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Lessons from the SEC's Whistleblower Anti-Retaliation Cases

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I. Introduction

While announcements of large cash awards grab most of the spotlight for the Securities and Exchange Commission's (SEC or the Commission) whistleblower program, SEC officers have also stated that protecting whistleblowers is an SEC priority, and that they are committed to enforcing the program's whistleblower anti-retaliation provisions.[1] To date, the SEC has brought three actions where it has found an employer's treatment of an employee whistleblower to be retaliatory. Through two of those actions, the SEC has also made clear that it will bring charges against employers based solely on the manner in which they handle employee whistleblowers, without charging other violations of the federal securities laws. Management, compliance, legal and human resource professionals should therefore understand how the SEC's anti-retaliation provisions work, as well as the circumstances that have led to enforcement actions, in order to avoid unnecessary liability. This article explains the relevant law, describes the SEC's anti-retaliation enforcement actions, and offers suggestions for responding appropriately to employee whistleblowers.

II. The Anti-Retaliation Provisions

Section 21F(h)(1)(A) of the Exchange Act of 1934 (Exchange Act) states that "[n]o employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistle-blower in the terms and conditions of employment because of any lawful act done by the whistleblower …."[2] The provision is worded broadly in terms of the conduct that may constitute a violation. It also applies to a wide variety of activities, including (i) providing information to the Commission, (ii) participating in any Commission investigation or judicial or administrative action, or (iii) making disclosures required or protected by the Exchange Act, the Sarbanes-Oxley Act of 2002, "and any other law, rule or regulation subject to the jurisdiction of the Commission."[3]

The SEC's whistleblower program is implemented through a set of Whistleblower Rules.[4] Rule 21F-2(b)(2) states that "Section 21F(h)(1) of the Exchange Act …, including any rules promulgated thereunder, shall be enforceable in an action or proceeding brought by the Commission."[5] This rule is meant to make clear that the SEC can bring an action for retaliation against a whistleblower. It is important to note, however, that Exchange Act Section 21F(h) also permits employees to bring suit in federal district court to seek reinstatement, back pay, and compensation for litigation costs, expert witness fees, and reasonable attorneys' fees.[6] Accordingly, a violation of the anti-retaliation provisions exposes an employer to potential liability from both the SEC and the employee whistleblower.[7]

III. The Anti-Retaliation Cases[8]

A. In the Matter of Paradigm Capital Management, Inc. et al. (Paradigm)[9]

In this matter, Paradigm's head trader reported to the SEC that the firm had engaged in principal transactions with an affiliated broker-dealer without providing effective disclosure to, or obtaining effective consent from, its managed fund. The trader then told the firm's owner and its Chief Compliance Officer

1. See, e.g., SEC Charges Hedge Fund Adviser with Conducting Conflicted Transactions and Retaliating against Whistleblower, SEC Press Rel. No. 2014-118 (June 16, 2014) ("We will continue to exercise our anti-retaliation authority in these and other types of situations where a whistleblower is wrongfully targeted for doing the right thing and reporting a possible securities law violation" – Sean McKessy); Mary Jo White, Speech for the Ray Garrett, Jr. Corporate and Securities Law Institute-Northwestern University School of Law, The SEC as the Whistleblower's Advocate (Apr. 30, 2015) ("The ambivalence about whistleblowers can indeed sometimes manifest itself in an unlawful response by a corporate employer and we are very focused at the SEC on cracking down on such misconduct").

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2. 15 U.S.C. 78u-6(h)(1)(A). Section 21F, entitled "Securities Whistleblower Incentives and Protection," was added to the Exchange Act by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
3. Id.
4. 17 C.F.R. 240.21F-1 through 17.
5. 17 C.F.R. 240.21F-2(b)(2).
6. 15 U.S.C. 78u-6(h)(B) and (C).
7. In certain circumstances, a whistleblower may also be able to assert retaliation claims under state law. See, National Conference of State Legislatures, State Whistleblower Laws, which can be found at http://www.ncsl.org/research/labor-and-employment/state-whistleblower-laws.aspx.
8. It should be noted that all three of the actions described herein were settled without the respondents admitting or denying the Commission's findings. Accordingly, we take no view on whether the findings are accurate, but rather report what is stated in the settlement orders.
9. Exchange Act Rel. No. 72393 (June 16, 2014).

about his report. The SEC found that the firm removed the trader from Paradigm's trading desk, changed his job function from head trader to compliance assistant, stripped him of supervisory responsibilities, moved him to another floor, forced him to find suspect trades by reading through hard copy printouts, deprived him of access to the firm's trading systems, and otherwise marginalized him. The trader ultimately resigned.

The SEC brought an action for violations of both the anti-retaliation provisions and the Investment Advisers Act of 1940. The firm and its principal settled to a cease-and-desist order, disgorgement of $1.7 million, a $300,000 penalty, prejudgment interest and a set of undertakings related to the transactions at issue. In announcing the settlement, the SEC's Enforcement Director stated, "Paradigm retaliated against an employee who reported potentially illegal activity to the SEC. Those who might consider punishing whistleblowers should realize that such retaliation, in any form, is unacceptable."

B. In the Matter of International Game Technology (IGT)[10]

Here, a director of one of IGT's divisions became concerned that there were errors in the accounting for certain intra-company sales, which he believed could result in financial statement inaccuracies. The director raised his concerns during a presentation which led to a "heated disagreement" with a superior, who then purportedly took actions to terminate the director. The director in turn reported his concerns to the company's internal hotline, claimed he was being retaliated against, and then immediately reported to the SEC. The company put the termination proceedings on hold and brought in outside counsel to conduct an internal investigation. The SEC found that during the internal investigation IGT removed the employee from "two opportunities he considered significant to performing his job successfully;" namely, he was removed from a cost saving project associated with a merger and was directed not to attend an annual industry convention. The company terminated the employee after the internal investigation which, notably, found that there was no error in the company's financial statements because the sales at issue were addressed during an accounting reconciliation process. Likewise, the SEC did not bring any action with respect to IGT's accounting or disclosures.

The SEC did, however, bring charges based solely on the anti-retaliation provisions. In announcing the settlement, the SEC's Chief of the Office of the Whistleblower stated, "Bringing retaliation cases, including this first stand-alone retaliation case, illustrates the high priority we place on ensuring a safe environment for whistleblowers." In settling the action, the company agreed to pay a $500,000 penalty.

C. In the Matter of SandRidge Energy, Inc. (SandRidge)[11]

In this matter, an employee raised concerns about the company's process for calculating its publicly disclosed oil and gas reserves, as well as an internal audit designed to address the matter. In conjunction with a large-scale reduction in force, the company terminated the employee. The SEC found, however, that in discussing the employee's termination, "members of SandRidge senior management expressed among themselves their belief that the manner in which the Whistleblower was raising concerns regarding the reserve process was disruptive, and that the company could replace the Whistleblower with someone 'who could do the work without creating all of the internal strife.'" The SEC also found that the company did not investigate the employee's concern other than by conducting an internal audit, which it did not finish.

The SEC brought charges for violating the anti-retaliation provisions, as well as for violating Whistleblower Rule 21F-17(a), which prohibits employers from taking actions to impede individuals from communicating with the SEC. In connection with the settlement, the company agreed to pay a $1.4 million penalty.

10. Exchange Act Rel. No. 78991 (Sept. 29, 2016).
11. Exchange Act Rel. No. 79607 (Dec. 20, 2016).

IV. Analysis

A. When Does an Employee Become a Whistleblower?

For several reasons, the most prudent course of action for employers is to treat an employee as a whistleblower from the moment he or she raises concerns about potential violations of the federal securities laws.

First, there is no way to know whether an employee has already reported to the SEC. For purposes of anti-retaliation protections, an employee may report to the SEC at any time and in any manner. The definition of "whistleblower" in the SEC's Whistleblower Rules distinguishes between individuals eligible for an award and individuals eligible for anti-retaliation protections. To be eligible for an award, an individual must follow certain procedures.[12] Further, certain persons – such as officers, internal compliance personnel and attorneys – cannot receive an award unless they first report internally, and then only after certain circumstances occur.[13] However, none of these conditions apply to anti-retaliation protections; the Whistleblower Rules make clear that "[t]he anti-retaliation protections apply whether or not you satisfy the requirements, procedures and conditions to qualify for an award."[14]

Nor does the employee need to be correct about the existence of a violation. Instead, an employee is eligible for anti-retaliation protections whenever he or she reports information based on a "reasonable belief that the information [the employee] is providing relates to a possible securities law violation … that has occurred, is ongoing, or is about to occur."[15] In the Adopting Release to the final Whistleblower Rules, the SEC explained that the "reasonable belief" standard merely requires that the employee have a "subjectively genuine belief that the information demonstrates a possible violation" and that this belief is one that "a similarly situated employee might reasonably possess."[16] Accordingly, it is very easy for an employee to bring concerns to the SEC and be protected by the anti-retaliation provisions.

12. See 17 C.F.R. 240.21F-9.
13. See 17 C.F.R. 240.21F-4(a)(4).
14. 17 C.F.R. 240.21F-2(b)(1)(ii).
15. 17 C.F.R. 240.21F-2(b)(1)(i).
16. Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act Rel. No. 34-64545 (May 25, 2011), at 16. The SEC further explained that this standard was designed with the intention of encouraging employees to provide tips without fear of retaliation, while also not encouraging frivolous tips.

It is also possible that an employee may be eligible for anti-retaliation protections even if he or she does not report to the SEC, and only reports internally. While some courts have held that a person needs to report to the SEC before invoking anti-retaliation protections,[17] the SEC's position[18] and the position of some courts[19] is that internal reporting alone can qualify an individual for anti-retaliation protections. Accordingly, the simple act of raising concerns internally may be sufficient to cover an employee under the anti-retaliation provisions.

B. How Should an Employer Respond to a Potential Whistleblower?

Any adverse employment action may be deemed retaliatory if it is found to be caused by a lawful action taken by a whistleblower. As the actions described above show, the SEC has found a wide variety of employer responses to be retaliatory. These actions included changing an employee's job functions, removing responsibilities, removing access to systems and email accounts, moving an employee to another office, and depriving an employee of networking opportunities. While some responses may not appear to be significant in isolation – such as directing an employee not to attend an industry conference – the SEC's orders do not provide much analysis as to whether any of these actions, standing on their own, would be deemed actionable. However, given the broad wording of Exchange Act Section 21F(h)(1)(A), it should be understood that all such actions could be the basis for a charge.

On a practical level, initial reactions to employees who raise concerns can be very important for limiting potential anti-retaliation liability. A poor reaction can put an employee on the defensive and set into motion an irreconcilable chain of events. The IGT matter is instructive. In that case, the employee's presentation of his concerns was met with a hostile reaction. In the aftermath of that exchange, and perhaps because the employee understood that his superiors were taking steps to terminate him, the employee brought what was initially a matter for internal discussion directly to the SEC. In the Paradigm matter, the firm removed the employee from his duties the day after he told them he had brought concerns to the SEC, and subsequent negotiations on a severance package appear to have broken down quickly. From that point forward, the relationship between the firm and the employee was strained, and the firm's attempt to bring the employee back to work in another capacity was deemed retaliatory.

In sum, an employer should not react hastily or reflexively. Instead, a neutral response, or even an appreciative reaction for bringing concerns forward, has the potential for creating a more positive set of exchanges with an employee, one that need not create a chain of events liable to incur anti-retaliation charges. At the very least, a measured response is more likely to buy the employer time to assess the situation fully.

It should also be understood, however, that fault can be found even with more measured responses. In each of the cases above, the employer responded to the employee's concerns by conducting an internal investigation. That is a reasonable response. Yet, the manner in which the employers handled the employees while investigating was found to be retaliatory. An employer may understandably wish to separate an employee from the alleged conduct to determine for itself whether the allegations have merit. But in doing so, the employer risks being accused of marginalizing the employee or adversely changing his or her job functions. For instance, in Paradigm, the SEC pointed out that the employee was moved to another floor. The SEC also noted that the firm prevented the whistleblower from accessing its trading systems and instead asked the whistleblower to complete a task by hand. In IGT, the employer prohibited the employee from attending a supposedly important annual industry conference. The SEC's message in citing these facts is that actions that marginalize or ostracize employees can be deemed retaliatory. More important, of course, are actions that are material to an employee's career. In Paradigm, the employee's duties were changed from trading to compliance. In IGT, the employee was removed from a project very similar to the one that he raised concerns over. Employers face a very difficult dilemma when separating employees from the conduct at issue.

The better course of action, which in some cases can be very difficult, is to change the employee's duties, responsibilities and opportunities as little as possible during an internal investigation. Of course there may be situations in which it is impossible to leave an employee in the same position. This would be especially true if the employer believed the employee was culpable for the conduct at issue. Indeed, in such a case the employer could face another issue with the SEC if it finds the company did not take sufficient steps to remediate the misconduct. Such a finding could undermine a company's ability to seek cooperation credit, which in turn could lead to more severe remedies.

The only way to navigate these obstacles is through careful deliberation. It is therefore a best practice to have a whistleblower matter handled by personnel with as little

17. Asadi v. G.E. Energy (USA), LLC, 720 F.3d 620 (5th Cir. 2013), is the leading case taking this position. It held that a person may not be deemed a whistleblower unless he or she has reported information to the SEC because Exchange Act Section 21F(a)(6) defines a whistleblower as someone who reports information "to the Commission." Other decisions adopting this reasoning include Wiggins v. ING U.S., Inc., 2015 WL 3771646, at *9–11 (D. Conn. June 17, 2015); Verfuerth v. Orion Energy Systems, Inc., 65 F.Supp.3d 640, 643-46 (E.D. Wis. 2014); Banko v. Apple Inc., 20 F.Supp.3d 749, 756-57 (N.D. Cal. 2013); Wagner v. Bank of America Corp., No. 12-cv-00381-RBJ, 2013 WL 3786643, at *4-*6 (D. Colo. July 19, 2013); Verble v. Morgan Stanley Smith Barney, LLC, 148 F.Supp.3d 644, 656 (E.D. Tenn. 2015); and Puffenbarger v. Engility Corp., 151 F.Supp.3d 651, 664–65 (E.D. Va. 2015).

18. Interpretation of the SEC's Whistleblower Rules Under Section 21F of the Securities Exchange Act of 1934, 80 Fed. Reg. 47,829 (Aug. 10, 2015). As the SEC stated, "an individual who reports internally and suffers employment retaliation will be no less protected than an individual who comes immediately to the Commission . . . . A contrary interpretation would undermine the other incentives that were put in place through the Commission's whistleblower rules in order to encourage internal reporting."

19. Berman v. Neo@Ogilvy LLC, 801 F.3d 145 (2d Cir. 2015), is the leading case taking this position. It held that the tension between Exchange Act Sections 21F(a)(6) and 21F(h)(1)(A)(iii), which protects reporting in circumstances other than to the Commission, renders the statute "sufficiently ambiguous" as to require the court to afford administrative deference, under the holding of Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), to the SEC's interpretation that internal reporting qualifies an employee as a whistleblower for anti-retaliation purposes. Other courts taking the same position include Lutzeir v. Citigroup Inc., No. 4:14-cv-183, 2015 WL 7306443, at *2-3 (E.D. Mo. Nov. 19, 2015); Somers v. Digital Realty Trust, Inc., 119 F.Supp.3d 1088, 1094-1106, No. C-14-5180 EMC, 2015 WL 4483955, at *4–12 (N.D. Cal. July 22, 2015); Yang v. Navigators Grp., Inc., 18 F.Supp.3d 519, 533-34 (S.D.N.Y. 2014); Khazin v. TD Ameritrade Holding Corp., No. 13-4149 (SDWQ)(MCA), 2014 WL 940703, at *3-6 (D.N.J. Mar. 11, 2014); Azim v. Tortoise Capital Advisors, LLC, No. 13-2267-KHV, 2014 WL 707235, at *2-3 (D. Kan. Feb. 24, 2014); Ellington v. Giacoumakis, 977 F.Supp.2d 42, 44-46 (D. Mass. 2013); Genberg v. Porter, 935 F.Supp.2d 1094, 1106-07 (D. Colo. 2013); Nollner v. S. Baptist Convention, Inc., 852 F.Supp.2d 986, 995 (M.D. Tenn. 2012); and Kramer v. Trans–Lux Corp., No. 3:11CV1724 SRU, 2012 WL 4444820, at *4 (D. Conn. Sept. 25, 2012).

connection to the facts and the employee as possible. Further, and just as important, any changes in position and duties must be well-reasoned and well-documented.

C. Why Should Employers Encourage Internal Reporting?

Employers should also understand that the SEC's Whistleblower Rules are populated with incentives for whistleblowers seeking monetary awards to report internally and to allow an employer to investigate the matter. First, there is a 120-day look back provision that allows an internal whistleblower's information to be deemed "original" as of the date that he or she first reported internally, so long as the employee then reports to the Commission within 120 days.[20] Second, if an employee reports misconduct internally and the employer then conducts an investigation that yields further information that aids the Commission's successful enforcement action, the employee will be deemed to have been the original source of all of this information.[21] Third, the whistleblower award calculation criteria include provisions under which an award can be increased if the employee at issue first reported internally.[22] Conversely, an award can be reduced where an employee interferes with internal compliance and reporting systems.[23] With respect to anti-retaliation liability, these incentives can have the effect of creating time for an employer to assess the concerns raised and to engage in a positive dialogue with the employee that allows an issue to be resolved amicably.

For many reasons, it is a good idea to create a compliance and human resources culture that encourages employees to raise their concerns internally with confidence. First, one of the bases for cooperation credit with the SEC is the act of self-reporting.[24] Also, creating a culture of healthy internal reporting maximizes the investment spent on compliance. The ability to self-report is good in its own right because it gives an entity the opportunity to determine whether and how it approaches the SEC, and gives it the best chance to have a cooperative relationship during an investigation and/or to mount the most vigorous defense. On the other hand, entities that do not seek to maximize internal reporting possibilities may miss opportunities to bring issues to regulators cooperatively, which can result in more aggressive enforcement actions and steeper penalties.

D. How Should Employers Handle Separation?

Terminating whistleblowers is fraught with risk because it can be extremely difficult to separate the reasons for termination from the circumstances of the employee's whistleblower report. This is especially true if the events are close in time and there is little or no prior record to support employee discipline. Further, the employee's record may support a conclusion that the report was the reason for the termination. For example, in IGT the employee had an exceptional employment record, which the SEC cited at length in support of its finding that the termination was retaliatory. In SandRidge, management created a record in which they discussed the employee's termination in terms of finding someone not likely to raise concerns in the same way. Such statements can support a finding that the termination was retaliatory. In short, unless there are well-documented reasons sufficient for termination that exist independently of the circumstances surrounding the employee's report, then an employer is vulnerable to a charge of retaliation. Accordingly, as a practical point it is a good practice to memorialize an employee's accomplishments and shortcomings contemporaneously and diligently in order to support appropriate employment actions.

Assuming, on the other hand, that a separation is based on amicable and mutually agreed upon terms, the wording of the separation agreement can also create liability. An employer will naturally want to include language in a separation agreement that protects confidential information or prevents the employee from disparaging the company. Employers need to pay attention to SEC Whistleblower Rule 21F-17(a), which states that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications."[25] Over the past two years, the SEC has brought and settled nine cease-and-desist actions for violations of this provision.[26] These actions have involved both separation agreements and internal investigation agreements, and they have taken issue with several clauses often found in confidentiality agreements, including: provisions prohibiting disclosure of confidential information absent a subpoena or the company's permission; provisions that impose financial penalties on an employee who discloses confidential information; and non-disparagement clauses. In short, the SEC will take issue with any agreement that it believes impedes an employee's ability to volunteer information to the government. Moreover, as a condition of settlement in these cases, the SEC has required employers to inform all current and former employees who have signed an agreement found to violate the Rule that the restriction no longer applies and that they are free to report information to government authorities. Employers should not only be concerned about such language when negotiating separation agreements, but should also be reviewing their current employment agreements, compliance manuals and other policies and procedures for language that might violate the Rule.

V. Conclusion

The most well-informed whistleblower is only as good as an entity's true culpability. Moreover, the SEC's Division of Enforcement is adept at separating substantive allegations from frivolous ones. Therefore, companies and firms with sound financial controls, disclosure practices and compliance programs should have little to fear from whistleblowers. Nevertheless, an ill-considered reaction to an employee whistleblower can create a separate and wholly unnecessary source of liability. Employers should therefore anticipate the possibility of employee whistleblowers by creating deliberate response mechanisms that address employee concerns positively and carefully. ★

20. 17 C.F.R. 240.21F-4(b)(7).
21. 17 C.F.R. 240.21F-4(c)(3).
22. 17 CFR 240.21F-6(a)(4).
23. 17 CFR 240.21F(b)(3).
24. See Exchange Act Rel. No. 44969 (Oct. 23, 2001).
25. 17 C.F.R. 240.21F-17(a)
26. KBR, Exchange Act Rel. No. 74619 (Apr. 1, 2015); Merrill Lynch, Exchange Act Rel. No. 78141 (June 23, 2016); BlueLinx Holdings, Exchange Act Rel. No. 78528 (Aug. 10, 2016); Health Net, Exchange Act Rel. No. 78590 (Aug. 16, 2016); Anheuser-Busch InBev, Exchange Act Rel. No. 78957 (Sept. 28, 2016); NeuStar, Exchange Act Rel. No. 79593 (Dec. 19, 2017); SandRidge Energy, Exchange Act Rel. No. 79607 (Dec. 20, 2016); BlackRock, Exchange Act Rel. No. 79804 (Jan. 17, 2017); and Homestreet, Exchange Act Rel. No. 79844 (Jan. 19, 2017).