

# COMPANIES SHOULD HANDLE EMPLOYMENT DECISIONS CONCERNING POTENTIAL WHISTLEBLOWERS WITH UTMOST CARE

27 February 2018 | New York  
Legal Briefings

---

On February 21, 2018, the US Supreme Court [decided](#) that the Dodd-Frank Act's whistleblower protections do not extend to an individual who has not reported a potential securities law violation to the SEC. The decision resolved a previous split among federal appellate courts and narrowed the protection afforded by the Dodd Frank Act's anti-retaliation provision. Because the decision requires reports to the SEC as a prerequisite to gaining the protection afforded under the law, it will likely encourage more direct reporting to the SEC.

- [The Dodd-Frank Act's whistleblower protection provisions](#)
- [The split among US appellate courts](#)
- [The Supreme Court decision](#)
- [Implications](#)

## **THE DODD-FRANK ACT'S WHISTLEBLOWER PROTECTION PROVISIONS**

In 2010, in the wake of the financial crisis, Congress passed comprehensive financial regulation reform legislation known as the Dodd-Frank Act (Pub.L. 111-203). Section 922 of the Dodd-Frank Act established both a bounty award program as well as anti-retaliation protection for whistleblowers who report securities law violations.

Pursuant to the mandate of Section 922, the US Securities and Exchange Commission ("SEC") established an Office of the Whistleblower, and implemented its final rules on the Dodd-Frank Program through a comprehensive rulemaking process that involved significant public input in May 2011.

One of the key issues widely discussed in the rulemaking process was the question of who qualifies as a "whistleblower." The statute defines "whistleblower" to mean "any individual who provides . . . information relating to a violation of the securities laws to the [SEC], in a manner established, by rule or regulation, by the [SEC]." The anti-retaliation provision in the legislation prohibits discharge, harass and other discriminating acts against a "whistleblower," while the award program incentivize certain qualifying "whistleblowers" with financial rewards. In particular, only whistleblowers who "voluntarily" provided "original information" to the SEC that led to certain successful enforcement actions would be eligible for an award.

While initially the SEC proposed rules that state the anti-retaliation provision should apply irrespective of whether a whistleblower is qualified for an award, it required that the whistleblowers provided information to the SEC about a potential violation of securities law. After the notice-and-comment period, the SEC broadened the "whistleblower" definition for the purposes of the anti-retaliation protections. In particular, the SEC included certain whistleblowers, such as employees of public companies, who report to persons or government authorities other than the SEC, thereby aligning the definition with that set forth in the anti-retaliation provision of the Sarbanes-Oxley Act. If a qualifying whistleblower faces retaliation, he or she can bring an action in federal court within a certain time period against his or her employer.

## **THE SPLIT AMONG US APPELLATE COURTS**

Since the implementation of the SEC whistleblower program, federal appellate courts have reached different conclusions as to whether the anti-retaliation provision of the Dodd-Frank Act, as the SEC framed it in its rule, affords protection to persons who do not report to the SEC.

In 2013, the Court of Appeals for the Fifth Circuit [rejected](#) SEC's regulations and found that the plain language of the statute mandates disclosure to the SEC for the anti-retaliation provision to apply. In 2015, the Court of Appeals for the Second Circuit [deferred](#) to the SEC's statutory interpretation, on the basis that the reference to the Sarbanes-Oxley Act (which protects not only whistleblowers who report to the SEC) in the language of the Dodd-Frank Act's anti-retaliation provision creates sufficient ambiguity to warrant a deference to the SEC as long as its regulation is a reasonable interpretation of the statute.

The Court of Appeals for the Ninth Circuit [sided](#) with the Second Circuit in 2017 in *Paul Somers v. Digital Realty Trust, Inc.* There, Somers claimed that he made several reports to senior management regarding possible securities law violations by the defendant, and was fired due to the company's retaliation. Somers sued the company under, among other things, the Dodd-Frank Act's anti-retaliation provision. The defendants sought dismissal of the claim on the ground that Somers never reported to the SEC, and the District Court denied the motion. The Ninth Circuit affirmed the District Court's decision, holding that the Dodd-Frank Act's anti-retaliation provision should also protect those who were fired after making internal disclosures of alleged unlawful activity under the Sarbanes-Oxley Act and other laws, rules, and regulations. In particular, it agreed with the Second Circuit that, even if the use of the word "whistleblower" in a last-minute addition to the anti-retaliation provision of the Dodd-Frank Act created uncertainty, an SEC regulation resolved any ambiguity, and was entitled to deference.

## **THE SUPREME COURT DECISION**

Digital Realty Trust appealed to the Supreme Court. On February 21, 2017, the Supreme Court issued its decision reversing the Ninth Circuit's decision.

Justice Ginsburg wrote the majority decision, in which she noted that the "explicit definition" of "whistleblowers" in the statute must be followed. As "Congress has directly spoken to the precise question at issue," the Court could not defer to the SEC's interpretation. The majority opinion observed that fundamentally the purpose of the Dodd-Frank Act's whistleblower provision is to encourage reporting to the SEC of potential securities law violations, so whistleblowers who only report internally should not be afforded the same level of protection.

The Court responded to arguments that it was defining whistleblower too narrowly by explaining that the plain reading of the statute means that a whistleblower who reports to both the SEC and another entity can be protected even if he suffers retaliation because of the non-SEC disclosure. Thus, for example, professionals such as auditors and attorneys who have obligations to make internal report first under the Sarbanes-Oxley Act would be protected once these professionals have reported to the SEC. The Court also noted that such professionals are separately protected by safeguards set forth in the Sarbanes-Oxley Act.

## **IMPLICATIONS**

The Supreme Court's decision resolves uncertainties as to the scope of the anti-retaliation provision. Even though the decision on its face appears to have a limiting effect, in practice potential whistleblowers might, as a result, be more likely to make external reports to the SEC. A company will therefore not always have the opportunity to conduct its own internal investigations before the SEC begins its investigation. We also expect that the SEC will amend its current whistleblower rules to provide an even broader range of means for whistleblower reporting. Consequently, companies should handle employment decisions concerning potential whistleblowers with utmost care.

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



**JOHN O'DONNELL**  
PARTNER, NEW YORK

+1 917 542 7809  
John.ODonnell@hsf.com



**SCOTT S. BALBER**  
MANAGING PARTNER,  
NEW YORK

+1 917 542 7810  
Scott.Balber@hsf.com

---

## LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2021

---

**SUBSCRIBE TO STAY UP-TO-DATE WITH INSIGHTS, LEGAL UPDATES, EVENTS, AND MORE**

Close

© HERBERT SMITH FREEHILLS LLP 2021