

# *Whistleblower Protections in the Dodd-Frank Wall Street Reform and Consumer Protection Act*

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C O U N S E L O R S   A T   L A W

# *Overview of the Dodd-Frank Wall Street Reform Act (“D-F”)*

- **Overview of New Whistleblower Provisions**
  - **Important Changes to Sarbanes-Oxley (SOX)**
  - **New Whistleblower program through the SEC**
  - **Practical Implications Moving Forward**

# Part I: The Wall Street Reform Act Amendments to SOX

## 1. SOX Expanded to Cover Subsidiaries

- DOL traditional position → employees of subs not covered (absent significant nexus between mgmt. and employment relations of parent and sub)
- D-F def. public companies includes any “subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company”

## 2. Enhanced Statute of Limitations for SOX

- Increased from 90 days of a violation to 180 days of violation or after the date on which the employee became aware of the violation

## 3. No Waiver of SOX Claims

- “The rights and remedies provided for in this . . . may not be waived by any agreement, policy form, or condition of employment, including by a pre-dispute arbitration agreement.”
- Question: Can companies settle SOX claims prior to a filing with the DOL or Court? (Practical Implications)

# *Part I: The Wall Street Reform Act Amendments to SOX (cont'd)*

4. Pre-Dispute Arbitration agreements are invalid and unenforceable, if agreement requires arbitration of a dispute under D-F
5. Right to a federal court jury trial for Sox complainants
  - if they have not received a final decision from the Secretary of Labor within 180 days
6. SOX coverage extended to nationally recognized statistical rating organizations

## *Part II: New SEC Whistleblower Program (SEC-WP)*

1. Without replacing SOX, D-F adds a new federal whistleblower retaliation cause of action through SEC for employees who provide “original” information to the SEC about violations of the securities laws or who make SOX – or SEC – required disclosures
  - potential to be more lucrative to claimant than SOX action
    - = avoid SOX administrative proceedings
    - = avoid SOX new 180 day limitations period
    - = increased monetary incentives for whistleblowers
  - claimant has a **choice** = SEC-WP, SOX, or both!

## Part II: New SEC Whistleblower Program (SEC-WP) (cont'd)

2. To be Protected Activity under SEC-WP, Whistleblower (“WB”) must provide:
  - (a) “Original information”
    - independent knowledge or analysis by a WB
    - not known to SEC from any other source
    - not derived from an allegation in a judicial or administrative hearing or in a government report, hearing, audit or investigation or news media unless the WB is a source of the information.
  - (b) testify in, or assist in any investigation or judicial or administrative action of the SEC based upon or related to such information; or
  - (c) make disclosures that are required or protected under SOX or SEC laws/regulations
3. Unlike SOX:
  - (a) SEC-WP retaliation claims **filed directly in federal court** and prosecuted by plaintiff.
  - (b) no opportunity to win a preliminary order of reinstatement while his/her complaint is being pursued.
  - (c) an alleged retaliatory action against an employee who makes an internal complaint to a compliance hotline or other reporting mechanism is not covered by the SEC-WP.

## *Part II: New SEC Whistleblower Program (SEC-WP) (cont'd)*

### 4. Expanded Statute of Limitations for Retaliation Claims

- 6 years after date on which violation occurred or 3 years after facts underlying the complaint are known or could have been known by the WB
- No complaints over 10 years after the violation

### 5. Enhanced Recovery for Retaliation Claims

- Prevailing plaintiff entitled to reinstatement
- twice the amount of back pay owed, as well as interest, and attorney fees
- discretionary SEC reward (10%-30%) to those who contribute original information through SEC – WP that leads to recovery of monetary sanction of more than \$1 M in criminal and civil proceedings

## *Part II: New SEC Whistleblower Program (SEC-WP) (cont'd)*

### 6. Similar Burden for Retaliation Claim

- SOX = “reasonably believe” the information they report constitutes securities, bank, or wire fraud or a violation of an SEC rule or other federal law relating to fraud against shareholders”
- SEC – WP = proposed rules were silent, but final rules only provide retaliation protection if WB possesses “reasonable belief that the information [submitted] relates to a possible securities law violation . . . that has occurred, is ongoing, or is about to occur.”



# *Final SEC Rules*

Background: Dodd-Frank authorizes the SEC to provide monetary rewards of 10% to 30% of the monies recovered to individuals who voluntarily provide the SEC with original information that leads to recoveries of monetary sanctions of more than \$1 million in civil and criminal proceedings

- Accepted comments to proposed rules to accomplish this directive through December 2010
- Final rules were released on May 25, 2011 and become effective on August 12, 2011.

# Top 5 Highlights of Final Rules

## 1. Definition of Whistleblower

- SEC's proposed rules included "potential violation" language, but final rules use "possible violation that has occurred, is occurring, or is about to occur" language.
- SEC explained that a possible violation need not be "material," "probable," or even "likely," but should "indicate a facially plausible relationship to some securities violation."
- reflects SEC's view that anti-retaliation protections of D-F do not depend on a finding of an actual violation of the securities laws.
- WBs will not be paid awards based on monetary sanctions arising from their own misconduct

## 2. Award Eligibility

- voluntarily provide the SEC
- with original information
- that leads to the successful enforcement by the SEC of a federal court or administration action
- in which the SEC obtains monetary sanctions totaling more than \$1 million
- Anti-retaliation protection does not depend on whether the WB qualifies for an award.

## *Top 5 Highlights of Final Rules (cont'd)*

3. Voluntarily – SEC will not consider a WB's actions as voluntary if the WB is required to report the information to the Commission under a pre-existing legal duty, contractual duty, or a duty arising out of a judicial or administrative order to report.
4. Original Information - derived from WB's independent knowledge or independent analysis
  - not already known to the SEC, unless WB is the original source of the information, or unless WB reported internally and the entity passed along the information to the SEC
  - not exclusively derived from an allegation made in an administrative hearing, government report, news media, audit or investigation, unless WB is source
  - provided to SEC for the first time after July 21, 2010
  - information in communications protected by the attorney client privilege or otherwise obtained in connection with legal representation is excluded
  - some information from some accountants, company executives, and internal compliance personnel is also excluded.

# Top 5 Highlights of Final Rules (cont'd)

## 5. Award Amount Criteria

- if eligibility criteria met, SEC will decide the amount of the award (between 10% and 30% of sanctions collected) based on:

- factors that may increase amount of WB award:

- the significance of the information provided by the whistleblower;
- the degree of assistance provided by the whistleblower...in a Commission action or related action;
- the programmatic interests of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws; and
- whether the whistleblower participated in internal compliance systems.

## *Top 5 Highlights of Final Rules (cont'd)*

- factors that may decrease amount of WB award:
  - any culpability or involvement of the whistleblower in matters associated with the Commission's action or related actions;
  - any unreasonable reporting delay; and
  - any interference with internal compliance and reporting systems.

## *Part III: Five Practical Implications*

1. Review Waiver and Arbitration Agreements to ensure no conflicts with current law
2. Find New Ways to Incentivise Internal Reporting
  - how to encourage would-be WB's to raise compliance concerns internally to ensure that companies have the opportunity to investigate and correct any problems in a timely manner and reduce greater risks of liability
3. Possible Race to the SEC
  - consider preemptive reporting to undercut “original information” argument and enhance company’s position before the SEC
4. Review Coverage of Subsidiaries
  - SOX now includes subsidiaries or other related entities that are consolidated in the company’s books, companies need to revise internal procedures and programs to make sure that employees of subsidiaries are covered.

## *Part III: Five Practical Implications (cont'd)*

5. How do you settle a SOX claim in light of statute's prohibition of waiver of SOX rights and remedies by "agreement"?
  - consider certifications/acknowledgements in the settlement papers relating to a lack of wrongdoing or reporting of wrongdoing
  - consider pros and cons of tender back requirement for consideration attributable to a SOX claim if SOX claim is subsequently filed

# Hypothetical 1

1. George believes his employer has violated securities law and reports this suspected violation to the SEC. George's employer learns that George reported information to the SEC. What can George do if he believes his employer has taken action against him because he provided this information to the SEC? What if no person could reasonably believe that the information George reported was a violation of federal securities law? How long does George have to bring a whistleblower complaint? What can George recover if his lawsuit is successful?



# Proposed Answer

- George can bring a claim for retaliation.
- George has a claim for retaliation even if he did not reasonably believe the behavior violated securities law.
- George must bring his retaliation claim within 3 years of the retaliation or when George should have known of the retaliation. Any claim for retaliation must be brought within 10 years of the alleged retaliation.
- If George's retaliation lawsuit is successful, he is entitled to reinstatement with the same seniority he would have absent the retaliation, double back-pay plus interest, litigation costs, expert witness fees, and reasonable attorneys' fees.

## *Hypothetical 2*

1. Joan works in the corporate accounting department of Big Box Corporation. One day Joan notices some irregularities in the corporate accounts. Upon further investigation, Joan realizes that the company has been engaging in accounting fraud to conceal the fact that the company CEO, Mr. Moneybags, used corporate funds to purchase a yacht and to pay for his quest to sail around the world. Jane also realizes this fraudulent information had been included in the company's reports to investors. Joan decides to report this information to the SEC. If the SEC brings a successful enforcement action based upon this information, is Joan entitled to an award? How large would the award be? What if Joan is part of the company's internal compliance team?

# Proposed Answer

- Provided the information Joan provides is original information and the SEC recovers at least \$1 million, Joan is entitled to an award.
- The award would be between 10 and 30 percent of the monetary sanction obtained by the SEC.
- Generally, information provided by someone with internal audit responsibilities is not considered original information. However, if the company does not disclose the information to the SEC within a reasonable time or discloses the information in bad faith, then the information provided by Joan would be considered original information and Joan would be entitled to an award.



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***Thank you!***