INSIDE THE MINDS

Recent Developments in Securities Law

Leading Lawyers on Understanding Important Legislation and Complying with SEC Rules and Regulations

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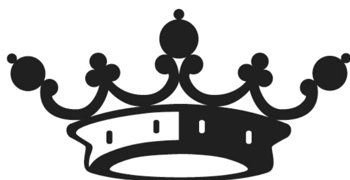

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Emerging Developments in Securities Litigation

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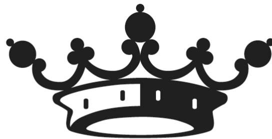

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Introduction

This year several developments have emerged in civil securities litigation and enforcement. In *Halliburton Co. v. Erica P. John Fund, Inc.*,[1] the Supreme Court examined the "fraud on the market" theory in class action securities cases. The Court has also reversed its decision to review the extent to which a filed class action securities case suspends the statute of repose for opt outs in *Police and Fire Retirement System of the City of Detroit v. IndyMac MBS*.[2] The Supreme Court defined whistleblower protection in *Lawson et al. v. FMR LLC et al.*,[3] and the Second Circuit addressed liability admissions in enforcement actions in *United States Securities and Exchange Commission v. Citigroup Global Markets, Inc.*[4]

Back to Basics in Halliburton II

On June 23, 2014, the Supreme Court in *Halliburton Co. et al v. Erica P. John Fund, Inc.*[5] confirmed that companies could rebut the fraud-on-the-market presumption at the class certification stage. The Supreme Court's decision reaffirmed its ruling in *Basic, Inc. v. Levinson*[6] on how investors can demonstrate reliance in the class context, while clarifying a defendant's right to present direct or indirect evidence to rebut the presumption.

Investors who rely on a company's misrepresentation to buy or sell its stock can recover damages in a securities fraud action. Here, the Erica P. John Fund, Inc. (Fund) brought a class action under 10(b) of the Securities Exchange Act and 10b-5 of the Securities and Exchange Commission Rule. The Fund alleged that Halliburton misrepresented its potential liability in asbestos litigation, expected revenue, and benefits of a company merger.

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[1] *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014).
[2] *See* Petition for a Writ of Certiorari at i, *Pub. Emps. Ret. Sys. of Miss. V. Indymac MBS, Inc.*, 134 S. Ct. 1515 (2014), (No. 13-640), 2013 WL 6185615.
[3] *See* Petition For a Writ of Certiorari filed by Public Employees' Retirement System of Mississippi on Nov. 22, 2013 (Pet. Br.) at i. *Police & Fire Ret. Sys. of the City of Detroit v. Indymac MBS, Inc.*, U.S., No. 13-640 (2013). *See also* Certiorari – Summary Disposition in *Police & Fire Ret. Sys. of the City of Detroit v. Indymac MBS, Inc.*, U.S., No. 13-640, dated Sept. 29, 2014 ("The writ of certiorari is dismissed as improvidently granted).
[4] *S.E.C. v. Citigroup Global Mkts. Inc.*, 827 F.Supp.2d 328, 332 (S.D.N.Y. 2011).
[5] *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398 (2014).
[6] *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

The Fund claimed that Halliburton's goal was to inflate its stock price, which subsequently dropped when Halliburton made corrective disclosures. As a result, investors lost money.

Under *Basic*, investors can meet the reliance requirement through a "presumption that the price of stock traded in an efficient market reflects all public, material information—including material misstatements."[7] Therefore, investors who trade the stock at the market price are presumed to have relied on those misstatements. The Supreme Court refused to overrule this holding in *Basic*, the wellspring of the "fraud-on-the-market" theory. Despite defendant's argument that this presumption is based on flawed economic theory, the Supreme Court rejected a proposal to shift the burden to plaintiffs at class certification, to prove that a defendant's misrepresentation actually affected the stock price.

Instead, the Court reaffirmed that the presumption of reliance "was rebuttable rather than conclusive" and agreed that a defendant may rebut the presumption with direct or indirect evidence. The Court focused on evidence that "severs the link" between the misrepresentation and the reliance: "So for example, if a defendant could show that the alleged misrepresentation did not, for whatever reason, actually affect the market price, or that a plaintiff would have bought or sold the stock even had he been aware that the stock's price was tainted by fraud, then the presumption of reliance would not apply."[8] A defendant may present evidence, even at the class certification stage, that the alleged misrepresentation did not actually affect the stock price. In that case, the presumption of reliance vanishes and the plaintiff, who still has the burden of persuasion to establish that Rule 23(b) is satisfied,[9] must then prove that the misrepresentation affected the stock price or that all class members directly relied on it.

The practical effect of the Supreme Court's *Halliburton* ruling is that parties can expect a renewed focus on the class certification stage. Class certification, as opposed to summary judgment, may become the new battleground in complex litigation and the primary source of discovery and

[7] *Halliburton*, 573 U.S. at 2398.
[8] *Id.*
[9] *See Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011).

expert expense for litigants. The Court's ruling is an important tool but one that defendants should use judiciously.

Statute of Repose for Class Action Opt-Outs

On March 10, 2014, the Supreme Court in *Police and Fire Retirement System of the City of Detroit v. IndyMac MBS* agreed to hear arguments to settle a circuit split on whether filing a class action lawsuit suspends the statute of repose under Section 13 of the Securities Act of 1933 (33 Act). Then, on September 29, 2014, without explanation, the Court dismissed its writ of certiorari as "improvidently granted."[10] This decision leaves opt-out practices in securities litigation open to challenges.

The Second Circuit addressed the issue in *Police and Fire Retirement System of the City of Detroit v. IndyMac MBS (Indymac)* when it decided whether the tolling principles set forth by the Supreme Court in *American Pipe & Construction Co. v. Utah*, 414 US 538 (1974) (*American Pipe*) suspend the three-year statute of repose found in Section 13 of the Securities Act of 1933.[11]

The plaintiff in *IndyMac* alleged violations of Sections 11, 12(a) and 15 of the Securities Act. Section 13 of the '33 Act governs the statue of repose for Section 11 claims, which states "no action shall be maintained to enforce any liability created under Section 11…unless brought within one year…in no event shall any such action be brought to enforce a liability created under Section 11…more than three years after the security was bonafide offered to the public…"[12]

A statute of limitations restricts available remedies and can be open to equitable considerations such as tolling or a discovery rule.[13] However, a statute of repose affects the underlying rights and can run without interruption once the triggering event occurs, even if equitable considerations would warrant tolling.[14]

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[10] *See also* Certiorari – Summary Disposition in *Police & Fire Ret. Sys. of the City of Detroit v. Indymac MBS, Inc.*, U.S., No. 13-640, dated Sept. 29, 2014 ("The writ of certiorari is dismissed as improvidently granted).
[11] *Id.*
[12] 15 U.S.C. § 77m (2012).
[13] *Police & Fire Ret. Sys. of the City of Detroit v. IndyMac MBS*, 721 F.3d 95 (2d Cir. 2013).
[14] *Id.*

In *American Pipe*, the Supreme Court focused on the policy implications of Fed. R. Civ. P. 23 for class actions and federal statutory limits on time, reasoning that just because a "federal statute providing for substantive liability also sets a time limitation upon the institution of suit does not restrict the power of the federal courts to hold that the statute of limitations is tolled under certain circumstances not inconsistent with the legislative purpose."[15] Relying on its own history, the Supreme Court restated a previous decision that "the commencement of…the suit fulfilled the policies of repose and certainty inherent in the limitation provisions and tolled the running of the period."[16]

The Supreme Court then concluded that the commencement of a class action that would "suspend 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."[17] While *American Pipe* dealt with a statute of limitations, the Court's use of the word "repose" in its opinion has led numerous lower level courts to toll statutes of repose in class action settings as well.[18]

Given the *American Pipe* analysis, the Second Circuit in *IndyMac* determined that the statute of repose has an absolute period of three years, with no deference to whether tolling is legal or equitable. The Second Circuit reasoned that the judicial branch created civil procedure rules and those rules cannot outweigh the statutory time limits on litigation that Congress created.[19] The Second Circuit then held that tolling did not apply and "absent circumstances that would render the newly asserted claims independently timely, neither Fed. R. Civ. P. 24 for interventions nor Fed. R. Civ. P. 15(c) under the "relation back" doctrine would permit "members of a putative class, who are not named parties, to intervene in the class action as named parties" to revive dismissed class action claims for want of jurisdiction. "[20]

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[15] *Am. Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 559 (1974).
[16] *Id.* at 558 (citing *Burnett v. N.Y. Cent. R. Co.,* 380 U.S. 424 (1965)).
[17] *Id.* at 554.
[18] *See id.* at 108. Later, the Supreme Court held that a statute of repose is inconsistent with tolling, but that was under a 10-b claim with the main discussion focused on state borrowing principles in relation to litigation time limits. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991).
[19] *See Police & Fire Ret. Sys. of the City of Detroit v. IndyMac MBS,* 721 F.3d 95, 109-10 (2d Cir. 2013).
[20] *Id.* at 111-112.

Despite the Second Circuit's *IndyMac* decision, lower courts in the circuit have already distinguished the decision. The district court in *Monroe County Employees' Retirement System v. VPF Sociedad Anonmia* explained that the Second Circuit addressed whether intervention was timely under Federal Civil Procedure Rules 24 and 15(c), not whether the action was timely under *American Pipe*. The court concluded that *American Pipe* tolling was available to the putative class members.[21] So, "the question of whether *American Pipe* tolls a statute of limitations where the initial plaintiff lacked standing is still open in the Second Circuit."[22]

Other courts also allow *American Pipe* tolling. In *Joseph v. Wiles,* the Tenth Circuit distinguished between equitable tolling and legal tolling by explaining that equitable tolling is more appropriate when there is a defective pleading or some type of trickery to make a plaintiff miss a deadline, whereas legal tolling should be used where an action is commenced and class certification is pending.[23] The Tenth Circuit decided that the claim at hand was legal tolling under *American Pipe*, reasoning that "[i]f all class members were required to file claims in order to insure the limitations period would be tolled, the point of Rule 23 tolling would be defeated."[24] The Tenth Circuit also explained that tolling applied because the plaintiff was effectively a party to the action because the class action covering him was never denied.[25]

On November 22, 2013, the petitioners in *Indymac* filed a request for certiorari, which the Supreme Court granted on March 10, 2014.[26] Many practitioners believed a Supreme Court decision in the coming year on this issue would have been considerable for opt-out litigation, particularly if the Court concluded that filing a class action does not toll the statue of repose under Section 13 of the '33 Act. However, the Supreme Court dismissed certiorari, leaving parties to navigate the lower court and circuit decisions.

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[21] FED. R, CIV. P. 24, 15; *Monroe Cnty. Emps. Ret. Sys. v. YPF Sociedad Anonima*, 980 F.Supp2d 487 (S.D.N.Y. 2013).
[22] *Id.*
[23] *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000).
[24] *See Joseph*, 223 F.3d at 1167.
[25] *Id.*
[26] *See* Petition for a Writ of Certiorari, *supra* note 3.

Whistleblower Protections Under Sarbanes-Oxley

Congress passed the Sarbanes-Oxley Act (SOX) in 2002 primarily to restore public trust in financial markets and to safeguard investors of public companies following the collapse of Enron and WorldCom.[27] As an integral part of that legislation, Congress created provisions to protect whistleblowers. In a landmark decision this year in March, the Supreme Court in *Lawson v. FMR LLC* (Lawson) extended whistleblower protection under Sarbanes-Oxley to individuals who are employed as private contractors and subcontractors of public companies.[28]

In *Lawson,* the plaintiffs were former FMR employees. FMR is a private company whose principal business is to advise and manage mutual funds. By their nature, mutual funds function predominantly as public companies with no actual personnel, which is why contractors are hired to run the funds. The plaintiffs alleged that they exposed fraud related to the mutual funds, and as result, suffered retaliation. [29]

In their lawsuit, plaintiffs invoked the provision under the Sarbanes-Oxley Act of 2002, 18 USC. §1514A that protects whistleblowers:

> No [public] company… or any officer, employee, contractor, subcontractor, or agent of any such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of [whistleblowing or other protected activity.]

FMR moved to dismiss, arguing that §1514A protects employees of public companies, not the employees of private companies who contract with them.[30] The district court denied FMR's motion to dismiss. On appeal, the First Circuit reversed the decision holding that the term "employee" under §1514A is only in reference to employees of public companies. A few

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[27] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

[28] *See* **Lawson v. FMR** *LLC,* ***134*** S. Ct. 1158 (2014).

[29] *Id.* Both plaintiffs originally filed individually, but later joined in suit after alleging they suffered retaliatory actions by FMR for blowing the whistle on fraudulent behavior by the mutual funds they were advising.

[30] *Id.*

months later, the Administrative Review Board, within the Department of Labor (DOL) issued a decision at odds with the First Circuit's interpretation of §1514A. The DOL found that the Act covers whistleblower protection for employees of "privately held contractors that render services to public companies."[31]

The Supreme Court then granted certiorari to resolve the division. The Court's primary question was whether §1514A shields only employees of public companies, or whether it also shields employees of privately held contractors and subcontractors—for example, investment advisors, law firms, accounting enterprises—who perform work for the public company. To address the question, the Court looked at the plain meaning of the text, the purpose and history behind Sarbanes-Oxley, the related provisions therein, congressional intent and the interpretation of §1514A by the DOL.[32]

For the plain meaning, the Court reasoned that if Congress meant to limit protection to employees of a public company when drafting §1514A, they would have explicitly done so. The Court concluded that the ordinary text and the provision itself supported the reading that a contractor could not terminate an employee for whistleblowing. The Court rejected FMR's argument that such a reading is contrary to the statute's headings and would result in an extension of protection to the household employees of company officers and directors. The Court found that other considerations supported its contextual analysis, namely, to avoid another Enron.

As far as the purpose and history, the Court pointed to legislative records. The employees of Enron's contractors were afraid of retaliation. This fear was the primary deterrent that prevented Enron's contractors from reporting suspected fraud. Congress enacted SOX to avoid this very situation. The goal was to deter widespread fraud. The SOX Act contains numerous provisions to control the conduct of contract professionals such as lawyers, accountants, and auditors who work with public companies. Prior to enactment, Congress specifically identified an overall lack of

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[31] *Id.* at 8-9; *Spinner v. David Landau & Assoc., LLC,* No. 10-111 Ect., ALJ No. 2012-SOX-029 (May 31, 2012). "The whistleblower in Spinner was an employee of an accounting firm that provided auditing, consulting, and Sarbanes-Oxley compliance services to a public company."

[32] *See Lawson*, 134 S. Ct. 1158.

whistleblower protection as a "serious deficiency" in the law because most commonly, employees are the only "first hand witnesses to a fraud."[33] So, the Court found it reasonable that Congress "enacted §1514A aiming to encourage whistleblowing by contractor employees who suspect fraud involving the public companies with whom they work."[34]

The Court addressed related provisions as well. The language in §1514A "has been [consistently] read to cover employees of contractors and subcontractors."[35] While other provisions within SOX provide for specific limitations for a class of employees that are protected for a specific type of employer, §1514A has no specific confining language.[36] Even without the other relevant portions within Sarbanes-Oxley, the Court reasoned that because mutual funds are required to file with the SEC, Congress would have had mutual funds "in mind when it added 'publicly traded companies'" in §1514A.[37]

With all these factors, the Court gave additional deference to the DOL interpretation. The DOL is largely responsible for SOX regulations and has interpreted whistleblowing provisions as protecting contractor employees since April of 2002.[38] In the end, the Court held that "based on the text of §1514A, the mischief to which Congress was responding, and earlier legislation Congress drew upon, that the provision shelters employees of private contractors and subcontractors, just as it shelters employees of the public company served by the contractors and subcontractors."[39]

The Impact of the *Lawson* Ruling

The *Lawson* ruling holds particular significance in the mutual fund industry but has left many open questions for lower courts and other employers.

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[33] *Id.*
[34] *Id.*
[35] *Id.*; Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, 49 U.S.C. § 4212.
[36] *See Lawson*, 134 S. Ct. 1158; "[A] broker or dealer and persons employed by a broker or dealer who are involved with investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate against any securities analyst employed by the broker or dealer or its affiliates . . . ." 15 U.S.C. § 78o-6(a)(1)(C).
[37] *See Lawson*, 134 S. Ct. 1158.
[38] *Id.*
[39] *Id.*

One question is whether whistleblower protection applies solely to shareholder fraud allegations or more expansively to other fraud claims. Another question is whether any limiting principles are in place to invoke §1514A protections. One court has distinguished *Lawson* and determined that whistleblower protections under §1514A are only available for allegations of shareholder fraud.

In *Gibney v. Evolution Marketing Research, LLC,* the plaintiff alleged retaliatory termination for reporting a plan approved by his privately held employer that would result in fraudulent billing to a client of the company.[40] In its discussion, the district court addressed the notion that if a public company is defrauded, then "by extension, its shareholders are defrauded."[41] The court decided that "nothing in §1514A or the *Lawson* decision suggest that Sarbanes-Oxley was intended to encompass every situation in which any party takes action that has some attenuated, negative effect on the revenue of a publicly traded company."[42] The Court did not believe that SOX was intended to address fraudulent conduct between two parties to a contract, where one party happened to be publicly traded.[43]

Given the narrow decision in *Gibney*, defendant companies may find it easier to argue against §1514A protection for situations without an apparent connection to shareholder fraud. But the *Lawson* decision is recent enough that the body of case law in the coming years will determine the scope of its applicability.

Updates for the Dodd-Frank Whistleblowing Program

While *Lawson* focused on whistleblowing under Sarbanes-Oxley, another whistleblower program was created as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Congress enacted Dodd-Frank in 2010 as part of US financial regulatory reform in the wake of the financial crisis of 2007–2010.

In an effort to encourage employees to come forward with inside information about possible employer securities law violations, the Securities

[40] *Gibney v. Evolution Mktg. Research, LLC,* No. 14-1913, 2014 WL 2611213 (E.D. Pa. June 11, 2014).
[41] *Id.*
[42] *Id.*
[43] *Id.*

Whistleblower Incentive and Protections provision was created through an amendment to the Securities Exchange Act by adding §21F. In general, the provision prohibits employers from taking adverse employment actions against an employee because the employee lawfully reported potential wrongdoing.[44]

A whistleblower may be entitled to monetary awards from the SEC when the information provided is original and voluntary, and results in a successful enforcement action with monetary sanctions that exceed $1 million.[45] The aggregate amount of an award ranges between 10 percent and 30 percent of the monetary sanctions imposed. The award amount depends on various factors regarding the information provided and cooperation in the investigation process. In addition to potential monetary rewards, for whistleblowers who have experienced retaliatory actions from their employers, the provision provides relief such as reinstatement at the same seniority status, two times back-pay and litigation costs.[46]

To strengthen the enforcement of the new whistleblower provisions, the SEC created the Office of the Whistleblower (OWB) in 2011. Since inception, the OWB has continually worked to increase the efforts to gather solid whistleblower information, which has resulted in a significant surge in enforcement proceedings. The 2013 Annual Report of the OWB provides insights into the volume and types of cases reported to the SEC.

While the number of complaints filed in 2011 began at 334, that number jumped significantly in 2012 to 3,001 and increased to 3,238 in 2013. The number of complaints filed over those three years totals 6,573.[47] The most common complaints include corporate disclosures and financials (17.2 percent), offerings fraud (17.1 percent) and manipulation (16.2 percent).[48] Beyond the number of claims filed, the OWB also paid out more than $14.8

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[44] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 922(a), 124 Stat 1841 (2010).

[45] U.S. SECURITIES AND EXCHANGE COMMISSION, ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM (2013), *available at* www.sec.gov/whistleblower/reportspubs/annual-reports/annual-report-2013.pdf [hereinafter 2013 SEC Annual Report on Whistleblower Program].

[46] Securities Exchange Act of 1934, 15 U.S.C. § 78u-6(h)(1)(C) (2010).

[47] 2013 SEC Annual Report on Whistleblower Program at 1.

[48] *Id.* at 8.

million to whistleblowers in 2013, with $14 million distributed to a single whistleblower in an extraordinary case.[49] Even more recently in August 2014, the SEC gave its first award, more than $300,000, to a whistleblower employee with an audit or compliance function at a company.[50] On September 22, 2014, the SEC announced its largest award to date to a whistleblower, totalling $30 million.

With an increased effort by the SEC in pursuing more whistleblowing claims, it will be critical to determine who qualifies as a whistleblower and for employers to ensure they implement solid internal reporting and compliance procedures in place to identify and mitigate chances of a retaliatory suit.

The Debate over Whistleblower Status and a Circuit Split

Under Dodd-Frank, the SEC was tasked with adopting rules to implement the whistleblower program, which were finalized in May 2011. As part of the process, the SEC weighed heavily the importance of internal company compliance programs. While the SEC chose not to require whistleblowers to report through internal procedures for an award, other portions of the finalized rules encourage whistleblowers to use internal procedures when appropriate under particular circumstances.[51]

Consequently, the SEC promotes a broad interpretation for the retaliation prohibition in qualifying a whistleblower as any employee who engages in specified whistleblowing activities "irrespective of whether the employee separately reports the information to the Commission."[52]

Despite the broad interpretation, recent disagreement exists on whether an employee can claim whistleblower status if they provide information directly to the SEC or through internal company procedures. In *Asadi v. GE*

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[49] *Id.* at 1, 16.

[50] *SEC announces $300,000 Whistleblower Award to Audit and Compliance Professional Who Company's Wrongdoing*, U.S. SEC. & EXCHANGE COMMISSION (Aug. 29, 2014), www.sec.gov/News/PressRelease/Detail/PressRelease/1370542799812#.VBMb7tewKgw

[51] 17 C.F.R. § 240 (2011). *See also* Brief for the Securities and Exchange Commission, as Amicus Curiae Supporting Appellant at 4 n.1, *Liu Meng-Lin v. Siemens AG*, (No. 13-4385), 2014 WL 663875.

[52] 17 C.F.R.§ 240.21F-2(b)(1)(ii).

Energy (USA) LLC,[53] the Fifth Circuit opted to narrow the definition of a whistleblower by allowing protection only for information given to the SEC rather than provided to an employer through internal company procedures. In so holding, the Court reasoned that the statutory language compelled a narrow reading.

The issue arose again in *Liu Meng-Lin v. Siemens AG*. In that case, the district court dismissed the whistleblower's retaliation lawsuit, which arose out of reporting violations of the Foreign Corrupt Practices Act (FCPA).[54] On appeal to the Second Circuit, the SEC filed an amicus brief to advocate for retaliation protections for whistleblowers who report issues internally. The SEC reasoned that a narrow interpretation significantly restricts protected whistleblower disclosures and weakens the purpose and effectiveness of internal procedures. Such procedures are necessary for "investigating and responding to potential violations," and keeping in compliance with federal securities laws.[55]

The SEC also argued that in some situations, a company is better suited to distinguish between meritorious and frivolous claims. If courts adopt a narrow termination for whistleblower status, which discourages whistleblower from reporting issues internally, the result could be a significant increase in the volume of tips to the SEC. This scenario would reduce efficiency and greatly increase the cost to qualify and validate all of the information. The SEC argued that encouraging employees to report internally and preserving their rights under the whistleblower protections will lead to a better chance that erroneous tips will be caught before reaching the SEC.[56] Additionally, allowing protections only to employees reporting directly to the SEC drastically reduces the SEC's authority to "pursue enforcement actions against employers that retaliate against individuals who report internally."[57]

In a recent decision, the district court in *Bussing v. Cor Clearing, LLC*[58] also adopted a broad interpretation for whistleblower status with similar policy

[53] *Asadi v. GE Energy (USA) LLC*, 720 F.3d 620, 625 (5th Cir. 2013).
[54] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494.
[55] Amicus Brief, *supra* note 51, at 10.
[56] *Id.* at 11 n.10.
[57] *Id.* at 4.
[58] *Bussing v. COR Clearing LLC*, No. 8:12-CV-238 (D. Neb. March 21, 2014).

arguments as the SEC in the *Liu Meng-Lin v. Siemens AG* amicus brief. But, the *Bussing* case posed a different technical aspect, since one of the primary issues in the case was to determine whether employee disclosures made pursuant to a FINRA rule document request qualified for whistleblower protections under Dodd-Frank.

The Court focused on subsection (iii) of Dodd-Frank's anti-retaliation provisions, which states that retaliatory actions are prohibited when "making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002…and any other law, rule or regulation subject to the jurisdiction of the Commission."[59] Since FINRA "creates and enforces rules that govern the industry alongside the SEC and is subject to significant SEC oversight," the Court held that a FINRA rule "does qualify as a rule subject to the jurisdiction of the SEC," and is thus privy to the Dodd-Frank anti-retaliation protections.[60]

The result of the decision may affect FINRA rules qualifying for whistleblower retaliation protection under Dodd-Frank as well as to any disclosures made under subsection (iii). In light of the *Bussing* decision, if the Second Circuit also adopts the SEC's broad interpretation of the whistleblower status under §21F in its pending decision in *Liu Meng-Lin v. Siemens AG*, then a further split with the Fifth Circuit will exist.

Implementing Procedures to Reduce Whistleblower Retaliation Suits

Beyond the courts, the SEC has also ramped up whistleblower protection efforts, which includes its first retaliation case against a hedge fund manager accused of retaliation against a top trader for exposing trade violations.[61] For attorneys, it will be very important to keep up to date with the effects

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[59] *Id.*; *See* 15 U.S.C. § 78u-6(h)(1)(A).

[60] *Aslin v.FINRA*, 704 F.3d 475, 476 (7th Cir. 2013). This was made possible by the Maloney Act, 15 U.S.C. §§ 78o et seq., which provided for the establishment of self-regulatory organizations to oversee the securities markets. *Aslin*, 704 F.3d at 476.

[61] Ed Beeson, *SEC Brings 1st-Ever Whistleblower Retaliation Case*, LAW360 (June 16, 2014), http://www.law360.com/articles/548394/sec-brings-1st-ever-whistleblower-retaliation-case. In an administrative action, Paradigm Capital Management Inc., paid $2.2 million in sanctions to settle SEC charges related to retaliation for a trader blowing the whistle on improper transactions. The firm agreed to pay about $2.2 million in sanctions to settle the SEC's charges, but did not admit or deny any wrongdoing.

on clients for both the whistleblower protection expansion as well as limitations in circuits having more strict requirements for whistleblowers.

With the SEC pushing for greater whistleblower program enforcement, employers should make sure that there are proper procedures in place and exercise great care when considering a possible negative action against an employee that could qualify for whistleblower protection. As part of the procedures, employers should implement an effective and efficient centralized system to handle reports of misconduct, prompt and thorough investigations and timely resolution of any issues. Employers must train their staff to not only handle a large volume of reports but also productively deal with complex and sensitive situations. Because any employee complaint regarding a possible securities law violation is a significant issue, in-house or outside counsel should be heavily involved throughout the entire process.

Recent Developments in SEC Enforcement Action

Companies that face SEC enforcement actions may find hope in the recent Second Circuit decision that affirmed a company's ability to settle without an admission of liability. In June, the Second Circuit reversed and remanded Judge Rakoff's 2011 order that rejected an SEC settlement arising from investment fraud claims against Citigroup. The proposed settlement resolved the SEC's securities fraud case against Citigroup for misrepresenting its role and financial interest in a billion dollar investment fund.[62]

In its complaint, the SEC alleged that Citigroup "exercised significant influence" in selecting the fund's assets, which were largely collateralized by subprime mortgage-backed securities. The SEC alleged that Citigroup also took a "short" position in the mortgage-backed assets at this same time and earned $160 million when the assets performed poorly. The fund investors, on the other hand, lost millions of dollars.

Soon after filing the complaint, the SEC entered a consent decree with Citigroup. Citigroup agreed to disgorge the $160 million net profits from the alleged conduct and pay $30 million in prejudgment interest and $95

[62] *U.S. Sec. & Exch. Comm'n v. Citigroup Global Mkts., Inc.*, 725 F.3d 285 (2d Cir. 2012).

million in civil penalties. The decree also imposed injunctive relief and remedial action. Citigroup made no admission of guilt or liability.

After a hearing on November 9, 2011, Judge Rakoff concluded that the proposed consent decree was "neither fair, nor reasonable, nor adequate, nor in the public interest" because sufficient basis did not exist to determine whether it was justified under those standards.[63] The judge largely criticized the lack of underlying facts on which to base an approval decision, as "the public is deprived of ever knowing the truth in a matter of obvious public importance."[64] The judge refused to approve the consent judgment and set the case for trial.

On an interlocutory appeal, the Second Circuit found that Judge Rakoff abused his discretion in applying an incorrect legal standard. In giving deference to the SEC or any other enforcement agency in reaching a consent decree, the proper standard for review is "whether the proposed consent decree is fair and reasonable, with the additional requirement that the 'public interest would not be disserved' when it includes injunctive relief." The Second Circuit concluded "the district court is required to enter the order" unless a "substantial basis in the record" exists to conclude that the proposed consent decree does not meet the requirements.

According to the Court, Judge Rakoff abused his discretion when requiring the SEC to establish the "truth" of the allegations against Citigroup as a condition for approving the consent decree. Trials are for "truth." Consent decrees concern "pragmatism."

For many companies, the Second Circuit's decision is seen as a victory, as liability admissions to enforcement and regulatory actions could have other implications that could disrupt business objectives.

Conclusion

Over the past year, the securities litigation landscape has evolved. The Supreme Court has spoken on class certification and whistleblower actions. Congress has implemented programs to encourage securities fraud

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[63] *S.E.C. v. Citigroup Global Markets Inc.*, 827 F.Supp.2d 328, 332 (S.D.N.Y. 2011).
[64] *Id.*

reporting. Finally, the Second Circuit has articulated that an acceptable settlement with the SEC can exclude an admission of liability. These and other trends will continue as complex securities litigation evolves.

Key Takeaways

- The *Halliburton* ruling clarified a defendant's right to rebut the fraud-on-the-market presumption at the class certification stage. Refer to *Basic, Inc. v. Levinson* for the guidance on a defendant's ability to present evidence to rebut the presumption.
- Expect a renewed focus on the class certification stage after *Halliburton*. Class certification, rather than summary judgment, could become the primary source of expense in discovery.
- Keep in mind that the SEC is pushing for greater whistleblower program enforcement. Create an effective and efficient centralized system to handle reports of misconduct. Undertake prompt and thorough investigations and resolve issues in a timely manner when issues are reported. Train staff thoroughly on how to handle a large volume of reports and deal with complex and sensitive situations in a productive manner. Keep in-house or outside counsel involved throughout the entire process.
- Make sure proper procedures are established and great care is exercised when considering possible negative actions against employees who could qualify for whistleblower protection.
- Understand the rights and remedies available when entering a consent decree with the SEC. The Second Circuit decision in *SEC v. Citigroup Global Markets Inc.* concludes that a consent decree without an admission of wrongdoing was fair and reasonable.

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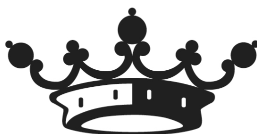

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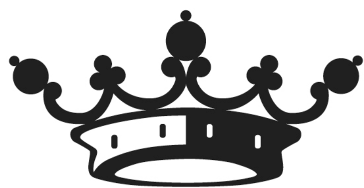

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