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What the Supreme Court's Whistleblower Decision Means for Companies

By limiting the availability of Dodd-Frank whistleblower anti-retaliation provisions, the Court's decision may incentivize increased SEC reporting.

In *Digital Realty Trust, Inc. v. Somers*,¹ the Supreme Court of the United States defined the class of individuals protected by the anti-retaliation provision contained in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The Court held that to constitute a protected "whistleblower" under Dodd-Frank, a person must first "provid[e] ... information relating to a violation of the securities laws" to the Securities and Exchange Commission (SEC, or the Commission).² Any company that retaliates against such a whistleblower is potentially subject to damages and injunctive relief.³

By incentivizing putative whistleblowers to report alleged misconduct directly to the SEC, the Court's decision may result in more SEC investigations before companies have had an opportunity to investigate internally. Because of the importance that the SEC places on its whistleblower program, companies should expect the SEC to continue to focus on investigations involving claims of retaliation, as well as continuing to focus on possible violations of Exchange Act Rule 21F-17.⁴

Statutory Whistleblower Protections

Both the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and Dodd-Frank protect putative whistleblowers from retaliation. Sarbanes-Oxley protects from retaliation all "employees" who report misconduct to a federal regulatory or law enforcement agency, including the SEC, Congress, or any "person with supervisory authority over the employee."⁵ By contrast, Dodd-Frank defines 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."⁶

Notwithstanding the statutory definition of whistleblower in Dodd-Frank, SEC regulations implementing Dodd-Frank's whistleblower anti-retaliation provisions do not require reporting to the SEC.⁷ The SEC regulations define whistleblower for purposes of Dodd-Frank's anti-retaliation protections to include persons who report internally, as long as they report to a supervisor or to a person working for the employer who has authority to investigate, discover, or terminate misconduct.⁸

The differences between the whistleblower protections in Sarbanes-Oxley and Dodd-Frank are significant because the statutes offer different paths to whistleblowers seeking redress for retaliation. Under Sarbanes-Oxley, whistleblowers cannot bring an action in federal district court unless they first exhaust their administrative remedies. Specifically, Sarbanes-Oxley requires an employee to file a complaint with the Department of Labor (DOL) within 180 days of the retaliation or learning of the retaliation.⁹ Only if the DOL fails to issue a final decision within 180 days after the whistleblower filed the administrative complaint may the whistleblower then file an action in federal district court alleging retaliation under Sarbanes-Oxley.¹⁰ On the other hand, Dodd-Frank permits whistleblowers to file complaints in federal court without first pursuing an administrative action.¹¹ Dodd-Frank also extends the statute of limitations, from Sarbanes-Oxley's 180 days, to a default limitation period of six years.¹²

Sarbanes-Oxley and Dodd-Frank also authorize different awards to prevailing whistleblowers. Under Sarbanes-Oxley, prevailing whistleblowers are entitled to reinstatement, back pay, and litigation fees and costs, as well as other special damages.¹³ Under Dodd-Frank, prevailing whistleblowers can obtain not only reinstatement and litigation fees and costs, but also double back pay.¹⁴

The Somers Action

Paul Somers, a former vice president for Digital Realty Investment Trust, Inc. (Digital Realty), filed suit in federal district court, asserting a claim of whistleblower retaliation under Dodd-Frank.¹⁵ Somers alleged that Digital Realty terminated his employment shortly after he reported suspected violations of securities laws to senior management.¹⁶ Somers did not report his suspicions about violations to the SEC, nor did he file an administrative complaint within 180 days of his termination.¹⁷

Digital Realty moved to dismiss Somers' claim, arguing that Dodd-Frank's whistleblower protections were not available to Somers because he had only reported internally, and had not provided any information to the SEC.¹⁸ The district court denied Digital Realty's motion, finding the statutory scheme ambiguous and according deference to the SEC's broad regulatory definition of whistleblower.¹⁹ A divided panel of the Court of Appeals for the Ninth Circuit affirmed the district court's decision on interlocutory appeal.²⁰ In doing so, the Ninth Circuit sided with the Second Circuit (which had likewise upheld the SEC's regulatory definition) and disagreed with the Fifth Circuit (which had held that Dodd-Frank only protects employees who first report to the SEC).²¹

Digital Realty sought review of the Ninth Circuit's decision in the Supreme Court, which granted certiorari to decide whether Dodd-Frank's anti-retaliation provisions extend to individuals who have not reported a violation of the federal securities laws to the SEC.

The Supreme Court's Decision

In a unanimous opinion with two concurrences, the Supreme Court agreed with Digital Realty and held that to sue under Dodd-Frank's whistleblower anti-retaliation provisions, a person must first "provide information relating to a violation of the securities laws" to the SEC.²² The Justices agreed that Dodd-Frank's statutory definition of whistleblower is unambiguous, and that the SEC's regulatory definition had impermissibly broadened the statute.²³ The Court explained that Dodd-Frank's statutory definition describes "who is eligible for protection" and advances Dodd-Frank's overarching purpose of encouraging employees to report suspected securities violations to the SEC.²⁴

Significance

By restricting who can qualify as a whistleblower to persons who first provide information relating to a violation of the securities laws to the SEC, the Supreme Court's decision in *Digital Realty* may incentivize employees to report suspected violations of securities laws directly to the SEC instead of internally.

Companies should not interfere with employees' efforts to report information to the Commission. However, companies frequently design and implement their internal reporting mechanisms, policies, and training to encourage internal reporting of compliance matters, including potential violations of federal securities laws. Such internal reporting mechanisms generally enable companies faced with internal allegations of compliance failures to investigate, respond, and remediate — and to assess whether self-reporting to the SEC is appropriate — without a simultaneous SEC investigation.

When the Commission interpreted Dodd-Frank's whistleblower anti-retaliation provisions not to require reporting to the SEC, it noted that "reporting through internal compliance procedures can complement or otherwise appreciably enhance [the Commission's] enforcement efforts" ²⁵ The SEC argued that its interpretation of Dodd-Frank's whistleblower anti-retaliation provisions to cover those who only report internally would help companies, by discouraging employees from bypassing internal mechanisms and taking their reports directly to the Commission in the first instance. *Digital Realty* may change those employees' calculus. Now, those same employees may lean toward reporting to the SEC directly — so as to take advantage of Dodd-Frank's retaliation protections — instead of relying on a patchwork of state laws or the more cumbersome Sarbanes-Oxley procedures for recovery for retaliation.

Such a response would continue the trend of increased reporting to the SEC. The SEC has stated that "[t]he whistleblower program has had a transformative impact on enforcement," ²⁶ and the program continues to grow, with ever-increasing reports and awards. In 2017, for example, the SEC received 4,400 tips, an increase of nearly 50% since FY 2012, and the SEC ordered awards totaling nearly US\$50 million to 12 individuals.

Digital Realty may result in the SEC receiving even more reports about possible violations from whistleblowers, and potentially reports of lesser quality. A purported whistleblower needs only a "reasonable belief" that the information he or she is providing to the Commission relates to a "possible" violation of the federal securities laws in order to qualify for Dodd-Frank's anti-retaliation provisions. ²⁷ Before *Digital Realty*, whistleblowers who believed they had information about a possible violation of federal securities laws, but were not fully confident in their belief, may have been inclined to report internally. Now those persons may forego reporting internally in favor of reporting to the Commission in the first instance.

Digital Realty may also prompt the Commission to attempt to expand the ways employees can provide information to the SEC and therefore qualify as whistleblowers under Dodd-Frank. Dodd-Frank expressly authorizes the SEC to establish the "manner" in which a whistleblower may provide information to the Commission. ²⁸ In response to concerns voiced by the Solicitor General that employees who, for example, give testimony to the SEC may not qualify as whistleblowers under Dodd-Frank's statutory definition, the Supreme Court expressly noted that "[n]othing in today's opinion prevents the agency from enumerating additional means of SEC reporting." ²⁹ Accordingly, the Commission may articulate expansive means through which an employee can provide information to the SEC for the purposes of Dodd-Frank, which could have the effect of further incentivizing employees to report externally.

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Endnotes

¹ 538 U.S. ___, No. 16-1276 (2018).

² *Id.* at *4.

³ 15 U.S.C. § 78u-6(h)(1)(C).

⁴ Rule 21F-17(a), 17 C.F.R. § 240.21F-17(a), prohibits “any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement [. . .] with respect to such communications.”

⁵ 18 U.S.C. §1514A(a)(1).

⁶ 15 U.S.C. §78u–6(a)(6).

⁷ 17 CFR §240.21F–2(b) (2017).

⁸ Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Release no. 34-64545 (May 25, 2011).

⁹ 18 U.S.C. §1514A(b)(2)(D). Here Somers did not file a complaint with the Secretary of Labor, and therefore did not satisfy the Sarbanes-Oxley Act requirements for anti-retaliation protection.

¹⁰ 18 U.S.C. §1514A(b)(1)(B).

¹¹ 15 U.S.C. §78u–6(h)(B)(i).

¹² 15 U.S.C. §78u–6(h)(B)(iii).

¹³ 18 U.S.C. §1514A(c).

¹⁴ 15 U.S.C. § 78u-6(h)(1)(C). Dodd-Frank does not provide for special damages beyond litigation costs, expert witness fees, and reasonable attorney fees.

¹⁵ *Digital Realty*, No. 16-1276, slip op. at 7.

¹⁶ *Id.*

¹⁷ *Id.* at 8.

¹⁸ *Somers v. Digital Realty Trust, Inc.*, 119 F. Supp. 3d 1088, 1094 (N.D. Cal. 2015).

¹⁹ *Id.* at 1096-1106.

²⁰ *Somers v. Digital Realty Trust, Inc.*, 850 F. 3d 1045 (9th Cir. 2017).

²¹ *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015) (holding reporting to SEC not required under Dodd-Frank whistleblower anti-retaliation provisions); *Asadi v. G. E. Energy (USA), LLC*, 720 F. 3d 620, 630 (5th Cir. 2013) (concluding that employees must provide information to the SEC to qualify for Dodd-Frank’s whistleblower anti-retaliation protections).

²² *Digital Realty*, No. 16-1276, slip op. at 2.

²³ *Id.* at 9-10.

²⁴ *Id.* at 11.

²⁵ See Implementation of the Whistleblower Provisions of Section 21f of the Sec. Exch. Act of 1934, Release No. 64545 n. 450 (May 25, 2011).

²⁶ Mary Joe White, Chair of the Commission, A New Model for SEC Enforcement: Producing Bold and Unrelenting Results (Nov. 18, 2016).

²⁷ 17 CFR §240.21F–2(b)(1)(i)-(ii).

²⁸ *Digital Realty*, No. 16-1276, slip op. at 18 (citing §78u–6(a)(6)).

²⁹ *Id.*