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Cementing a Trend: Financial Reform Act Dramatically Expands Whistleblower Protections

By Gregory C. Keating, Eric A. Savage, Ilyse W. Schuman, Roberta Limongi Ruiz and Amy E. Mendenhall

The newly enacted Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA") (H.R. 4173), signed into law by President Barack Obama on July 21, 2010, not only creates sweeping new whistleblower protections for employees in the financial services industry,[1] but also significantly broadens existing whistleblower protections far beyond the financial services industry. Viewed in isolation, these expansive new whistleblower protections represent a dramatic expansion of rights and remedies. Bathed in the light of the last ten years, it is clear that whistleblower protection has become ubiquitous. Only a decade ago, federal whistleblower protection existed mostly for companies involved in highly regulated industries. By contrast, it now appears that almost any company – large or small, publicly traded or privately held – faces the distinct possibility of being subject to one or more federal or state whistleblower statutes. Accordingly, all employers should be aware of this development and must take action now to establish compliance programs and train their workforce.

DFA Whistleblower Provisions

The enhanced whistleblower protections in the DFA create a new incentive program to encourage individuals to report Securities Exchange Act (SEC) violations; allow aggrieved employees to bring a civil action in federal court; and establish a more stringent burden-shifting approach to certain whistleblower claims. The new law also amends existing statutes like Sarbanes-Oxley Act of 2002 (SOX) and the False Claims Act (FCA) to provide broader protection to whistleblowers, and it includes provisions that severely limit the use of mandatory pre-dispute employment arbitration agreements and releases of whistleblower retaliation claims.[2] Employers should also note that the DFA expands the class of firms that must report to the SEC. In particular, private equity firms and hedge funds that manage over $100 million are now required to report to the SEC.

This expansion of whistleblower protections and the dramatic increase in available remedies is almost certain to spawn a deluge of whistleblower claims. It is important for employers in the financial services industry to understand these new provisions and to be proactive in the development and maintenance of compliance and reporting programs and procedures.

New Whistleblower Rights and Remedies for Direct Reports to the SEC

Section 922 of DFA Title IX amends The Security and Exchange Act of 1934 to provide a significant new monetary incentive for individuals to make whistleblower reports to the SEC and sets forth robust retaliation protection. To motivate those with knowledge of violations of securities laws to blow the whistle, Section 922 provides monetary awards to those who contribute original information that leads to recoveries of monetary sanctions of $1,000,000 or more in criminal and civil proceedings. The award ranges from 10 to 30 percent of any monetary sanctions actually collected based on the original information provided by the whistleblower.

Original information is defined as information derived from the independent knowledge or analysis of the whistleblower, is not known to the SEC from any other source, and is not exclusively derived from an allegation in an administrative hearing, governmental report, hearing, audit or investigation or from the news media. The award is determined in the SEC's discretion. If the amount awarded is not within the 10 to 30 percent statutory range, 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. Factors considered in determining the amount of the reward include the significance of the information provided, the degree of assistance provided, the programmatic interest of the SEC in deterring violations and other factors the SEC may establish.

Some commentators have questioned whether this new award program will dissuade employees from reporting misconduct through a company established hotline because they will no longer be the "original source."[3] Such concerns appear misplaced as the definition of "original information" appears on its face to encompass information a whistleblower provides through a company hotline. The confusion on this issue, however, underscores the fact that regulatory guidance is needed. The SEC has 270 days to issue proposed regulations interpreting this new statute and employers will then presumably have a period of notice and comment.

Not all would-be whistleblowers are entitled to awards, however. 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.

In addition to sweetening the remedies available to whistleblowers, Section 922 also enhances protections for whistleblowers. The statute prohibits retaliation due to lawful whistleblower acts, including providing information to the SEC, initiating or otherwise participating in investigations or judicial or administrative actions of the SEC, or making disclosures required or protected under SOX, the Security and Exchange Act of 1934 or any other law, rule or regulation in the SEC's jurisdiction. The protection extends to discharging, demoting, suspending, threatening, harassing (directly or indirectly) or otherwise discriminating against the whistleblower. Section 922 allows one who has been retaliated against to bring a private action in federal court against his or her employer for reinstatement, double back pay plus interest, and attorneys' fees and litigation costs. The private right of action is not limited to employees, but instead extends to claims by any individual claiming to have been threatened, harassed or subjected to discrimination because of protected activity. The statute of limitations for such actions is extremely long – 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 be known to the employee. There is no administrative exhaustion requirement to bringing such an action in federal court. In this and other regards, Section 922 is a significant expansion of the whistleblower protections offered by SOX, as discussed below.

New Whistleblower Provisions for Direct Reports to the Commodity Futures Trading Commission

Section 748 of the DFA amends the Commodity Exchange Act by adding a "Commodity Whistleblower Incentives and Protection" section,

Section 23, which provides whistleblower incentives and a new private right of action designed to protect whistleblowers in ways nearly identical to those set forth in Section 922. The new Section 23 prohibits employers from discharging, demoting, suspending, threatening, harassing (directly or indirectly) or otherwise discriminating against an employee for: (1) providing information to the Commodity Futures Trading Commission (CFTC) in accordance with the commodity whistleblower incentive program; or (2) assisting in an investigation or judicial or administrative action relating to the information provided. Employees alleging violations of this new law may bring an action in the appropriate federal district court. Such claims may not be brought more than two years after the violation complained of by the whistleblower. Relief for prevailing employees under this new private right of action includes reinstatement, backpay plus interest, and special damages, including attorneys' fees, expert witness fees and litigation costs. One notable difference between sections 748 and 922 is the ability of a commodity whistleblower to appeal any determination regarding an award made by the CFTC, not just awards outside of the 10 to 30 percent range, within 30 days.

The legislation also provides that no pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of a dispute arising under this section. This restriction is reflective of a continued scrutiny by Congress of mandatory arbitration agreements, and similar restrictions may appear in future whistleblower protection legislation.

New Whistleblower Provisions for Financial Services Employees

Section 1057 of the DFA provides protection against firings of, or discrimination against, employees who provide information or testimony to the Bureau of Consumer Financial Protection ("CFPB" or "Bureau") – an independent consumer entity within the Federal Reserve newly created by the legislation. The scope of coverage is very broad in that the new provisions also stipulate that:

> No covered person or service provider shall terminate or in any other way discriminate against, or cause to be terminated or discriminated against, any covered employee or any authorized representative of covered employees by reason of the fact that such employee or representative, whether at the initiative of the employee or in the ordinary course of the duties of the employee (or any person acting pursuant to a request of the employee), has –
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> (1) provided, caused to be provided, or is about to provide or cause to be provided, information to the employer, the Bureau, or any other State, local, or Federal, government authority or law enforcement agency relating to any violation of, or any act or omission that the employee reasonably believes to be a violation of, any provision of this title or any other provision of law that is subject to the jurisdiction of the Bureau, or any rule, order, standard, or prohibition prescribed by the Bureau;
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> (2) testified or will testify in any proceeding resulting from the administration or enforcement of any provision of this title or any other provision of law that is subject to the jurisdiction of the Bureau, or any rule, order, standard, or prohibition prescribed by the Bureau;
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> (3) filed, instituted, or caused to be filed or instituted any proceeding under any Federal consumer financial law; or
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> (4) objected to, or refused to participate in, any activity, policy, practice, or assigned task that the employee (or other such person) reasonably believed to be in violation of any law, rule, order, standard, or prohibition, subject to the jurisdiction of, or enforceable by, the Bureau.

A *covered employee* would include any individual performing tasks related to the offering or provision of a consumer financial product or service. Significantly, any predispute arbitration agreement intended to require arbitration of a dispute arising under this section is invalid and unenforceable.

The term *covered person* means any person that engages in offering or providing a consumer financial product or service, and any affiliate of such person if such affiliate acts as a service provider to such person.

A *service provider* is:

> any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service, including a person that: –
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> (i) participates in designing, operating, or maintaining the consumer financial product or service; or
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> (ii) processes transactions relating to the consumer financial product or service (other than unknowingly or incidentally transmitting or processing financial data in a manner that such data is undifferentiated from other types of data of the same form as the person transmits or processes).

The term *service provider* does not include a person solely by virtue of such person offering or providing to a covered person –

> (i) a support service of a type provided to businesses generally or a similar ministerial service; or
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> (ii) time or space for an advertisement for a consumer financial product or service through print, newspaper, or electronic media.

A person that is a service provider is not deemed to be a covered person to the extent that such person engages in the offering or provision of its own consumer financial product or service.

An employee aggrieved under this section has 180 days to file a complaint with the Secretary of Labor. An employee would have a viable cause of action if the Secretary determines that any of the employee's actions described in paragraphs (1) – (4), above, constituted a "contributing factor" to the alleged adverse employment action. In its defense, an employer would have to demonstrate "by clear and convincing evidence" that it would have taken the same adverse actions regardless of the employee's conduct. This new burden-shifting framework, already in place for SOX claims, is advantageous to the employee and represents a reversal of the burden of proof more typically seen in discrimination or harassment claims, where the burden is placed on the employee. In the event the Department of Labor fails to issue a final order within 210 days of the filing of the complaint, the complainant can bring a claim in federal court for *de novo* review and either party may request a trial by jury.

Amendments to Existing Laws

In addition to creating the new securities whistleblower incentive and protection program, the DFA expands protections available under existing laws, including the SOX and the False Claims Act.

<u>Sarbanes-Oxley Act of 2002</u>

Section 929A of the DFA significantly expands the protections available to whistleblowers under SOX. Section 922(c) of the DFA also expands the statute of limitations for filing a whistleblower claim under SOX from 90 days to 180 days.

Section 929A makes clear that SOX's whistleblower protections apply to employees of the subsidiaries of publicly traded companies, even where the subsidiary is a non-publicly traded company. Previously, the applicability of SOX to non-publicly traded subsidiaries was a hotly contested issue. The Administrative Review Board for the Department of Labor (the "ARB") recently observed that "ALJ's and courts have struggled with this question, resulting in a variety of diverging and conflicting opinions," and the ARB issued an order inviting amicus briefs in a case that presented this issue. The DFA now settles the question of SOX's applicability to non-public subsidiaries by defining a "publicly traded company" to include any "subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company." Under the DFA, SOX's whistleblower protections also apply to employees of nationally recognized statistical ratings organizations, including A.M. Best Company, Inc., Moody's Investors Service, Inc. and Standard & Poor's Ratings Service.

The DFA also declares that plaintiffs bringing claims under SOX are entitled to a jury trial, a right which had not previously existed.

Notably, the DFA further provides that pre-dispute arbitration agreements are no longer enforceable under SOX and that SOX remedies cannot be waived by agreement, such as a general release or settlement agreement.

Whether the amendments to SOX will apply retroactively is likely to be a highly disputed matter. The statute does not contain any specific guidance on this issue, thereby sowing seeds of disputes. For example, if on July 21, 2010, an employee had allowed more than 90 days to pass from the possible accrual of a SOX claim, does the new statute in effect extend the time to file for another 90 days, or is the matter stale? For SOX cases filed in federal court before July 21, 2010, is a jury now available, or do the pre-July 21 rules apply? These matters are expected to be sharply litigated.

Amendments to the False Claims Act

Section 1079B of the DFA amends the False Claims Act (FCA), which allows private citizens to file civil actions, called ***qui tam*** actions, on behalf of the government and provides such individuals a substantial portion of the government's recovery. The DFA expands the definition of protected whistleblower conduct under the FCA 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 FCA]." Under this expanded definition, employees are protected from so-called associational discrimination. Furthermore, protected activity will now include a broad range of actions that could potentially advance a ***qui tam*** action or constitute an attempt to stop an FCA violation.

Section 1079B also clarifies that the statute of limitations for actions brought under the FCA is three years. Previously, the U.S. Supreme Court held in *Graham County Soil & Water Conservation Dist. v. U.S. ex rel. Wilson*[4] that the most closely analogous state statute of limitations applies to FCA retaliation claims.

These changes to the FCA are significant given the recent increase in FCA enforcement actions. According to the U.S. Department of Justice, 34 prosecutions in 2009 resulted in $435.3 million in penalties. The DFA amendments are also consistent with a trend of pro-whistleblower amendments to the FCA, including those enacted as part of the Fraud Enforcement Recovery Act and the American Recovery and Reinvestment Act of 2009.

Next Steps for Employers

To address the new whistleblower provisions in the DFA effectively, employers, and not just the financial services entities who are the most obvious focus of the act, must continue to cultivate a culture of compliance and transparency and need to be conspicuous about doing so within their companies. This includes taking the following actions immediately:

- Update policies to encourage employees to report their reasonable good faith concerns with any issues within the company;
- Update policies to clearly articulate that the employer will not tolerate any reprisals or retaliation by anyone against an individual who reasonably in good faith makes a complaint;
- Develop and implement whistleblower reporting procedures for employees and procedures for handling such reports;
- Consider implementation of a Code of Conduct;
- Train management about whistleblower protections, handling of internal complaints, including how managers deal with employees who have complained about those same managers, and reporting procedures. In this regard, Littler Mendelson just completed a year-long project in conjunction with its Legal Learning Group and subject matter experts and has a new training product on Retaliation and Whistleblowing, which can be tailored to an employer's organization;
- Review mandatory arbitration agreements and revise as necessary.

Companies outside of the financial services industry also face a climate that is increasingly hospitable to whistleblower claims. In this environment, Congress is likely to include whistleblower provisions in a legislative response to a myriad of issues ranging from mine and workplace safety to the oil spill. For example, last week Rep. George Miller (D-CA) introduced the Offshore Oil and Gas Worker Whistleblower Protection Act (H.R. 5851), that the House passed in conjunction with a broader oil spill response bill. State legislatures have also jumped on the bandwagon — in the past few years, state legislatures have passed sixteen different statutes broadening whistleblower protections. Companies in other industries should heed this as another sign that Congress and the state legislatures have not finished expanding whistleblower protection laws. Even if companies are not currently targeted by specific federal or state whistleblower legislation, companies should take steps now to minimize their exposure to the ever-expanding web of whistleblower protection laws. Including whistleblower protections provisions in an employee handbook, and developing whistleblower reporting procedures and training management accordingly, are fairly simple to implement and relatively low in cost, compared to the cost and exposure of whistleblower litigation. The risk of failing to take these proactive steps is substantial and likely to increase as Congress, state legislatures and regulatory agencies continue to focus on developing and enhancing whistleblower protections.

Gregory C. Keating is a Shareholder in Littler Mendelson's Boston office; Eric A. Savage is a Shareholder in the Newark office; Ilyse W. Schuman is a Shareholder in the Washington, D.C. office; Roberta Limongi Ruiz and Amy E. Mendenhall are Associates in the Boston office. If you would like further information, please contact your Littler attorney at 1.888.Littler or info@littler.com; Mr. Keating at gkeating@littler.com; Mr. Savage at esavage@littler.com; Ms. Schuman at ischuman@littler.com; Ms. Ruiz at rruiz@littler.com; or Ms. Mendenhall at amendenhall@littler.com.

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[1] The SEC has 270 days from the date the legislation was enacted to issue regulations implementing the SEC's new whistleblower program.

[2] Additional information on existing whistleblower laws is available in the national treatise entitled "*Retaliation and Whistleblowing: A Guide for Human Resources Professionals and Counsel*" (3d edition 2010) by Littler Shareholder Greg Keating.

[3] For a more extensive discussion of this debate, see *Can Hedge Fund Managers Use Whistleblower Hotlines to Help Create and Demonstrate a Culture of Compliance? in The Hedge Fund Report* (July 23, 2010) by Jennifer Banzaca.

[4] 545 U.S. 409 (2005).