Whistleblower Incentives and Protections in the Financial Reform Act

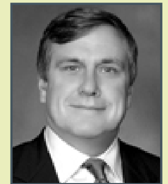
Employers subject to the regulations of the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) should be aware that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act) was recently passed in Congress and signed by the President on July 21, 2010. The Act will create new financial incentives and protections for employees who disclose information about alleged violations of commodities and securities laws that subsequently lead to successful SEC or CFTC enforcement actions. Protections also are provided to employees of providers of consumer financial products and services that report violations of consumer financial protection laws and regulations. Each of these provisions must be implemented by the SEC, the CFTC, and the newly created Consumer Financial Protection Bureau (the Bureau) through the rulemaking process within 270 days of the enactment of the legislation.

Financial "Bounties" for Employees to Disclose Information

Spurred by the perceived failures of regulatory agencies to discover improprieties in the securities and commodities markets, Congress sought to create a whistleblower program to incentivize individuals to assist with government investigations. The Act would authorize the CFTC and SEC to provide monetary rewards to whistleblowers who provide "original information" that assists in a successful enforcement action under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 leading to the recovery of greater than US$1 million in aggregate. These provisions would authorize the agencies to pay bounties ranging, at their discretion, from a minimum of 10 percent to a maximum of 30 percent of the total collected monetary sanctions from a corporation to any individual or group that discloses such "original information."

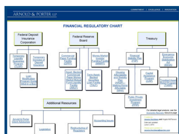
These new monetary incentives will likely increase the number of employees who report information to the SEC or CFTC; they provide a financial award for any fruitful tips and, in combination with the additional protections discussed in this advisory, may offset the perceived risk to employees of filing reports that might have otherwise jeopardized their current or future employment.

Contacts



Drew A. Harker
+1 202.942.5022

Matthew D. Keiser
+1 202.942.6398



Financial Regulatory Chart

Financial Regulatory Reform: *For Arnold & Porter's latest resources on this topic including Advisories, upcoming events, publications, please visit Financial Regulatory Reform. Also visit our Financial Regulatory Chart, which aggregates information on US government programs.*

Whistleblowers are allowed to make their initial reports on an anonymous basis if they are represented by counsel, and the SEC and the CFTC are prohibited from disclosing any information "which could reasonably be expected to reveal the identity of a whistleblower." In addition to these provisions, the SEC Enforcement Division has recently adopted a range of new tools designed to encourage individual cooperation with SEC investigations, ranging from the adoption of criteria to evaluate cooperation by individuals to deferred and non-prosecution agreements to facilitation of immunity requests.

Congress modeled the new whistleblower program after the successful Internal Revenue Service (IRS) Whistleblower Program, created in 2006, which mandated a minimum award percentage for successful tips and led to an increase in the number of tips received by the IRS regarding violations of tax laws. This new program has also been compared to the qui tam provisions of the False Claims Act, under which there have been large settlements in areas such as healthcare. There is certainly the potential that the program could be a boon to law enforcement in connection with laws such as the Foreign Corrupt Practices Act, under which there have been numerous recent large settlements. Given the key role of counsel in protecting the identity of the whistleblower, it is not unreasonable to expect that qui tam relators counsel, who have profited handsomely from the False Claims Act, will see this as a new opportunity for additional clients.

Prohibition on Reprisal for Employee's Disclosure of Alleged Wrongdoing

Further encouraging employees to report allegedly improper actions by their employers, the Act expands on whistleblower protections in the Sarbanes-Oxley Act (SOX) by prohibiting employers from retaliating against employees who have acted lawfully in providing information to the SEC or CFTC about alleged commodities and securities violations. Employers would be barred from firing, demoting, or otherwise discriminating against an employee based on that employee's lawful disclosure of information or assistance with an investigation of either the SEC or the CFTC.

Under the Act, employees who have been discharged or discriminated against are given a private right of action to sue their employers for retaliation. Unlike the SOX whistleblower provisions, the Act does not require the exhaustion of administrative remedies. While the precise type of violation necessary to trigger the statute of limitations lacks clarity in the Act's language, the Act appears to permit an employee who alleges that he or she suffered an adverse employment action based on providing information to or assisting the SEC or CFTC to file a complaint directly in federal court if the employee reported the alleged violation (1) to the CFTC, for a period of up to two years after the alleged retaliatory act transpired; or (2) to the SEC, the later of (a) six years after the alleged retaliatory act, (b) three years after the employee reasonably should have discovered the retaliatory act, or (c) no later than 10 years after the alleged violation of the securities laws. These limitations periods are significantly longer than provided for in the SOX whistleblower provisions.

An employer found liable for retaliating against a whistleblowing employee could be ordered to pay substantial damages and take certain actions including:

- Reinstating the employee with the same seniority status that the employee would have had if the alleged discrimination had never occurred;
- Paying the employee back pay with interest for claims relating to commodities violations or double back pay (i.e., twice the amount in the SOX provision) with interest for claims relating to securities violations; and
- Compensating the employee for litigation costs, expert witness fees, and reasonable attorneys' fees.

Finally, the provisions require that the SEC and/or CFTC hold all information provided by a whistleblowing employee in strict confidence. This stipulation may be particularly burdensome to employers as an employee suing under the Act retains his or her right to sue under any other applicable state or federal law, without such claim being preempted.

Consumer Financial Services Employee's Protection from Retaliation

Aside from creating the private right of action for whistleblowers, the Act creates protections for employees of providers of consumer financial products and services that will be regulated by the Bureau. Specifically, under the title providing for the creation of the Bureau, a consumer financial services employee may file a complaint with the US Department of Labor (DOL) against his or her employer if he or she believes that he or she has been discharged, demoted, or otherwise discriminated against for:

- Providing information, directly or indirectly, to the employer, the Bureau, or any other government authority relating to any violation of any law or regulation subject to the jurisdiction of the Bureau;
- Testifying in enforcement proceedings;
- Filing or instituting any proceeding under any federal consumer financial law; or
- Objecting to participate in any activity that he or she reasonably believes to be a violation of a law or regulation enforceable by the Bureau.

Such a complaint must be filed with DOL within 180 days of the adverse employment action. The Secretary of Labor shall investigate the matter so long as the employee plausibly asserted that one of the four protected activities contributed to the discharge or discrimination and the employer cannot satisfy the high burden of proving that it would have taken the same action regardless of the employee's participation in that protected activity. If the Secretary finds a violation, he or she has the power to order remedies, including ordering the employer to abate the reprisal, to reinstate the employer to his or her previous position and providing the employee with missed compensation and benefits from the reprisal period, and ordering the employer to pay compensatory damages.

Additionally, the complaining employee will accrue a private cause of action within 90 days of receiving a written determination or if the Secretary fails to issue an order within 210 days of the submission of the complaint. The complaining employee will be allowed to file a private civil lawsuit in federal district court to seek compensatory damages and other relief. The case would be a de novo action, meaning that the federal court would look at the issue without regard to any prior findings by the Secretary of Labor. Federal district courts have jurisdiction to hear all cases arising out of this whistleblower provision without regard to the amount in controversy, and the employee or the employer may elect to have the case tried before a jury.

Liability for a Subsidiary's Actions under the Sarbanes-Oxley Act

In addition to creating its own new protections for whistleblowers, the Act also reinforces whistleblower provisions of SOX. SOX contains a provision providing whistleblower protection from retaliation for employees of publicly traded companies who have provided the SEC with information relating to securities fraud. The new legislation confirms those protections extend to the employees of subsidiaries "whose financial information is included in the consolidated financial statements of [a publicly] traded company" rather than merely direct employees of the publicly traded companies.

The statute is now clear that a subsidiary may not terminate or otherwise discipline an employee who has provided information to the SEC, federal prosecutors, or Congress. If the employee sues, the company may be forced to provide back pay, reinstate the employee, and pay the employee's attorney and court costs. Thus, public companies should carefully monitor proper compliance with SOX's whistleblower provisions by their subsidiaries.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

Drew A. Harker
+1 202.942.5022
Drew.Harker@aporter.com

Matthew D. Keiser
+1 202.942.6398
Matthew.Keiser@aporter.com

Sionne C. Rosenfeld
+1 202.942.6104
Sionne.Rosenfeld@aporter.com

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