SIMPSON THACHER

SECURITIES LAW ALERT

JULY 2012

This month's Alert addresses three circuit court decisions: a First Circuit ruling affirming the dismissal of a securities fraud suit against Boston Scientific Corporation; a Second Circuit decision reinstating a securities fraud suit against Grant Thornton in connection with its audit of Winstar Communications' 1999 financial statements; and an Eleventh Circuit ruling affirming judgment as a matter of law in favor of the defendants in the BankAtlantic subprime action.

We also discuss two Southern District of New York decisions applying the Supreme Court's holding in *Morrison v. National Australia Bank*, 130 S. Ct. 2869 (2010): one denying the defendants' motion for summary judgment in an SEC action concerning transactions between foreign investment funds; and the other addressing when Racketeer Influenced and Corrupt Organizations Act ("RICO") claims implicate an extraterritorial application of the RICO statute.

Finally, we cover two recent district court decisions addressing the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"): one holding that the Dodd-Frank Act's anti-retaliation provision does not apply extraterritorially; and the other holding that the Dodd-Frank Act amendment to Section 806 of the Sarbanes-Oxley Act to include employees of subsidiaries of public companies applies retroactively.

The First Circuit Affirms Dismissal of a Securities Fraud Suit against Boston Scientific Corporation

On July 12, 2012, the First Circuit affirmed dismissal of a securities fraud suit alleging that Boston Scientific Corporation and several of its officers made materially misleading statements in 2009 and 2010 in violation of Section 10(b). *In re Boston Sci. Corp. Sec. Litig.*, 2012 WL 2849660 (1st Cir. July 12, 2012) (Boudin, J.). The court found that there was "clearly insufficient basis to find materiality" as to the statements at issue made in 2009 or to "infer scienter" as to the statements at issue made in 2010. *Id.* at *9.

Background

The plaintiffs alleged that Boston Scientific and three of its officers failed to disclose information regarding the termination of several members of the company's cardiac rhythm management ("CRM") device sales team in statements they made in 2009 and January of 2010.

In late 2009, "ten members of the CRM sales force

The Securities Law Alert is edited by Paul C. Gluckow (pgluckow@stblaw.com/212-455-2653), Peter E. Kazanoff (pkazanoff@stblaw.com/212-455-3525) and Jonathan K. Youngwood (jyoungwood@stblaw.com/212-455-3539).

were [allegedly] fired for their 'repeated[ ]' breaches of Boston Scientific's internal code of ethics." *Id.* at *2. One of the terminated employees had been a Divisional Vice President of Sales, responsible for managing one of the company's three domestic sales regions. At the time, the CRM sales force "consisted of about 1,100 employees[,]" and sales of CRM devices accounted for "around 30 percent" of Boston Scientific's total sales. *Id.* at *1.

On January 4, 2010, St. Jude Medical, one of Boston Scientific's competitors, hired the Divisional Vice President that Boston Scientific had discharged along with allegedly "'many' of the other nine fired CRM sales group members …." *Id.* at *2. Boston Scientific "revealed the firing and St. Jude's subsequent hiring of the CRM sales representatives" on February 11, 2010, when the company announced its fourth quarter 2009 results. Boston Scientific's President and CEO Raymond Elliott stated that "'[i]n the short haul,'" Boston Scientific would "'for certain lose sales ….'" *Id.* "On the same day as these remarks, the price of Boston Scientific common stock … closed down about 10 percent" from the previous day. *Id.* at *3. "Several months later," Boston Scientific reported that the CRM staff terminations and an unrelated CRM device issue "had [together] led to $16 million globally in lost sales for the first quarter of 2010—a period in which the CRM sales revenue was $538 million." *Id.*

On September 19, 2011, the District of Massachusetts dismissed the plaintiffs' claims, finding that the statements at issue made in 2009 "were not materially false or misleading" and that "the allegations of scienter as to the January 2010 statement were inadequate." *Id.* The plaintiffs appealed.

Section 10(b) Does Not Require the Disclosure of All Material Information

At the outset of its analysis, the First Circuit emphasized that "Section 10(b) 'do[es] not create an affirmative duty to disclose any and all material information.'" *Id.* at *4 (quoting *Matrixx Initiatives v. Siracusano*, 131 S. Ct. 1309, 1321 (2011)). "Instead, it extends to omissions only where affirmative statements are made and the speaker fails to 'reveal[ ] those facts that are needed so that what was revealed would not be so incomplete as to mislead.'" *Id.* (quoting *Hill v. Gozani*, 638 F.3d 40, 57 (1st Cir. 2011)).

The First Circuit explained that the reason "[w]hy companies do not have to disclose immediately all information that might conceivably affect stock prices is apparent: the burden and risks to management of an unlimited and general obligation would be extreme and could easily disadvantage shareholders in numerous ways (*e.g.*, if a new invention were prematurely disclosed to competitors or a take-over plan to the target company)." *Id.* "So the securities laws forbid false or misleading statements in general but impose more specific disclosure obligations only in particular circumstances." *Id.*

The Complaint Fails to Allege the Statements Made in 2009 Were Material

The First Circuit determined that none of the statements made in 2009 was materially misleading because the employees under investigation "represented only about *two percent* of the CRM sales

force, and CRM sales themselves were only a portion of the company's business." *Id.* The court explained that "the possible or imminent discharge of a tiny fraction of sales personnel for a single line of products [is] of minimal expected consequence for a company with global operations and 25,000 employees." *Id.* at *5. "This is not even close to the level at which other cases have found omissions to be material." *Id.*

The Complaint Fails to Allege the January 2010 Statements Were Made with Scienter

During a January 2010 conference call, Boston Scientific's President and CEO Raymond Elliott "made several statements … favorable to the company's sales, including a claim that it had a 'stable, large, experienced' and 'very successful' sales force." *Id.* at *7. The plaintiffs contended that these statements were materially misleading because "by this time not only were the firings complete, but at least one, and perhaps more, of the fired employees had been re-hired by one of Boston Scientific's competitors." *Id.* "The district court found material the failure to disclose the threat in January 2010 … but also found the statement non-actionable for lack of adequate allegations of scienter." *Id.* On appeal, the First Circuit assumed the district court's materiality finding was correct and only considered scienter.

The First Circuit explained that under the Private Securities Litigation Reform Act ("PSLRA"), the complaint must "set forth facts making the inference of scienter 'cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'" *Id.* (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007)). "Thus, when Elliott spoke blandly but favorably in January 2010 of the strength of the company's sales force, the facts pled had to provide a clear indication that he was either dishonest or reckless in not mentioning the defection of up to ten salespeople to a competitor." *Id.*

The court noted that "[i]n cases where [it has] found the pleading standard satisfied, the complaint often contains clear allegations of admissions, internal records or witnessed discussions suggesting that at the time they made the statements claimed to be misleading, the defendant officers were aware that they were withholding vital information or at least were warned by others that this was so." *Id.* "No such direct evidence is pled in the complaint here." *Id.* Moreover, the plaintiffs did "not identify any other basis for imputing such wrongful intent, nor was the omitted information of such powerful importance that wrongful intent [could] reasonably be inferred." *Id.*

"In fact, the complaint does not even squarely allege that the individual defendants knew on January 12, 2010 that St. Jude had hired some Boston Scientific salespeople, and that cannot be merely assumed." *Id.* at *8. If Elliott was aware of this information, the First Circuit found it reasonable to assume that his delay in disclosing it was due to the fact that "some or all of the fired employees had only very recently been hired by St. Jude," and the company "surely required some period to assess" the amount of "business they might take with them[.]" *Id.*

The plaintiffs contended that the district court had "erred by failing to consider their arguments for scienter 'holistically,' as *Tellabs* suggests is proper." *Id.* The First Circuit acknowledged that "allegations that

are individually insufficient can sometimes combine together to make the necessary showing." *Id.* "But in this case, a single central risk existed—that sales personnel might leave and perhaps take some of their business with them." *Id.* "If the likely magnitude of the loss was great in relation to company revenues, and had been so understood by [the] defendants, a basis would likely exist for concluding that they were dishonest or at least reckless in failing to mention it." *Id.* at *9. However, "[b]ecause the losses … were extremely modest in relation to revenues[,]" the First Circuit held that "no such inference exists." *Id.* The court therefore concluded that "the January 2010 statements do not pass the PSLRA's heightened pleading standard for scienter." *Id.*

The Second Circuit Reinstates a Securities Fraud Suit against Grant Thornton Involving Its Audit of Winstar Communications' 1999 Financial Statements

On July 19, 2012, the Second Circuit vacated a district court order granting summary judgment in favor of Grant Thornton LLP ("GT") in a securities fraud action arising from GT's audit of Winstar Communications, Inc.'s 1999 financial statements. *Gould v. Winstar Commc'ns., Inc.*, 2012 WL 2924254 (2d. Cir. July 19, 2012) (Lohier, J.) (*Winstar*).[1] The Second Circuit found that "genuine issues of material fact exist[ed]" as to whether GT acted with scienter for purposes of the plaintiffs' Section 10(b) claims, and whether there was actual reliance for purposes of the plaintiffs' Section 18 claims. *Id.* at *1. The court also found that the plaintiffs had presented sufficient evidence for a jury to infer loss causation.

Background

"Winstar was a broadband communications company whose core business was to provide wireless Internet connectivity to various businesses." *Id.* "GT served as Winstar's independent auditor from 1994 until Winstar filed for bankruptcy in April 2001, and GT regarded Winstar as 'one of [its] largest and most important clients.'" *Id.* "In 1999, however, the relationship deteriorated." *Id.* Winstar warned GT that it might terminate their relationship. "[A]t least one member of Winstar's board of directors openly urged … that the GT partner overseeing the audit of Winstar be removed from the Winstar account." *Id.* GT ultimately re-staffed the Winstar account "so that the 1999 audit was managed by a partner, Gary Goldman, and a senior manager, Patricia Cummings, neither of whom had previously reviewed or audited the financial records of a telecommunications company." *Id.*

The court found that "GT's audit for 1999 included several 'large account' transactions that Winstar consummated in an attempt to conceal a

1. Simpson Thacher represented three individual defendants in Winstar-related securities litigation. The claims against Simpson Thacher's clients were dismissed earlier in the litigation pursuant to a settlement.

decrease in revenue associated with Winstar's core business." *Id.* Together, these transactions accounted for "approximately 26 percent of Winstar's reported 1999 operating revenues and 32 percent of its 'core' revenues that year." *Id.* "At the time, GT considered these transactions to be 'red flags,' warranting the firm's 'heightened scrutiny.'" *Id.* "However, GT ultimately approved Winstar's recognition of revenue in connection with each of these transactions." *Id.* On February 10, 2000, "GT issued an unqualified audit opinion letter stating that Winstar's annual Form 10–K for fiscal year 1999 complied with GAAP and fairly represented Winstar's financial condition at the end of that year[.]" *Id.* at *5.

In March 2001, Asensio & Company, an investment firm and well-known activist short seller, issued press releases questioning Winstar's revenue accounting practices. On April 16, 2001, Winstar publicly disclosed the cancellation of its $2 billion credit facility and announced that it was considering a Chapter 11 reorganization. "[T]he [Asensio] press releases, coupled with the subsequent announcements of Winstar's financial troubles, were followed almost immediately by an additional steep decline in Winstar's stock price[.]" *Id.* at *6. "On April 18, 2001, Winstar filed for bankruptcy." *Id.*

Plaintiffs brought suit against GT under Section 10(b), and a subset of those plaintiffs (the "Jefferson Plaintiffs") brought suit against GT under Section 18 of the Exchange Act.[2] After discovery, GT moved for summary judgment. In September 2010, the Southern District of New York granted GT's motion on the grounds that "(1) the [p]laintiffs had failed to demonstrate that a genuine dispute of material fact existed as to whether GT acted intentionally or recklessly, as required under Section 10(b) of the Exchange Act, and (2) the Jefferson Plaintiffs had failed to demonstrate that such a dispute existed as to whether they actually relied on GT's audit opinion letter, as required under Section 18 of the Exchange Act." *Id.* The plaintiffs appealed.

A Genuine Issue of Material Fact Exists as to Scienter

In considering whether the plaintiffs had raised a genuine issue of material fact as to GT's scienter, the Second Circuit relied on its prior decision in *AUSA Life Insurance Co. v. Ernst & Young*, 206 F.3d 202 (2d Cir. 2000) (Oakes, J.) (*AUSA Life*). Like the plaintiffs here, the *AUSA Life* plaintiffs alleged that Ernst & Young ("E & Y") had "'consistently noticed, protested, and then acquiesced in' the financial misrepresentations of an audit client under pressure from the client's management." *Winstar*, 2012 WL 2924254, at *7 (quoting *AUSA Life*, 206 F.3d at 205). The Second Circuit in *AUSA Life* "held that by issuing an unqualified audit report despite its knowledge of accounting improprieties by the client, E & Y 'intentionally engaged in manipulative conduct' … in violation of

2. Section 18 provides, *inter alia*, that "[a]ny person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement … which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading." 15 U.S.C. § 78r(a).

Section 10(b)." *Id.* (quoting *AUSA Life,* 206 F.3d at 221).

Here, the Second Circuit determined that "there was admissible evidence that in the course of its audit GT learned of and advised against the use of indisputably deceptive accounting schemes, but eventually acquiesced in the schemes by issuing an unqualified audit opinion." *Id.* at *8. The court found that "[t]his evidence [went] beyond a mere failure to uncover the accounting fraud and, in general, relate[d] to (1) Winstar's recognition of revenue for the sale of equipment or services without sufficient indicia of delivery, (2) its recognition of all revenue associated with the incomplete sale of telecommunications systems, and (3) its recognition of revenue for sales of [fiber optic network capacity], equipment, and services to financially unstable companies to whom Winstar paid back large sums under separate contractual obligations." *Id.* The court also found "evidence that GT [had] failed to confirm Winstar's representations regarding these transactions or to retain and review documents evidencing each transaction." *Id.*

The Second Circuit concluded that "regardless of the hours GT spent or the number of documents it reviewed in the course of its 1999 audit of Winstar, a jury reasonably could determine that the audit was so deficient as to be 'highly unreasonable, representing an extreme departure from the standards of ordinary care … to the extent that the danger was either known to [GT] or so obvious that [GT] must have been aware of it.'" *Id.* at *9 (quoting *Rothman v. Gregor*, 20 F.3d 81, 90 (2d Cir. 2000)). The court held that "[a]t this stage, the [p]laintiffs ha[d] proffered enough facts constituting evidence of conscious misbehavior or recklessness to survive summary judgment." *Id.* at *8.

A Genuine Issue of Material Fact Also Exists as to Reliance

"Section 18 of the Exchange Act, 15 U.S.C. § 78r(a), requires actual rather than constructive reliance upon a materially false or misleading statement by one who has purchased or sold a security." *Id.* at *9. The district court held that the Jefferson Plaintiffs had "failed to show reliance because they could not demonstrate that they or their representatives 'actually saw Winstar's 1999 Form 10–K filing, much less read the included independent account report of GT.'" *Id.* (quoting *In re Winstar Commc'ns Sec. Litig.*, 2010 WL 3910322, at *6 (S.D.N.Y. Sept. 29, 2010)).

The Second Circuit found that "the [d]istrict [c]ourt's conclusion somewhat understate[d] the record evidence on this score." *Id.* One of the plaintiffs' representatives testified that although she could not "recall specifically" reviewing GT's audit opinion letter, "she actively reviewed such letters as a matter of practice in deciding whether to recommend certain stocks." *Id.* The Second Circuit held that "from that evidence, a jury reasonably could infer that she actually reviewed the relevant documents." *Id.*

The Plaintiffs Presented Sufficient Evidence for a Jury to Infer Loss Causation

"GT argue[d] in the alternative that the [d]istrict [c]ourt's grant of summary judgment should be affirmed because the [p]laintiffs failed to show loss causation." *Id.* at *10. The plaintiffs relied "largely" on the deposition testimony of an expert witness economist and "argue[d] that they [had] adduced proof of loss causation in the form of the press releases from Asensio and Winstar's April 2001 announcements, which publicly exposed Winstar's substantial financial weaknesses and together suggested for the first time that Winstar had engaged in improper revenue recognition practices for a period of time that included 1999." *Id.* GT "counter[ed] that any decline in Winstar's stock price that was not caused by" the collapse of the telecom bubble was the result of the cancellation of its $2 billion credit facility. *Id.*

Although the Second Circuit found that the loss causation question was "a much closer call," the court concluded that "a jury could reasonably infer based on the expert testimony and other evidence that the precipitous decline in Winstar's stock price in 2001 was attributable in part to the alleged fraud." *Id.*

The Eleventh Circuit Affirms Judgment as a Matter of Law in Favor of the Defendants in the BankAtlantic Subprime Action

On July 23, 2012, the Eleventh Circuit affirmed the Southern District of Florida's decision granting the defendants' post-trial motion for judgment as a matter of law in a securities fraud action alleging that BankAtlantic Bancorp, Inc. ("Bancorp") and its management "had misrepresented the level of risk associated with commercial real estate loans held by its subsidiary, BankAtlantic." *Hubbard v. BankAtlantic Bancorp, Inc.*, 2012 WL 2985112, at *1 (11th Cir. July 23, 2012) (Tjoflat, J.). The Eleventh Circuit concluded that "the evidence was insufficient to support a finding of loss causation, an element required to make out a securities fraud claim under Rule 10b–5." *Id.*

Background

State-Boston Retirement System ("State-Boston"), a shareholder and the lead plaintiff, alleged that "Bancorp [had] fraudulently misled the public about the deteriorating credit quality of BankAtlantic's commercial real estate portfolio." *Id.* "That portfolio comprised land acquisition and development loans; land acquisition, development, and construction loans; and builder bank loans ('BLB loans')." *Id.*

On April 25, 2007, Bancorp "partially disclosed its concern about [its] commercial real estate portfolio" in an 8–K reporting financial results for the first quarter of 2007. The 8–K also stated that "[t]he current environment for residential land acquisition and development loans is a concern, particularly in Florida" and noted that Bancorp could "experience further deterioration in [its] portfolio over the next several quarters as the market attempts to absorb an oversupply of available lot inventory." *Id.* at *3.

On April 26, 2007, Bancorp's former CEO "warned that the Florida housing market was slowing and that, as a result, the risk associated with the BLB portfolio could worsen." *Id.* He explained that "[b]ecause of market conditions, … homebuilders were becoming more reluctant to buy lots on the land that secured the BLB loans." *Id.* "That day, Bancorp's stock price dropped from $10.55 per share to $9.99." *Id.*

Over the course of the next several months, "Bancorp's public statements continued to note the risk associated with BankAtlantic's BLB loans but minimize the risk associated with the non-BLB portion of the commercial real estate portfolio." *Id.* However, "[o]n October 25, 2007, Bancorp released an 8–K that, according to State-Boston, brought the fraud to an end." *Id.* at *4. The October 25, 2007 8–K made it clear that BankAtlantic faced credit issues across its entire commercial real estate loan portfolio, not simply with its BLB loans. "By the time the 8–K was released, Bancorp's stock price had already fallen

gradually over the class period, from $12.66 per share to $7.65." *Id.* "On October 26, 2007, it fell by another $2.93, or 38 percent, to $4.72." *Id.*

Three days later, State-Boston brought a class action suit under Section 10(b). The case went to trial, and the jury returned a verdict in State-Boston's favor. The defendants then filed a post-trial motion for judgment as a matter of law, which the Southern District of Florida granted on April 25, 2011.[3] The district court found, *inter alia*, that State-Boston "had not presented evidence sufficient to support a finding that the statements found by the jury to violate [Section] 10(b) had caused their losses …." *Id.* at *6. State-Boston appealed.

The Eleventh Circuit Affirms the District Court's Ruling Based on State-Boston's Failure to Establish Loss Causation

The Eleventh Circuit explained that "when an investor buys stock at an artificially inflated price and resells at a lower price, the price decline, and the investor's consequent loss, may result in part from factors other than the dissipation of fraud-induced inflation." *Id.* at *7. The lower price "'may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.'" *Id.* (quoting *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 343 (2005)). "Thus, to succeed in a fraud-on-the-market case, it is not enough to point to a decline in the security's price after the truth of the misrepresented matter was revealed to the public." *Id.* at *8. "The plaintiff must also offer evidence sufficient to allow the jury to separate portions of the price decline attributable to causes unrelated to the fraud[.]" *Id.*

Here, State-Boston claimed that "class members [had] purchased Bancorp stock at prices that were artificially inflated because Bancorp [had] fraudulently concealed the poor credit quality of BankAtlantic's commercial real estate portfolio, and that those shares lost value when the portfolio's deterioration was revealed to the market." *Id.* at *9. State-Boston's loss causation expert testified that the entire 38% decline in the value of Bancorp's share price on October 26, 2007 resulted from "the materialization of a [concealed] risk … that [Bancorp's] commercial real estate portfolio would deteriorate[.]" *Id.*

The expert "attempted to isolate the effect of company-specific factors from the effect of general market trends by comparing the change in Bancorp's stock to the change in the S&P 500." *Id.* "She also attempted to separate the effect of company-specific factors from industry-wide trends by comparing Bancorp stock to the NASDAQ Bank Index, an index of the stock prices of hundreds of banks and bank holding companies traded on the NASDAQ." *Id.* However, the Eleventh Circuit determined that State-Boston's expert "failed … to account for the effects of the collapse of the Florida real estate market." *Id.* at *10.

The court explained that Florida "benefited more than most states from the real estate boom of the previous years" and was consequently "hit harder than most [in 2007] by the ensuing bust." *Id.* Moreover, "Florida financial institutions … made up only a small percentage of the NASDAQ Bank Index." *Id.* The Eleventh Circuit found that the NASDAQ Bank Index was therefore "inappropriate for the task of filtering out the effects of industry-wide factors that might affect the stock price of a bank … whose assets were concentrated in loans tied to Florida real estate in 2007." *Id.*

In this case, "BankAtlantic and Bancorp were particularly susceptible to any deterioration in the Florida real estate market" because "BankAtlantic's assets were concentrated in loans tied to Florida

3. Please click here to read our discussion of the district court's order in the May 2011 edition of the Alert.

real estate." *Id.* "To support a finding that Bancorp's misstatements were a substantial factor in bringing about its losses," State-Boston "had to present evidence that would give a jury some indication, however rough, of how much of the decline in Bancorp's stock price resulted not from the fraud but from the general downturn in the Florida real estate market—the risk of which Bancorp is not alleged to have concealed." *Id.* The Eleventh Circuit found that "State Boston failed to do so." *Id.* "None of its evidence excluded the possibility that class members' losses resulted not from anything specific about BankAtlantic's commercial real estate portfolio that Bancorp hid from the public, but from market forces that it had warned of—and that would likely have caused significant losses for an investor in any bank with a significant credit portfolio in commercial real estate in Florida in 2007." *Id.* The Eleventh Circuit held that "Bancorp [was] therefore entitled to judgment as a matter of law." *Id.*

The Southern District of New York Denies the Defendants' Motion for Summary Judgment on *Morrison* Grounds in an SEC Action Concerning Transactions between Foreign Investment Funds

On June 21, 2012, the Southern District of New York denied ICP Asset Management LLC's motion for summary judgment in an SEC action alleging that the New York-based investment advisory firm had defrauded investors in several foreign investment vehicles it managed, including four Cayman Islands-based collateralized debt obligations (the "Triaxx CDOs"). *SEC v. ICP Asset Mgmt., LLC*, 2012 WL 2359830 (S.D.N.Y. June 21, 2012) (Kaplan, J.) (*ICP*). Relying

on the Second Circuit's recent decision in *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012) (Katzmann, J.) (*Absolute Activist II*), the *ICP* court found that there was sufficient evidence to permit the inference that the transactions at issue were "domestic transactions in other securities" within the meaning of the Supreme Court's ruling in *Morrison v. National Australia Bank*, 130 S. Ct. 2869, 2884 (2010).[4]

Background

On June 21, 2010, the SEC brought suit against ICP Asset Management LLC and its president, as well as two related entities (collectively, the "ICP Defendants") alleging, *inter alia*, that the ICP Defendants had "engaged in a range of improper transactions that defrauded the Triaxx CDOs of tens of millions of dollars and placed them at risk of substantial additional losses in the future." Complaint and Jury Demand at 2. "Starting in 2007, as the mortgage markets increasingly deteriorated," the ICP Defendants allegedly "repeatedly caused the Triaxx CDOs, their advisory clients, to overpay for bonds—often in order to protect another ICP client

4. The *Morrison* Court held that Section 10(b) only applies to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities …." 130 S.Ct. at 2884.

from realizing losses or to make money for ICP." *Id.* The SEC asserted claims under Section 10(b) of the Exchange Act, Section 17(a) of the Securities Act, and the Investment Advisers Act of 1940.[5]

On November 9, 2011, the ICP Defendants moved for summary judgment on *Morrison* grounds, arguing that "the Supreme Court made clear … that foreign transactions are beyond the scope of the federal securities laws, even if a significant portion of the allegedly fraudulent conduct takes place in the United States." ICP Defendants' Memorandum of Law in Support of Motion for Partial Summary Judgment at 1 ("Summary Judgment Motion"). The ICP Defendants emphasized that "[n]one of the relevant investment funds issued securities that were listed on a domestic exchange; nor were any of their securities 'purchased' or 'sold' in the United States." *Id.*

In support of these arguments, the ICP Defendants pointed to *Absolute Activist Value Master Fund Ltd. v. Homm*, 2010 WL 5415885 (S.D.N.Y. Dec. 22, 2010) (Daniels, J.) (*Absolute Activist I*), among other authorities. The ICP Defendants claimed that the *Absolute Activist I* court had "examined nearly identical transactions by and between foreign funds" and "determined that they did not constitute domestic transactions under *Morrison*." Summary Judgment Motion at 14. In *Absolute Activist I*, "hedge funds registered in the Cayman Islands, which invested on behalf of foreign and American investors, sued their foreign investment manager, a foreign seller, and a United States-based broker for arranging allegedly fraudulent purchases of penny stocks issued by United States companies registered with the SEC." *Id.* The *Absolute Activist I* court dismissed with prejudice the hedge fund plaintiffs' complaint, finding that the "plain language of the 'transaction test' established in *Morrison* precludes this action from moving forward." *Absolute Activist I*, 2010 WL 5415885, at *5.[6]

On March 1, 2012—several months after the ICP Defendants moved for summary judgment—the Second Circuit issued its decision in *Absolute Activist II* "interpret[ing] *Morrison*'s second prong and determin[ing] under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered 'domestic' within the meaning of *Morrison*." *Absolute Activist II*, 677 F.3d at 66–67. The Second Circuit held that "to sufficiently allege the existence of a 'domestic transaction in other securities,' plaintiffs must allege facts indicating that irrevocable liability was incurred or that title was transferred within the United States." *Id.* at 62. While the Second Circuit affirmed the dismissal of the hedge funds' complaint in *Absolute Activist I*, the court "conclude[d] that the plaintiffs should be given leave to amend the complaint to assert additional facts suggesting that the transactions at issue were domestic." *Id.*[7]

The Court Relies on *Absolute Activist II* to Deny the ICP Defendants' Motion for Summary Judgment as to the SEC's Claims under Section 10(b) and Section 17(a)

The Southern District of New York found that the ICP Defendants' motion for summary judgment "implicate[d] the issue of when 'transactions in other securities' are domestic" under *Morrison*. *ICP*, 2012 WL 2359830 at *2. The ICP Defendants' principal argument was that "[t]he *Morrison* transactional test is not satisfied by the conduct of entities in the United States facilitating private transactions between

5. The Advisers Act prohibits investment advisers from, *inter alia*, "employ[ing] any device, scheme, or artifice to defraud any client or prospective client" or "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client[.]" 15 U.S.C. § 80b–6 (1940).

6. Please click here to read our discussion of the *Absolute Activist I* ruling in the January 2011 edition of the Alert.

7. Please click here to read our discussion of the *Absolute Activist II* ruling in the March 2012 edition of the Alert.

foreign funds." Summary Judgment Motion at 14. The court noted that in making this argument, the ICP Defendants relied on *Absolute Activist I*, which the Second Circuit in *Absolute Activist II* had since reversed in part.

Without discussing the SEC's allegations against the ICP Defendants, the Southern District of New York held simply that "[t]he evidence before this [c]ourt is sufficient to at least permit the inference that the trades complained of were domestic transactions with the meaning of *Absolute Activist [II]*." *ICP*, 2012 WL 2359830, at *2. "Accordingly," the court determined that the ICP Defendants' motion "must be denied" as to the SEC's claims brought under Section 10(b). *Id.*

With respect to the SEC's Section 17(a) claim, the court explained that "[t]he elements of a claim under Section 17(a) of the Securities Act are essentially the same as those under Section 10(b) of the Exchange Act." *Id.* "Many courts—including the Second Circuit—analyze claims under both statutes together." *Id.*

The *ICP* court observed that "[s]ince *Morrison*, three courts in this district have applied its holding to claims under the Securities Act." *Id.* (citing *In re Vivendi Universal, S.A., Sec. Litig.*, 2012 WL 280252, at *5 (S.D.N.Y. Jan. 27, 2012); *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 164 (S.D.N.Y. 2011); *In re Royal Bank of Scot. Grp. PLC Sec. Litig.*, 765 F. Supp. 2d 327, 338 & n.11 (S.D.N.Y. 2011)). The *ICP* court "join[ed] this nascent consensus and conclude[d] that the *Morrison* analysis for the Securities Act claim is identical [to] that applicable to claims under the Exchange Act." *Id.* The court therefore denied the ICP Defendants' motion for summary judgment as to the Section 17(a) claim.

The Court Denies the ICP Defendants' Motion for Summary Judgment as to the SEC's Advisers Act Claims

The ICP Defendants argued that "'*Morrison* bars the [SEC's] Advisers Act claims because the statute does not 'regulate the activity of investment advisers with respect to foreign clients engaged in foreign transactions.'" *Id.* at 2 (quoting Summary Judgment Motion at 28).

In *SEC v. Gruss*, 2012 WL 1659142 (S.D.N.Y. May 9, 2012) (Sweet, J.), the defendant similarly argued that "under *Morrison*, claims predicated on fraud must only be directed at domestic clients because the focus of the [Advisers Act] is not upon the place where the fraud allegedly originated but upon the location of the client." *Id.* at *6. Rejecting this contention, the *Gruss* court "concluded that the 'text and regulatory structure [demonstrate that] the focus of the [Advisers Act] is clearly on the investment adviser and its actions'—not the location of the client." *ICP*, 2012 WL 2359830, at *3 (quoting *Gruss*, 2012 WL 1659142, at *9).

The *ICP* court agreed with the *Gruss* court's analysis, and held that evidence that the ICP Defendants' "clients were foreign entities [did] not entitle them to summary judgment dismissing the Advisers Act claims." *Id.* "Indeed, the evidence before the [c]ourt is sufficient to at least permit the inference that the conduct complained of was domestic and violated the Advisers Act."

The Southern District of New York Addresses When RICO Claims Implicate an Extraterritorial Application of the RICO Statute in Violation of *Morrison*

On May 14, 2012, the Southern District of New York denied a motion to dismiss Racketeer Influenced and Corrupt Organizations Act ("RICO") claims brought by Chevron Corporation against various domestic defendants in connection with a lawsuit in Ecuador. *Chevron Corp. v. Donziger*, 2012 WL 1711521 (S.D.N.Y. May 14, 2012) (Kaplan, J.). The court held that the case did not involve an extraterritorial application of RICO in violation of the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010).

Background

Chevron alleged that "Steven Donziger, a New York lawyer, and others based in the United States, here conceived, substantially executed, largely funded, and significantly directed a scheme to extort and defraud Chevron, a U.S. company, by, among other things, (1) bringing a baseless lawsuit in Ecuador; (2) fabricating (principally in the United States) evidence for use in that lawsuit in order to obtain an unwarranted judgment there; [and] (3) exerting pressure on Chevron to coerce it to pay money not only by means of the Ecuadorian litigation and [j]udgment, but also by subjecting Chevron to public attacks in the United States and elsewhere based on false and misleading statements …." *Id.* at *1.

Chevron brought substantive and conspiracy claims against the defendants under RICO Sections 1962(c) and (d).[8] Steven Donziger and related defendants (collectively, the "Donziger Defendants") moved to dismiss the substantive RICO claim on the grounds that "it would require an impermissible attempt to apply the statute extraterritorially …." *Id.* at *3. This "extraterritoriality argument stem[med] from *Morrison* …." *Id.* at *4.

The Location of the Racketeering Activity Should Determine Whether Claims Involve an Extraterritorial Application of RICO

The court explained that "*Morrison* … requires consideration of two questions: whether the presumption against extraterritorial application applies to RICO and, if it does, whether applying RICO to all or part of Chevron's claim in fact would be extraterritorial." *Id.* The court found that the first question "requires no extensive analysis" because "[t]he Second Circuit has held that RICO,

8. Section 1962(c) provides that "[i]t shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt." 18 U.S.C. § 1962(c).

Section 1962(d) provides that "[i]t shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section." 18 U.S.C. § 1962(d).

like the Exchange Act, is silent as to extraterritorial application and, in consequence, that the presumption against extraterritorial application governs in RICO cases." *Id.* (citing *Norex Petroleum Ltd. v. Access Indus., Inc.*, 631 F.3d 29, 32–33 (2d Cir. 2010) (per curiam)). "The more difficult question is whether all or part of Chevron's claims would involve extraterritorial application of the statute." *Id.*

"Unlike the *Norex* complaint, the scheme alleged here was conceived and orchestrated in the United States to injure a U.S. plaintiff, involved a predominately U.S. enterprise, and was carried out in material respects, though by no means entirely, here." *Chevron*, 2012 WL 1711521 at *5. Moreover, the *Norex* court "found it unnecessary to articulate an approach to deciding whether application of RICO in a given situation is extraterritorial, beyond drawing a conclusion with respect to the particular complaint before it[.]" *Id.* The *Chevron* court determined that "*Norex* therefore does not control" and "sheds no light on the pivotal question before this [c]ourt." *Id.*

The *Chevron* Court Rejects the "Foreign Enterprise" Test Set Forth in *Cedeño v. Intech Group*

In *Cedeño v. Intech Group, Inc.*, 733 F. Supp. 2d 471 (S.D.N.Y. 2010) (Rakoff, J.), *aff'd*, 457 Fed. Appx. 35 (2d. Cir. 2012), the Southern District of New York dismissed a RICO claim brought by a Venezuelan plaintiff against various defendants allegedly connected to the Venezuelan government on the grounds that "RICO evidences no concern with foreign enterprises [and] … does not apply where, as here, the alleged enterprise and the impact of the predicate activity upon it are entirely foreign." *Id.* at 474.

The *Chevron* court rejected "*Cedeño*'s emphasis on the domestic or foreign character of the alleged RICO enterprise" as neither "persuasive [n]or helpful" for two reasons. *Chevron*, 2012 WL 1711521 at *5. First, the court found it "very unlikely that Congress had 'no concern' with the conduct of the affairs of foreign enterprises through patterns of racketeering activity, at least if the prohibited activities injured Americans in this country and occurred here, either entirely or in significant part." *Id.* at *6. "[F]oreign enterprises have been at the heart of precisely the sort of activities—committed in the United States—that were exactly what Congress enacted RICO to eradicate." *Id.*

"Second," the *Chevron* court explained that the question of "whether the RICO enterprise is domestic or foreign simply begs the question of how to determine the enterprise's character." *Id.* "Citizenship or legal status is not a viable approach, as it would produce absurd results." *Id.* For example, suppose there was a RICO enterprise involving "officials of two corporations—one incorporated in Delaware and the other in Bermuda[.]" *Id.* "The idea that the officials of the Delaware corporation could be prosecuted criminally and sued civilly under RICO because their enterprise was a domestic corporation while their counterparts with the Bermudian corporation would be immune solely because the Bermudian corporation was foreign would be risible." *Id.* "Moreover, citizenship or legal characteristics would afford no reliable or principled basis for characterizing association-in-fact enterprises consisting of citizens or entities organized under the laws of different countries." *Id.*

The *Chevron* Court Endorses the Location of the Racketeering Activity Approach Set Forth in *CGC Holding Co. v. Hutchens*

In *CGC Holding Co., LLC v. Hutchens*, 824 F. Supp. 2d 1193 (D. Colo. 2011) (Jackson, J.) (*CGC*), the court denied a motion to dismiss a RICO claim where "most of the participants in the activities that [were] the subject of the RICO claim" resided in Canada, but "the racketeering activity of the enterprise … was directed at and largely occurred within the United States." *Id.* at *1209. The *CGC* court found that "[t]hese facts [were] a far cry from those of *Norex* and [*Cedeño*], where the actors, victims and conduct were foreign, and the connection to the United States was

essentially incidental." *Id.* at 1210. "In the present case, the conduct of the enterprise within the United States was a key to its success." *Id.*

The *Chevron* court found "the general approach taken in *CGC* to be persuasive and an appropriate means for determining when a proposed application [of] Section 1962(c) of RICO is domestic or foreign[.]" *Chevron*, 2012 WL 1711521 at *8. "This approach … would afford a remedy to a U.S. plaintiff who claims injury caused by domestic acts of racketeering activity without regard to the nationality or foreign character of the defendants or the enterprise whose affairs the defendants wrongfully conducted." *Id.* "And it almost certainly would be consistent with Congressional intent, which included protecting American victims at least against injury caused by the conduct of the affairs of enterprises through patterns of racketeering activity that occur in this country." *Id.* "Accordingly," the *Chevron* court held that "[i]f there is a domestic pattern of racketeering activity aimed at or causing injury to a domestic plaintiff, [then] the application of Section 1962(c) to afford a remedy would not [be] an extraterritorial application of the statute." *Id.*

Chevron's Claims Do Not Involve an Extraterritorial Application of RICO

The *Chevron* court explained that "the RICO violation alleged in this case consisted of the conduct of the affairs of the enterprise through a pattern of racketeering activity." *Id.* "The scheme (1) allegedly was conceived and orchestrated in and from the United States (2) in order wrongfully to obtain money from a company organized under the laws of and headquartered in the United States, and to cover up unlawful and improper activities, and (3) acts in furtherance were committed here by Americans and in Ecuador by both Americans and Ecuadorians." *Id.* "Assuming that the amended complaint alleges a domestic pattern of racketeering activity," the *Chevron* court held that "applying the statute to that pattern would not be extraterritorial." *Id.*

"Moreover, even if the nationality, citizenship, or location of the enterprise were pertinent in such circumstances, the enterprise alleged in this case, an association in fact including both Americans and Ecuadorians, with the Americans predominant in number and charged with conceiving and supervising the scheme, would cut in favor of application of the RICO statute here." *Id.*

"Accordingly, insofar as the Donziger Defendants' motion seeks dismissal of the RICO claims under *Morrison*," the court held that "their motion must be denied." *Id.* at *9.

Two District Courts Address the Whistleblower Provisions of the Dodd-Frank Act

In two recent decisions, courts have addressed the contours of the whistleblower protections enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). The Southern District of Texas ruled that the Dodd-Frank Act's anti-retaliation provision does not apply extraterritorially, and the Southern District of New

York held that the Dodd-Frank Act's amendment to Section 806 of the Sarbanes-Oxley Act, to provide protection for employees of subsidiaries of publicly traded companies, applies retroactively.

The Southern District of Texas Holds That the Dodd-Frank Act's Anti-Retaliation Provision Does Not Apply Extraterritorially

On June 28, 2012, the Southern District of Texas granted the defendants' motion to dismiss a Dodd-Frank Act whistleblower retaliation claim brought under 15 U.S.C. § 78u–6(h)(1)(A) (the "Anti-Retaliation Provision") in connection with events that took place in Jordan. *Asadi v. G.E. Energy (USA), LLC*, 2012 WL 2522599 (S.D. Tex. June 28, 2012) (Atlas, J.). The court held that "Dodd-Frank's Anti-Retaliation Provision *per se* does not apply extraterritorially." *Id.* at *7.

Background

The plaintiff was "employed by GE Energy from 2006 through 2011 as the GE-Iraq Country Executive." *Id.* at *1. This position "required him to coordinate with Iraq's governing bodies in order to secure and manage energy service contracts for GE." *Id.* Although the plaintiff was allegedly "a U.S-based employee of GE Energy," he had "agreed to 'temporarily relocate' to Amman, Jordan, where he had an office." *Id.* While in Jordan, the plaintiff "informed his supervisors that GE had potentially violated the Foreign Corrupt Practices Act ('FCPA') and company policies." *Id.* Shortly thereafter, GE terminated the plaintiff's employment. The plaintiff "was informed of his termination by an email … stat[ing] that GE was terminating his employment 'as an at-will employee, as allowed under U.S. law' …." *Id.*

The plaintiff subsequently brought suit for "whistleblower retaliation under the Dodd-Frank Act[,]" alleging that "his termination was illegal retaliation for his disclosures of the alleged bribery." *Id.* at *2–3. The defendants moved to dismiss.

The Court Relies on *Morrison* to Hold That the Anti-Retaliation Provision Does Not Have Extraterritorial Effect

The Southern District of Texas found that "[t]his case requires the [c]ourt to decide whether Dodd-Frank's Anti-Retaliation Provision applies extraterritorially." *Id.* at *4. The court turned to the Supreme Court's decision in *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), for guidance. "In *Morrison*, the Court considered Section 10(b) of the Securities and Exchange Act of 1934, which is silent regarding extraterritorial effect." *Id.* Finding "no affirmative indication in the Exchange Act that § 10(b) applies extraterritorially," the *Morrison* Court "therefore conclude[d] that it does not." 130 S. Ct. at 2883.

"Like the language of Section 10(b)," the *Asadi* court noted that "the language of the Dodd-Frank Anti-Retaliation Provision is silent regarding whether it applies extraterritorially." *Asadi*, 2012 WL 2522599, at *4. The court "therefore applie[d] the presumption that the Provision does not govern conduct outside the United States." *Id.*

In *Morrison*, "the Court [also] emphasized that 'when a statute provides for some extraterritorial

application, the presumption against extraterritoriality operates to limit that provision to its terms.'" *Id.* (quoting *Morrison*, 130 S.Ct. at 2883). With respect to the Dodd-Frank Act, the *Asadi* court found it significant that "Section 929P(b) gives the district courts extraterritorial jurisdiction, but only over certain enforcement actions brought by the SEC or the United States." *Id.* The court determined that "[t]he language of Dodd-Frank's Section 929P(b) thus strengthens the conclusion that the Anti-Retaliation Provision does not apply extraterritorially." *Id.*

The plaintiff argued that even if the Anti-Retaliation Provision does not apply extraterritorially, it "should apply to [him] … because he was terminated in the U.S. as an at-will employee, as allowed under U.S. law." *Id.* at *5 (quotation omitted). However, the *Asadi* court found that "the majority of events giving rise to the suit occurred in a foreign country." *Id.* (quotation omitted). "[T]he Termination Email invoking U.S. employment law was sent to [the plaintiff] in Jordan, was related to his employment in Jordan, and [stated] that a letter would be sent to [the plaintiff's] home in Jordan." *Id.*

The *Asadi* court determined that "[u]nder *Morrison*, the email's reference to U.S. employment law [was] insufficient to extend the territorial reach of the Anti-Retaliation Provision." *Id.* As the *Morrison* court explained, "it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States." *Morrison*, 130 S. Ct. at 2884. The *Asadi* court therefore held that "the Anti-Retaliation Provision does not extend to or protect [the plaintiff's] extraterritorial whistleblowing activity." *Asadi*, 2012 WL 2522599, at *5.

The Sarbanes-Oxley Act and the Foreign Corrupt Practices Act Do Not Extend the Extraterritorial Reach of the Anti-Retaliation Provision in This Case

The plaintiff contended that "even if the Anti-Retaliation Provision *per se* is not extraterritorial, the Provision's reach is extended because other statutes incorporated into the Provision [specifically, the Sarbanes-Oxley Act ("SOX") and the Foreign Corrupt Practices Act ("FCPA")] have extraterritorial reach and those provisions either protected or required his overseas disclosures." *Id.*

"First," the plaintiff claimed that "his disclosures were protected by Section 806 of SOX, 18 U.S.C. § 1514A, a whistleblower provision." *Id.* However, in the pre-*Morrison* case of *Carnero v. Boston Scientific Corp.*, 433 F.3d 4 (1st Cir. 2006) (Campbell, J.), the First Circuit held that Section 806 of SOX did not apply extraterritorially. The First Circuit "relied heavily on the presumption against extraterritorial application, noting that the SOX provision was silent as to its territorial reach." *Asadi*, 2012 WL 2522599, at *5. The *Asadi* court found the First Circuit's holding to be "in harmony with *Morrison*[.]" *Id.*

"Second," the plaintiff "invoke[d] Sections 302 and 404 of SOX, arguing that they required the disclosure of the alleged FCPA violations." *Id.* The *Asadi* court explained that "these provisions pertain to required disclosures and internal controls by certain companies subject to SOX" and that in any event, "the provisions do not explicitly address extraterritorial application." *Id.*

Finally, the court rejected the plaintiff's claim that "the FCPA extends the territorial reach of the Provision." *Id.* "[B]ecause the FCPA is clearly intended to apply extraterritorially," the plaintiff reasoned that "the Provision also must apply extraterritorially." *Id.* However, the Anti-Retaliation Provision "states that an employer may not retaliate against a whistleblower because of the whistleblower's lawful acts 'in making disclosures that are required or protected' under the relevant law, which for present purposes is the FCPA." *Id.* (quoting 15 U.S.C. § 78u–6(h)(1)(A)(iii)) (emphasis added by the court). While the plaintiff "alleged that his internal disclosures at GE pertained to bribery of foreign officials, he has cited the [c]ourt to no provision of the FCPA that 'protects' or 'requires' his internal report of the alleged bribery." *Id.* "Therefore," the

Asadi court held that "the Provision does not protect [the plaintiff] against retaliation for his disclosures of the alleged bribery." *Id.*

The Southern District of New York Holds that the Dodd-Frank Act Amendment to Section 806 of the Sarbanes-Oxley Act to Include Employees of Subsidiaries of Public Companies Applies Retroactively

The Dodd-Frank Act amended Section 806 of the Sarbanes-Oxley Act to provide that whistleblower protections apply not only to employees of public companies but also to employees of wholly-owned subsidiaries of those companies. On July 9, 2012, the Southern District of New York held that this amendment "applies retroactively" because "the amendment is [simply] a clarification of Congress's intent with respect to the Sarbanes-Oxley whistleblower provision[.]" *Leshinsky v. Telvent GIT, S.A.*, 2012 WL 2686111, at *1 (S.D.N.Y. July 9, 2012) (Oetken, J.). The court determined that it therefore had subject matter jurisdiction over whistleblower claims brought by a plaintiff who had allegedly been wrongfully terminated by the non-public subsidiaries of Telvent GIT, S.A., a publicly-traded company, prior to the enactment of the Dodd-Frank Act.

Background

Before the Dodd-Frank Act amendment, Section 806 provided for "[w]histleblower protection for employees of publicly traded companies." 18 U.S.C. § 1514A(a) (2002). "Under this version of the statute, it was unclear whether 'employees of publicly traded companies' included employees of the public company's wholly owned subsidiaries, or if the statute applied only to employees who were employed directly by the publicly traded parent company." *Leshinsky*, 2012 WL 2686111, at *5. "Few federal courts [had] considered the issue, although a handful of district courts held that the statute did not apply to employees of non-public subsidiaries." *Id.*

On July 21, 2010, the Dodd-Frank Act amended Section 806 "to provide that no public company, 'including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company,' may retaliate against a whistleblowing employee." *Id.* at *6 (quoting the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub.L. No. 111–203, § 929A, 124 Stat. 1376, 1852 (2010)). On March 31, 2011, the Department of Labor's Administrative Review Board ("ARB") "held that this amendment should be applied retroactively to pending cases because the amendment [was] a mere clarification of the previous statute, intended to make 'what was intended all along ever more unmistakably clear.'" *Id.* (quoting *Johnson v. Siemens Bldg. Tech. Inc.*, 2011 WL 1247202, at *11 (DOL ARB Mar. 31, 2011)). "The ARB's conclusion was consistent with the views expressed by the [SEC] and OSHA, each of which submitted an amicus brief to the ARB urging a conclusion that the Dodd-Frank amendment applied retroactively as a clarification of Congress's original intent in passing Section 806." *Id.*

The Section 806 Amendment Is a Clarification of Previously-Existing Law and Thus Applies Retroactively

"As a general rule, a new statute does not apply retroactively to conduct that occurred prior to the statute's enactment." *Id.* at *7. "Notwithstanding this presumption, several Courts of Appeals have held that when an amendment merely clarifies existing law, rather than effecting a substantive change to the law, then retroactivity concerns do not come into play." *Id.*

The Southern District of New York noted that "'there is no bright-line test' for determining whether an amendment clarifies existing law." *Id.* at *8 (quoting

Levy v. Sterling Holding Co., 544 F.3d 493, 506 (3d Cir. 2008)). Rather, courts must consider "(1) whether the enacting body declared that it was clarifying a prior enactment; (2) whether a conflict or ambiguity existed prior to the amendment; and (3) whether the amendment is consistent with a reasonable interpretation of the prior enactment and its legislative history." *Id.* In *Johnson*, the ARB "appl[ied] these factors" and "concluded that the Dodd-Frank amendment [to Section 806] clarifies, rather than changes, the statute's meaning." *Id.* The Southern District of New York "agree[d] with this conclusion." *Id.*

First, with respect to the legislative intent, the court noted that the Dodd-Frank Act itself "does not contain any statement that the amendment serves as a clarification of Section 806." *Id.* "However, the Senate Report accompanying S. 3217, which ultimately became Section 929A of Dodd-Frank, states that it '[a]mends Section 806 of the Sarbanes-Oxley Act of 2002 to *make clear* that subsidiaries and affiliates of issuers may not retaliate against whistleblowers ….'" *Id.* (quoting S.Rep. No. 111-176, at 114 (2010) (emphasis added by the court). The court did not "rely on the statements in the Senate Report that the legislation was meant to 'clarify' Section 806 as a definitive statement of Congress's intent" but did "find it relevant to the overall analysis." *Id.* at *9.

Second, the Southern District of New York had "little difficulty in concluding that there was … conflict and ambiguity regarding the statute's meaning" prior to the Dodd-Frank Act amendment. *Id.* "The statutory language did not define who qualifies as an 'employee of' the publicly traded company, and until it was amended it did not address the issue of subsidiaries of the public company at all." *Id.* Department of Labor Administrative Law Judges "ha[d] not adopted a uniform interpretation" of the statute, and the few "district court decisions were far from 'unequivocal' on this issue." *Id.* at *10–11 (quotation omitted).

Third, the Southern District of New York found that the Dodd-Frank Act amendment to Section 806 "reflects a reasonable interpretation of the statute." *Id.* at *14. "Based on the policy and legislative history of Sarbanes-Oxley, the [c]ourt conclude[d] that it [was] reasonable to infer that Congress [had] intended to provide protection for whistleblowers at all levels of a public company's corporate structure, and not solely those who were employed directly by the public entity itself." *Id.* "In light of the fact that corporate malfeasance can—and often does—occur within subsidiaries of a public company, and that such malfeasance was precisely what precipitated the passage of Sarbanes-Oxley, it is certainly reasonable to infer that, in enacting whistleblower protections, Congress intended to protect the employees of a corporation's subsidiaries in addition to employees of the parent itself." *Id.* at *15.

"For the foregoing reasons," the Southern District of New York determined that "the Dodd-Frank amendment to Section 806 of Sarbanes-Oxley applies retroactively as a clarification of the statute." *Id.* at *22. In so holding, the court did "not express any view about the retroactive application of Dodd-Frank in general, or of any other specific provisions of Dodd-Frank." *Id.* at *18.

NEW YORK

Bruce D. Angiolillo
212-455-3735
bangiolillo@stblaw.com

Mark G. Cunha
212-455-3475
mcunha@stblaw.com

Paul C. Curnin
212-455-2519
pcurnin@stblaw.com

Michael J. Garvey
212-455-7358
mgarvey@stblaw.com

Paul C. Gluckow
212-455-2653
pgluckow@stblaw.com

Nicholas Goldin
212-455-3685
ngoldin@stblaw.com

David W. Ichel
212-455-2563
dichel@stblaw.com

Peter E. Kazanoff
212-455-3525
pkazanoff@stblaw.com

Joshua A. Levine
212-455-7694
jlevine@stblaw.com

Linda H. Martin
212-455-7722
lmartin@stblaw.com

Mary Elizabeth McGarry
212-455-2574
mmcgarry@stblaw.com

Joseph M. McLaughlin
212-455-3242
jmclaughlin@stblaw.com

Lynn K. Neuner
212-455-2696
lneuner@stblaw.com

Barry R. Ostrager
212-455-2655
bostrager@stblaw.com

Thomas C. Rice
212-455-3040
trice@stblaw.com

Mark J. Stein
212-455-2310
mstein@stblaw.com

Alan C. Turner
212-455-2472
aturner@stblaw.com

Mary Kay Vyskocil
212-455-3093
mvyskocil@stblaw.com

George S. Wang
212-455-2228
gwang@stblaw.com

David J. Woll
212-455-3136
dwoll@stblaw.com

Jonathan K. Youngwood
212-455-3539
jyoungwood@stblaw.com

LOS ANGELES

Michael D. Kibler
310-407-7515
mkibler@stblaw.com

Chet A. Kronenberg
310-407-7557
ckronenberg@stblaw.com

PALO ALTO

Alexis S. Coll-Very
650-251-5201
acoll-very@stblaw.com

James G. Kreissman
650-251-5080
jkreissman@stblaw.com

WASHINGTON, D.C.

Peter H. Bresnan
202-636-5569
pbresnan@stblaw.com

Cheryl J. Scarboro
202-636-5529
cscarboro@stblaw.com

Peter C. Thomas
202-636-5535
pthomas@stblaw.com

"Widely agreed to have 'a world class securities litigation group'"

—THE LEGAL 500 UNITED STATES 2012
(quoting a client)

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Tokyo
Ark Mori Building
12-32, Akasaka 1-Chome
Minato-Ku, Tokyo 107-6037
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000

"[O]ne of a 'very small number of "go to" firms that can be relied upon to handle the most challenging issues'"

THE LEGAL 500 UNITED STATES 2012

(quoting a client)