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Will SEC's Broad Definition Of 'Whistleblower' Prevail?

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In response to the growing disagreement among courts regarding the scope of the Dodd-Frank Act's employment retaliation protections, and likely, in an effort to persuade a circuit court to adopt its position, on Aug. 4, 2015, the U.S.Securities and Exchange Commission issued an "interpretive rule" restating its position that individuals who have not reported alleged misconduct to the SEC may nevertheless qualify as “whistleblowers.” Although the SEC’s interpretation is consistent with the position it has taken since the passage of the Dodd-Frank Act in 2010, it is contrary to the holding of the only circuit court to have addressed the issue thus far.

Section 922 of Dodd-Frank amended the Securities Exchange Act of 1934 to (1) establish a whistleblower bounty program administered by the SEC and (2) prohibit retaliation by employers against whistleblowers. Since Dodd-Frank's passage, courts have grappled with the scope of the definition of "whistleblower" under the anti-retaliation provision because the statute, on one hand, 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” but, on the other hand, it prohibits retaliation against “whistleblowers” who make "disclosures that are required or protected under" Sarbanes-Oxley, the Exchange Act, 18 U.S.C. Sec. 1513(e), and “any other law, rule or regulation subject to the jurisdiction of the [SEC]."

In the wake of Dodd-Frank's passage, the SEC promulgated regulations for the purpose of implementing the whistleblower bounty program, but that also touched on the anti-retaliation aspect of Dodd-Frank. The SEC promulgated two separate definitions of “whistleblower” — one for the bounty provision and another for the anti-retaliation provision.

With respect to the procedures to receive a whistleblower bounty award (Rule 21 F-9), the SEC made it plain that to be a "whistleblower," individuals must submit information about a possible securities violation to the SEC. The SEC's definition of "whistleblower" for the anti-retaliation provision of Rule 21F-2(b), however, provides that an individual must: (1) "possess a reasonable belief that the information [he/she] is providing relates to a possible securities law violation (or, where applicable, to a possible violation of [the provisions set forth in Dodd-Frank]) that has occurred, is ongoing, or is about to occur;" and (2) provide that information in a manner described in the statute. The SEC's rule further provides that "[t]he anti-retaliation protections apply whether or not you satisfy the requirements, procedures and conditions to qualify for an award."

Split of Authority on the Scope of Dodd-Frank's Anti-Retaliation Provision

On July 17, 2013, the Fifth Circuit Court of Appeals in Asadi v. G.E. Energy (USA) LLC, 720 F.3d 620 (5th Cir. 2013), held that the text of Dodd-Frank's anti-retaliation provision is unambiguous and requires that a "whistleblower" report an alleged violation to the SEC to be covered by the statute. The Fifth Circuit noted that whenever possible, courts "interpret provisions of a statute in a manner that renders them compatible, not contradictory." Id. at 622.

The court then concluded that the statutory definition of "whistleblower" and the anti-retaliation provision of Dodd-Frank do not conflict because the former identifies who is entitled to protection and the anti-retaliation provision identifies what conduct is entitled to protection. The court also offered additional reasons in support of its decision.

First, the court noted that the anti-retaliation provision of Dodd-Frank protects "whistleblowers," not "individuals" or "employees." Id. at 626. Second, the court stated that defining protected activity in a way that does not require disclosure to the SEC, and requiring a whistleblower to be someone who disclosed to the SEC, are compatible because the statute protects someone who, for example, made both internal disclosures and disclosures to the SEC, but whose employer knows about only the internal disclosures. Id. at 627-28.

Third, the court explained that expanding the scope of the definition of "whistleblower" "renders the SOX anti-retaliation provision, for practical purposes, moot" because Dodd-Frank enables recovery of potentially greater monetary damages (e.g., double backpay), provides a substantially longer statute of limitations, and enables plaintiffs to sue directly in federal court without exhausting administrative remedies. Id. at 628-29.

Several district courts have followed Asadi and held that mere internal complaints are not protected under Dodd-Frank. See Englehart v. Career Educ. Corp., (M.D. Fla. May 12, 2014); Duke v. Prestige Cruises International Inc., (S.D. Fla. Aug. 14, 2015); Banko v. Apple Inc., (N.D. Cal. Sept. 27, 2013); Yang v. Navigators Group Inc., (S.D.N.Y. May 8, 2014); Berman v. Neo@Ogilvy, No. 1:14-cv-523-GHW-SN (S.D.N.Y. Dec. 4, 2014). These courts have rejected the argument that the statute is ambiguous and have refused to defer to the SEC's regulations.

Other district courts, some in the same districts that have found to the contrary, have rejected Asadi and adopted the SEC's interpretation of the regulation, holding that an internal complaint of an alleged securities law violation is sufficient to invoke Dodd-Frank's anti-retaliation protection. See Rosenblum v. Thomson Reuters (Markets) LLC, 984 F. Supp. 2d 141, 148 (S.D.N.Y. 2013). Khazin v. TD Ameritrade Holding Corp., No. 13-4149, (D.N.J. Mar. 11, 2014).

Asadi remains the only circuit court of appeals to decide the issue; however, an appeal addressing the question is currently pending in the Second Circuit, and the Third Circuit recently decided an appeal and declined to address the issue. Prior to oral argument in these cases, at the end of last year, the SEC filed an amicus brief with the Third Circuit advocating its broad definition of "whistleblower" in Safarian v. American DG Energy Inc., even though the district court had not even addressed whether Safarian was entitled to protection under the anti-retaliation provision of Dodd-Frank and concluded that it "need not weigh in on this issue and determine if Plaintiff's failure to report to the SEC alone forestalls his claim because Plaintiff fails to show that his disclosures fall under any of the four categories listed in Section 78-u6(h)(1)(A)(iii)."

The SEC, however, seized this opportunity to argue that the court should defer to its interpretation in Rule 21F-2(b)(1) that Dodd-Frank's anti-retaliation provision protects all individuals who disclose activity specified in Dodd-Frank regardless of whether they report to the SEC. In its amicus brief, the SEC portrayed Rule 21F-2 as a "carefully calibrated" response to concerns that Dodd-Frank's bounty program undermined internal corporate compliance programs by incentivizing external reporting to the SEC. The SEC submitted that "if the rule were invalidated, the Commission's authority to pursue enforcement actions against employers that retaliate against individuals who report internally would be substantially weakened."

The SEC also asserted that there is "considerable tension" between the types of activity the statute protects, enumerated in Section 21F(h)(1)(A), and the definition of "whistleblower" in Section 21F(a)(6). It noted that "Section 21F(h)(1)(A) prohibits an employer from retaliating against a whistleblower: (i) for 'providing information to the Commission in accordance with this section'; (ii) for assisting in an investigation or action of the Commission 'based upon or related to such information'; or (iii) for 'making disclosures that are required or protected under' Sarbanes-Oxley, the Exchange Act, 18 U.S.C. § 1513(e), 'and any other law, rule, or regulation subject to the jurisdiction of the Commission." The SEC submitted that it is clear that "clauses (i) and (ii), together, protect individuals who report to the Commission about securities law violations," but that the anti-retaliation protection afforded by clause (iii) "reaches beyond just disclosures involving securities law violations and disclosures to the Commission."

The SEC attempted to address the Fifth Circuit's observations in Asadi that the SEC's broad reading of who constitutes a Dodd-Frank whistleblower for anti-retaliation purposes "renders the SOX anti-retaliation provision, for practical purposes, moot." In seeking to defend its interpretation, the SEC pointed to the various differences between the SOX and Dodd-Frank enforcement mechanisms, conceding that Dodd-Frank enables recovery of potentially greater monetary damages (e.g., double backpay), provides a substantially longer statute of limitations, and enables plaintiffs to sue directly in federal court without exhausting administrative remedies. The SEC contended that, notwithstanding all of these benefits from pursuing a retaliation claim under Dodd-Frank, whistleblowers might still prefer to pursue a claim under SOX over Dodd-Frank because of the lower cost and burden associated with SOX's administrative procedures and the possibility of recovering for "pain and suffering" under SOX.

More recently, in a February 2015 amicus brief it filed with the Second Circuit in Berman v. Neo@Ogilvy,[1] the SEC continued to promote its view of protecting "disclosures" other than those made to the SEC, but now expanded its focus from internal reports to reports made to other governmental agencies. While the SEC's brief contained essentially the same arguments it asserted in Safarian, it argued for the first time that failing to defer to its interpretation could "arbitrarily and irrationally deny" protection to whistleblowers who first report violations to the U.S. Department of Justice, Federal Bureau of Investigation or other self-regulatory organizations (e.g., theFinancial Industry

Regulatory Authority).

In support, the SEC maintained that the Dodd-Frank bounty program requires the SEC to pay an award based on monetary sanctions collected in "related actions." It contended that because Dodd-Frank's whistleblower protections "complement the related component of the award program" there is no basis to believe that Congress had intended for "disparate treatment based purely on the happenstance of which agency the individual reported to first." Despite the SEC's position in its amicus brief, the Second Circuit panel appeared divided over the appropriate definition of "whistleblower" during oral argument earlier this summer. See Law360 http://www.law360.com/articles/669075/2nd-circ-wrestles-with-dodd-frank-s-whistleblower-lingo.

The Effect of the SEC's Interpretive Rule

On the heels of all of this activity, the SEC has now issued its interpretive guidance that a whistleblower is entitled to the anti-retaliation protections of Dodd-Frank after reporting potential securities violations internally even if the individual does not report such violations to the SEC. The SEC's interpretive rule sets forth essentially the same positions it has asserted in its various amicus briefs and states that for purposes of Dodd-Frank's employment retaliation protections, "an individual's status as a whistleblower does not depend on adherence to the reporting procedures specified in Rule 21F-9(a)."

In issuing its clarification, the SEC states that the definition of "whistleblower" for purposes of Dodd-Frank's employment retaliation provision is "ambiguous," but that the SEC's interpretation "best comports with our overall goals in implementing the whistleblower program." The SEC further states that "by providing employment retaliation protections for individuals who report internally first to a supervisor, compliance official, or other person working for the company that has authority to investigate, discover, or terminate misconduct, our interpretive rule avoids a two-tiered structure of employment retaliation protection that might discourage some individuals from first reporting internally in appropriate circumstances and, thus, jeopardize the investor-protection and law-enforcement benefits that can result from internal reporting."

Notably, the SEC did not attempt to alleviate the concern the Fifth Circuit articulated in Asadi that expanding the definition of "whistleblower" would render SOX moot, and in fact, noted that under its reading, individuals who do not comply with the reporting requirements of Rule 21F-9(a) "would be afforded employment retaliation protection under the catchall language of Section 21F9h((1)(A)(iii) — which incorporates the protections of Section 806 of the Sarbanes-Oxley Act."

The SEC's interpretive rule also comes shortly after the U.S. Supreme Court's decision in Perez v. Mortgage Bankers Association, 575 U.S. ___ (2015), overturning pre-existing Supreme Court precedent and holding that the Administrative Procedure Act does not mandate any notice-and-comment rule-making process for interpretive rules. The SEC appears to have seized upon this newfound ability to issue easily new interpretative rules in the hope of influencing courts' assessments of the scope of Dodd-Frank retaliation claims.

The question that remains to be answered is whether courts, particularly circuit courts, will adopt the SEC's interpretation. The answer to this question may turn on the degree to which courts defer to the SEC's interpretive guidance. Courts will have to decide whether, in the first instance, Dodd-Frank's definition of whistleblower is ambiguous. If, as the Asadi court decided, it is not, then there is no need to defer to the SEC. Assuming that a statute is ambiguous, agency rules enacted after notice and comment may be afforded deference under Chevron USA Inc. v. Natural Resources Defense Council Inc., 467 U.S.

837 (1984), and therefore have the force of law. Where, as here, however, the interpretive guidance was issued without any notice and comment, Chevron deference would be inappropriate (even if the statute were otherwise found to be ambiguous).

In the absence of Chevron deference, the SEC's interpretive rule may be afforded a lower level of deference, such as that set forth under Skidmore v. Swift & Co., 323 U.S. 134 (1944), or no deference at all. Applying such a lesser degree of deference, a court will evaluate an agency's "power to persuade." If courts thus find that Chevron deference is not appropriate, they will retain broader discretion to interpret the statute in a manner contrary to that articulated by the SEC. Here, it seems that a court would have to confront whether the SEC has adequately countered the claim that its interpretation is essentially nullifying the entire SOX whistleblower enforcement scheme.

It remains to be seen how courts, including the Second Circuit, will address the SEC's interpretive guidance in considering the scope of Dodd-Frank's anti-retaliation provision, especially where the SEC has already advocated its position before these courts in its amicus briefs. If the Second Circuit rejects Asadi and agrees with the SEC's guidance, there will be a circuit split on the issue, making it ripe for Supreme Court review.

In the meantime, the SEC's interpretive rule nevertheless increases the risk that mere internal complaints may constitute protected activity under Dodd-Frank (and thus increases employer exposure to litigation). In addition, last year, the SEC brought its first enforcement action under the anti-retaliation provision of Dodd-Frank and has unequivocally stated that it intends to pursue enforcing this provision of the statute on a broader scale in the future. Unless and until the SEC's position on the definition of a "whistleblower" is rejected by the courts, its position subjects employers to greater risks of both litigation by employees and enforcement action by the SEC.

—By Lloyd B. Chinn and Noa M. Baddish, Proskauer Rose LLP

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[1] This is the second amicus brief the SEC has filed with the Second Circuit on this issue. In March 2014, the SEC filed an amicus brief in Liu v. Siemens, arguing that courts should defer to SEC's interpretation in Rule 21F-2(b)(1) that Dodd-Frank's anti-retaliation provisions protect all individuals who disclose activity specified in Dodd-Frank regardless of whether they report directly to the SEC. The Second Circuit, however, affirmed the dismissal of the complaint on other grounds and declined to address whether one qualifies as a whistleblower under Dodd-Frank if he or she has disclosed the alleged misconduct only within the corporation, and not to the SEC.
