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Alert | Labor & Employment

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SCOTUS Rules Dodd-Frank Does Not Protect Internal Whistleblowing

On Feb. 21, 2018, the U.S. Supreme Court held that the anti-retaliation provision of the Dodd-Frank Act (DFA) protects only employees who complain to the Securities and Exchange Commission (SEC) and not those who make only internal complaints.

In a unanimous decision, the justices ruled in favor of Digital Realty Trust (Digital Realty), finding that employees who bring securities law complaints against their employers must first take their allegations to the SEC to be protected by the DFA anti-retaliation provisions.

The decision resolves a long-standing circuit split, discussed in a prior GT Alert, between the Fifth Circuit Court of Appeals which held internal reporting was not protected by the DFA, and the Second and Ninth Circuits which held that internal reporting was protected.

Statutory Background

The DFA's anti-retaliation provisions were enacted in 2010, eight years after passage of the Sarbanes-Oxley Act (SOX). The DFA establishes an incentive program for individuals who provide information to the SEC that results in successful enforcement actions. Section §78u-6(a)(6) of the DFA defines "whistleblower" as an individual who provides "information relating to a violation of the securities laws *to the Commission*."

In tension with the DFA's definition of "whistleblower" is the statute's anti-retaliation provision, § 78u-6(h)(1)(A)(iii), which prohibits retaliation against individuals who make certain disclosures, including those that are required or protected under SOX, which, in turn, requires and protects certain internal disclosures of accounting and other irregularities.

Facts and Procedural History

Somers was employed as a Vice President by 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 the 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, 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 (N.D. Cal. 2015). A divided panel of the Ninth Circuit Court of Appeals, analyzing the history behind Congress' enactment of SOX in 2002, affirmed the decision of the district court. 850 F. 3d 1045 (9th Cir. 2017).

The Supreme Court's Decision

At the Supreme Court, Somers and the Solicitor General argued that DFA's whistleblower definition applied only to the award program and not, as the statutory text suggests, to its anti-retaliation provisions. They urged the Court to construe the term "whistleblower" in its "ordinary sense" without an SEC reporting requirement. Doing otherwise, they warned, would i) vitiate the protections of those who make disclosures to persons and entities other than the SEC; ii) jettison protections for auditors, attorneys, and other employees who are required to report internally before making external disclosures; and iii) allow "identical misconduct" to "go punished or not based on the happenstance of a separate report to the SEC."

The Supreme Court, however, rejected these concerns holding that the statute's explicit definition must be followed, even if it varies from a term's ordinary meaning. The Court concluded that the statute's definition first describes *who* is eligible for protection -- namely a "whistleblower" -- one who provides pertinent information "to the Commission." Second, the DFA defines *what* is protected. Its anti-retaliation provisions protect a whistleblower from adverse action by an employer when the whistleblower engages in certain activities, including making disclosures required or protected under SOX. The Court held that both the *who* and the *what* must be satisfied. An individual who falls outside the protected category of "whistleblower" is ineligible for relief regardless of whether that individual engages in activities protected by the DFA's anti-retaliation provisions.

In sum, the Court held that Dodd-Frank's anti-retaliation provision does not extend to an individual, like Somers, who does not fall within the "whistleblower" definition because he has not reported a violation of the securities laws to the SEC.

The Court found that its decision was further corroborated by DFA's purpose and design. The "core objective" of DFA's whistleblower program is to aid the commission's enforcement efforts by "motivat[ing] people who know of securities law violations *to tell the SEC*."

Notably, the Court's decision is contrary to the view advanced by the SEC. In Rule 21-F-2, the SEC adopted the position that if an individual is engaged in activities protected by the DFA's anti-retaliation provisions, that individual is entitled to protection as a whistleblower, including those who make internal disclosures. The Court held that deference would not be afforded to the SEC because the statute's definition of whistleblower was unambiguous and "Congress has directly spoken to the precise question at issue."

Implications

The decision is welcome news to many employers and pro-business entities that argued a broader definition of "whistleblower" under the DFA was not only contrary to the plain terms of the statute, but would encourage dubious complaints and potentially open companies to litigation on multiple fronts.

Employers should be cautioned, however, that the decision may lead to more employees choosing to report externally to the SEC prior to reporting internally. Additionally, employees who report certain matters internally are still covered by SOX, and if they complain to the SEC as well, then such employees may be protected by both SOX and the DFA.

Employers should continue to review, implement, and actively monitor internal compliance and corporate governance programs that encourage employees to come forward with potential violations. Well-constructed supervisor training should explain in sufficient detail both the range of potential protected activity, as well as the range of what might be considered retaliatory adverse employment action. Employers may also wish to emphasize a commitment to compliance and ethical conduct, the company's reporting procedures, the company's process of addressing complaints, and the company's zero tolerance for retaliation in training materials.

GT attorneys are available to provide more information on the further legal implications of this critical Supreme Court decision, and to assist companies in implementing compliance programs, proactively training employees, and in responding to potential complaints.

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