October 3, 2017

Securities Cases to Watch this Term at the Supreme Court

Last Term, the Supreme Court continued its recent trend of taking up significant securities litigation enforcement matters. For the first time in many years, in *Salman* v. *United States*, the Court waded into the thorny question of the scope of insider trading liability. It took a strong stand on the statute of repose for private plaintiffs under the Securities Act of 1933 in *CalPERS* v. *ANZ*, and imposed limits on the SEC's ability to obtain disgorgement in *Kokesh* v. *SEC*. It was, by any measure, as active a Term as the Court has had in this area in years.

In this respect, the Term beginning this week appears to be a continuation of the last. The Court has already granted certiorari in three significant cases affecting securities litigation and enforcement, and parties have filed numerous additional petitions for certiorari that await decision. In this alert, we preview the three cases already granted, and highlight a petition for certiorari of note.

Cases on the Docket

***Cyan, Inc.* v. *Beaver County Employees Retirement Fund*—Argument Date Pending.** In *Cyan*, the Court will address jurisdictional provisions of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") and the Securities Act of 1933. The case presents the question whether state courts have subject matter jurisdiction over "covered class actions" as defined in SLUSA for claims arising only under the Securities Act. The Securities Act of 1933 ("the '33 Act") includes an anti-removal provision, which allows concurrent state and federal jurisdiction. SLUSA, however, mandates exclusive federal jurisdiction over certain "covered class actions." State courts and federal district courts are split on the question whether SLUSA precludes concurrent state court jurisdiction over class actions alleging claims only under the '33 Act. This lack of consistency has led to what Cyan's petition for certiorari describes as "disarray" among lower courts. Judges in the same district have written contradictory opinions, and some investors have resorted to commencing parallel suits in both federal and state court to preserve their options.

The case originally was filed in California state court in April 2014 by purchasers of Cyan's common stock. Plaintiffs alleged that the registration statement and prospectus filed in conjunction with Cyan's 2013 IPO contained misleading and inaccurate statements in violation of the '33 Act. Cyan moved to dismiss the case, arguing that the court lacked subject matter jurisdiction under SLUSA. Following the California appellate court decision in *Luther* v. *Countrywide Financial Corp.*, which held that SLUSA did not preclude concurrent state and federal court jurisdiction, the trial court rejected Cyan's arguments. Both the California Court of Appeal and the California Supreme Court declined to review the decision. The

© 2017 Paul, Weiss, Rifkind, Wharton & Garrison LLP. In some jurisdictions, this publication may be considered attorney advertising. Past representations are no guarantee of future outcomes.

Supreme Court granted Cyan's petition for a writ of certiorari. The case should help bring order to the chaotic landscape of class action litigation asserting '33 Act claims in the wake of the passage of SLUSA—a law originally intended to bring consistency in how securities class actions are litigated. The case will also determine whether plaintiffs may avoid the restrictions of the Private Securities Litigation Reform Act of 1995 (the "PSLRA") in covered class actions under the '33 Act by filing such claims in state, rather than federal, court.

***Digital Realty Trust, Inc.* v. *Somers*—Argument Date Pending.** In this case, the Court will address whether the whistleblower protection provisions of the Dodd-Frank Act extend to individuals who report alleged misconduct only within their organizations, and do not report the alleged wrongdoing to the SEC. Dodd-Frank's anti-retaliation provision extends protection from employer retaliation to whistleblowers who provide information to the SEC, as well as to those who make disclosures required or protected under the Sarbanes-Oxley Act ("SOX") or any other law, rule, or regulation subject to the SEC's jurisdiction. However, in other provisions, Dodd-Frank explicitly defines the term "whistleblowers" to include only those who report alleged violations of securities laws *to the Securities and Exchange Commission*. Focusing on this apparent conflict, in rules that took effect in 2011, the SEC defined the term "whistleblower" more broadly than the definition set forth in Dodd-Frank to include individuals who report alleged violations internally to their employers in addition to those who report externally to the SEC. In 2015, the SEC reiterated this position in an interpretive release, explaining that the rule bolstered the "investor-protection and law-enforcement benefits that can result from internal reporting."

Nonetheless, circuit courts are split on the question whether Dodd-Frank protects internal whistleblowers. The Ninth Circuit (whose decision the Supreme Court will review), consistent with the Second Circuit, held that Dodd-Frank's definition of a whistleblower is sufficiently ambiguous that *Chevron* deference should be given to the SEC's interpretive rulemaking. By contrast, the Fifth Circuit has held that an individual who only reports internally is not a whistleblower under Dodd-Frank, notwithstanding the SEC's rulemaking efforts. The decision likely will have a significant impact on the manner in which employees pursue alleged whistleblowing retaliation claims. Although SOX expressly protects employees who report wrongdoing internally, even if they do not report such conduct to the SEC, retaliation claims brought under Dodd-Frank are easier to prosecute. In contrast to such claims brought under SOX, under Dodd-Frank, employees are not required to file an administrative complaint prior to bringing suit, and they reap the benefit of a longer statute of limitations and broader potential relief. The Fifth Circuit noted these benefits to bringing such claims under Dodd-Frank and observed that, if the SEC's interpretation is allowed to stand, it effectively would render the protections available under SOX moot, because employees always would elect to pursue remedies under Dodd-Frank.

***Leidos, Inc.* v. *Indiana Public Retirement System*—Argument Date: November 6, 2017.** The Court will consider whether omission of a disclosure required by Item 303 of Securities and Exchange Commission Regulation S-K ("Item 303") is actionable under Section 10(b) of the Exchange Act of 1934

and SEC Rule 10b-5. The Supreme Court has long held that a duty to disclose arises only if an omission would render affirmative disclosures misleading or would violate a specific duty to disclose. In the case on review, the Second Circuit held that Item 303 gives rise to an affirmative duty to disclose on which a claim under Section 10(b) can be based. In so finding, the Second Circuit concluded that a securities class action plaintiff may base a securities fraud claim on failure to disclose information under Item 303, such as "known trends or uncertainties . . . that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

The Second Circuit and the Ninth Circuit are split on this issue—a split of particular significance given that, together, these two circuits handle more federal securities cases than the rest of the circuits combined. Because Item 303 requires the disclosure of subjective predictions, petitioners and amici argue that prospective plaintiffs, with the benefit of hindsight, will be able to manipulate negative market developments to allege that management knew or was reckless in not anticipating those developments. A reversal by the Supreme Court not only would eliminate claims based on Item 303, but also may call into question the viability of claims predicated on other SEC regulations. For further discussion of the issue in *Leidos*, see the Paul, Weiss client memorandum available here.

Pending Petition for Certiorari

***Lucia* v. *Securities and Exchange Commission*—Pending Petition.** This case presents an opportunity for the Court to resolve a circuit split over whether administrative law judges ("ALJs") of the Securities and Exchange Commission are "officers of the United States" within the meaning of the Appointments Clause of the Constitution. That Clause requires that officers be appointed either by the president, the courts, or agency heads who are directly accountable to the president. SEC ALJs are appointed through an administrative process, not directly by commissioners. If the Court takes the case and concludes that ALJs are officers, as opposed to mere "employees," the SEC's appointment process will be deemed unconstitutional. In the case on review, the D.C. Circuit, relying on its earlier ruling in *Landry* v. *FDIC*, held that the SEC's ALJs are not "officers" principally because they lack authority to issue final decisions. The Tenth Circuit rejected this interpretation in *Bandimere* v. *SEC*, instead concluding that SEC ALJs are indeed inferior officers. The Fifth Circuit recently deepened this circuit divide, staying an FDIC order on the basis that the plaintiff likely would succeed in his claim that the appointment of the ALJ who oversaw his hearing was unconstitutional. While not, strictly speaking, presenting a question of securities law, this constitutional case has significant practical impact for securities enforcement practitioners and defendants, and beyond. A Supreme Court holding that the SEC's appointment process is unconstitutional would call into question the legitimacy of the appointments of numerous ALJs who exercise meaningful authority in enforcement proceedings, such as those who work at the Consumer Financial Protection Bureau and the Federal Mine Safety Commission. Moreover, it could jeopardize many past proceedings before SEC ALJs.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Susanna M. Buergel
+1-212-373-3553
sbuergel@paulweiss.com

Charles E. Davidow
+1-202-223-7380
cdavidow@paulweiss.com

Andrew J. Ehrlich
+1-212-373-3166
aehrlich@paulweiss.com

Roberto J. Gonzalez
+1-202-223-7316
rgonzalez@paulweiss.com

Brad S. Karp
+1-212-373-3316
bkarp@paulweiss.com

Daniel J. Kramer
+1-212-373-3020
dkramer@paulweiss.com

Richard A. Rosen
+1-212-373-3305
rrosen@paulweiss.com

Audra J. Soloway
+1-212-373-3289
asoloway@paulweiss.com

Associates Crystal Johnson, Michelle S. Kallen and law clerk Grace H. Tiedemann contributed to this Client Memorandum.