# SOUND THE ALARM:
## WHISTLEBLOWER TRENDS AND THE PITFALLS OF RETALIATION CLAIMS

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"The whistleblower program recently completed its third full year of operation, and the statistics show an impressive start..."

The 2008 economic downturn shook the financial world and spurred Congress to enhance regulation of financial institutions. In 2010, Congress passed the "Dodd-Frank Wall Street Reform and Consumer Protection Act," more commonly known as "Dodd-Frank." Dodd-Frank amended the Securities Exchange Act of 1934 and added a provision, "Securities Whistleblower Incentives and Protection," to entice potential whistleblowers with the possibility of lucrative rewards for information on potential securities laws violations. As important, the law also created new protections for whistleblowers from employment retaliation. The whistleblower program recently completed its third full year of operation, and the statistics show an impressive start to the program and leave little doubt that the Office of the Whistleblower ("OWB"), created to administer the program, takes its responsibilities seriously.

But as the program kicks into high gear, a fundamental question hangs in limbo. Dodd-Frank encourages internal reporting via corporate compliance policies as the first step of any whistleblower complaint. The U.S. Court of Appeals for the Fifth Circuit, however, has held that Dodd-Frank's anti-retaliation provision applies only to individuals who report information to the SEC, *not* to those who report information internally under their company's complaint procedure. This has created a tension: pursuant to its rulemaking authority under the act, the SEC promulgated a rule adopting the opposite position, that the anti-retaliation provision protects both individuals reporting internally within their company, and those reporting directly to the SEC. In the face of this tension, the district courts are split: while a slim majority has sided with the SEC, a significant minority has followed the Fifth Circuit's lead and refused to apply the whistleblower protections to internal complaints.

Many commentators (and the SEC) have criticized the Fifth Circuit's ruling, arguing that it can discourage a whistleblower's appetite for internal reporting, causing him or her to immediately escalate matters to a formal SEC complaint. And if there is a trend where whistleblowers bypass internal complaint procedures, companies might place less importance on internal compliance regimes. We disagree. Indeed, we believe that the Fifth Circuit's position makes good sense, both as a matter of statutory interpretation and public policy. Dodd-Frank has other mechanisms to encourage internal reporting. And the Fifth Circuit's ruling has the potential to shield companies from frivolous anti-retaliation suits by weeding out less meritorious claims. If the anti-retaliation provision applies only to individuals who file with the SEC, then companies need not worry that every employment action they take in response to internal allegations of wrongdoing could subject them to potential liability under Dodd-Frank. Rather, only individuals who have gone through the SEC's formal submission process gain those protections.

## I. THE BASICS: UNDERSTANDING THE IMPLEMENTATION AND EFFECTIVENESS OF THE WHISTLEBLOWER PROGRAM

The Dodd-Frank Wall Street Reform and Consumer Protection Act[1] overhauled the U.S. financial regulatory system by both building on existing laws, such as the Sarbanes-Oxley Act of 2002 ("SOX")[2], and creating new rights and responsibilities. Its key provision, "Securities Whistleblower Incentives and Protection,"[3] focuses, naturally, on "whistleblowers," defined as "any individual" who provides information "relating to a violation of the securities laws" "to the Commission."[4] The provision rests on three key tenets: monetary awards, confidentiality, and protection from retaliation.

### A. The Three Pillars of the Whistleblower Program

First, and perhaps most important, the Act requires the SEC to pay awards to eligible whistleblowers. Whistleblowers are eligible if they voluntarily provide original information to the SEC that leads to a successful enforcement action resulting in monetary sanctions of more than $1 million. "Original information" means information from the whistleblower's "independent knowledge or analysis," not already known to the SEC from another source and not "exclusively derived" from public information, such as news reports or administrative hearings. The SEC has the discretion to award the whistleblower anywhere from ten to thirty percent of monetary sanctions collected over $1 million.

Second, the Act imposes confidentiality obligations. It prohibits the SEC from disclosing not only the information provided by a whistleblower, but also any information that could "reasonably be expected to reveal the identity" of the whistleblower. Of course, if the whistleblower assists the SEC in a public proceeding, that individual's identity may become public.

Third, the Act prohibits retaliation by employers against whistleblowers who come forward with information or assistance.[5] Generally speaking, employers may not "discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against" whistleblowers in terms of their employment. To bolster the provision's impact, the Act creates a private right of action, authorizing private lawsuits in federal court. These private suits carry the potential for significant relief: reinstatement at the same seniority status that the whistleblowers would have attained absent the employment discrimination; two times the amount of back pay owed, plus interest; and litigation costs, expert witness fess, and reasonable attorneys' fees. The anti-retaliation provision acts as a powerful deterrent to companies from engaging in any employment actions—improper *or* proper—when dealing with whistleblower complaints.

These three components—monetary awards, confidentiality, and retaliation protections—offer powerful incentives and protection to whistleblowers. Congress believed this combination would encourage public involvement in the enforcement of the securities laws. Based on the statistics, it looks like Congress was right.

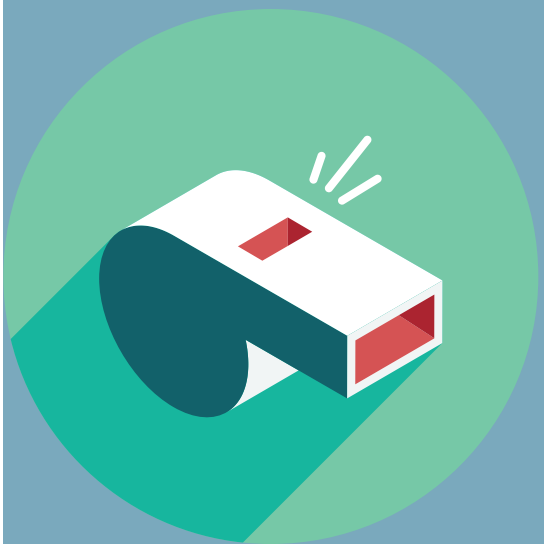
### B. The Statistics on Whistleblower Tips

Each year, the SEC must report to Congress on the performance of the whistleblower program. The annual report[6] summarizes the OWB's priorities and key statistics. From this report, we get a good sense of how far the program has come since its inception in 2011.

Briefly stated, the number of tips received by the OWB has steadily increased. In 2012, the first full year of the program, the OWB received 3,001 tips. This past year, it received 3,620, an increase of more than 20%. And these tips come from all over the world: in 2014, the OWB received complaints from all 50 states, Washington, D.C., Puerto Rico, and 60 different foreign countries.

The OWB asks whistleblowers to identify the nature of their allegations, which the annual report breaks into ten categories.[7] By a healthy margin, the most common complaint categories were corporate disclosures and financials (16.9% of complaints), offering fraud (16%), and manipulation (15.5%). These categories have consistently

1. Pub. L. No. 111-203, § 922(a), 124 Stat. 1841 (2010).
2. 15 U.S.C. § 7201 *et seq.*
3. 15 U.S.C. § 78u-6.
4. 15 U.S.C. § 78u-6(a)(6).
5. 15 U.S.C. § 78u-6(h).
6. U.S. Securities and Exchange Commission, Annual Report to Congress on the Dodd-Frank Whistleblower Program Fiscal Year 2014 (Nov. 2014).
7. These are: corporate disclosures and financials, offering fraud, manipulation, insider trading, trading and pricing, FCPA, unregistered offerings, market event, municipal securities and public pension, and the ubiquitous "other." Technically, there is also an eleventh category for those who leave this inquiry blank.



More than 40% of [whistleblower award] recipients have been current or former company employees.

ranked highest, and in 2014 they made up nearly 50% of all complaints.

**C. A Snapshot of Whistleblower Cases**

As the number of whistleblowers has increased, so has the number of award claimants. So far, fourteen whistleblowers have received awards, nine of these in 2014. More than 40% of recipients have been current or former company employees. (And of these current or former employees, more than *eighty* percent raised their concerns internally before going to the SEC.) Another 20% of award recipients were contractors or potential contractors. The remaining 40% consisted of a mix of investors, industry professionals, and individuals with personal relationships with individual defendants.

The OWB made some key awards in 2014. A whistleblower received more than $400,000 for reporting to the SEC after the company failed to address the whistleblower's concerns through its internal grievance process.[8] Importantly, the whistleblower did not satisfy the statutory requirement of providing the information "voluntarily," but the SEC waived this requirement in light of the whistleblower's "persistent efforts" to report internally. In another key case, the SEC granted the first award, over $300,000, to an individual with compliance or internal audit responsibilities.[9] Ordinarily, these individuals do not qualify for awards because they cannot provide "original information" as defined under the statute. But in this case, a statutory exception applied. The individual reported the information internally then waited at least 120 days before going to the SEC. Because the company failed to take corrective action within this extended time period, the whistleblower qualified.

The OWB made its largest award to date in 2014, awarding a whistleblower more than $30 million.[10] According to the annual report, this whistleblower provided information leading to both a successful enforcement action and successful related actions. The whistleblower's information unveiled a fraud that, according to reports, otherwise would have been difficult for the SEC to detect.

And the SEC brought its first anti-retaliation enforcement action in 2014. The case, *In re Paradigm Capital Management, Inc. & Candace King Weir*,[11] involved a whistleblower who reported possible securities law violations and ended up resigning after suffering adverse treatment from his employer, Paradigm Capital Management. The whistleblower, Paradigm's head trader, reported to the SEC that Paradigm had engaged in principal transactions with C.L. King & Associates. Both Paradigm and C.L. King were owned by Candace Weir, which meant that the transactions required approval by an unconflicted conflicts committee, which never happened.

After the whistleblower informed Weir and C.L. King's chief operating officer that he had reported the violations to the SEC, Paradigm took a series of actions against him. It removed him from his trading desk and temporarily suspended his day-to-day trading and supervisory responsibilities. The firm also instructed him to work

8. Order Determining Award Claim, SEC Rel. No. 72727, File No. 2014-8 (July 31, 2014).
9. Order Determining Award Claim, SEC Rel. No. 72947, File No. 2014-9 (Aug. 29, 2014).
10. Order Determining Award Claim, SEC Rel. No. 73174, File No. 2014-10 (Sept. 22, 2014).
11. SEC Rel. No. 72393, File No. 3-15930 (June 16, 2014).

So SOX protects a subset of employees who report possible fraud internally through their companies' compliance regimes.

remotely, to investigate the allegations that he himself had reported to the SEC, and to prepare a report detailing all facts supporting the allegations. But Paradigm failed to give the whistleblower access to the information necessary to compile the report. Rather than provide remote access to trading and account systems—or even his own company email—Paradigm dumped him with 1,900 pages of trading data to review. Although Paradigm allowed the whistleblower to return to work about a week after revealing himself as a whistleblower, it would not reinstate him as head trader. The whistleblower resigned less than a month later.

Based on its investigation, the SEC concluded that "Paradigm had no legitimate reason" for taking any of these actions against the whistleblower. Furthermore, the actions began "immediately" after Paradigm learned "that the [w] histleblower reported potential securities violations" to the SEC. Exactly two years after the whistleblower notified Paradigm that he had reported potential violations to the SEC, Paradigm settled the enforcement action for just under $2.2 million.

These cases demonstrate the power of the whistleblower program. With tips coming in from all over the world and covering a broad range of conduct, the SEC has a wealth of information at its disposal to ferret out securities laws violations. And the OWB is making good on its obligation to compensate whistleblowers for the risks they take and the assistance they provide in successful enforcement actions. But even though the OWB is up and running, could the Fifth Circuit's arguably "narrow" interpretation of the anti-retaliation provision undermine Dodd-Frank's purpose?

## II. THE LAW: DECIPHERING THE ANTI-RETALIATION PROVISION

To understand the split among the courts and the SEC, we need to step back for a minute and look at SOX. Dodd-Frank did not create a wholly new whistleblower program; it built on preexisting law. It made numerous amendments to several existing statutes and had a significant impact on SOX's own whistleblower protection provision.[12]

The SOX whistleblower protection prohibits public companies from retaliating against employees who "provide information" relating to conduct that "the employee reasonably believes constitutes" any one of several types of fraud.[13] It protects those employees when they provide information to, among others, "a person with supervisory authority over the employee."[14] So SOX protects a subset of employees who report possible fraud *internally* through their companies' compliance regimes.

The Supreme Court recently rendered a decision that greatly expanded membership in that subset. In *Lawson v. FMR LLC*, the Supreme Court determined that the SOX whistleblower protections are not limited to the employees of public companies; its protections also extend to the employees of private companies that work as the contractors and subcontractors of the public companies.[15] In the words of Justice Sotomayor in dissent, the Supreme Court's interpretation gives SOX a "stunning reach," potentially pulling "hundreds of thousands" more businesses within its ambit.[16]

But SOX has certain limitations that make bringing an anti-retaliation claim less than ideal. For example, it requires the aggrieved employee to file a complaint with the Secretary of Labor; only if the Secretary fails to issue a decision within 180 days can the employee bring an

12. For a more in-depth look at the relationship between SOX and Dodd Frank, see Jonathan Ben-Asher, *New Developments in Whistleblower Cases Under Sarbanes-Oxley and Dodd-Frank*, Am. Bar Assoc. Section of Labor & Employment Law Annual Meeting (2014), *available at* http://bit.ly/1TTkQj3
13. 18 U.S.C. § 1514A.
14. *Id.*
15. *Lawson v. FMR LLC*, 134 S. Ct. 1158 (2014).
16. *Lawson*, 134 S. Ct. at 1178 (Sotomayor, J., *dissenting*).

Should the individuals making these internal complaints receive the statutory protections as well? The courts are split.

action in federal district court. And the provision has a short statute of limitations: 180 days from the date of the violation or the date on which the employee became aware of the violation.

Enter Dodd-Frank. Dodd-Frank protects whistleblowers who engage in three types of conduct. It covers those who provide information to the SEC and those who initiate or assist in investigations or judicial or administrative actions. And it covers those who, among other things, make disclosures "protected under the Sarbanes-Oxley Act" and "any other law, rule, or regulation subject to the jurisdiction of the Commission."[17] In other words, Dodd-Frank brings within its bounds those "hundreds of thousands" who may be reporting to their supervisors through internal compliance channels. Plus, Dodd-Frank expands the statute of limitations to a maximum of ten years and side-steps the administrative requirement by providing a private right of action. But does Dodd-Frank really reach that broadly?

**A. The courts split over whether individuals who report only internally receive protection from employer retaliation**

Everyone agrees that individuals who report potential securities laws violations to the SEC earn the full protection of the Dodd-Frank anti-retaliation provision. But what about those individuals who, under that third avenue, report only internally, or report to another federal agency whose rules come within SEC jurisdiction? The SEC encourages internal reporting to resolve potential violations early and to avoid SEC involvement altogether. Should the individuals making these internal complaints receive the statutory protections as well? The courts are split.

The difficulty arises from two statutory provisions that some courts have found in conflict. The anti-retaliation provision prohibits employers from taking adverse action against "a whistleblower."[18] This is a defined term: it means "any individual who provides" information regarding a securities law violation "to the Commission."[19] According to its terms, the anti-retaliation provision protects only those "whistleblowers" who provide information to the SEC, initiate or assist in investigations or actions, or make protected disclosures under SOX or another law under SEC jurisdiction. But adhering to this definition, the employee who makes a protected disclosure to a supervisor pursuant to SOX is not a "whistleblower": he or she did not provide information "to the Commission." And neither is the employee who provides information to another regulatory agency whose jurisdiction overlaps with that of the SEC.[20] So does this mean that none of these individuals benefit from the Dodd-Frank anti-retaliation provisions?

The Fifth Circuit said "yes." In *Asadi v. G.E. Energy (USA), L.L.C.*,[21] the Fifth Circuit, the only Court of Appeals to address the issue, found the statutory language clear and unambiguous. The definition of "whistleblower," said the Fifth Circuit, "expressly and unambiguously requires that

17. 15 U.S.C. § 78u-6(h)(1)(A).
18. *Id.*
19. 15 U.S.C. § 78u-6(a)(6).
20. *See Bussing v. COR Clearing, LLC*, 20 F. Supp. 3d 719, 729-30 (D. Neb. 2014) (citing FINRA as an example).
21. 720 F.3d 620 (5th Cir. 2013).

an individual provide information to the SEC to qualify as a 'whistleblower.'" As far as the Fifth Circuit was concerned, this definition ended the matter. Because the plaintiff employee reported an alleged violation of the Foreign Corrupt Practices Act to his supervisor, but not to the SEC, he did not qualify as a Dodd-Frank whistleblower and could not claim the statute's anti-retaliation protections. The Fifth Circuit further opined that it saw no conflict between the definition and the third category of protected disclosures. This category would protect individuals who made a required disclosure to the SEC but suffered retaliation based on a different protected disclosure, such as a manager who simultaneously reports a securities law violation to a supervisor and the SEC.

The SEC, on the other hand, said "no;" individuals should receive protection from retaliation whether they report securities violations directly to the SEC, to another regulatory body, or to an internal compliance authority. In its Final Rules, adopted in 2011, the SEC defined a "whistleblower" for purposes of the anti-retaliation provision as a person who reasonably believes that he or she has reported information of a possible securities laws violation and who has "provide[d] that information in a manner described in Section 21F(h)(1)(A) of the Exchange Act (15 U.S.C. 78u-6(h)(1)(A))."[22] In other words, under the SEC rule, anyone who reports information internally pursuant to any of the three protected categories under the anti-retaliation provision qualifies for its protection.

In the past year, the SEC has lobbied strongly for its position. It submitted an amicus brief in the Second Circuit case *Liu Meng-Lin v. Siemens AG*, which raised, but ultimately did not address, this issue.[23] And it also submitted amicus briefs in three district court cases. One of these cases settled, another is in alternative dispute resolution, but the third court agreed with the SEC's position.[24] The SEC has argued that the definition of whistleblower stands in tension with the third category of protected activities and that this tension creates a statutory ambiguity. In light of this ambiguity, the SEC, as the agency with rulemaking authority under the statute, adopted a reasonable interpretation of the statute that reads into the third category an implied exception to the whistleblower definition. Because this interpretation is reasonable, the SEC argues, it is entitled to judicial deference under well-settled law.[25]

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**B. So... Who got it right?**

Since the Fifth Circuit's decision in *Asadi*, numerous commentators have flocked to the SEC's defense. Encouraging internal reporting makes good sense, they say. The SEC calibrated its Final Rules to preserve the potency of internal reporting policies.[26] Internal reporting bolsters corporate compliance. Companies often know better whether allegations of securities laws violations are meritorious or frivolous. And once the allegations are brought to the attention of internal compliance officers, the company may be able to resolve the problem without ever getting the SEC involved, conserving valuable public resources and promoting corporate responsibility. Removing anti-retaliation protections for internal reports may undermine the regime of corporate integrity.

Certainly, these are all good points. But there are also significant policy considerations favoring the Fifth Circuit's position. The Fifth Circuit's interpretation prevents every minor employment matter from creating a federal cause of action. It also avoids exposing employers to legions of baseless anti-retaliation suits by disgruntled employees seeking to avoid justified employment actions. And it prevents a new wave of frivolous suits from bogging down the already heavy district court dockets.

Plus, as the statistics show, a healthy proportion of award

22.17 C.F.R. § 240.21F-2(b)(1).
23. See Brief of the SEC, Liu Meng-Lin v. Siemens AG, No. 13-4385 (2d Cir. 2013).
24. Order, Peters v. LifeLock, Inc., No. 14-cv-00576 (D. Ariz. Sept. 19, 2014) (Silver, J.) (Dkt. #47).
25. See Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).
26. See Brief of the SEC, Liu Meng-Lin v. Siemens AG, No. 13-4385 (2d Cir. 2013), at 2-3.

recipients—those whose allegations proved well-founded—reported the violations internally before moving on to the SEC. The parade of horribles contemplated in the wake of the Fifth Circuit's decision has not come to pass. And there is little reason to think this trend will not continue. Dodd-Frank and the SEC rules have structured incentives to encourage internal reporting, such as giving larger awards to recipients who report internally first and dating the information based on the date of the internal report rather than the date of the report to the SEC. Measures like these strike the right balance without tipping the scales too far in favor of employees.

The Fifth Circuit also got it right on the law, and nearly half the district courts to address this issue in the wake of *Asadi* have agreed.[27] After all, the courts all agree that the definition of "whistleblower" is unambiguous. The Fifth Circuit's interpretation credits that clarity. And the three anti-retaliation subsections defining the protected conduct are not particularly ambiguous either; here, too, the courts agree that the statute speaks clearly on what is covered. The possible ambiguity arises only from the interaction of these two provisions. Yet the Fifth Circuit interpreted the statute both to dispel this ambiguity and to apply both provisions according to their clear terms. The *Asadi* decision implements ordinary principles of statutory interpretation and yields sound whistleblower policy.

## IV. THE END?

The Fifth Circuit gets criticized for undermining congressional efforts to fight corporate crime. But the court's decision makes good legal sense and reinforces important policies by resisting the temptation to elevate every employment dispute to a federal cause of action. As the number of whistleblower tips and enforcement actions continues to rise, the Fifth Circuit's limitation on the anti-retaliation provision of Dodd-Frank may prove an important counterweight to ensure both corporate and individual responsibility.

27. Since *Asadi*, eleven district courts have addressed this issue. Six have adopted the SEC's position. *Bussing v. COR Clearing, LLC*, 20 F. Supp. 3d 719 (D. Neb. 2014); *Yang v. Navigators Grp., Inc.*, 18 F. Supp. 3d 519 (S.D.N.Y. 2014); *Ahmad v. Morgan Stanley & Co.*, 2 F. Supp. 3d 491, 495-97 n.5 (S.D.N.Y. 2014); *Khazin v. TD Ameritrade Holding Corp.*, No. 13-4149(SDW)(MCA), 2014 WL 940703, at *6 (D.N.J. Mar. 11, 2014); *Rosenblum v. Thomson Reuters (Mkts.) LLC*, 984 F. Supp. 2d 141, 146-49 (S.D.N.Y. 2013); *Ellington v. Giacoumakis*, 977 F. Supp. 2d 42, 44-46 (D. Mass. 2013). These courts agreed that the statute creates an ambiguity and that the SEC's rule is a reasonable interpretation of that ambiguity entitled to deference. Five courts have adopted the *Asadi* position, agreeing that the statute is unambiguous and that they must therefore give deference to Congress's clear intent that the statute cover only those who report to the SEC. *Berman v. Neo@Ogilvy LLC*, No. 14-cv-00523, 2014 WL 6860583 (S.D.N.Y. Dec. 5, 2014); *Verfuerth v. Orion Energy Sys.*, No. 14-C-352, 2014 WL 5682514 (E.D. Wis. Nov. 4, 2014); *Wagner v. Bank of America Corp.*, No. 12-cv-00381-RBJ, 2013 WL 3786643, at *4-6 (D. Colo. July 19, 2013); *Englehart v. Career Educ. Corp.*, No. 8:14-CV-444-T-33 EAJ, 2014 WL 2619501, at *9 (M.D. Fla. May 12, 2013); *Banko v. Apple Inc.*, 20 F. Supp. 3d 749 (N.D. Cal. 2013). Taking into consideration a few additional cases that pre-date *Asadi* and adopted the SEC's position, the SEC currently has a slight edge among the district courts.

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