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Does Dodd-Frank Protect Internal Whistleblowers?

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There is a well-entrenched circuit split on whether whistleblowers who report potential securities law violations to their employers but not to the Securities and Exchange Commission (SEC) are protected from retaliation under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). What *is* unambiguous is that individuals who provide information internally are protected by the Sarbanes-Oxley Act of 2002 (SOX), which states that employers may not retaliate against employees who have "provide[d] information [to a supervisor] . . . regarding any conduct which the employee believes constitutes" a violation of one of the fraud-related laws and regulations referenced in the statute. 18 U.S.C. § 1514A.

What Does Dodd-Frank Say?

Unlike SOX, Dodd-Frank defines a whistleblower as "any individual who provides . . . information relating to a violation of the securities laws to the Commission [i.e., the SEC]. 15 U.S.C. § 78u-6(a). Dodd-Frank protects whistleblowers who engage in three categories of conduct:

1. providing information to the SEC in accordance with the Dodd-Frank whistleblower incentive program;
2. participating in proceedings based on or related to such information; or
3. making disclosures "required or protected" under SOX, the Exchange Act, 18 U.S.C. § 1513€, or any other law, rule, or regulation under SEC jurisdiction. 15 U.S.C. § 78u-6(h)(1)(A).

The expansive nature of the conduct protected by the third category seems somewhat at odds with the definition of "whistleblower" itself since SOX would protect those who make internal disclosures but Dodd-Frank defines whistleblowers as those who report to the SEC. It is this possible tension that led the SEC to promulgate a rule to clarify the Dodd-Frank coverage provisions, and which has fostered disagreement in the courts.

What Does the SEC Say?

The SEC promulgated a regulation stating that it defines "whistleblower" to include those who report possible securities violations externally to the SEC as well as internally to supervisors or managers and to governmental authorities other than the SEC. 17 C.F.R. § 240.21F-2(b)(1) (2011).

What Do the Courts Say?

The Fifth Circuit concluded that the plain language of the statute dictates that only those who provide information relating to a violation of the securities laws to the SEC are protected from retaliation. [See *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620, 630 (5th Cir. 2013).] In reaching this conclusion, the Fifth Circuit held that the SEC rule is not entitled to deference because there is no ambiguity in the statute, quoting the *Chevron* standard that "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. *Id.* quoting *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43

(1984).

In contrast, the Second Circuit found the statutory language ambiguous because of the "arguable tension" between the definition of "whistleblower" and the description of "protected conduct" as including SOX-protected internal reports, and thus deferred to the SEC regulation. (See *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145, 147-48 (2d Cir. 2015.) In a strong dissent, Judge Dennis Jacobs found the definition unambiguous and its application to the protections identified in the same statutory section to be inarguable, noting that "[t]he thing about a definition is that it is, well, definitional." *Id.* at 158 (Jacobs, J. dissenting).

After the Fifth Circuit expressed its view that the SEC regulation is not entitled to deference, the SEC issued an interpretive rule to further clarify its position and emphasize its view that providing protections for those who make internal reports is consistent with the overall goals in implementing the whistleblower program because, without protection from retaliation, individuals might be discouraged from reporting thereby jeopardizing the investor-protection and law-enforcement benefits that can result from internal reporting. (See SEC Release No. 75592, 2015 WL 4624264). The SEC noted that it had reported to Congress in 2014 that it had consistently taken the view that the employment retaliation protections apply not only to those who report to the SEC but also to individuals who report violations internally at public companies.

Lower courts have divided in following the lead of either the Fifth or Second Circuits. [See *Berman*, 801 F.3d at 153 (collecting cases on both sides of the dispute)].

For example, the district court in the Eastern District of Virginia held that an employee who reported to her supervisor what she thought were unlawful cash payouts to another employee was not a whistleblower under the plain language of Dodd-Frank. [See *Puffenbarger v. Engility Corp.*, 151 F. Supp. 3d 651 (E.D. Va. 2015)].

Likewise, the district court in the Eastern District of Tennessee dismissed a plaintiff's Dodd-Frank claim based on his confidential reports to the Federal Bureau of Investigation (FBI), holding that the definition of "whistleblower" in Dodd-Frank confines its retaliation protections to those who make complaints to the SEC. [See *Verble v. Morgan Stanley Smith Barney, LLC, and Morgan Stanley & Co., Inc.*, 148 F. Supp. 3d 644 (E.D. Tenn. 2015), *appeal pending*]. The court held that, because the whistleblower definition is unambiguous, it could not accord any deference to the SEC rule expanding the definition to include internal whistleblowers and those who complain to government agencies other than the SEC. *Id*. at 651-656.

In contrast, the district court in the Northern District of California, like the Second Circuit, held that the statute is sufficiently ambiguous to call for *Chevron* deference to the SEC interpretation and concluded that it could not dismiss the Dodd-Frank claim of an internal whistleblower who told managers that a senior vice president had hidden seven million dollars in cost overruns on a development. [See *Somers v. Digital Realty Trust, Inc.*, 119 F. Supp. 3d 1088 (N.D. Cal. 2015), *certified for interlocutory appeal* 2015 WL 4481987 (N.D. Cal. July 22, 2015)].

What Difference Does It Make?

In rejecting the broader definition in the SEC rule, Judge Jacobs, who dissented from the Second Circuit majority opinion in *Berman,* emphasized that there are no horrendous consequences that flow from denying coverage under Dodd-Frank to internal whistleblowers because they still have the protections of SOX, and "[n]o markets collapse, no castles fall." [See *Berman*, 801 F.3d at 159 (Jacobs, J. dissenting)]. The dissenting judge was contrasting this statutory issue with that addressed by the Supreme Court in *King v. Burwell*, 135 S. Ct. 2480 (2015), the Affordable Care Act case on

which the majority had relied in deciding to stretch the literal words of the Dodd-Frank statute to avoid consequences it did not think Congress intended.

It is true that an individual who is not protected from retaliation under Dodd-Frank still enjoys the protections of SOX, but they are not as robust. Dodd-Frank provides a direct right of action in federal court, while SOX complainants must exhaust administrative remedies first. Dodd-Frank has a much more generous statute of limitations, allowing suit within 6 years of the violation, while SOX administrative complaints must be filed within 180 days. Dodd-Frank provides that the potential relief includes reinstatement, double back pay with interest, and attorneys' fees and costs, while SOX does not provide for double back pay.

How Will This Be Resolved?

The Sixth Circuit heard argument in *Verble v. Morgan Stanley* on Sept. 14 of this year, and the Ninth Circuit will hear argument in *Somers v. Digital Realty Trust* on Nov.16. Decisions in these two circuits will inevitably deepen the already existing circuit split between the Second and Fifth Circuits. Given the significant procedural and remedial benefits of pursuing a claim under Dodd-Frank, the dispute over the breadth of the whistleblower protections is not likely to abate any time soon.