Client Update
Supreme Court Clarifies Scope of Dodd-Frank's Whistleblower Protections

The U.S. Supreme Court ruled on February 21, 2018 that the Dodd-Frank Act's anti-retaliation provision only protects individuals who report a violation of the federal securities laws to the U.S. Securities and Exchange Commission (the "SEC").[1] In so holding, the Court expressly rejected the SEC's interpretation of the statute, which extended anti-retaliation protection to an individual who reported alleged wrongdoing internally to his or her employer, even if the person did not report to the SEC. The decision resolves a circuit split regarding the reach of the anti-retaliation provision[2] and provides much needed clarity for companies regarding the provision's scope. At the same time, the decision makes it more likely that whistleblowers concerned about retaliation will report to the SEC at the same time they raise concerns internally or without going through internal channels at all.

BACKGROUND

As discussed in a prior Client Alert regarding the Ninth Circuit's decision, which the Supreme Court's decision reversed, this case arises from two provisions of the statute that address anti-retaliation protection for "whistleblowers." First, Dodd-Frank Section 21F(a)(6) defines a "whistleblower" as "any individual who provides . . . information relating to a violation of the securities laws *to the Commission*" (emphasis added). Second, Section 21F(h)(1)(A)'s anti-retaliation provision prohibits retaliation against a "whistleblower" "because of any lawful act done" in three scenarios: (i) "providing information to the Commission;" (ii) "assisting in any investigation . . . or action of the Commission;" and (iii) "making disclosures that are required or protected" by Sarbanes-Oxley and the Securities Exchange Act of 1934.[3] With regard to the third

[1] *Digital Realty Trust, Inc. v. Somers*, No. 16-1276, slip op. (Feb. 21, 2018) ("Supreme Court's Decision").

[2] *Compare Somers v. Digital Realty Trust Inc.*, 850 F.3d 1045 (9th Cir. 2017) (internal whistleblowing protected) and *Berman v. NEO@OGILVY LLC*, 801 F.3d 145 (2d Cir. 2013), with *Asadi v. G.E. Energy (USA), L.L.C.* 720 F.3d 620 (5th Cir. 2013) (only reporting to SEC protected).

[3] 15 U.S.C. § 78u-6(h)(1)(A).

scenario, Sarbanes-Oxley protects from retaliation employees who report federal securities law violations to "a person with supervisory authority over the employee."[4]

When the SEC issued rules implementing Dodd-Frank's whistleblower provisions in 2011, it sought to resolve what it saw as a tension between the Act's definitional and anti-retaliation sections (*i.e.*, whether a whistleblower who reports wrongdoing under Sarbanes-Oxley to a supervisor, but not also to the SEC, is a protected "whistleblower" under Dodd-Frank). The SEC's rule adopted a broad definition of "whistleblower" for purposes of the anti-retaliation section and specifically included within the definition employees who only report internally under Sarbanes-Oxley.[5]

In *Digital Realty*, a former employee reported alleged federal securities law violations to the company's senior management and was terminated shortly thereafter. Although the employee did not report the alleged violations to the SEC before he was terminated, he sued the company, alleging that the company violated Dodd-Frank's anti-retaliation provisions when it terminated him.[6] The company moved to dismiss, arguing that the employee did not meet the definition of "whistleblower" under Dodd-Frank. The district court denied the motion and deferred to the SEC's rule, which construed anti-retaliation provisions more broadly. On interlocutory appeal, the Ninth Circuit agreed with the district court, finding that requiring whistleblowers to report wrongdoing to the SEC would narrow the anti-retaliation provision of Dodd-Frank "to the point of absurdity."[7]

THE SUPREME COURT'S DECISION

The issue before the Supreme Court was whether the "anti-retaliation provision of Dodd-Frank extend[s] to an individual who has not reported a violation of the securities laws to the SEC and therefore falls outside the Act's definition of 'whistleblower.'"[8] Justice Ginsburg, writing for the Court, concluded that unless a person reports the alleged violation to the SEC before the company terminates or otherwise retaliates against him or her, Dodd-Frank's anti-retaliation provision does not apply.

The Court held that the "explicit definition" in Dodd-Frank articulates the full scope of individuals eligible for protection (*i.e.*, those who provide pertinent information to the SEC),

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[4] 18 U.S.C. § 1514A(a).

[5] *See* Exchange Act Rule 21F-2, 17 C.F.R. § 240.21F-2.

[6] The employee was ineligible for relief under Sarbanes-Oxley because he failed to file an administrative complaint within 180 days of his termination. Supreme Court's Decision, at 8.

[7] *Somers*, 850 F.3d at 1049.

[8] Supreme Court's Decision, at 2.

while the anti-retaliation section describes what conduct by such persons is protected (*i.e.*, the three scenarios described above). Only the "individual who meets both measures may invoke Dodd-Frank's protections."[9] The Court emphasized that, "[c]ourts are not at liberty to dispense with the condition—tell the SEC—Congress imposed."[10] Because "Congress has directly spoken to the precise question at issue," the Court refused to give the SEC's rule deference under *Chevron*.[11]

The Court found further support in the legislative record, noted that the "core objective" of the Dodd-Frank whistleblower provisions is "to motivate people who know of security law violations to *tell the SEC*."[12] By contrast, the Sarbanes-Oxley whistleblower regime was designed with a "more far-reaching objective," *i.e.*, to "disturb the corporate code of silence" and encourage internal whistleblowing.[13]

The Court rejected arguments that its reliance on the plain meaning of the statutory definition would gut much of the protections afforded by Dodd-Frank's anti-retaliation provision. While acknowledging that its decision would protect fewer individuals, the Court noted that the provision would still protect a whistleblower who reports misconduct both to the SEC and his or her employer, and would make recovery easier for the individual because he or she would not need to demonstrate whether retaliation was a result of the SEC disclosure or the internal report.[14]

KEY TAKEAWAYS AND RISK MITIGATION STRATEGIES

The Supreme Court's ruling is likely to have several effects, some of which were acknowledged by the Court.

- Fewer individuals will receive anti-retaliation protection under Dodd-Frank because those who report only internally will not be protected.

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[9] *Id.* at 10-11.

[10] *Id.*

[11] *Id.* at 18-19.

[12] *Id.* at 11 (citing to S. Rep. No. 111-176, at 38). The two concurring opinions reflect a split between the justices on the appropriateness of looking at legislative history when interpreting statutes. Justice Thomas, who concurred in part and concurred in the judgment, and was joined by Justices Alito and Gorsuch, dismissed the need to go beyond the text when a statute's meaning was clear and specifically questioned the reliability of committee reports, cited by the majority, as an indicator of congressional intent. Justice Sotomayor, joined by Justice Breyer, concurred separately "to note [her] disagreement with the suggestion . . . that a Senate Report is not an appropriate source for this Court to consider when interpreting a statute."

[13] *Id.* at 12 (internal quotation omitted).

[14] *Id.* at 14.

- Because there will be no retroactive anti-retaliation protection for the period before the whistleblower reported to the SEC, individuals who report internally but do not report to the SEC until after the company takes retaliatory action will not be protected.
- This absence of retroactive protection seems likely to alter the timing of internal and SEC reporting by whistleblowers. Although whistleblowers are still financially incentivized to participate in internal compliance systems to receive a higher whistleblower reward and to take advantage of information the company may provide after the internal reporting,[15] they will also be incentivized to report alleged wrongdoing concurrently to the SEC to receive anti-retaliation protection.
- It is uncertain whether this decision will lead to more SEC reports and potentially more SEC investigations or whether only the timing and sequence of reporting will be affected. In either case, however, the Court's decision is likely to decrease frivolous retaliation suits that have nothing to do with securities law violations, which as the majority pointed out, might have been permitted under the broad reading initially adopted by the SEC, since reporting to the SEC is now necessary to take advantage of retaliation protections.

Although the Court's ruling eliminates the ability of individuals who report only internally to bring retaliation actions under Dodd-Frank's anti-retaliation provisions, internal whistleblowers still have certain protections under Sarbanes-Oxley.[16] In addition, companies should keep in mind that the SEC has brought—and will continue to bring—actions against companies for retaliation, as well as for actions that interfere with whistleblower activity, as we have noted in previous client updates.[17] Nothing in this ruling is likely to change the SEC's resolve with regard to those issues. Accordingly, companies should:

- Review internal policies, practices, agreements, and training programs to ensure that employees are encouraged to report suspected misconduct promptly and without fear of retaliation;

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[15] *See* Exchange Act Rule 21F-6, 17 C.F.R. § 240.21F-6 (listing as a factor that may increase an award whether the individual reported internally before, or at the same time, as any report to the SEC); *id. at* § 240.21F-4(c)(3) (giving a whistleblower credit for information uncovered as part of internal audit or investigation that arose from whistleblower information).

[16] Such protections differ from those under Dodd-Frank. For example, whistleblowers under Sarbanes-Oxley must first exhaust administrative remedies before filing in federal court, must file within 180 days, and are limited in any recovery to actual backpay with interest. *See* 18 U.S.C. § 1514A(b)-(c).

[17] *See* Debevoise & Plimpton LLP, Client Update: SEC Brings Two Enforcement Actions Against Employers for Taking Steps to Impede Whistleblower Activity (Jan. 20, 2017), *available at* http://www.debevoise.com/insights/publications/2017/01/sec-brings-two-enforcement-actions. *See also* Debevoise & Plimpton LLP, Client Update: SEC Exams Focus on Whistleblower Compliance by Investment Advisers and Brokers (Oct. 26, 2016), *available at* http://www.debevoise.com/insights/publications/2016/10/sec-exams-focus-on-whistleblower-compliance.

- Train managers on anti-retaliation measures and implement procedures requiring the company's legal or compliance department to be involved in any disciplinary action against an employee who is or might be considered a whistleblower;
- Investigate internal reports about potential federal securities law violations in a timely and thorough manner; and
- Maintain open communication lines with employees who report potential misconduct and share the final investigative results with those employees, as appropriate.

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