A Primer

The Dodd-Frank Whistleblower Bounty Provision

By Darryl C. Thomas II

Become a go-to lawyer for Dodd-Frank issues by embracing the changes and working to develop specific expertise about the new law.

Cheryl Eckard has become a virtual poster child for wannabe whistleblowers everywhere. In 2010, the Department of Justice (DOJ) awarded her $96 million as a reward for information that she provided about her employer, GlaxoSmithKline, concerning alleged systemic abuses in one of GlaxoSmithKline's foreign facilities. The government used the information it obtained from Eckard to net a $750 million settlement from the corporation. While Eckard's 12.8 percent share of the settlement proceeds may seem impressive, it is modest compared to the 30 percent share that whistleblowers may now receive under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203.

Quite expectedly, the plaintiffs' bar has started to pitch cases using Eckard's story supplemented with tidbits about their experience in qui tam, IRS, and Sarbanes-Oxley whistleblower claims. One plaintiff's attorney even purchased airtime before the movie *Wall Street—Money Never Sleeps* to advertise his experience in achieving whistleblower awards for his clients. *See* SEC. Snitch.com, http://www.secsnitch.com/new-sec-snitch-commercial.html. The news is also filled with statistics reflecting the harsh disparity in the compensation received by staff-level employees compared to corporate executives. Employees certainly have a financial incentive to report corporate malfeasance.

As defense attorneys who represent the corporations that may be vulnerable to whistleblower claims, it is imperative that we are well versed in the law concerning whistleblower claims and be able to effectively work with our clients to prevent and defend against these claims. With that in mind, this article will analyze the act's whistleblower provisions and various whistleblower retaliation protections, discuss some of the SEC's most important whistleblower provision regulatory proposals, and offer tips for defending clients facing SEC enforcement actions or retaliation claims brought by employees.

Background

On July 21, 2010, following the worst American economic collapse since the Great Depression, President Barack Obama signed the Dodd-Frank Act. In addition to its announced purpose of ending "too big

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to fail" and protecting the country from taxpayer bailouts, the Dodd-Frank Act aims to protect investors from securities regulations violators. We should not underestimate the impact of the Dodd-Frank Act as several commentators have called the act one of the most sweeping measures of financial regulation since Franklin Delano Roosevelt enacted the Securities Act of 1933 and the Securities and Exchange Act of 1934.

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Dodd-Frank is nothing if not expansive. It includes 16 titles, is over 2,000 pages long, and regulates business contracts from reinsurance agreements to credit-default swaps. Moreover, the act mandates new regulatory agencies, including the Bureau for Consumer Financial Products and Services, which has as its goal the protection of consumers from everyday financial products through new regulations aimed at mortgages, car loans, and insurance products.

Furthermore, the act creates new rules for corporate governance, such as the "say-on-pay" provision, which requires that public companies allow their shareholders voting input on executive compensation. The act also calls for shareholder say on nominees to corporate boards by proxy voting. Included among Dodd-Frank's 16 titles is section 922—a new whistleblower bounty provision that increases awards and protections to persons assisting the Securities and Exchange Commission (SEC) in enforcing various securities laws and regulations.

Specifically, the act amends the Exchange Act of 1934 and defines "whistleblower" as any individual who provides original information not known to the SEC from another source. This act enhances previous whistleblower provisions by increasing and expanding the scope for whistleblower awards. Now, under the act, the SEC will pay a whistleblower for providing information related to virtually *any* securities violation, as opposed to only those violations directly involving insider trading.

Moreover, and perhaps most importantly, the act mandates that the SEC award whistleblowers no less than 10 percent and no more than 30 percent of a monetary sanction resulting in the collection of over $1 million and based on information voluntarily provided by the whistleblower. The SEC maintains discretion over the actual percentage using the criteria provided in Dodd-Frank. In determining the amount of any award, the SEC must take the following into consideration: the significance of the information provided by the whistleblower to the success of the enforcement action, the degree of assistance provided by the whistleblower or his or her representative in an enforcement action, the SEC's interest in deterring securities violations, and such additional factors as the SEC may establish by rule or regulation. A whistleblower may make an appeals within 30 days of an award determination directly to the appropriate federal court of appeals.

The act also requires the SEC to establish an office devoted specifically to whistleblower investigations and administration. SEC official reports indicate it will devote nearly $452 million to rewarding whistleblowers. The SEC intends to use these funds to pay whistleblowers covered under the act's bounty provisions.

Although the expansive scope of the act and the rules implementing it will certainly accelerate both public and private lawsuits, the whistleblower provision alone provides fertile ground for a rise in litigation.

Whistleblower Provisions and Retaliation Protections

The Dodd-Frank Act creates a new private right of action for whistleblowers and amends existing protections within existing law. The net effect requires defense attorneys to employ new analyses, tools, and methods in defending against a host of retaliation-based claims.

Section 922 of the Dodd-Frank Act creates a private right of action for employees who face retaliation after assisting the SEC in its enforcement of potential or alleged violations of the securities laws. This new claim means that employers may not retaliate against employees who legally provide information to the SEC in accordance with section 922 by initiating, testifying, or assisting in an investigation or tribunal action of the SEC based on or related to that information. Retaliation includes any adverse act of an employer toward an employee including, but not limited to, discharging, demoting, suspending, threatening, harassing, or in any other manner discriminating against a whistleblower.

An employee may pursue a section 922 retaliation claim directly in federal court. Furthermore, a plaintiff with a section 922 retaliation claim may seek remedies including reinstatement, double back pay with interest, and legal costs, including expert witness expenses and reasonable attorneys' fees. Moreover, under Dodd-Frank employers may not require employees to waive the right to pursue section 922 retaliation claims and remedies through employment agreements, company policies, or pre-employment conditions. Furthermore, the act also invalidates mandatory predispute arbitration clauses calling for the disposition of retaliation claims.

The act similarly expands and enhances *existing* whistleblower protections—such as those under the Sarbanes-Oxley Act—by subjecting employers to harsher penalties for wrongdoing and increasing employees' access to court. For instance, the act increases the statute of limitations for Sarbanes-Oxley whistleblowers from 90 to 180 days.

The Dodd-Frank Act also forecloses a popular defense to Sarbanes-Oxley whistleblower claims by removing a loophole previously used by non-public companies. Before the Dodd-Frank Act, several courts held that particular employees could not bring retaliation claims under the Sarbanes-Oxley Act because Sarbanes-Oxley applied only to public corporations. Under that reasoning, a public company's subsidiary could avoid penalties under Sarbanes-Oxley's whistleblower provision. The Dodd-Frank Act also removed the requirement that retaliation claims under Sarbanes-Oxley commence in the Department of Labor. The Dodd-Frank Act now permits those claims to proceed directly to federal court.

The Dodd-Frank Act additionally establishes anti-retaliation protections to financial services employees who provide information to the new Bureau of Consumer Financial Protection or any other governmental agency regarding fraudulent or deceptive acts specifically related to offerings or provisions within consumer financial products or services. Financial services employees are individuals working for companies such as those that extend credit or broker loans, those that provide real-estate settlement services or property appraisals, or those that offer financial advisory services to consumers for proprietary products. The financial services industry even includes companies providing credit counseling.

The SEC's Regulatory Proposals to Implement the Whistleblower Bounty

On November 17, 2010, the SEC released its Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934. 17 C.F.R. pt. 240, 249. Although the final rules are not due until April 21, 2011, the proposed rules shed light on some important terms.

As reported in the SEC's annual whistleblower program report, the rules seek to "delineate eligibility for a whistleblower award and the procedures for applying for an award in SEC actions and related actions." U.S. Securities and Exchange Commission, *Annual Report on Whistleblower Program* (Oct. 2010), http://www.sec.gov/news/studies/2010/whistleblower_report_to_congress.pdf.

Under the currently proposed rules, the SEC will "pay awards, subject to certain limitations and conditions, to whistleblowers who *voluntarily* provide the Commission with *original information* about a *violation of securities laws* that leads to a *successful enforcement* of an action brought by the Commission that results in *monetary sanctions* exceeding $1,000,000, and of *certain related actions*." 17 C.F.R. pt. 240, 249 (emphasis added).

When Is Information Voluntarily Provided?

Under the Dodd-Frank Act, whistleblowers are eligible for awards only when they provide original information voluntarily. The proposed rules consider a submission voluntary if a "whistleblower provides the SEC with information before receiving any formal or informal inquiry, request, or demand from the SEC, Congress, or any other federal agency, State or local authority, or other regulatory body including self regulatory organizations such as the Financial Industry Regulatory Authority (FINRA)." 17 C.F.R. pt. 240, 249.

Enforcement investigations typically commence when the SEC opens an informal inquiry. This is the stage before SEC staff have granted authority to issue subpoenas. Thus, at this initial stage, SEC investigators gather information from companies by requesting information on a voluntary basis. After a formal investigation begins, SEC personnel have the authority to subpoena information and compliance is mandatory. The proposed rules seek to clarify that to have acted voluntarily, a whistleblower must come forward with information before receiving *any kind of request*, informal or formal, from a government, oversight, or self-regulating authority. If a request for information is directed to an employer, then it "is considered directed to employees who possess the documents or other information that is within the scope of the request to the employer," and if one of those employees puts forth information after the employer receives a request, that would not qualify as "voluntary." 17 C.F.R. pt. 240, 249. Finally, under the proposed rules, disclosure to the SEC is not considered voluntary if the potential whistleblower has a clear duty to report the alleged violations. Officers and directors, for instance, have such duties and, in some cases, attorneys.

What Is Original Information?

Section 922 and the proposed rules impose three requirements on "original information." First, the information must come from a whistleblower's independent knowledge or analysis. Second, the SEC cannot already know the information "unless the whistleblower is the original source" of that knowledge. 17 C.F.R. pt. 240, 249. Third, the information cannot be exclusively derived from an allegation made in a judicial, administrative, or other context, such as the news media, an audit, or a government report, unless the whistleblower him- or herself is the original source of that information.

Although the Dodd-Frank Act doesn't specifically define "independent knowledge," the SEC's proposed rules to implement the whistleblower enhancements define "independent knowledge" as factual information in the potential whistleblower's possession that the whistleblower doesn't obtain from publicly available sources. 17 C.F.R. pt. 240, 249. Under that definition, public sources may include both widely disseminated sources, such as corporate releases, and generally available public sources, such as civil filings or Freedom of Information Act requests.

The proposed rules do not require direct knowledge, meaning that a potential whistleblower may derive information secondhand from other parties. Furthermore, the proposed rules also would allow a whistleblower to derive independent knowledge by analyzing information from other individuals or sources, "either alone or in combination with others," even generally available information, as long as examining and evaluating it "reveals information that is not generally known or available to the public." 17 C.F.R. pt. 240, 249. In the words of the SEC, the rules include this type of analysis because "there are circumstances where individuals can review publicly available information, and, through their additional evaluation and analysis, provide vital assistance to the Commission staff in understanding complex schemes and identifying securities violations." 17 C.F.R. pt. 240, 249. Under the act, certain individuals may not receive an award even though they provide original information. For example, the act does not allow awards to whistleblowers who are, at the time the information is provided, members, officers, or employees of a regulatory agency, the U.S. Department of Justice, a self-regulatory organization, the Public Company Accounting Oversight Board, or another law enforcement organization. The proposed rules further exclude people with legal, compliance, audit, supervisory, or governance responsibilities for an entity as alluded above, when those persons receive information about potential violations and when the information is communicated to those persons for the reasonable purpose of initiating entity response. For example, if an employee at Company X communicates a potential violation to his or her supervi-

sor with the expectation that the supervisor will remedy the situation, that supervisor cannot then contact the SEC and claim that he or she has "independent knowledge" of a potential securities violation.

The Dodd-Frank Act also prohibits awards to those who gain information performing an audit of a corporation's financial statements as required under the securities laws. Under the proposed rules, however, this exclusion would not apply to a company's accountants even though they individuals may have contact with the company's independent public accountant.

Under the proposed rules attorneys who receive information from their clients while subject to attorney-client privilege could not receive whistleblower awards. This exclusion holds unless the person communicating the information has waived the privilege or if 17 C.F.R. §205.3, which creates exceptions for securities violations to the attorney-client privilege, applies, or state bar ethics rules permit disclosure. *See* Model Rules of Prof'l Conduct R. 1.6(b) (confidentiality of information), R. 1.13(c) (organization as client). An attorney could not take information from a potential whistleblower seeking legal representation or services and then contact the SEC on the attorney's own behalf for the attorney's own benefit.

Finally, both the Dodd-Frank Act and the proposed implementing rules exclude those who obtain information by a means or in a manner that violates federal or state criminal law.

What Is an Eligible Enforcement Action?

A whistleblower's eligibility for an award also partially depends on whether the information leads to the *successful enforcement of an SEC or a related action*. If the SEC can establish unlawful conduct by a preponderance of the evidence then it would consider an enforcement action successful. As such, a whistleblower's original information must connect to evidence leading to a successful enforcement and play a significant role in making the SEC's case against the wrongdoer.

Determining whether a whistleblower would receive a bounty would depend somewhat on when the whistleblower provides information. The SEC files an action typically after starting an initial investigation of a securities violation and after staff investigators recommend enforcement based on preliminary findings. The proposed rules would consider the significance of a whistleblower's information to both the decision to open an investigation and the success of the resulting enforcement action. Furthermore, if the whistleblower's information caused the SEC staff to begin an investigation, the whistleblower would receive a larger award than if the information simply related to conduct already under investigation—unless that information was essential and unobtainable without the whistleblower's help.

Finally, the proposed rules set up a two-part test for situations involving information regarding conduct that the SEC is not already investigating. First, the information must cause the SEC to open an investigation. The information need not be the sole information in the SEC's decision to open an investigation. Second, if the information did cause the SEC to open an investigation, the proposed rules require that the information "significantly contributes" to a successful enforcement.

Tips and Strategies for Defending Enforcements and Retaliation Claims

The effect of the Dodd-Frank Act's whistleblower bounty is clear. The provision will dramatically increase government prosecution of securities laws. The increased enforcement actions will inevitably lead to more private securities litigations. Related to the retaliation claims, Dodd-Frank's enhanced protections will increase discovery and require longer document-holding periods. The anti-arbitration provisions in Dodd-Frank will likely raise overall discovery burdens in retaliation cases since arbitration significantly limits some forms of traditional discovery.

Additionally, establishing an immediate right to a jury trial in these types of retaliation cases will increase potential exposure of employers and influence pretrial negotiations. Simply put, allowing juries to hear retaliation claims will likely increase damage awards especially given the current financial situation and the apparent public sentiment against corporate citizens.

To counteract these negative effects on corporations, below are a number of tips and strategies for handling the inevitable increase in SEC enforcement actions and securities-related whistleblower claims.

- Counsel your corporate client to establish an incentive program for employees who initiate contact with the company regarding compliance issues.
- Obtain and review your corporate client's detailed, companywide publications asking employees to report potentially illegal activity to appropriate individuals working for your client, including, but not limited to, compliance issues involving false claims, securities violations, and governance mishaps.
- Counsel your corporate client to document its actions each time an employee or other party notifies the client about a compliance issue.
- Counsel your corporate client to provide and note all compliance training that it provides to employees.
- Counsel your corporate client to increase holding periods for personnel files and ensure that your client properly documents records to take the Dodd-Frank Act's extension of the statute of limitations for whistleblower claims.
- Update your corporate client on recent changes to the Sarbanes-Oxley Act regarding subsidiaries and affiliates of publicly traded companies so that they are prepared to withstand related whistleblower claims.

Conclusion

As mentioned, the SEC's proposed rules will become concrete rules in April 2011. Along with the whistleblower regulations, the Dodd-Frank Act mandates a number of new regulations. This article provided a glimpse into one small portion of Dodd-Frank's effect on corporate clients. We should embrace the changes and work to develop specific expertise about the new act and its implementing regulations. Doing so will help us become valuable, go-to lawyers for Dodd-Frank-related issues. FD