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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Whistleblower Provisions Of The Dodd-Frank Act

Law360, New York (July 20, 2010) -- Recognizing that robust whistleblower protection is critical to preventing another financial crisis, Congress included in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) numerous provisions designed to encourage whistleblowing and to provide robust protection from retaliation.

These provisions create monetary awards for whistleblowers who provide original information to the U.S. Securities and Exchange Commission or Commodity Futures Trading Commission, strengthen the whistleblower protection provisions of the Sarbanes-Oxley Act and the False Claims Act, and create additional whistleblower retaliation causes of action.

Reward for Whistleblowing to the SEC and Prohibition Against Retaliation (Section 922)

Under Section 922, the SEC will be required to pay a reward to individuals who provide original information to the SEC resulting in monetary sanctions exceeding $1 million in civil or criminal proceedings. The purpose of this reward program is to “motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated securities laws and recover money for victims of financial fraud.”

According to Senate Report 111-176, whistleblower tips identified 54.1 percent of uncovered fraud schemes in public companies, while external auditors, including the SEC, detected only 4.1 percent of uncovered fraud schemes.

The award will range from 10 to 30 percent of the amount recouped and the amount of the award shall be at the discretion of the SEC. Penalties, disgorgement and interest paid count toward the $1 million threshold.

Factors to be considered in determining the amount of the reward include the significance of the information provided by the whistleblower, the degree of assistance provided by the whistleblower, the programmatic interest of the SEC in deterring violations of the securities laws by making awards to whistleblowers, and other factors that the SEC may establish by rule or regulation.

If the amount awarded is less than 10 percent or more than 30 percent of the amount recouped, a whistleblower may appeal the SEC’s determination by filing an appeal in the appropriate federal court of appeals within 30 days of the determination.

To qualify for a whistleblower reward, Section 922 requires that the individual provide “original information,” which means information that “(A) is derived from the independent knowledge or analysis of a whistleblower; (B) is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and (C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information.”

In contrast to the qui tam provisions of the FCA, Section 922 does not provide a private right of action to whistleblowers to prosecute securities fraud or other violations of SEC rules.

Section 922 prohibits the SEC from providing an award to a whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower provided information; who gains the information by auditing financial statements as required under the securities laws; who fails to submit information to the SEC as required by an SEC rule; or who is an employee of the U.S. Department of Justice or an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board, or a law enforcement organization.

Section 922 also creates a new private right of action for employees who have suffered retaliation "because of any lawful act done by the whistleblower — '(i) in providing information to the Commission in accordance with [the whistleblower reward subsection]; (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act,'" the Securities Exchange Act of 1934, and "'any other law, rule, or regulation subject to the jurisdiction of the [SEC].'"

The action may be brought directly in federal court and remedies include reinstatement, double back pay with interest, as well as litigation costs, expert witness fees, and reasonable attorney's fees. A Section 922 retaliation action can be brought six years after the date on which the retaliation occurred or three years after the date on which the facts material to the right of action are known or reasonably should have been known by the employee. In contrast to the anti-retaliation provision of SOX, a Section 922 plaintiff need not exhaust administrative remedies before bringing a Section 922 retaliation action in federal court.

Reward for Whistleblowing to the Commodity Futures Trading Commission and Protection Against Retaliation (Section 748)

Section 748 amends the Commodity Exchange Act to create a whistleblower incentive program and whistleblower protection provision that are substantially similar to the SEC reward program and anti-retaliation provision contained in section 922.

Under section 748, the amount of a reward is determined by the CFTC and unlike section 922, a whistleblower may appeal any determination regarding an award, not just rewards outside of the 10 to 30 percent range. Protected conduct under Section 748 includes providing information to the CFTC in accordance with the whistleblower incentive provision and "assisting in any investigation or judicial or administrative action of the [CFTC] based upon or related to such information."

New Whistleblower Protection for Financial Services Employees (Section 1057)

Section 1057 creates a robust private right of action for employees in the financial services industry who suffer retaliation for disclosing information about fraudulent or unlawful conduct related to the offering or provision of a consumer financial product or service.

The scope of coverage is quite broad in that Section 1057 applies to organizations that extend credit or service or broker loans; provide real estate settlement services or perform property appraisals; provide financial advisory services to consumers relating to proprietary financial products, including credit counseling; or collect, analyze, maintain, or provide consumer report information or other account information in connection with any decision regarding the offering or provision of a consumer financial product or service.

Section 1057 prohibits retaliation against an employee who has engaged in any of the following protected acts:

- Provided, caused to be provided, or is about to provide or cause to be provided, to an employer, the newly created Bureau of Consumer Financial Protection (Bureau), or any other government authority or law enforcement agency, information that the employee reasonably believes relates to any violation of any provision of Title X of the Dodd-Frank Act, which

establishes new consumer financial protections, or any rule, order, standard or prohibition prescribed or enforced by the Bureau;

- Testified or will testify in a proceeding resulting from the administration or enforcement of any provision of Title X;

- Filed, instituted, or caused to be filed or instituted any proceeding under any federal consumer financial law; or

- Objected to, or refused to participate in any activity, practice, or assigned task that the employee reasonably believes to be a violation of any law, rule, standard, or prohibition subject to the jurisdiction of, or enforceable, by the Bureau.

Remedies include reinstatement, backpay, compensatory damages, and attorney's fees and litigation costs, including expert witness fees. Where reinstatement is unavailable or impractical, front pay may be awarded.

Section 1057 employs a burden-shifting framework that is favorable to employees. A complainant can prevail merely by showing by a preponderance of the evidence that her protected activity was a contributing factor in the unfavorable action. A contributing factor is any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision.

Once a complainant meets her burden by a preponderance of the evidence, the employer can avoid liability only if it proves by clear and convincing evidence that it would have taken the same action in the absence of the employee's protected conduct.

The procedures governing section 1057 claims are identical to those governing retaliation claims brought under the Consumer Product Safety Improvement Act of 2008, 15 U.S.C. § 2087. The statute of limitations is 180 days and the claim must be filed initially with the Occupational Safety and Health Administration, which will investigate the complaint and can order preliminary reinstatement.

Once OSHA issues its findings, either party can request a hearing before a U.S. Department of Labor administrative law judge. If the DOL has not issued a final order within 210 days of the filing of the complaint, the complainant has the option to remove the claim to federal court and either party can request a trial by jury. Section 1057 claims are exempt from predispute arbitration agreements.

Strengthening SOX's Whistleblower Protection Provision (Sections 922 and 929A)

Sections 922 and 929A contain important amendments to Section 806 of SOX that broaden the scope of coverage, increase the statute of limitations, exempt SOX whistleblower claims from mandatory arbitration, and clarify that SOX claims can be tried before a jury.

Section 929A clarifies that the whistleblower protection provision of SOX applies to employees of subsidiaries of publicly traded companies "whose financial information is included in the consolidated financial statements of [a publicly] traded company."

This amendment eliminates a significant loophole that some courts have read into SOX that has substantially narrowed the scope of SOX coverage. Elevating form over substance, some judges have permitted publicly traded companies to avoid liability under SOX merely because the parent company that files reports with the SEC has few, if any, direct employees, and instead employs most of its workforce through non-publicly traded subsidiaries.

As Judge Levin pointed out in Morefield v. Exelon Servs. Inc., ALJ No. 2004-SOX-002 (ALJ Jan. 28, 2004), this loophole is contrary to the purpose of SOX in that "[a] publicly traded corporation is, for Sarbanes-Oxley purposes, the sum of its constituent units; and Congress insisted upon accuracy and integrity in financial reporting at all levels of the corporate

structure, including the non-publicly traded subsidiaries ... [Congress] imposed reforms upon the publicly traded company, and through it, to its entire corporate organization."

Eliminating this loophole will remove a popular defense that has enabled employers to delay litigating SOX claims on the merits.

Section 922(b) further expands SOX coverage to employees of nationally recognized statistical ratings organizations (NRSROs). Covered organizations include Moody's Investors Service Inc., A.M. Best Company Inc., and Standard & Poor's Ratings Service.

According to Sen. Benjamin Cardin, D-Md., a co-sponsor of an amendment expanding SOX coverage, "NRSROs played a large role — by overestimating the safety of residential mortgage-backed securities and collateralized debt obligations — in creating the housing bubble and making it bigger. Then by marking tardy but massive simultaneous downgrades of these securities, they contributed to the collapse of the subprime secondary market and the 'fire sale' of assets, exacerbating the financial crisis."

In a May 7, 2010 press release, Sen. Cardin's office noted that "91 percent of the AAA-rated securities backed by subprime mortgages issued in 2007 have been downgraded to junk status, along with 93 percent of those issued in 2006. Someone at these agencies had to be aware of the problems with these ratings early enough to have made a difference in the severity."

Section 922(c) doubles the statute of limitations for SOX whistleblower claims from 90 to 180 days and clarifies that the statute of limitations begins to toll when an employee becomes aware of a SOX violation, not the date on which the violation occurs. In addition, Section 922(c) clarifies that SOX whistleblowers can elect to try their claims before a jury.

While Congress intended for SOX whistleblowers to have the option to try their claims before a jury, some courts held that the relief provided in SOX is solely equitable in nature and therefore SOX plaintiffs do not have the right to a jury trial. Section 922(c) also declares void any "agreement, policy form, or condition of employment, including a predispute arbitration agreement" which waives the rights and remedies afforded to SOX whistleblowers.

These significant changes to SOX will likely result in more SOX plaintiffs removing their claims from the Department of Labor Office of Administrative Law Judges to federal court, and a significant increase in compensatory damages.

Amendments to the Anti-Retaliation Provision of the False Claims Act (Section 1079B)

Section 1079B amends the anti-retaliation provision of the False Claims Act, 31 U.S.C. § 3730(h), by expanding the definition of protected conduct to include "lawful acts done by the employee, contractor, or agent or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of [the False Claims Act]," thereby protecting against associational discrimination and covering a broad range of activities that could further a potential qui tam action, such as investigating potential contractor fraud.

Section 1079B also clarifies that the statute of limitations for FCA retaliation actions is three years, which brings much-needed clarity in the wake of the Supreme Court's decision in Graham County Soil & Water Conservation Dist. v. U.S. ex rel. Wilson, 545 U.S. 409 (2005) holding that the most closely analogous state statute of limitations applies to FCA retaliation claims.

Approximately one year ago, Congress strengthened the FCA's anti-retaliation provision by providing for individual liability and broadening the scope of coverage to include contractors and agents. See Fraud Enforcement and Recovery Act of 2009 (FERA), Pub. L. No. 111-21, § 4(d), 123 Stat. 1617, 1624-625.

The FERA amendments to § 3730(h), combined with the Dodd-Frank Act amendments, substantially broaden the scope of covered employees and the scope of protected conduct.

Employees who suffer retaliation for blowing the whistle on fraud related to economic stimulus funds, however, have a stronger cause of action under the Section 1553 of the American Recovery and Reinvestment Act of 2009.

Impact of Whistleblower Provisions in Dodd-Frank Act

The whistleblower provisions in the Dodd-Frank Act will likely have several significant effects on the financial services industry and on publicly traded companies.

First, the whistleblower reward provisions will increase disclosures to the SEC and CFTC, thereby strengthening the ability of regulators to uncover and prosecute fraudulent schemes. It remains to be seen, however, whether the culture at the SEC has changed such that the SEC will investigate whistleblower disclosures. The SEC's repeated failure to act on detailed tips about Bernard Madoff's ponzi scheme is just one example of the consequences of the SEC's failure to investigate whistleblower tips.

Second, whistleblowers now have a broad range of options to pursue retaliation claims, and many of the loopholes that courts and administrative agencies carved into SOX's anti-retaliation provisions have been eliminated, including loopholes that substantially narrowed the scope of covered employees.

Third, the option to try whistleblower retaliation claims before juries will likely increase damages awards. General antagonism about the role of financial services firms in precipitating the financial crisis might spur large jury verdicts.

Fourth, exempting whistleblower retaliation claims from predispute arbitration agreements will enable whistleblowers to obtain broader discovery and will increase public exposure of fraudulent schemes.

Fifth, the option to bring certain whistleblower retaliation claims directly in federal court and to try SOX claims before a jury will put pressure on DOL to promptly adjudicate SOX claims and to demonstrate that it will conduct effective investigations rather than rubber-stamping pretextual employer justifications for retaliatory adverse actions.

--By R. Scott Oswald (pictured) and Jason M. Zuckerman, The Employment Law Group PC

Scott Oswald and Jason Zuckerman are principals at The Employment Law Group in Washington, D.C., where they litigate whistleblower retaliation claims, qui tam actions and other employment related claims on behalf of employees.

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