Second Circuit Allows Whistleblower Retaliation Protection Without Reporting to SEC

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On September 10, 2015, in a 2-1 decision in *Berman v. Neo@Ogilvy LLC*, the US Court of Appeals for the Second Circuit ruled that whistleblowers who report securities law violations internally but not to the US Securities and Exchange Commission (SEC) are protected under the Dodd-Frank Act from employer retaliation. No. 14-4626, 2015 WL 5254916, at *9 (2d Cir. Sept. 10, 2015). The decision creates a split with the Fifth Circuit, which ruled in *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013), that Dodd-Frank anti-retaliation provisions protect only whistleblowers who report to the SEC.

Background

Since 2011, the federal courts have focused on an inconsistency between two provisions in Section 21F of the Securities Exchange Act of 1934, as modified by Dodd-Frank. *See, e.g., Egan v. TradingScreen, Inc.*, No. 10 CIV. 8202, 2011 WL 1672066, at *4 (S.D.N.Y. May 4, 2011). On the one hand, Section 21F(a)(6) defines a "whistleblower" as an individual who provides information related to a violation of the securities laws *to the Commission*. On the other hand, a separate subsection of the statute includes Sarbanes-Oxley-related disclosures reported *internally at a company* as protected whistleblowing activity. See Securities Exchange Act of 1934, § 21F(h)(1)(A), 15 U.S.C. § 78-u6(h)(1)(A) (2010).

The first two of Dodd-Frank's three anti-retaliation provisions explicitly protect from retaliation only those who disclose to the SEC. *See* Sections 21F(h)(1)(A)(i)-(ii). The third anti-retaliation provision, however, extends protection to whistleblowers who make disclosures that are required or protected by the Sarbanes-Oxley Act, the Securities Exchange Act of 1934, 18 U.S.C. § 1513(e) (prohibiting retaliation against a witness, victim or informant), and "any other law, rule, or regulation subject to the jurisdiction of the Commission." See Section 21F(h)(1)(A)(iii) (2010). This third provision therefore appears to extend whistleblower anti-retaliation protections beyond communications with the SEC. For example, the Sarbanes-Oxley Act protects from retaliation individuals who disclose information that they reasonably believe constitutes a violation of SEC rules or regulations to a person with supervisory authority over the employee. See 18 U.S.C. § 1514A(a)(1)(c) (2010). Such communications seem to fall into the third category of protected conduct under Dodd-Frank, despite

not fitting the definition of whistleblowing in Section 21F(a)(6) of the statute.

The SEC attempted to harmonize the apparent inconsistency in the statute by enacting Rule 21F-2, which includes two separate definitions of "whistleblower." In Rule 21-F(2):

1. Part 21F-2(a) provides that only individuals who report possible securities law violations to the Commission are eligible for a whistleblower bounty payment.
2. Part 21F-2(b), which defines the scope of the anti-retaliation protections afforded by Dodd-Frank, contains a broader definition of the term "whistleblower." Under Rule 21F-2(b)(1)(ii), individuals who report "in a manner described in Section 21F(h)(1)(A) of the Exchange Act"—which includes internal reports under Sarbanes-Oxley—are entitled to Dodd-Frank's anti-retaliation protections, regardless of whether the individuals have provided the same information to the Commission.

Federal courts are divided over how to resolve the ambiguity. The majority of federal district courts to have addressed this tension have deferred to the SEC's interpretation—that internal reports made under Sarbanes-Oxley are entitled to Dodd-Frank's anti-retaliation protections (though not the potential bounty). Several of these district courts have followed the approach to analyzing agency decision-making set forth in *Chevron*, *U.S.A.*, *Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984): they have held that the statute is ambiguous, have determined that the SEC is the expert agency charged with the statute's implementation, have held that the SEC's interpretation of the uncertain statutory provisions is reasonable, and therefore have deferred to the SEC. *See, e.g., Murray v. UBS Sec., LLC*, No. 12 CIV. 5914 JMF, 2013 WL 2190084, at *4-5 (S.D.N.Y. May 21, 2013); *Rosenblum v. Thomson Reuters (Markets)* LLC, 984 F. Supp. 2d 141, 147-48 (S.D.N.Y. 2013); *Kramer v. Trans-Lux Corp.,* No. 3:11CV1424 SRU, 2012 WL 4444820, at *4-5 (D. Conn. Sept. 25, 2012).

Other federal courts, including the Fifth Circuit, have held that the definition of "whistleblower" in Section 21F(a)(6) controls the entire section, including Subsection 21F(h)(1)(A). *See Asadi*, 720 F.3d at 630; *Verfuerth v. Orion Energy Sys., Inc.*, 65 F. Supp. 3d 640, 643-46 (E.D. Wis. 2014); *Banko v. Apple Inc.*, 20 F. Supp. 3d 749, 756-57 (N.D. Cal. 2013); *Wagner v. Bank of Am. Corp.,* No. 12-cv-00381-RBJ, 2013 WL 3786643, at *4-6 (D. Colo. July 19, 2013).

Thus, in *Asadi*, the Fifth Circuit held that the "plain language" of Section 21F(h)(1)(A) creates a private right of action for unlawful retaliation only for individuals who meet the statutory definition of whistleblower in Section 21F(a)(6). The court found no conflict between the statutory definition of "whistleblower" in Section 21F(a)(6) and the scope of activity protected from retaliation in Section 21F(h)(1)(A)(iii). The Fifth Circuit's interpretation of the statutory language of Section 21F conflicts with the more expansive reading of the anti-retaliation provision by the SEC and the majority of federal district courts to consider the question.

On August 4, 2015—just over one month before the Second Circuit's decision—the SEC issued an interpretive release clarifying that, for purposes of protection from employer retaliation, an individual's status as a whistleblower does not depend on whether the individual reported to the SEC. Rather, according to the SEC's interpretive guidance, "Rule 21F-2(b)(1) alone governs the

procedures that an individual must follow to qualify as a whistleblower eligible for Section 21F's employment retaliation protections," meaning that individuals who make internal disclosures under Sarbanes-Oxley are protected by the Dodd-Frank anti-retaliation provisions. Interpretation of the SEC's Whistleblower Rules Under Section 21F of the Securities Exchange Act of 1934, Release No. 34-75592 (Aug. 4, 2015).

The *Berman Case*

Plaintiff Daniel Berman was a finance director at Neo@Ogilvy LLC who alleged that he was terminated after reporting various practices that he believed amounted to accounting fraud, including delayed payments, improperly recognized revenues, accounting reserves improperly reversed into profits, and selectively lenient payment terms. *Berman v. Neo@Ogilvy LLC*, No. 14-CV-00523, 2014 WL 6865718, at *1 (S.D.N.Y. Aug. 15, 2014) (magistrate judge report and recommendation). The district court dismissed the case, reasoning that Section 21F provides whistleblower protection only to those discharged for reporting securities violations to the SEC.

On appeal, the Second Circuit reversed, holding that it need not "definitively construe" Section 21F. *Berman*, 2015 WL 5254916, at *9. The court instead concluded that, because Section 21F as a whole is ambiguous, it was obliged to defer to the "reasonable interpretation of the agency charged with administering the statute," the SEC. *Id*. The court reasoned that, while it has no doubt that the phrase "provide . . . to the Commission" means what it literally says, "the issue is whether the statutory provision applies to another provision of the statute, or, more precisely, whether the answer to that question is sufficiently unclear to warrant *Chevron* deference to the Commission's regulation." *Id*. at *5. The panel majority found that Section 21F is ambiguous and held that the court therefore should defer to the SEC's reasonable interpretation of the statutory provision, as reflected in the rule. As a result, the Second Circuit reversed the district court and remanded the case for further proceedings. *Id*. at *9.

In his dissent, Second Circuit Judge Dennis Jacobs largely followed the reasoning of the Fifth Circuit's *Asadi* opinion, arguing that the majority opinion "extends deference to an SEC regulation that alters the unambiguous definition of 'whistleblower' to include anyone who reports a securities law violation 'in a manner described in . . . 15 U.S.C. 78u-6(h)(1)(A),' 17 C.F.R. § 240.21F-2(b)(1), including those who report a securities violation to their employer only." *Berman*, 2015 WL 5254916, at *11 (Jacobs, J., dissenting). The dissent asserted ed that the statute's definitions section is unambiguous in applying the definition of "whistleblower" to all of the relevant provisions in that section of the statute. Id. at *12. Thus, according to the dissent, "when Congress used the word 'whistleblower' in 15 U.S.C. 78u-6(h)(1)(A), it 'mean[t] any individual who provides . . . information relating to a violation of the securities laws *to the Commission*.'" Id. (citing 15 U.S.C. § 78u-6(a)(6)) (emphasis added).

Practical Impact

The Second Circuit's decision in *Berman* creates a circuit split, which increases the likelihood of Supreme Court review. Until that time, companies—particularly those with operations in the Second Circuit (Connecticut, New York and Vermont)—should anticipate whistleblower anti-retaliation

claims on the basis of putative internal reports.

Companies should consider implementing the following strategies for mitigating whistleblower retaliation risks:

- processes to review internal reports of compliance concerns;
- written procedures for safeguarding the identity of reporting employees;
- periodic mandatory training for managers on confidentiality and anti-retaliation;
- well-publicized communications across the organization about internal reporting mechanisms;
- regular formal opportunities for internal reporting, including during annual certification and employee exit processes; and
- internal processes to resolve retaliation complaints.

For a detailed discussion about mitigating the retaliation risks associated with whistleblowers, see *Don't Tread on Whistleblowers: Mitigation and Managing Retaliation – Part II* SEC. REG. & LAW REP. (Jan. 27, 2014).

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