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DODD-FRANK WHISTLEBLOWER LITIGATION HEATING UP

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The past few months have been busy for courts and the SEC dealing with securities whistleblowers. The Supreme Court's potentially landmark decision in *Lawson v. FMR LLC* back in March already seems like almost ancient history. In that decision, the Supreme Court concluded that Sarbanes-Oxley's whistleblower protection provision (18 U.S.C. §1514A) protected not simply employees of public companies but also employees of private contractors and subcontractors, like law firms, accounting firms, and the like, who worked for public companies. (And according to Justice Sotomayor's dissent, it might even extend to housekeepers and gardeners of employees of public companies). Since then, a lot has happened in the world of whistleblowers. Much of the activity has focused on Dodd-Frank's whistleblower-protection provisions, rather than Sarbanes-Oxley. This may be because Dodd-Frank has greater financial incentives for plaintiffs, or because some courts have concluded that it does not require an employee to report first to an enforcement agency.

The following are some interesting developments:

What is a "whistleblower" under Dodd-Frank?

This seemingly straightforward question has generated a number of opinions from courts and the SEC. The Dodd-Frank Act's whistleblower-protection provision, enacted in 2010, focuses on a potentially different "whistleblower" population than Sarbanes-Oxley does. Sarbanes-Oxley's provision focuses particularly on whistleblower disclosures regarding certain enumerated activities (securities fraud, bank fraud, mail or wire fraud, or any violation of an SEC rule or regulation), and it protects those who disclose to a person with supervisory authority over the employee, or to the SEC, or to Congress. On the other hand, Dodd-Frank's provision (15 U.S.C. §78u-6 or Section 21F) defines a "whistleblower" as "any individual who provides . . . information relating to a violation of the securities laws to the Commission." 15 U.S.C. §78u-6(a)(6). It then prohibits, and provides a private cause of action for, adverse employment actions against a whistleblower for acts done by him or her in "provid[ing] information to the Commission," "initiat[ing], testif[ing] in, or assist[ing] in" any investigation or action of the Commission, or in making disclosures required or protected under Sarbanes-Oxley, the Exchange Act or the Commission's rules. 15 U.S.C. §78u-6(h)(1). A textual reading of these provisions suggests that a "whistleblower" has to provide information relating to a violation of the securities laws to the SEC. If the whistleblower does so, an employer cannot discriminate against the whistleblower for engaging in those protected actions. However, after the passage of Dodd-Frank, the SEC

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promulgated rules explicating its interpretation of Section 21F. Some of these rules might require providing information to the SEC, but others could be construed more broadly to encompass those who simply report internally or report to some other entity. *Compare* Rule 21F-2(a)(1), (b)(1), and (c)(3), 17 C.F.R. §240.21F-2(a)(1), (b)(1), and (c)(3). The SEC's comments to these rules also said that they apply to "individuals who report to persons or governmental authorities other than the Commission." Therefore, one issue beginning to percolate up to the appellate courts is whether Dodd-Frank's anti-retaliation provisions consider someone who reports alleged misconduct to their employers or other entities, but not the SEC, to be a "whistleblower." The only circuit court to have squarely addressed the issue (the Fifth Circuit in *Asadi v. G.E. Energy (USA) LLC)* concluded that Dodd-Frank's provision only applies to those who actually provide information to the SEC. In doing so, the Fifth Circuit relied heavily on the "plain language and structure" of the statutory text, concluding that it unambiguously required the employee to provide information to the SEC. Several district courts, including in Colorado, Florida and the Northern District of California, have concurred with this analysis. More, however, have concluded that Dodd-Frank is ambiguous on this point and therefore have given *Chevron* deference to the SEC's interpretation as set forth in its own regulations. District courts, including in the Southern District of New York, New Jersey, Massachusetts, Tennessee and Connecticut, have adopted this view. The SEC has also weighed in, arguing (in an amicus brief to the Second Circuit) that whistleblowers should be entitled to protection regardless of whether they disclose to their employers or the SEC. The agency said that *Asadi* was wrongly decided and, under its view, employees that report internally should get the same protections that those who report to the SEC receive. The Second Circuit's decision in that case (*Liu v. Siemens AG*) did not address this issue at all. Finally, last week, the Eighth Circuit also decided not to take on this question. It opted not to hear an interlocutory appeal, in *Bussing v. COR Securities Holdings Inc*., in which an employee at a securities clearing firm provided information about possible FINRA violations to her employer and to FINRA, rather than the SEC, and was allegedly fired for it. The district court concluded that the fact that she failed to report to the SEC did not exclude her from the whistleblower protections under Dodd-Frank. It reasoned that Congress did not intend, in enacting Dodd-Frank, to encourage employees to circumvent internal reporting channels in order to obtain the protections of Dodd-Frank's whistleblower protection. In doing so, however, the district court did not conclude that the statute was ambiguous and rely on the SEC's interpretation. A related question is what must an employee report to be a "whistleblower" under Dodd-Frank. Thus far, if a whistleblower reports something other than a violation of the securities laws, that is not protected. So, for example, an alleged TILA violation or an alleged violation of certain banking laws have been found to be not protected. These issues will take time to shake out. While more courts thus far have adopted, or ruled consistently with, the SEC's interpretation, as the Florida district court stated, "[t]he fact that numerous courts have interpreted the same statutory language differently does not render the statute ambiguous."

Does Dodd-Frank's whistleblower protection apply extraterritorially?

In August, the Second Circuit decided *Liu*. Rather than focus on who can be a whistleblower, the Court concluded that Dodd-Frank's whistleblower-protection provisions do not apply to conduct occurring exclusively extraterritorially. In *Liu*, a former Siemens employee alleged that he was

terminated for reporting alleged violations of the FCPA at a Siemens subsidiary in China. The Second Circuit relied extensively on the Supreme Court's *Morrison v. Nat'l Aust. Bank* case in reaching its decision. In *Morrison*, the Court reaffirmed the presumption that federal statutes do not apply extraterritorially absent clear direction from Congress. The Second Circuit in *Liu*, despite Liu's argument that other Dodd-Frank provisions applied extraterritorially and SEC regulations interpreting the whistleblower provisions at least suggested that the bounty provisions applied extraterritorially, disagreed. The court concluded that it need not defer to the SEC's interpretation of who can be a whistleblower because it believed that Section 21F was not ambiguous. It also concluded that the anti-retaliation provisions would be more burdensome if applied outside the country than the bounty provisions, so it did not feel the need to construe the two different aspects of the whistleblower provisions identically. And finally, the SEC , in its amicus brief, did not address either the extraterritorial reach of the provisions or *Morrison*, so the Second Circuit apparently felt no need to defer to the agency's view on extraterritoriality. *Liu* involved facts that occurred entirely extraterritorially. He was a foreign worker employed abroad by a foreign corporation, where the alleged wrongdoing, the alleged disclosures, and the alleged discrimination all occurred abroad. Whether adding some domestic connection changes this result remains for future courts to consider.

The SEC's Use Of The Anti-Retaliation Provision In An Enforcement Action

In June, the SEC filed, and settled, its first Dodd-Frank anti-retaliation enforcement action. The Commission filed an action against Paradigm Capital Management, Inc., and its principal Candace Weir, asserting that they retaliated against a Paradigm employee who reported certain principal transactions, prohibited under the Investment Advisers Act, to the SEC. Notably, that alleged retaliation did not include terminating the whistleblower's employment or diminishing his compensation; it did, however, include removing him as the firm's head trader, reconfiguring his job responsibilities and stripping him of supervisory responsibility. Without admitting or denying the SEC's allegations, both respondents agreed to cease and desist from committing any future Exchange Act violations, retain an independent compliance consultant, and pay $2.2 million in fines and penalties. This matter marks the first time the Commission has asserted Dodd-Frank's whistleblower provisions in an enforcement action, rather than a private party doing so in civil litigation.

The SEC Announces Several Interesting Dodd-Frank Bounties

Under Dodd-Frank, whistleblowers who provide the SEC with "high-quality," "original" information that leads to an enforcement action netting over $1 million in sanctions can receive an award of 10-30 percent of the amount collected. The SEC recently awarded bounties to whistleblowers in circumstances suggesting the agency wants to encourage a broad range of whistleblowers with credible, inside information. In July, the agency awarded more than $400,000 to a whistleblower who appears not to have provided his information to the SEC voluntarily. Instead, the whistleblower had attempted to encourage his employer to correct various compliance issues internally. Those efforts apparently resulted in a third-party apprising an SRO of the employer's issues and the whistleblower's efforts to correct them. The SEC's subsequent follow-up on the SRO's inquiry resulted in the enforcement

action. Even though the “whistleblower” did not initiate communication with the SEC about these compliance issues, for his efforts, the agency nonetheless awarded him a bounty. Then, just recently, the SEC announced its first whistleblower award to a company employee who performed audit and compliance functions. The agency awarded the compliance staffer more than $300,000 after the employee first reported wrongdoing internally, and then, when the company failed to take remedial action after 120 days, reported the activity to the SEC. Compliance personnel, unlike most employees, generally have a waiting period before they can report out, unless they have a reasonable basis to believe investors or the company have a substantial risk of harm. With a statute as sprawling as Dodd-Frank, and potentially significant bounty awards at stake, opinions interpreting Dodd-Frank’s whistleblower provisions are bound to proliferate. Check back soon for further developments.