

Justices Could Reshape Securities Law Without Blockbuster

By **Evan Weinberger**

Law360, New York (September 29, 2017, 9:30 PM EDT) -- The U.S. Supreme Court's docket includes three cases that could go some way toward redefining the legal framework for the securities industry, including one that could change the way companies disclose potentially damaging information, another on lawsuit venues, and a third on whistleblower protections.

While none of those cases is expected to lead to blockbuster rulings, each could shape the way that companies, investors and regulators interact with each other. And one, *Digital Realty Trust Inc. v. Somers*, could lead to courts giving less deference to federal regulators' interpretations of statutes than they've enjoyed for decades if the newest member of the court, Justice Neil Gorsuch, is able to persuade his colleagues to make an expansive ruling.

"Even though they might be technical on the securities side, they may be insightful into a broader range of cases," Paul Hastings LLP partner William Sullivan said of the securities cases the Supreme Court will hear this term.

Digital Realty Trust Inc. v. Somers

Of the three securities cases on the Supreme Court's docket this term, the *Digital Realty* litigation has drawn the most interest in part because of its subject — the reach of the 2010 Dodd-Frank Act's whistleblower protections — and in part because it could be a vehicle for challenging Chevron deference, the high court doctrine that gives regulatory agencies wide latitude for interpreting federal law.

"This is one where the agency has actually gone through the process of making a rule to interpret the statute, so it's a pretty good vehicle for the court on that issue," said David Kornblau, the chair of Covington & Burling LLP's securities litigation group. "And the court has endless discretion on how they write their decision. If they wanted to, I think they could make some changes to that doctrine."

The Supreme Court accepted *Digital Realty's* petition for writ of certiorari in June, agreeing to review a Ninth Circuit opinion that revived former *Digital Realty* executive Paul Somers' claims he was terminated based on false allegations of misconduct after he complained to senior management that a senior vice president had eliminated some internal corporate controls in violation of the Sarbanes-Oxley Act.

A split panel ruled that Dodd-Frank's whistleblower anti-retaliation provision "unambiguously and

expressly protects" both those who report to the U.S. Securities and Exchange Commission and internal whistleblowers.

The provision in question, subdivision (iii) of Section 21F of Dodd-Frank, prohibits employers from discharging or discriminating against a whistleblower who makes disclosures that are required or protected by Sarbanes-Oxley.

The question of whether the SEC went too far in expanding Dodd-Frank's whistleblower protections is a key one for companies. Many attorneys argue that the SEC did just that when it said that any whistleblower is covered under the law no matter where the complaints are reported.

"I think it's hard to get to the SEC's position here, because you don't need to read the statute the way they do to get coverage for everybody," said Tom Gorman, a partner with Dorsey & Whitney LLP.

While some pro-business groups have **thrown their support** behind Digital Realty Trust's case, a victory in the Supreme Court may lead to more whistleblower headaches.

If potential whistleblowers feel that they will only get the expansive protections that Dodd-Frank and the SEC provided by going to the commission rather than reporting internally and getting Sarbanes-Oxley's less stringent anti-retaliation protections, they're going to go to the SEC, said Jordan Thomas, the chair of Labaton Sucharow LLP's SEC whistleblower practice.

And that would mean more probing by the SEC, more costs for outside counsel and potentially more enforcement actions, said Thomas, who helped set up the SEC's whistleblower program.

"If Digital Realty wins, corporate America loses," he said.

But there's a bigger issue involved in this case, and that is Chevron deference.

Justice Neil Gorsuch has been skeptical of the idea of giving wide deference to federal regulatory agencies' interpretations of federal statutes, and Digital Realty Trust may provide an opening to challenge that standard.

If Justice Gorsuch is able to convince a majority to go that far, removing Chevron deference could impact all regulatory agencies.

But it's unlikely that enough justices would be willing to go that far, so look for a narrower ruling, said Nick Morgan, a partner with Paul Hastings LLP.

"Finding a narrow path to rule in favor of the defense in my view is the likely scenario," he said.

Digital Realty is represented by Kannon K. Shanmugam, Amy Mason Saharia, A. Joshua Podoll and Meng Jia Yang of Williams & Connolly LLP, and by Brian T. Ashe, Kiran A. Seldon, Shireen Y. Wetmore and Kyle A. Petersen of Seyfarth Shaw LLP.

Somers is represented by Peter K. Stris, Brendan S. Maher, Daniel L. Geyser and Douglas D. Geyser of Stris & Maher LLP and Stephen F. Henry of Stephen F. Henry Esq.

The case is Digital Realty Trust Inc. v. Paul Somers, case number 16-1276.

Leidos Inc. v. Indiana Public Retirement System

The Leidos case is expected to resolve a circuit split over when companies are required to disclose all "known trends and uncertainties" to investors.

The case, which the Supreme Court agreed to hear in March, asks when companies are required to report those uncertainties under Item 303 of the SEC's Regulation S-K. The Second Circuit ruled that a failure to comply with that part of the regulation can, under certain circumstances, give rise to claims under Section 10(b), an anti-fraud regulation.

The Ninth Circuit has ruled differently, engendering a split that the high court will weigh in on.

Attorneys for the plaintiffs bar say that a ruling for Leidos could eliminate a key tool in their kit when pursuing private securities fraud claims.

"Obviously it would mean that investors would have one less weapon in their arsenal," said Daniel Sommers, a partner with Cohen Milstein Sellers & Toll PLLC.

Investors sued Leidos in 2012 after its then-parent Science Applications International Corp. — which spun Leidos off in 2013 — agreed to a more than \$500 million settlement to avoid criminal claims connected to New York City's scandal-plagued CityTime payroll project.

Prosecutors had alleged that Leidos failed to control an employee who orchestrated an elaborate kickback scheme that ballooned the project's budget from \$73 million in 2000 to about \$620 million by 2011.

A district court tossed the investors' suit in January 2014, but the Second Circuit in March 2015 revived the case on the grounds that the Leidos investors had a viable claim that the company misled the public through omissions in its 2011 financial statements.

Leidos argues that private investors do not have the ability to enforce a disclosure duty under Item 303, an argument that could hold sway with some justices on the right.

"This, in some sense, is a liberal versus conservative issue. The liberals tend to prefer implied causes of action, but conservatives don't," Gorman said.

But the facts of the case, and **support from the government** for the investors' position, could weigh against Leidos. The settlement and potential criminal complaints it faced could likely be seen as material, so arguing that they should not have been disclosed may be tough to do, Gorman said.

"Everybody knew what the facts were, and to say that's not a known trend that's impacting the company, that's kind of silly," he said, but added that could limit the scope of any ruling on the issues.

Oral arguments in the Leidos case are set for Nov. 6.

Leidos is represented by Andrew S. Tulumello, Mark A. Perry, Jason J. Mendro, Joshua D. Dick, Kellam M. Conover, Christopher S. Rigali, John D. Avila and Monica L. Haymond of Gibson Dunn & Crutcher LLP, and in-house counsel Vincent A. Maffeo and Michele M. Brown.

The investors are represented by Douglas Wilens, Joseph Russello, Darren Robbins and Samuel Rudman of Robbins Geller Rudman & Dowd LLP.

The case is Leidos Inc. v. Indiana Public Retirement System et al., case number 16-581.

Cyan Inc. et al. v. Beaver County Employees' Retirement Fund et al.

The Cyan case could close a question involving whether securities fraud suits can be filed in state court under the Securities Litigation Uniform Standards Act, a technical question that could limit the ability of plaintiffs firms to choose jurisdictions for their cases.

Amendments to the Securities Act of 1933 enacted through SLUSA provide that state and federal courts have concurrent jurisdiction over federal claims except "with respect to covered class actions," but courts and parties have disagreed over whether the provision removes state court jurisdiction over all federal securities law class actions or just certain state law securities fraud claims.

The Supreme Court agreed to resolve the issue in late June.

A group of investors led by the Beaver County Employees' Retirement Fund sued Cyan in 2014, alleging the company violated Section 11 of the 1933 Act by failing to disclose anticipated issues with the company's revenue stream.

Cyan, which was purchased by Ciena Corp. in May 2015, moved for judgment on the pleadings in August 2015, asserting that SLUSA precluded state court jurisdiction over the claims, but the motion was denied by a California state court, and a full California appeals court and the California Supreme Court both declined to review that decision.

While the case is important for **where securities cases start**, it may not mean much in the end, Gorman said.

In most instances, securities cases are going to get sent to federal court, he said.

"If it is, in fact, the plaintiffs are right and [a case] gets filed, it just gets removed. It's really a question of how you're going to bring these cases to start with," Gorman said.

Cyan is represented by Boris Feldman, Ignacio E. Salceda, Gideon A. Schor and Aaron J. Benjamin of Wilson Sonsini Goodrich & Rosati PC, and Neal Kumar Katyal, Frederick Liu, Daniel J.T. Schuker, Allison K. Turbiville and Thomas P. Schmidt of Hogan Lovells.

The investors are represented by Andrew S. Love, Susan K. Alexander, John K. Grant and Kenneth J. Black of Robbins Geller Rudman & Dowd LLP, Thomas C. Goldstein of Goldstein & Russell PC, and Robert V. Prongay and Ex Kano S. Sams II of Glancy Prongay & Murray LLP.

The case is Cyan Inc. et al. v. Beaver County Employees' Retirement Fund et al., case number 15-1439.

Potential Cert Grants

While there are three pending securities cases at the high court, the bar will also be looking to see

whether the Supreme Court agrees to hear several other cases.

Two of those — *Holtz v. JPMorgan Chase & Co.* and *Goldberg v. Bank of America Corp.* — involve similar questions of whether breach of fiduciary duty claims can be brought in state law under SLUSA.

A third case could be much more consequential though.

The *Lucia v. SEC* litigation concerns whether the SEC's administrative judges **function as inferior officers** that need to be appointed, rather than hired, under the appointments clause of the U.S. Constitution.

The D.C. Circuit has rejected that argument, but the Tenth Circuit has supported it.

Counsel for Lucia has filed a petition for a writ of certiorari, and the case could prove to be monumental not just for the SEC but for other agencies that use administrative law judges.

"It's a big issue because nobody's ever discussed the remedies if Lucia wins. His underlying case would be invalidated, [but] what about all the other ones?" Gorman said.

A decision on whether the Supreme Court will take that case is expected later this term.

--Editing by Mark Lebetkin and Katherine Rautenberg.