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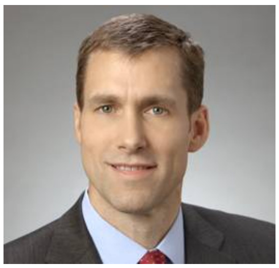
Despite Confusion Regarding Key Whistleblower Statutes, Companies Must Be Prepared



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Most everyone in corporate America is aware of the whistleblower provisions of the Sarbanes-Oxley Act of 2002 ("SOX") and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). Exactly who is a "whistleblower" under these statutes, however, is far from clear.

For example, what kind of complaints render one a whistleblower under SOX? Can employees of private entities be SOX whistleblowers? Must a Dodd-Frank whistleblower report his or her complaint to the SEC? Despite the high-profile nature of these statutes and years of litigation, regulators and federal courts continue to wrestle with these and other very fundamental aspects of both statutes.

The Sarbanes-Oxley Act

Section 806 of SOX, 18 U.S.C. 1514A protects individuals from retaliation because they have provided information or caused information to be provided or otherwise assisted in an investigation "regarding any conduct which the employee reasonably believes constitutes a violation of 18 U.S.C. 1341 [mail fraud], 1343 [wire fraud], 1344 [bank fraud], or 1348 [securities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of federal law relating to fraud against shareholders … ."[1] The remedies available to a SOX whistleblower are reinstatement, back pay with interest, and special damages, including litigation costs and attorneys fees.[2]

An employee alleging violations of Section 806 may file a complaint with the Secretary of Labor. After the Secretary has issued findings, the parties can seek a hearing before an administrative law judge and review by the Department of Labor's Administrative Review Board (ARB). SOX whistleblower claims can be filed in federal court only if the Secretary does not issue findings within 180 days of the filing of the claim.

One key point of contention is the amount of detail that a SOX whistleblower must provide to show a "reasonable belief" regarding a violation. For several years, whistleblowers were required to show that they "definitively and specifically" communicated a belief that the enumerated laws had been violated.[3] One court, for example, held that the whistleblower's described "reasonable belief" of a violation must "approximate the elements of securities fraud" including materiality.[4] Recently, the ARB rejected the "definitively and specifically" requirement.[5] Recently, appellate court decisions have granted deference to the ARB's new interpretation.[6]

Another even more fundamental question – whether SOX's whistleblower provisions apply to employees of

[1] 18 U.S.C. § 1514A(a)(1).
[2] 18 U.S.C. § 1514A(c).
[3] *Platone v. FLYI, Inc.*, ARB 04-154 (Sept. 29, 2006), *aff'd.* 548 F.3d 322 (4th Cir. 2008).
[4] *Day v. Staples*, 555 F.3d 42, 55 (1st Cir. 2009).
[5] *Sylvester v. Parexel Int'l LLC*, ARB No. 07-123, Slip Op. at 17 (May 25, 2011).
[6] *See, e.g., Wiest v. Lynch*, 710 F.3d 121, 134 (3d Cir. 2013*; Brown v. Lockheed*, 717 F.3d 1121, 1132 (10th Cir. 2013).

private companies – soon will be decided by the Supreme Court. SOX prohibits public companies "or any officer, employee, contractor, subcontractor, or agent of such company" from taking action against "an employee" who has engaged in protected conduct. The question is what type of "employees" are protected by this language. The ARB has held that employees of non-public companies are covered.[7] Recently, in *Lawson v. FMR LLC*, 670 F.3d 61 (1st Cir. 2012), the first appellate court to address the issue ruled that the provision does *not* extend protections to employees of private companies working pursuant to contracts with mutual funds that are public companies.[8] Despite that decision, the ARB since has held that an employee of a private accounting firm doing work pursuant to a contract with a public company was a covered employee under Section 806 when he reported misconduct at the publicly-traded company.[9]

The Supreme Court accepted certiorari of *Lawson*, and oral argument is scheduled for November 12, 2013.

The Dodd-Frank Act

The Dodd-Frank whistleblower provisions went much further than SOX. Section 922 of Dodd-Frank required the SEC to award eligible whistleblowers a bounty of 10 to 30 percent of the monetary sanctions recovered in SEC or related actions resulting from a whistleblower's information that result in monetary sanctions exceeding $1 million.[10] The information that a whistleblower provides must relate to "a violation of the securities laws."[11] The debate about which "employees" can be whistleblowers does not exist under Dodd-Frank; with a few exceptions almost anyone can be a whistleblower.[12] Dodd-Frank also allows whistleblowers who have been retaliated against to sue employers in federal court without first filing an administrative complaint.[13] And in addition to reinstatement, whistleblowers can recover up to twice their back pay with interest.[14]

Dodd-Frank required that the SEC pass rules implementing its whistleblower provisions. The SEC's proposed rules, which allowed whistleblowers to receive a bounty without raising complaints internally, were extremely controversial and generated a great deal of comment from interested parties. The business community, not surprisingly, believed that providing incentives for employees to blow the whistle to the SEC would undermine the progress that companies had made with respect to their own internal compliance programs and whistleblower hotlines. These criticisms were to no avail and, on May 25, 2011, the final SEC rules passed by a 3-2 vote.

While not requiring that a whistleblower first bring a matter to the company before reporting to the SEC, the SEC sought to provide incentive for whistleblowers to report internally. First, the whistleblower may be eligible for an award where the company reports to the SEC information received from the whistleblower. Second, the rules grant a 120-day grace period for the whistleblower to report to the SEC after having reported internally, during which time the individual would be deemed to have reported directly to the SEC at the same time the individual reported internally. Finally, the SEC, when considering an award to grant a

[7] *Funke v. Federal Express Corp.*, ARB No. 09-004, Slip Op. at 9-10 (July 8, 2011).
[8] *Lawson v. FMR LLC*, 670 F.3d 61 (1st Cir. 2012).
[9] *Spinner v. Laudau and Assoc., LLC*, ARB Case Nos. 10-111 and 10-115, Slip Op. at 16 (May 31, 2012).
[10] 15 U.S.C. § 78u-6(b)(1).
[11] 15 U.S.C. § 78u-6(a)(6).
[12] The key whistleblower exclusions include (1) officers, directors, trustees and partners of an entity who learn of misconduct; (2) individuals with compliance or audit responsibilities who receive information about potential violations; (3) attorneys who learn of potential violations in the course of legal representation; (4) accountants who obtain information while providing auditing services; and (5) individuals with pre-existing legal obligations to report information about potential violations.
[13] 15 U.S.C. § 78u-6(h)(1)(B).
[14] 15 U.S.C. § 78u-6(h)(1)(C). Dodd-Frank extended the period for whistleblowers to file SOX claims from 90 days to 180 days, provided for jury trials for SOX retaliation claims, and prohibited the use of pre-dispute arbitration agreements for matters that were subject to SOX retaliation claims. Perhaps most importantly, it extended SOX's whistleblower protections to employees of "any subsidiary [of a publicly-traded company] whose financial information is included in the consolidated financial statements of such company."

whistleblower, will consider whether the individual made use of internal compliance procedures.

The first significant litigated issue to arise under Dodd-Frank is whether a "whistleblower" is required to report information to the SEC. The statute's definition of "whistleblower" requires a person to provide information to the SEC, but the retaliation provisions protect "whistleblowers" from retaliation for making disclosures that are protected by SOX, which does not require reporting to the SEC. Several district courts have held that Dodd-Frank retaliation claims were available to an individual who engaged in protected activity under SOX, even if that individual did not provide information to the SEC.[15] In *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013), the first appellate court to consider the issue disagreed, holding that, to be a "whistleblower," the statute "expressly and unambiguously" requires that an individual provide information to the SEC. The Fifth Circuit declined to give deference to the SEC's rules, stating that allowing Dodd-Frank retaliation claims for simply making disclosures protected by SOX would render the SOX anti-retaliation provisions moot.

What Should Companies Be Doing?

The changes brought on by the Dodd-Frank Act and recent interpretations of SOX indeed are dramatic.[16] While the appropriate course depends on the size and nature of any organization, there are a few basic things that companies should think about with respect to whistleblowers.

Tone at the Top. Senior executives should support the company's policies and internal reporting system and encourage its use in visible ways. Consider holding an "Ethics Week," "Compliance Day," or some other event reflecting senior executives' commitment to compliance and the company's internal processes. Another potentially useful tool is a survey to gauge employees' attitudes regarding compliance issues and fear of retaliation if they reported potential violations.

Whistleblower Policies. The company should have policies and procedures, written in plain English, that describe how employees can internally report perceived violations. Hotlines are commonplace now, but companies should consider making those hotlines anonymous in order to encourage their use. Companies should also consider whether contractors, vendors, and others should be encouraged to use the hotlines to report potential violations. These policies should be publicized through multiple channels, including codes of conduct, intranets, and workplace posters.

Training. All employees should be trained regarding the company's commitment to integrity and internal complaint procedures. Companies should require employees to complete an annual training exercise and to certify electronically that they have done so.

Complaint Follow-up. How complaints are handled will depend on the size and sophistication of the company. Regardless of the size of the organization, the follow-up on the complaint should foster trust in a company's internal reporting system. Companies must respond in a timely fashion to any credible tips or complaints. A liaison should be selected to stay in contact with the person who made the complaint. Third-parties can provide administration over hotlines and similar procedures.

Do Not Retaliate. Avoiding retaliation can be easier said than done. Retaliation can take many different forms, and a lack of knowledge about the law can cause well-meaning managers and supervisors to take actions that look suspect in hindsight. Managers and supervisors should receive specific training regarding how to respond to whistleblower complaints. The fact that an employee engaged in protected conduct also should be kept confidential to the extent possible. Finally, it may be wise to involve human resources in a review of a whistleblower's performance evaluations to reduce the risk of a potential retaliation claim.

[15] *See, e.g.*, *Murray v. UBS Securities, LLC*, 2013 U.S. Dist. LEXIS 71954 (S.D.N.Y. May 21, 2013); *Kramer v. Trans-Lux Corp.*, 2012 U.S. Dist. LEXIS 136939 (D. Ct. Sept. 25, 2012); *Nollner v. Southern Baptist Convention, Inc.*, 852 F. Supp. 2d 986, 993-95 (M.D. Tenn. 2012).

[16] According to the SEC's Office of the Whistleblower, in the SEC's fiscal year 2012, the Office received 3,001 tips. As of the writing of this article, four awards have been made to whistleblowers under the program. The largest award to date is approximately $46,000.

Be Prepared. The need to act quickly is greater with the advent of the Dodd-Frank bounties. If the whistleblower has not reported to the SEC, a prompt and thorough investigation could head off a report to the SEC. Companies should have plans in place regarding who will conduct the review, whether outside counsel will be involved, and how the results of that review will be implemented. Depending on an organization's size, multiple departments may need to be involved. For example, human resources, compliance, and legal functions may need to coordinate a comprehensive approach to dealing with whistleblowers.

Consider Self-Reporting. If the company has reason to believe the SEC either is aware or may become aware of the complaint, it may be in the company's best interest to promptly investigate the matter and discuss it with the SEC. It often is better to report a matter to the SEC directly than to allow the SEC to first hear from a whistleblower. The SEC rules invite companies to self-report findings, but recognize that a company may not have completed its own internal investigation within 120 days. Thus, the SEC encourages companies to communicate with the SEC staff and suggests that the staff may wait for the results of the company's internal investigation before deciding whether and how to investigate the matter on its own.

Rewarding Whistleblowers. Most companies are not financially able to match the potential bounties that are available through the SEC's whistleblower program. Yet rewarding good faith whistleblowers is a visible way to make a statement about a company's commitment to compliance and ethics. Whistleblowers could be recognized through a letter of commendation or some other form of recognition made known to their peers. Some companies may publicize their internal processes by providing examples of complaints and the company's response to those complaints by intranet or some other mechanism.

Last Word: Restrictive Settlement Agreements for Whistleblowers

The SEC's rules prohibit "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing or threatening to enforce, a confidentiality agreement … with respect to such communications."[17] But how far employees can go without running afoul of these rules is unclear. For example, in exchange for a severance package, can employees renounce their right to receive an award from the SEC? Can a company require the employee to disclose to the company any communications the employee has with the SEC? Can the severance agreement require the employee to cooperate with the company in any SEC investigation that may arise?

The SEC has brought no cases based on such agreements, but the SEC's Whistleblower Chief, Sean McKessey, said in 2012 that his office will be scrutinizing potentially "aggressive" employment and severance agreements.[18] Mr. McKessy has declined to specify what agreement language might be problematic, but he said: "If you're dissuading or prohibiting individuals from reporting to us, you're violating the rules."[19]

Conclusion

While the correct interpretation of certain SOX and Dodd-Frank whistleblower provisions remains uncertain, one fact is not debatable: the landscape has changed and whistleblowers have more incentive than ever to bypass internal reporting procedures. Companies should continue to work on compliance efforts generally and do all they can to encourage internal reporting. When investigating complaints, the possibility that the SEC may already be aware of the matter adds another layer of complexity to the situation. Companies need to be prepared to act quickly to handle whistleblower allegations and respond appropriately and strategically to reduce risk to the organization, while at the same time being sure to avoid retaliation claims.

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[17] SEC Rule 21F-17.
[18] *Susan Beck's Summary Judgment: SEC's Whistleblower Chief Disappointed in Questions from Corporate America,* The American Lawyer (Nov. 26, 2012).
[19] *Id.*