Second and Ninth Circuits Weigh in on Securities Litigation Standards

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Executive Summary

On January 31, 2018, the United States Court of Appeals for the Ninth Circuit issued an opinion in ***Mineworkers' Pension Scheme v. First Solar Inc.***, No. 15-17282 (9th Cir. Jan. 31, 2018). In its Per Curiam opinion, the court considered a question certified by the district court on interlocutory appeal as to the correct test for establishing loss causation under the Securities Exchange Act of 1934. The court concluded that the appropriate test is whether a defendant's misstatement (or omission), as opposed to some other fact, is responsible for causing the plaintiffs' loss. The court clarified that a plaintiff "may prove loss causation by showing that the stock price fell upon the revelation of an earnings miss, even if the market was unaware at the time that fraud had concealed the miss." *Id.* at 8.

On January 12, 2018, the United States Court of Appeals for the Second Circuit issued an opinion in ***Arkansas Teachers Retirement System v. Goldman Sachs Group, Inc.***, No. 16-250 (2d Cir. Jan. 12, 2018), vacating a district court order certifying a federal securities class. The plaintiffs claimed that Goldman Sachs had, during the class period, made material misstatements about its efforts to avoid conflicts of interest, and that eventual public disclosure of such conflicts caused the company's shares to decline in value. *Id.* at 6, 9. The case involved the question whether the plaintiffs were entitled to the so-called fraud on the market presumption announced in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). This question arose because at the class certification stage, the defendants had come forward with affirmative evidence that the market had not reacted to the disclosure of information that allegedly was hidden during the class period. The Second Circuit found that, at class certification, the defendant bears the burden of establishing, by a preponderance of the evidence, that the fraud on the market presumption should not apply. *Id.* at 21.

Although *Mineworkers Pension Scheme* focuses on loss causation at the motion to dismiss stage whereas *Arkansas Teachers* considers the fraud on the market presumption at the class certification stage, the decisions both clarify how courts consider the impact of alleged misstatements—and the subsequent disclosure of the "truth"—in federal securities class actions. While the decisions make clear that plaintiffs have multiple avenues for alleging that they suffered a compensable loss, they can also provide a path for defendants and their experts to challenge certification.

Mineworkers Pension Scheme

The case arose from First Solar's alleged handling of design and manufacturing defects that the company discovered sometime in between April 30, 2008 and February 28, 2012. *Mineworkers Pension Scheme*, at 3-4. The plaintiffs, who had purchased First Solar's stock during the class period, alleged that First Solar wrongfully concealed the defects. The price of First Solar's stock fell from nearly $300 per share to nearly $50 per share. As the court explained, "[s]teep declines in First Solar's stock, beginning on July 29, 2010, followed the release of quarterly financial disclosures reporting the defects and associated costs, the departure of First Solar's CEO, and disappointing financial results." *Id.* at 4. The plaintiffs claimed that these disclosures—even in the absence of proof that the market was aware of an alleged fraud—occasioned their losses. *Id.*

The defendants moved for summary judgment on all claims. In considering the motion, the district court identified what it saw as two competing lines of Ninth Circuit precedent on the appropriate loss causation test. The first test "represents the rule that drawing a causal connection between the facts misrepresented and the plaintiff's loss will satisfy loss causation." The second, which the district court concluded offered a "more restrictive view," allows the plaintiff to recover "only if the market learns of the defendants' fraudulent practices." The district court adopted the former standard, but certified to the Ninth Circuit the question which standard should apply. *Id.* at 5.

The Ninth Circuit agreed with the district court's conclusion and held that the loss causation inquiry "requires no more than the familiar test for proximate cause." *Id.* at 6. That is, a plaintiff must show that there is a causal connection between the fraud and the loss, which the plaintiff can accomplish by "tracing the loss back to 'the very facts about which the defendant lied.'" *Id.* at 6 (quoting *Nuveen Municipal Income Opportunity Fund v. City of Alameda*, 730 F.3d 1111, 1119 (9th Cir. 2013)). Although the plaintiffs in many securities cases seek to establish loss causation by arguing that a stock drop was occasioned by a revelation of the fraud, the court concluded that this is simply one way—but not the only one—for a plaintiff to establish loss causation. *Id.* at 7-8.

Arkansas Teachers

The case arose from statements that Goldman Sachs made between February 5, 2007 and June 10, 2010 that it attempted to avoid conflicts of interest in its business. *Arkansas Teachers* at 6-7. The plaintiffs claimed that these statements were materially misleading "because Goldman acted in direct conflict with the interests of its clients in at least four collateralized debt obligation ("CDO") transactions involving subprime mortgages between 2006 and 2007." *Id.* at 7. They further claimed that the federal government's decision to initiate enforcement actions against Goldman Sachs regarding those transactions "revealed the falsity of defendants' statements and caused the company's share price to decline." *Id.* at 9.

At class certification, the plaintiffs argued that common issues predominated over individual ones including because the court could presume under the fraud on the market doctrine announced in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) that the market price of Goldman Sachs reflected the impact of the defendants' alleged misstatements regarding conflicts of interest. *Id.* at 11. In response, the defendants argued that the presumption should not apply because (1) during the class period, the defendants repeatedly disclosed the same information that the plaintiffs claimed had been hidden about the CDO transactions, and (2) Goldman Sachs' stock price did not decline when that information was released. The defendants argued that, in light of this evidence, there was no basis for presuming under *Basic* that an alleged misstatement was baked into the stock price. *Id.* at 12-13. The district court rejected this evidence and certified the class, concluding that the evidence offered by the defendants was not conclusive. *Id.* at 14.

The Second Circuit vacated and remanded. Addressing competing arguments about the appropriate standard for analyzing the fraud on the market presumption, the court found that a defendant seeking to avoid the *Basic* presumption must show, by a preponderance of the evidence, that the release of relevant information did not impact the stock price. Where a defendant makes such a showing, the plaintiff cannot satisfy an essential element under *Basic*, which is that a claimed misrepresentation "was reflected in the market price at the time of the transaction." *Id.* at 23. Because the district court had not considered the defendants' proffered evidence under the correct standard, the Second Circuit remanded the case.

Conclusion

Mineworkers Pension Scheme and *Arkansas Teachers* reflect the continuing debate in the courts regarding the significance of stock price movements in assessing the overall viability of a securities fraud class action premised upon *Basic's* fraud-on-the-market presumption.

Since the Supreme court's decision in *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005), courts have grappled with when to properly consider the issue of loss causation and materiality: on a motion to dismiss, or only later in a case. While the Supreme Court has indicated that loss causation need not be proven by plaintiffs in order to satisfy the requirements of Rule 23 at the class certification stage, the Supreme Court—and various circuit courts, including the Second Circuit again in *Arkansas Teachers*—make plain that these issues must still be considered in the class certification context when defendants seek to rebut the *Basic* presumption. While it may be possible to reconcile all of these decisions at some level based on the procedural stage of the case and an assessment who bears the burden of persuasion and proof, sorting it all out remains a difficult task to be sure. *Mineworkers Pension Scheme* and *Arkansas Teachers* do not do much to help one navigate the dense thicket. But they underscore the notion that litigants on both sides of "v" in securities fraud class actions will need to dive into that thicket in cases where defendants reasonably can dispute loss causation.

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