Morgan Lewis

Preventing and Defending Whistleblower Claims

Date: December 5, 2012
Time: 12:00-1:00 pm ET

Presenters:
Sarah Bouchard
Thomas Linthorst

Agenda

- Review of SEC's Annual Report
- New Developments in Whistleblower Cases
- Practical Issues in Preventing, Investigating, Defending, and Settling Whistleblower Claims

Overview

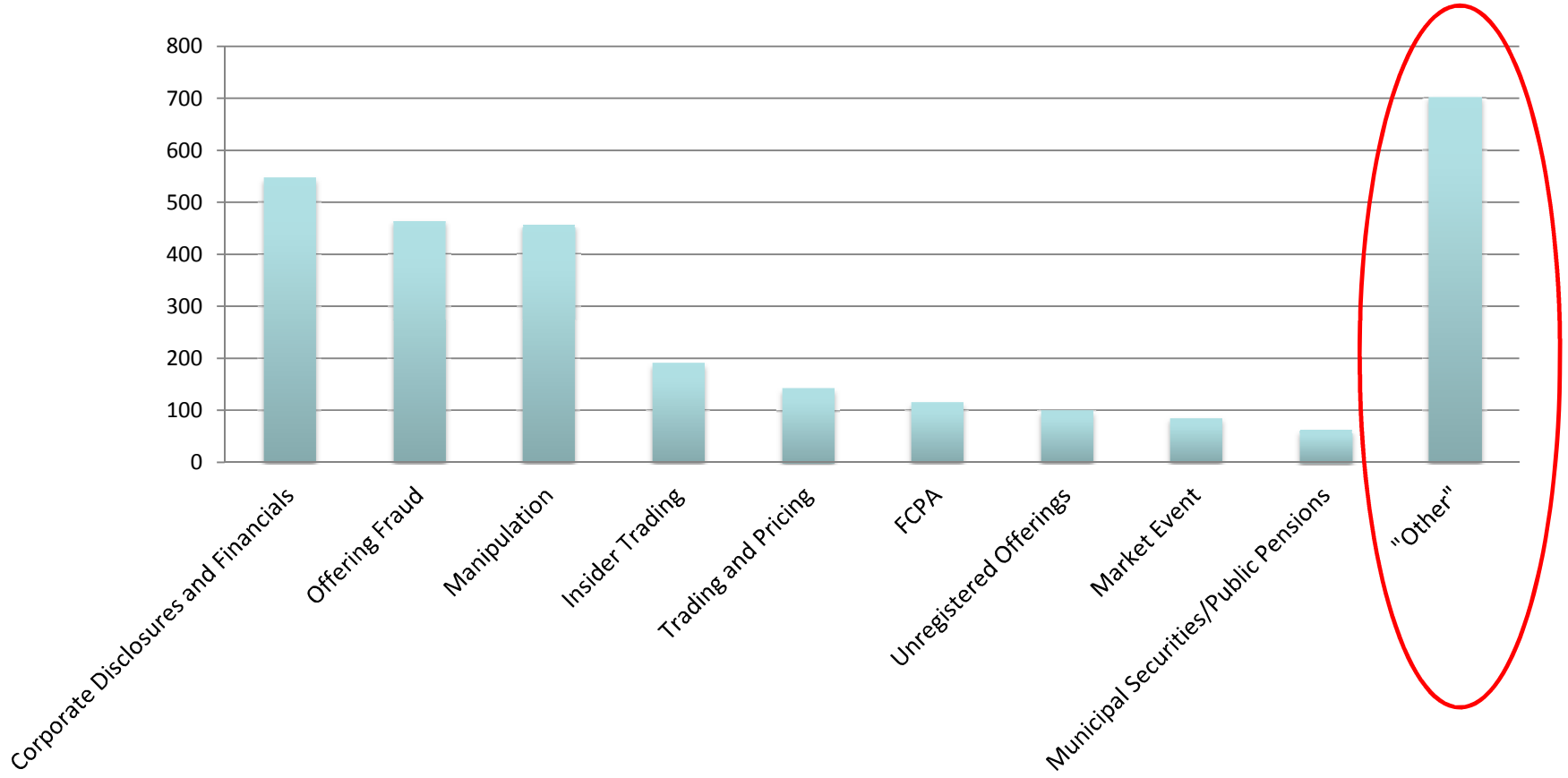
- At a glance, Dodd-Frank:
  - Created three new stand-alone whistleblower programs:
    - *Securities and Exchange Commission (SEC) Program,*
    - *Commodity Futures Trading Commission (CFTC) Program*
    - *Consumer Finance Program*
  - Amended the Sarbanes-Oxley Act (SOX)
- Between new case law under Dodd-Frank's retaliation provisions, Dodd-Frank's amendments to SOX, and recent case law under SOX issued by the Administrative Review Board (ARB), the scope of civil whistleblower protections continues to broaden.

SEC Annual Report

SEC Annual Report

- On Nov. 15, 2012, the SEC released its Annual Report on the Dodd-Frank Whistleblower Program, summarizing the Office of the Whistleblower's (OWB's) activities during fiscal year 2012.
  - 3,050 hotline phone calls from members of the public in fiscal year 2012, a sharp increase over the 650 phone calls received during the five months of the hotline's operation in 2011.
  - 3,001 formal whistleblower tips via submission of Form-TCR (tips, complaints, and referrals) by mail, by fax, and online.

SEC Annual Report: Subject of Tips



Morgan Lewis

SEC Annual Report: Origin of Tips

- Tips came from all 50 states and from 49 countries.
- Majority of tips originated from CA (17%), NY (almost 10%), FL (8%), TX (6%), NJ ($%), WA (4%), IL (4%) and PA (3.6%).
- Not an entirely expected distribution and not always driven by population size. *See, e.g.,* KY (with more than 60 complaints).

SEC Annual Report: Result of Tips

- On August 21, 2012, the SEC made its first award under the new program to a whistleblower who helped the SEC stop an instance of ongoing fraud.
  - The whistleblower received an award of 30% (nearly $50,000) of the amount collected in the SEC's enforcement action, which is the maximum percentage payout allowed by law.
  - The Commission also denied a claim from a second individual seeking an award in this same matter because the information provided did not lead or significantly contribute to the enforcement action.
- During the 2012 fiscal year, the OWB posted 143 Notices of Covered Action (covered actions are enforcement actions where final judgments/orders result in sanctions totaling more than $1 million).

Case Law Developments

Recent Developments: New Cases Under Dodd-Frank

- Kramer v. Trans-Lux Corp. (D. Conn. Sept. 25, 2012): **First Dodd-Frank claim to survive a motion to dismiss in federal court!**
  - Plaintiff claimed that his employment had been terminated in violation of the Dodd-Frank antiretaliation provisions after he reported to his employer's board of directors and the SEC that he believed that his supervisors had violated the company's pension plan.
  - Defendant moved to dismiss the Dodd-Frank claim, arguing that the plaintiff had failed to make a disclosure to the SEC in a manner required by the SEC, and therefore the plaintiff had failed to satisfy the definition of a "whistleblower" under the Dodd-Frank antiretaliation provisions.
  - Plaintiff argued in response that the Dodd-Frank antiretaliation provisions cover any individual who makes a disclosure required or protected by SOX, even if the individual had not made the disclosure in a manner required under the definition of "whistleblower."
  - The court held that the Dodd-Frank antiretaliation provisions protect individuals who make disclosures that are required or protected under SOX or the 1934 Act.
- **TAKEAWAY**: Conduct protected by Dodd-Frank antiretaliation provisions includes all SOX-protected conduct. This includes any laws enumerated by SOX, and expands the Dodd-Frank antiretaliation provisions beyond just securities laws.

Recent Developments: New Cases Under Dodd-Frank

- Egan v. TradingScreen, Inc., Case No. 10-cv-8202, 2011 U.S. Dist. LEXIS 103416 (S.D.N.Y. Sept. 12, 2011)
  - First federal case to interpret the antiretaliation provisions of Section 922 of Dodd-Frank
  - Interpreted Section 922 very broadly
- Court held that there is a narrow exception to the definition of "whistleblower" for disclosures "required or protected" under:
  - SOX;
  - Securities Exchange Act;
  - 18 U.S.C. § 1513(e); or
  - Other laws subject to the SEC's jurisdiction
- Such reports are protected, even if they are not made to the SEC

Recent Developments: New Cases Under Dodd-Frank

- Expanded view of protected conduct under Dodd-Frank retaliation provisions is supported by SEC commentary in final rules
- Nollner v. S. Baptist Convention, Inc., 852 F. Supp. 2d 986, 993 (M.D. Tenn. 2012) (term "whistleblower" includes individuals who make internal disclosures of security law violations, as long as the disclosures are made in accordance with the "certain laws within the SEC's jurisdiction")
- Ott v. Fred Alger Mgmt., Inc., 11 Civ. 4418-LAP (S.D.N.Y. Sept. 22, 2012) (antiretaliation provisions of Dodd-Frank do not require an individual to provide "original information")

Recent Developments: Retroactivity of Dodd-Frank Amendments

- Courts have reached inconsistent decisions regarding whether different provisions of Dodd-Frank's amendments to SOX apply retroactively.
  - Subsidiary Coverage
    - *Ashmore v. CGI Grp. Inc., 2012 WL 2148899 (S.D.N.Y. June 12, 2012) (Dodd-Frank amendment applying protection to SOX employees of private subsidiaries of publicly traded companies retroactive); Leshinsky v. Telvent GIT, S.A., 2012 WL 2686111 (S.D.N.Y. July 9, 2012)(same).*
  - Predispute Arbitration Provisions
    - *Pezza v. Investors Capital Corp., 2011 U.S. Dist. LEXIS 20038 (D. Mass. Mar. 1, 2011) (Dodd-Frank amendment to SOX precluding predispute arbitration agreements applies to arbitration agreements entered into before the enactment of Dodd-Frank).*
    - *But see Henderson v. Masco Framing Corp., 2011 WL 3022535, at *3-4 (D. Nev. July 22, 2011) (holding that Dodd-Frank's SOX provisions are not retroactive); Holmes v. Air Liquide USA LLC, 2012 WL 267194 (S.D. Tex. Jan. 30, 2012) (same); Taylor v. Fannie Mae, 2012 WL 928170 (D.D.C. Mar. 20, 2012) (same); Blackwell v. Bank of Am. Corp., 2012 WL 1229673 (D.S.C. Mar. 22, 2012) (same).*

Recent Developments: Contractor Coverage Under SOX

- SOX covers "any officer, employee, contractor, subcontractor or agent" of a covered company. 18 U.S.C. § 1514A(a). The terms "officer," "employee," "contractor," "subcontractor," and "agent" are not defined in SOX, and there has been significant debate as to the scope of these terms.
- Federal court decisions suggest a narrow interpretation:
  - In Lawson v. FMR LLC, No. 10-2240 (1st Cir., Feb. 3, 2012), a divided First Circuit reversed the district court's denial of a motion to dismiss, holding that the whistleblower protection provisions of SOX do not cover employees of certain contractors or subcontractors retained by public companies.
    - *Petition for a writ of Certiorari filed, and, in October 2012, the Solicitor General was invited to file a brief expressing the views of the United States.*
  - Fleszar v. U.S. Dept. of Labor, 598 F.3d 912 (7th Cir. 2010), in dicta, suggested that the scope of "contractor, subcontractor, or agent" coverage should be limited to entities that "participate in the activities" of the publiclytraded company, particularly activities in relation to the employment of the claimant.

Recent Developments: Contractor Coverage Under SOX

- ARB opinions, however, suggest a broader interpretation.
  - See, e.g., Charles v. Profit Inv. Mgmt., ARB No. 10-071, ALJ No. 2009-SOX-40 (ARB Dec. 16, 2011).
    - *Reasoned that the use of the term "any" in the phrase "any officer, employee, contractor, subcontractor, or agent of such company" indicated that Congress intended this clause to be interpreted in "an all-encompassing manner."*
    - *The ARB then held that the ALJ erred by concluding that Section 806 could not include any privately held company under contract with the publicly traded company.*
  - But see Gupta v. Johnson & Johnson, 2010-SOX-54 (ALJ Jan. 07, 2011) (ALJ rejected the complainant's claim that he was covered because the proprietorship was a "contractor" of the publicly traded respondent).

Recent Developments: Extraterritorial Application

- SOX does not contain express language relating to its extraterritorial application to employees overseas who engage in protected disclosures.
- In Villanueva v. Core Laboratories, NV, ARB No. 09-108, ALJ No. 2009-SOX-6 (ARB Dec. 22, 2011), the ARB dismissed the complaint because the alleged violation involved extraterritorial laws and not U.S. laws or financial documents filed with the SEC.
  - The ARB's interpretation heavily influenced by the Supreme Court's Morrison decision in 2010, creates a "transactional test" to determine extraterritorial application of securities law.
  - The ARB assessed four factors to evaluate in determining whether a case involves the attempted extraterritorial application of SOX:
    - *the location of the protected activity,*
    - *the location of the job and the company the complainant is fired from,*
    - *the location of the retaliatory act, and*
    - *the nationality of the laws allegedly violated that the complainant has been fired for reporting.*
- Extraterritorial Application of Dodd Frank?
  - Asadi v. G.E. Energy (USA), LLC, No. 4:12-CV-00345, 2012 *WL* 2522599 (S.D. Tex. June 28, 2012), uses the Supreme Court's Morrison analysis to determine that Dodd-Frank's antiretaliation protections for SEC whistleblowers do not apply to employees stationed abroad.

Recent Developments: Scope of "Protected Activity" Under SOX

- Possible divergence developing between the ARB and federal courts on the scope of protected activity under SOX.
- ARB's Sylvester standard:
  - Sylvester v. Parexel Int'l, ARB Case No. 07-123 (ARB May 25, 2011) (whistleblower only needs a "reasonable belief" of a violation to engage in protected activity under SOX).
  - Prioleau v. Sikorsky Aircraft Corp., ARB No. 10-060, ALJ No. 2010-SOX-3 (ARB Nov. 9, 2011) (complainant need only a reasonable belief that there is a violation of one of the laws enumerated in SOX when he makes the communication, not whether he communicates that belief to respondent or whether he puts respondent on notice of protected activity; protected activity does not have to relate to shareholder fraud, if complainant "reasonably believes" that conduct complained of constitutes a violation of one of the laws listed in Section 806(a)).
- Federal court's "definite and specific" standard:
  - Nance v. Time Warner Cable, Inc., 433 F. App'x 502 (9th Cir. 2011), the Ninth Circuit held that an "employee's communications must definitively and specifically relate to [one] of the listed categories of fraud or securities violations [in] 18 U.S.C. § 1514A(a)(1)."
  - Wiest v. Lynch, 2011 WL 5572608 (E.D. Pa. Nov. 16, 2011), the federal district court held that an employee's complaint concerning treatment of certain corporate expenses was not protected activity under Section 806(a), as it did not "definitively and specifically" relate to shareholder fraud or a law covered by Section 806(a). The court specifically observed that the ARB's decision in Sylvester was not controlling.
    - *Wiest is on appeal, with oral argument held on October 5, 2012.*

Recent Developments: Document and Data Raiding

- Vannoy v. Celanese Corp., ARB Case No. 09-118 (Sept. 28, 2011)
  - The ALJ ruled that termination of the employee was based on "breach of confidential information without [Celanese's] knowledge or permission" and rejected complainant's claim of "informer's privilege"
  - The ARB, relying on Internal Revenue Service (IRS) and SEC whistleblower bounty programs, reversed that finding and remanded for evidentiary hearing, ruling that:
    - *The employee had reasonable belief "that the company was engaging in accounting misconduct in violation of SOX"*
    - *Reports to IRS could be SOX-protected conduct*
    - *Suspension with pay can be an adverse employment action under certain circumstances*

Recent Developments: Document and Data Raiding

- Vannoy v. Celanese Corp., ARB Case No. 09-118 (Sept. 28, 2011).
  - The ARB noted that bounty programs like those operated by the IRS and SEC generally prohibit employers from relying on confidentiality agreements to prohibit whistleblower disclosures.
  - The ARB concluded that "the crucial question for the ALJ to resolve with a hearing on remand is whether the information that Vannoy procured from the company is the kind of '*original information*' that Congress intended to be protected under either the IRS or SEC whistleblower programs, and whether the manner of the transfer of information was protected activity within the scope of SOX."

Recent Developments: Document and Data Raiding

- Quinlan v. Curtiss-Wright Corp., Docket No. 25-1-0217 (NJ 2011):
  - New Jersey Supreme Court reversed a lower court holding and reinstated a jury verdict in favor of a plaintiff who was fired after copying more than 1,800 confidential company documents and sending them to her attorneys for use in her pending discrimination lawsuit against the company.
  - While holding that the copying in these circumstances was not "protected activity" under New Jersey's Law Against Discrimination (LAD), the court further held that Quinlan's attorneys' subsequent use of one of the confidential documents taken from the company (specifically, the performance appraisal of Quinlan's boss) at a deposition in a pending discrimination case *was* protected activity for which the plaintiff could not be lawfully terminated.

Practical Implications

Practical Implications

- Recognize and think broadly about protected conduct under Dodd-Frank retaliation provisions and SOX.
  - C.f., Tides v. The Boeing Co., 644 F.3d 809 (9th Cir. 2011) (SOX does not protect leaks of confidential company information to media organizations).
- Consider scope and enforcement of confidentiality agreements/policies in light of competing interests.
  - Company's interest in protecting confidential information, and importance of policies to taking action against employees who violate them.
  - SEC warnings on enforcement of confidentiality agreements/policies on those who may be reporting to the SEC.

Practical Implications

- How do you settle SOX and SEC whistleblower retaliation claims in light of the statute's prohibition of waiver of SOX rights and remedies by "agreement," and prohibition in the commentary to the Final Rules on "waiv[ing] or limit[ing] [employee's] anti-retaliation rights under Section 21F"?
  - Consider filing with a court or the DOL – res judicata and/or DOL approval and order
  - Consider certifications/acknowledgments in the settlement papers relating to a lack of wrongdoing, reporting of wrongdoing, or retaliation
  - Consider agreements for resignation or mutual separation in the settlement papers

Practical Implications

(continued)

- Consider pros and cons of express SOX/SEC whistleblower waiver for those who have asserted, and settled, SOX/SEC whistleblower claim before filing
- Consider pros and cons of a tender-back requirement for consideration attributable to the settlement of an asserted SOX/SEC whistleblower claim if that claim is subsequently filed

Practical Implications

- Certifications/acknowledgments relating to a lack of wrongdoing or reporting of wrongdoing
  - Option One:
    - *"Employee is not aware of any facts that may constitute a violation of the Company's Code of Conduct and/or legal obligations, including the federal securities laws."*
  - Option Two:
    - *"Employee agrees that s/he has advised the Company of all facts of which s/he is aware that s/he believes may constitute a violation of the Company's Code of Conduct and/or legal obligations, including the federal securities laws, that the Company has resolved those issues to his/her satisfaction, that Employee is not aware of any current violations of the Company's Code of Conduct and/or legal obligations, including the federal securities laws, and that Employee has not suffered any adverse actions as a result of his/her conduct in this regard."*

Polling Question

- Would you like us to follow up with you directly after the webinar today? Please answer the polling question on the right-hand side of your screen.

Questions?

Contact Information

Sarah Bouchard
Philadelphia
215.963.5077
sbouchard@morganlewis.com

Thomas Linthorst
Princeton
609.919.6642
tlinthorst@morganlewis.com

Almaty Beijing Boston Brussels Chicago Dallas Frankfurt Harrisburg Houston Irvine
London Los Angeles Miami Moscow New York Palo Alto Paris Philadelphia
Pittsburgh Princeton San Francisco Tokyo Washington Wilmington