

The Legal Intelligencer

Recent Supreme Court Decision Narrows Definition of Whistleblower

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Last week the U.S. Supreme Court significantly narrowed the definition of a “whistleblower” under Dodd-Frank. In *Digital Realty Trust v. Somers*, the court, ruled that for an employee to be deemed a whistleblower under Dodd-Frank, and thus be entitled to Dodd-Frank’s anti-retaliation safeguards, he must report the information relating to a violation of securities law to the Securities and Exchange Commission. Relying on the plain language of the statute and its legislative history, Justice Ruth Bader Ginsburg, held that an employee who merely reports potential securities law violations internally has not done enough to avail himself of the extensive Dodd-Frank anti-retaliation protections, including “the immediate access to federal court, a generous statute of limitations (at least six years), and the opportunity to recover double backpay.” The court’s opinion is interesting both for its rejection of deference to the SEC’s rulemaking, and the policy implications that will likely flow from mandating reporting to the SEC.

STATUTORY FRAMEWORK AND REGULATIONS

The Dodd-Frank Act was passed in 2010 in reaction to the financial crisis “to safeguard investors in public companies and restore trust in the financial markets ...” “Designed to incentivize employees to report possible corporate misconduct or fraud, it created a cash rewards program whereby whistleblowers would be entitled to “10 to 30 percent of the monetary sanctions collected” in an enforcement action based on their information. They also had a right to significant anti-retaliation protections. In part of the statute, Dodd-Frank defined a “whistleblower” as “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.”

Following Dodd-Frank’s enactment, the SEC promulgated rules defining a “whistleblower” for purposes of the cash rewards program and anti-retaliation protection. The initial SEC rule defined a whistleblower for purposes of gaining anti-retaliation protection as someone who “provides the commission with information ... relating to the possible violation of federal securities laws.” After a vigorous notice and comment period, however, the SEC changed course and used the following definition of “whistleblower” for purposes of the anti-retaliation provisions: “you are a whistleblower if ... you possess a reasonable belief that the information you are providing relates to a possible securities law violation” and you provide the information in a manner that does not necessitate communicating it to the SEC. In the final rule promulgated by the SEC, to invoke the anti-retaliation provisions, an employee whistleblower did not need to provide the information to the SEC.

THE OPINION

Digital Realty Trust is a real estate investment trust that acquires and develops data centers. Digital Realty Trust's Vice President Paul Somers alleged that he was terminated soon after he reported to senior management that he suspected violations of securities laws. Somers, however, did not report these suspected violations to the SEC, and in reviewing the district court's denial of Digital Realty's motion to dismiss, the court held that Somers' failure to report his suspicions to the SEC was fatal to Somers' attempt to invoke Dodd-Frank's anti-retaliation provisions.

Justice Ginsberg, writing for the majority, relied on the plain language of the statute and the legislative intent to reject the SEC's rule that did not mandate reporting to the SEC. First, Ginsberg found that Dodd-Frank "unequivocally" defines a whistleblower as "any individual who provides ... information relating to a violation of the securities laws to the commission." Merely reporting internally to management does not extend the anti-retaliation provisions to an employee seeking their protection. Because the "definition of 'whistleblower' is clear and conclusive," the court refused to "accord deference to the contrary view advanced by the SEC in its rule" promulgated under the statute.

In 2015, the SEC issued an interpretative rule stating that the statute was ambiguous as to what definition of whistleblower applied to both the incentive awards program and the anti-retaliation provisions of the statute. "To resolve this ambiguity," the SEC promulgated the two definitions of "whistleblower," one of which allows individuals to avail themselves of the anti-retaliation protections regardless of whether information is provided to the commission. Somers and the solicitor general made the same arguments before the court, arguing that the limited statutory definition of "whistleblower" requiring reporting to the SEC should only apply to the statute's award program and not to its anti-retaliation provisions.

The high court disagreed, holding that the statutory definition of "whistleblower" applies "throughout" the applicable portion of Dodd-Frank that refers to whistleblowers. As the court read it, the definitional portion of the statute laid out "who is eligible for protection—namely, a whistleblower who provides pertinent information to the Commission." Employees, therefore, cannot qualify as a whistleblower if they have not first "told the SEC."

Despite finding the plain language of the statute unambiguous, the majority opinion, in reaching its conclusion, also looked to Dodd-Frank's structure and legislative history to bolster its opinion, in particular the purpose of the bill which was "to motivate people who know of securities law violations to tell the SEC." Justice Sonia Sotomayor, joined by Justice Stephen Breyer, wrote separately to note that the analysis of legislative history was a "reliable source" to ensure that the court's definition was correct. Justice Clarence Thomas, joined by Justice Samuel Alito and Justice Neil Gorsuch, concurred in judgment but disagreed with the court's use of the bill's legislative history, stating that having first found that the plain language of the statute was unambiguous, the Court should not have even looked to the legislative history or intent.

THE POLICY IMPLICATIONS OF DIGITAL REALTY TRUST

At first blush, the win for Digital Realty Trust, a significant narrowing of who is a "whistleblower" under Dodd-Frank, looks like a major victory for employers—but this is probably not the case in the long run. While one might expect that narrowing the scope of whistleblower protections would result in fewer individuals being certified as whistleblowers, the fact is that the requirements to become a "whistleblower" are not onerous. As Justice Ginsberg noted multiple times in the opinion—whistleblowers need only "tell the SEC." It is likely that plaintiff-side employment attorneys will quickly account for this new definition of "whistleblower" and uniformly advise clients that they must report potential securities law violations to the SEC.

The other negative for companies is likely an uptick in SEC enforcement. Requiring “whistleblowers” to report securities law violations to the SEC will undoubtedly result in an increase in the number of SEC tips and a corresponding increase in the number of SEC investigations. In the wake of Digital Realty Trust, we also expect the SEC to make it easier to report possible securities law violations (maybe via internet submission).

The irony of this “win” is that during the regulation notice and comment period, the U.S. Chamber of Commerce and a number of large corporations argued that for a whistleblower to be eligible for an award under the statute, they should first avail themselves of the internal reporting opportunities of the company. The Chamber argued “effective compliance programs rely heavily on internal reporting ... because they permit companies to discover instances of potential wrongdoing, to investigate the underlying facts, and to take remedial actions, including voluntary disclosures to relevant authorities, as the circumstances may warrant.”

When employers receive an internal tip or complaint, they often have time to conduct an internal investigation or review before the SEC or some other state or federal regulator shows up. Forcing whistleblowers to report to the SEC, without first (or also) reporting such allegations to their employer, may leave companies unable to take remedial action, and flat-footed and unprepared should the SEC surface with a subpoena or an informal request for information. For publicly traded companies, lack of internal reporting may result in delayed corrective disclosures of material information and potentially increased liability from shareholder lawsuits. To combat this problem, companies should create programs that incentivize internal reporting through reporting hotlines or other measures.

Internal reporting hotlines are only as effective as an employee’s willingness to use them. Therefore, companies should ensure that they continue to reinforce and build a company culture of compliance, and assure employees that their tips are being investigated and identified problems are being rectified. Companies should also be aware that a culture of retaliation will also incentivize employees to go to the SEC and forgo internal reporting. A strong culture of compliance along with mechanisms to incentivize employees to report possible violations of securities laws internally will allow companies to continue to stay ahead of possible misconduct. That way, when the SEC comes knocking, the company is ready to respond.

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