

ALERTS

US Supreme Court Narrowly Defines Whistleblowers Entitled to Anti-Retaliation Protection

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Last week, the Supreme Court issued its highly anticipated opinion in *Digital Realty Inc. v. Somers* (Feb. 21, 2018),^[1] unanimously holding that only employees who report possible securities laws violations to the U.S. Securities and Exchange Commission (“SEC”) are protected by the anti-retaliation provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). As a result, individuals who report possible securities laws violations only internally may not bring retaliation claims under Dodd-Frank.

Summary

Respondent Paul Somers reported certain alleged securities laws violations internally to senior management at petitioner Digital Realty Trust Inc. Thereafter, his employment by the company was terminated. Somers filed suit, seeking recourse for retaliation as a whistleblower under Dodd-Frank. Digital Realty moved to dismiss the claim on the ground that Somers was not within the definition of a “whistleblower” under Section 21F of the Securities Exchange Act of 1934 (“Exchange Act”) because he did not report the alleged violations to the SEC prior to the termination of his employment. The District Court denied the motion to dismiss, and the Ninth Circuit affirmed. The Supreme Court reversed. Until now, there was a circuit split as to whether “whistleblowers” under Dodd-Frank include individuals who report violations only internally within their companies. In *Asadi v. G.E. Energy (USA) L.L.C.*,^[2] the Fifth Circuit concluded that it

must follow the plain language of the definition of “whistleblower” set forth in Dodd-Frank: an individual who provides “information relating to a violation of the securities laws *to the Commission*.”[3] By contrast, in *Berman v. Neo@Ogilvy LLC*,[4] the Second Circuit found that the definition of “whistleblower” set forth in Dodd-Frank was unclear on its face. Therefore, it deferred to the SEC’s regulation interpreting the statute. In 2011, the SEC adopted Rule 21F-2, taking the position that individuals who report internally may bring claims under Dodd-Frank’s anti-retaliation provisions. In *Somers*, the Ninth Circuit agreed with the Second Circuit’s approach.[5]

The Supreme Court resolved the circuit split with its unanimous decision in *Somers*, based on the plain language of the statute, which the Court viewed as “unequivocal” — Dodd-Frank protects only individuals who report securities law violations to the SEC. The Court buttressed its decision by referring to the purpose of Dodd-Frank, as reflected in its legislative history — “to motivate people who know of securities law violations to tell the SEC.” The Court contrasted the limited purpose of Dodd-Frank with the broader purpose of the Sarbanes-Oxley Act of 2002 (“SOX”) — to disrupt the “corporate code of silence” after Enron. Accordingly, SOX protects internal-only whistleblowers.

Implications for Private Investment Fund Managers

Retaliation claims asserted under Dodd-Frank predicated on internal-only reports will be dismissed. Employees with knowledge of securities laws violations are now incentivized to report violations to the SEC. This is particularly true for employees of most private fund managers, which are nonpublic companies that are not covered by SOX. To strengthen their potential retaliation claims, such individuals may also report to their employers that they have reported violations to the SEC, after the fact. Investment managers should consider these new incentives in conjunction with their internal policies. While a policy that promises employees no retaliation for making internal reports may give rise to contractual claims against the employer, encouraging internal reporting by adopting anti-retaliation policies — and taking prompt and effective action in response to internal reports — may be prudent.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] *Digital Realty Trust Inc. v. Somers*, 583 U.S. ____ (2018).

[2] 720 F.3d 620 (5th Cir. 2013).

[3] *Id.* at 623.

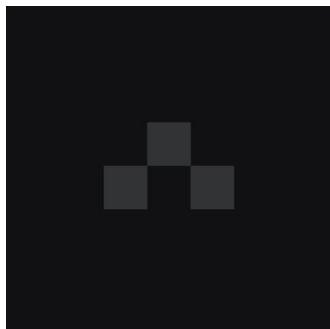
[4] 801 F.3d 145 (2d Cir. 2015).

[5] *Somers v. Digital Realty Tr. Inc.*, 850 F.3d 1045, 1047 (9th Cir. 2017).

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