Whistle-Blowers

The Sound of Uncertainty: Whistleblowers and the SEC

If you blow a whistle and the Securities and Exchange Commission isn't around to hear it, does it still make a sound? For almost six years, courts, including two federal appeals courts, have been divided on this question.

In particular, they disagree over who qualifies as a ''whistle-blower'' for purposes of Dodd-Frank Wall Street Reform and Consumer Protection Act anti-retaliation protections. Some courts focus on the act while others focus on the recipient of the report—i.e., is reporting suspected misconduct to corporate managers sufficient, or must the would-be whistleblower take his or her concerns to the SEC?

The Dodd-Frank whistle-blower provisions were enacted in response to the SEC's failure to investigate Bernard Madoff, despite complaints by tipster Harry Markopolos that the convicted fraudster's investment advisory business was a Ponzi. In overhauling the whistle-blower program, Congress mandated new incentives and protections for those who report suspected securities law violations. These mandates have confused American courts ever since.

Bio.
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In its definitions section, Dodd-Frank states that a whistle-blower is ''[a]ny individual who provides . . . information [concerning a securities violation] to the Commission.'' 15 U.S.C.A. § 78u-6 (2010) (emphasis added). The source of the confusion lies further in the text–a cross-reference in Dodd-Frank to the Sarbanes-Oxley Act.

Specifically, Dodd Frank provides that ''[n]o employer may . . . directly or indirectly . . . discriminate against, a whistleblower. . . in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002.'' 15 U.S.C.A. § 78u-6 (2010). (emphasis added).

Sarbanes-Oxley, in turn, states that whistle-blower protections are available to employees who report a suspected violation to a law enforcement agency, a member or committee of Congress, or even a person with supervisory authority over the reporting employee. The courts now are attempting to square the narrow Dodd-Frank definition of a whistle-blower with Sarbanes-Oxley, which contains broader provisions that protect internal reporting.

In short, under Dodd-Frank an employee would have to report to the SEC in order to be a whistle-blower thus receiving anti-retaliation protections. Under the Sarbanes-Oxley Act, however, anti-retaliation protections cover employees who report to other institutions, even those who only report internally.

Opting for the broader interpretation, in 2011, the SEC adopted a rule establishing a whistle-blower bounty program as mandated by Dodd-Frank. Although the rule encouraged whistle-blowers to approach their employers first, the agency didn't require whistle-blowers to report their concerns through internal compliance procedures. In a bid for clarity, it stated that an individual is also a whistle-blower if they ''provide . . . information in a manner described in [the Sarbanes-Oxley cross-reference] of the Exchange Act.'' 17 C.F.R. § 240.21F-2 (2011).

Unfortunately, the commission didn't achieve its goal. However, given that the federal circuits are divided over who qualifies as a whistle-blower under Dodd-Frank, the U.S. Supreme Court may become the final arbiter.

5th Circuit. The Fifth Circuit's Analysis (SEC Required) In 2013, the U.S. Court of Appeals for the Fifth Circuit held that to receive Dodd-Frank anti-retaliation protection against their employer, an employee must report his or her concerns to the SEC. *Asadi v. G.E. Energy (USA), LLC.*, 720 F.3d 620, 629 (5th Cir. 2013). Courts that follow the Fifth Circuit's line of reasoning focus on the recipient of the report—not on the act of reporting itself.

For example, an employee reports a suspected violation to a superior. If the employee suffers adverse employment action for reporting the violation, she isn't protected against retaliation. The Fifth Circuit wouldn't consider the employee a ''whistle-blower'' because she didn't take her concerns to the SEC.

The Fifth Circuit reasoned that ''[u]nder Dodd-Frank's plain language and structure, there is only one category of whistle-blowers: individuals who provide information . . . to the SEC.'' Since only those who report to the SEC are whistle-blowers, they are the only employees who receive anti-retaliation protections. There is no need to defer to the SEC's interpretation.

But how does the court explain the Sarbanes-Oxley cross-reference embedded within Dodd-Frank? Sarbanes-Oxley, after all, protects internal reporting. The Fifth Circuit offers an example: assume that an employee discovers that her company has committed a securities law violation. On the day of her discovery the employee not only reports to the SEC, she also reports to the company's chief executive officer. The CEO, unaware of the employee's report to the SEC, fires the employee. In that case, the employee will receive anti-retaliation protection.

According to the Fifth Circuit, an employee is protected if the SEC is somehow involved in the reporting.

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The SEC doesn't have to be the sole recipient of the report, but it needs to be one of the recipients when reporting internally and externally. In that court's view, Sarbanes-Oxley merely allows for simultaneous reporting.

2d Circuit. The SEC's and The Second Circuit's Analysis (SEC Not Required) The Second Circuit sees things a little differently. In *Berman v. Neo@Ogilvy L.L.C.*, 801 F.3d 145, 146 (2015), it held that ''the pertinent provisions of Dodd-Frank create sufficient ambiguity to warrant our deference to the SEC's interpretative rule.'' Because the Second Circuit accepts the SEC's interpretation, the court focuses on the act of reporting and not on the recipient of the report.

The Second Circuit agreed that for Dodd-Frank purposes, ''whistle-blower'' is defined as someone who reports to the SEC. But where exactly does the Second Circuit diverge from the Fifth? Where the Sarbanes-Oxley cross-reference occurs.

In *Berman*, the court inquires into another plausible reading: is the whistle-blower definition, which requires reporting to the SEC, limited up until the part where Sarbanes-Oxley is cross-referenced? Or does the definition of ''whistle-blower'' apply throughout the text, including where Sarbanes-Oxley is cross-referenced?

Because the court found the statute ambiguous, it deferred to the SEC's rule, which cross references Dodd-Frank (the law that defines a whistle-blower as someone who reports to the SEC) which cross-references Sarbanes-Oxley (which provides protection to those who report internally).

The Second Circuit supported its decision by pointing out that some employees are required to report internally, such as lawyers and auditors. Dodd-Frank states that if the company doesn't clean up its act within a given time frame, only then may the employee report to the SEC. The issue, according to the Second Circuit, is that ''any retaliation [from an employer] would almost always precede Commission reporting.'' This would leave lawyers and auditors in a precarious position and at a disadvantage compared to other employees. For most, the safe route would be to avoid reporting altogether.

More broadly, the Fifth and Second Circuits disagree over whether there is any ambiguity in Dodd-Frank's definition of a whistle-blower. The relevance of ambiguity is that if a statute is ambiguous, the court could defer to the implementing agency's reasonable interpretation of the law. However, if a court concludes that the statute isn't ambiguous, it would rely on its own interpretation of the text—even if the agency subsequently attempted to clear up any misunderstandings.

The Fifth Circuit found no ambiguity in the definition of a whistle-blower and didn't defer to the SEC's rule. The Second Circuit, however, found significant ambiguity and adopted the SEC's double cross-referenced definition.

Divided Setting. Although the difference of opinion created a circuit split, it did so in an already divided setting as many lower courts were already at odds on this issue. Meanwhile, a third case on the reporting-out issue is currently before the Sixth Circuit. *Verble v. Morgan Stanley Smith Barney L.L.C.*, No. 3:15-cv-74-TAV-CCS, 2015 BL 402700, (E.D. Tenn. Dec. 8, 2015), appeal docketed, No. 15-6397 (6th Cir. Dec. 17, 2015). Whatever the outcome, it will further highlight the uncertainties involved and the need for resolution.

Although the ultimate answer may lie with the Supreme Court, the outcome is difficult to predict, even more so with the passing of Associate Justice Antonin Scalia. The makeup of the court hangs in the balance.

What is clear, however, is that to receive a monetary award under the SEC's whistle-blower bounty program, an employee will have to report the violation to the agency. If job security is a concern for an employee, it is best, at this juncture, to consider the SEC as one of his or her intended recipients. Doing so will eliminate any inquiry as to whether the employee qualifies as a ''whistle-blower.''

In the end, does blowing a whistle make you a whistle-blower? As of now, the answer depends on an employee's geographical location and—in some instances—their profession. For the cautious employee, the consequences of reporting misconduct is an open question. Hopefully the sound of uncertainty will result in Supreme Court review.

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