held that class action defendants seeking to rebut plaintiffs' allegations that companies' misstatements impact their stock prices must do so by a preponderance of the evidence.

"The court thus properly recognizes that the standard is preponderance of the evidence, something very different from 'conclusive proof,' which means at least 'clear and convincing evidence,' if not more," said Richard W. Painter, a professor at the University of Minnesota Law School.

"The district court probably applied the wrong standard in evaluating the evidence," Painter added. "The court will have to rehear the evidence and decide whether it was more probable than not that the statements moved market price. If defendants show that it was more probable than not that market price was unaffected, then the reliance presumption cannot be applied and each individual plaintiff must show reliance."

The Goldman shareholders, who were not investors of the Abacus CDO and related investments, allege Goldman made numerous material statements about its ethical compliance that were revealed to be false when the Abacus conflicts came to light and Goldman revealed it was the target of investigations by the U.S. Securities and Exchange Commission and other regulators. Goldman eventually settled the SEC suit in July 2010 for \$550 million.

Ann Lipton, a law professor at Tulane University and a former plaintiffs attorney, said the real clarity likely will emerge after the district court rehears the case. One question left unanswered by the Second Circuit's ruling is whether it will firmly establish a lower bar for defendant companies to rebut allegations that their misstatements impacted stock price, making it harder for class action suits to get certified.

"We're still left not knowing where this is going to go," Lipton said. "I think the Second Circuit really avoided getting into the details of what would answer that question. All the really interesting questions will be forthcoming."

Lipton said that, in her view, the U.S. Supreme Court's 2014 ruling in *Halliburton Co. v. Erica P. John Fund Inc.* "ultimately created a fairly unworkable" set of requirements for establishing standards of proof. "It will be interesting to see how courts try to square that circle," she said. The Supreme Court in *Halliburton* ruled that investors in class action suits have to prove they relied on the defendant's misrepresentation when they purchased or sold a stock.

Circuit Judges José A. Cabranes and Richard C. Wesley and District Judge William K. Sessions III sat on the panel for the Second Circuit.

The investors are represented by Thomas C. Goldstein of Goldstein & Russell PC, Thomas A. Dubbs, James W. Johnson and Michael H. Rogers of Labaton Sucharow LLP, and Susan Katina Alexander and

Andrew Love of Robbins Geller Rudman & Dowd LLP.

Goldman Sachs is represented by Jacob E. Cohen, Richard H. Klapper, Theodore Edelman, Robert J. Giuffra Jr., David M.J. Rein and Benjamin R. Walker of Sullivan & Cromwell LLP.

The case is In re: Goldman Sachs Group Inc., case number 16-250, in the U.S. Court of Appeals for the Second Circuit.

--Editing by Philip Shea and Jill Coffey.

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