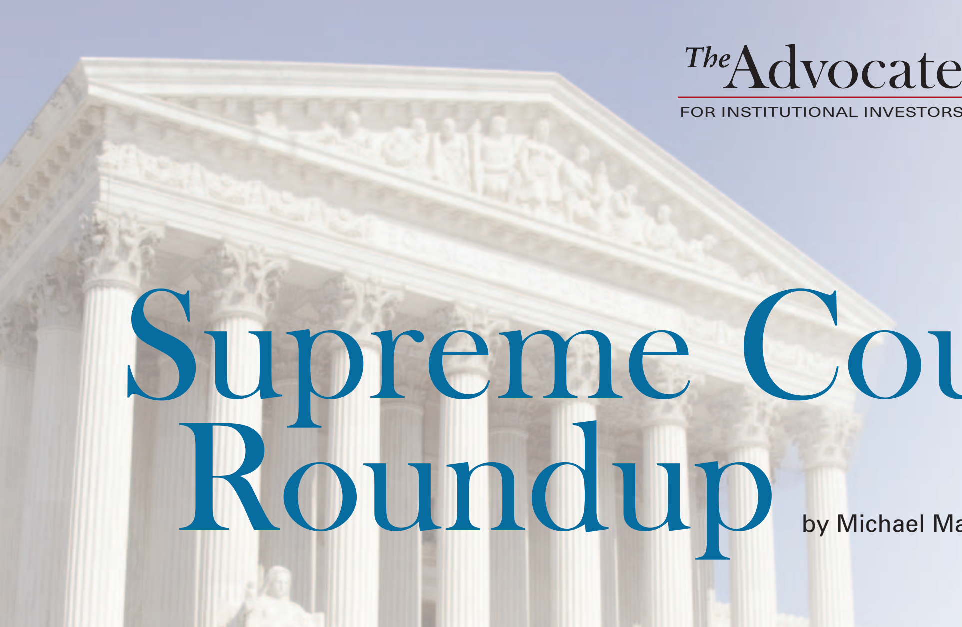
The Advocate
FOR INSTITUTIONAL INVESTORS



Supreme Court Roundup

by Michael Mathai and Kate Aufses

China Agritech

In June 2018, the Supreme Court limited how long investors are permitted to rely on a filed class action before deciding whether to potentially assert their rights in a separate class action litigation. In *China Agritech v. Resh*, the Court reaffirmed that if an investor is a passive member of an asserted class of investors—meaning that they are not named plaintiffs—the applicable statute of limitations for the investor to file suit *individually* is tolled until a decision denying class certification, if any. In other words, the investor can wait and see if it is necessary to file an individual suit (while remaining mindful of any expiring statute of repose—a separate time limitation often applicable to investors' securities claims). However, the *China Agritech* Court announced a new rule that limits investors' choices if they wait to file suit: the Court held that the statute of limitations is *not* tolled in the same way if the investor filing separately frames her litigation as a *class action*. If an investor remains a passive member of an existing class action past the expiration of the statute of limitations, the only separate suit it can file is an individual suit. *China Agritech* meaningfully alters strategic considerations for proposed class members who wish to see class claims pursued. Rather than remain as passive proposed class members waiting to see the result of class certification, such parties must now carefully consider filing a separate complaint early in order to avoid the risk of a denial of class certification in the already-pending action. In addition, this case leaves unchanged prior rulings finding that the statute of repose cannot be tolled. Thus, investors and their counsel should remain vigilant in monitoring expiring statutes of limitations in light of *China Agritech.*

Lorenzo v. SEC

On June 18, 2018, the Supreme Court granted a writ of certiorari in *Lorenzo v. SEC*. *Lorenzo* has potentially wide-ranging implications for the scope of liability for people who deceive investors by passing along misleading statements. By way of background, the Supreme Court's 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders* clarified that liability under SEC Rule 10b-5(b) could only attach to the "maker" of a statement—i.e., "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." Under *Janus*, therefore, a person who merely repeats a false and misleading statement made by another cannot ordinarily be held liable under Rule 10b-5(b). At issue in *Lorenzo* is whether such a person can be held liable under Rules 10b-5(a) and (c). While Rule 10b-5(b) prohibits fraudulent "statements," Rules 10b-5(a) and (c) prohibit defrauding investors through deceptive schemes, acts, or practices.

In *Lorenzo*, an investment banker sent emails to prospective investors containing false representations about a company's financials, but the false representations were written by the banker's boss and the emails were sent at the boss's direction. The SEC determined that the banker had violated Rule 10b-5(b) by making materially misleading statements in the emails, as well as Rules 10b-5(a) and (c), by knowingly sending materially misleading information to prospective investors. On appeal, the DC Circuit Court of Appeals, in a 2-1 opinion, partly affirmed the SEC's decision. The majority found that Lorenzo had not violated Rule 10b-5(b) because Lorenzo was not the "maker" of the challenged statements under *Janus* — his boss was. However, the court found the trader liable for the scheme under Rules 10b-5(a) and (c). As discussed on page 22, then-Judge Brett Kavanaugh issued a strong dissent to the DC Circuit panel opinion. He wrote that under *Janus* and other Supreme Court precedent, the investment banker could not be held liable.

Before President Trump nominated Judge Kavanaugh to the Supreme Court, many commentators expected that the Court, as then constituted, would vote 5-4 to overturn the DC Circuit's decision and thereby limit the scope of scheme liability. It was expected that Justice Kennedy would vote with Justices Thomas, Gorsuch, Roberts, and Alito to form the majority, and that the remaining four Justices would dissent — as they had all done in *Janus*. Justice Kavanaugh's confirmation creates an interesting twist on this guessing game. Under standard Supreme Court practice, Justice Kavanaugh must recuse himself from participating in the Supreme Court's adjudication of *Lorenzo* because he participated in the DC Circuit decision that is being appealed. This, in turn, suggests that the Supreme Court could likely split 4-4 on the case and the DC Circuit's decision would stand. Such a result would, for now, maintain a broader view of primary scheme liability under Rules 10b-5(a) and (c).

Cyan Inc. v. Beaver County Employees Retirement Fund

The Supreme Court's recent ruling in *Cyan Inc. v. Beaver County Employees Retirement Fund* is a positive development for investors. Issued in March 2018, the *Cyan* opinion preserves plaintiff investors' right to choose the venue — either state court or federal court — for their lawsuits alleging violations of the Securities Act of 1933. Defendants have often filed removal motions to thwart investors' selection of state court for their securities claims and this ruling closes the door on such maneuvers.

As discussed in the winter 2018 issue of The Advocate, *Cyan* resolved a split among lower courts over whether the 1998 Securities Litigation Uniform Standards Act (SLUSA) deprived state courts of jurisdiction over certain class actions asserting only federal Securities Act claims. In a unanimous decision authored by Justice Kagan, the Court held that SLUSA "did nothing to strip state courts of their longstanding jurisdiction to adjudicate class actions alleging only [Securities] Act violations."

Cyan means that plaintiff investors retain their ability to choose whether to assert Securities Act claims in state courts or federal courts. Plaintiffs should understand, however, that when Securities Act claims are combined with additional federal claims in the same case, the case still may be removable to federal court under *Cyan*. Thus, when a plaintiff chooses to assert not only Securities Act claims, but also additional claims, federal court may be the only option. After *Cyan*, it is particularly important for investors and their counsel to think critically about available claims and jurisdictions when crafting their allegations under the federal securities laws.

Lucia v. SEC

In *Raymond J. Lucia and Raymond J. Lucia Companies, Inc. v. Securities & Exchange Commission*, the Supreme Court held in June 2018 that administrative law judges of the Securities and Exchange Commission are "inferior officers of the United States subject to the Appointments Clause of the Constitution." This means that, contrary to the prior practice of the SEC — by which the SEC selected ALJs through an in-house hiring practice — ALJs must now be appointed by the President, a court, or a department head. The Court held that because ALJs hold a continuing office established by law and have the authority to conduct hearings similar to federal trials, and because the SEC may decline to review an ALJ's decision, the ALJs are officers of the United States and must be appointed pursuant to the Appointments Clause.

While the *Lucia* decision resolved an important circuit split on this issue, it also created uncertainty. The Court decided that the "remedy for an adjudication tainted with an appointments violation is a new hearing before a properly appointed official." Many such "tainted" adjudications surely exist, as numerous past and current ALJs across various government agencies were not installed under the Appointments Clause — the validity of these decisions is now called into question. To take one example, the Court did not consider whether the SEC must, or can, reopen for rehearing cases that have long since been decided by ALJs who were not properly appointed under *Lucia*. Litigants may argue that *Lucia* upended settled law in numerous fields of regulatory law, including securities regulation and enforcement.

Contributing further to the uncertainty surrounding ALJs, on July 10, 2018, President Trump issued an executive order eliminating the competitive examination and selection procedures used to appoint ALJs across federal agencies. The order allows the heads of agencies, who are political appointees, to hire ALJs directly, thus bypassing the traditional merit-based hiring process. This gives political agency heads vast discretion to determine who will serve as ALJs. Commentators fear that this action could further politicize the civil service.

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