<u>Representing Executive-level Whistleblowers</u>

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I. Introduction

Nearly all employees who face retaliation after blowing the whistle on unlawful conduct in the workplace also face a myriad of challenges in bringing legal claims against their employers. There are, however, certain issues that are unique to executive-level whistleblowers that require particular attention by both client and counsel. In contrast to a line worker at a manufacturing plant, for example, who has personal knowledge about specific conditions in a particular workplace, executive-level whistleblowers often have access to information about company-wide policies and practices and unlawful activity by upper management. In addition to their bird's-eye view of corporate activity, executive-level whistleblowers often handle highly confidential documents and engage with and seek advice from the highest levels of management, including corporate legal counsel. They may also be subject to legal duties that do not attach to employees in non-managerial positions. As a result, attorneys for executive-level whistleblowers must be cognizant of a number of issues that can impact retaliation claims, and clients' eligibility for federal whistleblower rewards programs.

II. Gatekeepers: In-House Counsel and Compliance Officers

A. Protected Activity

Representing executive-level whistleblowers, such as in-house counsel and corporate compliance officers, presents unique issues due to the nature of their function within an organization. Employees in these roles often have access to the most sensitive, confidential corporate information, some of which relates directly to whether certain conduct is lawful. As a result, in-house counsel and compliance officers are ideally situated to identify and report instances when management has deliberately (or negligently) engaged in unlawful activity. Employees in these roles also have unique duties, however, under state and federal law and rules of professional conduct, as well as under the norms of corporate culture. Due to their involvement with sensitive information, in-house attorneys and compliance personnel are held to high standards of confidentiality and discretion that can have a significant impact on their rights as whistleblowers.

As whistleblower protections expand, the way in which in-house counsel and compliance officers can avail themselves of whistleblower protections is becoming more clearly articulated by lawmakers and courts, but much remains unsettled in this area. These issues have been addressed most directly in the context of the Sarbannes-Oxley Act of 2002 ("SOX"), 10 U.S.C. § 1514A, and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), 15 U.S.C. § 78u-6, and accompanying regulations promulgated by the Securities and Exchange Commission ("SEC").[1] As regulators have developed a keener understanding of how attorneys

[1] SOX and Dodd-Frank have received much attention in recent years as the SEC has engaged in high-profile, high-recovery enforcement efforts, and whistleblowing activity related to securities fraud has increased apace. There are, of course, various other federal whistleblower statutes applicable to workers in fields such as nuclear energy, transportation, environmental, aviation, etc. *See, e.g.,* Energy Reorganization Act, 42 U.S.C. § 5851; Surface Transport Assistance Act, 49 U.S.C. § 31105; Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, 49 U.S.C. § 42121; Clean Air Act, 42 U.S.C. § 7622. Where the language and structure of these statutes is similar, as is often the case, courts and agency tribunals generally construe their provisions consistently across the field of whistleblower law

and compliance personnel can facilitate the exposure of wrongdoing, corporate interests have responded by decrying any move to incentivize whistleblowing by the very people upon whom they rely for open discussion of regulatory matters.[2] Current regulations attempt to balance the benefits of whistleblowing by these employees (particularly when it protects investors from significant harm) with the benefit of protecting internal procedures that encourage voluntary compliance with the law.

For in-house counsel, a major issue is whether privileged communications can be used to report unlawful conduct, and/or to show that the attorney was retaliated against after making such a report, whether internally or externally. The SEC's rules for attorneys practicing before the Commission, widely known as "Part 205," provide guidelines that are balanced in favor of disclosure, but their authority is contested and unclear. Part 205 requires in-house counsel to first report "material violations" of SEC regulations to a corporation's Chief Legal Officer (CLO), for example. 17 C.F.R. § 205.3(b). If the CLO does not make an "appropriate response in a reasonable amount of time," the in-house attorney is then required to report the violation to the board of directors or a board committee. 17 C.F.R. § 205.3(b)(3). The SEC does not mandate that in-house attorneys must then, or at any time, report violations to the Commission itself, but the Commission does provide that attorneys may disclose confidential information without permission from their employer, *i.e.* "report out," in the following circumstances: (1) to prevent a material violation that will cause "substantial injury to the financial interests or property of the [company] or investors;" (2) to prevent the company from engaging in perjury or fraud on the Commission; or (3) to rectify a material violation causing substantial injury to the financial interests of the company or investors that involved the use of the attorney's services. 17 C.F.R. § 205.3(d)(2).

While Part 205 allows for disclosure of confidential information by in-house attorneys to federal regulators, there is debate over whether the SEC has the legal authority to override local legal ethics rules about disclosure of privileged and/or confidential client information. The SEC has attempted a kind of self-executing protective rule for attorneys by declaring: "Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, [Part 205] shall govern." 17 C.F.R. § 205.1.[3] This declaration simply begs the question of whether a federal agency can preempt local rules, however. The New York County Lawyers' Association issued a formal opinion in 2013 stating that disclosures in violation of state ethics rules would be subject to discipline, regardless of the SEC's attempt to carve out exceptions, and California Bar Association committees have also disputed whether the

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(although precedent does evolve uniquely in each jurisdiction). For an overview of state and federal whistleblower statutes, see LISA J. BANKS & JASON C. SCHWARTZ, WHISTLEBLOWER LAW: A PRACTITIONER'S GUIDE (2016).

[2] For the official account of the comments received during the SEC's final rulemaking process related to the whistleblower reward program established by Dodd-Frank, see 76 Fed. Reg. 34,300 *et seq.* (June 13, 2011).

[3] *See also*, 17 C.F.R. § 205.6(c) ("An attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices.").

SEC's authority overrides its local rules.[4] There has been no formal challenge to the SEC's Part 205 to date and thus no judicial determination of whether federal or state rules govern attorney disclosures to the Commission; in-house counsel and their employment attorneys must therefore navigate these waters with little certainty.

Regarding the use of privileged communications in the course of retaliation claims, the Department of Labor Administrative Review Board (ARB) and at least one federal court of appeals have held that attorneys may introduce these communications as evidence to the degree necessary for their claim. *See Van Asdale v. Int'l Game Tech.*, 577 F.3d 989 (9th Cir. 2009); *Jordan v. Spring Nextel Corp.*, ARB No. 2005-SOX-41 (ARB Sept. 30, 2009). These tribunals have made clear that attorney-litigants must limit disclosures to protect client information as much as possible. To avoid discipline by state ethics authorities and to preserve claims to the greatest extent, it is therefore advisable that in-house attorneys and their representatives use careful judgment in determining the volume and scope of disclosures.

In addition to these privilege issues relevant to in-house counsel whistleblowers, there is also the more general question of whether in-house counsel or compliance personnel may engage in protected activity in the course of fulfilling their duties, and therefore come within the retaliation protections of any number of federal whistleblower statutes. Some courts have held that litigants whose job includes a reporting or compliance-related function engage in protected activity only when they have "stepped outside" from their normal duties and made a report of unlawful activity in a manner that is above and beyond what is required by the nature of their positions. *See, e.g.*, *Lukov v. Schindler Elevator Corp.*, 594 F. App'x 357, 358 (9th Cir. 2015) (noting "the federal 'step outside of his role' rule"); *U.S. ex rel. Brown v. Aramark Corp.*, 591 F. Supp. 2d 68, 77 (D.D.C. 2008) (holding in an FCA case that "notice [of fraud to the employer] stemming from the performance of one's normal job responsibilities is typically inadequate [to establish protected activity]."). This "step outside" doctrine (also known as the "manager rule"), originally developed in the context of Fair Labor Standards Act,[5] can potentially impose significant restrictions on protected activity by in-house attorneys and compliance officers because their positions *require* them to review and evaluate the legality of corporate activity. As such, they would nearly always have to show that they did more than simply fulfill the duties of

[4] *See* NYCLA Committee on Professional Ethics, Formal Opinion 746 (2013), at 15 ("New York lawyers, in matters governed by the New York RPC, may not disclose confidential information under the Dodd-Frank whistleblower regulations, except to the extent permissible under the Rules of Professional Conduct."); Ethics Alert, The New SEC Attorney Conduct Rules v. California's Duty of Confidentiality (Spring 2004), available at http://ethics.calbar.ca.gov/Portals/9/documents/Publications/EthicsHotliner/Ethics_Hotliner-SEC_Ethics_Alert-Spring_04.pdf. Note that most jurisdictions either require or permit attorneys to disclose privileged information to avoid assisting in the commission of a crime. *See, e.g.*, N.J. Prof. Conduct 1.6(b) (requiring disclosure in order to prevent illegal or fraudulent acts); N.Y. R. Prof. Conduct 1.6(b) (permitting disclosure of confidential information to, *inter alia*, prevent the commission of a crime).

[5] For further discussion of the origins and current application of the doctrine, see Lisa J. Banks and Sam Kramer, Emerging Issues in Anti-Discrimination Law (2016), available at http://www.kmblegal.com/sites/default/files/ALI-Anti-Discrimination-Law-Emerging-Issues-Lisa-Banks.pdf.

their role in order to come within the protections of anti-retaliation provisions. *See Weeks v. Kansas*, 503 F. App'x 640, 642 (10th Cir. 2012) (holding that an attorney is not engaged in protected activity under Title VII when she is "acting within her role as counsel… and simply seeking to assist [her employer] in fulfilling its legal obligations").

The step outside doctrine has sway in some jurisdictions under a variety of federal statutes, such as Title VII, the FCA, and the Fair Labor Standards Act (FLSA).[6] *See, e.g., Lasater v. Texas A & M Univ.-Commerce*, 495 F. App'x 458, 461-62 (5th Cir. 2012). While there is little case law regarding the doctrine under SOX, the Administrative Review Board has ruled that it does not generally apply to such claims and at least one federal court has deferred to this position. *See Yang v. Navigators Grp., Inc.*, 18 F. Supp. 3d 519, 530 (S.D.N.Y. 2014) (noting that the ARB "has made clear that an employee may engage in protected activity even where the employee is discharging her duties," and deferring to the agency's determination); Robinson v. Morgan–Stanley, ARB Case No. 07–070, 2010 WL 2148577 (ARB Jan. 10, 2010). In addition, at least one DOL administrative law judge has ruled that the doctrine is not appropriate for SOX retaliation claims brought by in-house counsel, because the SEC has expressly authorized (and sometimes requires) these attorneys to make reports to management about unlawful activity. *See Leznik v. Nektar Therapeutics, Inc.*, 2006-SOX-00093 (ARB Nov. 16, 2007).

The Supreme Court's decision in *Crawford v. Metropolitan Government of Nashville*, 555 U.S. 271 (2009), suggests that the Court might reject the "step outside" doctrine if given the opportunity to rule on the question directly. In *Crawford*, an employee brought a retaliation claim under Title VII when she suffered adverse actions after recounting harassment during an internal investigation of her supervisor. The employee had not initiated the complaint leading to the investigation, nor had she reported the harassment independently outside of responding to questions. The employer argued that in merely answering questions posed by an investigator, the employee had not "opposed" the discriminatory conduct, as required for protected activity under Title VII. The Court rejected this argument, holding that any account of harassing conduct comprised opposition for the purposes of retaliation; the employee did not have to more to qualify for protection. The decision suggests that the Court is generally supportive of finding protected activity where employees bring unlawful conduct to light, even without taking exceptionally active steps to do so. In a case where in-house counsel or a compliance officer has been subjected to an adverse action following her efforts to address such conduct, *Crawford* provides a strong foundation for finding protected activity.[7]

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[6] Courts have also addressed this issue when construing state whistleblower statutes. *See, e.g., Harrison v. Granite Bay Care, Inc.*, 811 F.3d 36, 51 (1st Cir. 2016) (holding that under Maine's Whistleblower Act, "although a particular employee's job duties may be relevant in discerning his or her actual motivation in reporting information, those duties are not dispositive of the question").

[7] The EEOC has relied upon *Crawford* for its position that the "manager rule" does not apply to retaliation claims under its jurisdiction. *See* U.S. Equal Employment Opportunity Commission, Proposed Enforcement Guidance on Retaliation and Related Issues (Jan. 21, 2016) at 11-16, available at https://www.regulations.gov/#!documentDetail;D=EEOC-2016-0001-0001.

B. Eligibility for Whistleblower Rewards Programs

In addition to the protections against retaliation set out in SOX, Dodd-Frank, and other federal statutes, there are also a number of whistleblower rewards programs that provide sizeable payments to individuals who assist in bringing enforcement actions against corporate lawbreakers. The SEC Office of the Whistleblower administers one of the highest-profile reward programs, established by Dodd-Frank. The statute provides that whistleblowers who voluntarily provide original information leading to a successful enforcement action that results in sanctions of $1 million or more are eligible to receive awards of 10-30% of the total amount collected by the Commission.[8] Similar rewards programs are administered by the Commodities Futures Trading Commission (CFTC)[9] and the Internal Revenue Service (IRS).[10] While retaliation claims raise the question of whether in-house attorneys and compliance officers should be protected for blowing the whistle on illegal conduct, whether within or outside of their normal job duties, whistleblower rewards programs raise the even more difficult question of whether these employees should be actively incentivized to reach out to regulators.

The SEC has acknowledged that its reward program creates potential conflicts of interest for in-house attorneys in particular, who might prefer to go to regulators with concerns in order to qualify for a significant monetary award rather than report internally and facilitate compliance from within their companies.[11] To maintain access to information that might otherwise go undetected, while still encouraging voluntary compliance with regulations, the SEC has established general exclusions for reward eligibility and a number of relatively narrow exceptions to these exclusions. With respect to attorneys, there is no eligibility for an award if information provided to the Commission is obtained through (1) communications subject to

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[8] 17 C.F.R. §§ 240.21F-3, 240.21F-5. The SEC program was established by Dodd-Frank in 2010. In 2015, the program made awards to eight whistleblowers, totaling more than $37 million. *See* U.S. Securities and Exchange Commission, 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program, p. 13, *available at* https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf.

[9] 17 C.F. R. § 165. The CFTC program has made just three awards since it was established by Dodd-Frank in 2010, with the most recent award totaling $10 million dollars-plus to a single whistleblower. *See* Press Release, CFTC Announces Whistleblower Award of More Than $10 Million, *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7351-16.

[10] 26 U.S.C. § 7623. The IRS program has been in place since 2007. In 2015, the agency made awards to 99 whistleblowers, totaling more than $103 million. *See* Internal Revenue Service, IRS Whistleblower Program Fiscal Year 2015 Annual Report to the Congress, p. 11, *available at* https://www.irs.gov/pub/whistleblower/WB_Annual_Report_FY_15_Final%20Ready%20for%20Commissioner%20Feb%208.pdf.

[11] *See* 76 Fed. Reg. 34,300, 34,314 (June 13, 2011) ("[C]ompliance with the Federal securities laws is promoted when individuals, corporate officers, and others consult with counsel about possible violations, and the attorney-client privilege furthers such consultation. This is an important benefit that could be undermined if the whistleblower award program created monetary incentives for counsel to disclose information about possible securities violations in violation of their ethical duties to maintain client confidentiality.") (footnotes omitted).

attorney-client privilege, unless those communications may be disclosed under Part 205 or state ethical rules, or (2) legal representation of a client, unless disclosure is permitted under Part 205, state ethical rules, or otherwise.[12] 17 C.F.R. § 205.3(d)(2); 17 C.F.R. §§ 240.21F-4(b)(i)-(ii). As discussed above, it is not at all clear how Part 205 interacts with state ethics rules, many of which explicitly prohibit disclosures that are permitted by the SEC; as a result, the exceptions and exclusions for attorneys provide little clear guidance.

With regards to compliance officers, the SEC program has also established general exclusions, with narrow exceptions, that significantly narrow their eligibility for rewards. Among the people who are ineligible for whistleblower awards are: (a) an officer, director, trustee, or partner of an organization who was informed of misconduct by another person, or the employee learned of the information from the organization's processes for reporting violations; (b) an employee with principal duties related to compliance or internal auditing, or an employee of a firm carrying out those functions; (c) an employee of a firm conducting an inquiry or investigation of unlawful conduct; or (d) an employee of a public accounting firm who has learned the information through an audit required under federal law. C.F.R. § 240.21F-4(b)(iii).[13] Notwithstanding these exclusions, compliance personnel can be eligible to receive an award if the employee reasonably believes that disclosure is necessary to prevent conduct resulting in substantial injury to the financial interest or property of the company or investors; that the company is engaging in conduct that will impede investigation of wrongdoing; or at least 120 days have passed since the employee provided the information to the audit committee, Chief Legal Officer, or other executive or supervisory officers, or the information was received in a way to suggest that these personnel were already aware of its content. C.F.R. § 240.21F-4(b)(v). At least two compliance officers have received whistleblower awards under these exceptions, totaling $300,000 and $1.4 million-plus, proving that they are not merely theoretical paths to a reward.[14]

While the FCA is not technically a "rewards" program, it also authorizes individuals to receive between 15-25% of the proceeds from successful actions brought against companies that defraud the government. 31 U.S.C. § 3730. Just as the SEC has acknowledged the need to balance whistleblower incentives with confidential access to legal counsel, courts have been careful to take ethical obligations into account when evaluating FCA claims by attorneys.

[12] While most often applicable to attorneys, these exclusions apply to non-attorneys, well. *Id.* at 34,315 ("[B]oth exclusions apply to non-attorneys. Thus, if an attorney in possession of the information would be precluded from receiving an award based on his or her submission of the information to us, a non-attorney who learns of this information through a confidential attorney-client communication would be similarly disqualified.").

[13] The SEC also excludes information obtained through criminal means. C.F.R. § 240.21F-4(b)(iv).

[14] *See* Press Release, SEC Announces Million Dollar Whistleblower Award to Compliance Officer (April 22, 2015) (announcing award of $1.4-1.6 million), available at www.sec.gov/news/pressrelease/2015-73.html; Press Release, SEC Announces $300,000 Whistleblower Award to Audit and Compliance Professional Who Reported Company's Wrongdoing (Aug. 29, 2014), available at www.sec.gov/News/PressRelease/Detail/PressRelease/1370542799812 .

Stopping short of an outright categorical bar on attorneys acting as FCA "relators" (*i.e.* individuals litigating on behalf of the government), courts have generally refused to release attorney-relators from their ethical obligations. One federal trial court, for example, held that an attorney-relator could not proceed with his claim because pursuit would require the disclosure of confidential attorney-client communications. *See United States ex rel. Doe v. X Corp.*, 862 F. Supp. 1502, 1506-1507 (E.D. Va. 1994). Courts have not been tolerant of FCA claims that involve violations of ethics rules by attorneys, and representation of attorney-clients with such claims requires a thorough analysis of how to survive fairly high judiciary scrutiny.

III. Retaining and Disclosing Corporate Documents

Most attorneys who represent whistleblowers have encountered the issue of whether their clients have accessed, retained, and/or disclosed confidential documents in the course of reporting unlawful conduct or pursuing a legal claim following subsequent retaliation. In the case of executive-level clients, it is almost certain that confidential documents will be involved due to the reliance on written communication such as email, intraoffice messaging, memoranda, and reports by upper management. Confidential documents raise a variety of concerns for both clients and their legal representatives, including potential counterclaims related to confidentiality agreements and fiduciary duties (discussed in more detail below), for-cause termination due to violations of employer policies, discipline from professional ethics authorities, and even criminal liability.

While many courts recognize that whistleblowing will almost always require the disclosure of confidential information, and that whistleblower protections passed by state and federal legislators establish a public policy in favor of protecting such disclosures, courts have rejected indiscriminate use of employer information by whistleblower employees. *See, e.g., United States ex rel. Cafasso v. General Dynamics C4 Systems, Inc.*, 2009 U.S. Dist. LEXIS 43154 (D. Ariz. May 21, 2009), *aff'd* 637 F.3d 1047 (9th Cir. 2011). Tribunals have been most willing to find that the use of confidential employer information is protected activity where the employee has been able to show that she did not obtain the documents through nefarious means and disclosed them in a limited way that was related to her report of wrongdoing. *See e.g., Vannoy v. Celanese Corp.*, 2008-SOX-00064, (ARB July 24, 2013).

The unauthorized use of corporate documents is often expressly prohibited by confidentiality clauses included in employment agreements, or under employer policies, and can therefore constitute lawful grounds for termination that preclude a retaliation claim. While this entire area of law is somewhat unsettled, False Claims Act precedent is arguably the most protective of employees' use of confidential information. *See, e.g., Shmushkovich v. Home Bound Healthcare, Inc.*, No. 12 C 2924, 2015 WL 3896947, at *2 (N.D. Ill. June 23, 2015) (noting that the "Seventh Circuit has… recognized a broad policy interest in fostering employee actions under the False Claims Act") (internal quotation marks and citation omitted). Even within FCA cases, however, courts have been careful to stress that indiscriminate collection and retention of confidential information is not protected activity. *See U.S. ex rel. Rector v. Bon Secours Richmond Health Corp.*, No. 3:11-CV-38, 2014 WL 66714, at *6 (E.D. Va. Jan. 6, 2014) ("It is true that the FCA contemplates whistleblower possession of documents obtained from employers that evidence fraud upon the government. However, the FCA does not permit whistleblowers to have carte blanche to acquire such information in any way they deem necessary.") (internal citation omitted); *Cafasso* (holding that accessing and retaining large amounts of employer data, including proprietary information and patents, was not protected activity under the FCA). In retaliation cases under Title VII, the Age Discrimination in Employment Act (ADEA), and SOX, courts have also held that employees who retain or disseminate confidential documents in an unreasonable manner that goes beyond what is necessary to report wrongdoing or prove retaliation will not be protected from discipline or termination when such prohibitions are in place.[15] *See*, *e.g.*, *Smith v. Chicago Transit Auth.*, No. 12 C 8716, 2014 WL 3892233, at *9 (N.D. Ill. Aug. 5, 2014) (noting the five-factor balancing test for "reasonable" disclosure in Title VII retaliation claims set out in *Niswander v. Cincinnati Insurance Co.*, 529 F.3d 714, 722 (6th Cir. 2008)); *Aldrich v. Rural Health Servs. Consortium, Inc.*, 579 F. App'x 335, 337 (6th Cir. 2014) (holding that an employee did not engage in protected activity under the ADEA when she "indiscriminately" sent confidential employer documents to her personal email account and refused to delete them); *JDS Uniphase Corp. v. Jennings*, 473 F. Supp.2d 697 (E.D. Va. 2007) (holding that a former accountant was not protected by SOX for retaining documents that he was otherwise prohibited to disclose under the terms of his confidentiality agreement).

Some plaintiffs have successfully argued that enforcement of a confidentiality policy was mere pretext for their retaliatory termination, particularly where the temporal proximity of protected activity and termination was unusually close, or where violation of the policy was in dispute. *See, e.g.*, *Gibson v. Reliant Renal Care-Alabama, LLC*, No. 7:14-CV-02002-LSC, 2016 WL 1212611, at *6-7 (N.D. Ala. Mar. 29, 2016) (noting that one month proximity between activity and adverse action raised issued of fact regarding pretext); *O'Donnell v. Caine Weiner Co., LLC*, No. 14 C 6839, 2016 WL 693204, at *4 (N.D. Ill. Feb. 22, 2016) (denying summary judgment where, *inter alia*, plaintiff asserted that she obtained confidential documents inadvertently); *Boddy v. Astec, Inc.*, No. 1:11-CV-123, 2012 WL 5507298, at *12 (E.D. Tenn. Nov. 13, 2012) (noting that a plaintiff may show pretext by establishing that a confidentiality policy was selectively enforced). The balance of cases, however, indicates that courts are unwilling to condone generalized retention and dissemination of confidential employer information. Attorneys should therefore warn executive-level whistleblower clients of the risks associated with the possession and use of such information, and should determine whether it is appropriate to review confidential documents for use in legal action. As a general rule, courts have been most amenable to excusing employees from confidentiality restrictions where dissemination has been made in the most limited manner possible *(i.e.*, to legal counsel and/or government officials as required to establish a cognizable legal claim, and in no event released in a public forum or on social media).

[15] The reasonability test has developed out of Title VII opposition-to-discrimination cases, and is not necessarily applicable to cases involving an employee's participation in a discrimination case. *See, e.g., Randolph v. ADT Sec. Servs., Inc.*, No. CIV.A. DKC 09-1790, 2011 WL 3476898, at *6 (D. Md. Aug. 8, 2011) (holding in a FLSA retaliation case that the reasonableness test does not apply to participation-retaliation claims).

IV. Counterclaims Against Executives

Employers facing retaliation claims frequently threaten, and occasionally file, counterclaims against employees to deter legal action and signal to current employees that such action holds significant risks. Because executives are charged with greater legal duties towards their employers, whether implied or expressly provided in employment contracts, they are typically more susceptible to counterclaims than lower level employees. Representation of executive-level whistleblowers should therefore include an assessment of counterclaim exposure for the most accurate assessment of the case and realistic expectations for litigation.[16]

Nearly all executives are subject to employment contracts that contain confidentiality provisions for proprietary and sensitive corporate information. These terms typically prohibit an employee from disseminating such information outside of the company, and from retaining documents after their separation from the company. As discussed above, these agreements can potentially restrict an employee's use of documents in reporting wrongdoing and bringing a retaliation claim. They can also provide grounds for a breach of contract counterclaim should the employee move forward with litigation. In such cases, whistleblowers have had some success arguing that enforcement of these contract provisions would violate public policy. *See, e.g., Saini v. International Game Technology*, 434 F. Supp.2d 913, 923 (D. Nev. 2006) (ruling that confidentiality agreements may be unenforceable where an employee has acted as a whistleblower for illegal or "wrongful" behavior). Courts have not been willing, however, to provide blanket protection to breaches of contract for use of confidential information, particularly where some of the information is unrelated to protected activity. *See Cafasso,* 2009 U.S. Dist. LEXIS 43154 (ruling that confidentiality agreements are enforceable even where an employee purports to use employer information to report wrongdoing); Zody v. Microsoft Corp., No. C-12-00942-YGR, 2013 WL 2468250, at *5 (N.D. Cal. June 7, 2013) (denying a motion to dismiss breach of contract counterclaim related to plaintiff's use of confidential documents for wrongful termination action). In situations where an employee's disclosures related to criminal activity, there is also a strong public policy argument established by the criminal code itself that disfavors breach of contract claims.

Another potential counterclaim that is more likely arise for executive-level whistleblowers than other employees is breach of fiduciary duty. General agency principles require that an employee not use or communicate information obtained through employment unless the information is already generally known. Restatement (Second) of Agency § 395. There are few reported decisions addressing breach of fiduciary duty claims against whistleblowers, but unfortunately this small sample indicates that courts are willing to allow these claims to move forward. *See, e.g., Nesselrotte v. Allegheny Energy, Inc*., 615 F. Supp.2d 397, 410 (W.D. Pa. 2009) (finding a breach of fiduciary duty where an employee retained confidential information to support an age discrimination claim). The paucity of case law in this

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[16] Attorneys should also be mindful that threats of civil or criminal complaints against an employee can themselves constitute an adverse action of unlawful retaliation. *See, e.g., Brown v. TD Bank, N.A.,* No. CV 15-5474, 2016 WL 1298973, at *6-7 (E.D. Pa. Apr. 4, 2016).

area suggests that fiduciary duty counterclaims are uncommon, but whistleblowers and their counsel should be cognizant of potential liability related to the dissemination of company information in the course of their activities.

Even less likely than the forgoing counterclaims, but more serious in its potential for life-altering consequences, is the possibility of criminal liability for conduct related to blowing the whistle on unlawful activity. In a small number of high-profile cases, former employees have faced criminal prosecution for accessing and providing to the press company documents related to aviation safety, accessing and releasing information related to voter machine fraud, and reporting fraudulent medical practices to a state regulatory authority.[17] In one exceptionally unusual case, a whistleblower who brought massive tax fraud to the attention of the IRS and eventually earned a $104 million reward for his assistance was sentenced to 40 months in prison for his role in the scheme.[18] Charging decisions by prosecutors are highly discretionary and often difficult to predict. Legal counsel for executive whistleblowers should familiarize themselves with all potentially relevant criminal offenses, applicable statutes of limitations, and, to the extent possible, charging priorities in the relevant jurisdictions.

In light of the reliance on computer-based communications in almost every workplace, representatives for executive-level whistleblowers should pay particular attention to statutes such as the Computer Fraud and Abuse Act of 1986 ("CFAA"), 18 U.S.C. §1030 *et seq*., which can be an especially potent source of liability for whistleblowers. The CFAA includes a criminal provision for the unauthorized access of computers in interstate commerce, and a civil action for various acts of computer access "without authorization or exceeding authorized access." 18 U.S.C. § 1030(a). There is a significant split among federal circuits over how to construe "authorization" for computer access in the workplace under the CFAA. The most draconian construction, adopted by the Fifth, Seventh, and Eleventh Circuits, holds that an employee acts without authorization whenever she acts against interests of her employer or in breach of her duty to her employer.[19] Other courts, such as the Fourth and Ninth Circuits, have held that employees do not violate the CFAA so long as they were authorized to access the employer's computer system at the time they did so, notwithstanding their subsequent use of the information obtained.[20] Criminal liability is an unlikely outcome for most whistleblowers, but it is not

[17] *See* Singer, "Was Inspector Source of Leak at Boeing?," The Seattle Times (March 26, 2008), available at www.seattletimes.com/business/boeing-aerospace/was-inspector-source-of-leak-at-boeing/; Hoffman, "E-voting 'hero' pleads guilty to computer crime in Diebold case," Inside Bay Area (Nov. 21, 2006), available at www.insidebayarea.com/sanmateocountytimes/ci_4701950; Sack, "Whistle-Blowing Nurse Is Acquitted in Texas," New York Times (Feb. 11, 2010), available at www.nytimes.com/2010/02/12/us/12nurses.html.

[18] Goldfarb, "Whistleblower in Swiss Bank Case Sentenced to 40 Months," Washington Post (Aug. 22, 2009), available at www.washingtonpost.com/wp-dyn/content/article/2009/08/21/AR2009082101566.html.

[19] *See, e.g., United States v. John,* 597 F.3d 263 (5th Cir. 2010); *International Airport Centers LLC v. Citrin,* 440 F.3d 418 (7th Cir. 2006); *United States v. Rodriguez,* 628 F.3d 1258 (11th Cir. 2010), *cert. denied* 563 U.S. 966 (2011).

[20] *See, e.g., WEC Carolina Energy Solutions, LLC v. Miller*, 687 F.3d 199 (4th Cir. 2012), *cert denied* 133 S.Ct. 831 (2013); *United States v. Nosal*, 676 F.3d 854 (9th Cir. 2012) (*en banc*).

without precedent. Whistleblowers and their representatives should review relevant state and federal criminal laws related to documents and underlying conduct to assess these risks and minimize them where possible.

V. Disclosures to Government Officials

For many whistleblowers, full-blown litigation is an intensely disruptive, stressful, and uncertain path to recovery. In most cases, if not all, the former employee is better served by entering into a voluntary settlement agreement that sets out mutually agreeable terms of departure. In addition to the standard release of claims, confidentiality, and non-disparagement clauses that nearly all such agreements contain, representatives for whistleblowers should be on guard against attempts to secure the employee's agreement to refrain from communications with government officials about matters related to their employment, and/or to decline any recovery that might flow from regulatory enforcement. Such provisions are contrary to public policy and the equitable interests of the whistleblower.

On the first issue of reports to government agencies, there is a clear public interest in the disclosure of wrongdoing to those charged with the protection of civil rights, health and safety, and consumer protection. Despite this clear and self-evident principle, only the SEC has promulgated a rule expressly providing that confidentiality agreements cannot be enforced where they would prevent an employee from providing information to the Commission related to a securities violation. 17 C.F.R. § 240.41f-17(a). In April 2015, the SEC brought its first enforcement action against an employer for requiring employees to sign confidentiality agreements during internal investigations that required them to vet all disclosures with the corporate legal department.[21] Following the SEC's investigation, the employer agreed to pay a $130,000 penalty and amended its confidentiality agreements to clarify that employees are permitted to make reports of securities violations to the Commission without fear of reprisal.

For reports to other government agencies, employees who have entered into confidentiality agreements without such carve-outs potentially face breach of contract claims from their former employers. Public policy arguments that have been effective in the FCA context, as noted above, might prevail against a breach of contract claim, particularly in jurisdictions with favorable whistleblower precedents. Whistleblowers could nevertheless face considerable costs in responding to or defending these claims. An explicit carve out is therefore an important part of any settlement agreement.

On the second issue of whether an employee should agree to forgo any financial recovery related to a report to a government agency (*i.e.*, a whistleblower reward), representatives for whistleblowers should also advocate vigorously against such provisions. Employers enter into settlement agreements in part to bring a dispute to a final resolution, with the assurance that they will have no further, indeterminate financial liability to the individual going forward. This legitimate interest is not implicated, however, by an employee's eligibility for a whistleblower award under any current federal programs because awards are not paid from the employer to the employee in these matters. Employers instead pay penalties to the federal government for

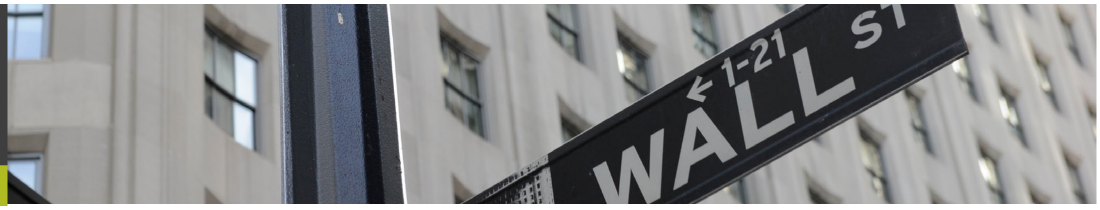
[21] Press Release, SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements (Apr. 1, 2015), *available at* https://www.sec.gov/news/pressrelease/2015-54.html.

violations of the law, and agency authorities then make independent and discretionary decisions about issuing a reward to the whistleblower. The amount of a whistleblower's award is thus *determined* by the amount recovered from the corporation, but not is paid directly from it. As such, there is no duplicative recovery by the employee from the employer, nor additional liability that is created through operation of the rewards programs.

VI. Conclusion

Representing executive-level whistleblowers requires attorneys to be aware of many nuanced issues for which clear guidance is often sparse. An executive's broad access to confidential corporate information can provide strong evidence of unlawful conduct and retaliation, but this access is often accompanied by implied and express duties that can significantly constrain that executive's legal position, as well. On the employer's side, the stakes are high when facing the potential claims of an executive-level whistleblower; settlement will be more expensive than in the case of a lower-level employee, yet litigation also has substantial economic and reputational risks. Employers therefore have increased incentives to find effective ways to thwart retaliation claims by executives and stifle reports to regulators. Attorneys for executive whistleblowers must therefore be aware of and consider all the unique issues that may arise in order to most effectively represent their client.

Labaton Sucharow



SEC Whistleblower Program Handbook

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TABLE OF CONTENTS

SEC WHISTLEBLOWER PROGRAM

HANDBOOK

by

JORDAN A. THOMAS*

I. BACKGROUND

In 2010, in response to a long series of corporate scandals that defrauded countless investors and shook investor confidence, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), one of the most significant financial reform efforts since the Great Depression. Section 922 of that legislation amended the Securities Exchange Act of 1934 (the "Exchange Act") by adding Section 21F, entitled "Securities Whistleblower Incentives and Protections."[1] This new Section 21F required the Securities and Exchange Commission (the "SEC" or "Commission") to enact a whistleblower program to pay financial awards to individuals who provide information about possible securities violations to the SEC.

Shortly after the passage of Dodd-Frank, the SEC made public its proposed rules to implement the new Section 21 of the Exchange Act. The proposal generated much discussion—the SEC received over 240 comment letters and about 1,300 form letters.[2] The SEC made a number of revisions to the proposed rules in response to the commentary, and on May 25, 2011, the Commission adopted the final rules governing the new whistleblower program as Regulation 21F.[3] Under these new rules, an individual who voluntarily provides the SEC with original information resulting in a successful enforcement action in which the SEC collects over $1 million in sanctions will be eligible for a financial reward of between 10% to

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He also is the editor of secwhistlebloweradvocate.com, a website dedicated to helping organizations establish a culture of integrity and courageous whistleblowers to report possible securities violations – without regrets.

1 Codified at 15 U.S.C. § 78u-6.

2 Implementation of the Whistleblower Provisions of the Securities Exchange Act of 1934, Securities and Exchange Commission, Release No. 34-64545 ("Implementation Release") at 4.

3 17 C.F.R. § 240.21F *et. seq.*

30% of the amount collected, depending on various factors. The program became effective on August 12, 2011.

The program recognizes, for the first time, that law enforcement authorities need the public's help to effectively and efficiently police the marketplace. The reality is that securities fraud schemes are often difficult to detect and prosecute without inside information or assistance from participants in the scheme, or their associates. As Sean McKessy, Chief of the SEC's Office of the Whistleblower stated in a speech at Georgetown University, the SEC "simply cannot be everywhere," and that "is why the new whistleblower program . . . is so crucial to [the Commission's] work." The program, Mr. McKessy stated, will "help [the SEC] to more quickly identify and pursue frauds that [it] might not have otherwise found on [its] own"; "strengthen [the SEC's] ability to carry [its] mission"; and "save [the SEC] much time and resources in the process."[4]

II. PROTECTIONS FOR EMPLOYEE WHISTLEBLOWERS

Dodd-Frank established new and powerful anti-retaliation protections for individuals who act as whistleblowers, including a new private right of action for employees subjected to retaliatory action from their employer. The Act also significantly improved existing whistleblower-protection laws, most notably the relevant provisions of the Sarbanes-Oxley Act of 2002 ("SOX"). Many whistleblowers are also eligible for other federal and state whistleblower protections.

A. New Anti-Retaliation Protections for SEC Whistleblowers

Under the new Section 21F of the Exchange Act, an employer may not discharge, demote, suspend, threaten, harass, or take any other retaliatory action against an employee who either:

(i) provides information about his or her employer to the SEC in accordance with the whistleblower rules;

(ii) initiates, testifies in, or assists in an investigation or judicial or administrative action; or

(iii) makes disclosures that are required or protected under SOX, the Exchange Act, and any other law, rule, or regulation subject to the jurisdiction of the Commission.[5]

In the event of a retaliatory act, Section 21F(h) grants an automatic private right of action in federal court to all employees who are subjected to the retaliatory act, without the need to exhaust administrative remedies prior to filing.[6] This right of action, moreover, is not limited to employees of publicly traded companies and its subsidiaries. The remedies available to a plaintiff under this section include reinstatement to the same seniority, double

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[4] Transcript available at http://www.sec.gov/news/speech/2011/spch081111sxm.htm (last visited January 10, 2012).

[5] Exchange Act § 21F (h)(1)(A)(i)-(iii).

[6] *Id.* at § 21F(h)(1)(B)(i).

back pay, and litigation costs (including attorneys' fees and expert witness fees).[7] An employee suing under this section must file the claim no later than six years from the retaliatory conduct or three years from when the employee knew, or reasonably should have known, of the retaliatory conduct, but in no event to exceed 10 years after the date of the violation.[8]

To be eligible for these anti-retaliatory protections, the whistleblower rules established by the SEC provide that the whistleblower must possess a "reasonable belief" that the information provided relates to a possible securities violation, and the information must be submitted in accordance with the procedures set forth in the rules (*see* Section IV).[9] According to the SEC, a whistleblower has a "reasonable belief" if he or she holds a subjectively genuine belief that the information demonstrates a possible violation, *and* that this belief is one that a similarly situated employee might reasonably possess.[10] Furthermore, the information must demonstrate a "possible violation," which requires, at minimum, a facially plausible relationship to some securities law violation, thus eliminating frivolous submissions from eligibility.[11]

At least one federal court has held that the prohibition against retaliation and the private right of action apply to an employee who makes a disclosure required or protected by law—like a disclosure under SOX, for instance—under Section 21F(h)(1)(A)(iii), even if that employee did not provide the disclosed information to the SEC.[12] In other words, the employee would still be protected from retaliation, and could still bring a claim in the event of a retaliatory act, even if he or she would not otherwise qualify as a "whistleblower" for purposes of receiving an award. This holding is consistent with the statute and the whistleblower rules; indeed, even a statutory whistleblower is entitled to the anti-retaliation protections, regardless of whether he or she eventually qualifies for an award.[13]

It is important to note that these anti-retaliation protections do not go into effect until an employee reports the possible securities violation to the SEC in accordance with the whistleblower program's rules or otherwise makes a protected disclosure pursuant to Section 21F(h)(1)(A)(iii). Reporting internally does not typically satisfy this important procedural requirement.

B. Enhancement of SOX Employee Protections

Dodd-Frank also enhanced the employee protections established in SOX. In particular, the statute expanded SOX 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."[14] This includes foreign

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7 *Id.* at § 21F(h)(1)(C)(i)-(iii).

8 *Id.* at § 21F(h)(1)(B)(iii).

9 17 C.F.R. § 240.21F-2(b).

10 Implementation Release at 16 (emphasis original).

11 *Id.* at 13.

12 *Egan v. TradingScreen, Inc.*, No. 10 Civ. 8202, 2011 WL 1672066, *5 (S.D.N.Y. May 4, 2011).

13 Implementation Release at 18.

14 Pub. L. 111-203, § 929A.

subsidiaries and affiliates of U.S. public companies.[15] Thus, Dodd-Frank now provides extraterritorial reach in actions brought by the SEC and the Justice Department.[16] Furthermore, Dodd-Frank expands SOX coverage to employees of nationally recognized statistical ratings organizations, such as Moody's Investors Service Inc., A.M. Best Company Inc., and Standard & Poor's Ratings Service.[17]

Finally, Dodd-Frank doubles the statute of limitations for SOX whistleblower claims from 90 to 180 days; provides for a jury trial for claims brought under SOX whistleblower protections; and declares void any "agreement, policy form, or condition of employment, including a predispute arbitration agreement" which waives the rights and remedies afforded to SOX whistleblowers.[18]

C. New Protections for Financial Service Employees

Congress, in enacting Dodd-Frank, also created the Consumer Financial Protection Bureau to protect whistleblowing employees who work for a financial products or services company. A "financial products or services" company is 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.[19]

Employees of such companies cannot be retaliated against for any of the following:

(i) testifying or expressing the willingness to testify in a proceeding for administration or enforcement of Dodd-Frank;

(ii) filing, instituting or causing to be filed or instituted, any proceeding under any federal consumer financial law; or

(iii) 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.[20]

A financial services employee who is subjected to retaliation must file a complaint within 180 days of the retaliatory conduct with the Secretary of Labor, and may seek *de novo* review in federal district court within 120 days of the Secretary of Labor's determination (or 210 days after filing with the Secretary of Labor). The only requirement for filing a claim is that the employee must show, by a preponderance of the evidence, that the protected conduct

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[15] *Id.* at § 929P(b).

[16] *Id.* at § 929P(c).

[17] *Id.* at § 922(b)

[18] *Id.* at § 922(c)

[19] *Id.* at § 1002(15)(A).

[20] Pub. L. 111-203, § 1057(a)(1)-(4).

was a "contributing factor" to the retaliation.[21] Upon such a showing, 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.[22]

III. QUALIFYING FOR A REWARD AS A WHISTLEBLOWER

In general, Regulation 21F provides for a monetary award to any individual or group of individuals (a company or other entity is not eligible), regardless of citizenship, who:

(i) voluntarily provides the Commission;

(ii) with original information about a possible violation of the federal securities laws;

(iii) that leads to a successful enforcement action;

(iv) resulting in monetary sanctions exceeding $1,000,000.[23]

A. "Voluntarily Provide"

To qualify as a whistleblower, the first requirement is that the individual "voluntarily provide" the information to the SEC. Information is provided voluntarily if it is provided "before a request, inquiry, or demand" for such information by either (i) the SEC; (ii) by the Public Company Accounting Oversight Board or any self-regulatory organization in connection with an investigation, inspection or examination; or (iii) in connection with an investigation by Congress, the Federal Government, or a state Attorney General or securities regulatory authority.[24]

Moreover, the submission will not be considered voluntary if the whistleblower was required to provide the information to the SEC as a result of a pre-existing legal duty to the Commission, or a contractual duty owed to the Commission or one of the other enumerated authorities.[25]

It is important to clarify, however, that such a request, inquiry, or demand must be made on the individual, and not simply the organization for which he or she is employed. Thus, if an employee is aware that a demand for information was made to his or her employer or that the employer is being investigated, and that employee provides the SEC with information about a possible securities violation, the submission would still be deemed voluntary. But an issue could arise if the employee provides the same information to the Commission that the Commission received as part of its investigation of the company (or would have received even if the employee had not provided the information to her employer during the investigation). That could affect the determination of whether the employee's submission led to a successful enforcement action.

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21 *Id.* at §1057(c)(3)(c).

22 *Id.*

23 17 C.F.R. § 240.21F-3.

24 *Id.* at § 240.21F-4(a)(1).

25 *Id.* at § 240.21F-4(a)(3).

Another important caveat is that a submission to the SEC will be deemed voluntary even if made after receiving a request, inquiry, or demand from the SEC, if the information was voluntarily provided to one of the other authorities prior to the SEC's request or inquiry.

B. "Original Information"

The second requirement for receiving a reward is that the individual provide "original information." To be considered "original information," the information must be:

(i) derived from independent knowledge or independent analysis;

(ii) not already known to the SEC from any other source;

(iii) not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the media, unless the whistleblower was the original source for the information; and

(iv) provided to the SEC after July 21, 2010.[26]

Independent Knowledge and Independent Analysis. The Commission defines "independent knowledge" as factual information in the individual's possession that is not derived from publicly available sources.[27] Significantly, the information could be gained from experiences, communications, and observations in business or social interactions. In other words, the individual need not have first-hand knowledge of the potential violation, but could have learned of the facts from a third-party. "Independent analysis" is defined in the Regulation as an individual's own examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.[28]

There are a number of important circumstances in which the SEC will not consider information as being derived from independent knowledge or analysis. These exclusions generally apply to narrow categories of individuals, such as lawyers, consultants, and other third parties who acquire information as part of their work on behalf of a client, or company insiders who learn of the information in connection with their role in an internal investigation into wrongdoing, as well as information acquired illegally. Specifically, information is excluded in the following circumstances:

(i) when the information is subject to the attorney-client privilege, unless disclosure of that information would otherwise be permitted by an attorney pursuant to § 205.3(d)(2), the applicable state attorney conduct rules, or otherwise;

(ii) the information is obtained in connection with the legal representation of a client, and the lawyer seeks to make a whistleblower submission for his or her own benefit, unless disclosure

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26 *Id.* at § 240.21F-4(b).

27 *Id.* at § 240.21F-4(b)(2).

28 *Id.* at § 240.21F-4(b)(3).

of that information would otherwise be permitted by an attorney pursuant to § 205.3(d)(2), the applicable state attorney conduct rules, or otherwise;

(iii) the information was obtained because the individual was (a) an officer, director, trustee, or partner of an entity and was informed of the allegations by another person, or learned of the allegations in connection with the entities internal process for identifying and reporting violations of law; (b) an employee whose duties involve compliance or internal audits, or an employee of a firm retained to perform compliance or internal audit; (c) employed by a firm retained to conduct an internal investigation; or (d) an employee of a public accounting firm and the information was obtained during an engagement; or

(iv) the information is obtained by means determined by a United States court to violate federal or state criminal law.[29]

As for the third category of exclusions—for individuals who are insiders and third parties retained to perform legal, audit, or investigative work—there are a few important exceptions. Specifically, the exclusion will not apply if the individual has a reasonable basis to believe that the disclosure is necessary to prevent the entity from engaging in conduct that will cause substantial injury to the entity or the investing public, or that the relevant entity is engaging in conduct that will impede an investigation. Moreover, if more than 120 days elapsed since the whistleblower provided the information to the entity's audit committee, chief legal or compliance officer, or his or her supervisor, the exclusion will not apply.[30]

Original Source. As stated above, for information to be considered "original," it cannot already be known to the SEC from any other source. There are two exceptions to this rule. First, the SEC will consider a whistleblower the original source of information that was previously received by the SEC from another source if that source obtained the information from the whistleblower or the whistleblower's representative in the first place (and the information otherwise satisfies the definition of original). Second, the SEC will consider a whistleblower to be the original source of information if that information derives from the whistleblower's independent knowledge or analysis *and* materially adds to the information already known to the Commission.[31]

C. "Successful Enforcement Action"

Third, the voluntarily provided, original information must lead to a successful enforcement action. The Regulation sets forth three circumstances constituting a successful enforcement action:

(i) The information provided to the Commission caused the Commission to commence an examination, open an investigation, reopen a

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[29] 17 C.F.R. § 240.21F-4(b)(4)(i)-(iv).

[30] *Id.* at § 240.21F-4(b)(4)(v).

[31] *Id.* at § 240.21F-4(b)(5)-(6).

previously-closed investigation, or inquire about different conduct as part of a current investigation, and the Commission brings a successful action based in whole or in part on the original information provided;

(ii) The original information relates to a conduct that is already under investigation by the Commission (or other federal authority) and significantly contributes to the success of an enforcement action based on that conduct; or

(iii) The information is provided by an employee through his or her employer's internal reporting procedures before or at the same time the employee submits the information to the Commission, and the employer then provides the employee's information (or the results of an internal investigation) to the SEC, which leads to a successful enforcement action (the employee will get the full credit for providing the information to the SEC).[32]

This last category was not in the original rules proposed by the SEC, and many comments expressed the concern that whistleblowers would completely bypass organizations' internal reporting mechanisms.[33] Thus, this provision was added in an effort to encourage individuals to utilize internal compliance programs so that such programs will continue to play an important role in facilitating compliance with the securities laws.

In addition, the SEC will pay an award based on sanctions collected in a related proceeding brought by the Attorney General of the United States, a regulatory authority or self-regulatory organization, or a state attorney general, and that is based on the same information that led to the Commission's successful enforcement action.[34]

D. "Monetary Sanctions Exceeding $1,000,000"

Generally, the monetary sanctions must exceed $1 million in a single judicial or administrative action. In some circumstances, however, the SEC will aggregate the sanctions collected in two or more proceedings if the proceedings arise out of a common nucleus of operative facts.[35] Once this threshold is met, a whistleblower would be eligible for a monetary award based upon all monetary sanctions collected in related enforcement actions—regardless of amount.

IV. PROCEDURES FOR MAKING A SUBMISSION AND CLAIMING AN AWARD

The procedures for submitting original information to the Commission are relatively simple, yet it is extremely important that they be followed correctly. Otherwise, a potential

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[32] *Id.* at § 240.21F-4(c).

[33] Implementing Release at 101-07.

[34] 17 C.F.R. *Id.* § 240.21F-(2)(b).

[35] *Id.* at § 240.21F-4(d).

whistleblower might be disqualified from receiving a reward and, critically, might not be eligible for the anti-retaliation protections provided by Dodd-Frank.

Regulation 21F provides two methods for submitting information to the SEC: (1) online using the Commission's website (http://www.sec.gov), or (2) by mailing or faxing a Form TCR to the SEC Office of the Whistleblower.[36] In addition, the whistleblower must declare under penalty of perjury that the information contained in the submission is true and correct to best of his or her knowledge.[37] If the whistleblower wishes to remain anonymous, his or her submission must be made by an attorney in accordance with the same procedures just described.[38]

Once a final judgment in an action is entered and the damages exceed the $1 million threshold, the SEC will publish a Notice of Covered Action. In order to claim a reward, the whistleblower must then complete, sign, and submit to the SEC a Form WB-APP[39] within ninety (90) days of the date of the Notice of Covered Action. If the whistleblower provided his or her original submission anonymously, the whistleblower must disclose his or her identity on the Form WB-APP.[40]

V. DETERMINING THE AMOUNT OF THE AWARD

If all the conditions are met and a whistleblower is entitled to an award, the amount of that award will be between 10 and 30 percent of the sanctions collected by the SEC or other prosecuting authority.[41] Even if there are multiple whistleblowers, the total amount awarded to all whistleblowers will still be between 10 and 30 percent of the sanctions, with the amount of the award for each whistleblower determined on an individual basis. The determination of the actual amount of a reward is in the sole discretion of the SEC.

In reaching its determination, SEC considers several factors unique to the circumstances of each case.

The factors that may increase a whistleblower's award include:

(i) the significance of the information provided to the success of the action or related action, including how the information related to the action and the degree to which the information supported one or more successful claims;

(ii) the degree of assistance provided by the whistleblower to the Commission in the action or related action, including, among other things, the extent to which the whistleblower explained complex transactions and interpreted key evidence, and assisted the

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[36] *Id.* at § 240.21F-9(a).

[37] *Id.* at § 240.21F-9(b).

[38] *Id.* at § 240.21F-4(c).

[39] Application for Award for Original Information Provided Pursuant to Section 21F of the Securities and Exchange Act of 1934.

[40] 17 C.F.R. § 240.21F-10.

[41] 17 C.F.R. § 240.21F-5(b).

authorities in the recovery of the fruits and instrumentalities of the violation;

(iii) law enforcement interest in prosecuting and deterring the type of securities violation involved in the submission; and

(iv) whether the whistleblower reported the potential violation internally using organizational compliance procedures (another attempt by the SEC to preserve the importance of internal compliance programs).[42]

Conversely, the factors that could reduce the size of a whistleblower's award are:

(i) the culpability or involvement of the whistleblower in the securities violation, including the whistleblower's role in and the extent he or she benefited from the violation;

(ii) whether the whistleblower unreasonably delayed reporting the potential violation; and

(iii) if the whistleblower internally reported the potential violation in accordance with his or her employer's compliance program, whether, and the extent which, the whistleblower interfered with or undermined that program.[43]

As the above indicates, an individual will not automatically be precluded from receiving an award as a whistleblower if he or she had some culpability in the underlying violation. The extent of the culpability would merely be a factor considered by the SEC in determining the size of the award.

VI. ELIGIBLE SECURITIES VIOLATIONS

With the prospect of large financial awards and robust employee protections provided by Dodd-Frank and the new SEC whistleblower program, it is important that individuals are aware of those violations that qualify for the program. A whistleblower may report any violation of the federal securities laws that has occurred, is ongoing, or is about to occur. However, for the SEC to obtain a monetary civil penalty, the relevant securities violation(s) must have occurred, or have remained ongoing, within the past five (5) years, even if the whistleblower did not discover the possible violation until a later date.[44] The reported misconduct may occur anywhere in the world. International organizations and individuals that do business or have contacts with the United States may also be subject to this jurisdiction.

The following is a brief summary of the most common types of securities violations—and, according to the SEC's Annual Report on the Dodd-Frank Whistleblower Program for

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[42] *Id.* at § 240.21F-6(a).

[43] *Id.* at § 240.21F-6(b).

[44] *See* 28 U.S.C. 2462; *Gabelli v. SEC,* 133 S.Ct. 1216 (2013).

fiscal year 2012, released in November 2012,[45] the most commonly reported violations by whistleblowers.

A. Financial Fraud/Corporate Disclosures

Financial fraud involves the filing of false or misleading financial statements with the SEC, and often occurs when a company engages in accounting practices that create the appearance of increased earnings and revenues for a particular reporting period. Another common financial fraud is the use of manipulative business transactions that generally have no practical purpose but to manipulate revenues, expenses, earnings, and/or losses for a reporting period. Sometimes these transactions might even be legal on their face, but they are being used unlawfully. Financial fraud could also occur when a company fails to speak truthfully when discussing its financial results.

B. Offering Fraud

Offering fraud occurs when an individual (or group of individuals) make misrepresentations and/or omissions of material fact to potential investors in a new company. For example, individuals might contact potential investors and attempt to induce them into investing in a new, unknown company, by making false claims about the company. It is also often the case that the securities being sold are not properly registered with the SEC, an additional violation of the securities laws called an "Unregistered Offering." Another common type of offering fraud is a Ponzi scheme, where investors are paid returns from their own money or from the money invested by subsequent investors, rather than from any actual profit earned. New investors are induced with unusually consistent or abnormally high returns being paid to older investors.

C. Insider Trading

Insider Trading is the buying or selling of a corporate security while in possession of material information that is not known to the public at the time, but then becomes public and causes the price of the security to rise or fall significantly. This information is often obtained by corporate insiders who have access to the information based on their position inside the organization. That insider then buys or sells the securities based on that information. Insider trading may also occur when a corporate insider "tips" the nonpublic information to someone outside of the organization, and that person then buys or sells securities. In that case both the "tipper" of the information and the "tipee" (the person receiving the information) are liable for illegal insider trading.

D. Trading and Pricing

Trading and pricing violations are any number of unlawful trading techniques that involve unfair trades or affect the price of the security being bought or sold. These include:

- <u>Market timing/late trading</u>: Market timing is a trading "arbitrage" strategy that seeks to take advantage of pricing inefficiencies in mutual funds and similar vehicles, which are generally priced only once per day. For example, a market timer may learn that changes in

[45] Available at: http://www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf.

the price of securities traded on a foreign exchange have not yet been incorporated into the price of a mutual fund's shares, and buy or sell the shares on that basis. While market timing is not illegal per se, it may cause harm to long-term investors and may constitute a securities violation if not properly disclosed to investors. Late trading occurs when a mutual fund permits certain customers to purchase shares in the fund after trading has closed for the day. Because mutual fund prices are set once a day, a customer that purchases after trading is closed can do so at that day's price and not at the following day's price.

- Marking the Close: Buying or selling a stock near the close of the day's trading in order to affect the closing price.

- Front running: The act of buying or selling a security with the knowledge that another investor is about to make a trade that will influence the price of the security one way or the other.

- Pooling: An agreement among a group of people delegating authority to a single manager to trade in a specific stock, for a specific period of time, and then to share in the resulting profits or losses.

E. Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act ("FCPA") is an anti-bribery statute that prohibits the offering, payment, or promise to pay money or anything of value to any foreign official in an effort to win or retain business from that foreign official's government. It is not a violation of the FCPA, however, if (i) the payments are legal under the written laws of the country in which the payments are made; or (ii) the payment is a reasonable expenditure directly related to the conducting of business with a foreign government.

F. Market Manipulation

Market manipulation is the interference with the free and fair operation of the market by engaging in transactions that create an artificial price or maintain an artificial price for a security. Examples of market manipulation include:

- Churning: Churning is the placing of both buy and sell orders for the same security at the same price in order to create the appearance of increased activity in the buying and selling of the security, thereby increasing its price.

- Pump and Dump: Where owners of a security spread false information so that the price of the security will increase (the pump). When the price of the security does increase based on these false rumors, the owners who spread the false information sell off their shares, making a profit (the dump).

- Wash Trades: Like churning, wash trades involve the selling and repurchase of the same security for the purpose of generating activity and increasing the price.

G. Market Events

"Market events" refer to disruptions or aberrations in the securities markets, such as an unexpected interruption in trading on a securities exchange, a liquidity crisis or a "flash crash". While not all such market events represent securities violations, the SEC has brought enforcement actions against exchanges and related entities where the market event was caused or exacerbated by the exchange's failure to follow relevant SEC or internal rules.

H. Municipal Securities

Municipal securities are debt securities issued by state and local governments in the United States and its territories, and are generally used to fund items such as infrastructure, schools, libraries, general municipal expenditures. Under the Exchange Act, dealers in municipal securities are required to provide certain important information about the municipal securities to investors. In addition, as with any security, the anti-fraud provisions prohibit any person from making a false or misleading statement of material fact, or omitting to state any material fact, in connection with the offer, purchase, or sale of any municipal security. Thus, a failure to comply with these laws in connection with the purchase or sale of municipal securities would be an actionable securities violation subject to SEC enforcement.

VII. CONCLUSION

The passage of Dodd-Frank and the enactment of the SEC whistleblower program were watershed moments in financial regulation and investor protection. Although the whistleblower program is still in its infancy, its impact is already being felt: in fiscal year 2012 alone, the Office of the Whistleblower received more than 3,000 tips, coming from individuals in all 50 states as well as 49 foreign countries. The SEC has now paid several whistleblower awards, a significant fact given that SEC enforcement actions typically take two to four years to complete. As Associate Director of the Division of Enforcement Stephen Cohen commented in June 2013, the SEC is "receiving information from individuals much closer in time to the misconduct, in some instances during the misconduct, and these individuals are often insiders, which is very unusual, are in a position to point [the SEC] precisely to where the useful information is and save [the SEC[extraordinary resources… I expect you will see a lot more impact from the program publicly in the coming months and years."[46]

Going forward, it is likely that many of the SEC's most significant enforcement actions will be the result of whistleblower tips, changing the landscape of securities enforcement. Accordingly, it is vital that potential whistleblowers and their counsel familiarize themselves with the relevant statutory provisions and the rules adopted by the SEC so that whistleblowers can maximize their award and protect themselves from retaliation. It will also be important for responsible organizations to evaluate their internal reporting systems and to establish a culture of integrity.

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[46] See SEC's Cohen Predicts Major Whistleblower Awards Soon, Corporate Crime Reporter, Jun. 12, 2013, available at: http://www.corporatecrimereporter.com/news/200/seccohenwhistleblower06122013/.

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Wall Street's New Enforcers Aim to Muzzle Whistle-Blowers

By [JORDAN THOMAS] and [TOM DEVINE]
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Jordan Thomas is chairman of the whistle-blower representation practice at Labaton Sucharow and was a former assistant director in the enforcement division of the Securities and Exchange Commission. Tom Devine is legal director of the Government Accountability Project and co-author of "The Corporate Whistleblower's Survival Guide: A Handbook for Committing the Truth."

Welcome to Wall Street, where the unwritten rule has always been that you don't talk about illegal or unethical activities with law enforcement or regulatory authorities. Of course, this type of code of silence is not new. What is new is that this corporate omerta is being enforced by lawyers wielding gag orders.

In the wake of the economic crisis, our country debated how to break the cycle of corporate scandals that have plagued financial markets. Our financial watchdogs landed on two simple, fundamental truths: the investor protection status quo wasn't working; and those responsible for law enforcement could not effectively and efficiently police the marketplace without help from private individuals.

Consequently, four years ago this Monday, the Dodd-Frank financial overhaul was signed into law. Among its many provisions, the statute established the Securities and Exchange Commission's whistle-blower program, which offers eligible whistle-blowers significant employment protections, monetary awards and the ability to report possible securities violations anonymously. Potential monetary awards can be substantial because the agency secures over $3 billion a year in monetary sanctions and whistle-blowers are entitled to 10 to 30 percent of the sanctions collected as a result of their tips.

Although public debate on Dodd-Frank continues, few have questioned the whistle-blower program's early success and potential to protect investors. The $8.9 billion settlement with BNP Paribas, although not reported through the S.E.C. program, is the latest example of how whistle-blowers can help law enforcement detect, investigate and prosecute corporate wrongdoing.

Mary Jo White, the S.E.C. chairwoman, said last year that the program "has rapidly become a tremendously effective force-multiplier, generating high quality tips and, in some cases, virtual blueprints laying out an entire enterprise, directing us to the heart of an alleged fraud."

As Dodd-Frank has steadily increased the probability of detection, companies have become more sophisticated and aggressive in their efforts to discourage employees from reporting possible violations to the S.E.C. and other authorities. The legal countermeasures being deployed include a variety of employment, severance and settlement agreements that weaken both new and existing whistle-blower programs.

It was no isolated aberration that KBR, one of the nation's largest government contractors, required employees seeking to report fraud to sign internal confidentiality agreements prohibiting them from reporting violations to law enforcement authorities. Rather, it reflects a growing trend of companies trying to silence whistle-blowers, at the same time Congress strengthens their rights.

Examples include: failing to educate employees about the S.E.C. whistle-blower program and their rights, unlike other corporate, state and federal programs; preventing employees from consulting legal counsel through the use of nondisclosure agreements, effectively eliminating their ability to file anonymously in accordance with S.E.C. rules; exploiting corporate whistle-blowers' fear of retaliation and blacklisting by requiring notice of external reporting, in violation of their right under Dodd-Frank and S.E.C. rules to report anonymously; de-incentivizing tips by making employees sign agreements waiving any future monetary awards for blowing the whistle; and intimidating potential whistle-blowers with lawsuits to enforce secrecy agreements, a battle few whistle-blower have the desire and resources to fight.

To be sure, the vast majority of companies want to do the right thing. Many need guidance on lawful boundaries for standard employment agreements. Others appear to be intentionally crossing the line and using gag orders to chill external reporting. While no court has issued an opinion on the legality of these agreements in light of Dodd-Frank, many of them are clearly at odds with public policy, not justified by a legitimate corporate interest and inconsistent with principles of employment, contract and securities law. Because of the systemic nature and continuing harm, we have just filed a petition with the S.E.C. that will provide companies clear direction regarding these troubling agreements.

We are joined by a broad and growing coalition, representing more than 250 organizations and nearly two million citizens, including Americans for Financial Reform, the National Employment Lawyers Association, the International Brotherhood of Teamsters and other prominent groups. This coalition has also submitted a petition, urging the S.E.C. to hold a series of hearings around the country to discuss the problem of workplace retaliation and explore new ways to increase reporting, internally and externally. It also asks the agency to create an advisory committee on whistle-blower reporting and protection to recommend program improvements and best practices; and engage in appropriate rule-making to clarify and strengthen whistle-blower protections.

With whistle-blowers beginning to break Wall Street's code of silence, it would be a historic mistake if the S.E.C. and other authorities allowed corporations to systematically dismantle this landmark investor protection reform through private agreements and legal bullying. If their rights are protected, in the coming years, enforcement records will be broken and many of the S.E.C.'s most significant cases will come from courageous whistle-blowers. More important, whistle-blowers will become the enforcers of a new culture of integrity on Wall Street that deters future violations and restores the public's trust in our financial system.

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The **Limitations** of Corporate Compliance

Establish an ethical culture in an era of scandal.

BY JORDAN A. THOMAS

AFTER MORE than 15 years in federal law enforcement, first as a Trial Attorney at the Department of Justice and later as an Assistant Director in the Enforcement Division of the U.S. Securities and Exchange Commission (SEC), one thing has become certain about corporate compliance: Many programs, well wrought, thoughtful and expensive as they may be, only address half of the equation. They focus largely on the mechanics of compliance and the practical response to misconduct. A more important and preemptory issue—establishing an ethical culture that deters misconduct—is often absent from the calculus.

Without a robust ethical platform, corporate compliance is a post-facto and tactical exercise. In a post-Dodd-Frank environment, the stakes are too high for tactics. Companies need ethical strategists. Any corporate leader who disagrees need only consider that, with the new SEC whistleblower provisions enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the federal government has deputized virtually every company employee, vendor, customer (and their second cousins) to serve as their eyes and ears. The scrutiny is, and will grow far more, intense.

It's time to develop a new paradigm for corporate character. This is particularly important in an economic downturn, when executives send messages about profit-or-else and fears about job security can supersede ethical decision-making. It's time for corporate leaders, in-house and outside counsel included, to make principles like doing the right thing and fulfilling responsibilities to investors, customers, and employees a fundamental part of doing business. Given the unprecedented attention the whistleblower provisions of Dodd-Frank have generated, this is a moment of real opportunity.

Beyond Cops and Robbers

Over the years, the field of corporate compliance has undergone a major and positive transformation. A long series of scandals beginning with Enron, regulatory reform under Sarbanes-Oxley, and favorable dispensation under the sentencing guidelines have all contributed to the growth of strong and independent compliance functions, often separate from an in-house law department, with direct reporting to the top. These functions, an important first line of defense, often have impressive arsenals: strong leadership; assorted corporate bodies like governance committees and peer review boards; and solid training programs. There are sophisticated internal controls and monitoring systems; ombudsmen, hotlines and investigation teams; and, voluminous employee manuals, policy statements and memoranda about conduct. Of course, these tools are a vital part of any company's fight against malfeasance. But do they work?

In 2007, surveying various indicia of misconduct, the Compliance and Ethics Leadership Council determined that, of 45 variables tested, the fear of speaking up is the strongest indicator of misconduct. The study found that "companies in which employees are uncomfortable speaking up or fear retaliation have significantly elevated levels of misconduct."[1] Recent related studies are equally troubling. Consider these findings from KPMG's 2008-2009 Integrity Survey:

• 74 percent of employees surveyed reported that they had personally observed or had first-hand knowledge of wrongdoing *during the previous 12 months*;[2]

• Only 57 percent of employees surveyed would feel comfortable using a hotline to report misconduct;[3] and

• Only 53 percent of employees believed they would be protected from retaliation.[4]

In light of such statistics, we need to accept as a given that conventional reporting mechanisms are not working. Indeed, the best evidence of the inadequacy of traditional compliance programs is the long list of distinguished companies that have been the subject of significant SEC enforcement actions, from "white shoe" financial services firms such as Goldman Sachs and Bear Stearns, to corporate giants like Tyco, Siemens and General Electric. Surely these organizations had vigilant compliance officers and sufficient resources to establish state-of-the-art compliance programs. However, during the relevant times, what many of these organizations and others like them have lacked was a strong ethical culture.

> With a **strong ethical culture**, an organization is able to instill in its employees a sense of **stewardship** and **personal accountability** that looks beyond the next quarter's earnings.

Too many organizations ignore this fundamental area and focus their energies and resources on the latest compliance trends. With such a limited focus, we're doomed to a reactive Whack-a-Mole mentality: racing to respond to fraud only after it emerges, with no ability to prevent its occurrence. Apply this scenario to a large compliance department with oversight responsibility for tens-of-thousands of employees and it isn't hard to imagine how fraud escapes detection. In the end, policies and procedures may create a standard for conduct, and outline penalties for wrongdoing, but they do not adequately prevent it.

Creating a Strong Ethical Culture

Big misconduct often results from long chains of little mistakes; one breakdown in judgment cascades to another breakdown, and then another. It could be smoothing out revenue figures one financial quarter, and then creating nonexistent clients to cover up the prior misconduct the next. In time, isolated and seemingly random bad choices snowball into front-page scandals.

Former SEC Chairman Richard Breeden remarked that "it is not an adequate ethical standard to aspire to get through the day without being indicted."[5] We can take this a step further. It's not an adequate standard to have good compliance initiatives in place. We need to prevent or deter misconduct, with a better grounding in operational ethics, rendering compliance less necessary. With a strong ethical culture, an organization is able to instill in its employees a sense of stewardship and personal accountability that looks beyond the next quarter's earnings.

For some, the tricky part is determining who is responsible for creating and maintaining an ethical culture. Time after time, we have heard congressional and trial testimony of CEOs who, without apology, have shirked responsibility for misconduct in their organizations because they couldn't possibly know what their employees were doing all of the time. Similarly, many GCs and chief compliance officers believe that the realm of ethos is best reserved for parents, priests and professors. If an organization receives a Wells Notice from the SEC, will the organization be harmed and who will be held responsible? This is, intellectually and practically, a broad and shared responsibility. Oftentimes, disaster—from SEC fines and shareholder actions to public censure and reputational harm—could have been avoided if the company had operated within a culture where doing the right thing was the only standard.

A New Paradigm

Successful strategies for promoting ethical conduct involve creating a culture that maximizes an employee's ethical potential. The details will differ from company to company; some will take a more formal approach to training than others. However, at the end of the day, organizations with a strong ethical culture tend to have the following characteristics:

A Sense of Community. Ethics is a natural outgrowth of a healthy work environment where employees have a sense of belonging and are concerned about the well-being of their colleagues, customers, and the organization as a whole. Organizations can foster employee engagement in the workplace and

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studies have shown that "trust" and "integrity" were key drivers of employee engagement.[6] If employees do not have this emotional or intellectual connection to their work, they are more likely to engage in unethical behavior because they are not constrained by the potential impact of their misconduct on others. To more effectively promote ethical conduct, invest more time in laying the brick and mortar of the corporate community.

A Compelling Vision. Ethical organizations are driven by a common ethical vision that is clear, understandable and viable. Employees need a set of values, with a related body of rules or Code of Ethics, which they can buy into. This vision should appeal to each employee's own sense of reason and moral judgment. It will guide employees in making day-to-day decisions and assist them in managing the conflicting interests of multiple constituencies. Successful organizations earn employees' trust by convincing them that the company's ethical vision will help them to do the right thing and, at the same time, allow them to succeed in the workplace. Since all potential problems cannot be anticipated or prevented by internal policies and procedures, an organization's ethical vision is the best compass for employees to navigate the complex and dynamic corporate landscape.

Shared Responsibility. An organization's ethical vision must apply, and be important, to everyone. Although there is no such thing as top-down ethics, leaders have the added responsibility of ensuring that their organization lives up to its ethical vision in everything it does. They must lead by example and be devoted cheerleaders of this vision, regularly and clearly communicating its principles to employees.

Empowered Employees. In order for employees to accept an organization's ethical vision, they must be trusted to make decisions consistent with the company's Code of Ethics. Leaders must allow for, and entertain, questions and challenges by employees to earn their moral trust. Studies show that ethics systems which are perceived to be just "window dressing" do no good and actually may be harmful.[7] Of course, at every juncture, encourage employees to report possible misconduct and assure them that they will not be subjected to retaliation of any kind. Make such assurances credible with meaningful follow-up with employees who report misconduct.

Integrated Values. Doing the right thing has to be embedded in an organization's DNA through a deep integration of what it says and does. This ethical vision cannot be a remote, abstract thing that sits bound and dusty on a cubicle shelf. It must be a factor as important to daily decision making as other strategic priorities set by senior leadership. Organizations should develop values-based manuals, compensation structures and performance goals that establish and reinforce these principles within the workplace. All employees need to regularly incorporate this vision into their daily activities—everything from hiring to 360 evaluations to promotions to strategic partnerships.

Accountability. Since trust is an important factor in establishing employee engagement, organizations must endeavor to be fair and consistent regarding all ethical matters. Leaders should look for innovative ways to encourage employees to report possible unethical conduct—including public recognition and financial incentives. Organizations should be prepared to investigate, in a timely manner, reports of misconduct. When legal or ethical violations are discovered, violators should be held accountable, regardless of their position in the organization and in a manner consistent with others similarly situated. Any potential benefits for employees that report possible violations should also be dispensed in an equitable fashion.

Transparency. If "sunshine is the best disinfectant," in an organization, more transparency will generate more credibility and trust. To this end, it is critical that organizations communicate more often and more effectively. Too often companies bury in the corporate vault how they dealt with reports of misconduct. This practice significantly undermines employees' confidence in their organization's commitment to ethics, leads to unnecessary whistleblower submissions, and misses a crucial opportunity to stand against and deter misconduct. A key driver of ethical conduct is the perception of what is acceptable behavior—so shaping the normative view of conduct is important to establishing a powerful and lasting ethical culture. One powerful way to establish an organization's commitment to creating an ethical culture (and to earn cooperation credit) is to self-report significant violations to the SEC and other law enforcement organizations.

Ethics Training and Support Programs. Like any other skill set, an employee's ability to make ethical decisions is enhanced with ongoing training and support programs. Beyond avoiding corporate scandals, studies have shown that ethics training can lead to a boost in workforce morale, an increased work ethic, and a higher quality product or service. Savvy organizations make long-term investments in ethics training and support programs. For well-regarded training and other practice resources, consult the Ethics Resource Center or the Ethics and Compliance Officer Association.

Commitment to Continuous Improvement. Ethical organizations continuously seek ways to improve the manner in which they do business. Leaders challenge employees and themselves by asking: What more can be done to empower employees to make good decisions? Do we encourage employees to speak up and out against wrongdoing? Do the businesses we associate with operate with the highest ethical standards? Do we hold individuals and entities accountable when unethical conduct is discovered? What more can we do to protect investors? Equally important, and often overlooked, removing obstacles to desired behaviors—by modifying internal protocols—can be more effective than developing newer and more complex policies and procedures.

Some great examples of innovative and effective initiatives that build upon these common characteristics include:

- The standards handbook and training programs of the AeroSpace Corporation;
- Employee empowerment strategies at the Ford Motor Company;
- The mandatory ethics component in annual performance appraisals at United Technology Corporation;
- The Talent Sustainability and the "Internal Audit methodology" at the Pepsi Company;
- The ethical partnership strategies at Starbucks;
- The Best Buy ethics blog that is open to employees and the public; and
- The monthly ethical surveys and Tone from the Top strategies at Xerox;

Read up on them. Mirror them. Become a model organization.

Ambivalence Has a New Price Tag

Never doubt that 10 years of financial scandals can ignite a crusade. From federal and state law enforcement to potential whistleblowers and the ordinary citizens who are disgusted by the greed and misconduct pervading the commercial marketplace, there are new and formidable armies poised and ready to root out bad behavior. Some are protesting on Wall Street and others are sitting in board rooms or working in offices down the hall. This new reality presents organizations and their leaders with a critical and urgent question: How committed are they to establishing an ethical culture?

History will show that, with respect to the whistleblower provisions of Dodd-Frank, Congress and the SEC got it right. The genius of Dodd-Frank is that it recognized that law enforcement authorities cannot effectively and efficiently police the marketplace without the assistance of private individuals and entities. Now, for the first time, individuals have significant protections to come forward and report violations of the federal securities laws. In the coming years, whistleblowers will revolutionize securities enforcement and strengthen investor confidence in our markets. It would not be farfetched to predict that many of the SEC's most significant cases will be the direct result of whistleblowers.

Sophisticated organizations will embrace this change and look for innovative ways to recognize employees for exposing unethical behavior. Since the probability of detection has dramatically increased, legal and compliance officers will now have a compelling argument for increased resources and support in establishing strong ethical cultures and state-of-the-art compliance programs. As a result, their organizations will receive tips that they would not have otherwise received. More securities violations will be detected and stopped earlier. Investors will be protected. And their organizations' invaluable reputations will be preserved.

Unsophisticated organizations will remain steadfast to a flawed status quo and treat employees who expose unethical behavior as disloyal or opportunistic, a costly mistake that will result in future SEC whistleblower submissions.

1. The Compliance and Ethics Leadership Council Identifies Leading Indicators of Misconduct at Large Organizations (Aug. 8, 2007), executiveboard.com.
2. Significantly, 46 percent of these employees reported that what they observed could cause a significant loss of public trust if discovered—with that number growing to 60 percent for employees working in the banking and financial services industries.
3. In practice, only 3 percent of reports of misconduct are made to hotline telephone numbers. Ethics Resource Center, 2009 National Business Ethics Survey.
4. Disturbingly, 15 percent of employees who observed and reported misconduct perceived retaliation as a result. Ethics Resource Center, 2009 National Business Ethics Survey.
5. "Managing for Organizational Integrity," Harvard Business Review, L.S. Paine, March-April 1994.
6. Employee Engagement: A Review of Current Research and Its Implications, John Gibbons, The Conference Board, Inc. (November 2006).
7. "Ethical Culture Building: A Modern Business Imperative," Ethics Resource Center (2009).

BNA Daily Labor Report®

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.[1] 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, subject to certain limitations. Whistleblowers who provide such information are eligible for an award of 10 percent to 30 percent of the monetary sanctions.[2]

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

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[1] 17 C.F.R. § 240.21F-1, et seq.

[2] 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.[3] 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.

- 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.[4] 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

[3] See, e.g., 17 C.F.R. § 240.3a-10.

[4] See 17 C.F.R. § 240.21F-9(a).

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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.''[5] Included in this measure are foreign subsidiaries and affiliates of U.S. public companies;[6] Dodd-Frank provides extraterritorial reach in actions brought by the SEC and the Justice Department.[7] 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.[8] 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.[9] Retaliatory acts by employers include discharge, demotion, harassment, suspension, threats, and other discrimination as a result of any lawful act by the whistleblower.[10] Dodd-Frank expanded the statute of limitations to six years from the retaliatory conduct or three years upon discovery of the conduct.[11] Remedies were also expanded to include double back pay and litigation costs (including expert witness fees).[12]

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.[13]

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.[14]

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.[15]

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.[16] 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.[17] The process for filing claims follows the framework for retaliation claims brought under the Consumer Product Safety Improvement Act of 2008.[18]

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.[19] 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-

[5] Id. at Section 929(a).
[6] Id. at Section 929P(b).
[7] Id. at Section 929P(c).
[8] Id. at Section 922 (h)(1)(A)(i)-(iii).
[9] Id.
[10] Id. at Section 922 (h)(1)(A).
[11] Id. at Section 929(a); Section 922(h)(1)(B)(iii).
[12] Id. at Section 922(h)(1)(C)(i)-(iii).
[13] Id. at Section 748(h)(1)(C).

[14] Id. at Section 1002(15)(A).
[15] Id. at Section 1057(a)(1)-(4).
[16] Id. at Section 1057(c)(3)(c).
[17] Id.
[18] 15 U.S.C. § 2087 (claims filed with the Labor Department's Occupational safety and Health Administration within 180 days).
[19] 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.''[20] 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. Understanding 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.

[20] 17 C.F.R. § 240.21F-17.

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De Facto Gag Clauses: The Legality of Employment Agreements That Undermine Dodd-Frank's Whistleblower Provisions

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I. Introduction

In 2010, in the wake of the financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (Dodd-Frank or Act), which established a new whistleblower program for the U.S. Securities and Exchange Commission (SEC or Commission) to more effectively detect, investigate, and prosecute the kind of financial misconduct that has caused repeated and substantial harm to investors.[2] Dodd-Frank's whistleblower provisions implement

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1. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, & 15 U.S.C.).

2. *See* 15 U.S.C. § 78u-6 (2012). Dodd-Frank created a similar program for the Commodity Futures Trading Commission (CFTC). *See* Commodity Whistleblower Incentives and Protection, 7 U.S.C. § 26 (2012). This Article focuses on the SEC Whistleblower Program because of its greater visibility and potential impact; however, the Article's conclusions can be applied equally to the CFTC whistleblower program given the similarity in the programs' statutory and regulatory authority. *Compare* 15 U.S.C. § 78u-6 (2012) *and* 17 C.F.R. § 240.21F.1 et seq. (2013) (SEC Program), *with* 7 U.S.C. § 26 (2012) *and* 17 C.F.R. § 165.1 et seq. *(2013)* (CFTC program).

three incentives to encourage whistleblowers to report securities fraud to the SEC: the availability of substantial monetary awards for reporting,[3] the ability to remain anonymous when reporting to the SEC,[4] and broad protection from employment retaliation.[5] The basic idea of this incentive structure is simple: rewarding and protecting whistleblowers will motivate more individuals to report potentially relevant information about securities violations.[6]

In response, some companies are now seeking to counteract Dodd-Frank by drafting and enforcing a variety of agreements with employees that significantly reduce or eliminate the congressional incentives promoting SEC whistleblowing. These agreements—which seek to alter the statutory risks and rewards of whistleblowing—may have profound consequences not only for current and prospective whistleblowers, but also for the success of the Dodd-Frank whistleblower program itself. The stakes are just as high for employers, who may find themselves facing civil—or, in extreme cases, criminal—liability if they are too aggressive in attempts to shield information from government authorities.

This Article discusses the enforceability of these increasingly prevalent contractual restrictions on whistleblowing, which fall into three broad categories.[7] First, some agreements require an employee to report possible misconduct internally *before* disclosing misconduct to the SEC.[8] Second, some agreements require an employee to waive any monetary award received from blowing the whistle under Dodd-Frank's whistleblower bounty provisions.[9] Both of these types of agreements could significantly limit employees' desire to communicate with the SEC regarding employer misconduct.

In a third type, employers impose general confidentiality provisions in agreements when employment commences or after receiving some benefit, such as a severance package. Although such confidenti-

3. *See* 15 U.S.C. § 78u-6(b) (2012).

4. *See* 15 U.S.C. § 78u-6(d)(2), (h)(2) (2012); 17 C.F.R. §§ 240.21F-7, -9(c) (2013).

5. *See* 15 U.S.C. § 78u-6(h)(1) (2012).

6. Sec. & Exch. Comm'n, Release No. 34-64545, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 101 n.222 (2011) [hereinafter Adopting Release].

7. These examples summarize actual provisions several of the authors and other employment attorneys have frequently seen during the course of representing SEC whistleblowers. *See, e.g.*, Letter from Katz, Marshall & Banks, LLP to the U.S. Sec. & Exch. Comm'n, at 4–6, 8–10 (May 8, 2013), *available at* http://kmblegal.com/wordpress/wp-content/uploads/130508-Letter-to-SEC-Commissioners.pdf (provisions in employee severance and settlement agreements that impede reporting); *see also* Scott Higham & Kaley Belval, *Workplace Agreements Appear to Violate Federal Whistleblower Laws*, Wash. Post (June 29, 2014), http://m.washingtonpost.com/investigations/workplace-secrecy-agreements-appear-to-violate-federal-whistleblower-laws/2014/06/29/d22c8f02-f7ba-11e3-8aa9-dad2ec039789_story.html.

8. Higham & Belval, *supra* note 7.

9. *Id.*; *see also* Letter from Katz, Marshall & Banks, *supra* note 7, at 4–8.

ality agreements are usually not problematic and frequently serve legitimate corporate interests, the potential conflict with Dodd-Frank arises when companies use these types of agreements as the basis for a breach of contract claim against a whistleblower. Employers may argue that the whistleblower violated the confidentiality provision in the process of disclosing possible misconduct to the government. This use of a confidentiality agreement not only punishes an employee after the whistle is blown, but also chills the willingness of employees to blow the whistle in the future due to fear of being sued by a current or former employer.

We label these agreements "de facto gag clauses," and courts, the SEC, and counsel on both sides of the employment bar are grappling with the question of whether they are lawful and enforceable in the face of Dodd-Frank's statutory and regulatory requirements. This determination requires a careful balancing of public, personal, and business interests. While no court has ruled on the legality of de facto gag clauses in the Dodd-Frank whistleblower context, we argue that SEC rules and key principles of contract, qui tam, employment, and securities law strongly suggest that courts will, and should, refuse to enforce agreements that preclude voluntary cooperation with the SEC or materially diminish the whistleblower incentives created by Dodd-Frank.

Part II briefly explains the SEC's Dodd-Frank whistleblower program. Part III examines whether the use of the three categories of contractual restrictions on whistleblowing violate Dodd-Frank's public policy purpose. We conclude that courts would find many currently used provisions unenforceable as against public policy. Part IV proposes practical steps that both employers' and employees' attorneys can take to avoid the risks posed by these provisions and, even more importantly, the specific action that the SEC, as well as the Occupational Safety and Health Administration (OSHA), can take to ameliorate the problems these provisions pose to the effectiveness of the SEC's Dodd-Frank whistleblower program. Given the immediate threat that de facto gag clauses pose to the whistleblower program—even if ultimately found unenforceable by courts—we argue that government agencies should not wait for courts to act. Rather, the SEC and OSHA should immediately act to protect the whistleblower program by clarifying its regulations invaliding agreements that, even indirectly, undermine employees' willingness to disclose wrongdoing to the SEC.

II. The SEC Whistleblower Program

Section 922 of Dodd-Frank created the SEC's current whistleblower program (the SEC Whistleblower Program) as part of Congress's response to the sweeping financial crisis that came to the public's attention in 2008.[10] The SEC Whistleblower Program is a unique blend of approaches taken in previous laws to encourage corporate insiders to report misconduct and to protect them when they do. First, Dodd-Frank adopted a "bounty" model by creating a reward program to incentivize reporting wrongdoing to the SEC.[11] Whistleblowers are eligible to receive a monetary award when they "voluntarily" provide the SEC with "original information" that "leads to successful enforcement" by the Commission, resulting in the recovery of total sanctions in that enforcement action and any related actions that exceed $1 million.[12] If all eligibility criteria are met, the Commission awards the whistleblower an amount equal to ten to thirty percent of the total sanctions collected.[13]

Second, Dodd-Frank incorporates the more commonplace anti-retaliation model by providing a cause of action for corporate whistleblowers who suffer retaliation for disclosing securities violations.[14] The Commission itself may also bring a retaliation action against an employer,[15] a procedure that recently resulted in one company paying a settlement of more than $2.2 million.[16]

Finally, Dodd-Frank incorporated a "structural" model to encourage whistleblowers to report by providing a defined reporting channel.[17] To receive an award under the Act, employees must provide information directly to the SEC.[18] The Act required the SEC to estab-

10. *See* S. Rep. No. 111-176, at 2 (2010) (the bill that would become Dodd-Frank "is a direct and comprehensive response to the financial crisis that nearly crippled the U.S. economy beginning in 2008").

11. *See* Richard E. Moberly, *Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. Rev. 1107, 1108–09 & n.5 (2006) (the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley or SOX) utilizes several models to encourage whistleblowing, including a "bounty" model, an "anti-retaliation model," and a "structural" model). Prior to Dodd-Frank, the bounty model had been used only to reward whistleblowers who reported misconduct that affected the government. *See id.* at 1108 n.5. Dodd-Frank, by contrast, rewards whistleblowers who report wrongdoing directed at private corporations and shareholders.

12. 17 C.F.R. § 240.21F-3 (2013). "Voluntarily," "original information," and "leads to successful enforcement" are defined terms. *See id.* § 240.21F-4.

13. *Id.* § 240.21F-5.

14. *See* 15 U.S.C. § 78u-6(h) (2012).

15. 17 C.F.R. § 240.21F-2(b)(2) (2013).

16. Paradigm Capital Mgmt., Inc., Exch. Act Release No. 72,393, Inv. Advisers Act Release No. 3857 (June 16, 2014).

17. *See* Moberly, *supra* note 11, at 1131–41 (the structural model of many whistleblower laws requires the identification and provision of a specific disclosure channel for whistleblowers). Other laws use the structural model, including Sarbanes-Oxley, which requires corporations to implement a channel for whistleblowers to report misconduct directly to independent directors on the corporation's audit committee of the board of directors. *See* 15 U.S.C. § 78j-1(m)(4)(A) (2012). Also, the Civil Service Reform Act of 1978 created the Office of Special Counsel to receive whistleblower disclosures from federal employees. *See* 5 U.S.C. § 1101 (2012).

18. Dodd-Frank defines a "whistleblower" as one who provides "information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission." 15 U.S.C. § 78u-6(a)(6) (2012). The SEC's

lish a new office to fulfill this obligation and to administer the reward program.[19] Subsequently, the SEC created the Office of the Whistleblower,[20] which receives whistleblower disclosures, works with the SEC's enforcement staff regarding those disclosures, and determines whether to make awards for eligible enforcement actions.[21] The Act and its regulations also explicitly provide for anonymous whistleblowing.[22]

The SEC promulgated extensive regulations to implement section 922.[23] In addition to detailing the three whistleblower models incorporated into Dodd-Frank, the regulations also expressly preclude parties, including employers, from interfering with those whistleblower programs. Specifically, Rule 21F-17(a) states:

> No person may take any action 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 . . . with respect to such communications.[24]

While the SEC has not yet brought an enforcement action based on Rule 21F-17, the chief of the SEC's Office of the Whistleblower, Sean McKessy, publicly warned that "we are actively looking for examples of confidentiality agreements, separat[ion] agreements, employee agreements that . . . in substance say 'as a prerequisite to get this benefit you agree you're not going to come to the commission or you're not going to report anything to a regulator.'"[25] McKessy further cautioned that "if we find that kind of language, not only are we going to go to the companies, we are going to go after the lawyers who drafted it," possibly by revoking those attorneys' right to practice before the Commission.[26]

McKessy's remarks and Rule 21F-17 make it clear that employers may not compel employees to waive their whistleblowing rights in exchange for a monetary payment or other benefit. Yet, despite Rule 21F-17, whistleblowers and their counsel continue frequently to

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regulations further acknowledge that a whistleblower who reports wrongdoing internally before reporting to the SEC may still be eligible for a reward, if the whistleblower ultimately discloses the misconduct to the SEC within 120 days of the whistleblower's initial internal report. *See* 17 C.F.R. § 240.21F-4(c)(3) (2013).

19. *See* 15 U.S.C. § 78u-7(d) (2012).

20. *See* 17 C.F.R. § 240.21F-1 (2013).

21. *See* U.S. Sec. & Exch. Comm'n, 2013 Annual Report to Congress on the Dodd-Frank Whistleblower Program 5–7 (2013), *available at* http://www.sec.gov/about/offices/owb/annual-report-2013.pdf.

22. *See* 15 U.S.C. § 78u-6(d)(2), (h)(2) (2012); 17 C.F.R. §§ 240.21F-7, -9(c) (2013).

23. *See* Adopting Release, *supra* note 6.

24. 17 C.F.R. § 240.21F-17(a) (2013).

25. Brian Mahoney, *SEC Warns In-House Attys Against Whistleblower Contracts*, Law360 (Mar. 14, 2014), http://www.law360.com/articles/518815/sec-warns-in-house-attys-against-whistleblower-contracts.

26. *Id.*

encounter agreements limiting or discouraging whistleblowing in more subtle, yet often equally pernicious, ways, including the three types of de facto gag clauses identified above.[27]

These agreements raise the important question of how far Rule 21F-17 extends. Does it merely prohibit confidentiality agreements purporting to completely restrict all communications with the SEC, or does it also prohibit agreements technically allowing communications with the SEC, but indirectly *impeding* whistleblowing by making it harder, riskier, or otherwise less desirable?

Absent any SEC enforcement actions under Rule 21F-17, or private litigation directly addressing the enforceability of such clauses, courts are very likely to rely on existing contract law to balance the public and private interests that these agreements implicate. This reliance is particularly likely in private litigation between whistleblowers and their employers (as opposed to SEC enforcement actions brought under Rule 21F-17), because—although a court is very likely to find that any contract that violated Rule 21F-17 would be unenforceable—Rule 21F-17 does not supply employees with a private right of action.[28]

Accordingly, the next part of this Article examines whether the types of de facto gag clauses companies use would be enforceable under existing law. Specifically, we conclude that such agreements should not be enforced in the SEC whistleblower context because they violate Dodd-Frank's public policy. Additionally, while preexisting law does not define the limits of Rule 21F-17, a court could find a contract void based on the plain language of the Rule.

III. De Facto Gag Clauses Violate Dodd-Frank's Public Policy

A. *The Public Policy Limitation on Contractual Enforcement*

The most logical starting point for analyzing the enforceability of agreements affecting an employee's ability to participate in the SEC Whistleblower Program, or to obtain benefits for doing so, is the bedrock principle that contracts between private individuals may be void if they violate public policy.[29] In *Town of Newton v. Rumery*, the

27. *See* Letter from Katz, Marshall & Banks, *supra* note 7, at 4 ("While companies and their counsel are largely avoiding attempts to prohibit outright an individual's communicating with the SEC, our law firm and other [sic] that represent SEC whistleblowers are nonetheless seeing an increase in proposed settlement language that is intended to achieve the same result in a more roundabout and crafty manner.").

28. *See* 17 C.F.R. § 240.21F-17 (2013).

29. *See* Town of Newton v. Rumery, 480 U.S. 386, 392 (1987); Restatement (Second) of Contracts § 178(1) (1981) ("A promise . . . is unenforceable on grounds of public policy if . . . the interest in its enforcement is clearly outweighed . . . by a public policy against the enforcement of such terms."); Alan Garfield, *Promises of Silence: Contract Law and Freedom of Speech*, 83 Cornell L. Rev. 261, 294–95 (1998) ("The power of courts to deny

Supreme Court provided a framework for applying this long-standing principle, concluding that contracts may not be enforceable under federal common law when the public policy considerations against enforcement outweigh any interests supporting enforcement.[30] Accordingly, it is not enough merely to establish that an agreement is contrary to *some* public policy; instead, *Town of Newton* requires identifying the public interests that militate both for and against enforcement, and comparing those interests to each other.[31]

Courts have applied *Town of Newton*—or the common law principles upon which *Town of Newton* is based—to numerous types of contracts purporting to prohibit individuals from communicating with government authorities about violations of law. They have repeatedly found such blanket bans unenforceable. Courts have rarely hesitated to strike down contracts that conceal crimes, which many SEC violations also are, or suppress evidence.[32] The normal justifications for contractual enforcement—facilitating economic activity and meeting party expectations by encouraging reliance on promises[33]—do not overcome the powerful public desire for law enforcement.[34] In fact, a contract that conceals a crime not only is unenforceable, but also may constitute the state law crime of "compounding"[35] or the federal crime of obstruction of justice.[36]

Even outside the criminal context, courts have often rejected agreements purporting to prohibit voluntarily reporting to the government possible civil violations. For example, in *EEOC v. Astra U.S.A., Inc.*,[37] the First Circuit invalidated provisions in settlement agreements prohibiting employees from communicating with the Equal Employment Opportunity Commission (EEOC).[38] The court explicitly

enforcement to a contract on public policy grounds is not only indisputable, but also open-ended.").

30. *See* 480 U.S. at 392 ("The relevant principle is well established: a promise is unenforceable if the interest in its enforcement is outweighed in the circumstances by a public policy harmed by enforcement of the agreement."); Garfield, *supra* note 29, at 295; Restatement (Second) of Contracts § 178(1).

31. 480 U.S. at 392.

32. *See* Garfield, *supra* note 29, at 307–08.

33. *See* Terry Morehead Dworkin & Elletta Sangrey Callahan, *Buying Silence*, 36 Am. Bus. L.J. 151, 174 (1998) (public policy benefits of enforcing contracts).

34. *Cf.* Richard Moberly, *The Supreme Court's Antiretaliation Principle*, 61 Case W. Res. L. Rev. 375, 378 (2010) (a common theme of the Supreme Court's retaliation jurisprudence is the principle that "protecting employees from retaliation will enhance the enforcement of the nation's laws").

35. Generally, "compounding" is defined as accepting consideration for a promise not to report a crime. *See* Garfield, *supra* note 29, at 307–08.

36. 18 U.S.C. § 1505 (2012); *see also* Stephen Gillers, *Speak No Evil: Settlement Agreements Conditioned on Noncooperation Are Illegal and Unethical*, 31 Hofstra L. Rev. 1, 15 (2002).

37. 94 F.3d 738 (1st Cir. 1996). *See also* EEOC v. Cosmair, Inc., L'Oreal Hair Care Div., 821 F.2d 1085, 1091 (5th Cir. 1987).

38. *See Astra*, 94 F.3d at 743.

balanced the impact of those agreements on the EEOC's ability to investigate systemic discrimination against the impact that invalidating the provisions would have on private dispute resolution,[39] concluding that limiting the ability of employees to communicate with the EEOC would "sow[] the seeds of harm to the public interest."[40] Similar decisions have been reached when employers use contractual promises of silence to impede government investigations of securities violations,[41] unfair labor practices,[42] and investment advisor misconduct.[43]

These cases confirm that there is a strong public policy in favor of reporting possible violations of the law to the government, which can outweigh competing interests in protecting confidential information and promoting private dispute resolution. Certainly, these cases indicate that any provision designed to prevent an employee from making "any complaint" about the company—as some general releases do—should not and would not be enforced to block communications about possible unlawful activity with the SEC or other law enforcement agencies. They also suggest that courts should give heightened scrutiny to provisions that make reporting to the SEC more onerous to ensure that they do not indirectly pursue a goal that could not be sought directly.[44]

But, as instructive as these cases are, they do not fully answer the question of whether, and to what extent, companies can use agreements that allow whistleblowing, but decrease or eliminate congressional incentives for doing so. To answer that question, it is necessary to look not only to the broad public policies animating *Astra* and its progeny, but also to the specific public policy underlying, and supported by, Dodd-Frank.

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39. *See id.* at 744.

40. *Id.*

41. *See* SEC v. Lipson, No. 97 C 2661, 1997 WL 801712, at *2 (N.D. Ill. Oct. 28, 1997) (agreement not to speak with SEC without a subpoena void as against public policy).

42. *See* D'Arrigo Bros. of Cal. v. United Farmworkers of Am., 169 Cal. Rptr. 3d 171, 181–83 (Cal. App. 2014) (contractual language purporting to prohibit union from cooperating with government investigation of unfair labor practices unenforceable).

43. *See* Cariveau v. Halferty, 99 Cal. Rptr. 2d 417, 423–24 (Cal. App. 2000) ("The use of confidentiality agreements that purport to restrict a registered member's customers from reporting improper conduct to the [National Association of Securities Dealers (NASD)] serves to perpetuate the improper conduct and is condemned by NASD policies.").

44. Courts have repeatedly rejected contract interpretations that allow parties to do indirectly what they could not do directly. *See, e.g.*, Century Marine Inc. v. United States, 153 F.3d 225, 230 (5th Cir. 1998) ("To allow such recovery would permit Century to do indirectly what it could not do directly."); Safran v. United Steel Workers of Am., AFL-CIO, 678 F. Supp. 1178, 1181 (W.D. Pa. 1988) ("We decline to permit the plaintiffs to do indirectly what they could not contractually do directly."); Ables v. United States, 2 Cl. Ct. 494, 501 (1983), *aff'd*, 732 F.2d 166 (Fed. Cir. 1984) ("What they could not do directly they certainly should not be allowed to do indirectly under the guise of an intended third party beneficiary.").

1. Identifying Dodd-Frank's Public Policy

Dodd-Frank's text and legislative history make clear that one of its primary public interests is better protection for investors and the financial markets themselves following the financial crisis in 2008.[45] In particular, the whistleblower provisions' purpose is to assist the SEC in detecting, investigating, and prosecuting serious securities violations to further the public policy goal of protecting investors and the markets.[46] In this respect, Dodd-Frank also evinces a strong public policy interest in whistleblowing and private cooperation with public law enforcement.

As the First Circuit's decision in *Astra* indicates, however, an analysis of a statute's public policy aims encompasses more than evaluating its general purpose; it also requires a court to assess the specific statutory scheme designed to further that purpose.[47] In *Astra*, the court examined not just the public policy behind Title VII but also *how* Congress intended to protect and advance that public interest by giving the EEOC the power to investigate both individual and systemic discrimination.[48]

Dodd-Frank's statutory scheme reflects an important public policy judgment: incentives are needed to promote whistleblowing because "whistleblowers often face the difficult choice between telling the truth and the risk of committing 'career suicide.'"[49] The SEC, too, recognized that incentives are an integral part of Dodd-Frank's investor-protection scheme:

> [T]he broad objective of the whistleblower program is to enhance the Commission's law enforcement operations by increasing the financial incentives for reporting and lowering the costs and barriers to potential whistleblowers, so that they are more inclined to provide the Commission with timely, useful information that the Commission might not otherwise have received.[50]

In particular, Congress developed three primary incentives to counterbalance the profound personal and professional risks that whistleblowers often face, and to support the public policy of encouraging whistleblower reports to the SEC.[51] First, of course, is the provision of financial awards to whistleblowers. As the Senate Committee

45. *See* S. Rep. No. 111-176, at 36 (2010) ("During the crisis, it became apparent that investors needed better protection . . . and the SEC need[ed] assistance.").

46. *Id.*

47. EEOC v. Astra U.S.A., Inc., 94 F.3d 738, 743–44 (1st Cir. 1996).

48. *Id.* at 744.

49. S. Rep. No. 111-176, at 111.

50. Adopting Release, *supra* note 6, at 105.

51. *See id.* at 197 ("The Congressional purpose underlying Section 21F of the Exchange Act is to encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees.").

on Banking, Housing and Urban Affairs noted in its report on Dodd-Frank, "the minimum payout that any individual could look towards in determining whether to take the enormous risk of blowing the whistle in calling attention to fraud" is "the critical component of the Whistleblower Program," particularly because it helps counter the economic harm that whistleblowers may face as a result of employment-related retaliation or blacklisting.[52]

Second, Dodd-Frank and the SEC Whistleblower Rules allow whistleblowers to report possible misconduct to the SEC anonymously.[53] The importance of anonymity can be seen throughout Dodd-Frank's statutory provisions and the implementing regulations. Both the statute and regulations prohibit the SEC from "disclos[ing] any information . . . which could reasonably be expected to reveal the identity of a whistleblower," except in narrow circumstances.[54] Whistleblowers also benefit from the fact that all SEC investigations remain confidential until the Commission files a complaint or begins an administrative proceeding.[55] The anonymity continues even after the SEC issues an award; none of the fourteen whistleblower awards issued as of December 2014 have identified the recipients or provided potentially identifying information.[56]

These anonymity safeguards are significant because they dramatically decrease the risk that whistleblowers will become known to others, in turn decreasing the risk that they will face retaliation or blacklisting. Moreover, the SEC has emphasized that the anonymity protection provides essential encouragement for a whistleblower to come forward, and that fewer people would blow the whistle without

52. S. REP. NO. 111-176, at 111. Indeed, although the Program's results still cannot fully be assessed because of the program's relative newness and the length of time before an award can be issued, it seems to be successfully encouraging whistleblowers to provide tips to the SEC. The SEC has received thousands of complaints under the program each year since it began in 2011. *See* U.S. SEC. & EXCH. COMM'N, 2013 ANNUAL REPORT, *supra* note 21. As of December 1, 2014, the Program has made awards to fourteen whistleblowers, including one award the SEC estimates will be between $30 and $35 million. *See Final Orders of the Commission*, U.S. SEC. & EXCH. COMM'N, OFF. OF THE WHISTLEBLOWERS, http://www.sec.gov/about/offices/owb/owb-final-orders.shtml (last visited Dec. 1, 2014).

53. *See* 15 U.S.C. § 78u-6(d)(2), (h)(2) (2012); 17 C.F.R. §§ 240.21F-7, -9(c) (2013).

54. 15 U.S.C. § 78u–6(h)(2) (2012); 17 C.F.R. § 240.21F-7(a) (2013). Pursuant to 17 C.F.R. § 240.21F-7(b), whistleblowers reporting anonymously must file their complaint through an attorney, follow prescribed certification procedures, and disclose their identities to the Commission only for verification before receiving any award.

55. *See, e.g.*, ADOPTING RELEASE, *supra* note 6, at 126 ("As a general matter, it is the Commission's policy and practice to treat all information obtained during its investigations as confidential and nonpublic."). The SEC is entitled to disclose nonpublic information in narrow circumstances, including to other government entities, self-regulatory organizations, and bankruptcy trustees. *See* 17 C.F.R. § 240.24c-1(b) (2013).

56. *See* SEC. & EXCH. COMM'N, OFFICE OF THE WHISTLEBLOWER, FINAL ORDERS OF THE COMMISSION, *available at* http://www.sec.gov/about/offices/owb/owb-final-orders.shtml (last visited Dec. 1, 2014) (whistleblower award notices).

it.[57] Common sense and social science research also support the conclusion that "individuals are more willing to state a dissenting viewpoint if they can do so anonymously."[58]

Third, Dodd-Frank provides robust remedies to whistleblowers who face retaliation for reporting suspected violations to the SEC.[59] In particular, the statute gives whistleblowers who experience retaliation the right to seek reinstatement, double back pay, and legal fees.[60] The Dodd-Frank protections have procedural advantages as well because a whistleblower can bring a retaliation claim directly to federal court for up to six years after retaliation occurs,[61] while many other federal anti-retaliation provisions require whistleblowers to bring an administrative claim before filing a court action, often within 180 days.[62] These enhanced remedies are particularly important because according to a recent survey, more than twenty percent of employees reporting workplace misconduct experience some form of retribution.[63]

In short, in Dodd-Frank Congress identified a strong public interest in protecting investors and determined that this interest is advanced by (a) protecting from retaliation whistleblowers who report securities violations, (b) allowing whistleblowers to report anonymously, and (c) giving whistleblowers the chance to obtain significant monetary awards. Thus, any balancing of public policy interests under *Town of Newton* must take into account the role that Dodd-Frank's incentives play in protecting investors and, conversely, the potential impact that removing or undercutting these incentives would have on investors.

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57. *See* Adopting Release, *supra* note 6, at 198 (whistleblowers would be "less inclined to report possible securities law violations" if they believed the SEC would disclose the whistleblower's identity to the corporation being investigated).

58. Moberly, *supra* note 11, at 1139, 1143 n.168; *see also* Ass'n Certified Fraud Examiners, Report to the Nation on Occupational Fraud and Abuse 17 (2010); Terance D. Miethe, Whistleblowing at Work: Tough Choices in Exposing Fraud, Waste, and Abuse on the Job 54–57 (1999); Cass R. Sunstein, Why Societies Need Dissent 20 (2003). *But see* Marcia P. Miceli, Whistle-Blowing in Organizations 158 (2008) ("[T]here is scant evidence that anonymity promotes whistle-blowing.").

59. *See* Richard Moberly, *Sarbanes-Oxley's Whistleblower Provisions: Ten Years Later*, 64 S.C. L. Rev. 1, 14–16 (2012) (Dodd-Frank was one of several new anti-retaliation provisions that "take Sarbanes-Oxley as a baseline and improve upon it").

60. 15 U.S.C. § 78u-6(h)(1)(C) (2012).

61. *See* 15 U.S.C. § 78u-6(h)(1)(B)(i) (2012) (whistleblowers may file claims in federal district court); 15 U.S.C. § 78u-6(h)(1)(B)(iii) (2012) (claims must be filed within six years after retaliation occurs or within three years of when the employee should have reasonably known about the facts material to the right of action, but not more than ten years after the date of the violation).

62. *See* Richard Moberly, *Protecting Whistleblowers by Contract*, 79 Univ. Colo. L. Rev. 975, 1004–05 (2008).

63. *See National Business Ethics Survey of the U.S. Workforce,* Ethics Res. Ctr. 1, 13 (2013), http://www.ethics.org/nbes.

2. Contracts That Undermine Dodd-Frank's Whistleblower Program

With this analytical framework in mind, we turn to the various contractual provisions companies use that may interfere with the SEC Whistleblower Program. As noted above, many of these provisions do not directly bar whistleblowing to the SEC—which would be a clear violation of *Astra* and Rule 21F-17—but instead alter the costs and benefits of whistleblowing, thus changing the likely behavior of prospective whistleblowers. In particular, we will analyze the competing public and private interests raised by three types of commonly observed clauses: (1) provisions that require employees to disclose their communications with the SEC to employers in some manner, (2) provisions waiving employees' ability to obtain an award under the SEC Whistleblower Program, and (3) general confidentiality provisions that may be used to bring a breach of contract claim should a whistleblower disclose confidential information or documents to the SEC.

A. Contracts Requiring Disclosure of SEC Communications

The first general category of contractual provision is designed to elicit information about whether employees have, or plan to, report possible wrongdoing to the SEC or other government authorities. One particularly common variant allows employees to blow the whistle to the SEC but provides that they must first report the wrongdoing internally, or otherwise alert the company that they have disclosed, or plan to disclose, information to the SEC. Applying *Town of Newton*,[64] it is clear that some legitimate interests weigh in favor of enforcing such provisions. Employers may contend that, because information derived through the course of a party's employment generally belongs to the employer, they should be able to control this information, provided they do not use a confidentiality agreement to conceal unlawful conduct from the government.[65] In particular, obtaining the relevant information before the whistleblower discloses it to the SEC allows the employer to self-report violations, which can minimize the sanctions it faces in any SEC enforcement action.[66] It also helps the company

64. Town of Newton v. Rumery, 480 U.S. 386, 392 (1987).

65. *See* Diamond v. Oreamuno, 248 N.E. 2d 910, 912 (N.Y. 1969) ("As a general proposition, a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit, but must account to his principal for any profits derived therefrom."); *see also* Restatement (Second) of Agency § 388 (1958).

66. *See, e.g.*, Press Release, Sec. & Exch. Comm'n, SEC Announces Non-Prosecution Agreement with Ralph Lauren Corporation Involving FCPA Misconduct (Apr. 22, 2013) ("'When they found a problem, Ralph Lauren Corporation did the right thing by immediately reporting it to the SEC and providing exceptional assistance in our investigation,' said George S. Canellos, Acting Director of the SEC's Division of Enforcement. 'The NPA in this matter makes clear that we will confer substantial and

understand the problem, prepare for a possible SEC investigation, and take quicker remedial action. Indeed, because of these reasons, some commentators suggest that internal whistleblowing is preferable to external whistleblowing.[67]

Additionally, employers may argue that such provisions pose relatively few risks to whistleblowers in light of SEC Rule 21F-4(c)(3), which provides that a whistleblower may be considered the source of "original information," and therefore remain eligible for a monetary award, when that information is first reported internally by the whistleblower and then self-reported to the SEC by the company.[68] In other words, the whistleblower can still reap the monetary benefits of the SEC Whistleblower Program, even by reporting internally first.

Whistleblowers, on the other hand, are likely to argue that these provisions impede whistleblowing and, in so doing, undercut Dodd-Frank's public policy. Most significantly, these provisions take direct aim at the statutory anonymity protections.[69] Employees cannot remain anonymous if they have to inform the company of their plan to report, or that they have reported, to the SEC. Even if employees need only internally disclose the violation and not their intention of reporting to the SEC, the employer can easily trace any subsequent SEC inquiry back to the internal reporter, making Dodd-Frank's guarantee of anonymity an empty promise.

For this and other reasons, the SEC considered, but rejected, mandating internal reporting as a prerequisite for the recovery of a monetary award, concluding that any internal reporting requirement would undermine Dodd-Frank's anonymity mandates.[70] Likewise, the SEC found that "a general requirement that employees report internally . . . would impose a barrier that in some cases would dissuade potential

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tangible benefits on companies that respond appropriately to violations and cooperate fully with the SEC.'").

67. *See* Dworkin & Callahan, *supra* note 33, at 190. Dworkin and Callahan suggest that the law should enforce confidentiality agreements that require internal reporting first:

> The employer could fashion an agreement which requires that the employee first disclose any information internally. This gives it the advantage of correcting the situation without the confidence being breached. The company can also designate the appropriate recipient to ensure that the information is handled correctly. Since these measures do not thwart whistleblowing and have the advantage of allowing for earlier correction of any wrongdoing, the courts are likely to uphold these promises.

Id.

68. 17 C.F.R. § 240.21F-4(c)(3) (2013).

69. S. Rep. No. 111-176, at 111 (2010).

70. *See* Adopting Release, *supra* note 6, at 105–06 n.230 ("[I]n some cases an anonymous whistleblower's identity can be gleaned from the facts and circumstances surrounding the whistleblower's complaint. . . . [R]equiring the whistleblower to report internally would be in tension with . . . Section 21F that we protect information that could reasonably be expected to reveal the identity of a whistleblower.").

whistleblowers from providing information to the Commission, contrary to the purpose of the whistleblower provision."[71] Instead, the SEC included in the rules features designed to "incentivize whistleblowers to utilize their companies' internal compliance and reporting systems when appropriate,"[72] including expanding the definition of "original information" and treating internal reporting as a positive factor when determining monetary awards.[73] These provisions reflect the SEC's judgment that investor protection is best served by allowing, but not mandating, internal reporting.[74]

Section 301 of the Sarbanes-Oxley Act of 2002[75] (Sarbanes-Oxley or SOX) reflects a similar public policy judgment in favor of confidential reporting. That provision requires employers to implement channels for employees to report illegal conduct to a corporate board of directors anonymously, without the knowledge of their direct supervisors or managers.[76] In fact, the Department of Labor's (DOL) Administrative Review Board (ARB) has recognized that a company that publicly identifies a whistleblower may have committed an adverse action against the whistleblower and be liable under Sarbanes-Oxley's anti-retaliation provision.[77] In *Menendez v. Halliburton*, the ARB noted:

> The reason for requiring audit committees to create confidential and/or anonymous disclosure procedures is evident. Employee whistleblowers are one of the most effective sources of information concerning questionable accounting and auditing matters as well as fraud and corporate crime. Since employees are more willing to identify misconduct if they can do so anonymously, it stands to reason that anonymous and/or confidential reporting mechanisms encourage internal reporting of corporate misconduct. Furthermore, the confidentiality that Section 301 provides allows employees to report problems directly to the independent audit committee and thus effectively to their employer, while at the same time permitting the whistleblowing employee to avoid possible retaliation from supervisors or high-ranking company managers who may be defensive about wrongdoing

71. *Id.* at 105.

72. *Id*. at 5.

73. *See* 17 C.F.R. § 240.21F-6(4) (2013).

74. *See* Brief of the Sec. & Exch. Comm'n, Amicus Curiae in Support of the Appellant, Liu Meng-Ling v. Siemens AG, No. 13-4385, 2014 WL 663875, at *2 (2d Cir. Feb. 20, 2014). ("Throughout the rulemaking process, the Commission considered the 'significant issue' of how to ensure that the whistleblower program does not undermine the willingness of individuals to make whistleblower reports internally at their companies before they make reports to the Commission."); *see also* Adopting Release, *supra* note 6, at 90–91 ("The objective of this provision is to support, not undermine, the effective functioning of company compliance and related systems by allowing employees to take their concerns about possible violations to appropriate company officials first while still preserving their rights under the Commission's whistleblower program.").

75. 15 U.S.C. § 78j-1(m)(1) (2012).

76. *See id.*

77. *See* Menendez v. Halliburton, Inc., ARB Nos. 09-002, 09-003, ALJ No. 2007-SOX-005, at 23-24 (ARB Sept. 13, 2011).

> in which they might be implicated. Congress well recognized the importance of encouraging the reporting of accounting irregularities and potential fraud by means of confidential disclosures.
>
> . . .
>
> Since the purpose of confidentiality is to encourage employees to come forward with information about SOX violations, permitting an employer to indiscriminately expose the identity of an employee who presents information concerning questionable accounting or auditing matters would most assuredly chill whistleblower-protected activity.[78]

In addition to implicating Dodd-Frank's anonymity provisions, agreements purporting to require internal reporting may also undercut the statute's anti-retaliation protections. Several courts, including the Fifth Circuit, have held that the Act does not protect internal whistleblowers because its statutory definition of "whistleblower" requires a report to the SEC.[79] This result is controversial, and several other courts have reached the opposite conclusion for a variety of reasons.[80] However, to the extent the Fifth Circuit's view prevails, it would be anomalous to permit an employer to require a whistleblower to report internally before reporting to the SEC because the employer would then have a defined window in which it could retaliate without facing any Dodd-Frank penalties.[81] This result seems likely to dissuade prospective whistleblowers from coming forward, particularly as reported retaliation rates remain strikingly high.[82]

The potentially profound effect of these "internal reporting" agreements on Dodd-Frank's anonymity and anti-retaliation protections—and the corresponding centrality of these dual protections to the statute's overall investor-protection scheme—indicates that they should, and very likely will, be found unenforceable under *Town of Newton*. An employer's desire to learn of potential problems cannot justify the risk that fewer whistleblowers will come forward if private con-

78. *See id.*

79. *See* Asadi v. G.E. Energy (USA), L.L.C., 720 F.3d 620, 630 (5th Cir. 2013); *see also* Banko v. Apple Inc., No. 13–02977, 2013 WL 7394596, at *1 (N.D. Cal. Sept. 27, 2013); Wagner v. Bank of Am. Corp., No. 12-CV-00381, 2013 WL 3786643, at *1 (D. Colo. July 19, 2013).

80. *See, e.g.*, Bussing v. COR Clearing, LLC., No. 8:12-CV-238, 2014 WL 2111207, at *12 (D. Neb. May 21, 2014); Rosenblum v. Thomson Reuters (Markets) LLC, No. 13 Civ. 2219, 2013 WL 5780775, at *3–5 (S.D.N.Y. Oct. 25, 2013); Ellington v. Giacoumakis, No. 13-11791, 2013 WL 5631046, at *2–3 (D. Mass. Oct. 16, 2013); Murray v. UBS Sec., LLC, No. 12 Civ. 5914, 2013 WL 2190084, at *3–7 (S.D.N.Y. May 21, 2013); Genberg v. Porter, 935 F. Supp. 2d 1094, 1106–07 (D. Colo. 2013); Kramer v. Trans-Lux Corp., No. 11 Civ. 1424, 2012 WL 4444820, at *3–5 (D. Conn. Sept. 25, 2012); Nollner v. S. Baptist Convention, Inc., 852 F. Supp. 2d 986, 993–95 (M.D. Tenn. 2012); Egan v. TradingScreen, Inc., No. 10 Civ. 8202, 2011 WL 1672066, at *5 (S.D.N.Y. May 4, 2011).

81. Sarbanes-Oxley clearly would protect this internal whistleblower from retaliation, but as mentioned above, its procedures and remedies are not as favorable to whistleblowers as Dodd-Frank's provisions.

82. *See* Ethics Res. Ctr., *supra* note 63, at 9.

tracts can dismantle these two pillars of Dodd-Frank's statutory scheme. Instead, public policy favors preserving the delicate balance that the SEC, after public comments and deliberation, struck with respect to internal reporting.[83]

This result would be consistent not only with congressional and administrative intent, but also with prior case law recognizing as unenforceable contractual provisions that burden, but do not completely bar, communications with the SEC.[84] For example, in *SEC v. Lipson*, an Illinois district court refused to enforce a provision that would have limited the extent to which employees could communicate with the SEC without a subpoena, reasoning that

> Neither the fact that [the] SEC remains free to subpoena the signatories to the agreement with Mr. Lipson, nor the possibility that the language of the agreement might be construed narrowly by the signatories to permit informal discussions with SEC personnel on certain topics, satisfies this court that the challenged provisions are harmless.[85]

As in *Lipson*, the question is not whether employees might still be able to communicate with the SEC despite their contractual restrictions, but instead whether those restrictions threaten material harm to the SEC's investigative abilities. Here, as in *Lipson*, the answer is that they do, and therefore should not be enforceable.

B. Contracts Requiring Relinquishment of a Dodd-Frank Reward

Equally common, and equally troubling, are contractual provisions that preserve employees' right to report possible securities violations to the SEC, but mandate that the employee waive, decline, or agree not to seek a monetary award. Such a provision might state, for example, "[n]othing in this agreement is intended to prevent Employee from communicating or cooperating with a government agency, except Employee agrees that Employee will not be entitled to any individual monetary payment or relief resulting from any administrative claim or investigative proceeding."

Some employers may argue that such provisions are voluntary waivers of a statutory right, which courts typically permit unless expressly prohibited by statute. Thus, these employers would contend, the provision is exempt from analysis under *Town of Newton*.[86] Employers are likely to point to the fact that, while Dodd-Frank amended SOX to include such an express prohibition on statutory waivers, it

83. *See generally* Adopting Release, *supra* note 6.

84. *See* SEC v. Lipson, No. 97 C 2661, 1997 WL 801712, at *2 (N.D. Ill. Oct. 28, 1997).

85. *Id*.

86. *See* United States v. Mezzanatto, 513 U.S. 196, 201 (1995) ("[A]bsent some affirmative indication of Congress' intent to preclude waiver, we have presumed that statutory provisions are subject to waiver by voluntary agreement of the parties.").

included no such prohibition with respect to Dodd-Frank's own whistleblower provisions.[87] In the face of the Sarbanes-Oxley amendment, employers may argue that congressional silence about waiver in Dodd-Frank whistleblower provisions implies that Congress intentionally permitted employees to waive their bounty right.

However, the Supreme Court has noted that the absence of an anti-waiver provision is not dispositive when "legislative policy would be thwarted by permitting" contractual waivers of statutory rights.[88] The Court has applied a similar public policy test as described in Part III.A, *supra*, by voiding a contractual waiver provision when it was "inconsistent with the provision creating the right sought to be secured."[89] Thus, whether an agreement to relinquish a Dodd-Frank award is viewed as a waiver of a statutory right or a standard contract under *Town of Newton*, the relevant question remains the same: would enforcement of the agreement impermissibly undercut the public policy goals of the relevant statute?

Employers are likely to contend that the answer is no because such provisions allow whistleblowers to communicate with the SEC on a voluntary and anonymous basis. The employee does not face any punishment or penalty for whistleblowing; the employee simply cannot receive an award for doing so. Employers are also likely to argue that the potential harm to the SEC is low because the Commission retains its traditional investigative tools, including the ability to speak to witnesses without a subpoena.

In support of this argument, employers may analogize agreements waiving Dodd-Frank awards to similar provisions used in employment severance or settlement agreements. These typically permit an employee to file a discrimination claim with the EEOC but not to obtain personal damages or other monetary relief. In other words, employees could notify the EEOC of possible discrimination, allowing the EEOC to investigate potentially systemic or continuing discrimination, but would release individual claims to relief.

Although certain EEOC offices are beginning to challenge such provisions,[90] they have so far been routinely enforced by

87. *See* 18 U.S.C. § 1514A(e)(1) (2012) ("The rights and remedies provided for in [SOX] may not be waived by any agreement, policy form, or condition of employment.").

88. Brooklyn Sav. Bank v. O'Neil, 324 U.S. 697, 713 (1945).

89. New York v. Hill, 528 U.S. 110, 116 (2000); *see also Brooklyn Sav. Bank*, 324 U.S. at 704 (in determining that the right to liquidated damages under the Fair Labor Standards Act is not waivable, the Court noted: "Where a private right is granted in the public interest to effectuate a legislative policy, waiver of a right so charged or colored with the public interest will not be allowed where it would thwart the legislative policy which it was designed to effectuate.").

90. *See, e.g.*, Complaint, EEOC v. CVS Pharmacy, Inc., No. 14-cv-863, 2014 WL 540344 (N.D. Ill. Feb. 7, 2014); Complaint, EEOC v. Baker & Taylor, Inc., No. 13-cv-03729 (N.D. Ill. May 20, 2013).

courts.[91] The Supreme Court considered a similar issue in *EEOC v. Waffle House*[92]—whether an arbitration agreement can prevent the EEOC from litigating on an employee's behalf in court—and concluded that the EEOC could bring claims in court despite the employee's arbitration agreement, but that "[the employee's] conduct may have the effect of limiting the relief that the EEOC may obtain."[93] Employers are likely to argue that the same rule should apply in the Dodd-Frank context; that is, that agreements may not validly waive employees' rights to make a Dodd-Frank disclosure, but they may waive employees' rights to benefit personally from that disclosure.

This comparison, while superficially appealing, ignores the substantial differences between the public policy goals of Title VII and Dodd-Frank, and the two statutes' enforcement schemes. The EEOC enforces antidiscrimination laws by investigating claims of alleged discrimination victims, who may prosecute their claims directly by intervening in an EEOC action or, when the EEOC declines to bring an action, by filing their own private lawsuits.[94] Damages obtained by an employee in an EEOC action are based primarily on the EEOC's vindication of the employee's own rights.[95] Therefore, failing to enforce the waiver in an EEOC action would typically result in a double recovery for the employee, who would receive both the consideration given for the waiver and the damages from the EEOC action.[96] As the Supreme Court has made clear, "courts can and should preclude double recovery by an individual."[97]

The same logic does not apply to Dodd-Frank's unique statutory scheme, in which the SEC is not seeking to vindicate the personal rights of a whistleblower—who may not have suffered any injury as a result of the reported securities violations—but is instead bringing

91. *See, e.g.*, EEOC v. Cosmair, Inc., L'Oreal Hair Care Div., 821 F.2d 1085, 1091 (5th Cir. 1987) ("[A]lthough an employee cannot waive the right to file a charge with the EEOC, the employee can waive not only the right to recover in his or her own lawsuit but also the right to recover in a suit brought by the EEOC on the employee's behalf."); EEOC v. Goodyear Aerospace Corp., 813 F.2d 1539, 1543 (9th Cir. 1987); EQUAL EMP'T OPPORTUNITY COMM'N, ENFORCEMENT GUIDANCE ON NON-WAIVABLE EMPLOYEE RIGHTS UNDER EQUAL EMPLOYMENT OPPORTUNITY COMM'N (EEOC) ENFORCED STATUTES (Apr. 10, 1997), *available at* http://www.eeoc.gov/policy/docs/waiver.html ("[T]he Commission notes that even though an individual who has signed a waiver agreement or otherwise settled a claim subsequently files a charge with the Commission based on the same claim, the employer will be shielded against any further recovery by the charging party . . . .").

92. 534 U.S. 279 (2002).

93. *Id.* at 296 (citations omitted).

94. *See generally* 42 U.S.C. § 2000e et al. (2012).

95. *Id.*

96. *See Waffle House*, 534 U.S. at 297; *Goodyear Aerospace Corp.*, 813 F.2d at 1543 (while injunctive relief against employer would serve the public good, any back pay awarded to EEOC would "go directly to [the employee]" and is therefore not recoverable if previously waived).

97. *Waffle House*, 534 U.S. at 297.

claims on behalf of the government, for the ultimate benefit of investors. Typically, the whistleblower only has the right to seek a Dodd-Frank award, which compensates the whistleblower for information, not injury. Therefore, a whistleblower award cannot be duplicative of the consideration that an employee may have received from the employer in exchange for a release of the claims that the employee could have brought directly against the employer.[98]

Given these distinctions, the enforceability of Dodd-Frank award waivers should not rest on EEOC precedent. Instead, a more apt, though still imperfect, analogy for the SEC whistleblower program is the *qui tam* regime of the False Claims Act[99] (FCA). The FCA resembles Dodd-Frank by providing a reward for whistleblowers who report employer misconduct[100] and by involving claims in which the injury being vindicated also belongs to the government rather than the whistleblower.[101] Unlike Dodd-Frank, though, FCA whistleblowers, or "relators," bring these claims by filing their own lawsuit against the company, in which the government may or may not intervene.[102] FCA waiver cases typically arise when an employee signs an agreement releasing all claims against an employer, and then subsequently files an FCA complaint.[103]

Consistent with *Town of Newton*[104] and *Lipson*,[105] courts assessing the enforceability of FCA waivers have sought to balance the "public interest in having information brought forward that the government could not otherwise obtain" with the public interest in "encouraging parties to settle disputes."[106] Significantly, courts have recognized

98. This rationale would also prevent an employer from suing a whistleblower under a more general release of claims against the employer. Because the SEC award is not based on any whistleblower claim against the employer, it should not be included in a general release.

99. 31 U.S.C. §§ 3729–3733 (2012).

100. *See id.* § 3730(d).

101. *See id.* §§ 3729–3733. *See also* Geoffrey Christopher Rapp, *Mutiny on the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act*, 2012 BYU L. Rev. 73, 76–77 (2012) ("Dodd-Frank drew some of its inspiration from the False Claims Act," but Dodd-Frank is inferior because it does not adopt the *qui tam* aspect of the FCA that allows "whistleblowers to *litigate cases independently* from federal action") (emphasis added); *id.* at 132–43 (differences between the reward programs of the False Claims Act and Dodd-Frank).

102. 31 U.S.C. § 3730(b) (2012).

103. *See, e.g.*, United States *ex rel.* Radcliffe v. Purdue Pharma L.P., 600 F.3d 319, 329 (4th Cir. 2010); United States *ex rel.* Ritchie v. Lockheed Martin Corp., 558 F.3d 1161, 1168–69 (10th Cir. 2009); United States *ex rel.* Gebert v. Transp. Admin. Servs., 260 F.3d 909, 916 (8th Cir. 2001); United States *ex rel.* Hall v. Teledyne Wah Chang Albany, 104 F.3d 230, 231–33 (9th Cir. 1997); United States *ex rel.* Green v. Northrop Corp., 59 F.3d 953, 966 (9th Cir. 1995); United States *ex rel.* Nowak v. Medtronic, Inc., 806 F. Supp. 2d 310, 336–37 (D. Mass. 2011).

104. 480 U.S. 386 (1987).

105. No. 97 C 2661, 1997 WL 801712 (N.D. Ill. Oct. 28, 1997).

106. *Hall*, 104 F.3d at 233.

that the dispositive question here is not whether an employee could still have the right to blow the whistle if the damage waiver or release were enforced, but whether enforcement of the waiver would substantially reduce the efficacy of the statute's incentive structure.[107] As the Ninth Circuit noted in *United States ex rel. Green v. Northrop Corp.*:

> [A]lthough, as Appellees maintain, enforcing the Release at issue in this case would not *prohibit* a relator from coming forward with information concerning Appellees' alleged misconduct, our analysis of the structure and purposes of the Act demonstrates that this consideration is not dispositive. If the *qui tam* provisions *never* had been enacted, presumably whistleblowers still *could* come forward. The Act reflects Congress's judgment that *incentives to file suit* were necessary for the government to learn of the fraud or to spur government authorities into action; permitting a prefiling release when the government has neither been informed of, nor consented to, the release would undermine this incentive, and therefore, frustrate one of the central objectives of the Act.[108]

Under *Green* and its progeny, a waiver of an incentive award would be invalid if it frustrated a statute's central objectives.

As *Green* reflects, courts applying this reasoning in FCA waiver cases have typically refused to enforce prefiling releases when the government was unaware of the alleged misconduct until the relator filed the claim, on the theory that enforcing such releases would limit the government's ability to detect wrongdoing. On the other hand, some courts have agreed to enforce FCA waivers when the government was already aware of the alleged misconduct before the filing of the complaint because "the public interest in having information brought forward that the government could not otherwise obtain [was] not implicated."[109]

Applying this rationale to the Dodd-Frank context suggests that a similar, but not identical, outcome should prevail. First, given the centrality of monetary awards to the SEC Whistleblower Program, it seems clear that the "central objectives" of Dodd-Frank's whistleblower provisions would be substantially frustrated if courts enforced award waivers executed when the SEC did not already know the underlying information. As in the FCA context, enforcement of such waivers would decrease willingness to report misconduct and decrease the flow of potentially valuable information to the SEC. Indeed, one of the key concerns behind the statute was that the SEC was not receiving or generating sufficient information about possible securities viola-

107. *See* United States *ex rel*. Head v. Kane Co., 668 F. Supp. 2d 146, 152 (D.D.C. 2009); United States *ex rel*. Grandeau v. Cancer Treatment Ctrs. of Am., 350 F. Supp. 2d 765, 773 (N.D. Ill. 2004); X Corp. v. Doe, 805 F. Supp. 1298, 1310 n.24 (E.D. Va. 1992).

108. *Green*, 59 F.3d at 965.

109. United States *ex rel*. Radcliffe v. Purdue Pharma, L.P., 600 F.3d 319, 332 (4th Cir. 2010) (citing *Hall*, 104 F.3d at 233).

tions prior to Dodd-Frank.[110] Significantly, allowing the waiver of Dodd-Frank awards would not only dissuade employees subject to the waiver from coming forward, but also decrease the SEC's ability to use awards to build program awareness, encourage others to come forward,[111] and deter future securities violations,[112] all of which are crucial programmatic interests of Dodd-Frank and the SEC whistleblower rules.

Unlike the prevailing FCA rule, however, applying this rationale to the SEC Whistleblower Program suggests that Dodd-Frank waivers should not be enforced even if they are executed *after* the SEC has learned of the potential misconduct. First, there is a basic distinction between the mechanics of Dodd-Frank and the FCA. In an FCA case, the whistleblower brings a claim against the company in court and has an opportunity to receive a share of any resulting settlement or judgment. Thus, it makes more sense to allow for the private resolution of claims between the relator and the company, provided that it does not result in violations of law being concealed from the government. The SEC whistleblower, on the other hand, has no direct claim against the company and is not a party to enforcement actions. Likewise, the SEC whistleblower award is not paid by the company in any way, but instead is paid from a separate fund established by Congress.[113] Therefore, there is no actual dispute or claim between the employee and the employer with respect to the award, and the public interest in promoting settlement of disputes is simply not implicated. It makes little public policy sense to allow employers to insert themselves into this award scheme, regardless of whether the SEC is aware of the misconduct.

Moreover, a rule allowing the enforcement of waivers when the SEC has independently learned of the misconduct rests on the incorrect assumption that subsequent whistleblower assistance will not have significant investigative value to the SEC. In practice the SEC

110. *See* Sec. & Exch. Comm'n, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Release No. 34-63237 (Nov. 17, 2010) ("More frequent reporting of high-quality information promotes greater deterrence by enhancing the efficiency and effectiveness of the Commission's enforcement program.").

111. *See* 17 C.F.R. § 240.21F-6(a)(3)(ii) (2013) (a factor in any award amount determination is "[t]he degree to which an award encourages the submission of high quality information from whistleblowers by appropriately rewarding whistleblowers' submission of significant information and assistance").

112. *See* 15 U.S.C. § 78u-6(c)(1)(B)(III) (2012) (a factor in any award amount determination is "the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead[s] to the successful enforcement of such laws"); 17 C.F.R. § 240.21F-6(a)(3) ("The Commission will assess its programmatic interest in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws.").

113. *See* U.S. Sec. & Exch. Comm'n, 2013 Annual Report, *supra* note 21, at 16.

often obtains valuable information and assistance from whistleblowers even after it has begun to investigate an alleged violation and the SEC actively solicits follow-up complaints from whistleblowers who have already filed complaints.[114] In fact, an important factor that may increase the amount of a whistleblower's award is the level of "[a]ssistance provided by the whistleblower."[115] Enforcing waivers when the SEC has already learned of the general misconduct would limit this flow of potentially useful information and assistance, impeding a federal interest. Accordingly, a balancing of public policy interests dictates that waivers of a Dodd-Frank whistleblower award should not be enforced, regardless of when and how the SEC learns of the underlying securities violation.

C. Using Confidentiality Agreements to Impede Dodd-Frank Whistleblowing

In addition to contractual provisions that directly limit or condition an individual's ability to report misconduct to government agencies, or to receive personal benefits for doing so, many whistleblowers also face more general confidentiality agreements, which could arguably prohibit some communication with the SEC.[116] Employment, compliance, and separation agreements frequently include terms providing, for example, that "Employee shall not disclose, and represents that Employee has not disclosed, any confidential company information to any third party." These agreements often define confidential information broadly to encompass any information that employees learned during the course of their employment at the company. These provisions are particularly significant because they can be used by an employer to bring, or threaten to bring, a breach of contract claim against a whistleblower seeking damages beyond the compensation that the employee received in connection with the contract, a tactic now being used against FCA whistleblowers with increasing frequency.[117]

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114. As chief of the SEC's Office of the Whistleblower, McKessy noted in an SEC video for prospective whistleblowers, "People often call us to ask if they should submit something, or submit an update, and we will almost always suggest that you submit it. As I often tell people, you never know what information may be the last piece of a puzzle for an investigation." SEC Office of the Whistleblower, *What Happens to Tips* (Transcript), *available at* http://www.sec.gov/about/offices/owb/owb-what-happens-to-tips.shtml (last visited Sept. 28, 2014).

115. *See* 15 U.S.C. § 78u-6(c)(1)(B)(i)(II) (2012); 17 C.F.R. § 240-21F-6(a)(2) (2013).

116. Another similar and troubling practice, beyond the scope of this Article, is the use of a broad confidentiality agreement that prevents employees from consulting independent legal counsel, effectively eliminating their ability to file whistleblower complaints anonymously in accordance with SEC rules.

117. *See, e.g.*, Walsh v. Amerisource Bergen Corp., Civ. No. 11-7548, slip op. at 13 (E.D. Pa. June 16, 2014); *see also* Marissel Descalzo, *Employers Fight Back Against Whistleblowers*, INSIDE COUNSEL (June 24, 2014), http://www.insidecounsel.com/2014/06/24/employers-fight-back-against-whistleblowers; Ben James, *5 Questions to Ask Before Suing over Whistleblower Theft*, LAW360 (May 21, 2014), https://www.law360.com/articles/533633/5-questions-to-ask-before-suing-over-whistleblower-theft; Jean F. Kuei & Michael

These commonplace confidentiality provisions implicate important interests on both sides. Employers have a strong interest in obtaining such agreements for legitimate employer concerns, such as promoting research and innovation, protecting trade secrets and corporate reputation, and facilitating communication between a principal and its agents.[118] For this reason, confidentiality agreements tailored to protect legitimate interests are enforceable when they are not contrary to public policy.[119]

It is equally clear that strictly enforcing such confidentiality agreements to prevent whistleblowers from reporting misconduct to the SEC would abridge important law enforcement interests. This would contravene Rule 21F-17, which expressly states that confidentiality agreements may not be used to impede individuals from communicating with SEC staff.[120] It would also be inconsistent with a long line of cases prohibiting secrecy agreements purporting to restrict individuals from reporting violations of law.[121] Courts have also held that information about wrongdoing cannot be a trade secret warranting confidentiality protection.[122]

A more difficult question arises when an employer accepts the whistleblower's right to report misconduct but argues that the whistle-

R. Kleinmann, *Health Care Employers Take Note: New Weapons Are Available When Defending False Claims Act Suits*, Forbes (June 20, 2014), *available at* http://www.forbes.com/sites/theemploymentbeat/2014/06/20/health-care-employers-take-note-new-weapons-are-available-when-defending-false-claims-act-suits/.

118. *See* O'Day v. McDonnell Douglas Helicopter Co., 79 F.3d 756, 763 (9th Cir. 1996) (employer had "strong interest" in preventing employees from improperly taking and disclosing to other co-workers confidential documents); Dworkin & Callahan, *supra* note 33, at 174.

119. *See, e.g.*, McGrane v. Reader's Digest Ass'n, Inc., 822 F. Supp. 1044, 1046 (S.D.N.Y. 1993) (confidentiality agreements involving "matters of substantial concern to the public" are distinct from "trade secrets or other legitimately confidential information").

120. Similarly, the Commission has stated "we wish to clarify that confidentiality agreements or protective orders entered into in [Self-Regulatory Organization] arbitration or adjudicatory proceedings may not be used to prevent a party from reporting a possible securities law violation." Adopting Release, *supra* note 6, at 201 n.407.

121. *See* Chambers v. Capital Cities/ABC, 159 F.R.D. 441, 444 (S.D.N.Y. 1995) ("Absent possible extraordinary circumstances . . . , it is against public policy for parties to agree not to reveal, at least in the limited contexts of depositions or pre-deposition interviews concerning litigation arising under federal law, facts relating to alleged or potential violations of . . . law."); EEOC v. U.S. Steel Corp., 671 F. Supp. 351, 357 (E.D. Pa. 1987) (agreements restricting former employees revealing violations of law to EEOC will "hinder[]" implementation of the "Congressionally mandated duty to enforce the provisions" of federal statutes), *overturned on other grounds*, 921 F.2d 489 (3d Cir. 1990).

122. *McGrane*, 822 F. Supp. at 1051–52; *id.* at 1046 ("Courts are increasingly reluctant to enforce secrecy arrangements where matters of substantial concern to the public—as distinct from trade secrets or other legitimately confidential information—may be involved."); *id.* at 1052 ("Disclosures of wrongdoing do not constitute revelations of trade secrets which can be prohibited by agreements binding on former employees.").

blower cannot take or use company documents that might support the claim. In this situation, does the employee's right to communicate with the government justify the taking and sharing of these confidential documents, or does the employer have a superior interest in maintaining the confidentiality of its proprietary information? Courts have long grappled with these questions in the FCA context,[123] and are now beginning to face them in the SEC whistleblower context.

Employers are likely to argue that the federal interest in SEC whistleblowing cannot outweigh traditionally recognized property and intellectual property rights, and are likely to characterize employees' taking of documents for whistleblowing purposes as theft or conversion.[124] Employers may also note that, once the SEC is alerted to wrongdoing, it can request or subpoena documents, reducing the need for employees to take confidential documents.[125] This argument finds at least some support in existing case law, as some courts have taken an anti-whistleblower stance even when employees took documents to support a disclosure of illegality to the government. A prominent example is *JDS Uniphase Corp. v. Jennings*,[126] in which an employee defended his former employer's claim for a breach of a confidentiality agreement by claiming that the agreement was unenforceable in violation of the public policy in favor of whistleblowing.[127]

123. *See* Zahodnick v. Int'l Bus. Mach. Corp., 135 F.3d 911, 914–15 (4th Cir. 1997); Siebert v. Gene Sec. Network, No. 11-cv-01987-JST, slip op. at 11–13 (N.D. Cal. Oct. 16, 2013); United States *ex rel*. Wildhirt v. AARS Forever, Inc., No. 1:09-cv-01215, slip op. at 9 (N.D. Ill. Sept. 19, 2013); United States *ex rel*. Ruhe v. Masimo Corp., 929 F. Supp. 2d 1033, 1039 (C.D. Cal. 2012); Glynn v. Impact Sci. & Tech., Inc., 807 F. Supp. 2d 391, 423–24 (D. Md. 2011), *aff'd*, 710 F.3d 209, 214–18 (4th Cir. 2013); United States *ex rel*. Head v. Kane Co., 668 F. Supp. 2d 146, 152 (D.D.C. 2009); United States *ex rel*. Grandeau v. Cancer Treatment Ctrs. of Am., 350 F. Supp. 2d 765, 773 (N.D. Ill. 2004); X Corp. v. Doe, 805 F. Supp. 1298 n.24 (E.D. Va. 1992). For a good discussion of FCA case law examining the enforceability of confidentiality agreements, see Joel D. Hesch, *The False Claims Act Creates a "Zone of Protection" That Bars Suits Against Employees Who Report Fraud Against the Government*, 62 Drake L. Rev. 361, 395–404 (2014).

124. *See, e.g.*, *Ruhe*, 929 F. Supp. 2d at 1038 (company claimed that the relator copied confidential documents and transmitted them to the government in violation of relator's nondisclosure agreement); *Head*, 668 F. Supp. 2d at 150 (D.D.C. 2009) (suit by former employer against a False Claims Act relator for fraud, libel, tortious interference with contract, and other associated claims arising from relator's disclosure of confidential employer documents to the government, in violation of the relator's nondisclosure agreement).

125. *See, e.g.*, Securities and Exchange Act of 1934, § 17(b), 15 U.S.C. § 78q-1(b) (2012).

126. 473 F. Supp. 2d 697 (E.D. Va. 2007).

127. *See id.* at 701–02. Pursuant to the agreement's choice of law provision, the court analyzed this claim under California law, which has a provision that asserts a "generalized declaration of public policy in favor of whistle-blowing." *Id.* at 701. However, the court also noted that "Sarbanes-Oxley is itself an embodiment of a federal policy encouraging whistleblowers to come forward, and the effect of the California declaration, if any, is to encourage liberal construction of whistleblower statutes by California courts or other courts applying California law." *Id.* at 701 n.5.

Specifically, the employee argued that he needed to take proprietary documents "to function as an effective Sarbanes-Oxley whistleblower."[128] In rejecting this argument, the court concluded that a pro-whistleblower public policy cannot "authorize disgruntled employees to pilfer a wheelbarrow full of an employer's proprietary documents in violation of their contract merely because it might help them blow the whistle on an employer's violations of law, real or imagined."[129] The court pointedly concluded that "Sarbanes-Oxley is not a license to steal documents and break contracts."[130]

Many other courts, however, take a more nuanced approach, focusing on the nexus between the confidential documents in question and the misconduct alleged by the whistleblower. These courts have often found that an employer can bring a breach-of-contract claim against the employee, or successfully repel a retaliation claim by the employee, based on a confidentiality agreement if the purportedly confidential documents or materials taken by the employee bear little relationship to the reported violation. For example, in *Cafasso, U.S. ex rel. v. General Dynamics C4 Sys., Inc.*,[131] an FCA relator argued that the court should adopt a public policy exception to enforcement of her confidentiality agreement.[132] The court determined that, even if it adopted such an exception, the exception would not protect the relator because of her "vast and indiscriminate appropriation" of the employer's files.[133] The relator had copied approximately "eleven gigabytes of data—tens of thousands of pages," with little understanding or limitation on her choice of documents to take:

> She decided which [employer] documents to copy by browsing through folders related to technology and technology development, and, she testified, "if I saw something that I thought actually could apply and should be investigated, *I just grabbed the whole folder*" (emphasis added). Further, she scanned only file names and "did not look at any individual documents at all." Swept up in this unselective taking of documents were attorney-client privileged communications, trade secrets belonging to [her employer] and other contractors, internal research and development information, sensitive government information, and at least one patent application that the Patent Office had placed under a secrecy order.[134]

The Ninth Circuit concluded that any employee asserting a public policy exception to a breach of confidentiality agreement claim must

128. *Id.* at 702.
129. *Id.*
130. *Id.* at 703.
131. 637 F.3d 1047 (9th Cir. 2011).
132. *See id.* at 1061–62.
133. *See id.* at 1062.
134. *Id.*

make a "particularized showing" that the "removal of the documents was reasonably necessary to pursue an FCA claim."[135]

When the relationship between the documents in dispute and the reported wrongdoing is close, courts typically will refuse to enforce the confidentiality provisions on public policy grounds.[136] For example, courts have repeatedly found that an FCA relator's taking of documents is not actionable if those documents could be used as evidence at trial or are "relevant to the alleged fraud" because the FCA reflects a "strong public policy in favor of protecting whistleblowers who report fraud against the government."[137] Otherwise, "[e]nforcing a private

135. *Id.* The Ninth Circuit did not rule out such an exception, but clearly limited its use:

> The need to facilitate valid claims does not justify the wholesale stripping of a company's confidential documents. Although courts perhaps should consider in particular instances for particular documents whether confidentiality policies must give way to the needs of FCA litigation for the public's interest, Cafasso's grabbing of tens of thousands of documents here is overbroad and unreasonable, and cannot be sustained by reference to a public policy exception.

Id.; *see also* Walsh v. Amerisource Bergen Corp., Civ. No. 11-7548, slip op. at 13 (E.D. Pa. June 16, 2014) (refusing to dismiss a counterclaim for breach of confidentiality agreement because it was too early to tell whether "the entirety" of the documents taken by the whistleblower were necessary for his FCA claim); Siebert v. Gene Sec. Network, Inc., 11-CV-01987-JST, slip op. at 13 (N.D. Cal. Oct. 16, 2013) ("The Court agrees that any alleged obligation by Siebert not to retain or disclose the confidential documents that form the basis of this action is unenforceable as a matter of public policy because it would frustrate Congress' purpose in enacting the False Claims Act. . . . But the Court cannot now conclude that the counterclaim in its entirety should be dismissed, because it is possible that Siebert also took confidential documents that bore no relation to his False Claims Act claim."); United States *ex rel.* Wildhirt v. AARS Forever, Inc., No. 1:09-cv-01215, slip op. at 6 (N.D. Ill. Sept. 19, 2013) (refusing to dismiss a counterclaim based on a confidentiality agreement when it was alleged that the relator took documents "with no intention of using" them in the qui tam suit and when the relator's disclosure went beyond what was necessary for the suit).

136. *See, e.g.*, *Siebert*, 2013 WL 5645309, slip op. at 13 ("[A]ny alleged obligation by Siebert not to retain or disclose the confidential documents that form the basis of this action is unenforceable as a matter of public policy because it would frustrate Congress' purpose in enacting the False Claims Act—namely, the public policy in favor of providing incentives for whistleblowers to come forward, file FCA suits, and aid the government in its investigation efforts," but holding that a breach of contract claim may still be appropriate if the relator took confidential documents that "bore no relation" to his FCA claim); United States *ex rel.* Ruhe v. Masimo Corp., 929 F. Supp. 2d 1033, 1039 (C.D. Cal. 2012) ("Relators sought to expose a fraud against the government and limited their taking to documents relevant to the alleged fraud. Thus, this taking and publication was not wrongful, even in light of nondisclosure agreements, given 'the strong public policy in favor of protecting whistleblowers who report fraud against the government.'") (quoting United States *ex rel.* Grandeau v. Cancer Treatment Ctrs. of Am., 350 F. Supp. 2d 765, 773 (N.D. Ill. 2004) (relator exempt from liability for breach of confidentiality agreement for disclosure to government of documents showing employer engaged in fraudulent healthcare billing)); United States *ex rel.* Head v. Kane Co., 668 F. Supp. 2d 146, 152 (D.D.C. 2009); X Corp. v. Doe, 805 F. Supp. 1298, 1310 n.24 (E.D. Va. 1992) (a confidentiality agreement would be void as against public policy if, when enforced, it would prevent "disclosure of evidence of a fraud on the government").

137. *Siebert*, 11-CV-01987-JST, slip op. at 12; *see also Ruhe*, 929 F. Supp. 2d at 1039; *Grandeau*, 350 F. Supp. 2d at 773.

agreement that requires a *qui tam* plaintiff to turn over his or her copy of a document, which is likely to be needed as evidence at trial, to the defendant who is under investigation would unduly frustrate the purpose" of the FCA.[138]

A similar rule prevails in the Sarbanes-Oxley context, in which courts also recognize that the federal interest in whistleblowing can trump employers' otherwise legitimate desire to protect confidential documents when there is a reasonable connection between the documents and the alleged securities violation.[139] For example, one court stated: "[T]he statute demonstrates the public policy in favor of allowing even current employees to assist in securities fraud investigations. It certainly does not establish a public policy in favor of allowing employers to muzzle their employees with overbroad confidentiality agreements."[140]

Even more specifically, the DOL's ARB, which hears appeals of Sarbanes-Oxley whistleblower retaliation claims, has indicated that employees should be able to take and share documents related to potential misconduct, despite the existence of a confidentiality agreement, if those documents represent "the kind of 'original information' that Congress intended be protected under either the Internal Revenue Service [(IRS)] or SEC whistleblower programs."[141] In *Vannoy v. Celanese Corp.*, an employee complained internally about his employer's financial practices, and then reported the practices to the IRS under the Agency's whistleblower reward program.[142] As part of the IRS complaint, the employee attached numerous proprietary and confidential company documents in violation of the company's general confidentiality agreement.[143] The employee filed a Sarbanes-Oxley retaliation claim after the employer terminated his employment.[144]

Initially, a DOL administrative law judge (ALJ) rejected the employee's claim, finding that the company properly discharged the employee for, among other things, copying confidential documents in violation of his confidentiality agreement.[145] The ALJ also rejected the employee's argument that he had an "informer's privilege" to use the company's confidential documents when reporting wrongdoing, asserting that "SOX allows for the reporting of violations but not for illegally obtaining documents."[146] On appeal, however, the ARB concluded

138. *Head*, 668 F. Supp. 2d at 152.
139. *In re* JDS Uniphase Corp. Secs. Litig., 238 F. Supp. 2d 1127, 1136 (N.D. Cal. 2002).
140. *Id.*
141. Vannoy v. Celanese Corp., ARB No. 09-118, slip op. at 17 (Sept. 28, 2011).
142. *See id.* at 4, 6.
143. *Id.* at 6.
144. *Id.* at 2.
145. *Id.* at 20–21.
146. *Id.* at 22 (citing JDS Uniphase Corp. v. Jennings, 473 F. Supp. 2d 697 (D. Va. 2007)).

that the confidentiality agreement did not necessarily prohibit the employee from providing documents to the government, even though they contained sensitive data such as social security numbers.[147]

The ARB noted the difficulty of resolving the "clear tension between a company's legitimate business policies protecting confidential information and the whistleblower bounty programs" and looked to the public policy supporting the bounty programs to resolve the tension.[148] The ARB asserted that Congress created the IRS and Dodd-Frank programs:

> to encourage whistleblowers to disclose confidential company information in furtherance of enforcement of tax and securities laws. Passage of these bounty provisions demonstrate that Congress intended to encourage federal agencies to seek out and investigate independently procured, non-public information from whistleblowers such as Vannoy to eliminate abuses in the tax realm under the IRS Whistleblower program and now in the securities realm with the SEC Whistleblower program . . . . [T]he Dodd-Frank Act established the SEC Investor Protection Fund, which is to be used to pay whistleblower claims and is funded with monetary sanctions that the SEC collects in a judicial or administrative action, or through certain disgorgements under the Sarbanes-Oxley Act of 2002. Similar to the IRS Whistleblower bounty program that Vannoy pursued, Section 21F(b) of the Dodd-Frank Act provides that the SEC "shall pay" a whistleblower who voluntarily provides original information to the SEC that leads to the successful enforcement of a covered judicial or administrative action and results in certain monetary sanctions.
>
> . . .
>
> . . . Under the terms of the SEC whistleblower bounty program, Congress anticipated that the whistleblower would provide independently garnered, insider information that would be valuable to the SEC in its investigation.[149]

Ultimately, the ARB remanded the case to the ALJ, noting that, in light of these public policy interests, "the crucial question for the ALJ to resolve . . . is whether the information [the employee] procured from the company is the kind of 'original information' that Congress intended be protected under either the IRS or SEC whistleblower programs, and whether . . . the transfer of information was protected activity."[150]

Vannoy offers a guiding principle that documents may be lawfully taken by an employee, notwithstanding a confidentiality agreement, if those documents reasonably support or relate to a whistleblower complaint that is required, protected, or encouraged by federal or state law because the government has a compelling interest in receiving the doc-

147. *See id*. at 8.
148. *Id.* at 16.
149. *Id.*
150. *Id.* at 17.

uments. Conversely, documents with no reasonably ascertainable relevance to a possible securities violation would be subject to the applicable confidentiality agreement.

As the ARB's discussion of Dodd-Frank in *Vannoy* suggests, there is good reason to extend this guiding principle to the SEC Whistleblower Program because it comports fully with the public policy aims of the statute. Relevant documents taken from an employer not only can provide potentially valuable evidence of a possible securities violation, but also can help the SEC confirm the veracity of the whistleblower's information and better distinguish between tips that warrant significant attention and those that do not. This is a critical function because the SEC received over 3,200 tips through the SEC Whistleblower Program in fiscal year 2013 alone,[151] and receives tens of thousands of other tips and referrals through other means, such as investor complaints.[152] Similarly, background documents such as organizational charts, compliance policies, and descriptions of relevant internal systems can save investigative time and resources by helping the SEC understand the facts of a case more quickly.[153] Indeed, the SEC expects whistleblowers to provide documentary support. The SEC's "Tips, Complaints and Referrals" form (Form TCR) specifically asks the whistleblower to "[d]escribe all supporting materials in the complainant's possession . . ." and to "[i]dentify with particularity any documents or other information in your submission that you believe could reasonably be expected to reveal your identity."[154] These questions would make little sense if the SEC did not expect whistleblowers to include relevant documents in their submissions.

Finally, while employers would obviously like to avoid SEC scrutiny, the disclosure of documents to the SEC poses relatively little risk of harm to employers who have not engaged in wrongdoing. SEC policy mandates that all investigations—and all documents produced therein—must be kept confidential and nonpublic until the filing of a complaint or administrative order, giving employers a high level of assurance that any confidential documents will not be leaked

151. U.S. Sec. & Exch. Comm'n., 2013 Annual Report, *supra* note 21.

152. As the SEC's Enforcement Manual indicates, the SEC cannot allocate the same level of resources to each tip and investigation, and instead must rank investigations based on a number of factors, including the scope of the misconduct and investor harm. U.S. Sec. & Exch. Comm'n., Enforcement Manual § 2.1.1 (2013) ("Devoting appropriate resources to investigations that are more significant will help ensure high quality investigations and maximize desired program outcomes.").

153. The ability to gain early access to documents is particularly significant because the SEC cannot subpoena documents without a formal order of investigation, which itself typically requires investigating attorneys to have some evidence that a securities violation is occurring or has occurred. *See id.* § 2.3.4.

154. U.S. Sec. & Exch. Comm'n, Form TCR, *available at* http://www.sec.gov/about/forms/formtcr.pdf.

to the public or third parties.[155] In this way, SEC investigations offer greater confidentiality protections to employers than an FCA suit, in which relators may choose to attach supporting documents to public filings.[156]

A rule that allows whistleblowers to provide the SEC with documents relevant to understanding and investigating a possible securities violation strikes an appropriate balance between employers' legitimate interests in confidentiality and data security, while ensuring that the SEC retains access to potentially valuable sources of evidence and supporting background information. While employers and employees may disagree about whether certain documents are relevant to a possible securities violation, this rule also has the benefit of being relatively easy to understand and intuitive, reducing the risk that whistleblowers will inadvertently expose themselves to personal liability while making a good-faith effort to report possible misconduct.

IV. Practical Steps to Reduce the Risks Posed by Agreements Restricting Whistleblowing

This analysis of the three types of de facto gag clauses indicates that courts will, and should, refuse to enforce agreements that would significantly threaten the flow of potentially actionable information and documents about possible securities violations from whistleblowers to the SEC. If our prediction is correct, and courts do strike down such contractual clauses, they will become less common over time. In the meantime, even if courts refuse to enforce de facto gag clauses, the inclusion of such provisions in agreements continues to pose a danger to the SEC Whistleblower Program. Many individuals, particularly those who are unrepresented, may not understand that such provisions could be challenged, and may decide to forgo reporting as a result. Other potential whistleblowers may recognize that such provisions are likely unenforceable but decide that staying silent is preferable to acting as a "test case" and risking personal liability by blowing the whistle. Employees may also reasonably fear that challenging such provisions will flag them as a potential whistleblower, leading to retaliation. The widespread use of such agreements poses risks for employers, too, who may reflexively seek the broadest confidentiality and release provisions possible without recognizing the law's substantial limitations.

155. ADOPTING RELEASE, *supra* note 6, at 126. Additionally, employers producing documents to the SEC can request confidentiality for those documents under the SEC's Freedom of Information Act procedures. *See* 17 C.F.R. § 200.83 (2014).

156. The FCA provides that relators must first file their complaints under seal to give the government an opportunity to investigate. *See* 31 U.S.C. § 3730(b)(2) (2012). Unless the government seeks an extension, however, the complaint may be unsealed after sixty days. *Id.*

Accordingly, our analysis suggests that the key stakeholders—employers, employees, and the SEC—should each take steps now to reduce the risks associated with these agreements. First, employers and their counsel should be aware that agreements that impede employees from reporting misconduct to the SEC or other government authorities may backfire. Although such agreements may dissuade some employees from reporting misconduct, other employees may challenge these provisions, resulting in uncertainty and added employer litigation costs. In such cases, employers may find that bargained-for contractual provisions are unenforceable, upsetting settled expectations.[157]

In addition to losing the benefit of their bargain, employers and their counsel may face substantial liability or sanctions for drafting agreements that purport to limit or condition communications with the SEC. Such agreements may put employers and their counsel in the SEC's crosshairs for violating Rule 21F-17 or federal and state statutes prohibiting compounding and obstruction of justice.[158] Such agreements also may subject employers' counsel to professional sanctions under Rule 3.4(f) of the Model Rules of Professional Conduct, which, with limited exceptions, states that attorneys shall not "request a person other than a client to refrain from voluntarily giving relevant information to another party."[159]

Even if the SEC does not act, employees may be able to bring Sarbanes-Oxley or Dodd-Frank retaliation claims against employers based upon an employment-related agreement that purports to limit or condition their ability to communicate with the SEC, on the theory that they have suffered an adverse employment action as a result of trying to exercise or preserve statutory rights.[160] Courts have previously allowed similar retaliation claims under other statutes where (1) the employee engaged in protected whistleblowing conduct prior to receiving the problematic agreement[161] or (2) the employee did not engage in prior protected conduct, but the employer either "(i) attempt[ed] to

157. Employers should also be aware that anonymity provisions discussed above make it possible that employers may never learn when and if an employee has breached an agreement by, for example, accepting a whistleblower award.

158. As Professor Bauer points out in an article exploring the ethical implications of evidence-suppressing settlements, it is unlikely that a settlement prohibiting voluntary disclosures would be deemed criminal conduct, especially if it includes a carve-out for disclosures pursuant to subpoena or court order. *See* Jon Bauer, *Buying Witness Silence: Evidence-Suppressing Settlements and Lawyers' Ethics*, 87 Or. L. Rev. 481, 506 (2008). Nevertheless, there is a risk that the SEC or a federal prosecutor might draw inferences from an agreement that aims to deter whistleblowing to the SEC. *See id.*

159. Model Rules of Prof'l Conduct R. 3.4(f) (1983). For a detailed discussion of Model Rule 3.4(f), see Bauer, *supra* note 158, at 506.

160. *See* 18 U.S.C. § 1514A (2012) (Sarbanes-Oxley); 15 U.S.C. § 78u-6(h) (2012) (Dodd-Frank).

161. Conn. Light & Power Co. v. Sec'y of U.S. Dep't of Labor, 85 F.3d 89 (2d Cir. 1996).

enforce the agreement against an employee who signed the agreement but nevertheless files or participates in an EEOC charge, or (ii) with[e]ld benefits already promised or owed from an employee who refuses to sign the agreement."[162] An agreement that the employer intended to use as a shield from liability may become a sword in the hands of a sophisticated employee-side attorney. Thus, employers and their counsel should take proactive steps to ensure that their agreements do not directly or indirectly impede their employees' ability to report misconduct to the government.

For their part, employees and their counsel should educate themselves about the legal ramifications of these provisions and take a firm stand against their enforceability and legality. In particular, employee-side counsel should understand both the relevant law, including SEC rules, ethical rules, and case law, and the available legal tools at their disposal, including public policy arguments to defend a breach-of-contract claim or bring a retaliation claim against the employer. Counsel can then argue against the inclusion of such provisions during negotiations or, if necessary, challenge their enforceability later. Likewise, employees and their counsel should seriously consider advising the SEC if a company is using agreements to block individuals from reporting possible securities violations, especially if the company is under investigation by the SEC for other possible misconduct. The SEC has expressed interest in receiving such information,[163] and reports can be made anonymously. Employees' attorneys also should inform clients about the potential risks of taking and disclosing documents—including the risk of a claim against the employee—to ensure that employees do not expose themselves to personal liability by indiscriminately taking documents that bear no reasonable relationship to a possible securities violation.

Finally, and perhaps most importantly, we believe that government agencies should take meaningful action to counter the chilling effect of de facto gag clauses on whistleblowing. First, the SEC should use its enforcement authority to sanction companies that run afoul of Rule 21F-17, as Sean McKessy has already warned.[164] In addition, the

162. EEOC v. Nucletron Corp., 563 F. Supp. 2d 592, 594 (D. Md. 2008).

163. Mahoney, *supra* note 25 (quoting McKessy as stating that "we are actively looking for examples of confidentiality agreements, separat[ion] agreements, employee agreements that . . . in substance say 'as a prerequisite to get this benefit you agree you're not going to come to the Commission . . . .'").

164. John A. Goldmark, *SEC Warns In-House Counsel Against Using Incentives to Deter External Whistleblowing*, DAVIS WRIGHT TREMAINE LLP (Apr. 14, 2014), *available at* http://www.dwt.com/SEC-Warns-In-House-Counsel-Against-Using-Incentives-to-Deter-External-Whistleblowing-04-14-2014 (quoting McKessy as stating that companies should "[b]e aware that this is something we are very concerned about. If you're spending a lot of your time trying to come up with creative ways to get people out of our programs, I think you're spending a lot of wasted time and you run the risk of running afoul of our regulations.").

SEC could bring administrative actions against attorneys who require employees to enter into impermissibly restrictive agreements and could potentially suspend such attorneys from practicing before the SEC.[165]

Moreover, we believe the SEC should amend Rule 21F-17 to provide additional guidance on the type of contractual provisions that impede an individual from communicating with the SEC. Such guidance should clarify that an attempt to condition payment of severance or any other benefit on any limitation to an employee participating in the SEC's whistleblower reward program (such as losing the ability to make an anonymous report or receive an award) violates Rule 21F-17.[166] In addition, an amended Rule 21F-17 could provide examples of prohibited provisions, while also clarifying that the examples are not exclusive.[167] Likewise, OSHA, which already reviews certain settlement agreements in Sarbanes-Oxley cases to ensure that they do not contain explicit gag clauses,[168] should also modify its existing settlement review policies to clarify that any provision that bars or impedes participation in the SEC Whistleblower Program is invalid.[169]

165. Under Rule 102(e)(1)(iii) of the SEC's Rules of Practice, the SEC "may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder." SEC Rules of Practice, Rule 102(e)(1)(iii), 17 C.F.R. § 201.102(e)(1)(iii) (2013).

166. While this Article is focused on contractual provisions that deter SEC whistleblowing, such provisions also undermine the effectiveness of similar whistleblower reward programs. Accordingly, the CFTC and IRS should consider issuing guidance barring these types of provisions. Furthermore, the General Services Administration should consider amending the Federal Acquisition Regulations to bar these types of provisions in any agreement between a government contractor and an employee of the contractor.

167. For this reason, one of the authors of this Article, Jordan Thomas, along with the nonprofit whistleblower advocacy organization Government Accountability Project, has submitted a rule-making petition to the SEC seeking such an amendment to Rule 21F-17(a). *See* SEC File No. 4-676; SEC File No. 4-677 (July 18, 2014).

168. *See* Occupational Safety & Health Admin., Whistleblower Investigations Manual 6–11 (2011) ("OSHA will not approve a 'gag' provision that restricts the complainant's ability to participate in investigations or testify in proceedings relating to matters that arose during his or her employment. When such a provision is encountered, the parties should be asked to remove it or to replace it with the following: 'Nothing in this Agreement is intended to or must prevent, impede or interfere with Complainant's providing truthful testimony and information in the course of an investigation or proceeding authorized by law and conducted by a government agency.'").

169. For this reason, one of the authors of this Article, Jason Zuckerman, along with the Government Accountability Project, has submitted a rule-making petition to OSHA seeking such an amendment.

Such guidance from the SEC and OSHA would provide additional clarity for both employers and employees, and help protect the efficacy of the SEC Whistleblower Program. If the SEC Whistleblower Program is to fulfill its goal of better protecting investors, it must be allowed to function as Congress intended, without being constrained by private agreements. The public policy behind Dodd-Frank is too significant to allow for any other result.

SEC Charges Hedge Fund Adviser With Conducting Conflicted Transactions and Retaliating Against Whistleblower

First SEC Case Under New Authority to Bring Anti-Retaliation Enforcement Actions

FOR IMMEDIATE RELEASE
2014-118

Washington D.C., June 16, 2014 — The Securities and Exchange Commission today charged an Albany, N.Y.-based hedge fund advisory firm with engaging in prohibited principal transactions and then retaliating against the employee who reported the trading activity to the SEC. This is the first time the SEC has filed a case under its new authority to bring anti-retaliation enforcement actions. The SEC also charged the firm's owner with causing the improper principal transactions.

Paradigm Capital Management and owner Candace King Weir agreed to pay $2.2 million to settle the charges.

According to the SEC's order instituting a settled administrative proceeding, Weir conducted transactions between Paradigm and a broker-dealer that she also owns while trading on behalf of a hedge fund client. Such principal transactions pose conflicts between the interests of the adviser and the client, and therefore advisers are required to disclose that they are participating on both sides of the trade and must obtain the client's consent. Paradigm failed to provide effective written disclosure to the hedge fund and did not obtain its consent as required prior to the completion of each principal transaction.

A Commission rule adopted in 2011 under the Dodd-Frank Act authorized the SEC to bring enforcement actions based on retaliation against whistleblowers who report potential securities law violations to the agency. The SEC's order finds that after Paradigm learned that the firm's head trader had reported potential misconduct to the SEC, the firm engaged in a series of retaliatory actions that ultimately resulted in the head trader's resignation.

"Paradigm retaliated against an employee who reported potentially illegal activity to the SEC," said Andrew J. Ceresney, director of the SEC Enforcement Division. "Those who might consider punishing whistleblowers should realize that such retaliation, in any form, is unacceptable."

According to the SEC's order, Paradigm's head trader reported trading activity revealing that Paradigm engaged in prohibited principal transactions with affiliated broker-dealer C.L. King & Associates while trading on behalf of hedge fund client PCM Partners L.P. II. The SEC's subsequent investigation found that Paradigm engaged in the trading strategy from at least 2009 to 2011 to reduce the tax liability of the firm's hedge fund investors. As part of that strategy, Weir directed Paradigm's traders to sell securities that had unrealized losses from the hedge fund to a proprietary trading account at C.L. King. The realized losses were used to offset the hedge fund's realized gains. Paradigm engaged in at least 83 principal transactions by selling 47 securities positions from the hedge fund to C.L. King and then repurchasing 36 of those positions for the hedge fund.

According to the SEC's order, since Weir had a conflicted role as owner of the brokerage firm in addition to advising the PCM Partners hedge fund, merely providing written disclosure to her as the hedge fund's general partner and obtaining her consent was insufficient. Paradigm attempted to satisfy the written disclosure and consent requirements by establishing a conflicts committee to review and approve each of the principal transactions on behalf of the hedge fund.

The SEC's order finds that the conflicts committee itself, however, was conflicted. The committee consisted of two people: Paradigm's chief financial officer and chief compliance officer – who each essentially reported to Weir. Furthermore, Paradigm's CFO also served as C.L. King's CFO, which placed him in a conflict. Specifically, there was a negative impact on C.L. King's net capital each time the broker-dealer purchased securities from the hedge fund. The CFO's obligation to monitor C.L. King's net capital requirement was in conflict with his obligation to act in the best interests of the hedge fund as a member of the conflicts committee.

According to the SEC's order, because the conflicts committee was conflicted, Paradigm failed to provide effective written disclosure to its hedge fund client and failed effectively to obtain the hedge fund's consent prior to the completion of each principal transaction. The SEC's order also finds that Paradigm's Form ADV was materially misleading for failing to disclose the CFO's conflict as a member of the conflicts committee.

"Paradigm's use of a conflicted committee denied its hedge fund client the effective disclosure and consent to which it was entitled," said Julie M. Riewe, co-chief of the SEC Enforcement Division's Asset Management Unit. "Advisers to pooled investment vehicles need to ensure that any mechanism developed to address conflicts in principal transactions actually mitigates those conflicts."

According to the SEC's order, Paradigm's former head trader made a whistleblower submission to the SEC that revealed the principal transactions between Paradigm and C.L. King. After learning that he had reported potential violations to the SEC, Paradigm immediately engaged in a series of retaliatory actions. Paradigm removed him from his head trader position, tasked him with investigating the very conduct he reported to the SEC, changed his job function from head trader to a full-time compliance assistant, stripped him of his supervisory responsibilities, and otherwise marginalized him.

"For whistleblowers to come forward, they must feel assured that they're protected from retaliation and the law is on their side should it occur," said Sean McKessy, chief of the SEC's Office of the Whistleblower. "We will continue to exercise our anti-retaliation authority in these and other types of situations where a whistleblower is wrongfully targeted for doing the right thing and reporting a possible securities law violation."

Paradigm and Weir consented to the entry of the order finding that Paradigm violated Section 21F(h) of the Securities Exchange Act of 1934 and Sections 206(3) and 207 of the Investment Advisers Act of 1940. The order finds that Weir caused Paradigm's violations of Section 206(3) of the Advisers Act. They each agreed to cease and desist from committing or causing future violations of these provisions without admitting or denying the findings in the order. Paradigm and Weir agreed to jointly and severally pay disgorgement of $1.7 million for distribution to current and former investors in the hedge fund, and pay prejudgment interest of $181,771 and a penalty of $300,000. Paradigm also agreed to retain an independent compliance consultant.

The SEC's investigation was conducted by Michael L. Riedlinger and Alex McCabe of the Asset Management Unit as well as Jacob Krawitz and David Williams. The case was supervised by Anthony Kelly of the Asset Management Unit.

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SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements

Agency Announces First Whistleblower Protection Case Involving Restrictive Language

FOR IMMEDIATE RELEASE
2015-54

Washington D.C., April 1, 2015 — The Securities and Exchange Commission today announced its first enforcement action against a company for using improperly restrictive language in confidentiality agreements with the potential to stifle the whistleblowing process.

The SEC charged Houston-based global technology and engineering firm KBR Inc. with violating whistleblower protection Rule 21F-17 enacted under the Dodd-Frank Act. KBR required witnesses in certain internal investigations interviews to sign confidentiality statements with language warning that they could face discipline and even be fired if they discussed the matters with outside parties without the prior approval of KBR's legal department. Since these investigations included allegations of possible securities law violations, the SEC found that these terms violated Rule 21F-17, which prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC.

KBR agreed to pay a $130,000 penalty to settle the SEC's charges and the company voluntarily amended its confidentiality statement by adding language making clear that employees are free to report possible violations to the SEC and other federal agencies without KBR approval or fear of retaliation.

"By requiring its employees and former employees to sign confidentiality agreements imposing pre-notification requirements before contacting the SEC, KBR potentially discouraged employees from reporting securities violations to us," said Andrew J. Ceresney, Director of the SEC's Division of Enforcement. "SEC rules prohibit employers from taking measures through confidentiality, employment, severance, or other type of agreements that may silence potential whistleblowers before they can reach out to the SEC. We will vigorously enforce this provision."

According to the SEC's order instituting a settled administrative proceeding, there are no apparent instances in which KBR specifically prevented employees from communicating with the SEC about specific securities law violations. However, any company's blanket prohibition against witnesses discussing the substance of the interview has a potential chilling effect on whistleblowers' willingness to report illegal conduct to the SEC.

"KBR changed its agreements to make clear that its current and former employees will not have to fear termination or retribution or seek approval from company lawyers before contacting us." said Sean McKessy, Chief of the SEC's Office of the Whistleblower. "Other employers should similarly review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC."

Without admitting or denying the charges, KBR agreed to cease and desist from committing or causing any future violations of Rule 21F-17.

The SEC's investigation was conducted by Jim Etri and Rebecca Fike and supervised by David L.

Peavler of the Fort Worth Regional Office.

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Related Materials

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