SEC Whistleblowers: Split in the Federal Circuit Courts on Dodd-Frank Section

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On September 10, 2015, the U.S. Court of Appeals for the Second Circuit (Second Circuit) held that the whistleblower protection statute in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or Act) is sufficiently ambiguous that the Securities and Exchange Commission (SEC or Commission) should be allowed to interpret it, specifically as to whom the statute applies. The Second Circuit decision conflicts with a 2013 decision by the U.S. Court of Appeals for the Fifth Circuit (Fifth Circuit), which held that the statute is clear and that the SEC must apply it according to its plain language. The conflict in the federal circuit courts on this issue could lead to review by the Supreme Court.

The controversy in the two cases concerns the definition of “whistleblower” in Dodd-Frank for purposes of the anti-retaliation provisions of the Act. Section 922 of Dodd-Frank defines a whistleblower to mean “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.” The anti-retaliation provision, also a part of section 922, states that an employer is prohibited from retaliating against a whistleblower who makes disclosures that are required or protected by the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), the Securities Exchange Act of 1934, 18 U.S.C. § 1513(e), and other laws and regulations subject to the jurisdiction of the SEC.

Sarbanes-Oxley, in contrast to Dodd-Frank, has several provisions that require internal corporate reporting of securities law violations; e.g. § 806. The SEC and the plaintiffs in the two cases have argued that the definition of “whistleblower” in Dodd-Frank, which seems to require that a whistleblower report externally to the SEC, when read in light of provisions in Sarbanes-Oxley, which require internal reporting, create ambiguity in the Dodd-Frank definition and its anti-retaliation guarantee. Added to this possible statutory ambiguity, the SEC’s rules implementing the whistleblower provisions of Dodd-Frank appear to interpret broadly who qualifies as a whistleblower for purposes of the anti-retaliation provision; the rules do not require that a whistleblower report externally to the SEC in order to be protected from retaliation.

Second Circuit. John Berman, the finance director of Neo, alleged violations of federal securities laws, including Dodd-Frank, and internal corporate policies. He claimed that the defendants fired him after he made his concerns known to the company, but he did not report his concerns to the SEC before the defendants took the actions that he claimed were retaliatory. The U.S. District Court for the Southern District of New York dismissed Berman’s anti-retaliation claim for failure to state a claim under FRCP 12(b)(6) on the grounds that he had not adequately alleged that he was a whistleblower under Dodd-Frank and that he was therefore unable to use Dodd-Frank’s anti-retaliation protections.

Berman appealed the dismissal of his motion for summary judgment to the Second Circuit, which reversed the district court decision and remanded for further proceedings. The Second Circuit first looked
to the Supreme Court’s finding in *King v. Burwell* that, if the words in the Affordable Care Act (ACA) “established by a state” were interpreted to mean that tax subsidies were not available also to persons who purchased health insurance on exchanges established by the federal government, the operation of the ACA would be undermined—a result that Congress did not intend. (For more on *King v. Burwell*, see a previously published CRS sidebar.) The Second Circuit went on to state that, although a definitional section (here, the definition of “whistleblower”) is usually to be taken literally, “mechanical use of a statutory definition” is not always appropriate. According to the Second Circuit, in the instant situation, other factors, such as late changes made to Dodd-Frank by the conference committee, quite possibly resulting in overlooking statutory consistency, must be considered. The court stated: “Ultimately, we think it doubtful that the conferees who accepted the last-minute insertion...would have expected it to have the extremely limited scope it would have if it were restricted by the Commission reporting requirement in the ‘whistleblower’ definition....” In addition, the Second Circuit believed that, if it followed the strict reading of the whistleblower definition, the scope of the anti-retaliation provision would be limited because whistleblowers reporting both to the SEC and internally would likely create a substantial risk of retaliation and because, as mentioned above, Sarbanes-Oxley has provisions that require internal reporting.

Most importantly, the Second Circuit opined, it did not even need to attempt to construe the statute because the statute as a whole seems sufficiently ambiguous as to oblige the court to give *Chevron* deference to the reasonable interpretation in the rules issued by the SEC, the agency charged with administering the statute. (In *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, the Supreme Court held that, where statutory language is ambiguous, courts should defer to agency interpretations of statutes unless the interpretations are unreasonable. For more on *Chevron* deference, see CRS Report R43203.)

**Fifth Circuit.** The Second Circuit mentioned other opinions that have come to different conclusions, particularly the Fifth Circuit decision in *Asadi v. G.E. Energy (USA), L.L.C.*. Like Berman, Asadi filed an internal report alleging a possible securities law violation by his employer; Asadi was fired and then filed an anti-retaliation claim. Unlike the Second Circuit, the Fifth Circuit concluded that the statutes at issue were plain and unambiguous—whistleblowers provide information to the SEC and are the only persons protected from retaliation: “Under 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.... The text protects whistleblowers from employer retaliation for the action that made the individual a whistleblower in the first instance; i.e., providing information relating to a securities law violation to the SEC.” Clearly, the Second Circuit disagreed with the Fifth Circuit’s reasoning and with other district courts that have followed *Asadi*. The Second Circuit seemed to take some comfort in its statement that “[o]n the other hand, a far larger number of district courts have deemed the statute ambiguous and deferred to the SEC’s Rule.”

Such significant disagreement among the federal circuit and district courts may well pave the way for a Supreme Court decision. Some commentators believe that the issue is even broader than for whistleblowers—for example, going to the heart of what is acceptable *Chevron* deference and statutory interpretation. The Supreme Court has not yet been petitioned to review the issue.