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Expanded Protection For Whistleblowers

Emerging trend stems from Dodd-Frank anti-retaliation provisions.

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) provides monetary awards and anti-retaliation protections to incentivize whistleblowers to report violations of the securities laws and to increase transparency and corporate accountability.

The act was signed into law in 2010 to address widespread concerns regarding corporate corruption and failed internal controls, and its anti-retaliation provisions were implemented through the addition of §21F to the Securities Exchange Act of 1934, and codified at 15 U.S.C. §78u-6. Recent decisions in diverse jurisdictions interpreting the Dodd-Frank Act's anti-retaliation provisions suggest an emerging trend to extend the act's protections beyond one who discloses information directly to the SEC to cover those who report violations internally as well, and to include protection for an employee's "reasonable belief" of a "possible" violation of securities laws.

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Anti-Retaliation Provision

On its face, the Dodd-Frank Act defines "whistleblower" as "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission."[1] The act's anti-retaliation provision provides that

> [n]o employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—(i) in providing information to the Commission in accordance with this section; (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002, the Securities Exchange Act of 1934, including section 10A(m) of such Act, and any other law, rule, or regulation subject to the jurisdiction of the Commission.[2]

At least five district courts have acknowledged an apparent conflict in the plain terms of the Dodd-Frank Act's definition of "whistleblower"—one who provides information "to the Commission"—and the third category of the anti-retaliation provision that protects an individual who makes disclosures "required or protected" under any law, rule or regulation subject to the jurisdiction of the Commission. These early cases provide important insight into a possible trend to extend protection from retaliation to those who disclose violations of the securities laws through internal channels.

Recent Decisions

First impression: The 'Egan' decision. U.S. District Court Judge Leonard B. Sand of the Southern District of New York was confronted with an issue of first impression in the federal courts in *Egan v. TradingScreen*, 2011 WL 1672066 (S.D.N.Y. May 4, 2011), in which the plaintiff, Egan, claimed he was entitled to protection under Dodd-Frank's anti-retaliation provision for his internal disclosure of securities violations by the CEO of his employer, TradingScreen. Egan alleged he learned that the CEO of TradingScreen was diverting corporate assets to another company solely owned by the CEO that offered products and services that competed with those of TradingScreen. Egan reported the CEO's actions to the company president, who passed the information to the independent members of the board of directors. The law firm hired by the independent directors confirmed Egan's allegations.

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The CEO fired Egan and denied Egan the company's customary severance package.

Egan brought a private action alleging, inter alia, that his termination was a violation of Dodd-Frank's anti-retaliation provision. TradingScreen argued that Egan was not protected by Dodd-Frank because Egan never personally provided information to the SEC. The court addressed two related questions: Whether any disclosure to the SEC is required as a predicate to an action under the whistleblower anti-retaliation provision of the Dodd-Frank Act, and if such disclosure is required, whether the party invoking the act must have personally and directly reported to the SEC.

The *Egan* court noted that the plain language of the statutory definition of "whistleblower" requires one to report to the SEC in order to invoke the anti-retaliation provision,[3] but the anti-retaliation provision's last category protects those who make disclosures that "are required or protected" under any law, rule or regulation subject to the jurisdiction of the Commission.[4] The court found that the latter provision does not require that disclosure be made directly to the SEC, so a literal reading of the definition of "whistleblower" (requiring reporting to the SEC) would effectively invalidate the anti-retaliation provision's protection for whistleblower disclosures that do not require reporting to the SEC. The court found "little evidence of Congress's purpose" in the legislative history of the act, but noted that the absence of broad protections for whistleblowers like those enacted in connection with the Bureau of Consumer Financial Protection[5] indicated that Congress intended to encourage whistleblowers reporting violations of securities laws to report to the SEC.

Sand held that the "contradictory provisions of the Dodd-Frank Act are best harmonized by reading 15 U.S.C. §78u6(h)(1)(A)(iii)'s protection of certain whistleblower disclosures not requiring reporting to the SEC as a narrow exception to 15 U.S.C. §78u-6(a)(6)'s definition of a whistleblower as one who reports to the SEC. Therefore, the plaintiff must either allege that his information was reported to the SEC, or that his disclosures fell under the…categories of disclosures delineated by 15 U.S.C. §78u-6(h)(1)(A)(iii) that do not require such reporting," those under the Sarbanes-Oxley Act, the Securities Exchange Act, or any other law, rule or regulation subject to the jurisdiction of the SEC.

The court found that Egan failed to meet the Dodd-Frank Act's requirement that disclosures be "required or protected" under a law or regulation subject to the SEC's jurisdiction. Egan's claims depended, therefore, upon proving that he acted jointly in efforts to disclose the CEO's actions to the SEC. For this purpose, it was sufficient "that the person invoking the private right of action have acted with others in such reporting, not that he or she led the effort to do so." The court acknowledged that an SEC Proposed Rule required that a whistleblower personally report directly to the SEC to receive a bounty award from the SEC but the retaliation protections apply irrespective of whether a whistleblower satisfies the procedures and conditions to qualify for an award.[6] Since Egan had raised factual allegations that the information he provided was reported to the SEC, Egan was given leave to amend his complaint to plead facts supporting his belief. However, in a later decision, the court determined that Egan was unable to sufficiently allege that information was actually provided to any law enforcement official and granted defendants' motion to dismiss.[7]

Recent decisions interpreting the Dodd-Frank Act's anti-retaliation provisions suggest an **emerging trend to extend the act's protections** beyond one who discloses information directly to the SEC to cover those who report violations internally as well, and to include protection for an employee's "reasonable belief" of a "possible" violation of securities laws.

Disclosures "required or protected": 'Nollner' and 'Asadi'. In *Nollner v. S. Baptist Convention*, 2012 WL 1108923 (M.D. Tenn. April 3, 2012), the court granted defendants' motion to dismiss a claim of retaliatory discharge under the Dodd-Frank Act, holding that the Foreign Corrupt Practices Act (FCPA) does not address "securities law violations" as is required to trigger Dodd-Frank's anti-retaliation provision. In *Nollner*, the plaintiff alleged that he was terminated in violation of the Dodd-Frank Act because he reported unsafe building practices and refused to participate in the making of bribes and other payments that are illegal under the FCPA.

Citing *Egan*, the court found that the Dodd-Frank Act does not require that the whistleblower interacted directly with the SEC—only that the disclosure, to whomever made, was "required or protected" by certain laws within the SEC's jurisdiction. The court included internal reporting in its explanation that, "if one of the referenced acts either (a) required an employee to report a potential securities violation internally or (b) protected an employee's disclosure of that information to another federal agency or federal law enforcement office, §78u-6(h)(1)(A)(iii) would prohibit retaliation against that whistleblower" by the employer. The court also noted the SEC rules implementing the provision state that disclosure by an employee of a public company not made to the SEC can be covered if disclosure is reported "to federal regulatory or law enforcement agencies, a member or committee of Congress, or a person with supervisory authority to investigate, discover or terminate misconduct."[8]

However, Nollner's claim under the Dodd-Frank Act was dismissed because he could not identify any aspect of the FCPA that "required" him to disclose FCPA violations or "protected" him for doing so, as required by §78u-6(h)(1)(A)(iii). Furthermore, Nollner's employer was not an "issuer" for purposes of the FCPA and was not "subject to the jurisdiction" of the SEC with respect to FCPA violations, and the violations reported by Nollner did not "relate to violations of the securities laws." The court therefore refused to "interpret the Dodd Frank Act as extending its whistleblower protections to companies that otherwise have no relationship to the SEC and that have not committed securities violations."

Similarly, in *Asadi v. GE Energy (USA)*, 2012 WL 2522599 (S.D.Tex. June 28, 2012), the court found that plaintiff's internal reporting of potential violations of the FCPA did not fall within the anti-retaliation provision of the Dodd-Frank Act because he could not show that his internal disclosures of alleged corrupt actions were "protected" or "required" by the terms of the FCPA. The *Asadi* court recited the reasoning of *Egan* and *Nollner* regarding whether a plaintiff qualified as a whistleblower without reporting to the SEC, but declined to decide the issue because the claim failed on other grounds.

Internal reporting and a "reasonable belief" of a "possible" securities law violation: 'Kramer' and 'Ott'. In *Kramer v. Trans-Lux*, 2012 WL 4444820 (D. Conn. Sept. 25, 2012), U.S. District Court Judge Stefan R. Underhill decided that Dodd-Frank's anti-retaliation provision protects a plaintiff who reports a "reasonable belief"

of a "possible" securities law violation in internal communications or a letter to the SEC.

Kramer, who was responsible for oversight of Trans-Lux's ERISA-governed pension plan, alleged a number of concerns with the company's administration of its pension plan. Kramer reported his concerns about these issues in emails to the CFO and CEO, and his concerns were dismissed. Kramer thereafter reported his concerns to the board of director's audit committee by email, and sent a letter to the SEC. Kramer alleged that after his report to the audit committee, he was reprimanded, stripped of his responsibilities and ultimately terminated.

Trans-Lux argued that because Kramer did not provide information to the SEC in a manner required by the SEC (online through the SEC website or submitting the Form TCR by mail or fax), he did not qualify as a "whistleblower" as defined in 15 U.S.C. §78u-6(a)(6). The *Kramer* court identified the same contradiction between the definition of "whistleblower" and the categories of the anti-retaliation provision that do not require reporting to the SEC, and determined the language of the Dodd-Frank Act to be ambiguous. The court cited the reasoning of *Asadi*, *Nollner* and *Egan* in its finding that Trans-Lux's interpretation would "dramatically narrow the available protections available to potential whistleblowers," which "seems inconsistent with the goal of the Dodd-Frank Act" to create new incentives and protections for whistleblowers.

Upon finding the act ambiguous, the court consulted the recently promulgated SEC Rule, 17 C.F.R. §240.21F-2, defining a whistleblower for purposes of the anti-retaliation protections of §21F(h)(1), as one who has "a reasonable belief" that the information he is providing relates to a "possible" securities law violation and who provides that information in a manner described in §21F(h)(1)(A) of the Exchange Act.[9] Trans-Lux argued that the SEC's Rule was an impermissible construction of the statute because it would allow potential plaintiffs to pursue under the Dodd-Frank Act retaliation claims they could not otherwise pursue under Sarbanes-Oxley due to Sarbanes-Oxley's shorter statute of limitations and exhaustion requirement. The court rejected this argument, finding that the Dodd-Frank Act was intended to expand upon the protections of Sarbanes-Oxley and noted that the *Egan* court had resolved the discrepancies in the anti-retaliation protections in the same way.

The court determined that Kramer's letter to the SEC and internal communications qualified as "providing information" in a manner described in 15 U.S.C. §78u-6(h)(1)(A) because that section references Sarbanes-Oxley, which protects persons who disclose information provided to, among others, "a person with supervisory authority over the employer (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)."[10] Sarbanes-Oxley's whistleblower protections also extend to persons who disclose information to a federal regulatory agency.[11] The court found that Kramer had alleged sufficient facts to support a Dodd-Frank Act whistleblower claim based on his internal and external communications reporting his "reasonable belief" that Trans-Lux committed securities law violations.

A few days after *Kramer* was decided, the chief judge of the Southern District of New York declined to dismiss a Dodd-Frank anti-retaliation claim. The plaintiff in *Ott v. Fred Alger Management*, 2012 WL 4767200 (S.D.N.Y. Sept. 27, 2012) alleged that she was fired for reporting her employer's alleged unlawful trading policy internally and in discussions with the SEC. As in *Kramer*, the court cited the SEC's Rule defining a whistleblower covered by the anti-retaliation provision as one with a "reasonable belief" that the information provided relates to a securities violation. The court further relied upon a release from the SEC indicating that the "reasonable belief" standard requires the employee to hold a "subjectively genuine belief that the information demonstrates a possible violation, and that this belief is one that a similarly situated employee might reasonably possess."[12]

Employer Actions

Claims under the Dodd-Frank Act are expected to increase with the expansion of whistleblower protections, and the relief available in a private action based on the anti-retaliation provisions includes reinstatement, double back pay, and costs and fees.[13] In light of the expected uptick in claims under Dodd-Frank, and the tendency of many courts to interpret expansively the anti-retaliation protections of the act, employers should aggressively implement robust policies and procedures to encourage internal reporting of improper or unlawful conduct. All employees should be educated on the company's policies and mechanisms for reporting at the time of hire and on a regularly repeated schedule. The reporting procedures should be accessible to all employees and periodically reviewed for improvements. Employers should consider providing an option to report by email or anonymous voicemail box. In addition, all reports should be addressed by the company in a serious and consistent manner. If the report is not received anonymously, the reporting employee should be informed of the investigation procedure in writing. The investigating party should interview the complainant and other witnesses and contemporaneously document the procedures followed after the complaint is received. Internal reporting affords employers an opportunity to address and remedy any issues before they must be reported to a regulatory agency. An internal reporting program will be most credible if it is transparent; employers should consider notifying employees of their statutory protections and alternative external reporting procedures. In addition, employers should thoroughly, consistently and contemporaneously document performance issues with underperforming employees and maintain contemporaneous records of the feedback given and disciplinary or other measures taken to advise employees of those problems.

Although it is still early in the life of the Dodd-Frank Act, and few courts have had the opportunity to interpret individual claims of retaliation, in light of the act's expressed intent to increase transparency and encourage whistleblowers to report, employers should take note of these early cases determining broad protections for internal reporting of one's "reasonable belief" of "possible" violations discussed here. A strong preventative policy and strategic response measures, in connection with legal counsel, can help position companies to respond appropriately to an emerging trend toward expansive protection for whistleblowers under the Dodd-Frank Act.

1. 15 U.S.C. §78u-6(a)(6) (emphasis added).
2. 15 U.S.C. §78u-6(h)(1)(A).
3. 15 U.S.C. §78-6(a)(6).
4. 15 U.S.C. §78-6(h)(1)(i)-(iii).
5. 12 U.S.C. §5567(a)(1).
6. 75 Fed.Reg. 70488, at 70519 (Nov. 17, 2010) (now codified at 17 C.F.R. 240.21F-2(b)(iii)).
7. *Egan v. TradingScreen*, 2011 WL 4344067, at *4 (S.D.N.Y. Sept. 12, 2011).
8. 76 Fed. Reg. 34300, at 34304 (June 13, 2011).
9. 15 U.S.C. §78u-6(h)(1)(A).
10. 18 U.S.C. §1514A(a)(1)(C).
11. 18 U.S.C. §15 14A(a)(1)(A).
12. Securities Exchange Commission, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act Release No. 34-64545 at 7 (May 25, 2011).
13. 15 U.S.C. §78-u-6(h)(1)(C).