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Upcoming Supreme Court Cases Worth Noting by Institutional Investors

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The U.S. Supreme Court's 2017 term begins October 2nd and we will be tracking at least three cases relevant to institutional investors:

- Cyan, Inc. v. Beaver County Employees Retirement Fund
- Digital Realty Trust v. Somers
- Leidos v. Indiana Public Retirement System

Cyan, Inc. v. Beaver County Employees Retirement Fund

Cyan addresses the procedural question of whether claimants may bring Securities Act class actions in state courts, and whether defendants can remove such cases to federal court. California federal district courts hold, yes, state courts retain jurisdiction over Securities Act class actions brought in those courts and such cases cannot be removed to federal courts. Federal district courts in New York, New Jersey, and Delaware, however, hold that class actions alleging Securities Act claims are removable to federal court.

The Securities Litigation Uniform Standards Act of 1998 ("SLUSA") is at issue here. Section 22 of the Securities Act provides that federal courts have concurrent jurisdiction with state courts for Securities Act class actions "except as provided in section 77p." Securities Act defendants seeking to remove their cases to federal court have argued that this provision refers specifically to subsection f of 15 U.S.C. § 77p, which defines "covered class action" to include any suit in which more than 50 people seek damages and common questions predominate. Thus, according to these defendants, any such "covered class action" falls within SLUSA's exception to its concurrent jurisdiction provision.

Class action plaintiffs, including the retirement fund that brought the case against Cyan, Inc., argue that state courts retain jurisdiction over Securities Act class actions because SLUSA only eliminates state court jurisdiction over class actions alleging exclusively state law claims. They further assert that class actions brought pursuant to the Securities Act may thereby be brought in state court and

such actions are barred from removal to federal court. 15 U.S.C. § 77v(a) provides that "no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States." However, SLUSLA amended this provision to allow for removal of "any covered class action." See 15 U.S.C. § 77p(c).

In its brief supporting the granting of certiorari, the Solicitor General's Office urged the Court to take an intermediate position—to use this case as a vehicle to opine on the scope of removal available under SLUSA, and to hold that Securities Act cases like the *Cyan* litigation are now removable to federal court even if they are not subject to dismissal.

This ruling will have practical consequences, as currently many plaintiffs are filing Securities Act class actions in California, seeking to avoid heightened pleading requirements imposed by federal courts and hoping for a speedier trial date.

Digital Realty Trust v. Somers

In *Somers*, the Court will consider whether whistleblowers who have reported alleged misconduct internally are protected by the anti-retaliation provision of the Dodd-Frank Act. The Dodd-Frank Act bars retaliation against whistleblowers under certain circumstances, including disclosures required or protected by the Sarbanes-Oxley Act ("SOX"). Dodd-Frank's plain language arguably limits the definition of "whistleblower," however, to individuals who report securities laws violations to the SEC. The Fifth Circuit, in Asadi v. G.E. Energy (USA), L.L.C., construed this plain language to preclude the application of the statute's anti-retaliation provision to whistleblowers that only made SOX disclosures internally and did not report to the SEC. The Second Circuit in Berman v. Neo@Ogilvy, and Ninth Circuit in Somers, both held that the statute is ambiguous, granting deference to the SEC's interpretation, which applies the anti-retaliation provision to both internal whistleblowers and those who report to the SEC.

For institutional investors, the Court's decision could have an impact on internal reporting regimes. A ruling that the anti-retaliation provision of Dodd-Frank does not apply to internal whistleblowers could limit employer liability in connection with internal investigations. However, such ruling may also discourage whistleblowers from utilizing internal reporting regimes, as whistleblowers will be afforded more protection by reporting directly to the SEC.

Leidos v. Indiana Public Retirement System

Leidos presents the question of whether non-disclosure of "known trends or uncertainties" under Item 303 of Regulation S-K may give rise to private liability for securities fraud under Section 10(b) of the Exchange Act and SEC Rule 10b-5. The Court will address a split between the Second Circuit, which has held that in some circumstances non-disclosure could give rise to private securities fraud liability, and the Third and Ninth Circuits, which have held that non-disclosure does not create a private claim. Specifically, in *Oran v. Stafford*, the Third Circuit rejected the plaintiffs argument that a private right of action existed for violations of Item 303. Additionally, the Third Circuit rejected the plaintiffs argument that a failure to make a disclosure required by Item 303 constitutes a *per se* violation of Rule 10b-5 because, according to the court, the disclosure obligations created by Item 303 "var[y] considerably from the general test for securities fraud materiality." Thus, the Third Circuit concluded that "[b]ecause the materiality standards for Rule 10b-5 and SK-303 differ significantly, the demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5." The Ninth Circuit adopted the Third Circuit's reasoning in the NVIDIA Corp. Securities Litigation, holding that "Item 303 does not

create a duty to disclose for purposes of Section 10(b) and Rule 10b-5."

Notably, in *Litwin v. Blackstone Group, L.P.* and *Panther Partners Inc. v. Ikanos Communications, Inc.*, the Second Circuit first held that Item 303 disclosures can form the basis of claims under Section 11 and 12(a)(2) of the Securities Act. Then, in *Stratte-McClure v. Morgan Stanley*, the Second Circuit held that a violation of Item 303's disclosure requirements could sustain a claim under Rule 10b-5 as well, noting in the process that its decision was at odds with the Ninth Circuit's decision in NVIDIA. In the *Leidos* case, the Second Circuit again held that a violation of Item 303 could provide the basis for a claim under Rule 10b-5.

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