

Reproduced with permission from Daily Labor Report, 196 DLR I-1 , 10/11/2011. Copyright © 2011 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

## WHISTLEBLOWERS

The protections and incentives for whistleblowers provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act will result in a significant increase in whistleblower activity and, by extension, will have a huge impact on the workplace environment, attorneys Tammy Marzigliano of Outten & Golden and Jordan A. Thomas of Labaton Sucharow say in this BNA Insights article.

The authors examine the protections provided by the statute and offer practical guidance for plaintiffs' employment lawyers in identifying and counseling potential SEC whistleblowers.

### Advocacy & Counsel for the SEC Whistleblower: A Primer for Employment Lawyers

By TAMMY MARZIGLIANO AND JORDAN A. THOMAS

In the wake of multiple far-reaching corporate scandals and pervasive misconduct that have eroded public faith in the markets, Congress enacted the whistleblower provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>1</sup> The provisions require the SEC to pay financial awards to whistleblowers who voluntarily provide original information leading to a judicial or administrative action in which the SEC obtains monetary sanctions over \$1 million, sub-

ject to certain limitations. Whistleblowers who provide such information are eligible for an award of 10 percent to 30 percent of the monetary sanctions.<sup>2</sup>

Since the enactment of the whistleblower provisions, there has been undue emphasis on the financial incentives available to qualified SEC whistleblowers. However, the new robust anti-retaliation provisions contained in the guidelines are equally important. Employers are prohibited from retaliating against individuals who provide the SEC with information about possible federal securities law violations, and victims of retaliation are granted an independent cause of action with significant potential remedies. Providing additional protection, whistleblowers are also permitted to report securities violations anonymously if they are represented by counsel.

These protections and incentives will result in a significant increase in whistleblower activity and, by extension, will have a huge impact on the workplace environment. This article examines the protections provided by the statute and offers practical guidance for

<sup>1</sup> 17 C.F.R. § 240.21F-1, et seq.

*Tammy Marzigliano, a partner at Outten & Golden LLP, represents employees in litigation and negotiation in all areas of employment law. She is co-chair of the firm's Financial Services Practice Group and its Whistleblower and Retaliation Practice Group. Jordan A. Thomas is a partner at Labaton Sucharow LLP and serves as chair of its Whistleblower Representation Practice. A former assistant director and assistant chief litigation counsel at the Securities and Exchange Commission, Jordan played a leadership role in the development of the agency's Whistleblower Program.*

<sup>2</sup> This article focuses on how best to represent whistleblowers who have information about possible violations of the securities laws. However, Dodd-Frank also amended the Commodity Exchange Act to protect and encourage whistleblowers to report CFTC violations. Accordingly, since the CFTC whistleblower provisions and implementing rules closely mirror the SEC's, the guidance in this article also applies to the CFTC whistleblower program.

the plaintiff's employment lawyer in identifying and counseling potential SEC whistleblowers.

### **Identifying the SEC Whistleblower Client: What Violations Meet the Standard?**

Any violation of the federal securities laws qualifies for protection under Dodd-Frank. The reported violation may have occurred anywhere in the world, involving public or private organizations and domestic or international violators. In most cases, securities fraud occurs when manipulative and deceptive practices are employed in connection with the purchase and sale of a security. Beyond stocks and bonds, the federal securities laws have interpreted "security" broadly to include investment contracts, notes, and other nontraditional investments.<sup>3</sup> Common securities violations that may lead to SEC investigations and whistleblower awards include misrepresentation or omission of important information about securities, manipulating the market prices of securities, stealing customers' funds or securities, violating broker-dealers' responsibility to treat customers fairly, insider trading, selling unregistered securities, and bribing foreign officials.

---

### **Employment lawyers should consider a new intake protocol to identify potential SEC whistleblowers and provide appropriate counsel.**

---

This broad scope of eligibility has a direct impact on case evaluation. Traditionally, in evaluating cases, employment lawyers have focused on the conduct of the employer toward a specific employee, or towards a group of similarly situated employees. Although this approach may be effective in analyzing potential state and federal employment violations, it is inadequate for identifying possible securities violations and related eligibility as a whistleblower under Dodd-Frank. To this end, employment lawyers should consider a new intake protocol to identify potential SEC whistleblowers and provide appropriate counsel. Some easy to implement steps include:

- Ask whether the client or potential client knows, suspects, or has heard that their employer or any other individual or organization has or is engaged in misconduct. This inquiry should not be limited to securities violations insofar as many employees will not know what constitutes a securities violation. Moreover, many securities violations do not initially appear to involve securities. For instance, if a company systematically disposed of hazardous waste in violation of state and local laws, most clients would not associate the misconduct with a securities violation. However, this conduct could in fact constitute a federal securities law violation depending upon the seriousness of the violation, whether the company's stock traded on a U.S. exchange and how the violation impacted the company's financials, among other factors.

---

<sup>3</sup> See, e.g., 17 C.F.R. § 240.3a-10.

- If the client or potential client reports a possible violation, flesh out the details with open-ended questions and seek documents and potential witnesses to corroborate the report. In fraud actions, a plaintiff must plead scienter, which refers to "a mental state embracing intent to deceive, manipulate or defraud." Accordingly, it is important to attempt to elicit facts about whether the violators knew or were reckless in their conduct.

- Where possible violations have been reported, determine whether investor funds are or were involved, if the violator is regulated by the SEC, and if stock traded or currently trades on any U.S. securities exchanges. Although these factors are not required to establish a securities violation, one or more of them are often present in SEC enforcement actions.

### **Who Is a Whistleblower? Qualifying for Retaliation Protections Under Dodd-Frank**

Under Dodd-Frank, a whistleblower is any individual or group of individuals that possess a reasonable belief that the information reported to the SEC, pursuant to its procedures, involves a possible violation of the federal securities laws that has occurred, is ongoing, or is about to occur. Similar to the interpretation of other whistleblower statutes, "reasonable belief" requires the whistleblower to genuinely believe, as any similarly situated employee would, that the reported conduct constitutes a possible securities violation. In addition, the source of the whistleblower's information can come from independent knowledge or analysis. The SEC implementing rules authorize submissions of information that would otherwise constitute hearsay evidence.

Qualifying as a whistleblower under Dodd-Frank can be complicated—especially when seeking a whistleblower award. However, the anti-retaliation provisions under Dodd-Frank apply to a whistleblower regardless of whether the whistleblower is ultimately entitled to a financial award. To qualify for the anti-retaliation protections of Dodd-Frank, whistleblowers are only required to report possible securities violations online or by submitting a Form TCR in accordance with SEC rules.<sup>4</sup> It is critically important that employee advocates understand that despite the financial incentives offered by the SEC, internal reporting does not entitle an individual to the anti-retaliation protections of Dodd-Frank. Accordingly, based upon the unique facts and circumstances of each client's case, counsel should carefully consider whether and when a whistleblower submission would be advantageous for their client.

### **Does Dodd-Frank Provide the Best Protection?**

Dodd-Frank not only provides robust whistleblower protection, but it has revived pre-existing whistleblower claims. The False Claims Act (FCA), once limited to individuals who were "original sources" with "direct and independent knowledge," has been expanded to cover individuals with either information or analysis.

Section 1079(b) of Dodd-Frank amends the FCA by expanding the concept of protected activity 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

---

<sup>4</sup> See 17 C.F.R. § 240.21F-9(a).

of [the False Claims Act].” As a result, the FCA now encompasses a more expansive range of activities that could further a potential qui tam action, including protections against associational discrimination.

Similarly, the Sarbanes-Oxley Act (SOX) now appears to have the teeth it was intended to have. Dodd-Frank expanded SOX by extending coverage beyond just public companies to employees of affiliates and subsidiaries of publicly traded companies “whose financial information is included in the consolidated financial statements of such publicly traded company.”<sup>5</sup> Included in this measure are foreign subsidiaries and affiliates of U.S. public companies;<sup>6</sup> Dodd-Frank provides extraterritorial reach in actions brought by the SEC and the Justice Department.<sup>7</sup> Furthermore, Dodd-Frank took a short 90-day statute of limitation and expanded it to 180 days (and though while still short, doubles the allotted time). It also provides for independent jurisdiction of a jury trial for claims brought under SOX whistleblower protections.

Dodd-Frank grants a private right of action in federal court and, in contrast to SOX’s previous requirements, the employee need not exhaust administrative remedies before filing in federal court.<sup>8</sup> To protect whistleblowing employees, the employee may remain anonymous until an award is made if she/he is represented by counsel. Under Dodd-Frank, an employer may not take retaliatory action against an employee who provides information to the SEC, initiates, testifies in, or assists in an investigation or judicial or administrative action, and makes disclosures that are required or protected under the law.<sup>9</sup> Retaliatory acts by employers include discharge, demotion, harassment, suspension, threats, and other discrimination as a result of any lawful act by the whistleblower.<sup>10</sup> Dodd-Frank expanded the statute of limitations to six years from the retaliatory conduct or three years upon discovery of the conduct.<sup>11</sup> Remedies were also expanded to include double back pay and litigation costs (including expert witness fees).<sup>12</sup>

Without the Dodd-Frank Act, these statutes would have remained lifeless. Dodd-Frank not only revived these familiar federal statutes, but it created additional whistleblower protections.

Dodd-Frank granted new protections for employees who report possible violations of the Securities Exchange Act and Commodity Exchange Act. Whistleblowers that bring violations to the SEC or the CFTC are granted a private right of action in federal court as long as they bring their claim within two years from the date of the retaliation.<sup>13</sup>

## The Function and Scope of Bureau of Consumer Financial Protection

Congress also expanded coverage to financial service employees by creating a Bureau of Consumer Financial Protection to protect whistleblowing employees from retaliation. Employers covered as “financial products or

services” include: any company that extends credit or service or broker loans; provides real estate settlement services or performs property appraisals; provides financial advisory services to consumers relating to proprietary financial products (including credit counseling); and collects, analyzes, maintains, or provides consumer report information or other account information in connection with any decision regarding the offering or provision of consumer financial product or service.<sup>14</sup>

The prohibited retaliatory conduct provided for by Dodd-Frank is broadly defined. Employees who work for such companies cannot be retaliated against for testifying or being willing to testify in a proceeding for administration or enforcement of Dodd-Frank; filing, instituting or causing to be filed or instituted, any proceeding under any federal consumer financial law; and objecting to, or refusing 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 the bureau.<sup>15</sup>

Filing a retaliation claim with the bureau only requires an employee to show (by a preponderance of the evidence) that the protected conduct was a “contributing factor” to the retaliation.<sup>16</sup> If shown, the burden shifts to the employer to show (by clear and convincing evidence) that it would have taken the same action in the absence of the employee’s protected activity.<sup>17</sup> The process for filing claims follows the framework for retaliation claims brought under the Consumer Product Safety Improvement Act of 2008.<sup>18</sup>

## Negotiating Settlements: Key Considerations

To effectively negotiate a claim covered by Dodd-Frank, employee advocates must be aware of the numerous changes made to existing whistleblowing laws in order to competently evaluate any offer and implement an effective strategy. Some important considerations:

- **No Rush to Settle:** The urgency that once plagued advocates to either settle or file has been mitigated by Dodd-Frank’s longer statute of limitations (three months under SOX but six years from the retaliatory conduct or three years upon discovery of the conduct under Dodd-Frank).

- **Don’t Sell Yourself Short:** These claims are now worth substantially more due to the expanded back pay awards of double damages. Make sure when you negotiate you understand the true value of the claims.

- **Release of Rights:** Be aware that Dodd-Frank invalidates any “agreement, policy form, or condition of employment, including a pre-dispute arbitration agreement” that has the effect of waiving rights and remedies available to whistleblowers.<sup>19</sup> Make sure there is a carve-out in the settlement agreement for these claims.

- **Confidentiality Provisions:** The SEC implementing rules expressly state that “[n]o person may take any ac-

<sup>5</sup> Id. at Section 929(a).

<sup>6</sup> Id. at Section 929P(b).

<sup>7</sup> Id. at Section 929P(c).

<sup>8</sup> Id. at Section 922 (h)(1)(A)(i)-(iii).

<sup>9</sup> Id.

<sup>10</sup> Id. at Section 922 (h)(1)(A).

<sup>11</sup> Id. at Section 929(a); Section 922(h)(1)(B)(iii).

<sup>12</sup> Id. at Section 922(h)(1)(C)(i)-(iii).

<sup>13</sup> Id. at Section 748(h)(1)(C).

<sup>14</sup> Id. at Section 1002(15)(A).

<sup>15</sup> Id. at Section 1057(a)(1)-(4).

<sup>16</sup> Id. at Section 1057(c)(3)(c).

<sup>17</sup> Id.

<sup>18</sup> 15 U.S.C. § 2087 (claims filed with the Labor Department’s Occupational safety and Health Administration within 180 days).

<sup>19</sup> Id. at Section 922(c).

tion 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.”<sup>20</sup> This is another potential carve-out in a settlement agreement.

■ **Nondisparagement Provision:** This provision becomes tricky in light of the Dodd-Frank provisions stated above, as an employer may believe it is “disparaging” for an ex-employee to allege that the company committed fraud, for example. It is important to insert carve-out language in this section too.

■ **Cooperation Provisions:** These are rather typical in settlement agreements, but it is important to make sure that embedded in this section is a “reasonable” factor.

■ **Indemnification:** This needs to be examined on a case-by-case basis, but if the employee had a hand in the wrongdoing, you should seek an indemnification provision.

Accordingly, any settlement agreement must be drafted and reviewed with Dodd-Frank in mind, including confidentiality agreements and nondisparagement clauses that expressly exclude the rights and remedies provided for by the act. Because Dodd-Frank provides additional retaliation causes of action, express language carving out the act is necessary to best protect employee interests.

### When to Seek Help

Without question, the SEC whistleblower guidelines are complex, encompassing a broad scope of conduct undertaken by a broad range of violators. Understand-

ing who is a whistleblower, where there are exceptions, and how best to advocate for their interests, is extremely nuanced. Further complicating the calculus, in establishing the Bureau of Consumer Financial Protection, Dodd-Frank added a new player to the whistleblower arena, requiring that advocates broaden their engagement to effectively represent clients. An additional minefield, though not addressed here, involves how to handle cases in which the client or potential client may have criminal or civil liability for the reported misconduct.

Given the complexity and variety of statutory whistleblower protections and incentives, employee advocates may wish to secure counsel or partner with experienced securities and employment attorneys who routinely litigate in this area. By tapping into the knowledge base of these legal specialists who are familiar with the claims processes, rewards, damages, statute of limitations, and defenses under the whistleblower program, employee advocates will position themselves—and their clients—for success.

### A New Regulatory Framework, A New Workplace Environment

The Dodd-Frank Act harkened a new era in the government’s fight against corporate malfeasance by greatly expanding whistleblower protections to include mandatory rewards, greater coverage for financial services workers and commodities violations, and expanding FCA protections. It is safe to assume that these new provisions will have a monumental impact on the global workplace. By understanding the remedies and protections available under the new SEC whistleblower program, attorney advocates will be better positioned to successfully guide their clients through this new, complex, and revolutionary terrain.

<sup>20</sup> 17 C.F.R. § 240.21F-17.