Market Trends 2017/18: Whistleblower Protections

A Lexis Practice Advisor® Practice Note by
Tracy Richelle High, Julia M. Jordan, and Christina Andersen, Sullivan & Cromwell LLP

Tracy Richelle High

Julia M. Jordan

OVERVIEW

This article is aimed at keeping practitioners informed of key regulatory and other legal developments in areas affecting whistleblower protections. For additional information on whistleblower protections, see Whistleblowing and Whistleblower Protections under Dodd-Frank and Sarbanes-Oxley (SOX). For a form of policy that may be used to comply with whistleblower reporting and protections, see Whistleblower Policy.

U.S. SUPREME COURT HOLDING ON WHISTLEBLOWERS WHO EXCLUSIVELY REPORT INTERNALLY

On February 21, 2018, in Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018), the Supreme Court held that the definition of a "whistleblower" under The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) (111 P.L. 203, 124 Stat. 1376) is "unambiguous" and "unequivocal." It means "any individual who provides . . . information relating to a violation of the securities laws to the Commission." The Court held, in accordance with that definition, that Dodd-Frank's anti-retaliation provision—which prohibits employers from retaliating against "whistleblowers" for each of three types of "lawful act[s]"—provides a private cause of action only for persons who report suspected wrongdoing directly to the Securities and Exchange Commission (SEC), and not for persons who report exclusively to their employers internally. The decision resolved a conflict in the courts of appeals, which had split over the question of whether the portion of the anti-retaliation provision that protects "whistleblowers" who make "disclosures that are required or protected under . . . any . . . law, rule or regulation subject to the jurisdiction of the Commission" protects individuals who make only internal complaints about possible violations of securities laws. As a result of this decision, individuals who do not report to the SEC may not bring claims under the Dodd-Frank anti-retaliation provision; however, they may well have claims under the Sarbanes-Oxley Act of 2002 (SOX) (15 U.S.C.S. § 7201), which explicitly protects individuals who report concerns internally from retaliation for having done so.

The decision provided needed clarity to courts, employers, and individuals. The immediate effect of the decision will be dismissal of pending claims under Dodd-Frank's anti-retaliation provision brought by individuals who did not report alleged violations to the SEC. Individuals who believe they have been retaliated against after internally reporting possible securities law violations may still bring claims under SOX. A SOX retaliation claim must be filed within 180 days of the violation (or the date that the employee became aware of the violation) and is decided in an administrative proceeding before the Occupational Safety and Health Administration (OSHA). By contrast, the statute of limitations on a Dodd-Frank retaliation claim is three years, and a Dodd-Frank claimant has immediate access to federal court. A successful Dodd-Frank whistleblower is entitled to double backpay with interest, whereas SOX limits recovery to actual backpay with interest.

Regarding dual reporting—i.e., where an employee reports both to the SEC and to the employer—the Court did not address whether there must be a "temporal or topical connection" between the violation that is reported to the SEC and any internal disclosure as to which the individual claims retaliation.

Finally, the Court observed that Dodd-Frank permits the SEC to define the "manner" in which information may be reported to it by a whistleblower. In response to this decision, the SEC may adopt a broader definition of the manner in which information can be reported, such as by providing testimony to the SEC or turning over information to the SEC in an indirect fashion. For additional information on Dodd-Frank's whistleblower protections, see Dodd-Frank Whistleblower Award Provisions and Dodd-Frank Wall Street Reform and Consumer Protection Act Key Provisions — Whistleblowers, Strengthened Securities Laws, and Specialized Disclosure.

ADMINISTRATIVE REVIEW BOARD'S EXTRATERRITORIAL APPLICATION OF SOX

On August 29, 2017, the Administrative Review Board (ARB), which reviews decisions by Department of Labor administrative law judges arising under SOX, took the position that SOX's whistleblower-protection provisions apply extraterritorially. See Blanchard v. Exelis Sys. Corp., ARB No. 15–031, ALJ NO. 2014-SOX-020, slip op. at 6–12 (ARB Aug. 29, 2017). The ARB cautioned, however, that its opinion should not be read to state that the SOX whistleblower provisions extend to all foreign conduct of publicly traded foreign companies. Rather, the misconduct of a foreign issuer under the statute must still "affect in some significant way" the United States. ARB decisions are not binding on the courts; thus, publicly traded companies may continue to argue, based on prior court holdings, that SOX does not apply to conduct alleged to have occurred outside the United States.

SOX §806, titled Whistleblower Protection For Employees Of Publicly Traded Companies, provides that a publicly traded company may not "discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee . . . to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of" certain specified anti-fraud provisions. (quoting 18 U.S.C. § 1514(a)). Applying the "presumption against extraterritoriality," as required by Supreme Court precedent, the ARB previously concluded that SOX "Section 806(a)(1) does not allow for its extraterritorial application." Villanueva v. Core Labs., NV, ARB No 09–108, ALJ No. 2009-SOX-006, slip op. at 8–12 (ARB Dec. 22, 2011) (en banc) (citing Morrison v. Nat'l Australian Bank, Ltd., 561 U.S. 247 (2010)).

In Blanchard, the ARB reversed course, finding instead that "SOX §806 applies extraterritorially" under the Supreme Court's decision in RJR Nabisco, Inc. v. European Community, 136 S. Ct. 2090 (2016). In a decision by Judge Royce (who dissented in Villanueva), the ARB concluded that Congress intended SOX §806 to apply extraterritorially because (i) the provision applies to publicly traded companies, which include foreign issuers, and (ii) certain "predicate offenses" for whistleblower protection, such as wire fraud, apply to "foreign commerce." The ARB found, however, that §806 does not "cover all foreign conduct of publically-traded foreign companies;" rather, the "misconduct of a foreign issuer/employer under the statute must still 'affect in some significant way' the United States."

The ARB also held that "[e]nforcement of Blanchard's complaint does not require extraterritorial application of SOX," because that plaintiff "alleged that his U.S. employer violated the U.S. mail and wire fraud statute by making false statements to the U.S. government in connection with U.S. contractual security and billing obligations." In addition, although the plaintiff was "located in Afghanistan," the conduct at issue "occurred on a U.S. air force base and directly implicated the security of the United States, U.S. military personnel, and U.S.

contractors." Therefore, the ARB's statement that SOX §806 has extraterritorial effect is likely dicta. In fact, Chief Judge Igasaki in his concurrence emphasized that Blanchard did not present "an opportunity to define the general extraterritoriality of §806."

The ARB's position also is contrary to the weight of court decisions, including in the Second Circuit, holding squarely that the whistleblower protections of SOX do not apply extraterritorially. See, e.g., Ulrich v. Moody's Corp., No. 13-CV-8 (VSB), (S.D.N.Y. Sept. 30, 2014) ("[T]he anti-retaliation provisions of the SOX Act or Dodd–Frank do not apply extraterritorially.") (citing Liu Meng-Lin v. Siemens AG, 763 F.3d 175 (2d Cir. 2014)); see also Carnero v. Boston Sci. Corp., 433 F.3d 1, 8-18 (1st Cir. 2006) ("Congress did not intend 18 U.S.C. § 1514A [SOX § 806] to apply extraterritorially.").

ME TOO MOVEMENT AND LEGISLATIVE CONSEQUENCES

In response to the widespread public attention garnered by the exposure of sexual harassment (known as the Me Too movement), the federal government and several states have enacted or proposed legislation aimed at preventing or discouraging the confidential resolution of claims of sexual assault and/or harassment.

On December 20, 2017, Congress passed a comprehensive tax reform bill (the Act) that the President signed into law on December 22. The Act created a new §162(q) of the Internal Revenue Code of 1986, as amended (I.R.C.), which eliminates the deductibility of amounts paid by employers to employees in connection with settlement of sexual harassment and sexual abuse claims if the settlement agreement requires non-disclosure on the part of the employee.

By way of background, a taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business. See I.R.C. §162(a). Settlement payments made to claimants in connection with employment-related disputes are, thus, treated as deductible business expenses by employers, including related attorney fees. Similarly, plaintiffs who sustain attorney fees in connection with settlements of employment disputes may deduct such fees. Section 162(q) eliminates those deductions in cases of settlement of sexual harassment and abuse claims that condition the settlement on non-disclosure.

Section 162(q) left several questions unanswered that will need to be resolved by the courts and the Internal Revenue Service.

- **Definitions.** First, when is a claim "related to" "sexual harassment" or "sexual abuse?" The Act does not define any of these terms. Admittedly, sexual abuse claims are subject to less ambiguity. But how broadly should employers interpret "sexual harassment" claims, let alone claims "related to" sexual harassment?
- **Mixed settlement payments.** Second, assume that the claim being settled is genuinely and unambiguously a sexual harassment claim, but the claimant has raised other claims as well and the settlement agreement includes a release of any and all claims the employee may have had against the employer, including but not limited to sex-based claims. The settlement payment is consideration for the release of all claims, not just the sex-based claims. This is a common situation. Can the settlement payment be allocated between the harassment-based claim and other claims being settled? That way, at least part of the payment—if such quantification and allocation is permissible under the Act—may be deductible. This approach brings its own complications, however, including determining how much of the settlement should be allocated to the sexual harassment or abuse claims.
- **Attorney's fees.** Third, what attorney fees are "related to such a settlement or payment," and, thus, non-deductible? The provision does not distinguish between the claimant's and the employer's attorney fees. Moreover, is it only the fees related to negotiating a settlement, drafting an agreement, and executing

payment? May parties deduct fees incurred in investigating the underlying claims, engaging in litigation, and evaluating the settlement value of a case? This could be a significant area to recoup some of the deductibility otherwise denied by §162(q) in the event a confidential settlement is preferred.

Also pending in Congress is proposed legislation titled Ending Forced Arbitration of Sexual Harassment Act of 2017. If enacted, arbitration clauses in employment agreements would not be enforceable in the context of sexual harassment claims. In light of the legislation, the Supreme Court's upcoming decision in the consolidated Epic Systems Corp. v. Lewis case is eagerly anticipated; argued in October 2017, the case presents the question of whether mandatory class-action and collective-action waivers in employment arbitration agreements are unenforceable under the National Labor Relations Act (NLRA).

Several states have also enacted or proposed legislation curtailing the ability of employees and employers to agree to arbitrate claims of sexual assault or harassment, and to agree to non-disclosure provisions related to settlement of those claims. For example, in the state budget signed into law this year, New York made unlawful the use of pre-dispute arbitration clauses for claims of sexual harassment, and also banned the use of confidentiality provisions in agreements to settle such claims (unless it is the claimant's preference to include such provisions). Washington state law now prohibits non-disclosure provisions in settling sexual harassment or assault claims, bans agreements that prevent a claimant from filing a sexual harassment or assault complaint with authorities, and also permits discovery in civil lawsuits of past instances of sexual harassment or assault even if there is a non-disclosure agreement in place. Other state legislatures, including California, Connecticut, Florida, New Jersey, and Pennsylvania, are considering similar proposals.

Provisions of state law restricting the use of arbitration likely will be challenged by employers. The Federal Arbitration Act establishes a clear Congressional command favoring enforceability of arbitration agreements and has been held to "preempt any state rule discriminating on its face against arbitration – for example, a 'law prohibiting outright the arbitration of a particular type of claim.'" Kindred Nursing Ctrs. Ltd. P'ship v. Clark, 137 S. Ct. 1421, 1427 (2017) (quoting AT & T Mobility LLC v. Concepcion, 563 U.S. 333, 341 (2011)). Accordingly, the restriction on arbitration of sexual harassment claims may well be held to be preempted.

CFTC ISSUES FINAL RULES TO EXPAND ITS WHISTLEBLOWER AUTHORITY

On May 22, 2017, the Commodity Futures Trading Commission (the CFTC) unanimously adopted final rules to amend and update Part 165 of the CFTC's rules that govern its whistleblower program (the Final Rules). The Final Rules amend the CFTC's regulations and forms to enhance the process for reviewing whistleblower claims and to make related changes to clarify staff authority to administer the whistleblower program. In addition, the Final Rules implement the CFTC's reinterpretation of its authority under the Commodity Exchange Act with respect to retaliation against whistleblowers and to make certain rule amendments to implement that expanded authority.

The Final Rules will allow the CFTC to bring enforcement actions against entities that retaliate against a whistleblower and will prohibit the enforcement of confidentiality clauses in employment contracts that would frustrate the whistleblower program. These changes will, in many respects, resolve inconsistent interpretations by the SEC and the CFTC of their respective authorizing statutes and signal a period of more aggressive enforcement by the CFTC with respect to whistleblower actions. In addition, while the Final Rules leave the basic framework of the CFTC's whistleblower rules substantially unchanged, they strengthen anti-retaliation protections for whistleblowers and add transparency to the CFTC's process of deciding whistleblower award claims.

In addition to the changes described above, the Final Rules include several other changes, including:

- Prohibiting employers from threatening, harassing, or retaliating against individuals who participate in the CFTC's whistleblower program, irrespective of whether those individuals qualify for an award
- Removing the requirement that the whistleblower be the original source of information received by the CFTC to be eligible for an award
- Revising the definition of "original source" to allow whistleblowers to claim an award based on information provided to certain persons or authorities other than the CFTC (including foreign futures authorities), provided that the CFTC receives the information within 180 days, compared to the previous threshold of 120 days, and the whistleblower files a Form TCR (used by a whistleblower to provide information to the CFTC)
- Clarifying that the CFTC may, in its sole discretion, waive any procedural requirements based upon a showing of extraordinary circumstances
- Expanding eligibility requirements for whistleblower awards to allow a claimant to receive an award based on an action brought by certain other agencies and authorities (including foreign futures authorities) that is merely related to the CFTC action for which it provided information
    - However, the CFTC will not make an award to a whistleblower for a related action if the whistleblower has been granted an award by the SEC for the same action under the SEC's whistleblower program.
- Creating a Claims Review Staff, in place of the Whistleblower Award Determination Panel, to handle the claims review process whereby a claimant can contest the denial of an award or the size of the award under a successful claim
- Revising Form TCR and Form WB-APP (used by a whistleblower to initiate a claim for a whistleblower award)

SEC 2017 ANNUAL WHISTLEBLOWER REPORT

The SEC's "2017 Annual Report on the Dodd-Frank Whistleblower Program" highlights that in fiscal year 2017 the SEC:

- Received over 4,400 whistleblower tips, the largest number in the program's history, and an increase of nearly 50 percent since fiscal year 2012
- Issued awards totaling nearly $50 million to 12 whistleblowers
- Continued its enforcement of whistleblower protections by bringing enforcement actions against companies for retaliating against whistleblowers and/or using restrictive language in separation and severance agreements
- Those agreements, among other things, imposed a financial penalty for the violation of a strict non-disclosure provision, required employees to waive their rights to monetary recovery in the event that they filed a complaint with the SEC, and/or prohibited departing employees from communicating information to the SEC.

Notably, in its 2017 Report, the SEC stated that "in the upcoming year," the Commission would continue to focus on reviewing "fact patterns of retaliation against whistleblowers and potential actions to impede communications with the Commission."

The 2017 Report also reflects that 62% of the 46 individuals who have received whistleblower awards under the program since its inception were insiders of the entity as to which they reported wrongdoing. Moreover, almost 83% of those insiders either raised their concerns internally to supervisors or compliance personnel, or understood that such personnel were aware of the violations, prior to their making a report to the SEC. Thus, many of the regulated companies that were the subject of successful whistleblower claims had an opportunity to address those claims prior to a report having been made to the SEC.

NLRB AND OSHA MEMORANDUM OF UNDERSTANDING (MOU)

In January 2017, the National Labor Relations Board (NLRB) and OSHA signed a new MOU to increase communication between the two agencies, particularly with respect to the anti-retaliation provisions administered by the two agencies.

As background, in June 1975, the NLRB and OSHA entered into an MOU providing that enforcement actions to protect safety and health activities should primarily be taken under the OSH Act rather than the NLRA. The new MOU rescinds the 1975 MOU in recognition that “both Acts have equally important roles in protecting these activities and that the determination as to the appropriate enforcement action must be made on a case-by-case basis in order to obtain the best possible relief for employees and advance the interests of the agencies.”

Pursuant to the new MOU, both the NLRB and OSHA will inform complainants of their right to report to the other agency. Moreover, if the complaint is considered untimely by OSHA, that agency also will notify the complainant that the time limit to file with the NLRB is longer (6 months) than OSHA’s (1 month).

The new MOU also provides for more communication about whistleblower retaliation between the two agencies. For example, the MOU provides that the NLRB and OSHA “shall endeavor to determine which course of action provides the best possible outcome for the complainant and is in the best interest of the agencies with due consideration of the different legal requirements and remedies under their respective laws, as well as of other relevant factors.”

WHEN WHISTLEBLOWERS TAKE CORPORATE DOCUMENTS

On February 14, 2017, in Erhart v. Bofi Holding, Inc., No. 15-cv-02287-BAS-NLS, 2017 U.S. Dist. LEXIS 20959 (S.D. Cal. Feb. 14, 2017), the District Court for the Southern District of California held that when whistleblowers take confidential documents from their employer in violation of a confidentiality agreement, courts should balance whether “enforcement of the Confidentiality Agreement is clearly outweighed in the circumstances by a public policy” of protecting whistleblowers. In Erhart, the court considered the case of an internal auditor who had signed a confidentiality agreement but took confidential information from his employer to report suspected wrongdoing to the government. In the ensuing litigation between Erhart and his employer, Erhart argued that he engaged in protected activity under a variety of statutes, including SOX and Dodd-Frank.

The court balanced “the interest in the enforcement of the Confidentiality Agreement,” on the one hand, and “a strong public policy in favor of whistleblowing and protecting whistleblowers from retaliation,” on the other, as to each aspect of Erhart’s conduct. First, the court found that “Erhart’s conduct in providing information to the government” qualified for whistleblower protection, and therefore “the public policy in favor of whistleblower protection clearly outweighs the interest in the enforcement of the agreement.” Second, the Court concluded that “there is merit to a public policy exception to confidentiality agreements to protect whistleblowers who appropriate company documents,” so long as whistleblowers “justify why removal of the documents was reasonably necessary to support the allegations of wrongdoing.” Third, the court found that Erhart’s “e-mailing confidential information to his mother and using his live-in girlfriend’s computer to access [confidential] documents . . . may be protected,” and declined to “summarily adjudicate Erhart’s whistleblower defenses.” Fourth, the court held that while “leaks to the media are not protected” by SOX’s anti-retaliation provision, it was disputed whether Erhard in fact “disclosed confidential information to the press,” which precluded summary judgment. Finally, the court found that “Erhart should be permitted to disclose [his employer’s] information in his complaint if doing so was ‘reasonably necessary’ to pursue his retaliation claim,” and whether the disclosure was “reasonably necessary” raised genuine issues of material fact.

As Erhart shows, courts will review the particular facts of each case carefully when determining whether whistleblowers should be held to their confidentiality agreements. Courts generally do not permit whistleblowers to take a substantial number of sensitive documents from their employers in service of their claims, but may permit them to take targeted documents specifically relevant to their allegations. Compare JDS Uniphase Corp. v. Jennings, 473 F. Supp. 2d 697, 702 (E.D. Va. 2007) (SOX does not “authorize disgruntled employees to pilfer a wheelbarrow full of an employer’s proprietary documents in violation of their contract merely because it might help them blow the whistle on an employer’s violations of law, real or imagined”), with Deltek, Inc. v. Dep’t of Labor, Admin. Review Bd., 649 F. Appx 320, 332 (4th Cir. 2016) (upholding SOX whistleblower retaliation award where employee e-mailed confidential documents to her personal account, because she only forwarded “documents that were relevant to her whistleblowing reports . . . to support her [Sarbanes-Oxley] allegations”).

Tracy Richelle High
Partner, Sullivan & Cromwell LLP

Tracy Richelle High is deputy managing partner of S&C's Litigation Group, and a member of both the Firm's Labor and Employment Law Group and Criminal Defense and Investigations practice. Ms. High's practice focuses on representing financial institutions and other corporations in complex civil litigation, internal investigations, and labor and employment matters.

Ms. High has also represented clients before a wide variety of regulatory and prosecutorial agencies, both at the state and federal levels, as well as Congressional committees, courts and independent examiners appointed by court order.

Julia M. Jordan
Partner, Sullivan & Cromwell LLP

Julia Jordan is a partner in the Firm's Litigation Group and co-head of both the Whistleblower Group and the Workplace Investigations Group. Ms. Jordan has a broad litigation practice that includes whistleblower litigation and workplace investigations, labor and employment, complex civil litigation and regulatory enforcement matters. She has represented prominent corporations and financial institutions in a wide variety of business litigation in state and federal courts throughout the country.

Ms. Jordan has extensive experience representing clients in criminal and regulatory investigations. She has represented financial institutions, corporations and individuals in investigations and proceedings before the U.S. Department of Justice, the U.S. Congress, the U.S. Securities and Exchange Commission, the Manhattan District Attorney's Office, various state attorney generals and the Financial Industry Regulatory Authority.

Ms. Jordan serves as co-head of the Labor and Employment Group and is a member of the Women's Initiative Committee and the Pro Bono Committee. She also serves as co-hiring partner for the Washington, D.C. office.