

## Employers May Regret Forcing Dodd-Frank Whistleblower Test

By **Carmen Germaine**

*Law360, New York (June 27, 2017, 10:43 PM EDT)* -- While the U.S. Supreme Court may take a narrow view of the Dodd-Frank Act's protections for whistleblowers by limiting them to those who report violations to the SEC, experts say such a decision could be a "Pyrrhic victory" for employers, as employees who would otherwise report violations internally may be forced into the agency's arms.

The high court on Monday accepted Digital Realty Trust Inc.'s petition to review a Ninth Circuit decision finding former Vice President of Portfolio Management Paul Somers can sue over alleged retaliation against him, agreeing to resolve a circuit split over whether the Dodd-Frank Act's whistleblower anti-retaliation protections extend to employees who report alleged securities law violations internally, but not to the U.S. Securities and Exchange Commission.

With the addition of Justice Neil Gorsuch — a strict textualist skeptical of so-called Chevron deference — to the Supreme Court bench, experts say there's a real possibility the high court will take the view the provision applies only to SEC whistleblowers. But many warned that such a defeat for employees won't necessarily be a victory for employers.

"This might ultimately be a Pyrrhic victory for employers," said whistleblower attorney Jason Zuckerman of Zuckerman Law. "Narrowing protection for internal whistleblowing will likely result in more whistleblowers disclosing securities law violations directly to the SEC."

Somers brought his case in November 2014, alleging he was discriminated against as an openly gay man at Digital Realty from July 2010 to April 2014, and was ultimately terminated based on "vague, trivial and false allegations of misconduct" after he complained to senior management that a senior vice president had eliminated some internal corporate controls, in violation of the Sarbanes-Oxley Act.

U.S. District Judge Edward M. Chen denied Digital Realty's motion to dismiss the suit in May 2015.

A split Ninth Circuit upheld Judge Chen's decision in March of this year, finding Dodd-Frank's whistleblower anti-retaliation provision "unambiguously and expressly protects" both those who report to the SEC and internal whistleblowers.

The provision in question, Subdivision (iii) of Section 21F of Dodd-Frank, prohibits employers from discharging or discriminating against a whistleblower who makes disclosures that are required or protected by Sarbanes-Oxley.

The Ninth Circuit's opinion followed the Second Circuit's 2015 holding that the retaliation provision is ambiguous and that courts must defer to the SEC's guidance. By contrast, a Fifth Circuit panel held in 2013 that only those who report to the SEC are whistleblowers for the purposes of the provision.

In its petition for writ of certiorari, filed in April, Digital Realty argued that the Ninth Circuit had upset the balance between the Sarbanes-Oxley Act and the Dodd-Frank Act and would effectively make Sarbanes-Oxley's anti-retaliation scheme obsolete.

Somers agreed that the petition presented a straightforward conflict and that the issue "is admittedly important and recurring." But he argued the circuit conflict is "hardly intractable," saying the Fifth Circuit may later reconsider its decision in light of other appellate decisions.

The Supreme Court evidently agreed with Digital Realty, agreeing on Monday to take up the case.

"The stakes are quite high," said Gregory Keating, chair of Choate Hall & Stewart LLP's whistleblower defense group. "This is a case that people have been watching and waiting for the Supreme Court to clear up the circuit split."

Keating explained that the stakes are particularly high because of differences in the remedies available under the Dodd-Frank Act and under the Sarbanes-Oxley Act of 2002.

Employees bringing a retaliation claim under Dodd-Frank have at least six years and up to 10 to bring a suit in federal court, where they can sue for double back pay. Under Sarbanes-Oxley, employees have only 180 days to bring a claim and must first arbitrate before the U.S. Department of Labor.

Zuckerman said the anti-retaliation provisions of Sarbanes-Oxley remain a strong remedy to combat whistleblower retaliation, pointing to a recent federal jury verdict that awarded former Bio-Rad general counsel Sanford Wadler \$8 million in back wages and punitive damages for retaliation.

But Rebecca Katz, a whistleblower attorney with Kessler Topaz Meltzer & Check LLP, said Sarbanes-Oxley "isn't the great panacea that defendants are touting for whistleblowers who report internally." She said that in her experience, the earlier statute doesn't offer a particularly effective process for wronged employees.

As the Supreme Court takes up the case, there is some hope for employees hoping to retain their Dodd-Frank protections. Two of the three circuit courts to have considered the issue have ruled the provision applies to internal whistleblowers, and the dissenting court, the Fifth Circuit, ruled against internal whistleblowers before the SEC published its own guidance.

But the circuit courts ruling in favor of employees have issued divided opinions. More pressingly, experts noted the high court bench is currently stacked with strict constructionists inclined to take a literal reading of Dodd-Frank.

Significantly, the newest justice on the court, Justice Gorsuch, is not only a textualist but has specifically taken issue with Chevron deference, the doctrine enshrined in the Supreme Court's 1984 decision in *Chevron USA Inc. v. Natural Resources Defense Council* that requires courts to defer to agency interpretations — such as the SEC's interpretation of the anti-retaliation provision.

"His addition to the court is certainly a positive for Digital Realty," said Renee Phillips, the co-head of Orrick

Herrington & Sutcliffe LLP's whistleblower task force.

Justice Gorsuch made his distaste for Chevron deference clear in a concurrence to his own opinion in the Tenth Circuit case *Gutierrez-Brizuela v. Lynch*, saying the doctrine and its progeny allow "executive bureaucracies to swallow huge amounts of core judicial and legislative power and concentrate federal power in a way that seems more than a little difficult to square with the Constitution of the framers' design."

"Maybe the time has come to face the behemoth," Justice Gorsuch wrote.

Mark D. Cahn, a partner at WilmerHale who served as the SEC's general counsel, said the Digital Realty case presents an opportunity for the Supreme Court to discuss what deference courts must provide to the SEC and other administrative agencies in interpreting ambiguities in statutes, and a decision here could indicate how the high court will approach other similar cases.

"There are broader implications for the government generally in how the court approaches agency deference," Cahn said.

Phillips said that, with Justice Gorsuch joining fellow textualists Justices Clarence Thomas, Samuel Alito and John Roberts, "there's a really decent chance here of reversal."

Another potential factor stacking the cards against Somers, Keating explained, is Justice Anthony Kennedy's rumored retirement. If the 80-year-old justice does decide to retire before the case is argued, President Donald Trump will likely nominate a replacement with the same legal jurisprudence as Justice Gorsuch, Keating said.

With the smoke signals thus far suggesting the Supreme Court will reverse the Ninth Circuit, some companies and employment attorneys are hopeful the justices will reduce employers' liability.

"It can make a big difference to our clients if Dodd-Frank does not cover that internal whistleblowing," Phillips said. "From an employer perspective, it's one less cause of action that employees and their counsel have in their arsenal to sue employers for internal whistleblowing."

Phillips said she didn't anticipate a reversal would lead to an influx of SEC reports. She said that many retaliation claims are essentially created "after the fact," in consultation with a plaintiffs lawyer, and that at that point it would be too late for a terminated employee to take advantage of the anti-retaliation provision by reporting to the SEC anyway.

"I just don't think that employees are going to have the foresight to go to the SEC when they don't otherwise plan to, just to have an extra cause of action after their termination," Phillips said.

But many experts disagreed. Zuckerman said employees are already fearful that reporting securities law violations will result in reprisal and could ultimately be "career suicide."

"I think this will only heighten the concern that corporate employees have about blowing the whistle," Zuckerman said.

Jordan A. Thomas, chair of Labaton Sucharow LLP's whistleblower representation practice, also argued that savvy whistleblowers will be more likely to skip internal reporting altogether if the Supreme Court rules against Somers.

“An adverse decision will lead sophisticated whistleblowers to report to the SEC first, and because of the risk of retaliation in the workplace, many of these folks will bypass internal reporting systems altogether,” Thomas said.

Even employer defense attorney Holly H. Weiss of Schulte Roth & Zabel LLP said that, while at “first blush” employers may assume an adverse ruling would be a good thing, they may be overlooking how such a decision would incentivize employees to bypass internal reporting.

Weiss identified another reason employers may want more robust Dodd-Frank protections.

“If it goes the other way, meaning that employees are protected if they internally report, yes, you have the specter of a lawsuit under Dodd-Frank, but you also have an employer that has an internal report that it can act on appropriately,” Weiss said.

By removing retaliation protections for internal whistleblowers, the Supreme Court may remove one liability for employers but expose them to more SEC investigations and actions. And if employees aren’t reporting internally, Weiss and other experts explained, employers may not be able to detect and address securities violations before a problem is big enough to catch the SEC’s attention.

If that happens, Zuckerman said, employers would “win the battle but lose the war” by reducing their ability to detect fraud internally.

Thomas explained that if sophisticated whistleblowers are discouraged from first reporting violations internally, corporate America will be deprived of the ability to address problems immediately.

“It also negatively impacts what the Commission views as its first line of defense, which is internal compliance programs,” Thomas said. “It’s a lose-lose proposition for corporate America and the SEC.”

In some ways, the push to narrow Dodd-Frank’s anti-retaliation protections comes as ironic after many employers and corporate lobbyists pushed the SEC to require whistleblowers to report internally first, Katz said.

To now argue that only whistleblowers who report directly to the SEC are protected sends the message that employees should go straight to the agency and not report internally, Katz said.

“I think it creates a little bit of an issue for them, and it’s somewhat disingenuous,” she said.

The SEC ultimately didn’t opt to require whistleblowers to report internally first, but it did choose to incentivize internal reporting by taking it into account when calculating whistleblower bounties.

As a result, Thomas said, if the Supreme Court takes a narrow view of Dodd-Frank, the agency will be “between a rock and a hard place” and may have to rethink its rules.

He said the SEC could either remove its incentives encouraging internal reporting so it’s not sending whistleblowers into harm’s way, or embark on some kind of public education campaign to advise potential tipsters that although they can get additional credit for reporting internally, they won’t be protected against retaliation under Dodd-Frank.

“The Commission would have to say, ‘Don’t report internally unless you’re feeling lucky,’” Thomas said. “That’s a bad outcome for the SEC, it’s a bad outcome for responsible organizations and it’s a bad outcome for whistleblowers who are not sophisticated because they could be subject to retaliation.”

Up until now, Weiss said, the SEC has been “extremely active” in whistleblower enforcement, producing several publications interpreting the rule and taking enforcement actions to protect whistleblowers and penalize employers it deemed were muzzling tipsters, in addition to issuing awards.

The agency has also been active in litigation over the anti-retaliation provision, filing amicus briefs in both appellate and district courts expressing its strong view that the provision applies to internal whistleblowers, Weiss said.

“It may be very interesting to see how that plays out depending on how the decision comes out — would it be seen as a victory for the SEC, or a blow and perhaps signaling a rollback of some of the activities it took under the prior administration?” Weiss said.

A spokesman for Digital Realty said Monday the company welcomed the Supreme Court’s decision to hear the case and resolve the circuit split.

“The Supreme Court’s review should end the growing confusion in the lower courts and give employers greater clarity on the requirements under Dodd-Frank,” the spokesman said. “We look forward to presenting our case to the Supreme Court.”

Daniel L. Geysler, a partner with Stris & Maher LLP representing Somers, said he was not surprised the court elected to grant Digital Realty’s petition for writ of certiorari given the circuit split on the question of the application of Dodd-Frank’s whistleblower protections. However, he said the Ninth Circuit’s reading of the law was consistent with Congress’ intent when it drafted the whistleblower portion of Dodd-Frank.

“Digital’s reading, by contrast, would upset the proper operation of both Dodd-Frank and Sarbanes-Oxley. We look forward to litigating this important issue before the court,” Geysler said.

Digital Realty is represented by Kannon K. Shanmugam, Amy Mason Saharia, A. Joshua Podoll and Meng Jia Yang of Williams & Connolly LLP, and Brian T. Ashe, Kiran A. Seldon and Kyle A. Petersen of Seyfarth Shaw LLP.

Somers is represented by Peter K. Stris, Brendan S. Maher, Daniel L. Geysler and Douglas D. Geysler of Stris & Maher LLP, and Stephen F. Henry of Stephen F. Henry Esq.

The case is Digital Realty Trust Inc. v. Paul Somers, case number 16-1276, at the Supreme Court of the United States.

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