

Court decision raises risk of securities class actions for companies receiving whistleblower report

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Internal whistleblower reports raise a series of risks for securities issuers, including concerns about the [risks of conducting an inadequate investigation](#), potential employment lawsuits for [reprisals by company employees against the whistleblower](#), and potential liability for [impeding the whistleblower's ability to communicate with regulators](#). After a recent decision from the U.S. Court of Appeals for the Ninth Circuit, companies can now add to the list future securities misrepresentation actions.

What you need to know

- A recent U.S. Court of Appeal case held that a retaliation lawsuit by a whistleblower against an issuer can constitute a corrective disclosure for purposes of a securities misrepresentation action.
- It is only a matter of time before Canadian plaintiffs advance this same argument about whistleblower retaliation lawsuits in securities misrepresentation actions in Canada.
- Companies that receive an internal whistleblower report should take all appropriate steps to address the complaint and protect the whistleblower against retaliation to mitigate the risk of a future securities misrepresentation action.

The BofI decision

On October 8, 2020, the U.S. Court of Appeals for the Ninth Circuit released its [decision in *In re BofI Holding, Inc. Securities Litigation* \(BofI\)](#), a securities class action suit launched against bank holding company BofI Holding by investors. In the suit, the investors alleged that, between September 2013 and February 2016, BofI executives made misrepresentations to investors about the bank's loan underwriting standards, internal controls and compliance infrastructure.

The investors asserted that the stock price of BofI fell 30 per cent after the truth was revealed in a whistleblower retaliation lawsuit brought by a former company internal audit employee who was terminated after allegedly raising concerns within BofI of "rampant and egregious wrongdoing" at the company. The lower court concluded that

the whistleblower retaliation lawsuit could not serve as a corrective disclosure because it contained only “unconfirmed accusations of fraud” that could not establish with the requisite degree of certainty that any alleged misrepresentations were false.

In reviewing the lower court’s decision to dismiss the action, the Ninth Circuit held that the relevant question was “whether the market reasonably *perceived* [the employee’s] allegations as true and acted upon them accordingly”. Based on the significant drop in Bofl’s stock price following the lawsuit, the court concluded that the suit could serve as a corrective disclosure and reinstated the action.

Bofl and Ontario securities law

Ontario courts have generally followed American jurisprudence on whether an event can constitute a corrective disclosure. For instance, [in the United States](#) and [in Ontario](#), a corrective disclosure does not need to be a “mirror image” of the original misrepresentation, so long as there is some linkage or connection between the corrective disclosure and the earlier misrepresentation. Moreover, as [in the United States](#), a corrective disclosure under Ontario law can emanate from a source other than the issuer. Ontario courts have held that corrective disclosures may stem from a variety of third parties, including [anonymous internet blog posts](#) and [newspaper articles](#).

Given the close similarities between the treatment of corrective disclosures in the United States and Ontario, there is no doubt the plaintiff securities class action bar in Ontario is monitoring the *Bofl* development closely. Likely, it is only a matter of time before we begin to see plaintiffs in Ontario claiming that a whistleblower lawsuit against an issuer constitutes a corrective disclosure for the purposes of securities misrepresentation class actions. The high degree of detail and specificity contained in some whistleblower lawsuits, combined with the credibility inherent in some allegations made by former company employees, present a risk that the courts will accept such an argument.

Implications

The *Bofl* decision raises the stakes for companies that receive an internal whistleblower report of potential misconduct. While previously risks to a company from a whistleblower report included potential employment suits and regulatory scrutiny, the *Bofl* decision opens up companies to the possibility of a securities class action based on a whistleblower lawsuit.

In light of this new risk, companies would be well-advised to guard against potential whistleblower lawsuits by treating all internal whistleblower reports seriously, including conducting an investigation and taking remedial measures where appropriate, and taking care to ensure that whistleblowers do not perceive that they are being retaliated against for their report. Companies may also want to consult [our practical step-by-step guide](#) for handling such complaints that addresses these and other related concerns.

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