

# The Dodd-Frank Act: New Life for Whistleblowers and the SEC

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Over the last decade, several commentators have lamented the dearth of resources available to the Securities & Exchange Commission, arguing that understaffing and underfunding have resulted in an inability to effectively regulate the market. A recent response by Congress signifies its recognition of these deficiencies and makes the SEC better equipped to police Wall Street.

A portion of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) provides generous incentives to stimulate the reporting of securities fraud by corporate insiders.<sup>1</sup> While incentive-based whistleblower laws are not new to the enforcement arena, the unprecedented inducements and protections within the Dodd-Frank Act far exceed its predecessors in an effort to achieve a common goal: to encourage people to disclose information regarding the commission of illegal conduct. The program should, as Congress hopes, have a substantial impact on the securities enforcement regime. This article will 1) briefly outline the Dodd-Frank

Act whistleblower provisions; 2) compare them to other whistleblower statutes; and 3) discuss the potential impact the Dodd-Frank Act provisions will have on the three players affected—whistleblowers, corporations, and the SEC.

## The Incentive Provisions

The Dodd-Frank Act provides that the SEC must supply monetary awards to qualified whistleblowers whose information is integral to the successful resolution of an SEC enforcement action.<sup>2</sup> The SEC will determine the amount of the award—between 10% and 30% of the monetary sanctions imposed<sup>3</sup>—based on its consideration of several factors, including: 1) the significance of the information; 2) the de-

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### Securities Litigation Report

West LegalEdcenter  
610 Opperman Drive  
Eagan, MN 55123

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One Year Subscription ■ 10 Issues ■ \$498.00  
(ISSN#: PENDING)

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gree of assistance provided by the whistleblower; 3) the SEC's interest in deterring the laws allegedly violated; and 4) any other factors the SEC considers relevant.<sup>4</sup>

To be eligible to receive an award, the whistleblower must meet certain conditions. First, the whistleblower must disclose original information, that is, information derived from independent knowledge and analysis that is not already known to the SEC.<sup>5</sup> Second, the whistleblower must not be a member of a regulatory or law enforcement organization, must not have committed a crime related to the information disclosed, must not have obtained the information from an audit, and must submit all information required by SEC rule.<sup>6</sup>

The determination of an award by the SEC is reviewable by a federal court of appeals under an abuse-of-discretion standard.<sup>7</sup> However, the amount of the award is not appealable provided it falls within the percentage range of monetary sanctions set by the statute.<sup>8</sup>

The Dodd-Frank Act also creates a private right-of-action for whistleblowers who are the targets of employer retaliation for reporting securities violations.<sup>9</sup> These aggrieved whistleblowers can bring their action in federal court, where the remedies include reinstatement, two times back-pay, and costs and fees against their employers.<sup>10</sup> Under Dodd-Frank's statute of limitations, whistleblowers must bring the action within six years of the act, or within three years of when facts material to the action taken by the employer are known or reasonably should have been known by the whistleblower.<sup>11</sup>

To further protect whistleblowers, the Dodd-Frank Act includes a confidentiality provision which prohibits the SEC and its employees from disclosing any information "which could reasonably be expected to reveal the identity of a whistleblower," unless disclosure to a defendant is required in connection with a criminal proceeding, or a public proceeding instituted by the SEC.<sup>12</sup>

Whistleblower bounties, and protection from retaliation, however, are nothing new. But the Dodd-Frank Act does something unique. It guarantees anonymity to the whistleblower.<sup>13</sup> Whistleblowers may remain anonymous under the

Dodd-Frank Act provided they are represented by counsel. Counsel can then submit the complaint and necessary paperwork in his or her own name, rather than in the name of the whistleblower. Whistleblowers are not even required to disclose their identity to the SEC until payment of an award.<sup>14</sup>

## Comparison to Other Statutes

Several similarities exist between the Dodd-Frank Act and past whistleblower statutes but none of its predecessors have put together a commensurate incentive package of financial rewards and protection.

For example, like the Dodd-Frank Act, the federal False Claims Act (FCA)<sup>15</sup> offers whistleblowers between 10% and 30% of the proceeds collected from what are known as "*qui tam*" actions—false claims actions brought by the government or on behalf of the government by the relator.<sup>16</sup> However, the FCA's financial incentive is less enticing than the Dodd-Frank Act provision for several reasons.

First, the FCA only pertains to false claims, or fraud, against the government.<sup>17</sup> Thus, it is substantially narrower than the Dodd-Frank Act which would apply to any corporate wrongdoing if in violation of the federal securities laws.

Second, a relator in a *qui tam* action may have to bring the case on behalf of the government, at his or her own expense. Thus, if the relator loses the case, he or she cannot recuperate costs and fees.<sup>18</sup> Such risks do not exist with SEC enforcement actions which are brought solely by the SEC.

And finally, companies are quick to settle enforcement actions as negative publicity and the potential for litigation can bring down stock prices. And, these cases are usually settled for substantial sums of money. Thus, the financial incentives offered by the Dodd-Frank Act should be more attractive to whistleblowers because they carry such a substantial upside, with virtually no downside.

The Dodd-Frank Act's whistleblower protection provisions are broader than other whistleblower statutes as well. For example, the whistleblower provisions in the Sarbanes-Oxley Act of 2002 (SOX) protects whistleblowers only if they

“reasonably believe” that the information reported constitutes a fraud or violation of an SEC rule.<sup>19</sup> Moreover, SOX requires whistleblowers to first bring their complaints to the Department of Labor (through OSHA) within 180 days of the alleged retaliatory conduct.<sup>20</sup>

In contrast, the Dodd-Frank Act protects whistleblowers regardless of the reasonableness of their complaint and allows whistleblowers to go straight to federal court without having to satisfy any administrative requirements.<sup>21</sup> Thus, the Dodd-Frank Act provisions afford whistleblowers considerably more protection from retaliation.

Finally, and most importantly, whistleblowers disclosing information to the SEC under the Dodd-Frank Act may retain anonymity.<sup>22</sup> No other federal whistleblower statute explicitly provides for the concealment of the whistleblower’s identity. Consequently, one of the biggest reasons that people who are aware of wrongdoing do not come forward—fear that their identities will be exposed, leading to retribution or otherwise unwanted notoriety—has been removed.

While SOX requires companies to maintain internal policies, such as anonymous hotlines, that will allow a whistleblower to keep his or her identity a secret, the FCA does not provide such safeguards. A complaint, filed with the government by the relator in a qui tam action remains under seal, with the relator’s identity withheld, for “at least sixty days,” when the government generally must decide whether to intervene.<sup>23</sup> However, at the end of the seal period, the government must announce its intention. Following this announcement, the defendant is served with the complaint, revealing the relator’s identity.<sup>24</sup> The Dodd-Frank provisions, therefore, are far more protective of a whistleblower’s identity.

The whistleblower program outlined by the Dodd-Frank Act is more encompassing than its predecessors. Still in its infancy, the impact of these provisions likely won’t be felt for sometime. But, to be sure, the incentives may prove irresistible to whistleblowers and likely require review of, and may necessitate substantial changes in, corporate governance.

## The Potential Impact

The Dodd-Frank Act whistleblower provisions compile a recipe for dramatic change in the corporate enforcement landscape—Wall Street has become a prime target for regulators and nearly all barriers for disclosure have been removed. The three parties that will be most affected by the new provisions are the whistleblowers to whom this unprecedented incentive program has been offered, the corporations which will have to manage any fallout arising from increased reporting, and the SEC whose enforcement authority is substantially broadened by the Act.

For whistleblowers, as has been outlined above, blowing the whistle has never been safer or more financially advantageous. Disclosing information about violations committed by coworkers or superiors has never been an easy choice for a variety of reasons. However, the Dodd-Frank provisions have virtually taken all self-preservation considerations off the table for whistleblowers who are likely to be galvanized by all of the protection afforded under the Act.

Further, the financial crisis has brought substantial regulator and public focus on the financial services industry. SEC enforcement actions have been increasing in number and settlement amounts. For example, Goldman Sachs (\$550 million) and Dell (\$100 million) recently made settlements with the SEC that would have resulted in substantial payouts to whistleblowers based on the percentages offered under the statute. Armed with unprecedented protections and substantial financial incentives, whistleblowers will be faced with strong motivations to come forward and report securities violations from within the workplace.

For corporations, internal control programs will have to be reviewed and may have to be bolstered. Employees with inside information about internal SEC violations are likely to go straight to the SEC rather than report the information to their superiors. While SOX protects whistleblowers from retaliation, the potential for, and the fear of, reprisals is still substantial given that disclosures are made internally. Now, whistleblowers

have an anonymous avenue to follow in reporting violations of SEC rules.

This may prove costly for many corporations. The Dodd-Frank Act not only increases corporate exposure to future enforcement actions by the SEC, but it forces them to immediately familiarize themselves with these provisions and pay more attention to corporate governance. Companies will no longer have an opportunity to get a first look at internal SEC violations, or be able to handle them before they get to the enforcement level. Moreover, current employees may be acting as whistleblowers reporting violations to the SEC as they occur. Substantial investments in the oversight infrastructure of these companies may be necessary.

Finally, for the SEC, the Dodd-Frank Act grants it broad authority to initiate enforcement actions and award whistleblowers. The rise in investigation and enforcement actions spurred by the new provisions will give the SEC even greater leverage in the enforcement arena. Further, the provisions allow the SEC sole discretionary power to award whistleblowers. While previous SEC whistleblower programs, like Insider Trading and Securities Fraud Enforcement Act of 1988, limited the extent to which the SEC could grant such awards, Dodd-Frank gives the SEC full reign.

It had long been held that the threat of actions by an attorney general, or civil 10(b) actions brought by investors, coupled with the SEC enforcement actions, sufficiently kept Wall Street in check. The recent breakdown of the financial markets confirms that more needed to be done. Congress took a step in the right direction by reinforcing the authority of the SEC, and further incentivizing the public to assist the SEC's regulation of the market. Only time will tell the effect

this piece of legislation will have on the industry, but judging from the overwhelming response of commentators and industry insiders thus far, all parties are bracing for impact.

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#### NOTES

1. See Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010) (hereinafter cited as Dodd-Frank Act).
2. Dodd-Frank Act § 21F(a).
3. Dodd-Frank Act § 21F(b)(1).
4. Dodd-Frank Act § 21F(c)(1).
5. Dodd-Frank Act § 21F(a)(3).
6. Dodd-Frank Act § 21F(c)(2).
7. Dodd-Frank Act § 21F(f).
8. Dodd-Frank Act § 21F(f).
9. Dodd-Frank Act § 21F(h)(1).
10. Dodd-Frank Act § 21F(h)(1).
11. Dodd-Frank Act § 21F(h)(1).
12. Dodd-Frank Act § 21F(h)(2).
13. Dodd-Frank Act § 21F(d)(2).
14. Dodd-Frank Act § 21F(d)(2).
15. See False Claims Act, 31 U.S.C.A. §§ 3729-3733 (2006) (hereinafter cited as False Claims Act).
16. False Claims Act, § 3730(d).
17. False Claims Act, § 3730(b).
18. False Claims Act, § 3730(c).
19. See Sarbanes-Oxley Act of 2002, PL 107-204, 116 Stat 745 (hereinafter cited as Sarbanes-Oxley Act).
20. Sarbanes-Oxley Act § 806.
21. Dodd-Frank Act § 21F(h)(1).
22. Dodd-Frank Act § 21F(d)(2).
23. False Claims Act, § 3730(b)(2).
24. False Claims Act, § 3730(b)(2).