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Ninth Circuit Widens Circuit Split on Whether Dodd-Frank Protects Internal Whistleblowing

Introduction

On March 8, 2017, in *Somers v. Digital Realty Trust Inc.*, No.15-cv-17352 (9th Cir., March 8, 2017), the Ninth Circuit Court of Appeals affirmed the district court's denial of the defendant's motion to dismiss a whistleblower claim brought under the Dodd-Frank Act's ("DFA")'s anti-retaliation provision.

In a 2-1 decision, the majority endorsed the approach of the Second Circuit, and not that of the Fifth Circuit, in holding that Congress did not intend to limit DFA whistleblower protections to only those who disclose information to the Securities and Exchange Commission ("SEC"). Rather, the court held that the DFA anti-retaliation provision also protects those who are fired after making internal disclosures of allegedly unlawful activity under the Sarbanes-Oxley Act ("SOX") and other securities laws, rules, and regulations.

The majority also agreed with the Second Circuit that, to the extent there was any ambiguity in the statute, an SEC regulation, 17 C.F.R. § 240.21F-2 (Rule 21F-2) interpreting the DFA to protect those who made only internal disclosures resolved any such ambiguity and was entitled to *Chevron* deference.

Background

As the decision discusses in detail, the appeal presented an issue of securities law that has divided the federal district and circuit courts. "It results from a last-minute addition to the anti-retaliation protections of the [DFA] to extend protection to those who make disclosures under the Sarbanes-Oxley Act and other laws rules, and regulations." *Somers*, No.15-cv-17352, *3.

The issue presently dividing courts is whether Congress intended to limit DFA protections only to individuals who disclose information to the SEC, as provided for in the DFA's formal definition of "whistleblower", or whether the law also covers those who are fired after making internal disclosures of alleged unlawful activity, such as the fact pattern presented in *Somers*.

In tension with the statute's definition of "whistleblower" (15 U.S.C. § 78u-6(a)(6)) is the statute's anti-retaliation provision at 15 U.S.C. § 6(h)(1)(A)(iii), which prohibits retaliation against individuals who make disclosures that are required or protected under SOX, as Section 806 of SOX protects employees who report internally.

Facts and Procedural History

Plaintiff-Appellee, Somers was employed as a Vice President by Defendant-Appellant, Digital Realty Trust, Inc. ("Digital Realty"), from 2010 to 2014. Somers alleged in his complaint that he made several reports to senior management regarding possible securities law violations by the company, soon after which the company fired him. Somers did not report his concerns to the SEC before Digital Realty terminated his employment.

Somers subsequently sued Digital Realty, alleging violations of various state and federal laws, including Section 21F of the Exchange Act. That section, entitled "Securities Whistleblower Incentives and Protection," includes the anti-retaliation provisions created by DFA. Digital Realty sought to dismiss the DFA claim on the grounds that Somers only reported the possible violations internally and not to the SEC and, therefore, he was not a "whistleblower" entitled to DFA's protections.

The district court denied Digital Realty's motion to dismiss the DFA claim, but certified the issue for interlocutory appeal. *See Somers v. Dig. Realty Tr. Inc.*, 119 F. Supp. 3d 1088, 1100-05 (N.D. Cal. 2015).

The Ninth Circuit's Analysis

The Ninth Circuit began its analysis by reviewing the history behind Congress' enactment of SOX in 2002 following a major financial scandal, and noting its purpose was "to safeguard investors in public companies and restore trust in the financial markets following the collapse of Enron Corporation." *Somers*, No.15-cv-17352, *6 (citation omitted). It further noted that, "[l]ike Sarbanes-Oxley, DFA was passed in the wake of a financial scandal – the subprime mortgage bubble and subsequent market collapse of 2008." *Id.* at 7.

While acknowledging that Subdivision (iii) of DFA's anti-retaliation provision was added after the bill went through Committee and that there was no legislative history explaining its purpose, the divided panel held that the DFA's broad incorporation of SOX's disclosure requirements and protections "necessarily bars retaliation against an employee of a public company who reports violations to the boss, i.e., one who 'provide[s] information' regarding a securities law violation to 'a person with supervisory authority over the employee.'" *Id.* at 8.

In supporting its decision, the Ninth Circuit also emphasized that certain provisions of SOX and the Exchange Act mandate internal reporting before external reporting, and reasoned that "[l]eaving employees without protection for that required preliminary step would result in early retaliation before the information could reach the regulators." *Id.* at *8-9. In so doing, the court specifically agreed with the Second Circuit which had noted, "[i]f subdivision (iii) requires reporting to the [SEC], its express cross-reference to the provisions of Sarbanes-Oxley would afford an auditor almost no Dodd-Frank protection for retaliation because the auditor must await a company response to internal reporting before reporting to the Commission, and any retaliation would almost always precede Commission reporting." *Berman v. Neo@Ogilvy LLC*, 801 F.3d. 145, 151 (2d Cir. 2015).

Similarly, the court also noted that SOX requires lawyers to report internally and that there are limited instances in which an attorney may reveal client confidences to the SEC, thus reasoning that a more restrictive interpretation of the statute would leave attorneys with little DFA protection. *Somers*, No.15-cv-17352, *9.

In seeking to reconcile the express definition of "whistleblower" in the statute with its holding, the court cited to *King v. Burwell*, 135 S.Ct. 2480, 2489 (2015), a Supreme Court decision interpreting provisions of the Patient Protection and Affordable Care Act ("ACA") which held that terms can have different operative consequences in different contexts.

The Ninth Circuit also rejected the view of the Fifth Circuit set forth in the *Asadi v. GE Energy (USA)*, 720 F.3d. 620 (5th Cir. 2013) decision that if the DFA protected the same conduct that SOX did, then the SOX enforcement scheme would be rendered moot or superfluous, on the theory that no one would use it. The Fifth Circuit had highlighted that SOX lacks DFA's double damage provision, has a shorter statute of limitations, and has more extensive administrative requirements. But the *Somers* court found this reasoning unpersuasive stating that SOX may actually be more attractive than the DFA in some instances because it 1) provides for adjudication through administrative review which would likely be less costly and stressful for whistleblowers than having to file an action in federal court; and 2) that while the DFA provides awards for double back pay, SOX allows for the recovery of special damages, which courts have held to include damages for emotional distress. *Somers*, No.15-cv-17352, *11.

Finally, the Ninth Circuit articulated its agreement with the Second Circuit that "even if the use of the word 'whistleblower' in the anti-retaliation provision creates uncertainty because of the earlier narrow definition of the term, the agency responsible for enforcing securities laws has resolved any ambiguity and its regulation is entitled to deference." *Id.* at *12 citing Rule 21F-2 (stating that anyone who does any of the things described in subdivisions (i), (ii), and (iii) of the anti-retaliation provision is entitled to protection, including those who make internal disclosures).

The Dissent

In a pithy one paragraph dissent, Judge John Owens took issue with the majority's reliance on the *King v. Burwell* decision, and the concept that terms in one part of a statute may mean a different thing in a different part of the statute. Invoking a pop culture reference, Judge Owens wrote "[i]n my view, we should quarantine *King* and its potentially dangerous shapeshifting nature to the specific facts of that case to avoid jurisprudential disruption on a cellular level. *Cf. John Carpenter's The Thing* (Universal Pictures 1982)."

Uncertainty Ahead

On Monday, March 20, 2017, the U.S. Supreme Court declined to review a decision from the Sixth Circuit which some had hoped might resolve this circuit split as to whether internal reporting is protected activity under DFA. *See Verble v. Morgan Stanley Smith Barney, LLC*, No. 16-946 (cert. denied, March 20, 2017). In that case, the district court had ruled that DFA's whistleblower protections only applied to those who reported to the SEC, but the Sixth Circuit did not consider the issue on appeal holding that the allegations were too vague to state a claim for relief. *See Verble v. Morgan Stanley Smith Barney, LLC*, Civil No. 15-6397; 2017 FED App. 0033n (6th Cir. 2017). The *Somers* decision, however, seems far more likely to receive Supreme Court review as the decision turned squarely on the issue of whether internal reporting was sufficient under the DFA.

Notably, the Third Circuit is also due to weigh in on the circuit split shortly. In that case, a former in-house attorney is seeking to revive his whistleblower suit in which he claims he was fired for issuing warnings via internal company reporting about the company's purported tax fraud.[1] The SEC, under the prior administration, filed an *amicus curiae* brief supporting the claim's revival while the company has argued that the case was rightly tossed due to plaintiff's failure to report his allegations to the SEC before the alleged retaliation.

While resolution of this circuit split by the Supreme Court seems almost inevitable, at this point there is uncertainty as to how the Court would rule. Adding to this uncertainty is the fate of Judge Gorsuch's nomination to the Court. Notably, Judge Gorsuch's prior decisions have demonstrated concerns with the concept of *Chevron* deference. *See e.g.*, *Gutierrez-Brizuela v. Lynch*, No. 14-9585 (10th Cir. 2016); *Hwang v. Kansas State University*, 753 F.3d. 1159 (10th Cir. 2014). In his *Gutierrez-Brizuela* concurrence, Judge Gorsuch referred to *Chevron* as the "elephant in the room" and stated that "[m]aybe the time has come to face the behemoth." *Id.* at *15 (Gorsuch, J.) (concurring).

[1] *See Danon v. The Vanguard Group, Inc.*, Civil Action No. 15-6854 (E.D.P.A., May 23, 2016 (Jones, J.).

Further adding to the uncertainty around current whistleblowing laws are looming questions as to whether SOX and DFA will continue to exist in their current form, if at all. The new administration has rolled back certain Dodd-Frank regulations through executive order, and the statutes may be further amended or abolished through legislative process.

In the meantime, disputes about whether internal reporting constitutes protected activity under the DFA are likely to continue.

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