Dodd-Frank: Picking Up Where SOX Fell Short

by Lynne Anne Anderson and Meredith R. Murphy

Retaliation continues to be the most prevalent employment litigation claim. The passage of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[1] further expands protection for whistle-blowers.[2] Yet, while there has been an undeniable trend to provide alleged whistle-blowers increased opportunity and incentive to file claims, the legislation and resulting regulations still provide core defenses that will continue to resonate with fact finders, whether administrators, judges or juries.

Dodd-Frank's Expansion of SOX

In 2002, Congress passed the Sarbanes-Oxley Act (SOX)[3] in response to Enron and other scandals. SOX encouraged employee reporting of fraud and securities-related violations as a means to protect shareholders from losses due to financial misconduct. Despite the initial ominous predictions of SOX opening the litigation floodgates and having whistle-blower claims irreparably damaging corporate reputations, employers have been relatively successful in defending SOX claims. As expected, the plaintiffs' bar vociferously complained that SOX protections needed reinforcement. The tipping point came with the 2009 financial crisis. As a result, Congress passed Dodd-Frank in 2010.

The most publicized aspect of Dodd-Frank is the 'bounty' provision. Section 922 amends the Securities Exchange Act to require the Securities and Exchange Commission (SEC) to pay an award to individuals who provide "original information" to the SEC regarding *all* securities laws, including violations of the Foreign Corrupt Practices Act, that lead to imposition of sanctions in excess of a million dollars. The bounty reward is substantial: The SEC has the discretion to award the whistle-blower up to 30 percent of the total amount of sanctions imposed.[4]

However, for employment lawyers Dodd-Frank's impact on retaliation litigation is the real news. Dodd-Frank undercuts key defenses previously available to employers in SOX litigation. For example, employers successfully defended SOX claims on the basis of statutes of limitations and failure to exhaust administrative remedies. In response, Dodd-Frank extended from 90 to 180 days the time for financial services employees to file a SOX complaint with the Occupational Safety and Health Administration (OSHA).[5]

On another front, although SOX covers publicly traded companies, it generally did not extend to private subsidiaries/affiliates. Dodd-Frank expands SOX to cover the private subsidiaries or affiliates of publicly traded companies whose financial information is included in consolidated financial statements.[6] In addition, while SOX whistle-blowers could file in federal district court if the Department of Labor (DOL) did not issue a final administrative order within 180 days, they did not have a clear right to a jury trial. Dodd-Frank provides that right.[7]

Dodd-Frank also prohibits pre-dispute arbitration agreements, as well as other waivers of SOX rights.[8] As the courts begin to issue rulings, a split in authority has already emerged regarding the retroactivity of Dodd-Frank's ban on pre-dispute arbitration agreements. In March 2011, in *Pezza v. Investors Capital Corp.*, a decision issuing from the District of Massachusetts, the court concluded that the arbitration bar has retroactive applicability, finding Congress considered the potential unfairness of retroactive application but nonetheless determined that it is an "acceptable price to pay for the countervailing benefits."[9] However, the District of Nevada and Southern District of Texas reached different conclusions in *Henderson v. Masco Framing Corp.*[10] and *Holmes v. Air Liquide USA LLC*.[11] Both of these decisions found that retroactive application of the arbitration bar would impair the rights of the parties who had previously agreed to arbitrate SOX claims.

Dodd-Frank's New Private Rights of Action

Not only does Dodd-Frank expand protections for SOX whistle-blowers, it affords a new private right of action to employees of *all* employers who believe they suffered an adverse employment action because they provided information to the SEC, participated in a SEC investigation or proceeding based on information provided by the employee, or engaged in any protected activity under SOX.[12] Moreover, employees in such actions are not required to exhaust administrative remedies as mandated by SOX, and can directly file in federal court.[13] And there is an expansive statute of limitations under which employees may file within six years after the violation occurred, or three years after they knew or reasonably should have known of material facts, provided the complaint is filed within 10 years of the alleged violation.[14]

In Section 1057, Dodd-Frank also creates a private cause of action for financial services employees who suffer adverse employment actions because of reporting suspected unlawful conduct related to provision of consumer financial products or services.[15] Financial services employees who claim retaliation under Section 1057 have 180 days to file a claim with the Occupational Safety and Health Whistleblower Protection Program, and can then remove the claim to federal court if the DOL fails to issue a final order within 210 days of filing. The Section 1057 anti-retaliation provisions apply to companies that extend credit, service or broker loans, provide financial advisory services, real estate settlement services or property appraisals, or work with consumer financial products or services.

An area of emerging litigation is the question of what constitutes "providing information" to the SEC, federal authority or law enforcement. In *Egan v. Trading Screen, Inc.*,[16] the Southern District of New York applied a very expansive interpretation. The reported facts show that Egan, the employer's head of U.S. sales, did not personally report to the SEC, but instead made an internal complaint about financial misconduct by the CEO that was subsequently investigated by a law firm hired by the board of directors. Egan was interviewed, and it appears the law firm then decided to report some of the information he provided to the SEC. Egan then argued in his whistle-blower action that the law firm's ultimate disclosure to the SEC of information he provided qualified him as a whistle-blower under the act.[17] The employer argued that the absence of reference to such indirect reporting in the statute indicated a lack of legislative intent to cover an internal complaint.

The court did not disagree, but nevertheless held that the requirement to directly report conflicted with Dodd-Frank's general protection of whistle-blower disclosures that do not require direct reporting to the SEC.[18] The court concluded Egan was not required to personally report to the SEC, and he "acted jointly" with the investigating attorneys in an effort to provide information to the SEC regarding the CEO's alleged misconduct. The court ultimately dismissed Egan's claim, without prejudice, because he did not specifically allege the law firm had actually reported the CEO's misconduct to the SEC. However, the court gave Egan the opportunity to refile to include that allegation.

SEC Final Rules

As required by the Dodd-Frank Act, the SEC and Commodities Futures Trading Commission (CFTC) have adopted final rules implementing whistle-blower programs and anti-retaliation protections.[19] During the comment period, concerns were raised that employees were being incentivized to report potential violations to the SEC rather than to their employers. In response, provisions were added to encourage internal reports, including giving the SEC discretion to reduce a bounty award if the employee failed to make use of an employer's internal compliance procedures.[20] However, the regulations still do not require whistle-blowers to first report internally. Moreover, Dodd-Frank whistle-blowers may internally report perceived violations and still be bounty-eligible if they also report to the SEC within 120 days.[21]

When defining a "possible violation," the SEC refused to require that the potential violation be "material." Instead, it adopted the more lenient standard that the information "should indicate a facially plausible relationship to some securities law violation," but also included the "gate keeping" language that "frivolous submissions would not qualify for whistle-blower status."[22]

The regulations also address defenses common to retaliation claims. For example, to satisfy the "reasonable belief" component, the employee must demonstrate a subjective, genuine belief that the information reveals a possible violation, and this belief must be one a similarly situated employee might reasonably possess.[23] In addition, consistent with the legal premise that whistle-blower status should not be conferred on any employee whose job it is to identify, investigate and respond to internal concerns/complaints, the regulations specify that individuals will not qualify as whistle-blowers if they are senior personnel or other individuals who are responsible for compliance or internal audits, or for performing investigations of reported concerns.[24] Also, employers still have an opportunity to obtain summary judgment dismissal of these cases when the facts clearly demonstrate a reason other than retaliation was the basis for the adverse or "unfavorable" personnel action.

Expanded Whistle-Blowing Protection for Healthcare Employees

Section 1079B of Dodd-Frank expands the scope of protected activity and protected individuals covered by the False Claims Act's (FCA) anti-retaliation provision.[25] The FCA provides that employees of healthcare providers who receive reimbursements via Medicare or Medicaid, who perceive their employer has committed financial fraud against the government, may file a "qui tam" action on behalf of the government, and are then entitled to a percentage of any recovery, typically between 18 and 25 percent. Section 1079B amends the FCA to broaden the definition of potential whistle-blowers. Current and former employees, as well as vendors/independent contractors, are covered.

While FCA only applies to financial fraud committed against the government, Dodd-Frank applies to any type of financial fraud committed by a company that falls within the jurisdiction of the SEC or CFTC, including claims for mischarging for goods or services not provided, off-label marketing of pharmaceuticals, and defective pricing.

Dodd-Frank also provides, in response to a recent U.S. Supreme Court ruling that required plaintiffs to apply the most closely analogous state statute of limitations, that an employee has up to three years to bring a civil action for retaliation under the FCA.[26]

The Practical Impact of Dodd-Frank on Company Operations

While Dodd-Frank does not impose new obligations to establish codes of conduct or ethics programs, such programs are still mandated by SOX. Also, it is important to remember that Dodd-Frank's whistle-blower protections are not limited to financial institutions. To encourage self-reporting, and limit liability, employers should adopt and implement codes of conduct/compliance programs for all employees, and emphasize that all employees should feel comfortable reporting questionable behavior without fear of retaliation. An open-door corporate culture, responsive to internal complaints, clearly protects against retaliation claims filed by disenfranchised and maligned employees. Equally important, such a culture allows companies to proactively identify and self-report violations of criminal laws, such as the Foreign Corrupt Practices Act, fraud and abuse laws, etc. In addition, the Department of Justice will consider the presence of an effective corporate compliance program in evaluating an action in response to criminal misconduct by employees. For purposes of evaluating the integrity of a compliance program, the federal sentencing guidelines outline the components of an effective corporate compliance program.[27]

Conclusion

Clearly, Dodd-Frank provides new opportunities for purported whistle-blowers, and there will be an increase in filed claims. However, employers will continue to rely on some of the same defenses that have allowed them to successfully defend SOX claims in the past.

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Endnotes

1. Pub. L. No. 111-203, 124 Stat. 1376 (2010).
2. Additionally, the Patient Protection and Affordable Care Act (PPACA), 29 U.S.C. § 218c, as amended by Pub. L. No. 111-148, 124 Stat. 119 (2010) (PPACA) creates a cause of action for employees who report abuses, waste or fraudulent conduct with regard to the delivery of healthcare or consumer healthcare coverage. This new cause of action affects all employers subject to the relevant mandates under the act. While the constitutionality of PPACA has been challenged in federal courts nationwide, the whistle-blower provision has not yet been interpreted by the courts.
3. Sarbanes-Oxley Act of 2002, 15 U.S.C. 7201, *et seq.*; Pub. L. 107-204, 117 Stat. 745.
4. Release No. 34-64545, Implementation of the Whistle-Blower Provisions of section 21F of the Securities Exchange Act of 1934 (May 25, 2011).

5. Dodd-Frank Act § 922c(1)(A)(i), 124 Stat. at 1848.
6. Dodd-Frank Act § 929A, 124 Stat. at 1852.
7. Dodd-Frank Act, § 922c(1)(b), 124 Stat. at 1848.
8. Dodd-Frank Act, § 1514A(e)(2).
9. 767 F. Supp. 2d 225 (D. Mass. 2011).
10. No. 11-88, 2011 WL 3022535 (D. Nev. July 22, 2011).
11. No. 11-2580, 2012 WL 267194 (S.D. Tex. Jan. 30, 2012).
12. Dodd-Frank Act, § 922a(h)(1), 124 Stat. at 1845-46. The CFTC anti-retaliation provisions have a two-year statute of limitations. The CFTC has included a "Guidance with Respect to the Protection of Whistleblowers Against Retaliation" DFA Section 742(h)(1).
13. Dodd-Frank Act § 922a(h)(1), 124 Stat. at 1845-46.
14. Dodd-Frank Act. § 922a(h)(1)(B)(iii), 124 Stat. at 1846.
15. Dodd-Frank Act § 1057, 124 Stat. at 2031.
16. No. 10-8202, 2011 WL 1672066 (S.D.N.Y. May 4, 2011).
17. 15 U.S.C. Section 78u-6(a)(6). A whistle-blower is defined as "any individual who provides, or two or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission." (emphasis added).
18. *See*, *generally*, 15 U.S.C. Section 78u-6(h)(1)(A)(iii).
19. SEC Final Rules Release 17 C.F.R. pts 240, 249; CFTC Final Rules Release, 17 C.F.R. pt, 165. It bears noting that the CFTC final rules substantially parallel the SEC rules.
20. 17 C.F.R. § 240.21F-2(b)(2).
21. 17 C.F.R. § 240.21F-4(b)(7).
22. SEC Final Rules Release, 76 Fed. Reg. at 34,302.
23. 76 Fed. Reg. at 34,303.
24. See 17 C.F.R. Section 240.21F-4(iii)(A-D).
25. Dodd-Frank Act § 1079B(c)(2), 124 Stat. at 2079.
26. Dodd-Frank Act § 1079(B)(c)(2).
27. http://www.ussc.gov/Guidelines/2010_guidelines/Manual_HTML/8b2_1.htm.