

Virginia Federal Court Enters Dodd-Frank Internal Whistleblower Fray

January 19, 2016

At Katz, Marshall & Banks, we frequently get phone calls from people who have experienced some variation on the following situation. An employee is working for a large company and has uncovered what she believes to be evidence of financial misconduct or fraud. She then reports her findings to a supervisor or someone in company management. Perhaps the supervisor curtly thanks this employee for her work or says little in acknowledgment of her report. Then, the employee suddenly finds herself facing seemingly unrelated discipline at work or is even fired abruptly for a vague reason—or for no reason at all.

Whether this employee is protected under the fairly generous whistleblower protections of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is a matter that's currently under debate in the federal courts. In one of the latest decisions in this debate, a Virginia federal court ruled—contrary to several other courts and the interpretation of the Securities and Exchange Commission (SEC)—that Dodd-Frank law does not protect an employee who found herself in a similar situation to our above hypothetical client. But before turning to that decision and the current judicial debate, it is helpful to understand the whistleblower laws in play here.

Financial Whistleblower Protections under Federal Law

Dodd-Frank established new [financial whistleblower protections](#), building on those first enacted under the [Sarbanes-Oxley Act of 2002](#), or SOX. Dodd-Frank protects “whistleblowers” who:

1. Report certain types of financial fraud to the SEC
2. Participate in an SEC investigation, and
3. Make disclosures “required or protected” by SOX or certain other federal securities laws.

The ambiguity that federal courts are currently debating comes out of this third class of whistleblowers, combined with the fact that Dodd-Frank defines “whistleblower” as “any individual who provides...information relating to a violation of the securities laws to the [SEC].”

These two provisions, taken together, have created a legal debate. On the one hand, Dodd-Frank says that, to be a whistleblower, an employee has to report to the SEC. On the other, the law says that it protects whistleblowers who make disclosures protected under SOX, which legal authorities agree protects internal reporting. This raises the question whether an employee who only reports suspected legal violations within her company is protected by Dodd-Frank.

In an attempt to clarify the issue, the SEC announced in 2011 its official interpretation of this piece of Dodd-Frank: the law protects internal whistleblowers.

The Fight in Federal Courts



Since 2011, this interpretive fight has played out in several federal courts without a clear consensus on the answer.

On one side of the debate, some federal district courts—including the recent Virginia case I mentioned at the outset of this post—along with the 5th Circuit Court of Appeals have decided Dodd-Frank does not protect internal whistleblowers.

In the Virginia case, *Puffenbarger v. Engility Corporation*, plaintiff Janet Puffenbarger found herself in a situation very much like that of our hypothetical client: After believing to have uncovered payroll irregularities in violation of SEC regulations, she reported the issue to one of her superiors, a company vice president. Eight days later, the company restructured Ms. Puffenbarger's department and took away some of her job responsibilities. Ms. Puffenbarger sued her employer, and the court dismissed her claim, in part because the court ruled that Dodd-Frank offered her no protection.

The court, along with other courts to come to this conclusion, reasoned that the text of Dodd-Frank is clear and that text trumps the SEC's interpretation to the contrary: For the purposes of retaliation protections, a "whistleblower" means someone who has reported legal violations to the SEC. The court stressed that the three Dodd-Frank categories (which I referenced in the previous section), "represent the protected activity in a whistleblower-protection claim; they do not define which individuals qualify as whistleblowers." Under this logic, Ms. Puffenbarger and others like her are out of luck when it comes to Dodd-Frank's whistleblower protections.

However, the majority of courts at the district level, along with the 2nd Circuit Court of Appeals, have ruled that Dodd-Frank does protect internal whistleblowers. In coming to this decision, several of these courts have decided that the SEC's interpretation is correct—that taken as a whole and in context, Dodd-Frank was intended to protect and does protect internal whistleblowers. These courts point to the fact that whistleblowers who report violations to the SEC are already protected under the first class of whistleblowers, so the only way to give real, independent meaning to the third class would be to say that internal whistleblowers who report SOX violations are also protected. Other courts who have come out on this side of the debate say that the statute is simply ambiguous, and thus they defer to the SEC's reasonable interpretation of that ambiguity under the Supreme Court's *Chevron* doctrine, which states that courts should defer to an agency's reasonable interpretation of an ambiguous statute.

What's Next for Internal Whistleblowers?

There are two routes that this issue can take to clarify whether internal whistleblowers are entitled to Dodd-Frank protections. First, the U.S. Supreme Court could answer the question under the way the law is now written, and the Court often takes cases where there is a split in interpretations between two federal Courts of Appeals, as there is here. Second, as Dodd-Frank is an act of Congress, Congress could simply rewrite this portion of the law to answer the question one way or the other. Since the state of the law is currently uncertain, however, employees should take heed of that fact and think twice before reporting misconduct or fraud internally without going to the SEC or other appropriate government entity.