THE LITTLER REPORT

# DODD-FRANK AND THE SEC FINAL RULE:

## From Protected Employee to Bounty Hunter

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# DODD-FRANK AND THE SEC FINAL RULE: From Protected Employee to Bounty Hunter

## I. INTRODUCTION

The whistleblower and bounty hunter provisions of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") make internal auditing, reporting and compliance programs more important than ever for covered employers. The SEC regulations implementing Dodd-Frank (the Final Rules), released on May 25, 2011, clearly illustrate that the government's objective is to stimulate reporting of violations of the federal securities laws through financial incentives to individuals—usually employees—who discover such violations. The Dodd-Frank regulations are—above all—a law enforcement tool that signals a fundamental change in the SEC's approach to corporate corruption. Only ten years ago, Congress passed the Sarbanes-Oxley Act of 2002 ("SOX") in response to the breakdown in internal corporate controls, demonstrated most dramatically in the Enron prosecution. Dodd-Frank is a step farther on that continuum. No longer content with the enhanced self-governance approach of SOX, the SEC now puts the fear of prosecution into the boardroom and executive suite by incentivizing employees of every covered employer to expose corruption for a price. In addition, Dodd-Frank provides enhanced employment protection for the whistleblower providing the information.

In presenting the new regulations, SEC Chairperson Mary L. Schapiro stated that "for an agency with limited resources like the SEC, I believe it is critical to be able to leverage the resources of people who have first-hand information about potential violations" of the securities laws. To that end, among other things, the final regulations:

- Broaden the range of people who may qualify as whistleblowers;
- Promise to pay informant/whistleblowers for "original source" information that leads to a successful enforcement action by the SEC;
- Require only a "reasonable belief" that the information provided "relates to a *possible* securities law violation;"
- Simplify the reporting process for whistleblowers;
- Do not require an employee to make an internal complaint before reporting alleged unlawful conduct to the SEC, including complaints for unlawful retaliation.

As evidence of its serious commitment to enforcing its new program, the SEC recently leased 900,000 square feet of space for its expanding offices and has fully staffed a newly created "Office of the Whistleblower."[1] The SEC has also allotted more than $450 million to its investor protection fund, out of which whistleblower awards will be paid. In short, the SEC has girded itself for a massive increase in whistleblower reports, investigations and enforcement actions and, with the potential for multi-million-dollar awards to qualifying whistleblowers, it is not likely to be disappointed. At the same time, the U.S. Department of Labor (DOL) has issued a number of recent decisions that expand whistleblower protections.

The financial incentives laid out in the SEC regulations suggest that covered employers will face some or all of the following:

- Increased use of their ethics and compliance reporting procedures, because the regulations reward the use of those procedures;
- A need for prompt and efficient corporate responses to internal complaints, because effective responses are rewarded by the SEC, the U.S. Department of Justice prosecution principles, and the Federal Sentencing Guidelines;
- An increase in SEC and DOL investigations generally, because the bounty hunter system does not discourage reporting of questionable or borderline claims of misconduct; and
- The need for sensitive and sensible HR responses to employee complaints, because the Dodd-Frank whistleblower provisions can insulate employees who use them as a shield against performance management and legitimate employer discipline.

In anticipation of this increased activity, businesses should pay renewed and focused attention to their internal compliance, ethics and anti-retaliation policies and procedures, and be vigilant concerning, and nimble in responding to, potential employee allegations of wrongdoing.

To assist in this effort, this Littler Report provides an overview of the some of the more significant aspects of the SEC's Final Rules for implementing Dodd-Frank, including the SEC's attempt to strike a balance between promoting internal compliance and encouraging reports of unlawful conduct to governmental agencies. We also offer some practical suggestions about steps employers can take to foster a culture of compliance, encourage internal reporting, and place themselves in the best possible position to defend against whistleblower and retaliation claims that even the most careful and compliant companies may face.

## II. WHO CAN QUALIFY AS A WHISTLEBLOWER?

### A. The Basic Definition

To qualify as a whistleblower under Dodd-Frank, an individual must be "an employee of a public company or subsidiary whose financial information is included in the consolidated financial statements of a public company or the employee of a nationally recognized statistical rating organization."[2] The Final Rules define a whistleblower as one who possesses a "reasonable belief" that the information provided "relates to a *possible* securities law violation." The "reasonable belief" standard, also applicable in SOX and other whistleblower contexts, is intended to put "potential whistleblowers on notice that meritless submissions cannot be the basis for anti-retaliation protection."[3] The SEC notes that it included this phrase to deter frivolous claims so it could focus on more meritorious submissions and because of its concern about the cost of such claims to employers, not only in terms of the costs of litigation, but also because of "inefficiencies stemming from some employers' decisions not to take legitimate disciplinary action due to the threat of bad faith anti-retaliation litigation." [4]

The use of the term "possible violation" in the definition of whistleblower in the Final Rules is also significant. In the proposed rules, the SEC had used the word "potential," but changed it to "possible violation" that "has occurred, is ongoing, or is about to occur" to be more precise and clarify that whistleblower status applies to those who provide "information about possible violations, including possible future violations, of the securities laws."[5] The SEC rejected the use of the terms "probable violation" or "likely violation," stating that it thought that such a "higher standard" was "unnecessary" and would "make it difficult for the staff to promptly assess whether to accord whistleblower status to a submission."[6] In the SEC's view, the language it adopted was sufficient to ensure that "frivolous submissions would not qualify for whistleblower status."[7]

The SEC also decided not to limit the scope of the term "possible violations" by including a requirement that the information provided relate to a "material" violation of the securities laws. In keeping with its objective of encouraging informants, the Final Rules express the SEC's concern that a materiality threshold might limit the number of reports made. The SEC states that "it is preferable for individuals to provide us with any information they possess about possible securities violations (irrespective of whether it appears to relate to a material violation) and for us to evaluate whether the information warrants action."[8]

### B. Individuals Who Have a Legal or Contractual Duty to Report Violations Are Excluded

To qualify for receipt of an award under Dodd-Frank, a whistleblower must have "voluntarily" provided "original information" to the SEC that led to a successful enforcement action. The rules explain that an individual who reports information to the SEC pursuant to some legal or contractual duty has not done so "voluntarily" and therefore is not eligible for an award. Individuals who provide information following a request, inquiry or demand from the SEC or as part of an investigation by Congress or the Public Company Accounting Oversight Board or any self-regulatory body relating to the subject matter of the report are also deemed not to have "voluntarily" reported.

### C. Individuals in Compliance-Related Roles Are Excluded

To be deemed "original information," a whistleblower's report must, among other things, be derived from his or her own "independent knowledge or analysis." The rules apply this definition to exclude several categories of professionals who obtain information about violations because of their compliance-related roles:

- Attorneys, including in-house counsel, and non-attorneys who learn information from an attorney-client communication.
- Officers, directors, trustees or partners[9] of an entity if they obtained the information because another person informed them of allegations of misconduct, or they learned the information in connection with the entity's processes for identifying, reporting, and addressing potential non-compliance with the law.
- Employees whose principal duties involve compliance or internal audit responsibilities, as well as employees of outside firms that are retained to perform internal compliance or internal audit work.
- Those employed or otherwise associated with a firm retained to conduct an inquiry or investigation into possible violations of the law.
- Employees of a public accounting firm who acquire information through an audit or other engagement required under the federal securities laws relating to an alleged violation by the engagement client.

### D. Exceptions to the Exclusions

The categories of individuals listed above may nevertheless be eligible for whistleblower status under certain circumstances. For attorneys, the Final Rules include an exception for attorney

disclosures permitted under state bar rules. These rules vary, but most permit disclosures necessary to prevent the commission of a crime or fraud. The exception for permitted attorney disclosures applies equally to non-attorneys who receive the information in an attorney-client communication.[10]

Individuals in the other excluded categories listed above may be considered whistleblowers in the following circumstances:

- If they can demonstrate they have a "reasonable basis" to believe that disclosure of the information to the SEC is necessary to prevent "conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors."[11] This is similar to the crime-fraud exception applicable to reports by attorneys. The SEC explains that "in most cases" a whistleblower who seeks to collect an award on the basis of this exception will need to demonstrate that management or governance personnel at the entity were "aware of the imminent violation and were not taking steps to prevent it."[12]
- If they have a reasonable basis to believe that the "relevant entity is engaging in conduct that will impede an investigation,"[13] such as impermissibly influencing witnesses or destroying documents.
- 120 days after (a) providing information to the entity's audit committee, chief legal or compliance officer or his supervisor, or (b) receiving information under circumstances indicating the audit committee, chief legal or compliance officer, or supervisor was already aware of the information.

The Final Rules also clarify that an individual cannot collect an award on the basis of information obtained from someone who is excluded from eligibility for an award as a whistleblower. There is an exception to this rule, however, for information that the original source could permissibly report or if the whistleblower is providing information about possible violations involving the person from whom the information was obtained. For example, if an auditor learns from a colleague about his involvement in a client's securities law violation, the auditor could report the violation to the SEC and collect an award as a whistleblower if the report led to a successful enforcement action.

### E. Criminal Violators

Consistent with its basic focus on aiding law enforcement, the Final Rules incorporate the concept of "using a rogue to catch a rogue,"[14] to enhance the SEC's ability to detect federal securities violations and obtain evidence for its enforcement actions. Rejecting the suggestion by some commenters that the rules exclude from "whistleblower" status those who are themselves guilty of violations, the SEC notes that "[i]nsiders regularly provide law enforcement authorities with early and invaluable assistance in identifying the scope, participants, victims, and ill-gotten gains" from fraudulent schemes.[15] In further support of its position the SEC states, "[t]his basic law enforcement principle is especially true for sophisticated securities fraud schemes which can be difficult for law enforcement authorities to detect and prosecute without insider information and assistance from participants in the scheme or their coconspirators."[16]

However, in response to public policy concerns about rewarding wrongdoers, the Final Rules provide that the SEC will not count monetary sanctions against the whistleblower or any entity "whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated" in determining whether the $1,000,000 threshold for an award has been met.[17] In addition, any award the whistleblower receives will be decreased by amounts attributable to the whistleblower's conduct.

The rules also deny whistleblower status to those who obtain information "where a domestic court determines that the whistleblower obtained the information in violation of federal or state criminal law."[18] The SEC rejected recommendations to extend this provision to information obtained in violation of civil law. The exclusion also does not apply to information obtained in violation of a protective order.

## III. WHISTLEBLOWER ANTI-RETALIATION PROVISIONS

Other important sections of the Final Rules relate to the retaliation protections for whistleblowers under Dodd-Frank, which broadly prohibits employers from discharging, demoting, suspending, threatening, directly or indirectly harassing, or "in any other manner" discriminating against a whistleblower in the terms or conditions of employment.[19]

### A. Expansion of Who Is Protected

The Final Rules expressly state that the retaliation protections under Dodd-Frank apply regardless of whether a whistleblower is ultimately entitled to an award.[20] This is another provision that the SEC states is intended not to "unduly deter whistleblowers from coming forward with information." Thus, in order to be protected by the anti-retaliation provisions, the complainant need only have a "reasonable belief" that the information being provided relates to a "possible" violation of the federal securities laws.[21]

This approach is similar to that taken in *Sylvester v. Parexel International, L.L.C.*, a recent decision[22] by the DOL Administrative Review Board interpreting the whistleblower protection provisions under SOX. The case and its implication are discussed in a recent Littler ASAP.[23] Suffice it to say, the SEC regulations and the recent *Sylvester* decision dramatically expand those who are considered to have engaged in protected activity.

### B. Expansion of Protected Activity

Dodd-Frank provides whistleblower retaliation protection to any of the following activities:

- Providing information to the SEC;
- Initiating, testifying, or assisting in an investigation, or a judicial or administrative action of the SEC based on or related to information provided by the whistleblower;
- Making disclosures required or protected under SOX or any other law, rule or regulation subject to the SEC's jurisdiction.[24]

In the Final Rules, the SEC has further clarified that the anti-retaliation provisions apply to those who engage in these protected activities, regardless of whether they have reported to any of the following:

- The SEC;
- A federal regulatory or law enforcement agency;
- Any member or committee of Congress;
- A person with supervisory authority over the employee; or
- Such other person working for the employer who has authority to investigate, discover, or terminate misconduct. [25]

### C. More Avenues for Enforcement and an Expanded Statute of Limitations

The combination of the Final Rules and the provisions of the statute itself make Dodd-Frank very hospitable to whistleblower retaliation claims.

The SEC added a provision to the Final Rules expressly stating that it has authority to enforce the anti-retaliation provisions of the Act.[26] Thus, in contrast to SOX, which has only one avenue for a whistleblower retaliation complaint,[27] under Dodd-Frank an employee can bring a complaint to either the SEC or the DOL, or *file a claim directly in federal court*.[28]

The Dodd-Frank Act itself provides a more expansive statute of limitations than SOX for a retaliation claim. Under SOX, an employee has 90 days to file a retaliation claim with the DOL. Under Dodd-Frank, an employee has six years from the date of the retaliatory action, or three years from when "facts material to the right of action are known or reasonably should have been known," to file a retaliation claim in federal court.

## IV. PROCEDURAL ASPECTS OF THE WHISTLEBLOWER BOUNTY

### A. Procedures for Submitting Information to the SEC Have Been Simplified

The Final Rules make it significantly easier for individuals to submit information to the SEC concerning allegations of violations of federal securities laws. A person who wishes to file a whistleblower complaint with the SEC, must submit a Form TCR (Tip, Complaint or Referral) ("TCR") to the SEC on-line,[29] or by fax or mail. The TCR elicits basic identifying information about the alleged whistleblower and his or her concerns, including information used to determine whether or not the alleged conduct suggests a violation of federal securities law. The TCR requires that the purported whistleblower answer certain threshold questions to determine eligibility to receive an award. The whistleblower (or counsel, in the case of an anonymous submission) must sign the TCR under penalty of perjury.[30] The TCR has been revised to allow for joint submissions by more than one alleged whistleblower.

In its commentary, the SEC contends that the TCR has been revised to encourage internal compliance and reporting. As discussed further below, however, nothing in the Final Rules requires a whistleblower to use an employer's internal compliance and reporting systems before filing a complaint with the SEC.[31] Nevertheless, the TCR now asks a purported whistleblower to provide details about any prior actions taken regarding the complaint, and requires the whistleblower to indicate whether he or she has reported the alleged violation to his or her supervisor, compliance office, whistleblower hotline, ombudsman, or any other available internal complaint mechanism.[32]

### B. Calculating an Award Under the "Bounty Program"

If an SEC action results in sanctions totaling $1 million or more, the whistleblower is eligible to receive between 10% and 30% of any penalty recovered in a judicial or administrative action.[33] For purposes of an award, the Final Rules make clear that the SEC will aggregate two or more smaller actions that arise from the same nucleus of operative facts to "make whistleblower awards available in more cases." If there are multiple whistleblowers, the total compensation for all cannot exceed 30%. For example, one whistleblower could potentially receive an award equal to 25% of the penalty, and another could receive an award equal to 5% of the penalty, but they could not each receive an award equal to 30% of the penalty imposed.[34]

In determining the amount of the award, the SEC will consider the following criteria that may increase the award:

- The significance of the information provided by the whistleblower;
- The assistance provided by the whistleblower;
- Law enforcement interest in making a whistleblower award; and
- Participation by the whistleblower in internal compliance systems.

The following criteria that may decrease an award will also be considered:

- Culpability of the whistleblower;
- Unreasonable reporting delay by the whistleblower; and
- Interference with internal compliance and reporting systems by the whistleblower.[35]

No single criteria is determinative or mandatory.

## V. IMPLICATIONS OF THE FINAL RULES ON INTERNAL REPORTING PROCEDURES—A MIXED MESSAGE

### A. Internal Reporting Is Not Required

Internal reporting procedures have been an important part of corporate compliance programs at virtually all regulated companies for many years, and took on an even more prominent role after the enactment of Sarbanes Oxley. With the advent of Dodd-Frank—and its enhanced penalties and larger bounties—the need for strong internal reporting and investigatory systems has become even more acute. Indeed, most companies have enhanced these processes in the past year in the hope that they will learn of a problem before a whistleblower reports it to the authorities. The final Dodd-Frank regulations, however, seem to send a mixed message to companies and whistleblowers regarding internal reporting programs. Although the Final Rules do not require an employee to report an alleged securities violation to the employer first, they do contain some provisions that the SEC states will "expand upon the incentives for whistleblowers to report internally."

The decision not to require employees to report alleged violations internally prior to complaining to the SEC was the subject of much criticism by business and securities groups. The Association of Corporate Counsel harshly criticized this "no internal exhaustion" rule, stating that "[t]he SEC's bounty rule is a Pandora's box that, when opened, is likely to create new and even unanticipated harms rather than promoting better reporting of potential problems. Once the floodgates are open, we question whether the SEC even has the capacity to handle a torrent of new reports," adding that "the final SEC rules undermine internal compliance program[s] by preventing companies from addressing festering allegations of misconduct."[36]

The SEC goes to great lengths to explain its rationale for not mandating internal reporting. There is no question that the SEC's overriding goal, as expressed in the Final Rules, is to induce prompt reporting of possible securities violations and enhance its enforcement capabilities:

> [T]he broad objective of the whistleblower program is to enhance the Commission's law enforcement operations by increasing the financial incentives for reporting and lowering the costs and barriers to potential whistleblowers, so that they are more inclined to provide the Commission with timely, useful information that the Commission might not otherwise have received.[37] Noting that internal reporting will not always advance its goals, the SEC states that "providing information to persons conducting an internal investigation, or simply being contacted by them, may not, without more, achieve the statutory purpose of getting high-quality, original information about securities violations directly into the hands of Commission staff."[38] In this regard, the SEC also points out that not all internal reporting systems are created equal, stating "while many employers have compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances of confidentiality, others do not."[39] It is concerned that a company notified of a violation prior to an SEC investigation might destroy documents or attempt to tamper with witnesses.[40] Thus, the SEC concludes, there are cases where internal disclosures "could be inconsistent with effective investigation or the protection of whistleblowers."[41]

The SEC also emphasizes its belief that mandatory internal reporting might discourage some potential whistleblowers from reporting at all:

> There are a significant number of whistleblowers who would respond to the financial incentive offered by the whistleblower program by reporting **only** to the Commission, but who would not come forward **either** to the Commission or to the entity if the financial incentive were coupled with a mandatory internal reporting requirement.[42] (emphasis in the original)

In addition, the SEC believes that, because of the greater potential for financial reward, the cases most likely to go to the SEC without internal reporting are those "involving clear fraud or other instances of serious securities law violations by senior management."[43] The SEC's view is that the benefit to the public of bringing such cases directly to it is so great that it justifies bypassing the internal compliance system. In other words, as a law enforcement matter, the SEC wants the good cases as soon as it can get them.

### B. The SEC Continues to Support and Encourage Internal Reporting

Although the Final Rules do not make internal reporting mandatory, the SEC also plainly states, in several places throughout the regulations, its interest in promoting strong internal compliance and reporting systems rather than undermining them. The SEC believes that, even without requiring whistleblowers to report internally first, most are likely to do so anyway. The SEC cites sources as varied as the National Whistleblower Center and the New England Journal of Medicine for the proposition that the vast majority of whistleblowers first present their problems to management before consulting counsel or communicating with a government agency.[44] The SEC supports this limited empirical data by pointing out that whistleblowers are frequently motivated by non-monetary incentives, including "cleansing the conscience," punishing wrong-doers, simply doing the right thing for the sake of a general increase in social welfare, or self-preservation. Based on anecdotal evidence from defense lawyers, whistleblowers are frequently motivated by concern about their continued employment or personality conflicts with superiors or other employees. They blow the whistle as a weapon in the workplace battle and only later recognize the possibility of financial gain. Another obvious reason for employees to continue to raise their complaints internally is because Dodd-Frank whistleblower retaliation protection only attaches if the employer knows that the employee has engaged in protected activity. Internal reporting aids in that respect.

More significantly, the SEC has included provisions in the Final Rules that it believes create "strong incentives for employees to continue to use their employer's internal compliance systems."[45] Noting that "the federal securities laws [are] promoted when companies have effective programs for identifying, correcting, and self-reporting unlawful conduct by company officers or employees," the SEC emphasizes its goal is "to support, not undermine, the effective functioning of company compliance and related systems by allowing employees to take their concerns about possible violations to appropriate company officials first while still preserving their rights under the Commission's whistleblower program."[46]

How do the Final Rules encourage internal reporting?

- Probably the most favorable provision is Rule 21F-6 which provides for "credit in the calculation of award amounts to whistleblowers who utilize established internal procedures" to report misconduct.[47] On the flip side, that provision also makes it clear that an award may be decreased if a whistleblower is found to have intentionally interfered with internal compliance or reporting systems.[48]
- The rules further incentivize internal reporting by making a whistleblower eligible for an award based on "information that the whistleblower reports through the company's internal reporting system."[49] The award is available whether the company first reports the information to the SEC, or someone else (another employee) first reports to the SEC. In this way, the SEC explains, it is not rewarding the first employee to report a violation and penalizing the person who uses an internal reporting system to advise the company of a potential violation. In such a circumstance, "the whistleblower who had first reported internally will be considered the first whistleblower."[50]
- The SEC states that in "appropriate cases"—and being careful to protect the identity of the whistleblower—it may contact a company, describe the allegations and "give the company an opportunity to investigate the matter and report back."[51] Thus, it explains, "we do not expect our receipt of whistleblower complaints to minimize the importance of effective company processes for addressing allegations of wrongful conduct."[52] In addition, a company will be rewarded for self-reporting a violation even after an SEC investigation has begun.[53] In sum, it appears that if a company has a strong internal system, the SEC will allow you to use it to your advantage.

Despite these provisions, companies should keep in mind that the purpose of Dodd-Frank and the final regulations is to encourage employees to report securities violations to the SEC, regardless of whether they report internally.[54] In this regard, remember that an individual who files an internal complaint has a strong incentive to also file a complaint with the SEC within 120 days of the internal complaint to be eligible for a whistleblower bounty. Thus, as discussed further below, companies that have an internal complaint procedure should also have a vigorous internal investigation and enforcement mechanism to mitigate the risks of fall-out from an SEC investigation and enforcement proceeding.

## VI. TAKING ACTION IN A NEW WORLD OF WHISTLEBLOWING

It is important for employers to take notice now of this changing landscape and prepare for a new world of whistleblower bounties and intensive enforcement efforts by the SEC and DOL. Despite the lack of mandatory internal reporting requirements in the final Dodd-Frank regulations, it is now more important than ever to encourage internal reporting of possible violations and to prevent retaliation against whistleblowers. In the event a complaint brought to the SEC turns out to be meritorious, the SEC takes into consideration the existence of robust compliance programs in assessing the penalties to be paid by the company. Furthermore, the existence of an effective compliance and reporting program is a factor that the U.S. Department of Justice considers in deciding whether to bring a criminal action against an organization, and those same factors are taken into consideration under the Federal Sentencing Guidelines when a court decides how to punish a culpable organization.

Perhaps more significantly, the stronger a company's ethical culture and internal compliance systems, the more likely it is to avoid whistleblower claims altogether. By following some practical steps, companies can put themselves in the best possible position for dealing with potential whistleblower or retaliation claims and can go a long way toward preventing such claims.

### A. Create a Culture of Ethics and Compliance

Companies can help prevent complaints of corporate misconduct by fostering a culture of integrity, ethics and lawful business practice. As part of this effort, companies must promulgate—and enforce—a code of ethics or code of conduct. Reminders of the principles set forth in those codes can appear in employee newsletters and messages from senior management. Companies may also consider evaluating ethics and integrity as part of performance evaluations and should pay particular attention to evidence of dishonesty or lack of integrity at the hiring stage.

### B. Review Internal Compliance Programs

Companies should review their internal compliance and ethics programs, particularly with regard to federal securities laws and regulations. It may even be useful to provide an in-depth assessment and report on current compliance systems to the company's board or audit committee. A company's efforts to police and report its own misconduct are important factors in the SEC's decision whether to grant that company any leniency for corporate misconduct. Thus, any organization would be well-served by dramatically increasing its efforts to learn of misconduct internally rather than from a whistleblower's report to a government agency.

### C. Remind Employees About Reporting Procedures

As part of their in-depth review of compliance procedures, companies should evaluate their existing whistleblower reporting systems. One common mistake is assuming that "no news is good news." A quiet hotline may indicate that employees are not sufficiently aware of it or are leery of using it. If that is the case, it is important to take steps to boost employee confidence in the hotline. By far, the best way to ensure confidence in a company's reporting mechanisms is to take all complaints seriously and to respond in a manner that is swift, thorough and appropriate.

It is also important to ensure that reporting mechanisms are well-advertised by, for example, posting reminders in employee newsletters, sending ethics-related e-mails, or creating hotline posters. In these messages, companies should emphasize that a tipster can remain anonymous, that hotline reports bypass managers and supervisors and that the company will in no way retaliate against whistleblowers. It is also advisable to open alternative lines of communication, such as web-based reporting, in case some employees are more comfortable with or likely to use a different method.

### D. Take Complaints Seriously, Promptly Investigate, and Take Appropriate Action

While an effective compliance program can be a positive factor for a company facing an SEC or DOL enforcement action, evidence that an employer received a complaint but failed to take appropriate action can be equally harmful. It is well worth the time and cost for companies to use specially trained HR managers or experienced counsel to conduct a prompt, thorough investigation followed by appropriate action to address any problems. If no problems are found, the investigation and findings should be well-documented, with supporting evidence, in the event the matter nevertheless results in a federal agency investigation or claim.

### E. Prevent Retaliation

It is absolutely essential that no one retaliate against a whistleblower in any way and that managers and supervisors understand that retaliation can take many forms—not just a termination or demotion. Companies should ensure that their policies clearly articulate zero tolerance for any reprisals or retaliation against an individual who reasonably makes a complaint in good faith.

Now is the time for companies to embrace the whistleblower and to express appreciation when an employee uses internal reporting systems to expose suspicious or illegal conduct within the company. Companies may even go so far as to do "good

deeds" for a whistleblower. In addition to creating a culture where internal reports are encouraged, these "good deeds" may bolster a company's defense in a retaliation case by breaking the causal chain between protected activity and adverse action. Some companies are even considering offering their own financial and other incentives for good-faith whistleblowing. Such incentives may be viewed as a kind of "bonus" for an employee who has made an important contribution by spotting and reporting illegal or unethical conduct and as a necessary bulwark against the lure of big SEC bounty payments.

### F. Train Managers in Retaliation and Whistleblower Policies

Companies must train managers on three fundamental issues: (1) how to recognize whistleblower complaints; (2) how to respond to such complaints; and (3) how to avoid any retaliation against the individual who complained. Managers need to have enhanced awareness that when an employee reports possible ethical or other violations to them, they have a duty to involve both compliance and human resources immediately. This allows the company to address the substance of the report and to work with front-line managers to ensure that no retaliatory action is taken against the whistleblower.

### G. Take a Fresh Look at Retaliation and Whistleblowing Policies

Now is a good time to review and revamp an employer's slate of retaliation and whistleblowing policies. For example, consider adopting a policy that prohibits disclosure of confidential company information to outside entities other than those identified in the section of Sarbanes-Oxley (and incorporated into Dodd-Frank) regarding protected activity. Such a policy could prohibit disclosure of confidential company information to the media, without company approval. As discussed in a recent Littler ASAP,[55] the Ninth Circuit Court of Appeals recently held in *Tides v. Boeing Co.*[56] that the whistleblower provisions of SOX do not protect leaks of confidential company information to media organizations in violation of company policy. The *Tides* decision is just the latest in a number of decisions that show courts' willingness to support company policies prohibiting public disclosures of alleged company fraud rather than reporting through proper channels.

### H. Review Severance Agreements

Also, companies should be mindful of Dodd-Frank's whistleblowing and retaliation provisions when drafting severance and settlement agreements. Section 922 of the Dodd-Frank Act provides that "the rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment, including by a predispute arbitration agreement."[57] It is not yet clear what this prohibition will mean for the enforceability of releases of claims signed at the pre-filing stage (*i.e.*, severance agreements or settlements in response to demand letters) or post-filing stage. The final regulations also make clear that, except in the case of attorney-client relationships, a confidentiality agreement may not be used or threatened in a way that impedes an individual from reporting to the SEC.

## VII. CONCLUSION

There is no question that Dodd-Frank brought a sea change in corporate compliance mechanisms and the law of whistleblowing, the scale and significance of which have now been confirmed with the release of the SEC's final regulations implementing the law. The departure from reliance upon corporate internal complaint mechanisms also comes at a time when the DOL is taking a much more aggressive approach to enforcement in whistleblower cases. Under the Bush administration, Sarbanes-Oxley was something of a toothless tiger as very few claimants succeeded at the agency level. Between July 30, 2002, when SOX was enacted and June 7, 2007, the Administrative Review Board of the DOL had not found a single whistleblower case to have merit.[58] But things have changed. As mentioned earlier, the DOL's Administrative Review Board has already expressed its more expansive view of whistleblower protections under SOX in *Sylvester v. Parexel International, L.L.C,*[59] holding that simply making claims of general corporate fraud qualified as protected activity under SOX. This opinion represents a significant departure from previous SOX interpretations and dramatically expands the range of activity that may give rise to viable retaliation claims under Dodd-Frank as well.

In this environment, employers must prepare themselves for what undoubtedly will be an increase in whistleblowers and whistleblower retaliation claims in the wake of Dodd-Frank and its implementing regulations. The message of the Final Rules is—start now.

## VIII. ENDNOTES

1 http://www.sec.gov/foia/docs/oig-553.pdf.

2 17 C.F.R. pts. 240 & 249, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 ("Final Rules"), at 17. The Final Rules can be found on the SEC's website at http://www.sec.gov/spotlight/dodd-frank.shtml17.

3 Final Rules at 218.

4 *Id.* at 219.

5 *Id.* at 12.

6 *Id.* at 13.

7 *Id.*

8 *Id.* at 14.

9 Officers or other designated persons are not precluded from recovery as whistleblowers if they actually observe the violations rather than, for example, learning of them through an employee report. Also, notably, the SEC removed non-officer supervisors from the list of designated persons.

10 Final Rules at 59.

11 *Id.* at 145.

12 *Id.* at 74.

13 *Id.* at 145-146.

14 *Id.* at 193.

15 *Id.* at 195.

16 *Id.* at 194-195.

17 *Id.* at 195.

18 *Id.* at 80.

19 15 U.S.C. § 78u-6 (h)(1)(A).

20 Final Rules at 18.

21 *Id.* at 15.

22 ARB Case No. 07-123 (May 25, 2011).

23 Ken O'Brien & Greg Keating, *New SOX Decision Expands Scope of Protection to General Complaints of Corporate Fraud*, Littler ASAP (June 2011), *available at* http://www.littler.com.

24 15 U.S.C. § 78u-6 (h)(1)(A).

25 Final Rules at 17-18.

26 *Id.* at 18.

27 Under SOX, a whistleblower must file a complaint with the Department of Labor (DOL).

28 15 U.S.C. § 78u-6 (h)(1)(B)(i).

29 https://denebleo.sec.gov/TCRExternal/questionaire.xhtml.

30 Final Rules at 154.

31 *Id.* at 155.

32 *Id.*

33 *Id.*

34 *Id.* at 118.

35 *Id.* at 123.

36 Press Release, Association of Corporate Counsel Frustrated by Today's SEC Ruling on Whistleblowing Bounty Provisions of Dodd-Frank Law (May 25, 2011), http://www.acc.com.

37 Final Rules at 105.

38 *Id.* at 34.

39 *Id.* at 91.

40 *Id.* at 104.

41 *Id.*

42 *Id.* at 103.

43 *Id.* at 232, n.456.

44 *Id.* at 230, n.452.

45 *Id.* at 33.

46 *Id.* at 90-91.

47 *Id.* at 92, n.197.

48 *Id.* at 125.

49 *Id.* at 42.

50 *Id.* at 90.

51 *Id.* at 92.

52 *Id.*

53 *Id.* at 77.

54 *Id.* at 105.

55 Gregory Keating & Sarah Green, *SOX Protection Does Not Extend to Media Leaks, Ninth Circuit Rules*, Littler ASAP (May 2011), *available at* http://www.littler.com.

56 No. 10-cv-35238 (May 3, 2011).

57 18 U.S.C. § 1514A(e)(1).

58 D. Bruce Shine, "Pity the SOX Whistleblower; Pity the SOX In-House Counsel Whistleblower," 58 Lab. L.J. 228 (2007).

59 ARB Case No. 07-123 (May 25, 2011).

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