THE CORPORATE COUNSELOR

OCTOBER 2017

Internal Whistleblowers:
SCOTUS Review of Dodd-Frank to Change the Landscape

By Matthew B. Schiff and Kathryn C. Nadro

On June 26, 2017, the Supreme Court granted *certiorari* in *Digital Realty Trust Inc. v. Somers*, 16-1276, to review a Ninth Circuit decision regarding Securities and Exchange Commission (SEC) whistleblowing protections. The Court's ruling is highly anticipated, as it will clarify the landscape for whistleblower protections.

Somers was VP of Digital Realty. He was terminated from his position after reporting internally certain alleged eliminations of internal corporate controls in violation of the Sarbanes-Oxley Act (SOX). Somers sued under the anti-retaliation provision of SOX, alleging that he was "fired for making internal complaints protected under the Sarbanes-Oxley Act." Somers did not report this alleged misconduct to the SEC. *See* http://bit.ly/2xiLJGW.

Case History

Somers brought suit under Section 922 of the Dodd-Frank Act, 15 U.S.C. § 78u-6(h) (which amended Section 21F of the Securities Exchange Act of 1934). Digital Realty moved to dismiss the Dodd-Frank claim due to Somers's failure to report the alleged violations to the SEC, thus depriving him of protection as a "whistleblower" as defined in the Act. The district court for the Northern District of California denied the motion, finding that the SEC's broad interpretation of "whistleblower" is entitled to *Chevron* deference, allowing internal whistleblowers protections under Dodd-Frank. The U.S. Court of Appeals for the Ninth Circuit affirmed.

In 2011, the SEC issued a rule stating that the Dodd-Frank whistleblower protection extends to individuals who disclose potential securities law violations internally to their employers, in addition to those who report directly to the SEC. 17 C.F.R. § 240.21F-2. In 2015 the SEC stated that this interpretation strengthened "investor-protection and law-enforcement benefits that can result from internal reporting." 80 Fed. Reg. 47,829 (Aug. 4, 2015).

Both the Ninth and U.S. Court of Appeals for the Second Circuit have deferred to the SEC's interpretation of Dodd-Frank, while the U.S. Court of Appeals for the Fifth Circuit interpreted the anti-retaliation provision more narrowly. The Fifth Circuit in 2013 held in *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013) that Dodd-Frank's use of the word "whistleblower" in the anti-retaliation provision applied only to those whistleblowers that directly report misconduct to the SEC. The Second Circuit, by contrast, found the provision ambiguous and applied *Chevron* deference to the SEC's reasonable interpretation of the provision, which included all those who made disclosures of suspected violations, regardless of whether the disclosures are made internally or to the SEC. The Ninth Circuit in *Somers* followed the Second Circuit's interpretation and affirmed the district court's denial of Digital Realty's motion to dismiss.

The Issue Before SCOTUS

Digital Realty petitioned for *certiorari* to the Supreme Court, arguing the anti-retaliation provision for "whistleblowers" in Dodd-Frank does not extend to protection to individuals who have not

reported alleged misconduct to the SEC, and thus falls outside the Act's definition of "whistleblower." Digital Realty argued in its petition that the Ninth Circuit had upset the balance between SOX and the Dodd-Frank Act, effectively rendering the SOX anti-retaliation scheme "obsolete" due to the stronger protections available to whistleblowers under Dodd-Frank.

For his part, Somers argued SOX was intended to encourage internal reporting, and the Fifth Circuit's narrow interpretation of "whistleblowers" would "render entirely insignificant a critical anti-retaliation safeguard, and do so in a way that would upset the proper operation of both Dodd-Frank and Sarbanes-Oxley." *See* http://bit.ly/2jnIatU.

The Dodd-Frank Act protects "whistleblower[s]" from retaliation for " providing information to the Commission in accordance" with the anti-retaliation provision, or "making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 … and any other law, rule, or regulation subject to the jurisdiction of the Commission." 15 U.S.C. § 78u-6(h)(1)(A). The Dodd-Frank definition of "whistleblower" for the anti-retaliation provision is "any individual who provides … information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission." *Id*. at § 78u-6(a)(6). Digital Realty argues that this conflicting definition deprives internal whistleblowers of Dodd-Frank protection, and the SEC's interpretation of this provision is contrary to the statute's language.

Conclusion

The Supreme Court will likely hand down its ruling next year. Such a ruling on the definition of whistleblower will affect the viability of the whistleblower protections provided by SOX. Dodd-Frank offers more extensive protections for whistleblowers than SOX, with Dodd-Frank providing for at least six years and up to 10 to bring a suit, compared with 180 days under SOX.

Under SOX, there is also a requirement to exhaust administrative remedies. Finally, Dodd-Frank allows plaintiffs to sue for double back pay. Any ruling by the Supreme Court that only external whistleblowers qualify for Dodd-Frank protections may push more employees to report to the SEC rather than using internal corporate programs to report wrongdoing.

Court watchers have pointed out that Justice Gorsuch's appointment may impact the outcome of this case, given his well-known disdain for *Chevron* deference. Should Justice Gorsuch's narrow reading of deference to agency interpretation prevail at the Supreme Court, internal whistleblowers may decide that reporting to the SEC is the only safe route to protect them from employer retaliation. If that occurs, employers may find internal procedures for early detection of violations are underutilized in favor of SEC investigations.

*****

Matthew B. Schiff is a partner and **Kathryn C. Nadro** is an associate at Sugar Felsenthal Grais & Hammer LLP. Schiff leads the firm's labor and employment group. They can be reached at mschiff@sugarfgh.com, and knadro@sfgh.com, respectively.