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Arbitrating Dodd-Frank Whistleblower Retaliation Claims

By

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Whistleblowers have been entitled to legal protection in our country from before we even were a country. The Continental Congress enacted the first law supporting persons who reported wrongdoing by a unanimous resolution in 1778, both by encouraging whistleblowers in general and by paying the defense costs of two in particular who faced libel charges in retaliation for their reports.[1] Since then, those who report violations of law have had the benefit of various protections against retaliation. Protecting whistleblowers is a hotter topic than usual these days; the whistleblower who first disclosed President Trump's interactions with Ukraine's president and the one who revealed the problems with Boeing's 737 MAX before any of them crashed have shared front-page headlines in recent weeks. It seems a fitting time, then, to explore what may become the next new thing in FINRA arbitration—whistleblower retaliation claims by registered representatives of broker-dealers.

The federal securities laws have two whistleblower protection statutes. The first, enacted as part of the Sarbanes-Oxley Act of 2002,[2] protects whistleblowers who report violations of federal securities laws up the corporate ladder internally before reporting out to the authorities. The second is § 922 of the Dodd-Frank Wall Street Reform and Consumer Protection **Act** of 2012.[3] It protects those who report securities law violations to the Securities and Exchange Commission.

The two laws are similar but not identical. Sarbanes-Oxley permits the recovery of special damages—that is psychological injury—but it requires aggrieved whistleblowers to file a claim with the Department of Labor's Occupational Safety and Health Administration (OSHA) within 180 days of the retaliation. Only after exhausting administrative remedies at OSHA and before an Administrative Law Judge can they access the federal courts. A Dodd-Frank whistleblower, on the other hand, has immediate access to the courts and a longer 6-year statute of limitations. Dodd-Frank allows an award of double back-pay but not special damages. The key prerequisite of a Dodd-Frank retaliation claim, however, is that one must have reported wrongdoing to the SEC itself.

Last September, the Court of Appeals for the Second Circuit (sitting in New York) ruled—not very surprisingly—that Dodd-Frank whistleblowers can be compelled to arbitrate their retaliation claims. Erin Daly claimed she

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WELCOMING CHRISTINE LAZARO TO *SAC*'s BOARD OF EDITORS

Christine M. Lazaro has contributed to the field of dispute resolution in many different ways and in numerous capacities. She has just completed a year of service as President of the Public Investors Advocate Bar Association, having joined that organization in 2008 and served on its Board of Directors since 2015. Today, she teaches at St. John's School of Law, where she began as a Supervising Attorney in 2007. As a Professor of Clinical Legal Education, Christine heads the School's Securities Arbitration Clinic as its Director, while teaching classes in Broker-Dealer Regulation and Business Basics and serving as Faculty Advisor for the Corporate and Securities Law Society.

Christine also practices law in an Of Counsel capacity to the Law Offices of Brent A. Burns, LLC, where she consults on securities arbitration and regulatory matters. In addition to her Bar activities, which include service on the Securities Litigation and Arbitration Committee of the New York State Bar Association, she has accepted a seat on FINRA's Investor Issues Advisory Committee, commencing in October 2019.

Christine previously practiced law as an Associate with the well-known legal team of Davidson & Grannum (Partner Joel Davidson was a long-time member of SAC's Board), where she represented broker-dealers and brokers in disputes with clients in both arbitration and mediation, handled employment law matters and counseled broker-dealers with regard to their investment contracts with municipalities and government entities.

Christine appeared last May on the New York City Bar's annual "Hot Topics" Program and has spoken as a Panelist on a variety of issues at the PIABA Annual Conference, most recently at the October 2019 Conference on the subject of "Business Development Companies and Product Cases." As outgoing President, she also interviewed FINRA-DR officials Rick Berry and Manly Ray in a general session titled "Review of FINRA-DR Activities and Developments in 2019." Christine's writings have appeared in the PIABA Law Journal, NYSBA, NYCBA and PLI Program Materials, St. John's Law Review, Michigan Business & Entrepreneurial Law Review and other legal periodicals. She most recently wrote "An Overview of the Regulation Best Interest Rule Package" for the 2019 PIABA Conference.

Earlier this year, we interviewed Prof. Lazaro and her PIABA colleague, Sam Edwards, as the current and incoming PIABA Presidents, respectively, in a podcast that we later converted to a SAC feature article (2019 SAC, No. 4). We now proudly welcome Christine to the Board of this publication.

--- *Rick Ryder, SAC*

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was demoted and ultimately fired for, being a woman, not joining her firm's "boys club," and for reporting improper conduct by her superiors. She missed the filing deadline under Sarbanes-Oxley by over a year, so that claim was dismissed as untimely. Her Dodd-Frank retaliation claim was timely, but the employer moved to compel arbitration. Daly had signed an employment agreement in which she agreed to arbitrate all claims arising out of her employment, and the court, in *Daly v. Citigroup, Inc., et al.,*[4] ruled that those included her Dodd-Frank whistleblower retaliation claims.[5]

We forget that mandatory arbitration of securities law claims is a relatively new thing. Yes, the Federal Arbitration Act (FAA)[6] has mandated that all agreements to arbitrate "shall" be enforced since it was first enacted in 1925. Despite that, however, before 1987 claims seeking to vindicate rights granted by federal statute could *not* be arbitrated. In *Wilko v. Swan*,[7] the Supreme Court had ruled that parties could not by contract divest federal courts of their jurisdiction to hear federal claims. *Wilko* essentially limited the applicability of the FAA to state law claims.[8] Not until *Shearson/American Express Inc. v. McMahon,*[9] did the Supreme Court change its mind, overrule *Wilko*, and apply the FAA as written to the adjudication of securities law claims. Since then, arbitration has burgeoned to encompass virtually all legally enforceable rights, regardless how they arise.[10]

So it was no surprise the court in *Daly* ruled as it did. It applied the decisional rubric that federal claims must be arbitrated under a valid arbitration agreement unless there is clear statutory language precluding it. The court found that Sarbanes Oxley precluded arbitrating retaliation claims by specifically routing those claims to OSHA and an ALJ. Moreover, the Dodd-Frank Act amended Sarbanes-Oxley to add provisions voiding any agreement requiring arbitration of Sarbanes-Oxley whistleblower retaliation claims.[11] In doing so, Congress made the OSHA process the only way to redress whistleblower retaliation under Sarbanes-Oxley. However, Dodd-Frank contains no such requirement or prohibition with respect to its own whistleblower provisions. Daly argued, in effect, that the anti-arbitration provisions of Dodd-Frank, which by their terms applied to Sarbanes-Oxley, also by implication applied to Dodd-Frank's own whistleblower provisions. The Second Circuit rejected that argument. The Court reasoned that if Congress wanted anti-arbitration provisions to apply to Dodd-Frank whistleblowers, it could easily have said so as it did for Sarbanes-Oxley whistleblowers.[12] From that premise, the conclusion necessarily followed that Dodd-Frank whistleblower retaliation claims may be compelled to be arbitrated by a valid arbitration agreement.

In the wake of *Daly*, FINRA arbitration panels may soon learn a lot about whistleblower retaliation rights.[13] We know, of course, that all associated persons of FINRA—registered representatives of FINRA member firms—are required to arbitrate employment disputes arising out of the business of the member by FINRA, as reiterated in the Forms U-4 that they are required to sign. Those employees also sign their firms' employment agreements that contain arbitration clauses to cover, for good measure, any claims that might fall through the cracks of what FINRA and the Form U-4 inherently require to be arbitrated.[14] *Daly* ensures that FINRA member firms will now arbitrate the Dodd-Frank whistleblower retaliation claims of their registered employees like they would any other employment dispute.

Daly follows a scant few years after the Supreme Court settled a disagreement between the circuits over what exactly it means to be a "whistleblower" under Dodd-Frank. Some courts and even the SEC had taken the position that a Dodd-Frank whistleblower included anyone who reported wrongdoing in ways permitted by either Dodd-Frank or Sarbanes-Oxley.[15] Since Sarbanes-Oxley does not require reporting to the SEC (as Dodd-Frank does) those courts (and the SEC) would have extended Dodd-Frank's whistleblower protections to virtually all whistleblowers. However, the Supreme Court refused to go that far. In a unanimous ruling, the Court in *Digital Realty Trust, Inc. v. Somers,*[16] held that since Dodd-Frank defines a "whistleblower" as one who reported wrongdoing to the SEC, only someone who filed a tip with the SEC is protected from retaliation. All other whistleblowers can only invoke the protections of Sarbanes-Oxley.[17]

That ruling makes Dodd-Frank whistleblower retaliation claims unique in arbitration. Dodd-Frank defines a "whistleblower" as not merely one who reports to the SEC, but one who does so in the manner prescribed by the SEC. The SEC has promulgated its Rule 21F to govern how Dodd-Frank whistleblowers must provide their information. They must do so by submitting, either online or on paper, a Form Tips, Complaints and Reports, affectionately known as a "TCR," with its Office of the Whistleblower. But here is the point: Filing a TCR is a binary event—you either filed one or you didn't. If you didn't file a TCR before you suffered retaliation, then you aren't a Dodd-Frank whistleblower, whatever else you may be and whatever else happened to you.

And that also means that if you didn't file a TCR, you can't have a valid Dodd-Frank whistleblower retaliation claim—and FINRA and its arbitrators shouldn't waste their time hearing you say otherwise. Unlike virtually all other arbitration claims, Dodd-Frank whistleblower retaliation claims can be dismissed at the commencement of a case by asking simply whether and when a TCR was filed. Present FINRA rules do not contemplate a procedure for such dismissals; on the contrary FINRA Rule 13504(a)(6) would forbid granting such motions. That should change. It is wholly unnecessary to hold a hearing to determine whether or not a TCR was filed, when documentary proof of it exists in the form of an electronic filing receipt and often even a letter from the Office of the Whistleblower acknowledging it. So, the first and most obvious need in dealing with Dodd-Frank

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whistleblower arbitration claims is for FINRA to adopt a simple rule change that will permit dismissal of Dodd-Frank whistleblower retaliation claims when no prerequisite TCR was filed.

All that being said, it isn't hard to predict how Dodd-Frank whistleblower claims will arise in arbitration. Some will be the occasional affirmative retaliation claim that stands on its own. Anyone who has been a corporate gadfly, pointing out where regulatory corners have been cut or rules evaded, and who suffers any adverse job action, may have a claim to bring if they filed a TCR. But it would not surprise us if those pure anti-retaliation claims turn out to be relatively few. Far more likely, employers will invite retaliation claims when they make the all-too-common mistake of starting arbitrations against the wrong employees.

Here's the likeliest scenario. As we know, the general practice on the Street is to recruit promising brokers with money. These used to be called signing bonuses, but now they are almost universally called employee forgivable loans (EFL). The new firm pays cash to the new broker, for which the broker signs a promissory note. The promissory note provides that the "loan" is either forgiven, or repaid from the commissions that the broker earns, over time, from 4 to as long as 10 years. If the broker stays at the firm for the time needed to discharge the EFL, then all will be well.

However, it is not uncommon for a broker to discover, within a year or so of joining a new firm, that the place isn't for her. There are many reasons why that might be, but the usual catalyst of a move is that the broker is not making as much money at the firm as she expected to make when she went there. That means that she now goes to her next firm with a lower production base, and a lower compensation structure, and a lower upfront payment. Or even worse, the broker may have promised not to compete with the old firm for some months, or not to solicit the customers of that firm for some years. Now that broker can't get a new job at a new firm at all, and has to rebuild her business from scratch if and when she does.

All this results in the broker still owing her former firm some amount, usually large, on the EFL, that she won't be able to repay. And so, the old firm will take legal action to recover it. Since all employment disputes between broker-dealers and their brokers need to be arbitrated, almost all these EFL cases now end up in a FINRA arbitration. FINRA has even established, in Rule 13806, a whole set of procedures to accommodate them.[18]

EFL cases are tough to defend against. The narrative: "You got the money; you promised to pay it back; you didn't pay it back; so pay it back," is simplicity itself, which is why FINRA created a streamlined Rule 13806 to deal with them. That is also why the standard defense to an EFL case is an offense; it is to prove that the firm owes the broker more than the broker owes it. Typical counterclaims are that the firm breached the employment agreement by failing to support the broker's business, or by actively interfering with the broker's business, or in some way shape or form by preventing the broker from making the income she expected she would when she agreed to the EFL. Often this argument is couched as a fraud claim, in that the broker was fraudulently induced to join the firm to begin with. But all result in a claim for damages against the firm that will offset the EFL balance due.

Daly now adds a Dodd-Frank whistleblower retaliation claim to the broker's arsenal. Note that it has to be a Dodd-Frank claim. A Sarbanes-Oxley claim won't work against an EFL because that must be heard by OSHA and then appealed to an ALJ. Those procedures don't really help a broker who is facing an arbitration to repay an EFL, because the one can't be offset directly against the other. The broker's strategic goal is to pit anti-retaliation counterclaims directly against the firm's original EFL claim so as to force the arbitrators to decide the entire controversy all at once, and only a Dodd-Frank claim can be used to do so.

But, to repeat, only if the broker first filed a TCR. This suggests some universal practical advice. Any broker who contemplates raising concerns internally about unethical behavior at the firm would be well advised to file a form TCR sooner rather than later, to preserve a Dodd-Frank whistleblower retaliation claim to use later if the firm tries to collect an EFL from her in an arbitration.

We have three closing thoughts: *First*, there is a certain amount of karmic irony here. Firms have had a long habit of using compliance as an easy excuse to rid themselves of troublemakers. Regulatory obligations have become so granular and often subjective that it is too easy for a firm to find some fault somewhere that it can leverage into a termination. But as we all should know, no financial firm lacks its own skeletons. The broker's use of whistleblower retaliation laws to turn tables on firms tends to level a playing field that has for too long tilted in the firms' favor.

Second, it is a debatable point whether arbitration will be a good thing for Dodd-Frank whistleblower retaliation jurisprudence. *Digital Realty* left a number of unanswered questions about the extent of Dodd-Frank's protection of whistleblowers. For example, must the retaliation be motivated by the whistleblowing itself? Does that mean that protected whistleblowers cannot be anonymous, as Dodd-Frank expressly permits? Or is it that once one has filed a TCR with the SEC, he becomes protected against any kind of retaliation?[19]

These questions would in the normal course be answered through incremental litigation and court decisions. However, arbitration panels will impose some rough justice on the parties from which no governing principles can ever be divined. As a result, the true outlines of Dodd-Frank whistleblower retaliation law will take longer to develop. But then again, that has been the nature of all securities fraud jurisprudence since 1987, and we all have somehow learned to live with it.

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Third, it is possible all this will be moot. On September 23, 2019, the Whistleblower Programs Improvement Act was introduced to the U.S. Senate.[20] A similar bill passed the House of Representatives on July 9, 2019, by a rare bipartisan vote of 410-12.[21] If these bills become law, they would (a) extend the anti-arbitration provisions that Dodd-Frank enacted for Sarbanes-Oxley whistleblowers to Dodd-Frank whistleblowers, and (b) overrule *Digital Realty* to the extent that it limited Dodd-Frank whistleblower protections only to those who file TCRs. Of course, it is dangerous to predict what will happen to any legislation in this (or any) Congress, but practitioners should be aware of the possibility that this article may not have as long a shelf life as we intended when we started writing it.

ENDNOTES

1 *See Stephen M. Kohn, The Whistle-Blowers of 1777,* THE NEW YORK TIMES (JUNE 12, 2011), available at https://www.whistleblowers.org/wp-content/uploads/2018/11/1777whistle-blowers.pdf.

2 Codified at 18 U.S.C. §1514A.

3 Codified as § 21F of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-6(h)(1)(A).

4 No. 18-665 (2d Cir., Sept. 19, 2019) (slip op.), available at http://brokeandbroker.com/PDF/DalyCitigroup2CirOp190919.pdf.

5 The *Daly* court followed the 3d Circuit Court of Appeals, the only other federal appellate court to consider the issue. *See* Khazin v. TD Ameritrade Holding Corp., 773 F.3d 488, 495 (3d Cir. 2014); summarized at SOLA 2014-47).

6 9 U.S.C. §§ 1-16.

7 346 U.S. 427 (1953).

8 And sometimes not even to those: Some courts did not even require arbitration of state law claims if they were factually "intertwined" with non-arbitrable federal claims. *See, e.g., Miley v. Oppenheimer & Co., Inc.*, 637 F.2d 318 (5th Cir. 1981); *Sibley v. Tandy Corp., 543 F.2d 540 (5th Cir. 1976).*

9 482 U.S. 220 (1987).

10 These now include race, sex and age discrimination claims that also used to be the exclusive province of the federal courts. *See, e.g., 14 Penn Plaza LLC v. Pyett,* 555 U.S. 247 (2009); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991). Arbitration agreements even trump collective bargaining rights under the National Labor Relations Act. *Epic Systems Corp. v. Lewis*, 584 U.S. ___ (2017), slip op. available at https://www.supremecourt.gov/opinions/17pdf/16-285_q8l1.pdf. None of this is without modern objection, to be sure. *See* Kathleen McCullough, *Mandatory Arbitration and Sexual Harassment Claims: #MeToo- and Time's Up-Inspired Action Against the Federal Arbitration Act,* 87 Fordham L. Rev. 2653 (2019), available at: https://ir.lawnet.fordham.edu/flr/vol87/iss6/13.

11 *See Daly v. Citigroup, Inc., et al., slip op. at 16-23.*

12 *Id.* Dodd-Frank similarly amended the Commodity Exchange Act and the Consumer Financial Protection Act to prevent arbitration of whistleblower retaliation claims under those statutes. Why Dodd-Frank was excluded is a matter of speculation. The *Daly* court reasoned that the exclusion was deliberate. Recent activity in Congress suggests it may have just been an oversight. See text at notes 20-21, *infra.*

13 Or they may not. See text at notes 20-21, *infra.*

14 For example, the FINRA ByLaws and Form U-4 do not automatically require discrimination claims to be arbitrated. FINRA Rule 13201 permits arbitration of statutory discrimination claims "only if the parties have agreed to arbitrate it, either before or after the dispute arose." Available at https://www.finra.org/arbitration-mediation/printable-code-arbitration-procedure-13000#13201. Courts have enforced that limitation. *See, e.g., Joni D. Ffrench v. PricewaterhouseCoopers Corporate Finance, LLC, et al.,* 2012 WL 1900930 (S.D. Tex. May 24, 2012).

15 *See, e.g., Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015).

16 583 U.S. ___ (2018), slip. op. available at https://www.supremecourt.gov/opinions/17pdf/16-1276_b0nd.pdf.

17 *See generally,* Aegis Frumento & Stephanie Korenman, *SEC whistleblower retaliation – and the federal securities laws – after Digital Realty,* 19 J. INV. COMPL. 22 (2018), available at https://sterntannenbaum.com/wp-content/uploads/2018/10/SEC-Whistleblower-Retaliation-After-Digital-Realty-00070382xB16F4.pdf.

18 It is an interesting side note—and it should be no surprise—that firms are all too willing to avoid arbitration when it suits them. When Merrill Lynch tried to make EFLs payable to a non-FINRA-member subsidiary, so it could avoid FINRA arbitration of EFLs and instead have the benefit of accelerated summary judgment under New York's CPLR § 3213, it was sanction for violating Rule 2010. FINRA Letter of Acceptance, Waiver and Consent No. 2009020188101 (accepted by FINRA Jan. 25, 2012). But that did not stop other firms from attempting the same thing. Eventually, the New York courts ruled that brokerage firms could not use New York's accelerated procedure to evade their obligation to arbitrate employment disputes. *BGC Notes LLC v. Gordon, 142 A.D.3d 435, 36 N.Y.S.3d 130 (1st Dep't 2016).*

19 Many of these open questions are discussed in Aegis Frumento & Stephanie Korenman, *SEC whistleblower retaliation – and the federal securities laws – after Digital Realty, supra* note 17.

20 S. 2529, 116th Cong. (2019), available at https://www.congress.gov/bill/116th-congress/senate-bill/2529.

21 Whistleblower Protection Reform Act of 2019, H.R. 2515, 116th Cong. (2019), available at https://www.congress.gov/bill/116th-congress/house-bill/2515.