Securities Regulation Daily Wrap Up, TOP STORY—2d Cir.: Splitting with Asadi, Second Circuit extends Dodd-Frank to internal whistleblowing, (Sept. 10, 2015)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

The Second Circuit dealt a major victory to whistleblowers and the SEC, holding that Dodd-Frank's protections against retaliation extend to those who blow the whistle only internally and not to the SEC. The decision creates a circuit split: the Fifth Circuit, the only other appeals court to have ruled on this issue, held in *Asadi v. G.E. Energy* that the plain language of Dodd-Frank unambiguously requires SEC reporting. On the contrary, the Second Circuit's 2-1 decision holds that the statute is sufficiently ambiguous to warrant deference to the SEC's rulemaking, which protects internal reporting (*Berman v. Neo@Ogilvy LLC*, September 10, 2015, Newman, J.).

Underlying allegations. As finance director of Neo@Ogilvy North America (Neo), the plaintiff was responsible for financial reporting and compliance with GAAP and the accounting policies of Neo's parent. He alleged that he detected accounting irregularities, fraud, and material compliance failures and attempted to correct these issues, in some cases by reporting the transactions to his supervisors and having them canceled, and in other cases by correcting the company's books. After he was terminated on April 30, 2013, he reported the violations to senior management, to Neo's counsel, and to the parent company's audit committee. Finally, on October 31, 2013, the plaintiff reported the violations to the SEC. He later sued his employer for, among other things, violating Dodd-Frank's provisions against retaliation.

S.D.N.Y. decision. The magistrate judge that heard Neo's motion to dismiss determined that the employee was a whistleblower, but recommended dismissal on the basis that the connections between the transactions he identified and the claimed securities law violations were too tenuous. The Southern District of New York did dismiss the whistleblower complaint, but took a different route, adopting the Fifth Circuit's reasoning in *Asadi*. While Section 21F of Dodd-Frank defines "whistleblower" to mean one or more individuals reporting a securities law violation "to the Commission," the statute—specifically subdivision (iii) of Section 21F(h)(1)(A)—appears to protect disclosures that involve only internal reporting. Certain district courts have concluded that the statute contains an ambiguity that warrants deference to the SEC rule under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* (U.S. 1984). But the Southern District was persuaded by *Asadi*'s description of a hypothetical situation in which subdivision (iii) would be neither contradictory nor superfluous: An employee who reported a securities law violation both internally and to the SEC on the same day and was then fired by the CEO without knowledge of the SEC report would be protected under, and only under, this third category of protected disclosures.

Appellate decision. The Second Circuit's take on *Asadi*'s simultaneous-reporting scenario is that it renders subdivision (iii) extremely limited in scope. There are likely to be only few whistleblowers who simultaneously report to their employer and the SEC, the court wrote; some will feel that internal reporting is the best shot to end the wrongdoing while reducing the risk of retaliation. More significantly, the appeals court cited categories of whistleblowers—particularly auditors and attorneys—who are bound by specific Exchange Act provisions to report violations internally and await a company response before reporting to the SEC. These reporting requirements are among those cross-referenced in subdivision (iii).

Burwell v. King, the recent Supreme Court case interpreting the Affordable Care Act as providing tax subsidies to those who purchased health insurance on a federal exchange notwithstanding the language "established by a state," involved a far more problematic interpretive issue, in the majority's view. Indeed, the majority framed the issue at hand not as whether the "whistleblower" definition means something other than what it says, but

whether the definition applies to a subdivision, added late in the legislative process, that uses the defined term. More precisely, the court was tasked with determining whether the answer to that question is murky enough to require deference to the SEC's rule under *Chevron*.

The employee-plaintiff, employer-defendant, and SEC-amicus each argued that a particular reading would render some of Dodd-Frank's language superfluous. These arguments, the court wrote, ignore the realities of the legislative process: "When conferees are hastily trying to reconcile House and Senate bills, each of which number hundreds of pages, and someone succeeds in inserting a new provision like subdivision (iii) into subsection 21F(h)(1)(A), it is not at all surprising that no one noticed that the new subdivision and the definition of 'whistleblower' do not fit together neatly." While the legislative history shed no light on this question, the court doubted that the conferees expected subdivision (iii) to have the extremely limited scope it would have if constrained to the SEC reporting requirement in the "whistleblower" definition.

Nevertheless, the court stopped short of definitively interpreting the statute. The tension between subdivision (iii) and the "whistleblower" definition in subsection 21F(a)(6) rendered Section 21F, as a whole, sufficiently ambiguous to require *Chevron* deference to the SEC's reasonable interpretation of the statute. The appeals court reversed the district court and remanded for further proceedings, allowing the Southern District an opportunity to consider dismissing for lack of a sufficient allegation of a termination entitled to Dodd-Frank protection.

Dissent. Judge Jacobs dissented from the panel's decision. In his view, the court, despite being charged with applying statutes as written, took it upon itself to alter the statute by deleting the SEC-reporting requirement from the whistleblower definition. The majority's characterization of subdivision (iii) as purporting "to protect employees from retaliation for making reports required or protected by Sarbanes-Oxley" is "tantamount to a misquotation," the dissenting judge continued: the statute does not mention this generic employee, but instead lists three ways in which "a whistleblower" may take protected activity. "The majority asks: 'Who but "employees" could be discriminated against by an "employer" in the terms and conditions of "employment"'? My answer? A whistleblower."

Furthermore, the judge wrote, the majority claimed that the issue is whether the "whistleblower" definition applies to subdivision (iii), but looked everywhere for the answer except the text of Section 21F, which begins, "In this section the following definitions shall apply..." Nor was Judge Jacobs swayed by the majority's finding of "tension" in the statute due to section (iii)'s limited scope. "The majority has no support for the proposition that when a plain reading of a statutory provision gives it an 'extremely limited' effect, the statutory provision is impaired or ambiguous," he asserted. As to the effect of the provision on lawyers and auditors, the dissent posited that Congress may have decided against providing additional incentives for those professionals to fulfill their existing duties.

Finally, the dissent disagrees with the majority's application of *King v. Burwell*. This case did not effect a wholesale revision of statutory interpretation law, and it involved a situation where the consequence of applying the statute as written would be to upend the Affordable Care Act, a "hugely consequential enactment." In contrast, Judge Jacobs said, in the whistleblower case "the sole consequence of applying the statute as written is that those who report securities violations only to their employer will receive statutory protection that in the SEC's view is sub-optimal." He also quoted a section of *King v. Burwell* in which the Court emphasized that Congress could have limited tax credits in the definition of "applicable taxpayer." By looking everywhere but the definitions section, the majority "follows the sort of 'winding path of connect-the-dots provisions' that the Supreme Court ridiculed."

Expert view. Alan R. Kabat, partner at employment-law firm Bernabei & Wachtel, told Wolters Kluwer that this significant holding benefits companies as well as whistleblowers. "This decision is important because it ensures that those who report financial problems internally are protected from retaliation, and confirms that they do not have to make reports to the SEC in order to be protected," he said. "Indeed, companies ought to welcome this decision, as internal reporting can allow conscientious companies to fix the problem before the SEC finds out. A

contrary ruling would encourage whistleblowers to go right to the SEC without giving the company an opportunity to fix the problem."

The case is No. 14-4626.

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