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ALERT MEMORANDUM

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SECOND CIRCUIT ISSUES TWO SIGNIFICANT DECISIONS NARROWLY CONSTRUING THE ANTIRETALIATION PROVISIONS OF SARBANES-OXLEY AND DODD-FRANK

The Second Circuit recently decided two significant cases construing the antiretaliation provisions of the Sarbanes-Oxley Act of 2002 ("SOX") and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). *Liu v. Siemens AG* (No. 13-4385-cv) held that the antiretaliation provision of Dodd-Frank does not apply extraterritorially. The other case, *Nielsen v. AECOM Technology Corporation* (No. 13-235-cv), clarified what a plaintiff must show to demonstrate that he or she engaged in protected activity – an element of a retaliation claim under SOX. Together, these cases show the Second Circuit limiting the reach of the SOX and Dodd-Frank whistleblower protections.

Extraterritoriality: *Liu v. Siemens AG*

Simply stated, the antiretaliation provisions of SOX and Dodd-Frank protect employees from retaliation for reporting conduct that an employee reasonably believes constitutes fraud or a securities violation, or for engaging in other protected conduct.

In *Liu v. Siemens AG*, the Second Circuit importantly held that the antiretaliation provisions of Dodd-Frank do not apply "extraterritorially." The question in that case was whether the plaintiff, a Taiwanese citizen who was employed by an overseas subsidiary of a United States-listed company incorporated in Germany, was entitled to the protections of Dodd-Frank when he was fired in retaliation for reporting payments he believed violated the Foreign Corrupt Practices Act ("FCPA"). There was no question that the conduct the employee reported – if accurate – would have constituted a violation of the FCPA. There was also no question that the employee would have been entitled to the protections of SOX and Dodd-Frank had the employee been employed by a United States issuer and reported the information in the United States. The court nonetheless held that the employee was not entitled to whistleblower protection because he was employed by an overseas subsidiary.

The court based its decision on the plain language of the statute and the Supreme Court's decision in *Morrison v. National Australian Bank Ltd.*, 561 U.S. 247 (2010), that "legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." In holding that the statute did not apply extraterritorially, the court expressed concern about the impact of imposing an overlay of United States employment and labor standards on the employment law of foreign nations. At the same time, however, the decision significantly limits federal law. Much of the activity that would violate the FCPA as well as many other United States laws takes place overseas by companies owned by United States issuers, and the individuals involved and in a position to know about the conduct are frequently not United States nationals. Under *Liu*, that category of employees, however, is no longer entitled to Dodd-Frank antiretaliation protection.

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One argument the court rejected was that SEC regulations indicating that Dodd-Frank's whistleblower bounty provision apply extraterritorially could support applying the antiretaliation provision extraterritorially. Notably, the court expressed skepticism that "SEC regulations should be accorded weight in determining congressional intent with respect to the extraterritorial application of a statute." The court did not decide the issue, but its reasoning might suggest that the bounty provisions also do not apply extraterritorially.

Liu also presented another significant issue – whether the plaintiff's exclusively internal whistleblowing qualified for protection under Dodd-Frank. By deciding the case on extraterritoriality grounds, the court was able to avoid answering that question. Whether internal reporting alone can qualify an employee as a whistleblower under Dodd-Frank remains an important undecided question in the Second Circuit, although the Fifth Circuit has held that internal reporting is not sufficient. *See Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013).

Protected Activity: *Nielsen v. AECOM Technology Corporation*

The second important case the court decided was *Nielsen v. AECOM Technology Corporation.* The questions there were two: first, the standard that a plaintiff had to satisfy to establish that his warnings related to one of the categories of fraud or securities violations in the SOX antiretaliation provision, so that he would be deemed to have engaged in protected activity; and, second, whether the facts alleged made out a violation of the statute. The court relaxed the standard a plaintiff had to satisfy but – in so doing – also made clear that there are important limitations on what reports qualify for protection under the antiretaliation provisions. While, for example, any violation of law can potentially give rise to a books and records violation under the securities laws, not every violation of law, or even every violation of law that could result in a violation of the securities laws, can underlie a SOX retaliation claim.

The plaintiff in *Nielsen* was an engineer responsible for evaluating whether engineering plans comported with fire safety standards. One of his subordinates permitted plans to be approved even without the plaintiff's review. The plaintiff notified his superiors of his subordinate's activity, but his concerns went unaddressed and he was eventually fired.

The plaintiff filed a retaliation complaint under SOX. The main issue confronting the Second Circuit was whether the district court was correct in requiring the plaintiff to demonstrate that his warnings "*definitely and specifically* relate[d] to one of the listed categories of fraud or securities violations" in the statute in order to show that he had engaged in protected activity. The "definitely and specifically" requirement was initially promulgated by the Department of Labor's Administrative Review Board ("ARB") and adopted by the Second Circuit, but it was later disavowed by the ARB.

The Second Circuit found the ARB's rejection of the "definitely and specifically" requirement persuasive under *Skidmore* deference. The court held that to show that she has engaged in protected activity under SOX, an employee must demonstrate merely that she held an objectively and subjectively reasonable belief that she was reporting conduct that constituted a fraud or securities violation.

Although it rejected the "definitely and specifically" requirement used by the district court, the Second Circuit found that the plaintiff had not plausibly plead an objectively reasonable belief that the conduct he reported – "that a single employee failed properly to review fire safety designs" – constituted one of the fraud or securities violations listed in the statute. The Second Circuit quoted the ARB in finding that the plaintiff's "'complaint concern[ed] such a trivial matter,' in terms of its relationship to shareholder interests, 'that he . . . did not engage in protected activity under [SOX].'"

The court's analysis provides some indication of the types of reports that will qualify an employee as a whistleblower and the reports that will not. The court compared the plaintiff's "trivial" complaint with other complaints that have qualified as protected activity under SOX, such as falsifying information used in clinical drug tests, accounting misconduct occurring shortly after a corporate fraud scandal, and overbilling a large client. Unlike these examples, a single employee's misbehavior regarding the review of fire safety designs was neither sufficiently important to the company's business nor sufficiently indicative of "the complicity of the employer in unlawful conduct" to support a SOX claim.

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If you have any questions, please feel free to contact any of your regular contacts at the firm. You may also contact our partners and counsel listed under "White-Collar Defense, Securities Enforcement and Internal Investigations" or "Executive Compensation and ERISA" located in the "Practices" section of our website at http://www.clearygottlieb.com.

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