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Whistleblowers

Five Themes for General Counsel to Monitor with Respect to Dodd-Frank Whistleblowers and the FCPA

By F. Joseph Warin and John W.F. Chesley, *Gibson, Dunn & Crutcher LLP*

It's late at night and General Counsel is giving the deck for the next morning's Audit Committee presentation one final read through. The subject of the presentation is a succinct yet thorough post-mortem report distilling the key findings from a wide-ranging internal investigation into irregularities relating to a major contract award in one of the company's most challenging foreign markets. There is sufficient evidence of questionable conduct to merit real concern under the Foreign Corrupt Practices Act[1] (FCPA) and General Counsel, with Outside Counsel by her side, must make a recommendation to the Audit Committee as to whether the company should make a voluntary disclosure to U.S. authorities.

Flipping through the slides, General Counsel remarks to herself how familiar the facts have become, particularly the unattractive ones. She is also well versed in the factors weighing on the pro and con side of disclosure, Outside Counsel having provided her with a very helpful decision tree. But one wildcard prevents General Counsel from putting the presentation down and getting some much-needed rest: is there a whistleblower who has already informed the government? If so, the company's calculus is dramatically different. But General Counsel just doesn't know and that is one answer that Outside Counsel does not have for her.

Whistleblowers have long been a hot topic for corporate counsel. Ralph Nader is credited with coining the term in the early 1970s as an alternative to some less charitable descriptions that developed over the years.[2] But the concept of bringing internal corporate malfeasance to light in return for a financial bounty dates back at least to the 19th century and the False Claims Act.[3]

In the wake of the 2008 financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[4] This article concerns one of those "other purposes," specifically, Section 922 of Dodd-Frank, which amended the Securities Exchange Act of 1934 (Exchange Act) to add new Section 21F, "Securities Whistleblower Incentives and Protection."

In this article, we provide a brief primer on the regulatory framework governing whistleblower awards under Dodd-Frank, explore early developments in Dodd-Frank whistleblower litigation, with a particular focus on two important cases predicated upon alleged violations of the FCPA, and finally list some of the key issues that we see as emerging or that we expect to emerge in the near future.

A Primer on Dodd-Frank's Whistleblower Award Program

Section 21F of Dodd-Frank sets up a system of rewards and protections for whistleblowers who voluntarily provide original information about violations of the U.S. securities laws. Specifically, the law prescribes monetary rewards of between 10 and 30 percent of certain financial recoveries collected in an enforcement action brought by the Securities and Exchange Commission (SEC or Commission) or related actions brought by other U.S. government agencies, including the Department of Justice (DOJ).[5] To qualify, the putative whistleblower must:

1. "***Voluntarily***" (i.e., not pursuant to a pre-existing legal or contractual duty and before receiving a request for the information from the SEC, another regulatory agency, self-regulatory organization, or Congress);[6]
2. ***Provide "original information,"*** defined as information (i) derived from the whistleblower's independent knowledge or analysis (i.e., not publicly known), (ii) not already known to the SEC, (iii) provided to the SEC for the first time after July 21, 2010 (the date that Dodd-Frank was enacted), and (iv) not obtained through a communication that was subject to the attorney-client privilege;[7]
3. ***To "the Commission,"*** which may include information the SEC receives from a another party (e.g., Congress, another regulatory agency, or the whistleblower's employer) provided the whistleblower was the original source of information to the reporting party;[8]
4. ***That "leads to,"*** meaning the information is either "sufficiently specific, credible, and timely to cause the [SEC] to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation," or, in cases where there already was an ongoing investigation or examination concerning the subject of the information provided, the information "significantly contributed to the success of the action";[9]
5. ***A "successful enforcement [action] in which the Commission [or a related agency] obtains monetary sanctions totaling more than $1,000,000."*** Related agency actions include judicial or administrative actions brought by DOJ, certain other federal regulatory authorities, self-regulatory organizations (e.g., FINRA), and criminal cases brought by state attorneys general. Eligible "monetary sanctions" include penalties, disgorgement and prejudgment interest.[10]

SEC Office of the Whistleblower

As part of Dodd-Frank, in August 2011 the SEC set up a formal whistleblower program under the auspices of the newly-formed Office of the Whistleblower. This Office, headed by the talented Sean X. McKessy, receives, evaluates and refers whistleblower tips deemed worthy of further review to the Division of Enforcement and/or other regulatory agencies. The Office of the Whistleblower also receives applications for financial rewards from whistleblowers and evaluates their eligibility pursuant to the criteria discussed above.

In its first annual report to Congress, for Fiscal Year 2011, the Office of the Whistleblower reported receiving 334 "whistleblower tips" in the first seven weeks of operation. The most common categories of complaints were market manipulation (54 tips, or 16.2 percent), offering fraud (52 tips, or 15.6 percent), and corporate disclosures and financial statements (51 tips, or 15.3 percent). Tips relating to FCPA allegations totaled 13, or 3.9 percent. Tips rolled in from 37 states, most prominently California (34), New York (24), Florida (19) and Texas (18), as well as from 11 foreign nations, including China (10) and the United Kingdom (9). Given the short period available for study in the FY 2011 report, practitioners await a more fulsome study of relevant trends in the FY 2012 report, expected later this year.

On August 21, 2012, the Office of the Whistleblower announced its first award under the SEC's whistleblower program. The whistleblower will receive close to $50,000, which represents the maximum 30 percent award of the nearly $150,000 collected to date in connection with the more than $1 million judgment entered in connection with the enforcement action. The SEC's press release does not identify the whistleblower or the defendants who allegedly perpetrated the scheme, though it does note that a second application for a whistleblower award on the same investigation was denied because "the information provided did not lead to or significantly contribute to the SEC's enforcement action."

In announcing this first whistleblower award, Mr. McKessy stated that since the whistleblower program was established in August 2011, it has received approximately eight tips per day. He concluded, "The fact that we made the first payment after just one year of operation shows that we are open for business and ready to pay people who bring us good, timely information."

Dodd-Frank's Anti-Retaliation Provisions

Although the bulk of the Securities Whistleblower Incentives and Protections added by Dodd-Frank concern the whistleblower "bounty" program described above, the statute also gave new anti-retaliation protections to whistleblowers. Specifically, 15 U.S.C. § 78u-6(h)(1)(A) provides that no employer may discharge or otherwise discriminate in terms of employment against a whistleblower based upon any lawful act by the whistleblower in "providing information *to the Commission*," initiating or assisting in any Commission investigation or enforcement action based on or related to such information, or in making disclosures that are required by any law, rule or regulation subject to the Commission's jurisdiction. Subsections (B) and (C) of the same provision provide whistleblowers with a private cause of action in federal district court, including the right to seek reinstatement, double back-pay and costs and fees incurred in litigation.

Although the majority of Dodd-Frank's "Securities Whistleblower Incentives and Protection" provisions relate to the statute's bounty program, the anti-retaliation provisions are more susceptible to judicial challenge and thus have dominated the early landscape of Dodd-Frank whistleblower litigation, as described below.

Early Dodd-Frank Whistleblower Litigation

With Dodd-Frank on the books for scarcely two years now, it is too soon to draw definitive trend lines. But three early district court decisions are particularly instructive and warrant discussion: (1) Egan v. TradingScreen, Inc.;[11] (2) Nollner v. Southern Baptist Convention, Inc.;[12] and (3) Asadi v. G.E. Energy (USA), LLC.[13] All three concern allegedly wrongful terminations in purported violation of Dodd-Frank's anti-retaliation provisions and, interestingly, two of the three arise out of suspected violations of the FCPA. A brief discussion of each case follows.

Egan v. TradingScreen, Inc.

TradingScreen is a privately-held financial software provider that facilitates Internet stock trading by hedge funds, asset managers and private bankers, among others. According to the complaint, Plaintiff Patrick Egan, TradingScreen's Head of Sales, learned that the company's CEO was diverting corporate assets to another company owned by the CEO. Egan reported his allegations to the company president, who in turn passed the information on to TradingScreen's independent directors. An internal investigation followed, the findings of which supported Egan's allegations. But before disciplinary action could be taken against the CEO, he gained control of the full board and fired Egan.

Egan filed suit in the United States District Court for the Southern District of New York claiming, among other things, that his termination violated Dodd-Frank's anti-retaliation provisions. Defendants moved to dismiss the complaint arguing that because Egan reported his allegations only internally within the company, and not to the SEC, he did not qualify as a "whistleblower" within the statutory framework of Dodd-Frank.

In an opinion authored by the Honorable Leonard B. Sand, the Court began with Dodd-Frank's statutory definition of "whistleblower," which reads, in relevant part: "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws *to the Commission*."[14] Further, in the anti-retaliation provisions of Dodd-Frank, the statute prohibits employers only from discharging or otherwise discriminating against "whistleblowers" due to several enumerated lawful acts undertaken by those "whistleblowers."[15]

One of the enumerated lawful acts protected by Dodd-Frank is reporting information to the SEC. But, in addition, the statute protects those who make disclosures falling into one of four categories, namely "disclosures that are required or protected:" (1) "under the Sarbanes-Oxley Act"; (2) "the Securities Exchange Act of 1934"; (3) "section 1513(e) of title 18, United States Code"; and (4) "any other law, rule, or regulation subject to the jurisdiction of the Commission."[16] Because disclosures "required or protected" by these four categories of laws and regulations include a set of communications broader than just those with the SEC, the Court found that limiting these provisions to "whistleblowers" under Dodd-Frank, narrowly defined as those who provide information to the SEC, "would effectively invalidate" these other provisions.[17]

Judge Sand thus determined that the "contradictory provisions of the Dodd-Frank Act are best harmonized by reading [the anti-retaliation provisions'] protection of certain whistleblower disclosures not requiring reporting to the SEC as a narrow exception to [Dodd-Frank's statutory] definition of whistleblower as one who reports to the SEC."[18] In summary, the Court held that a Dodd-Frank whistleblower plaintiff must allege <u>either</u> that s/he reported information to the SEC <u>or</u> that his/her disclosures fell under one of the four categories of disclosures delineated in 15 U.S.C. § 78u-6(h)(1)(A)(iii).

Moving to the facts before the Court, Judge Sand rejected Egan's argument that his internal reporting was required by Sarbanes-Oxley because the provision he relied upon (Section 806) applies only to public companies, whereas TradingScreen is privately-held.[19] Similarly, the Court dismissed Egan's contention that the anti-retaliation provisions applied because the conduct he reported constituted a violation of certain FINRA regulations that are subject to the SEC's jurisdiction. Noting that Dodd-Frank protects only those "disclosures that are required or protected under . . . any other law, rule, or regulation subject to the jurisdiction of the Commission," Judge Sand held that "[m]erely alleging the violation of a law or rule under the SEC's purview is not enough; a plaintiff must allege that a law or rule in the SEC's jurisdiction explicitly requires or protects disclosure of that violation."[20]

Finding that Egan did not personally report the relevant information to the SEC and that his disclosures were not required by law, the Court next moved to Egan's claim that he "acted jointly" to report his information to the SEC on the theory that he reported his information to the law firm conducting the internal investigation, which in turn, he alleged, reported the information to the SEC. As noted above, Dodd-Frank's definition of "whistleblower" includes "2 or more individuals *acting jointly* to provide" information to the SEC.[21] Relying heavily upon Egan's proactive role in initiating the chain of events leading to the law firm investigation – as contrasted with one who merely passively provides information during an interview – the Court held that Egan adequately alleged that he "acted jointly" with the law firm.[22]

Unfortunately for Egan, he was unable to allege facts sufficient to support his assertion that the law firm, or anyone, actually reported the information to the SEC, even after being given an opportunity to amend and replead his complaint. The Court, therefore, dismissed the case with prejudice.[23] See also "In Case of First Impression, U.S. District Court Interprets Private Right of Action Under Whistleblower Provisions of Dodd-Frank Act, Limiting Claims of Dismissed Employee of Hedge Fund Technology Vendor," The Hedge Fund Law Report, Vol. 4, No. 22 (Jul. 1, 2011).

Although not itself an FCPA case, as the first Court to deal with the Dodd-Frank's whistleblower anti-retaliation provisions, *Egan* set the stage for the two FCPA whistleblower cases that would soon follow.

Nollner v. Southern Baptist Convention, Inc.

On April 3, 2012, in the first published decision to examine an FCPA-related whistleblower retaliation claim under Dodd-Frank, the Honorable Aleta A. Trauger of the U.S. District Court for the Middle District of Tennessee dismissed a wrongful termination lawsuit brought against Southern Baptist Convention, Inc. (SBC). In this case, husband and wife plaintiffs Ron and Beverly Nollner sued SBC for retaliatory discharge after Ron Nollner was terminated from his position overseeing the construction of an SBC office building in New Delhi, India. Nollner claimed that his discharge was impermissibly motivated by complaints that he allegedly made concerning purportedly corrupt payments by SBC contractors to Indian government permitting officials.

There was no allegation in *Nollner* that the Plaintiffs reported any information to the SEC, either directly or indirectly. Their claim thus rested on the same "catch-all" provision discussed extensively in the *Egan* case, which provides protection for disclosures "required or protected" by various laws and regulations within the SEC's jurisdiction. Adopting, in large measure, the *Egan* Court's analysis, Judge Trauger articulated the following four-part test that a whistleblower plaintiff must meet to invoke the "catch-all" anti-retaliation provision of Dodd-Frank:

1. "he or she was retaliated against for reporting a violation of the securities laws";
2. "the plaintiff reported that information to the SEC or to another entity (perhaps even internally) as appropriate";
3. "the disclosure was made pursuant to a law, rule, or regulation subject to the SEC's jurisdiction"; and
4. "the disclosure was 'required or protected' by that law, rule, or regulation within the SEC's jurisdiction."[24]

Plaintiffs correctly argued that the FCPA is a statute subject to the SEC's jurisdiction. But, as the Court noted, SBC is not a publicly-traded company and thus, for FCPA purposes, qualifies as a "domestic concern" rather than an "issuer."[25] Although the FCPA provides for dual enforcement authority by DOJ and the SEC, the SEC's jurisdiction under the FCPA is limited to issuers and does not encompass violations by domestic concerns.[26] Therefore, the Court held that "because the defendants are not 'issuers' for purposes of the FCPA, they are not 'subject to the jurisdiction' of the SEC with respect to FCPA violations."[27]

Plaintiffs' bid to invoke Dodd-Frank anti-retaliation protection for alleged FCPA violations by the privately-held defendant thus failed and the whistleblower claim was dismissed. Judge Trauger declined to exercise supplemental jurisdiction over the Nollners' pendent state-law claims and remanded their case back to Tennessee state court, in which it was originally filed.

Asadi v. G.E. Energy (USA) LLC

On June 28, 2012, the Honorable Nancy F. Atlas of the U.S. District Court for the Southern District of Texas dismissed another Dodd-Frank whistleblower claim in the FCPA context, but for a different reason. Khaled Asadi, a dual Iraqi/U.S. citizen residing in Jordan, sued G.E. Energy (USA), LLC for wrongful discharge, claiming that he received a "surprisingly negative" performance review and was ultimately terminated after being interviewed by an internal ombudsman investigating Asadi's complaint that the company hired a third-party intermediary "closely associated" with a senior Iraqi government official. Like the *Egan* and *Nollner* cases before it, the *Asadi* Court was faced with a putative whistleblower's internal reporting of allegedly protected information (i.e., not to the SEC). But unlike the prior cases, the corporate defendant is a subsidiary of a publicly-traded company.

Judge Atlas considered briefly whether *Egan* and *Nollner* were correct in holding that the "whistleblower" anti-retaliation protections of Dodd-Frank are broader than the statute's definition of "whistleblower." But ultimately, the Court did not decide this issue, focusing instead on the "longstanding principle" that legislation does not apply extraterritorially absent a clear and affirmative expression of Congressional intent.[28]

The Court held that, because Dodd-Frank's anti-retaliation provisions are silent concerning extraterritoriality, there is a strong presumption that they do not apply extraterritorially and thus do not govern conduct that takes place outside of the United States. This conclusion is bolstered by the fact that other provisions of Dodd-Frank explicitly do apply extraterritorially, which "'would be quite superfluous' if the rest of the statute already applied" outside of the United States.[29] Judge Atlas also rejected Asadi's argument that the FCPA expands the jurisdictional bounds of the anti-retaliation provisions because the FCPA itself applies extraterritorially, analogizing to precedent holding, in the RICO context, "that predicate acts in foreign countries in violation of statues with extraterritorial reach are insufficient to rebut the presumption against extraterritoriality of the encompassing statute."[30] The Court also held that the FCPA could not expand the reach of Asadi's specific claims because there is "no provision of the FCPA that 'protects' or 'requires' his internal report of the alleged bribery."[31] Agreeing with the *Egan* Court's analysis, Judge Atlas found that "merely alleging the violation of a law or rule under the SEC's purview is not enough; a plaintiff must allege that a law or rule in the SEC's jurisdiction explicitly requires or protects disclosure of that violation."[32]

Because, as Asadi's own complaint alleged, "the majority of events giving rise to the suit occurred in a foreign country" (the "termination e-mail" was sent to Asadi in Jordan, was related to his employment in Jordan, and said that a confirming letter would be sent to his home in Jordan), the Court held that "the Anti-Retaliation Provision does not extend to or protect Asadi's extraterritorial whistleblowing activity."[33] Judge Atlas dismissed Asadi's claims, which ruling Asadi has recently appealed to the United States Court of Appeals for the Fifth Circuit.

Five Takeaways for the General Counsel

With so much early activity, it is hard to believe that the Dodd-Frank whistleblower provisions are only two years old. And with the cottage industry of plaintiffs' lawyers that has sprung up to solicit and represent putative whistleblowers, it is clear that these provisions will be the subject of substantial litigation for many years. These developments are not unique to the FCPA, yet as two-thirds of the early decisions evidence, the robust state of FCPA enforcement in recent years is quite the convenient catalyst to the equally robust state of Dodd-Frank whistleblower litigation.

So what does General Counsel take away from this admittedly very preliminary landscape? We have set forth below five thoughts on developments to date and issues that merit following as they further mature with the Dodd-Frank statute itself:

1. *Shift in Self-Reporting Calculus*: First and foremost, there is no question that Dodd-Frank's "bounty hunting" mentality has already shifted the voluntary disclosure calculus. With the prospect of financially-incentivized, in-house whistleblowers, emboldened by anti-retaliation protections, the "will the Government find out" analysis will never again be the same.
2. *Facilitate and Encourage Internal Reporting*: It is imperative that companies ensure that they have robust internal control processes, including whistleblower hotlines and periodic training/audits, designed to surface compliance lapses early and on a routine basis. Companies should carefully consider strategies to encourage internal reporting of these potential problems before they lead to external reporting.
3. *Developing Definition of "Whistleblower"*: Expect some dissension to develop amongst the many federal courts on the subject of whether the scope of who qualifies as a "whistleblower" under Dodd-Frank's anti-retaliation provisions truly extends beyond what Congress said it was when it wrote the "individual who provides . . . information . . . to the Commission" definition set forth in Dodd-Frank.
4. *<u>Asadi</u> May Portend Jurisdictional Hurdles for Would-Be FCPA Whistleblowers*: The *Asadi* Court's discussion of the (lack of) extraterritorial application of Dodd-Frank's anti-retaliation provisions has particular resonance in whistleblower claims predicated on alleged FCPA

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violations. The lack of domestic conduct alleged in Asadi's complaint is much more the norm than the exception amongst putative FCPA whistleblowers and thus this ruling has the potential to significantly blunt the anti-retaliation club that is so-often wielded in employment disputes.

5. Bounty Challenges on the Horizon: Finally, as the SEC's Office of the Whistleblower processes more whistleblower bounty claims, expect a substantial body of administrative and then judicial challenges to develop in response to claim denials.

Joe Warin is the chair of Gibson, Dunn & Crutcher LLP's Washington, D.C. Litigation Department, the co-chair of the Firm's White Collar Defense and Investigations Practice Group, and a former Assistant United States Attorney in Washington, D.C. His areas of expertise include white collar crime and securities enforcement, including FCPA investigations, False Claims Act cases, special committee representations, compliance counseling, and complex class action civil litigation. He has conducted FCPA investigations relating to business in 35 countries and is the only person to serve as the FCPA compliance monitor or counsel to the monitor in connection with three separate corporate FCPA resolutions with DOJ and the SEC.

John Chesley is a litigation associate in Gibson Dunn's Washington, D.C. office. He focuses his practice on white collar criminal and securities enforcement matters, as well as high-stakes civil and administrative litigation and congressional investigations, and has substantial experience representing corporations, audit committees, and executives in internal investigations and before government agencies in matters involving the FCPA, government contracts fraud, securities violations, the antitrust laws, and several very colorful whistleblower claims.

[1] 15 U.S.C. § 78dd-1 *et seq.*
[2] Nader, Petkas, and Blackwell, Whistleblowing (1972). Only in comparison to monikers like "snitch" and "rat" could a word that invokes images of referees be characterized as a favorable alternative.
[3] 31 U.S.C. § 3729 *et seq.*
[4] P.L. 111–203.
[5] 17 C.F.R. 240.21F-4(a).
[6] 17 C.F.R. 240.21F-4(b)(1).
[7] 17 C.F.R. 240.21F-4(b). There are additional restrictions on the eligibility of awards for information derived from a company's internal compliance processes. These regulations are complex, controversial, and have been the subject of much debate between the SEC and the corporate bar. A detailed discussion of these provisions is a subject for another day and another article.
[8] 17 C.F.R. 240.21F-4(b)(5).
[9] 17 C.F.R. 240.21F-4(c).
[10] 17 C.F.R. 240.21F-4(d).
[11] 2011 U.S. Dist. LEXIS 47713 (S.D.N.Y. May 4, 2011).
[12] 2012 U.S. Dist. LEXIS 46484 (M.D. Tenn. Apr. 3, 2012).
[13] 2012 U.S. Dist. LEXIS 89746 (S.D. Tex. Jun. 28, 2012).
[14] 15 U.S.C. § 78u-6(a)(6) (emphasis added).
[15] 15 U.S.C. § 78u-6(h)(1)(A).
[16] 15 U.S.C. § 78u-6(h)(1)(A)(iii).
[17] *Egan*, 2011 U.S. Dist. LEXIS 47713, at *11.
[18] *Id.* at *13-14.
[19] *Id.* at *14.
[20] *Id.* at *17-18.
[21] 15 U.S.C. § 78u-6(a)(6) (emphasis added).
[22] *Egan*, 2011 U.S. Dist. LEXIS 47713, at *22.
[23] 2011 U.S. Dist. LEXIS 103416, at *14, 28 (S.D.N.Y. Sept. 12, 2011).

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[24] *Nollner*, 2012 U.S. Dist. LEXIS 46484, at *25.

[25] With respect to organizations, the FCPA defines "domestic concern" as "any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States" and "issuer" as a company "which has a class of securities registered pursuant to section 78l of [the Exchange Act] or which is required to file reports under section 78o(d) of [the Exchange Act]." 15 U.S.C. § 78dd-1(a); 15 U.S.C. § 78dd-2(h)(1).

[26] The SEC has, on certain, limited occasions, brought FCPA enforcement actions against non-issuer corporate defendants predicated on the theory that the non-issuer "caused" or "aided and abetted" an FCPA violation by an issuer. See, e.g., *SEC v. Panalpina, Inc.*, 10-cv-04334 (S.D. Tex. Nov. 4, 2010); *SEC v. KPMG Siddharta Siddharta & Harsono*, 01-cv-03105 (S.D. Tex. Sept. 11, 2001). These actions have all been settled with the corporate defendants and thus not subject to close judicial scrutiny.

[27] *Nollner*, 2012 U.S. Dist. LEXIS 46484, at *31.

[28] *Asadi*, 2012 U.S. Dist. LEXIS 89746, at *13-15. *See also Morrison v. Nat'l Australia Bank, Ltd.*, 130 S. Ct. 2869, 2878 ("When a statute gives no clear indication of an extraterritorial application, it has none.").

[29] *Asadi*, 2012 U.S. Dist. LEXIS 89746, at *18 (quoting *Morrison*, 120 S. Ct. at 2883). Section 929P(b) of Dodd-Frank amended three existing statutes to grant federal court jurisdiction to certain "action[s] or proceeding[s] brought or instituted by the Commission or the United States."

[30] *Asadi*, 2012 U.S. Dist. LEXIS 89746, at *25 (collecting cases).

[31] *Id.* at *31-32.

[32] *Id.* (quoting *Egan*, 2011 U.S. Dist. LEXIS 47713, at *17-18).

[33] *Asadi*, 2012 U.S. Dist. LEXIS 89746, at *22-23.