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CRIMINAL DEFENSE AND INTERNAL INVESTIGATIONS ALERT
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Supreme Court Narrows Whistleblower Definition Under Dodd-Frank: Now Are Your Company's Compliance Systems in Order?

By Laurel Brandstetter and Danielle Morrison

On February 21, 2018, the U.S. Supreme Court ruled that "Dodd-Frank's anti-retaliation provision does not extend to an individual, like Somers, who has not reported a violation of the securities laws to the SEC." The Justices unanimously agreed in the judgment of the Court, though a minority wrote concurring opinions to articulate different rationales. Although this decision narrows the definition of "whistleblower" and protects companies in certain respects, business leaders should now examine their internal compliance systems to ensure the new incentives for employees to report directly to the U.S. Securities and Exchange Commission (SEC) does not have unintended consequences for addressing and resolving potential problems.

As Schnader recently reported, the Supreme Court held oral argument for *Digital Realty Trust Inc. v. Somers* this past November to resolve a split among the Second, Fifth, and Ninth Circuit Courts of Appeal about whether the Dodd-Frank Act's anti-retaliation provisions protect internal whistleblowers. Dodd-Frank 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." At issue was whether this definition applied to the anti-retaliation provision in the Act. This week, our nation's highest court determined that it does, requiring whistleblowers to report to the Commission to receive the protection of the anti-retaliation provisions.

Congress established the Dodd-Frank Act and Sarbanes-Oxley Act to uncover corporate fraud by affording whistleblowers incentives to report wrongdoing and protection from retaliation. In recent years, whistleblowers have increasingly sued their former employers under Dodd-Frank, rather than Sarbanes-Oxley, due to longer filing deadlines, the ability to directly sue a former employer in federal court, and larger damage awards.

Following this trend, Paul Sommers sued Digital Realty Trust ("Digital") in a California federal court after he was terminated from a senior management position. Sommers claimed that he was terminated for internally reporting the alleged violations of federal securities laws by his former supervisor. Digital asserted that he was terminated for cause. Digital argued before the district court and Ninth Circuit that Somers did not qualify as a whistleblower under Dodd-Frank, but neither court found the argument availing based on the "overall operation of the statute."

Before the Supreme Court, Somers, joined by the Solicitor General, maintained his argument, contending that applying the whistleblower definition in the Act to the anti-retaliation provision would "create obvious incongruities" and "vitiate much of the [statute's] protection." The Supreme Court disagreed. The Court reasoned that if the SEC wanted to provide other means for whistleblowers to provide information rather than directly reporting the conduct to the SEC, it has the authority to do so.

Now that the Supreme Court has provided clarification on this issue, employers may notice a decline in internal reporting. Companies who experience such a decline should be wary. A decline in internal reporting in response to this legal development could and should be treated by companies as a red flag that their ethical house may not be in order. Silence should not be construed as compliance. Conversely, companies with robust compliance and ethics programs that provide for reporting mechanisms in which employees have confidence – such as anonymous hotlines – should not see a decline in internal reporting. In these environments, employees should continue to make reports when they are encouraged to do so and are supported by a culture of transparency within the business.

In all organizations, general counsel and senior executives should take this development as a moment to assess extant ethics and compliance programs. A baseline risk assessment of these programs should be taken with a critical eye toward an internal audit mechanism that will identify potential misconduct and an appropriate remediation protocol. If not presently in place, policies and procedures should be created to provide for and incentivize confidential reporting. As we stated in our last Alert, employers and employees are often at cross-purposes under Dodd-Frank, Sarbanes-Oxley, and other federal laws. Taking steps to strengthen compliance systems and establish confidence in these programs will go a long way toward supporting internal reporting, preempting potential liability under anti-retaliation laws, as well as demonstrating good faith efforts to prevent indictments by the Department of Justice or SEC if a violation occurs. ◆

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