CLEARY GOTTLIEB

ALERT MEMORANDUM

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

February 23, 2018

On Wednesday, the Supreme Court resolved a question that had created significant uncertainty concerning the scope of the anti-retaliation protections provided by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

In *Digital Realty Trust, Inc. v. Somers*, the U.S. Supreme Court unanimously rejected the expansive interpretation of Dodd-Frank's anti-retaliatory protections established by relevant Securities and Exchange Commission ("SEC") regulations and previously accepted by the Second and Ninth Circuits. In so doing, the Court held that employees who report potential securities law violations internally but *not* to the SEC fall outside the definition of a "whistleblower" under Dodd-Frank and accordingly do not benefit from its anti-retaliation protections. Instead, the Court held that the plain text and purpose of Dodd-Frank make clear that its anti-retaliatory protections – and not just Dodd-Frank's whistleblower bounty incentives – apply only to whistleblowers who report securities law violations *to the SEC*.

The decision provides an additional incentive for whistleblowers to report to the SEC, and limits some remedies that might otherwise be available to whistleblowers who face retaliation. However, the decision should not generally cause companies to change their whistleblower policies and practices.

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The SEC's Expansive Interpretation of Dodd-Frank's Whistleblower Protections

Enacted in 2010 in response to the financial crisis, Dodd-Frank included various provisions to incentivize and protect whistleblowers, including a program permitting the SEC to award bounties to individuals whose reports lead to successful enforcement action. The statute also provides strong prohibitions against employer retaliation against whistleblowers, and those protections are backed up by a robust private right of action for employees who have been the subject of retaliation, including:

- An entitlement to reinstatement at the same level of seniority,
- Twice the back pay otherwise owed, with interest,
- Litigation expenses and attorneys' fees, and
- A generous 6-year limitations period within which to bring a claim.

Dodd-Frank defines a "whistleblower" for purposes of that act as "any individual who provides . . . information relating to a violation of the securities laws to the [SEC]."[1] It is therefore clear that only a person who makes a report to the SEC itself is a "whistleblower." Regulations adopted by the SEC, however, were not as clear with respect to the application of the anti-retaliation protections. Rather, they provided that "[f]or purposes of the anti-retaliation protections … you are a whistleblower if you provide that information in a manner described in Section 21F(h)(1)(A) of the Exchange Act."[2]

Notably, the requirement that a "whistleblower" provide information "in a manner described in Section 21F(h)(1)(A) of the Exchange Act" in order to benefit from the anti-retaliation protections referred not to the whistleblower definition in Dodd-Frank itself, but rather to an *earlier* definition of whistleblowing established as part of the Sarbanes-Oxley Act in 2002. Sarbanes-Oxley, a statute adopted in response to a series of corporate fraud and accounting scandals, defines a "whistleblower" more broadly than Dodd-Frank to include employees who report internally only. While Sarbanes-Oxley contains its own anti-retaliation protections for whistleblowers, as defined therein, the remedies available are somewhat more limited than those under Dodd-Frank – including, importantly, a requirement that retaliation claims be brought through administrative proceedings within 180 days of the alleged adverse employment action.

The effect of the SEC's regulatory interpretation of Dodd-Frank, however, was to establish two different definitions of a "whistleblower" under the statute: only someone who reported to the SEC was defined as a whistleblower entitled to participate in the bounty program, but an employee who reported a potential securities law violation internally only – and who therefore did not come within the definition of a "whistleblower" under Dodd-Frank[3] – could *nonetheless* benefit from the anti-retaliation protections of the statute by satisfying the definition of a whistleblower under Sarbanes-Oxley (and could do so even if, for example, the remedies available under that statute were no longer available).

Prior to *Digital Realty Trust*, the circuit courts were divided in their view of the SEC's regulation. The Fifth Circuit reasoned in a 2013 opinion that Dodd-Frank's "whistleblower" definition "expressly and unambiguously requires that an individual provide information to the SEC to qualify as a 'whistleblower' for purposes of" the anti-retaliation provisions.[4] The Second and Ninth circuits disagreed, however, largely on the basis of the legislative history of Dodd-Frank and the effect that narrowly reading its anti-retaliation provision would have in significantly limiting the protections available to those who report violations of the securities laws internally – including those, like lawyers or auditors who are required to first report internally.[5]

[1] 15 U.S.C. § 78u-6(a)(6).

[2] 17 C.F.R. § 240.21F-2.

[3] 17 C.F.R. § 240.21F-2(a).

[4] *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013).

[5] *Somers v. Digital Reality Trust, Inc.*, 850 F.3d 1045 (9th Cir. 2017); *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015).

The Supreme Court's Decision

In *Digital Realty Trust*, the Supreme Court held that the plain language of Dodd-Frank's whistleblower definition controlled – accordingly, in order to trigger the anti-retaliation provisions of the statute, a "whistleblower" must report his or her concerns to the SEC.

The case involved a claim of whistleblower retaliation by a former Vice President of Digital Realty Trust who alleged that his employment was terminated shortly after he reported to senior management suspected securities law violations by the company. He did not file an administrative complaint within 180 days of his termination, and therefore did not fall within the scope of the whistleblower protections under Sarbanes-Oxley. Instead, even though he did not report his concerns to the SEC, he filed a claim under Dodd-Frank in the United States District Court for the Northern District of California.

The district court declined to grant Digital Realty Trust's motion to dismiss, reasoning that the SEC's rule implementing Dodd-Frank's anti-retaliation provision does not necessitate reporting to the SEC, giving the SEC's interpretation deference under *Chevron U. S. A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837 (1984),[6] on the basis that the statutory language was ambiguous. The Ninth Circuit affirmed on interlocutory appeal.

The Supreme Court reversed, in a unanimous decision authored by Justice Ginsburg. The Court determined that Dodd-Frank's "whistleblower" definition is *unambiguous*, and expressly reaches only those who provide information to the SEC. The Court rejected the argument that the two-part structure of the "whistleblower" definition in Dodd-Frank – first describing *who* is eligible for protection (a whistleblower who provides pertinent information *to the SEC*)[7] and then what *conduct* is shielded from discrimination (which goes beyond reporting to the SEC)[8] – creates an ambiguity, because an individual must meet *both* elements before invoking Dodd-Frank's protections. The Court also noted that its interpretation was consistent with Dodd-Frank's purpose "to motivate people who know of securities law violations to *tell the SEC*."[9]

Although the Court thus resolved the question of whether Dodd-Frank's anti-retaliatory provisions apply to individuals who do not report to the SEC (they do not), the Court's opinion goes on to respond to several additional arguments raised by the employee and Solicitor General, and in doing so provided further clarification on the scope of these provisions.

- *First*, the Court observed that its holding protects a whistleblower who reports misconduct *both* to the SEC and internally (or to another entity), even against retaliation resulting from the *non*-SEC disclosure. In other words, if an employee reports misconduct both internally and to the SEC, and then suffers an adverse employment action[10] for reporting misconduct internally, the employer can be held liable under Dodd-Frank's anti-retaliatory provisions *regardless of whether it was aware of the employee's reporting to the SEC.*
- *Second*, the Court dismissed concerns that its interpretation of Dodd-Frank will strip statutory protections for auditors, attorneys, and other employees who are subject to "up-the-ladder" internal-reporting requirements under Sarbanes-Oxley. The Court noted that these whistleblowers are entitled to Dodd-Frank's protections "as soon as they also provide relevant information to the [SEC]."[11] Although the Court acknowledged that

[6] Some had expected this case to turn on an interpretation of the *Chevron* doctrine concerning deference to administrative agency interpretations of statutes in this case. By finding Dodd-Frank's statutory language unambiguous, the Court avoided the need to consider the scope of *Chevron* deference.

[7] 15 U.S.C. § 78u-6(a)(6).

[8] *Id.* § 78u-6(h)(1)(A)(i)-(iii).

[9] *Digital Realty Trust*, slip op. at 11 (citing S. Rep. No. 111 – 176 at 38).

[10] *See*. §78u – 6(h) of Dodd-Frank (prohibiting employers from discharging, harassing, or otherwise discriminating against an employee).

[11] *Digital Realty Trust*, slip op. at 15.

those who are required to report "up the ladder" may face rapid retaliation *before* being able to report to the SEC, it stated that Congress may have determined that these sophisticated actors were already adequately protected by Sarbanes-Oxley.

- *Third*, the Court acknowledged that, under its interpretation of Dodd-Frank and the current SEC rules, an employer would not be precluded by Dodd-Frank from retaliating against an employee for testifying to the SEC if that employee had not previously reported to the SEC online or through the specific written form (*i.e.*, the methods currently prescribed by SEC Rule 21F-9 for a whistleblower to provide information to the SEC). The Court noted, however, that any such incongruity could be remedied by the SEC pursuant to its delegated rulemaking authority.

Implications of the Decision

The Supreme Court's decision in *Digital Realty Trust* does not change how companies generally should respond to whistleblowers – whether or not the employer believes there has been a report to the SEC. Those who report concerns with respect to potential securities law violations should be treated as whistleblowers and protected from retaliation in all cases. This is important for a variety of reasons, including that:

- A company can never be sure that an *employee* has *not* made a report to the SEC. Employees have an incentive to do so under Dodd-Frank's bounty program. Accordingly, while the employer may believe that a whistleblower has reported only internally, it may be subject to a claim under Dodd-Frank on the basis that the employee – having disclosed his or her concerns confidentially to the SEC – actually does fall within the statutory definition of a whistleblower. This is true even if the report to the SEC comes later in time – and potentially even after the retaliation has already begun.
- Companies have an incentive to take seriously whistleblower allegations that may point to violations of the securities laws that, if not remediated, may result in even more significant potential liability. Accordingly, employers are well advised to view whistleblowers in a manner that will not give rise to a retaliation claim – *particularly* those who raise their concerns first internally in an effort to help the company address potential issues in the first instance.
- Even those who do not qualify as whistleblowers under Dodd-Frank may still have claims under Sarbanes-Oxley, and even those who do not qualify as whistleblowers under either statute may have claims against their employers arising from retaliation under other legal theories grounded under state law.

At the same time, the decision may well change the behavior of whistleblowers – particularly those who have retained counsel or are otherwise sophisticated enough to appreciate its implications. In particular, in order to enjoy statutory protection against retaliation under the securities laws, an employee must now either (a) file an administrative claim within 180 days of the retaliation to trigger the anti-retaliation protections under Sarbanes-Oxley, or (b) make a report of the underlying alleged violations to the SEC. As a result, employees who believe they have been *or are likely to be* subject to retaliation would generally be incentivized – and potentially well-advised – to promptly report their concerns to the SEC as doing so will trigger the protections under Dodd-Frank's anti-retaliation provision and afford them a lengthy six-year period within which to file a retaliation claim. One might reasonably expect, therefore, that *Digital Realty Trust* will trigger an increase in the frequency of reporting of potential violations to the SEC, particularly among senior, sophisticated potential whistleblowers.[12]

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[12] Cleary Gottlieb associates Mark McDonald and Jack Allen contributed to this Alert Memorandum.