

Dodd-Frank: Impact of the Whistleblower Incentives and the Corporate Response

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[D. Michael Crites](#) , [Joseph C. Krella](#)

I. Introduction

When President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act") into law on July 21, 2010, it was a major step towards the administration's goal of promoting increased accountability and transparency in the United States' financial system. The Act contains sweeping reforms impacting all aspects of the financial system from corporate governance to securities law to executive compensation. Among Dodd-Frank's voluminous reforms are extensive provisions regarding whistleblowers and the protections afforded to them in reporting securities violations. The Act's whistleblower provisions, which are the focus of this article, create robust financial incentives and increased anti-retaliation protections for individuals who provide information that assists in the successful enforcement of the country's securities regulations. Now faced with the possibility that their employees will be tempted by the promise of personal financial gain, Dodd-Frank forces corporations to react quickly to potential securities violations, ensure they implement effective corporate compliance programs, and create a clear understanding with employees about the need to follow corporate protocol in the face of possible infractions.

II. Whistleblower Provisions

Dodd-Frank's whistleblower provisions create new financial incentives that encourage individuals to come forward to the Securities Exchange Commission ("SEC") with information that assists it in uncovering securities violations. In particular, Section 922 of the Act offers new monetary awards and increased anti-retaliation protection to encourage whistleblowers to

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report corporate infractions to the SEC. Pursuant to Section 922, the SEC is required to pay an "award to one or more whistleblowers who voluntarily provided original information to the [SEC] that led to the successful enforcement" of judicial or administrative proceedings that result in monetary sanctions exceeding one million dollars. Dodd-Frank also creates the same incentives to whistleblowers providing information to the Commodity Futures Trading Commission.

The key to receiving an award is that the whistleblower must provide the SEC with what Dodd-Frank defines as "original information." Under the Act, "original information" means "information that is derived from the independent knowledge or analysis of the whistleblower; is not known to the SEC from any other source, unless the whistleblower is the original source of the information; and is not exclusively derived from an allegation made in a judicial or administrative hearing, in a government report, hearing, audit, or investigation, or from news media, unless the whistleblower is a source of the information."

Along with the limitation that an individual provide "original information," the Act places other limits on the availability of awards to whistleblowers. Primarily, a whistleblower is ineligible for an award if the individual is "convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award." Awards will also be denied "to any whistleblower who gains the information through the performance of an audit of financial statements required under the securities laws and for whom such submission would be contrary to the requirements of section 10A of the Securities Exchange Act of 1934." Further, unlike the *qui tam* provisions of the False Claims Act ("FCA"), Dodd-Frank does not create a private cause of action for whistleblowers to prosecute securities violations. Accordingly, whistleblowers must work directly with the SEC in order to reap the benefits of any original information they provide.

Assuming an otherwise qualified individual is able to provide the SEC with "original information," Section 922 of the Act provides for potentially significant financial rewards to whistleblowers. Awards under the Act must range between 10 and 30 percent of the collected monetary sanctions imposed in the action. In determining the amount awarded to whistleblowers, Dodd-Frank directs the SEC to consider "the significance of

the information provided by the whistleblower to the success of the covered judicial or administrative action; the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the covered judicial or administrative action; the pragmatic interest of the [SEC] in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws; and such additional relevant factors as the [SEC] may establish by rule or regulation." Funds awarded to whistleblowers are to be paid from the Act's newly created SEC Investor Protection Fund.

The funds paid out under Dodd-Frank could end up being substantial, especially when considered in light of the noteworthy sanctions imposed in recent financial fraud cases. Going back several years, numerous defendants in Enron's securities litigation agreed to collectively pay approximately \$450 million as part of their settlements of SEC actions. In 2003, WorldCom settled its accounting fraud lawsuit for \$750 million. In 2006, the SEC, in coordination with the New York State Attorney General, the Superintendent of Insurance of the State of New York, and the United States Department of Justice, announced a settlement with American International Group, Inc. ("AIG") on charges that the insurance giant committed securities fraud. AIG agreed to pay in excess of \$1.6 billion to resolve claims related to improper accounting, bid rigging and practices involving workers' compensation funds.

More recently, the SEC announced a \$1.6 billion settlement with Siemens AG ("Siemens") whereby Siemens agreed to resolve SEC charges that the company violated the Foreign Corrupt Practices Act ("FCPA") by engaging in a systematic practice of paying bribes to foreign government officials to obtain business. And just this past summer the SEC announced that Goldman, Sachs & Co. will pay \$550 million and reform its business practices to settle SEC charges that the company misled investors.

While the amount of these settlements and penalties are uncommon and represent historic figures, they underscore the potential for a staggering recovery under Dodd-Frank's whistleblower award provisions. Recovery of anywhere between 10 and 30 percent of the billion dollar Siemens settlement, for example, would entitle the individual or individuals providing "original information" to the SEC to a payout in the hundreds of millions of dollars.

In addition to the financial incentives Dodd-Frank creates, the Act also provides additional encouragement for whistleblowers to offer information by strengthening anti-retaliatory protections. Section 922 prohibits employers from retaliating against an employee "because of any lawful act done by the whistleblower in providing information to the [SEC]; in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the [SEC] based upon or related to such information; or in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002." The Act creates a private right of action in the appropriate United States district court for any whistleblower who alleges such retaliation, and individuals must bring their claims within six years of the date of the retaliation or three years after the date when the facts material to the right of action are known or reasonably should have been known by the employee alleging the violation. With regard to remedies, Dodd-Frank provides the opportunity for substantial awards to employees as the Act directs that relief for individuals shall include "reinstatement with the same seniority status that the individual would have had, but for the discrimination; 2 times the amount of back pay otherwise owed to the individual, with interest; and compensation for litigation costs, expert witness fees, and reasonable attorneys' fees."

Section 1079B of Dodd-Frank also strengthens the anti-retaliation provisions of the FCA. Specifically, the Act broadens the language of the FCA by providing protection to "agents or associated others" who act in an effort to stop violations of the FCA. Section 1079B creates a three-year statute of limitations after the date of retaliation to bring a cause of action under the FCA.

III. Impact of Dodd-Frank Whistleblower Provisions and the Necessary Corporate Response

Since taking office, President Obama and his administration have made the uncovering of fraud in all federal programs a top priority. In the healthcare world, for example, the administration has expanded its efforts to crack down on Medicare and Medicaid fraud which costs taxpayers billions of dollars annually.¹ The implementation of Dodd-Frank is a continuation of the Obama administration's anti-fraud efforts and should greatly impact the SEC's investigation of fraud claims and corporations' response to how they monitor their behavior.

One impact of Dodd-Frank is its bolstering of existing SEC programs designed to reward whistleblowers. For example, while the Sarbanes-Oxley Act ("SOX") previously provided anti-retaliation protection for whistleblowers, it did not provide the monetary incentives present in Dodd-Frank to whistleblowers. The lure of a significant financial reward provided for by Dodd-Frank will likely encourage individuals to come forward to the SEC with SOX-related fraud information when they otherwise may have sought to resolve the issue in-house or simply remain silent altogether. Dodd-Frank also broadens other portions of SOX by increasing its scope of coverage and allowing SOX related claims to be tried to a jury in the appropriate United States district court. A large financial reward will also likely create increased whistleblowing in FCPA cases. A review of the settlement in the Siemens FCPA case alone would encourage any whistleblower contemplating reporting a potential infraction to come forward to the SEC on the hopes that the individual could obtain a multi-million dollar award under the Act.

Faced with the threat that Dodd-Frank's "bounty," as some are calling it, will lure employees to report potential infractions to the SEC, the Act will have a significant impact on corporations. Corporations must now manage the possibility that the enticement of a large reward will cause employees to usurp corporate compliance programs and race to the SEC at the first sign of a potential infraction rather than discussing the issue with their employer. The threat that employees will be overzealous with their reporting in the hopes of receiving a financial reward will require corporations to act quickly at the earliest hint of a violation. Corporations cannot lackadaisically monitor their compliance; rather, Dodd-Frank's new financial incentives forces companies to increase the speed at which they must implement internal investigations. Corporations must also be more willing to voluntarily self-disclose misconduct to the SEC in order to avoid a deluge of their employees knocking on the SEC's door looking for a payday.

Corporations should take a proactive response to the challenging environment created by the Act. Corporations should take the time to review their corporate compliance programs to ensure their procedures allow for the immediate response to violations that Dodd-Frank encourages. Businesses must also take steps to ensure their employees are aware of their applicable compliance programs and both employer and employee are on the same page with respect to reporting misconduct. Dodd-Frank creates enticing

incentives for employees to turn on their employers, so it is important for corporations to educate their employees about the value of corporate compliance programs and the need to follow corporate procedures when handling potential violations.

IV. Conclusion

Dodd-Frank's sweeping financial reform and its extensive whistleblower protections present unique challenges to businesses. Never before have employees been so encouraged to usurp corporate compliance programs and directly report potential infractions to the SEC. Tempted by the possibility of a life-changing award, Dodd-Frank provides individuals with the justification needed to avoid corporate protocol and run directly to the SEC at the first indication of corporate misconduct. Further, the Act's increased anti-retaliation provisions eliminate virtually any risk individuals might have to weigh when considering the ramifications of reporting employer infractions. These provisions seem to be a clear signal that Congress and the regulatory commissions have little faith that corporations can self-police their own conduct through an effective compliance and ethics program.

In order to combat this belief and navigate the challenging climate created by Dodd-Frank, corporations must proactively address their compliance programs and potential whistleblowers. Corporations should look at Dodd-Frank as an opportunity to revisit their corporate compliance programs and ensure that their programs effectively promote a culture of corporate compliance and encourage ethical conduct and compliance with all laws. Corporations must engage their employees and reinforce the importance of a corporate culture that promotes legal compliance and ethical conduct in the face of a potential infraction. Educating employees and instilling attitudes of compliance should help prevent rogue employees from prematurely reporting violations to the SEC. Finally, corporate compliance programs must allow for a speedy corporate response in dealing with potential violations, and corporations must be more willing to self-report violations. There is no doubt that with the passage of Dodd-Frank and the lure of its big rewards every potential violation may be reported. Corporations now, however, will increasingly be compelled to evaluate quickly the benefits of proactively reporting or waiting for someone else to blow the proverbial whistle.