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WHISTLEBLOWERS

The Dodd-Frank whistleblower rules recently issued by the Securities and Exchange Commission provide employees with enhanced protection against retaliation and a substantial monetary incentive, but the rules also could unsettle long-standing employer expectations regarding employee discretion, loyalty, and confidentiality, three Gibson, Dunn & Crutcher attorneys say in this BNA Insights article. They review the key whistleblower provisions of Dodd-Frank, discuss how they are likely to affect employment relationships, and offer practical advice for employers to adapt to the new rules.

Whistleblower Protection Under the SEC's New Dodd-Frank Regulations: A Practical Guide for Employers

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On May 25, 2011, the Securities and Exchange Commission issued its final rules implementing the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (101 DLR AA-1, 5/25/11). Those rules provide employees with enhanced protection against retaliation and a substantial monetary incentive to report suspected wrongdoing to the SEC. The rules also have the potential to unsettle some of employers' long-standing expectations for the workplace, particularly in the areas of employee discretion, loyalty, and confidentiality.

This article provides an overview of the key provisions of Dodd-Frank and how they are likely to affect existing employment relationships, as well as practical steps that employers can take to adapt to the new rules.

A Bounty for Whistleblowers

Dodd-Frank requires the commission to provide a substantial financial incentive to whistleblowers who report possible violations of the federal securities laws—between 10 percent and 30 percent of money recovered in a government enforcement action.[1] To recover an award, a whistleblower must provide the commission (1) voluntarily (2) with original information (3)

[1] The new whistleblower protection provisions are codified at 15 U.S.C. § 78u-6.

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that leads to a successful enforcement action or actions in federal court or before an agency (4) in which overall recovery totals over $1,000,000.[2]

In the lengthy SEC rules implementing these requirements, the provisions of particular interest from an employment perspective have to do with determining the amount of a whistleblower's bounty within the statutory range, and which employees are eligible to be whistleblowers.

Concerning the size of the award, the final rules set forth a variety of ''plus'' and ''minus'' factors that the commission can consider in determining the award amount. 17 C.F.R. § 240.21F-6.

The ''plus'' factors relate to the significance of the information and the degree of assistance provided by the whistleblower, the degree to which the award will deter future violations of the securities laws, and the extent to which the employee participated in the employer's internal compliance program. Of particular note, the commission may use as a ''plus'' factor the extent to which a whistleblower provides ''ongoing, extensive, and timely cooperation'' to the SEC, ''appropriately encourage[s] or authorize[s] others'' to do the same, or ''assist[s] the authorities in the recovery of the fruits and instrumentalities of the violations.''

''Minus'' factors include the degree of the whistleblower's culpability, whether there was an unreasonable delay in reporting, and whether the employee interfered with the company's internal review or investigation.

As these ''plus'' and ''minus'' factors reflect, the rules give whistleblowers certain incentives to use an employer's internal compliance program, but do not require them to do so. In response to concerns by the business community during the notice and comment period, the final rule includes other provisions aimed at encouraging use of internal compliance systems. For example, an employee who reports internally remains eligible for an award even if the employer ultimately self-reports the conduct to the SEC, and a complaint made internally at the company will be treated as if made to the SEC for purposes of determining who first brought the matter to the commission's attention, as long as the whistleblower reports to the SEC within 120 days of reporting to the company. 17 C.F.R. § 240.21F-4(b), (c).

The rules also exempt certain employees—such as attorneys, auditors, and internal compliance officers—from eligibility for an award. But there are notable exceptions to these exemptions. An attorney, for example, may recover an award if the attorney-client privilege has been waived, or if disclosure is permissible under applicable state laws or ethics rules. Auditors and internal compliance officers in turn may qualify as whistleblowers if, among other things, they have a ''reasonable basis to believe'' that disclosure would prevent the employer from engaging in activity ''likely to cause substantial injury to the financial interest or property of the [company] or investors.'' Id. § 240.21F-4(b)(4)(v).

This language leaves considerable room for interpretation, and some companies feel that compliance personnel will occasionally pursue whistleblower awards at the expense of rigorously performing their assigned responsibilities. If this occurs frequently, it could discourage some whistleblowers from complaining internally, for fear of competing with compliance personnel for the bounty.

Whistleblower Protection Under Dodd-Frank

Dodd-Frank expands the Sarbanes-Oxley (SOX) Act whistleblower protection cause of action by, among other things, extending the statute of limitations from 90 to 180 days and providing that parties to a SOX retaliation claim have a right to trial by jury. 18 U.S.C. § 1514A(b). Dodd-Frank also creates three new federal causes of action for whistleblowers.

Two of the new causes of action have received relatively little attention: They protect employees who report potential violations of the Commodity Exchange Act (CEA) to the CFTC (7 U.S.C. § 26), and employees who report potential violations of federal banking laws to their employers, the newly created Bureau of Consumer Financial Protection, or other government authorities (12 U.S.C. § 5567).

The new whistleblower protection provision that has received the most attention covers employees who (a) report potential violations to the SEC or cooperate with an investigation, (b) make any disclosures ''required or protected'' under any statute or rule dealing with securities (including SOX), or (c) provide law enforcement officials with ''any truthful information relating to the commission or possible commission of any Federal offense'' (18 U.S.C. § 1513(e)).

The new provision's reference to SOX already has received attention from the courts, because SOX protects internal reporting whereas the definition of ''whistleblower'' in Dodd-Frank is limited to ''any individual who provides . . . information relating to a violation of the securities laws *to the Commission*.'' 15 U.S.C. § 78u-6(a)(6).

Nonetheless, one federal district court recently held that under Dodd-Frank an employee does not need to provide information to the commission to be protected from retaliation, although reporting to the SEC would still be a prerequisite to receipt of any bounty. *Egan v. TradingScreen Inc.*, S.D.N.Y., No. 10 Civ. 8202, May 4, 2011.

If other courts follow this approach, Dodd-Frank retaliation claims could effectively subsume SOX retaliation claims. That is significant because there are substantial benefits to bringing retaliation claims under Dodd-Frank rather than SOX.

First, SOX has a 180-day statute of limitations, while the Dodd-Frank limitations period is six years (or three years after the material facts were known or reasonably should have been known to the employee, but in no event longer than ten years).

Second, a whistleblower must exhaust administrative remedies under SOX by filing a complaint with the Department of Labor's Occupational Safety and Health Administration (OSHA), while Dodd-Frank allows immediate suit in federal court.

Third, Dodd-Frank allows employees to recover double back pay, whereas only actual back pay is available under SOX. Compare 18 U.S.C. § 1514A with 15 U.S.C. § 78u-6(h).

Fourth, Dodd-Frank's final rules contain a provision that purports to prevent employers from enforcing confidentiality agreements to prevent whistleblower employees from cooperating with the SEC. 17 C.F.R.

[2] The final rules will be codified at 17 C.F.R. § 240.21F-1, et seq.

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§ 240.21F-17(a). This provision may prove controversial, since the commission's authority for adopting it is unclear and employers need some ability to prevent unauthorized, wholesale sharing of confidential and proprietary documents with the government.

Fifth, and finally, the SEC's rules provide the commission with the authority to enforce Dodd Frank's anti-retaliation provisions. Id. § 240.21F-2(b)(2). This provision surprised observers, as the Department of Labor historically has not brought enforcement actions under SOX.

Predispute Arbitration Agreements

It may interest employers who are considering employee arbitration agreements following the U.S. Supreme Court's recent decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (81 DLR AA-1, 4/27/11), that Dodd-Frank prohibits predispute agreements to arbitrate certain retaliation claims.

Dodd-Frank expressly prohibits predispute arbitration agreements governing claims under the CFTC, Bureau of Consumer Financial Protection, and SOX whistleblower provisions described above. Dodd-Frank does *not*, however, bar predispute agreements to arbitrate the ''core'' SEC whistleblower cause of action discussed immediately above (15 U.S.C. § 78u-6).

This is potentially significant, because retaliation claims can spawn expensive parallel litigation—such as shareholder class actions. If enforced by the courts, predispute arbitration agreements concerning Dodd-Frank's ''core'' SEC retaliation regime could minimize the publicity of retaliation claims and reduce potential exposure.

Impact on Employment Relationships

The final rules implementing Dodd-Frank have the potential to strain existing employment relationships and to upset employers' settled expectations for employee behavior.

For example, companies typically encourage internal reporting so they can respond quickly to potential wrongdoing and bring problems to the government's attention themselves as necessary. Dodd-Frank's monetary incentives, however, encourage employees to bypass internal compliance procedures.

The rules could also affect the discretion expected of participants in internal compliance review, such as attorneys, auditors, and internal compliance officers. The SEC also has said that it reserves the authority to deal directly with a company's officers or directors who self-report wrongful behavior, rather than treat them as parties represented by the company's counsel. 17 C.F.R. § 240.21F-17(b).

The new rules will present other employee relations challenges. For example, the rules permit employees to submit complaints to the SEC anonymously, but require those who do so to retain counsel. This will force many whistleblowing employees to hire lawyers, who may make it more difficult for companies to address genuine performance problems the employee is experiencing. (Plaintiffs' firms have already begun to advertise anonymous whistleblowing services.)

Also, because the SEC will reward ''ongoing'' cooperation with the commission, the final rules incentivize employees to act as agents for the SEC and even to enlist fellow employees to do the same. And, as noted above, some employers may face push-back from the SEC if they attempt to prevent employees from giving the commission confidential, proprietary company information in violation of the company's standard confidentiality agreement.

In short, the new rules could act as a powerful source of leverage for a small but significant number of employees, including those with a history of performance or disciplinary issues.

Encouraging a Culture of Compliance

Despite the challenges presented by the new Dodd-Frank regulatory landscape, employers will still be rewarded for taking steps that encourage a culture of compliance and prevent violations *before* whistleblowing occurs.

First, employers should take prophylactic measures to promote internal compliance, such as broadly distributing their ethics and compliance policies and providing clear avenues of communication for employees to self-report potential violations. Employers may also consider having employees sign certifications at regular intervals attesting that they are unaware of (or have disclosed) potential violations, or as a condition of signing a separation agreement.

Second, and related, employers should identify ways to encourage employees to make use of internal compliance procedures. Companies should consider instituting several accessible methods of anonymous reporting, such as an internal website, a toll-free telephone number, an anonymous e-mail address, and an ombudsman.

Third, companies should review their internal compliance systems, and consider ways to streamline procedures without sacrificing the quality of investigations.

Guidance for Human Resources Personnel

Human resources departments also will play a critical role in promoting the use of internal compliance procedures and in responding to whistleblower complaints. In particular, HR professionals can help prevent personality conflicts and other employment issues from spilling over into acrimonious whistleblower activity.

First, employers should exercise care when making hiring decisions. Every experienced employment lawyer has encountered a whistleblower who acted out of animus toward his supervisor or manager, and it is not uncommon in such instances to learn in the course of litigation that the person has a history of similar conduct or even a criminal record. Thus, requiring background checks and references for employees in key positions—consistent with applicable state and federal law—is invaluable in preventing wrongdoing as well as whistleblower abuse.

Second, and related, whistleblowing often arises out of troubled employment relationships. It is not unusual for employees to feel that their supervisors do not value their input, and thus look elsewhere when they have a complaint. Employers should consider deploying their most experienced HR personnel in support of employees in sensitive positions. Relatedly, managers should be trained to respond effectively to employee criticisms in a nonretaliatory fashion, and to inform HR and in-

house counsel as soon as an employee raises concerns that could result in whistleblowing.

Third, even after whistleblowing occurs, an employer must be careful to handle the complaint properly and not retaliate against the employee who reported the alleged unlawful activity. Employers should consider developing a cadre of HR professionals who are specially trained for handling retaliation cases. In cases in which disciplinary action against a whistleblower is warranted, the HR whistleblowing team should ensure that their investigation is well-documented, create a clear record to support any adverse employment action, and make any decisions in consultation with the company's attorneys.

Fourth, and finally, HR, legal, and compliance personnel should recognize their shared interest in responding quickly to employees' compliance concerns, and to avoiding even the appearance of whistleblower retaliation. In the wake of Dodd-Frank, communication and coordination among these separate functions will be more important than ever.

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