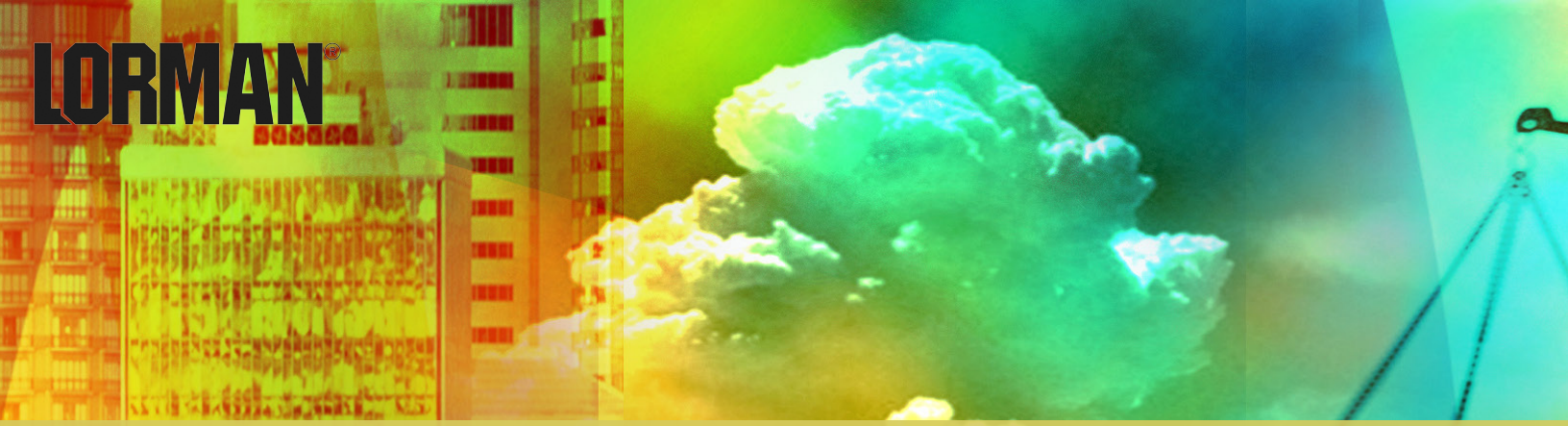

A Review of Recent Whistleblower Developments

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A Review of Recent Whistleblower Developments

4/17/18

Whistleblower Developments is a periodic report covering significant cases, decisions, proposals, and legislation related to whistleblower statutes and how they may impact your business. Recent developments include:

Only Persons Who Report Security Violations to the SEC are Whistleblowers Under Dodd-Frank: Supreme Court Decides *Digital Realty* Case

Seventh Circuit Affirms Dismissal of Dodd-Frank Act Whistleblower Claim for Failure to Meet Act's "Whistleblower" Definition

Tenth Circuit Breathes New Life into Sarbanes-Oxley Whistleblower Retaliation Case Eight Years After Employee's Termination

D.C. Circuit Court of Appeals Affirms the SEC's Denial of a Bounty Award

SEC's Office of the Whistleblower Announced its Largest-Ever Whistleblower Awards

SEC Awards More than $2.2 million to Whistleblower Who First Reported Information to Another Federal Agency Before Reporting to the SEC

Only Persons Who Report Security Violations to the SEC are Whistleblowers Under Dodd-Frank: Supreme Court Decides Digital Realty Case

In late February, the U.S. Supreme Court in *Digital Realty Trust*, which we have previously covered here and here, narrowed the definition of who qualifies as a "whistleblower" under the Dodd-Frank Act. Specifically, the Supreme Court ruled that, for purposes of the Dodd-Frank Act, only those individuals who have provided information about a securities law violation to the U.S. Securities and Exchange Commission (SEC) qualify as "whistleblowers" who are protected under the Act. The Supreme Court's decision resolved a longstanding split between the Fifth and Ninth Circuits and, in so doing, established a bright-line rule for who may sue for relief under the Dodd-Frank Act's anti-retaliation provision and be entitled to its bounties.

The decision, authored by Justice Ginsburg and joined by Chief Justice Roberts and Justices Kennedy, Breyer, Sotomayor, and Kagan, rejected the SEC's proposed expansive definition of a whistleblower in favor of a narrower definition based only on a plain reading of the statute. The Supreme Court's opinion focused on the Dodd-Frank Act's specific wording as to who is a whistleblower. Specifically, the Supreme Court focused on the fact that the statutory definition only includes "an individual who provides…information relating to a violation of the securities laws *to the Commission*, in a manner established, by rule or regulation, by the Commission." (emphasis added). Thus, only an individual who reports potential securities law violations to the SEC before filing a lawsuit is protected by the Dodd-Frank Act's anti-retaliation provision. The Supreme Court found this reading of the statute to be consistent with the core purpose of the Dodd-Frank Act's whistleblower program; namely, "motivate[ing] people who know of securities law violations to tell the SEC."

The decision underscores the importance of implementing compliance programs and a culture that encourages employees to report internally to employers, rather than externally to the SEC.

Digital Realty Trust, Inc. v. Somers, ___ U.S. ___, No. 16-1276 (Feb. 21, 2018)

Seventh Circuit Affirms Dismissal of Dodd-Frank Act Whistleblower Claim for Failure to Meet Act's "Whistleblower" Definition

Last year, before the Supreme Court's decision in *Digital Realty Trust*, an Illinois federal district court dismissed a would-be whistleblower's case for failure to plead facts that established he qualified as a whistleblower under the Dodd-Frank Act. In that case, *Martensen v. Chicago Stock Exchange*, the district judge ruled that because the plaintiff alleged he reported his concerns of potential securities law violations *internally* to his employer, and not *externally* to the SEC, the plaintiff did not qualify as a "whistleblower" under the express definition of the term in the Dodd-Frank Act.

On February 20, 2018, the Seventh Circuit upheld the dismissal and rejected plaintiff's argument that he should have been afforded an opportunity to amend his dismissed complaint. The Seventh Circuit, which decided the appeal just before the Supreme Court's decision in *Digital Realty Trust*, did not reach the question of whether the plaintiff met the definition of a "whistleblower" under the Dodd-Frank Act. Instead, the Seventh Circuit affirmed the dismissal of his lawsuit because plaintiff had conceded his report to the SEC was not the cause for his discharge. Instead, as the Seventh Circuit observed, the plaintiff alleged his

termination was related to a *later* report made internally that did not concern fraud or any other violation of the securities laws, and which never reached the SEC. As such, the Seventh Circuit concluded that even if the district court had allowed the plaintiff to amend his complaint, that amendment would have been futile.

The case is *Martensen v. Chicago Stock Exchange*, No. 17-2660, decided on February 20, 2018.

Tenth Circuit Breathes New Life into Sarbanes-Oxley Whistleblower Retaliation Case Eight Years After Employee's Termination

In 2010, a former executive of the pharmaceutical company Ceragenix claimed he was fired in retaliation for reporting securities law violations in two emails sent to the company's board of directors. The former executive also claimed the company's CEO defamed him in the wake of his termination. A federal district court in Colorado granted summary judgment against the former executive on both claims.

On February 22, 2018, however, the Tenth Circuit reversed the district court's decision, in part. The court decided plaintiff's Sarbanes-Oxley Act whistleblower retaliation claim could proceed, but his defamation claim could not. The Tenth Circuit's decision sets an important precedent, because it applied a broader standard of what constitutes Sarbanes-Oxley Act protected activity.

The district court applied the "definitive and specific" standard to the question of whether the former executive engaged in protected activity for purposes of protection under the Sarbanes-Oxley Act's whistleblower

provisions. Under that standard, for the former executive to be protected under the Act, he would have had to specifically identify the securities law or rule he believed was being violated in his emails to the board of directors. The Tenth Circuit ruled the "definitive and specific" standard was obsolete and inapplicable, and instead applied the "reasonableness" standard to the former executive's claims. Under the "reasonableness" standard, a plaintiff need only show that he or she reasonably believes the conduct he or she complains of constitutes a violation of any or all of the securities laws listed in the Sarbanes-Oxley Act. Based on the application of this standard, the Tenth Circuit found summary judgment against the former executive was inappropriate and remanded the case for further proceedings.

The case is *Genberg v. Porter, et al.,* No. 16-1368, decided on February 22, 2018.

D.C. Circuit Court of Appeals Affirms the SEC's Denial of a Bounty Award

On March 20, 2018, the D.C. Circuit Court of Appeals issued its judgment affirming the denial of an SEC bounty award to an unidentified individual who claims to have assisted with successful SEC enforcement actions. In January 2013, the unidentified individual ("John Doe") applied for a whistleblower award from the SEC in connection with an enforcement action against an investment company.

The Claims Review Staff for the SEC recommended denying Doe's whistleblower award application in part because, in the agency's view, the information Doe provided to the SEC did not "lead to" the enforcement action. Doe appealed that determination to the SEC, which denied his

application, affirming the determination that his information did not "lead to" the SEC's enforcement action against the investment company. The SEC elaborated by stating that Doe was not entitled to a whistleblower award because the SEC employees who investigated and tried the enforcement action against the investment company either did not have access to the information Doe provided, or had access to that information but did not use it. Doe then appealed that determination to the D.C. Circuit Court of Appeals.

In its review of Doe's appeal, the D.C. Circuit Court of Appeals upheld the SEC's decision based on declarations from individuals who worked on the enforcement action against the investment company that affirmed they did not access or use any information that Doe provided. As such, Doe was not entitled to a whistleblower award.

SEC's Office of the Whistleblower Announced its Largest-Ever Whistleblower Awards

At the end of March, the SEC's Office of the Whistleblower announced the highest Dodd-Frank whistleblower awards in its history. Two whistleblowers shared a nearly $50 million award, and a third whistleblower separately received more than $33 million. The previous highest whistleblower award was for $30 million, made in 2014 to an individual living overseas. As is typical with the SEC's whistleblower award announcements, the agency did not publicize which enforcement action the whistleblower award recipients helped to bring.

Including these awards, the SEC has paid over $264 million to 54 whistleblowers to date. In its announcement regarding these most recent awards, the SEC emphasized that all payments made to whistleblowers

through its program are made out of an investor protection fund established by Congress. That investor protection fund is financed entirely by monetary sanctions imposed on securities law violators, which are paid to the SEC.

SEC Awards More than $2.2 million to Whistleblower Who First Reported Information to Another Federal Agency Before Reporting to the SEC

On April 5, 2018, the SEC announced another whistleblower award of more than $2.2 million made to a former company insider whose information helped the agency start an investigation that led to a significant enforcement action. The whistleblower award recipient reportedly first disclosed that information to another federal agency before disclosing it directly to the SEC.

This is the first award the SEC has paid under the "safe harbor" of Exchange Act Rule 21F-4(b)(7). That "safe harbor" provision states that if a whistleblower submits information to another federal agency and submits the same information to the SEC within 120 days, the SEC will treat the information as though it had been submitted simultaneously to the SEC and to the other federal agency.