Simpson Thacher

SECURITIES LAW ALERT

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This month's Alert addresses three Second Circuit decisions: one affirming dismissal of an ERISA action brought by participants in the Lehman Brothers Savings Plan and holding that ERISA fiduciaries have no duty to seek out inside information; another ruling that the tolling doctrine set forth in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974) does not apply to the three-year statute of repose set forth in Section 13 of the Securities Act of 1933; and a third affirming dismissal on standing grounds of claims brought by the Madoff Trustee against a number of financial institutions for their alleged role in aiding and abetting Madoff's fraud.

We also discuss a Fifth Circuit decision holding that only individuals who report possible securities law violations to the SEC may bring anti-retaliation claims under the whistleblower protection provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Finally, we address a Delaware Chancery Court decision rejecting shareholder challenges to board-adopted forum selection bylaws requiring shareholders to bring "internal affairs" suits in Delaware courts.

Second Circuit Affirms Dismissal of Lehman ERISA Action and Holds ERISA Fiduciaries Have No Duty to Seek Out Inside Information

On July 15, 2013, the Second Circuit affirmed dismissal of an ERISA action brought by participants in the Lehman Brothers Savings Plan based on the *Moench* presumption of prudence. *Rinehart v. Akers,* 2013 WL 3491281 (2d Cir. July 15, 2013) (Wesley, J.).[1] Notably, the Second Circuit held that "[f]iduciaries are under no obligation to either seek out or act upon inside information in the course of fulfilling their duties under ERISA."

1 Simpson Thacher represents the members of the Lehman Employee Benefit Plans Committee in this action.

Background

The Lehman Brothers Savings Plan offered Lehman employees the opportunity "to contribute portions of their salaries to different investment funds to save for retirement." These funds included the Lehman Stock Fund, an employee stock ownership plan ("ESOP") that "invested exclusively in Lehman common stock." When Lehman filed for bankruptcy in September 2008, "retirement savings invested in the [Plan] [were] rendered essentially worthless."

Plan participants brought an ERISA action to recover their losses. Plaintiffs' second amended

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complaint named as defendants all members of Lehman's Employee Benefit Plans Committee (the "Benefit Committee Defendants") and certain of Lehman's former directors. Plaintiffs contended that "by no later than the collapse of Bear Stearns," defendants "knew or should have known that the Plan's heavy investment in [Lehman] Stock was imprudent."

On October 5, 2011, the Southern District of New York dismissed plaintiffs' ERISA claims in their entirety. *In re Lehman Bros. Sec. and ERISA Litig.*, 2011 WL 4632885 (S.D.N.Y. Oct. 5, 2011) (Kaplan, J.).[2] With respect to plaintiffs' prudence claim, the court found that plaintiffs had failed to allege that defendants knew or should have known that Lehman was in a "dire situation" at the time of Bear Stearns' sale to JPMorgan Chase. While "Bear Stearns's failure … no doubt was a cause for concern at Lehman" and its peer firms, there were no allegations that Bear Stearns' "circumstances alerted or ought to have alerted Lehman that it would suffer the same fate."

Plaintiffs appealed the district court's decision. While plaintiffs' appeal was pending, the Second Circuit adopted the presumption of prudence set forth in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). *See In re Citigroup ERISA Litig.*, 662 F.3d 128 (2d Cir. 2011).[3] The *Moench* court held that "an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision."

In *Citigroup,* the Second Circuit held that "only circumstances placing the employer in a 'dire situation' that was objectively unforeseeable by the settlor could require fiduciaries to override plan terms." Courts "cannot rely, after the fact, on the magnitude of [a] decrease in the employer's stock price" when evaluating a fiduciary's conduct. "[R]ather," courts

"must consider the extent to which plan fiduciaries at a given point in time reasonably could have predicted the outcome that followed."

As a "guiding principle," the *Citigroup* court found that "judicial scrutiny should increase with the degree of discretion a plan gives its fiduciaries to invest." "[A] fiduciary's failure to divest from company stock is less likely to constitute an abuse of discretion if the plan's terms require—rather than merely permit—investment in company stock."

Second Circuit Finds the *Moench* Presumption Applies to the Benefit Committee's Decision to Keep Plan Assets Invested in Lehman Stock

In the Lehman ERISA action, the Second Circuit found that the Plan did not give the Benefit Committee "discretion sufficient to undermine the policies requiring application of the *Moench* presumption." The terms of the Plan provided that "at all times" it was to "be invested exclusively in Lehman Stock."

The Plan's terms did permit the Benefit Committee "to eliminate or curtail investments in Lehman Stock … if and to the extent that the [Benefit] Committee determine[d] that such action [was] required in order to comply with [ERISA's] fiduciary duties rules."

2 Please click here to read our discussion of the Southern District of New York's decision in the October 2011 edition of the Alert.

3 Please click here to read our discussion of Second Circuit's decision in the October 2011 edition of the Alert.

However, the Second Circuit found that this language "does not equate to 'discretion' to divest." The court therefore determined that "[t]he *Moench* presumption applies in full force" to the Benefit Committee Defendants' decision to keep Plan assets invested in Lehman stock.

Second Circuit Holds ERISA Fiduciaries Have No Duty to Investigate Inside Information Because Fiduciaries Cannot Lawfully Act on Inside Information

To overcome the *Moench* presumption, plaintiffs were required to "allege facts sufficient to show that the Benefit Committee Defendants knew or should have known that Lehman was in a 'dire' situation.'" Plaintiffs contended that "the Benefit Committee Defendants had a duty to investigate whether Lehman was in a dire situation," and claimed that "any reasonable investigation would have revealed material, nonpublic information sufficient to confirm that Lehman was on the verge of collapse."

Rejecting plaintiffs' argument, the Second Circuit held that the duty of prudence under ERISA cannot "be construed to include an obligation to affirmatively seek out material, nonpublic information pertaining to plan investments." In so holding, the court noted that several other circuit courts had reached the same conclusion.

The Second Circuit described the "quandary" that would be "bound to occur" if ERISA required plan fiduciaries to "conduct an investigation into the financial condition of a plan asset that extend[ed] to material, nonpublic information." If the fiduciaries uncovered inside information establishing that "continued investment [was] imprudent," then they would be able to "limit[ ] further investment in the improvident asset without breaching securities laws." However, fiduciaries would "not be able to comply with their duty of prudence by divesting the plan of its pre-existing investment without risking liability for insider trading." The Second Circuit noted that "[t]he prudent man does not commit insider trading."

Second Circuit Finds Plaintiffs Failed to Rebut the *Moench* Presumption of Prudence

The Second Circuit found that plaintiffs had "not rebutted the *Moench* presumption because they fail[ed] to allege facts sufficient to show that the Benefit Committee Defendants knew or should have known that Lehman was in a 'dire situation' based on information that was publicly available during the class period." In reaching this conclusion, the court explained that "the fact that Lehman *ultimately* declared bankruptcy" could not influence its "assessment of whether the Benefit Committee Defendants acted prudently during the class period."

Limiting its analysis to the events that took place during the class period, the Second Circuit determined that "the forced sale of Bear Stearns alone" did "not show that Lehman specifically was in serious danger." "In fact, given that Bear Stearns was (effectively) bailed out by the government, … the Benefit Committee Defendants may have believed that Lehman would be saved as well." Moreover, the

court found that "[m]arket fluctuations and an above-water price immediately in advance of [Lehman's] bankruptcy would not have put a prudent investor on notice that Lehman had reached a 'dire situation.'"

The Second Circuit held that "the sum of Plaintiffs' plausible allegations [did] not overcome the *Moench* presumption." Emphasizing that "single-stock portfolios are *inherently* risky," the Second Circuit explained that it could not "penalize fiduciaries who allow plan-participants to invest in Congressionally-encouraged ESOPs absent very strong indications that fiduciaries knew or should have known that participants no longer desired to remain invested."

Second Circuit Holds *American Pipe* Tolling Does Not Apply to the Three-Year Statute of Repose Set Forth in Section 13 of the Securities Act of 1933

On June 27, 2013, the Second Circuit held that "[t]he tolling rule set forth by the Supreme Court" in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974) "does not apply to the three-year statute of repose in Section 13 of the Securities Act of 1933," which governs claims under Sections 11 and 12 of the Securities Act.[4] *Police and Fire Ret. Sys. of the City of Detroit v. IndyMac MBS, Inc.*, 2013 WL 3214588 (2d Cir. June 27, 2013) (Cabranes, J.) (*IndyMac II*). The Second Circuit further ruled that "neither Rule 24 nor the Rule 15(c) 'relation back' doctrine permits members of a putative class, who are not named parties, to intervene in [a] class action as named parties in order to revive claims that were dismissed from the class complaint for want of jurisdiction."

4 Section 13 states that "'[i]n no event shall any such action be brought to enforce a liability … more than three years after the [underlying] security was bona fide offered to the public, or … more than three years after [its] sale.'" *IndyMac*, 2013 WL 3214588 (*quoting* 15 U.S.C. § 77m).

Background

The case before the Second Circuit concerned putative class actions brought against IndyMac MBS and certain of its officers, directors, and underwriters (collectively, "IndyMac") in connection with mortgage pass-through certificates sold in 106 separate offerings. Plaintiffs asserted claims under Sections 11, 12(a) and 15 of the Securities Act.

On June 21, 2010, the Southern District of New York dismissed for lack of standing all claims based on offerings of securities that the named plaintiffs—the Wyoming State Treasurer and the Wyoming Retirement System—did not purchase. Certain members of the asserted class who *did* purchase securities in those offerings (the "*IndyMac* intervenors") subsequently moved to intervene after Section 13's three-year period of repose had run. The *IndyMac* intervenors contended that their claims were timely under the *American Pipe* tolling rule.

In *American Pipe*, the Supreme Court considered whether members of a proposed class could intervene in a class action that had been dismissed for failure to meet Rule 23's numerosity requirements where the applicable statute of limitations had run on the intervenors' claims. The Supreme Court

held that plaintiffs could intervene because "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action." *American Pipe*, 414 U.S. 538.

On June 21, 2011, the Southern District of New York held that the *IndyMac* intervenors' claims were untimely. The court ruled that "neither *American Pipe* nor any other form of tolling may be invoked to avoid the three year statute of repose set forth in Section 13 of the Securities Act of 1933." *In re IndyMac Mortg.-Backed Sec. Litig.*, 793 F. Supp. 2d 637 (S.D.N.Y. June 2011) (Kaplan, J.). The court also rejected the *IndyMac* intervenors' alternative argument that their claims were timely because they related back to the original complaint under Rule 15(c). The court explained that the Section 13 "statute of repose by its terms allows no exceptions." The *IndyMac* intervenors appealed.

Second Circuit Finds Section 13's Three-Year Statute of Repose Creates a Substantive Right To Freedom from Liability That Cannot Be Modified by *American Pipe* Tolling

The Second Circuit explained that the case involved "an unsettled question of law: whether the [*American Pipe*] tolling rule … applies to the three-year statute of repose in Section 13." *IndyMac II*, 2013 WL 3214588.

At the outset of its analysis, the Second Circuit addressed the difference between a statute of repose and a statute of limitations. "[W]hile statutes of limitations are 'often subject to tolling principles,' a statute of repose '*extinguishes* a plaintiff's cause of action after the passage of a fixed period of time, usually measured from one of the defendant's acts." "[I]n contrast to statutes of limitations, statutes of repose 'create[ ] a *substantive* right in those protected to be free from liability after a legislatively-determined period of time." The Second Circuit underscored that "a statute of repose is 'subject [only] to legislatively created exceptions.'"

Turning to the question before it, the Second Circuit held that "*American Pipe*'s tolling rule … does not extend to the statute of repose in Section 13" regardless of whether it is "grounded in equitable authority or on Rule 23." The Second Circuit explained that if the *American Pipe* tolling doctrine "is properly classified as 'equitable,' then application of the rule to Section 13's three-year repose period is barred by" the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991). The *Lampf* Court held that "Section 13's three-year limitation 'is a period of repose *inconsistent* with tolling,' and reiterated that 'the purpose of the 3-year limitation is clearly to serve as a cutoff.'" *IndyMac II*, 2013 WL 3214588 (*quoting Lampf*, 501 U.S. 350).

Alternatively, if the *American Pipe* tolling doctrine is "legal" in nature based upon Rule 23, the Second Circuit held that "its extension to the statute of repose in Section 13 would be barred by the Rules Enabling Act." This Act empowers the Supreme Court "to prescribe general rules of practice and procedure" that "shall not abridge, enlarge or modify any substantive right." 28 U.S.C. § 2072(b). The Second Circuit emphasized that "the statute of repose in Section 13 creates a *substantive* right, extinguishing claims after a three-year period." "Permitting a plaintiff to file a complaint or intervene after the repose period set forth in Section 13 of the Securities Act would therefore necessarily enlarge or modify a substantive right and violate the Rules Enabling Act."

The Second Circuit acknowledged the *IndyMac* intervenors' argument "that a failure to extend *American Pipe* tolling to the statute of repose in Section 13 could burden the courts and disrupt the functioning of class action litigation." However, the court found that this is a type of problem that "only Congress can address; judges may not deploy equity to avert the negative effects of statutes of repose."

Second Circuit Holds Rule 15(c)'s "Relation Back" Doctrine Cannot Revive Expired Claims That Were Dismissed From the Class Complaint on Jurisdictional Grounds

The Second Circuit next considered whether the *IndyMac* intervenors could "press their otherwise expired claims" under Rule 15(c)'s "relation back" doctrine.[5] The court held that this doctrine does not "permit members of a putative class, who are not named parties, to intervene in the class action as named parties in order to revive [expired] claims that were dismissed from the class complaint for want of jurisdiction" unless there are "circumstances that would render the newly asserted claims independently timely."

The Second Circuit explained that the district court had "dismissed for lack of constitutional standing all claims … arising from offerings that the Wyoming entities, as the only named plaintiffs, had not purchased." Those "very claims" were "now asserted" by the *IndyMac* intervenors. The Second Circuit found that the *IndyMac* intervenors' "ability to join the suit" was "foreclosed by the 'long recognized' rule that 'if jurisdiction is lacking at the commencement of a suit, it cannot be aided by the intervention of a plaintiff with a sufficient claim."

The Second Circuit therefore affirmed the district court's June 21, 2011 decision partially denying the *IndyMac* intervenors' motion to intervene. In so holding, the court noted that "through minimal diligence," plaintiffs "could have avoided the operation of the Section 13 statute of repose simply by making timely motions to intervene in the action as named plaintiffs, or by filing their own timely actions."

5 Rule 15(c) provides in relevant part that "[a]n amendment to a pleading relates back to the date of the original pleading when … the amendment asserts a claim or defense that arose out of the conduct, transaction, or occurrence set out--or attempted to be set out--in the original pleading." Fed. R. Civ. P. 15(c)(1)(B).

Second Circuit Affirms Dismissal of the Madoff Trustee's Claims Against Banks on Standing Grounds

On June 20, 2013, the Second Circuit affirmed dismissal of several actions brought by Irving Picard, the Trustee for the Securities Investor Protection Act ("SIPA") liquidation of Bernard L. Madoff Investment Securities ("BLMIS"), against a number of major financial institutions for their alleged role in aiding and abetting Madoff's fraud. *In re Bernard L. Madoff Inv. Sec. LLC*, 2013 WL 3064848 (2d Cir. June 20, 2013) (Jacobs, C.J.) (*BLMIS*). The Second Circuit held that under the doctrine of *in pari delicto*, the Trustee could not assert claims on behalf of BLMIS against the banks "for wrongdoing in which Madoff (to say the least) participated." Moreover, the court found the Trustee's claim for contribution "likewise unfounded" because "SIPA provides no such right." Finally, the Second Circuit ruled that the Trustee did not have standing to pursue common law claims against the banks on behalf of Madoff's customers.

Background

The Trustee brought several actions against a number of financial institutions—including JPMorgan Chase, HSBC, and UBS—alleging they "were complicit in Madoff's fraud and facilitated his Ponzi scheme by providing (well-paid) financial services while ignoring obvious warning signs." The Trustee contended that "when the [banks] were confronted with evidence of Madoff's illegitimate scheme, their banking fees gave incentive to look away, or at least caused a failure to perform due diligence that would have revealed the fraud." The Trustee "assert[ed] claims for unjust enrichment, breach of fiduciary duty, aiding and abetting fraud, and negligence, among others."

In 2011, the Southern District of New York dismissed the Trustee's claims in these actions. *See Picard v. HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011) (Rakoff, J.); *Picard v. JPMorgan Chase & Co.*, 460 B.R. 84 (S.D.N.Y. 2011) (McMahon, J.).[6] The Trustee appealed.

Second Circuit Finds the Doctrine of *in Pari Delicto* Bars the Trustee's Claims Against the Banks on Behalf of BLMIS

Under the doctrine of *in pari delicto,* "one wrongdoer may not recover against another." The Second Circuit noted that New York courts have "long applied" this doctrine "to bar a debtor from suing third parties for a fraud in which he participated." Pursuant to the rule set forth in *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991), a "claim against a third party for defrauding a corporation with the cooperation of management accrues to creditors, not to the guilty corporation." This doctrine also extends to trustees: A trustee "acts as the debtor's representative," and thus a "debtor's misconduct is imputed to the trustee."

The Second Circuit found that the Madoff Trustee's claims against the banks fell "squarely within the rule of *Wagoner*." Because the Trustee "stands in the shoes of BLMIS," the court held that he could "not assert claims against third parties for participating in a fraud that BLMIS orchestrated."

6 Please click here to read our discussion of the *JPMorgan* decision in the November 2011 edition of the Alert.

Second Circuit Rules the Trustee Has No Right to Contribution

In addition to the Trustee's common law claims on behalf of BLMIS, the Trustee also sought contribution from the banks for payments made to BLMIS customers under SIPA. The Trustee contended that the banks were "joint tortfeasors with BLMIS under New York law."

To recover under New York's contribution statute, "the party seeking contribution must have been compelled in some way [by New York state law] … to make the payment against which contribution is sought." Here, the payments for which the Trustee sought contribution "were not compelled by BLMIS's state law fraud liability to its customers." Rather, "his obligation to pay customers their ratable share of customer property" stemmed from "SIPA, a federal statute that does not provide a right to contribution."

"Because the Trustee's payment obligations were imposed by a federal law that does not provide a right to contribution," the court affirmed dismissal of the Trustee's contribution claims.

Second Circuit Rules Trustee Has No Third-Party Standing to Assert Claims On Behalf of BLMIS's Customers

The Second Circuit then turned to "the decisive issue": "whether the Trustee ha[d] standing to pursue … common law claims on behalf of Madoff's *customers*." The court held that the Trustee did not have standing because "[a] party must 'assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties.'" The Second Circuit found that "[t]his prudential

limitation has been consistently applied in the bankruptcy context to bar suits brought by trustees on behalf of creditors."

To support his claim to third-party standing, the Trustee relied on *Redington v. Touche Ross & Co.*, 592 F.2d 617 (2d Cir. 1978). The *Redington* court held that a SIPA trustee had standing to bring a private action under Section 17(a) of the Exchange Act on behalf of the customers of a failed brokerage against the brokerage's accountant. The court reasoned that "the Trustee, as bailee, is an appropriate real party in interest." *Redington*, 592 F.2d 617. The Supreme Court later reversed the *Redington* decision on the grounds that there is no private right of action under Section 17(a); the Court found it "unnecessary to reach" the question of the SIPA trustee's standing. *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979).

In *BLMIS*, the Second Circuit agreed that *Redington* "would favor" the Madoff Trustee's case, "except that *Redington* is no longer good law." *BLMIS*, 2013 WL 3064848. The court explained that "[t]he Supreme Court's reversal on the threshold question drained the … *Redington* opinion of force on other questions," including the standing issue. "Since *Redington*, at least six judges in [the Second] Circuit have questioned or rejected third-party claims brought by SIPA trustees." The Second Circuit acknowledged that "*Redington* has enjoyed something of a half-life, with several courts … assuming without deciding that *Redington* retains residual force." However, the Second Circuit resolved any remaining debate by holding that "*Redington* should be put to rest: it has no precedential effect."

The Second Circuit also rejected the Trustee's other arguments, including his "analogies to the law of bailment and the law of subrogation," and affirmed dismissal of the Trustee's claims against the bank defendants.

Fifth Circuit Finds the Dodd-Frank Act Whistleblower-Protection Provision Creates a Private Right of Action Only for Individuals Who Report Possible Securities Violations to the SEC

On July 17, 2013, the Fifth Circuit held that the whistleblower protection provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") "creates a private cause of action only for individuals who provide information relating to a violation of the securities laws to the SEC." *Asadi v. G.E. Energy (USA), LLC* 2013 WL 3742492 (5th Cir. July 17, 2013) (Elrod, J.). In so holding, the Fifth Circuit rejected recent court decisions finding that the Dodd-Frank Act's whistleblower protections extend to individuals who report internally, as well as the SEC's implementing regulation adopting a broader definition of "whistleblower."

Background

Khaled Asadi was an employee of GE Energy (USA) who temporarily relocated to GE Energy's Jordan office. In 2010, Asadi reported possible Foreign Corrupt Practices Act violations to his supervisor and GE's regional ombudsman. GE subsequently terminated Asadi's employment.

Asadi brought suit against GE Energy under Dodd-Frank's whistleblower protection provision; GE Energy moved to dismiss Asadi's claims. In June 2012, the Southern District of Texas determined that the Dodd-Frank Act's anti-retaliation provision "does not extend to or protect Asadi's extraterritorial whistleblowing activity" and dismissed Asadi's complaint. *Assadi v. G.E. Energy (USA)*, 2012 WL 2522599 (S.D. Tex. June 28, 2012) (Atlas, J.).[7] The court did not reach the question of whether Asadi qualified as a "whistleblower" under the Dodd-Frank Act. Asadi appealed.

Relying on the Statutory Text, Fifth Circuit Holds That Only Individuals Who Report to the SEC May Bring Anti-Retaliation Claims Under the Dodd-Frank Act

The Fifth Circuit "start[ed] and end[ed]" its analysis "with the text of the relevant statute," which defines the term "whistleblower" as "any individual who provides … information relating to a violation of the securities laws to the Commission." 15 U.S.C. § 78u-6(a)(6). The court found that "[t]his definition, standing alone, expressly and unambiguously requires that an individual provide information to the SEC to qualify as a 'whistleblower' for purposes of" the Dodd-Frank Act's anti-retaliation provision.

While Asadi conceded that he did not meet this statutory definition of "whistleblower," he argued that individuals who take actions that fall within the

7 Please click here to read our discussion of the court's decision in the July 2012 edition of the Alert.

third category of activities enumerated in the Dodd-Frank Act's anti-retaliation provision may bring anti-retaliation claims. This provision, entitled "Protection of whistleblowers," states in relevant part as follows:

> No employer may discharge … a whistleblower … because of any lawful act done by the whistleblower —
>
> (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002…, the Securities Exchange Act of 1934 …, and any other law, rule, or regulation subject to the jurisdiction of the Commission.

15 U.S.C. § 78u-6(h)(1)(A) (internal citations omitted).

Asadi claimed that "the whistleblower-protection provision should be construed to protect individuals who take actions that fall within … [this] third category of protected activity … even if they do not provide information to the SEC." In Asadi's view, this construction of the statute was warranted in light of the "conflict" between the statutory definition of "whistleblower," which requires reporting to the SEC, and the third category of activity protected under the anti-retaliation provision, "which does not necessarily require disclosure of information to the SEC."

The Fifth Circuit acknowledged that recent case law, as well as the SEC's implementing regulations, supported Asadi's position. "District courts that

have considered this question have concluded that the whistleblower-protection provision, as enacted, is either conflicting or ambiguous" and have determined that the statute "extends to protect certain individuals who do not make disclosures to the SEC. "Moreover, under the SEC's implementing regulation, a whistleblower is defined as an individual who provides information "relat[ing] to a possible securities law violation" "in a manner described" in the Dodd-Frank Act's anti-retaliation provision. 17 C.F.R. § 240.21F-2(b)(1). The Fifth Circuit recognized that under the SEC's definition, an individual can qualify as a "whistleblower" "even though he never reports any information to the SEC." *Asadi*, 2013 WL 3742492. "[R]eject[ing] the SEC's expansive interpretation of the term 'whistleblower,'" the Fifth Circuit held that the "plain language and structure" of the Dodd-Frank Act establishes "only one category of whistleblowers: individuals who provide information relating to a securities law violation to the SEC."

Fifth Circuit Finds No Conflict Between the Dodd-Frank Act's Definition of "Whistleblower" and the Anti-Retaliation Provision

Asadi contended that the Dodd-Frank Act's definition of "whistleblower" conflicts with the third category of activities protected under the anti-retaliation provision because "an individual can take actions falling within this category and, if he does not report information to the SEC, fail to qualify as a 'whistleblower.'"

Although the Fifth Circuit agreed that "individuals may take protected activity yet still not qualify as a whistleblower," the court found this "practical result does not render [the third category of activities protected under the anti-retaliation provision] conflicting or superfluous." The Fifth Circuit explained that "[c]onflict would exist between these statutory provisions only if we read the three categories of protected activity as additional definitions of three types of whistleblowers." But the court determined that "[t]he language and structure of the whistleblower-protection provision … does not support [this] construction."

The Fifth Circuit found it significant that "the placement of the three categories of protected activity in [the anti-retaliation provision] follows the phrase '[n]o employer may discharge … or in any other manner discriminate against, a *whistleblower* … because of any lawful act done by the *whistleblower*." (*Quoting* 15

U.S.C. § 78u-6(h)(1)(A)) (emphasis added). "If Congress had selected the terms 'individual' or 'employee,' Asadi's construction of the whistleblower-protection statute would follow more naturally because the use of such broader terms would indicate that Congress intended any individual or employee—not just those individuals or employees who qualify as a 'whistleblower'—to be protected from retaliatory actions by their employers." "Congress, however, used the term 'whistleblower' throughout" the anti-retaliation provision and "therefore, we must give that language effect."

The Fifth Circuit explained that "the third category of protected activity has effect even when we construe the protection from retaliation under Dodd-Frank to apply only to individuals who qualify

as 'whistleblowers.'" To illustrate how the two statutory provisions would work together in practice, the court offered the example of a mid-level manager who is fired by his company's CEO after reporting a securities law violation both to his CEO and to the SEC. Even if the CEO "was not aware of the report to the SEC at the time he terminated the mid-level manager, the mid-level manager [could] state a claim under the Dodd-Frank whistleblower-protection provision because he was a 'whistleblower' and suffered retaliation based on his disclosure to the CEO, which was protected under" the Sarbanes-Oxley Act ("SOX").

The Fifth Circuit "conclude[d] that the [Dodd-Frank Act] whistleblower-protection provision unambiguously requires individuals to provide information relating to a violation of the securities laws *to the SEC* to qualify for protection from retaliation." Because Asadi "did not provide any information to the SEC," the court found that "he does not qualify as a 'whistleblower.'" The Fifth Circuit therefore affirmed dismissal of Asadi's Dodd-Frank anti-retaliation claim.

Delaware Chancery Court Finds Board-Adopted Forum Selection Bylaws Valid and Enforceable

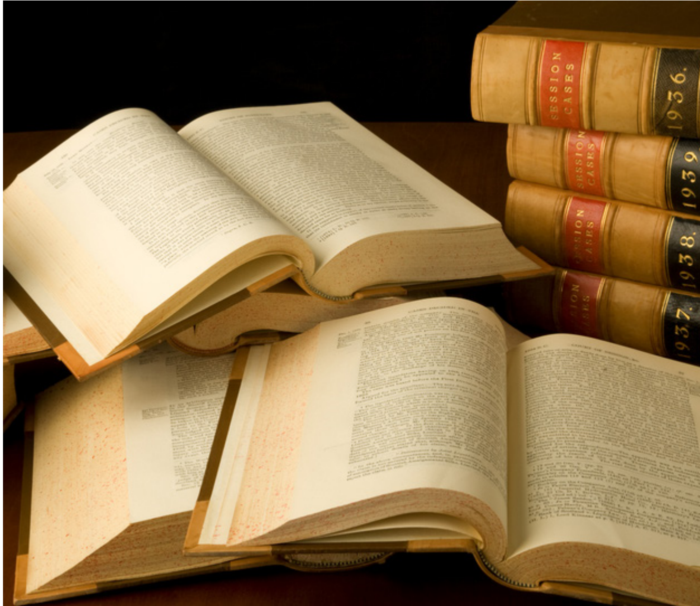
On June 25, 2013, the Delaware Chancery Court rejected shareholder challenges to forum selection bylaws adopted by the boards of Chevron Corporation and FedEx Corporation requiring that litigation relating to each company's "internal affairs" be conducted in Delaware courts. *Boilermakers Local 154 Ret. Fund. v. Chevron Corp.*, 2013 WL 3191981 (Del. Ch. June 25, 2013) (Strine, C.). The Chancery Court held that the forum selection bylaws were both "statutorily valid under Delaware law" and "contractually valid and enforceable."

Background

On September 29, 2010, Chevron's board adopted a forum selection bylaw providing that the Delaware Chancery Court[8] "shall be the sole and exclusive forum" for four categories of litigation: (1) shareholder derivative actions; (2) suits asserting breach of fiduciary duty; (3) actions asserting claims under the Delaware General Corporation Law ("DGCL"); and (4) suits asserting claims "governed by the internal affairs doctrine." On March 14, 2011, FedEx's board adopted a virtually identical forum selection clause. Both forum selection bylaws provided that the corporation could consent to an alternative forum. The Chevron and FedEx boards represented they had "adopted [these] forum selection bylaws in response to corporations being subject to litigation over a single transaction or a board decision in more than one forum simultaneously, so-called 'multiforum litigation.'"

Shareholders of Chevron and FedEx subsequently brought suit challenging the forum selection bylaws on two main grounds. First, plaintiffs claimed that the bylaws were "statutorily invalid" because they exceeded the board's authority under the DGCL. Second, plaintiffs contended that the bylaws were

8 Chevron's board later amended its bylaw to provide that the suits could be filed in any state or federal court in Delaware.



"contractually invalid" because they were unilaterally adopted by the boards of Chevron and FedEx. The Chevron and FedEx defendants moved for judgment on the pleadings seeking dismissal of the shareholders' claims. Given the similarity of the two bylaws and the "common legal issues" involved, the court "consolidated the Chevron and FedEx cases to address the purely facial legal challenges to the statutory and contractual validity of the bylaws raised by" the shareholders.

Chancery Court Finds the Forum Selection Bylaws Statutorily Valid Under the DGCL

In considering whether the forum selection bylaws were statutorily invalid, the Chancery Court first noted that "[b]oth Chevron's and FedEx's certificates of incorporation conferred on the boards the power to adopt bylaws under 8 *Del. C.* § 109(a)."[9] The court further explained that under 8 *Del. C.* § 109(b), board-adopted "bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." The Chancery Court found that the forum selection bylaws at issue "easily" met the requirements of *8. Del. C.* § 109(b) because the bylaws "only regulate suits brought by stockholders as stockholders in cases governed by the internal affairs doctrine."

"As a matter of easy linguistics, the forum selection bylaws address the 'rights' of the stockholders" within the meaning of 8 *Del. C.* § 109(b), insofar as "they regulate where stockholders can exercise their right to bring certain internal affairs claims against the corporation and its directors and officers." Moreover, the bylaws "also plainly relate to the conduct of the corporation by channeling internal affairs cases into the courts of the state of incorporation." The Chancery Court therefore "conclude[d]" that the forum selection bylaws at issue were "statutorily valid under Delaware law."

Chancery Court Finds the Forum Selection Bylaws Contractually Valid Even Though They Were Adopted Without Shareholder Assent

The Chancery Court then addressed plaintiffs' contention that the bylaws at issue were "contractually invalid" because they were adopted by the Chevron and FedEx boards without shareholder assent. Plaintiffs "acknowledge[d] that contractual forum selections are 'prima facie valid'" under governing Supreme Court and Delaware Supreme Court precedent. Nevertheless, plaintiffs claimed that the Chevron and FedEx forum selection bylaws were "contractually invalid … because they were adopted by a board, rather than by Chevron's and FedEx's dispersed stockholders."

9 8. *Del. C.* § 109(a) provides that "any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors."

The Chancery Court found "plaintiffs' argument that stockholders must approve a forum selection bylaw for it to be contractually binding" inconsistent with "the plain terms of the contractual framework chosen by stockholders who buy stock in Chevron and FedEx." "[A]n essential part of the contract stockholders assent to when they buy stock in Chevron and FedEx is one that presupposes the board's authority to adopt binding bylaws consistent with 8 *Del. C.* § 109." Pursuant to this "clear contractual framework, the stockholders assent to not having to assent to board-adopted bylaws."

Plaintiffs placed great weight on *Galaviz v. Berg*, 763 F. Supp. 2d 1170 (N.D. Cal. 2011), which found unenforceable a forum selection bylaw unilaterally adopted by the board of a Delaware corporation. The Chancery Court found that the *Galaviz* ruling "rest[ed] on a failure to appreciate the contractual framework established by the DGCL for Delaware corporations and their stockholders."

The Chancery Court concluded that "a forum selection clause adopted by a board with the authority to adopt bylaws is valid and enforceable under Delaware law to the same extent as other contractual forum selection clauses."

Chancery Court Emphasizes That Shareholders Have Safeguards for Board-Adopted Forum Selection Bylaws

The Chancery Court explained that shareholders have a number of "safeguards" for board-adopted forum selection bylaws that do not meet with shareholder approval. Under 8 *Del. C.* § 109(a), these bylaws are subject to "the most direct form of attack by stockholders who do not favor them: stockholders can simply repeal them by a majority vote."

Moreover, a shareholder may "challenge the real-world enforcement of a forum selection bylaw" by bringing suit in the shareholder's preferred forum. If the corporation then moves to dismiss for improper venue, the shareholder could argue that "the forum selection clause should not be respected because its application would be unreasonable" within the meaning of the Supreme Court's decision in *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972). The shareholder could also claim that "the forum selection clause should not be enforced because the bylaw was being used for improper purposes inconsistent with the directors' fiduciary duties."

The Chancery Court declined to consider "purely hypothetical situations" in which plaintiffs claimed "the bylaws of Chevron and FedEx might operate unreasonably." Finding that "[s]uch circumstantial challenges are required to be made based on real-world circumstances by real parties," the court held that plaintiffs' hypotheticals were "not a proper basis for the survival of [ ] plaintiffs' claims." The court therefore dismissed plaintiffs' statutory and contractual invalidity challenges to the Chevron and FedEx bylaws with prejudice.

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