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Employer Update

Courts Continue to be Divided Over the Scope of Dodd-Frank's Anti-Retaliation Protections

By Linda Shen

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In recent months, several court decisions have highlighted the split in federal courts over the scope of the anti-retaliation provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). In particular, courts have disagreed on whether the anti-retaliation provision of Dodd-Frank protects employees who report alleged violations of federal securities laws "internally" to their employers, without also providing information "externally" to the Securities and Exchange Commission (SEC). The continued uncertainty over the scope of Dodd-Frank's anti-retaliation provision has significant consequences for employers, both in terms of the potential volume and expense of defending against retaliation claims, and in terms of the impact that anti-retaliation protections may have on employees' willingness to cooperate with employers' internal compliance processes.

The Statutory Language of Dodd-Frank

It is well-settled that the whistleblower protections of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) apply regardless of whether an employee reports to the SEC.[1] However, courts disagree about whether an employee qualifies as a whistleblower under Dodd-Frank if the employee only internally discloses the alleged violations. This debate over the scope of Dodd-Frank's anti-retaliation provision stems from an apparent inconsistency in the language of Dodd-Frank. In one subsection, entitled "Protection of whistleblowers," Dodd-Frank permits a civil action for an adverse employment action injuring a whistleblower who (i) provides certain information to the SEC; (ii) assists the SEC in an investigation or action relating to the information provided; or (iii) makes "disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 … and any other law, rule, or regulation subject to the jurisdiction of the [SEC]." 15 U.S.C. § 78u-6(h)(1)(A). While subsections (i) and (ii) clearly entail direct interaction with the SEC, subsection (iii), read alone, appears to incorporate categories of internal reporting and other communications that are not necessarily made to the SEC, as long as the disclosures are required by mandates subject to the jurisdiction of the SEC. However, in a separate, prior subsection, Dodd-Frank defines a "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 [SEC], in a manner established, by rule or regulation, by the [SEC]." *Id.* at § 78u-6(a)(6). If this definition applies to the entirety of Dodd-Frank, then an employee cannot qualify as a whistleblower unless the employee provides information to the SEC.

The SEC's recommendation for resolving this apparent inconsistency is found in Rule 21F-2, which the SEC adopted in May 2011 along with other regulations implementing its whistleblower "bounty program."[2] While Rule 21F-2(a) incorporates Dodd-Frank's narrow definition of "whistleblower," Rule 21F-2(b) provides a more expansive definition of whistleblower "[f]or purposes of the anti-retaliation protections." Thus, the SEC rejects the view that Dodd-Frank's narrow definition of "whistleblower" governs its anti-retaliation provision, and believes that the anti-retaliation provision in subsection (iii) of 15 U.S.C. § 78u-6(h)(1)(A) should be given independent and expansive force.

Divergent Rulings Among Federal Courts

To date, the United States Court of Appeals for the Fifth Circuit is the only federal appellate court to address whether external disclosure is necessary for anti-retaliation protection under Dodd-Frank. Last year, in *Asadi v. GE Energy (USA), LLC.*, 720 F.3d 620 (5th Cir. 2013), the Fifth Circuit held that providing information to the SEC was a prerequisite to Dodd-Frank whistleblower protection, noting that if an employee merely reports within the company, such as to a supervisor or through an internal compliance program, the employee is not covered by the statute. According to the Fifth Circuit, "[u]nder Dodd-Frank's plain language and structure, there is only one category of whistleblowers: individuals who provide information relating to a securities law violation to the SEC." *Id*. at 625. Moreover, because the Fifth Circuit did not find the statutory language ambiguous, the court had no basis to defer to the SEC's interpretation, and further noted that the SEC may not, by regulation, extend a statute's reach. *Id.* at 629-30.

A number of district courts have reached determinations consistent with the Fifth Circuit.[3] Most recently, in *Englehart v. Career Education Corporation*, No. 8:14-CV-444-T-33 EAJ, 2014 WL 2619501 (M.D. Fla. May 12, 2014), the district court cited *Asadi* in dismissing with prejudice a former employee's Dodd-Frank claim, holding that the employee was not a "whistleblower" within the meaning of Dodd-Frank because the employee did not provide information regarding a securities law violation to the SEC. Like the Fifth Circuit, the district court concluded that it is not the role of the court "to second guess the reasoning or providence of unambiguous statutory language or expand explicit definitions within a statute to reach a desired result." Other district courts in this camp have pointed out that in the context of implementing the SEC's bounty program, limiting Dodd-Frank's anti-retaliation protections to employees who have reported to the SEC is consistent with the statutory scheme. Moreover, they note that the Fifth Circuit's interpretation does not leave internal reporters without a remedy, as these individuals would still have a claim under Sarbanes-Oxley.

Courts disagree about whether an employee qualifies as a whistleblower under Dodd-Frank if the employee only internally discloses the alleged violations.

A greater number of district courts, however, have reached conclusions contrary to that of *Asadi*.[4] According to these courts, Dodd-Frank does not unambiguously limit whistleblower protection to individuals who report violations to the SEC. In light of the perceived ambiguity, many of these courts have deferred to the SEC's interpretation of Dodd-Frank under *Chevron*.[5] These courts note that Rule 21F-2 provides a reasonable reading of Dodd-Frank that resolves the statute's linguistic tension, whereas *Asadi*'s interpretation would effectively moot subsection (iii) of 15 U.S.C. § 78u-6(h)(1)(A). Additionally, because Dodd-Frank was intended to expand upon the protections of Sarbanes-Oxley, it is unproblematic that an employee who reports internally might still have a similar claim under Sarbanes-Oxley.

Recently, in *Bussing v. COR Clearing, LLC*, 8:12-CV-238, 2014 WL 2111207 (D. Neb. May 21, 2014) *motion to certify appeal granted*, 8:12-CV-238, 2014 WL 3548278 (D. Neb. July 17, 2014), the District Court of Nebraska ruled on the internal disclosure issue as a matter of first impression in its jurisdiction. Unlike the other district courts, which have commonly relied on SEC deference or statutory construction as the primary rationale for their holdings, the District Court of Nebraska set forth a rationale based on policy and statutory purpose, in addition to a conclusion based on statutory construction.[6] In terms of policy, the court first noted that excluding employees who disclose only internally would push the "majority of whistleblowers" outside the protection of Dodd-Frank, including "those who are most vulnerable to retaliation." This is because empirically, employees tend to report matters internally before complaining to the SEC,[7] and employers are much more likely to be aware of an employee's reporting activities if the employee reports internally. Second, and more importantly, the court noted that *Asadi* would "discourage internal reporting" and undermine the significant benefits that internal reporting provides to both employers and the SEC. Such benefits include: allowing companies to remedy improper conduct at an early stage, perhaps before it rises to the level of a violation; encouraging whistleblowers to participate in internal compliance programs; preventing simple misunderstandings (such as where the employee is mistaken about alleged misconduct) from transforming into investigations that waste corporate and government resources; and vetting tips to the SEC so that it receives fewer and higher quality reports from whistleblowers. On July 17, 2014, the district court in *Bussing* granted the defendant's bid to pursue an interlocutory appeal to the Eighth Circuit on whether the plaintiff qualifies as a whistleblower under Dodd-Frank, despite having never provided information to the SEC. It remains to be seen whether the Eighth Circuit will permit the appeal.

In addition to the potential for a plaintiff-friendly ruling by the Eighth Circuit in *Bussing*, a circuit split on this issue may emerge if the Second Circuit reaches a conclusion contrary to *Asadi*. This past June, the Second Circuit heard oral argument in the appeal of *Liu v. Siemens A.G.*, 978 F. Supp. 2d 325 (S.D.N.Y. 2013). In support of the plaintiff's appeal, the SEC filed an amicus brief on the issue of whether internal disclosures are afforded anti-retaliation protection under Dodd-Frank. In its brief, the SEC asserted that 15 U.S.C. § 78u-6(h)(1)(A) "best reads as an implied exception to the definition of whistleblower," and that this interpretation avoids discouraging individuals from internal reporting, which the SEC encourages as one of its core objectives. Notably, all district court decisions within the Second Circuit have interpreted Dodd-Frank expansively, extending its anti-retaliation protections to those who disclose only internally. However, because the district court's dismissal in *Siemens* focused on whether Dodd-Frank's anti-retaliation provisions extend to overseas whistleblowers, the Second Circuit may not reach this issue in deciding the appeal.

Practical Implications

Requiring employees to report to the SEC as a pre-condition to receiving anti-retaliation protection under Dodd-Frank has significant implications for employers. To be sure, Sarbanes-Oxley addresses much of the same conduct as Dodd-Frank, and because Sarbanes-Oxley's anti-retaliation provision already protects internal reporters from retaliation, employers may face whistleblower retaliation liability for internal reporters regardless of whether other appellate courts follow the ruling in *Asadi*.

However, if either the Second or the Eighth Circuit do decide to extend Dodd-Frank's anti-retaliation protections to those who report only internally, this may equip a new class of individuals with a more powerful cause of action than what is available under Sarbanes-Oxley. This is because relative to Sarbanes-Oxley, Dodd-Frank provides significantly greater remedies for retaliation, and also offers significantly greater financial incentives under its bounty program. For instance, whistleblowers under Dodd-Frank are entitled to two times the amount of back pay owed, doubling the amount of back pay available under Sarbanes-Oxley. Dodd-Frank also allows plaintiffs to bring claims directly in federal court, without first filing with the Occupational Safety and

Health Administration (OSHA), as Sarbanes-Oxley requires. Further, Dodd-Frank offers a substantially longer statute of limitations than Sarbanes-Oxley.[8] In addition, Dodd-Frank created a bounty program backed by a $450 million Investor Protection Fund, from which the SEC can make awards ranging from 10 to 30 percent of the monetary sanctions collected in a successful enforcement action, provided the sanctions exceed $1 million. These plaintiff-friendly aspects of Dodd-Frank may in turn affect the frequency with which employees file whistleblower retaliation claims, if another appellate court addresses the internal reporting issue and finds in favor of more expansive anti-retaliation protection.

Regardless of how the court split is resolved, the outcome may yield a double-edged sword for employers. On the one hand, decisions consistent with *Asadi* may encourage savvier employees to bypass internal reporting mechanisms (or at least to simultaneously report to the SEC) to ensure anti-retaliation protection under Dodd-Frank. This may in turn reduce the efficacy of employers' compliance programs, and limit an employer's ability to correct potential wrongdoing internally, before an SEC investigation begins. In addition, to the extent *Asadi* and similar decisions incentivize reporting to the SEC, employers may confront greater risk of enforcement action, which may have financial and reputational consequences for the employer. On the other hand, a stronger Dodd-Frank anti-retaliation provision increases employer vulnerability to retaliation claims, and raises the cost of litigating those claims when they do arise. In either case, however, employers may benefit from implementing compliance programs that strongly encourage internal reporting, while simultaneously promoting policies and practices to reassure employees that internal disclosures will not result in adverse employment action against the disclosing employee.

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1. Section 806 of Sarbanes-Oxley prohibits retaliation against employees who communicate alleged wrongdoing to the SEC or to anyone "working for the employer who has the authority to investigate, discover, or terminate misconduct."

2. *See* 17 C.F.R. § 240.21F, "Securities Whistleblower Incentives and Protection."

3. *See, e.g., Banko v. Apple, Inc.*, No. 13-02977 RS, 2013 WL 7394596 (N.D. Cal. Sept. 27, 2013); *Wagner v. Bank of Am. Corp.*, No. 12-00381 RBJ, 2013 WL 3786643 (D. Colo. July 19, 2013), *aff'd on other grounds*, No. 13-1347, 2014 WL 3377648 (10th Cir. July 11, 2014).

4. *See, e.g., Yang v. Navigators Group, Inc.*, No. 13-203 (S.D.N.Y. May 8, 2014); *Khazin v. TD Ameritrade Holding Corp.*, No. 13-4149, 2014 WL 940703 (D.N.J. Mar. 11, 2014); *Azim v. Tortois Cap. Advisors*, No. 13-2267, 2014 WL 707235 (D. Kan. Feb. 24, 2014); *Rosenblum v. Thomson Reuters (Mkts.), LLC*, No. 13-2219, 2013 WL 5780775 (S.D.N.Y. Oct. 25, 2013); *Ellington v. Giacoumakis*, 977 F. Supp. 2d 42 (D. Mass. 2013); *Murray v. UBS Secs., LLC*, No. 12 CIV 5914 JMF, 2013 WL 2190084 (S.D.N.Y. May 21, 2013); *Genberg v. Porter*, 935 F. Supp. 2d 1094, 1106-07 (D. Colo. 2013); *Kramer v. Trans-Lux Corp.*, No. 3:11-1424 SRU, 2012 WL 4444820 (D. Conn. Sept. 25, 2012); *Nollner v. S. Baptist Convention, Inc.*, 3:12CV40, 2012 WL 1108923 (M.D. Tenn. Apr. 3, 2012); *Egan v. TradingScreen, Inc.*, No. 10 CIV 8202, 2011 WL 1672066 (S.D.N.Y. May 4, 2011).

5. *See Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-44 (1984) (setting forth a legal test for determining whether to grant deference to a government agency's interpretation of a statute which it administers).

6. The court in *Bussing* noted that unless the term "whistleblower" is accorded broader meaning than the definition that Dodd-Frank provides, subsection (iii) of 15 U.S.C. § 78u-6(h)(1)(A) would be rendered insignificant. *Id.* at *22. Moreover, the aim of subsection (iii) to protect a very broad range of disclosures is confirmed by comparing it to the language of subsections (i) and (ii), which both contain narrower wording that is distinct from the language in subsection (iii). *Id.* at *25.

7. According to a report based on 2013 data, 92 percent of employees who reported misconduct turned to someone inside the company upon their initial complaint, whereas only 9 percent of employees eventually reported misconduct to a governmental or regulatory authority. Ethics Res. Ctr., National Business Ethics Survey of the U.S. Workforce 29-30 (2014), *available at* http://www.ethics.org/downloads/2013NBESFinalWeb.pdf.

8. Under Dodd-Frank, plaintiffs must bring suit within six years of the alleged retaliation, or within three years after the material facts of the claim are (or should reasonably have been) known, but in no event more than ten years after the date of the violation. By contrast, under Sarbanes-Oxley, plaintiffs must file a claim with OSHA within 180 days of either the violation, or the date on which the plaintiff becomes aware of the violation.

UK Supreme Court Recognizes Rights of LLP Members to be Treated as "Workers"

By Ivor Gwilliams and Tas Voutourides

In the recent case of *Clyde & Co LLP and another v Bates van Winkelhof [2012] EWCA Civ 1207*, the UK Supreme Court held that LLP members can be "workers" for the purpose of whistleblowing legislation. This means that members of a limited liability partnership in the UK (and not just employees) can now claim whistleblowing rights, in addition to certain other rights available to "workers." One important practical implication of this decision is that private equity and investment firms that engage their investment professionals in the UK as members of limited liability partnerships will now need to keep these additional protections in mind when removing members. In addition, there may be other far-reaching implications to consider as well.

1 Whistleblowing Rights

If an employer subjects one of its workers to a detriment because the worker has made a protected disclosure, then that worker may be able to sue the employer for compensation which is not capped in the way that it is for, say, ordinary unfair dismissal. LLP members will therefore be entitled to uncapped compensation based on their actual and future losses, if they are able to show at an Employment Tribunal that they have been subjected to detrimental treatment by their firm on the grounds of the member having blown the whistle on wrongdoing. Detriment could mean dismissal or something else that falls short of dismissal, e.g. a reduction in pay or demotion. In order for a disclosure to be "protected," it must relate to one of the following: a criminal offence, a breach of a legal obligation, a miscarriage of justice, danger to health and safety of an individual, damage to the environment or the deliberate concealment of information about any of the above.

It will be obvious to most employers that a complaint concerning such matters as financial irregularities or unsafe working practices will be sufficient to give a worker protection under the whistleblowing legislation in the UK. However, a breach of any legal obligation, such as an alleged breach of the worker's own contract, could also be sufficient to give the worker such protection. All that workers need to do is show that (a) they had a reasonable belief that (i) the breach occurred (or is likely to occur) and (ii) the disclosure is in the public interest and (b) they were subject to a detriment because of the disclosure. Furthermore, departing workers have shown themselves creative in the way that they have tried to afford themselves of such protection. This can come as a nasty surprise to employers.

For private equity firms and other investment firms, this issue is most likely to occur in the context of acrimonious exit negotiations where a departing employee or LLP member tries to claim that they are being removed as a result of having "blown the whistle," either because the individual genuinely believes this to be the case or as tactic to lever a better termination package.

Private equity and investment firms that engage their investment professionals as members of limited liability partnerships will now need to take more care when removing members.

2 Other Rights

If LLP members are "workers" for the purposes of the whistleblowing legislation, then they will also have certain other statutory rights enjoyed by workers. These include the following rights:

(a) Part-Time Workers Regulations
Part-time LLP members will now have the right not to be treated less favourably than their firm treats comparable full-time LLP members, unless the treatment can be objectively justified by the firm. Objective justification means that an LLP must be able to show that the treatment achieves a legitimate business objective of the firm and is a proportionate way to achieve that objective.

Justification based on cost alone is unlikely to be sufficient. The less favourable treatment has to relate to the terms of the worker's contract or from the worker being subjected to some other detriment. The right does not give LLP members a right to work part-time, just protection from less favourable treatment if the member is a part-time worker.

(b) National Minimum Wage
Members will now be covered by the National Minimum Wage Act 1998. This provides for a statutory minimum level of pay for everyone who works legally in the UK. Although this is unlikely to cause many issues for LLPs, they may still need to review their current policies and practices and consider how they structure their drawings (and any "claw-back" provisions) in a way that ensures compliance with this legislation.

(c) The Working Time Regulations 1998
These Regulations govern the hours most workers can be required to work and, amongst other things, set out limits on the average working week and statutory entitlements to paid leave.

(d) Unlawful Deductions from Pay
The Employment Rights Act 1996 gives workers the right not to suffer unauthorised deductions from wages. Therefore, LLPs will have to ensure that any "claw-back" provisions in their LLP agreements are carefully drafted so as not to infringe this principle.

(e) Pension Auto-Enrolment
There is a continuing debate as to whether LLP members will have to be enroled automatically into a qualifying pension scheme with mandatory, minimum employer pension contributions, under the auto-enrolment regime. In order to determine this question, it would appear that one will need to decide first whether the LLP member is a "worker" for these purposes and then whether the LLP member receives "qualifying earnings" (i.e. salary, wages and commission but not genuine profit share). It remains to be seen whether any guidance on these points will be forthcoming from the UK Pensions Regulator.

3 Partners in Traditional Partnerships

The decision in this case does not, however, deal with the question as to whether partners in traditional partnerships could ever claim these "worker" rights.

4 Practical Steps for LLPs to Consider

In response to the decision in the *Clyde & Co LLP* case, those who operate LLP structures should review their LLP agreements and related policies and practices in order to assess the impact on their businesses. In short, they should:

(a) ensure that there is a whistleblowing policy in place setting out procedures by which LLP members can report concerns about illegal, unethical or otherwise unacceptable conduct;

(b) ensure that they do not subject any LLP members to any detriment if they "blow the whistle" (and consider taking legal advice before taking steps to remove an LLP member in order to establish whether the member might be able to bring a successful whistleblowing claim);

(c) carefully document genuine business reasons for any negative or otherwise detrimental actions taken against LLP members (e.g. compulsory retirement or reductions in profit share) so as to be able to show that the LLP has not taken any retaliatory action against LLP members for any alleged wrongdoing;

(d) ensure that they are in compliance with the Working Time Regulations (most notably regarding rest breaks and paid annual leave) and the regulations prohibiting less favourable treatment of part-timers in respect of their LLP members;

(e) ensure that the way that profits are drawn by LLP members and how this is drafted in the LLP agreement accords with national minimum wage legislation; and

(f) consider whether LLP members may need to be enroled into a suitable occupational pension scheme under the auto-enrolment regime and, if necessary, plan for such enrolment.

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