

II. *Whistleblower Provisions of the Dodd-Frank Act*

A. Introduction

Section 21F of the Securities Exchange Act of 1934, added by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), provides more substantial protections and potential rewards for corporate whistleblowers than were available under previous acts.¹ Just eight years prior to the enactment of the Dodd-Frank Act, the Sarbanes-Oxley Act (“SOX”) was enacted and subsequently lauded as “one of the most protective anti-retaliation provisions in the world.”² SOX introduced important anti-retaliation provisions for corporate whistleblowers by empowering courts and administrative agencies to award a whistleblower the necessary monetary and non-monetary remedies to make him whole.³ SOX also codified the remedies available to whistleblowers, which included reinstatement if the whistleblower had been fired or demoted; monetary damages for back pay and front pay; compensatory damages for torts, such as intentional infliction of emotional distress; and special damages, such as legal fees.⁴ SOX also created criminal penalties for those found to have retaliated against the whistleblower in certain circumstances.⁵

¹ See Recent Legislation, *Dodd-Frank Act, Pub. L. No. 111-203*, § 922, 124 Stat. 1376 (2010) (to be codified at 15 U.S.C. § 78U-6), 124 HARV. L. REV. 1829, 1829-30 (May 2011) (“Dodd-Frank dramatically expands the incentives for whistleblowers to come forward . . .”).

² Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 WM. & MARY L. REV. 65, 65 (2007).

³ See Joel D. Hesch, *Whistleblower Rights and Protections: Critiquing Federal Whistleblower Laws and Recommending Filling in Missing Pieces to Form a Beautiful Patchwork Quilt*, 6 LIBERTY U. L. REV. 51, 102 (2011) (“[T]he court or administrative agency is to award the prevailing whistleblower all the relief necessary to make him whole, as if the retaliation never took place.”).

⁴ See *id.* at 102-03 (discussing the various remedies available for the court to award and the factors considered).

⁵ Ben Kershberg, *The Dodd-Frank Act’s Robust Whistleblowing Incentives*, FORBES (Apr. 14, 2011, 9:20 AM), <http://www.forbes.com/sites/benkerschberg/2011/04/14/the-dodd-frank-acts-robust-whistleblowing-incentives/> (“Sarbanes-Oxley also has severe criminal penalties—up to 10

The enactment of the Dodd-Frank Act instituted sweeping financial reform in the United States, including codifying two important changes to the SOX whistleblower statutes: (1) the creation of a mandatory bounty program paid by the SEC for qualifying whistleblower tips and (2) the significant expansion of anti-retaliation provisions for whistleblowers in some situations.⁶ Part B of this article summarizes these important changes. Part C will explore the criticisms of the new whistleblower provisions and analyze these provisions in the context of the first Securities and Exchange Commission (“SEC”) report of whistleblower data under the Dodd-Frank Act. Finally, Part D will discuss the legislative changes already proposed to the Dodd-Frank Act whistleblower provisions and make recommendations for those changes.

B. Summary of Whistleblower Provisions Under the Dodd-Frank Act

1. The Creation of a Mandatory Bounty Program Paid by the SEC for Qualifying Whistleblower Tips

The Dodd-Frank Act’s most notable change related to whistleblowers is the requirement that when a whistleblower tip leads to enforcement actions where sanctions are greater than \$1 million, the SEC must pay a bounty to the whistleblower.⁷ To qualify for the bounty, the tip must be voluntarily provided and the information must be “original,” meaning that the whistleblower must have derived the information from “independent knowledge or analysis” and that the tip is not already known to the SEC.⁸

The amount of the bounty paid must be between ten and thirty percent of the monetary sanctions collected.⁹ However, the

years in prison—that can be levied upon those found to have retaliated against whistleblowers.”).

⁶ See Dave Ebersole, Note, *Blowing the Whistle on the Dodd-Frank Whistleblower Provisions*, 6 OHIO ST. ENTREPRENEURIAL BUS. L.J. 123, 124 (2011) (discussing the changes instituted by Dodd-Frank).

⁷ 15 U.S.C.A. § 78u-6(b)(1) (West 2010) (codifying the Dodd-Frank whistleblower bounty program).

⁸ *Id.* § 78u-6(a)(3), (c) (listing requirement to qualify for bounty and defining original information).

⁹ *Id.* § 78u-6(b)(1) (defining range of monetary damages).

SEC has discretion to determine the percentage to be awarded to the whistleblower within that range.¹⁰ The SEC will consider the following criteria in choosing the increase a whistleblower's reward: significance of the information provided in the success of the enforcement action; the degree of assistance provided by the whistleblower; the SEC's interest in using the reward to deter securities fraud; and whether the whistleblower first reported the fraud internally through his employer's compliance systems. The SEC may choose to decrease a whistleblower's award based on the following factors: whether the whistleblower was a participant in the fraud; whether the whistleblower delayed reporting the violation to the SEC; and whether the whistleblower attempted to hinder the employer's attempts to investigate the fraud.¹¹

2. The Significant Expansion of Anti-Retaliation Provisions in Some Situations, But Not Across the Board

The second major changes introduced by the Dodd-Frank Act are the enhanced retaliation protections offered to whistleblowers under SOX through the: (1) expansion of the definition of "employee",¹² and (2) extension of the statute of limitations for a whistleblower to file a claim.¹³ Originally, SOX offered protection from retaliation for whistleblowers that were "employees" and defined "employees" broadly to include current and former employees, those who applied for employment, and individuals whose employment could be impacted by the company or its representatives.¹⁴ SOX also included provisions that extended retaliation protection to contractors in order to prevent public companies from using contractors to evade the whistleblower

¹⁰ *See id.* § 78u-6(c)(1)(A) ("The determination of the amount of an award [within the range provided by the statute] shall be in the discretion of the Commission.").

¹¹ *Frequently Asked Questions*, SEC OFFICE OF THE WHISTLEBLOWER, http://www.sec.gov/about/offices/owb/owb-faq.shtml#P9_2483 (last visited Feb. 25, 2012) (listing factors to be considered).

¹² *See Hesch, supra* note 3, at 105 ("[I]t expressly includes employees of subsidiaries of publicly traded companies and parent companies.").

¹³ *See id.* ("[I]t extends the statute of limitations from 90 to 180 days.").

¹⁴ *See id.* at 99-100 (discussing the types of whistleblowers protected by SOX).

protections.¹⁵ Despite the previous, broad definition, the Dodd-Frank Act's whistleblower provision further expanded the meaning of "employee" to include employees of all subsidiaries and affiliates of public companies.¹⁶ By explicitly expanding the class of persons eligible for protection under the whistleblower provisions to include employees of subsidiaries and affiliates of public companies, the Dodd-Frank Act's whistleblower provisions resolved a major loophole under which whistleblowers seeking protection under SOX were denied for not being "covered employees."¹⁷

Second, under SOX, a whistleblower had to file a complaint within ninety days of a retaliation violation by their employer or within ninety days of becoming aware of such a violation.¹⁸ Under the Dodd-Frank Act provision, a whistleblower has 180 days to file a claim after the violation occurs or the whistleblower becomes aware of the violation.¹⁹ This change is a step in the right direction for protecting whistleblowers, since many considered the ninety-day period to be too short.²⁰ The short statute of limitations problem was further exacerbated by the fact that the agencies enforced the statute of limitations by the literal letter of the law, even in cases where extenuating circumstances existed.²¹ The doubling of the statute of limitations period may seem to represent only a small step, but it is a significant one; a previous study found that almost half of the whistleblower claims denied for failing to meet the limitations period

¹⁵ See *id.* at 100 (mentioning concerns about companies evading the protections offered by SOX to employers contracting work to outsiders).

¹⁶ See USCA Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929A, 124 Stat. 1852 (2010) (defining "employee").

¹⁷ See Moberly, *supra* note 2, at 109-13 (discussing the ambiguity as to whether employees of private subsidiaries and affiliates of public companies are covered by the provisions of SOX and the result of agency interpretation in denying protection to whistleblowers).

¹⁸ See *id.* at 107-09 (discussing problems with the short limitations period).

¹⁹ See Hesch, *supra* note 3, at 105-06 (contrasting statute of limitations for whistleblowers to bring a claim of retaliation).

²⁰ See Moberly, *supra* note 2, at 107-09 (mentioning criticisms of the ninety day statute of limitations period).

²¹ See *id.* (illuminating that the agency focus on strict adherence to the ninety day statute of limitations under SOX without making exceptions for tolling even in compelling cases had resulted in the dismissal of a substantial number of whistleblower cases).

were filed after the 90-day mark but before the 180-day mark.²² Furthermore, because “[m]any employment statutes have limitations periods of 180 days or more,” and “[n]o compelling rationale for a 90-day limitations period” exists, the change to the limitations period under the Dodd-Frank Act was necessary to better accomplish the goal of protecting whistleblowers.²³ Taken together, these two changes to SOX whistleblower provisions under the Dodd-Frank Act help remedy two of the major loopholes that hindered the effectiveness of SOX at protecting certain whistleblowers and bring the protections more in line with congressional intent.²⁴

C. Criticisms of the New Provisions and Analysis of the First Set of Whistleblower Data

1. Criticisms of the Bounty Program

The aim of the bounty program is to encourage increased reporting of suspected fraud.²⁵ However some have raised questions over whether the increased monetary incentives are properly structured for both incentivizing reporting and keeping costs of litigation relatively low.²⁶ The ten percent floor, which was intended to provide some security and predictability to the amount of the award the whistleblower would receive, may not actually be accomplishing this aim.²⁷ At the time whistleblowers are deciding whether or not to report a violation even whistleblowers with a sophisticated understanding of the enforcement action process may have difficulty predicting the total amount that may potentially be collected for a reported violation, particularly when other

²² See *id.* at 132-33 (summarizing the findings of a study of twenty-eight whistleblower cases dismissed for failing to meet the statute of limitations prescribed in the statute).

²³ *Id.* at 133-34.

²⁴ See *id.* at 154-55 (arguing that SOX legislation will only be effective at accomplishing Congressional aims of encouraging reporting if it sufficiently protects whistleblowers).

²⁵ Ebersole, *supra* note 6, at 124 (“By expanding anti-retaliation protection and monetary incentives, Dodd-Frank is designed to incentivize whistleblowers to expose securities fraud.”)

²⁶ See, e.g., *id.* at 142 (discussing potential problems arising from a ten percent floor).

²⁷ See *id.* at 143 (“[T]he ten percent floor is misplaced because it may not provide certainty as intended.”).

whistleblowers may also be entitled to a portion of any enforcement award.²⁸ While intended to increase a reporting whistleblower's certainty about receiving a bounty, the ten percent floor means the Agency does not have the discretion to award a bounty of less than ten percent to a whistleblower even when there is no additional marginal utility distinguishing a ten percent or a lower share.²⁹ For example, in a given case there may be no additional marginal utility between a five percent bounty and a ten percent bounty, but the floor requires the Agency to award a ten percent bounty, which is wasteful.³⁰

2. **Decreased Incentive for Whistleblowers to Report Internally**

Another criticism of the Dodd-Frank Act provisions is the fact that Congress defined "whistleblower" under Section 21F to mean a person who provides information regarding violations of the securities laws "to the Commission," so the expanded anti-retaliation provisions only apply to whistleblowers that report suspected securities law violations externally and not to those who report such issues through their employer's internal compliance systems.³¹ As several commentators have pointed out, this creates a "two-tiered" system of protection for whistleblowers wherein those who report directly to the SEC receive a higher level of protection under the Dodd-Frank Act than those who report internally.³² If a whistleblower reports internally, he may be protected by the weaker anti-retaliation protections and remedies of SOX or perhaps not

²⁸ *See id.* at 143 (explaining that a number of factors create uncertainty with regard to the ultimate amount of the bounty that the SEC determines to award to a whistleblower).

²⁹ *See id.* at 167 (suggesting that extremely large bounties may be a waste of funds and will not encourage additional reporting, even if the whistleblower is awarded the minimum ten percent of the enforcement award).

³⁰ *See id.* (suggesting that extremely large bounties may be a waste of funds and will not encourage additional reporting, even if the whistleblower is awarded the minimum ten percent of the enforcement award).

³¹ Recent Legislation, *supra* note 1, at 1832 (discussing the difference between two types of reporting protections).

³² *See, e.g.,* Hesch, *supra* note 3, at 105-06 ("SOX . . . which protects a smaller subset of whistleblowers, does protect those reporting internally, but they must rely on the weaker SOX protections instead of the more expansive protections or remedies of the Dodd-Frank Act.").

covered at all, in cases where the whistleblower is a member of a class covered by the expanded Dodd-Frank Act whistleblower protections.³³

By providing stronger protections for employees who report externally, the Dodd-Frank Act encourages external reporting over internal reporting.³⁴ This undermines the primary policy aims of SOX in creating a system of regulation that is centered around the establishment of robust internal corporate governance systems to help identify and quickly remedy violations internally.³⁵ Incentivizing whistleblowers to report externally rather than internally imposes additional costs on governmental agencies that are not best equipped to receive and investigate all whistleblower tips.³⁶

Rule 21F-4(b)(7), enacted by the SEC, attempts to encourage internal reporting despite the two-tier system by providing that whistleblowers that first report internally and then subsequently report the information to the SEC within 120 days will be treated as though they reported to the SEC on the date they reported to their employer for the purposes of considering whether or not information is original.³⁷ Although the Rules also state that reporting internally will be viewed favorably by the SEC for the purposes of determining the amount of the bounty in the event that a tip leads to successful enforcement action, taken as a whole, these provisions only encourage internal reporting but do not require it.³⁸

³³ See *id.* at 105 (mentioning that SOX provisions still provide some protections, albeit weaker ones).

³⁴ See Recent Legislation, *supra* note 1, at 1832 (assuming that whistleblowers are rational actors seeking the most protection).

³⁵ *Id.* at 1832-33 (reviewing the reasons for SOX's enactment and the primary goals of the legislation).

³⁶ See Ebersole, *supra* note 6, at 127-28 (assessing the benefits of strong corporate governance systems).

³⁷ See 17 C.F.R. § 240.21F-4(b)(7) (2011) (establishing rules for whistleblowers to be eligible to receive bounties).

³⁸ See *id.* at § 240.21F-4(c) (stating factors that will be considered in determining the percent of the enforcement action penalty to be awarded to the whistleblower).

3. The First Securities and Exchange Commission Report on the Dodd-Frank Act's Whistleblower Program

Under the Dodd-Frank Act, the SEC is required to make an annual report to Congress summarizing: the number of bounty awards granted to whistleblowers and the cases involved in those grants; the balance and earnings of the Investor Protection Fund from which bounties are paid; and various other metrics and data related to the operation of the bounty program.³⁹ The report for the fiscal year 2011 was released in November but contained only data for a period of seven weeks, from August 12, 2011 (the date the Final Rules became effective) to September 30, 2011 (the end of the fiscal year).⁴⁰ The total number of whistleblower tips received by the SEC during this period was 334.⁴¹ Despite concerns that the new bounty program and two-tiered system of protections would lead to increased whistleblower tips, the total number of tips during this first period was considered lower than expected by commenters.⁴² Although the SEC indicates that the small sample size of the first report does not allow the Agency to draw any specific conclusions or identify any trends under the new program, the early evidence seems to suggest that at least some of the concerns surrounding an increased burden on the SEC to respond to a sudden increase in the number of tips may be overblown.⁴³

³⁹ See 15 U.S.C.A. § 78u-6(g)(5) (West 2010) (codifying the requirements of the annual report to Congress regarding the bounty program).

⁴⁰ U.S. SEC. AND EXCH. COMM'N, ANN. REP. ON THE DODD-FRANK WHISTLEBLOWER PROGRAM: FISCAL YEAR 2011 5 (2011) [hereinafter ANNUAL REPORT] (listing the date range of data contained in the report).

⁴¹ See *id.* (stating the total number of tips).

⁴² See Kevin M. LaCroix, *SEC Releases Initial Report on the Dodd-Frank Whistleblower Program*, LEXIS NEXIS CORPORATE & SECURITIES LAW COMMUNITY (Nov. 18, 2011, 9:47 AM), <http://www.lexisnexis.com/community/corpsec/blogs/dodd-frank/archive/2011/11/18/sec-releases-initial-report-on-the-dodd-frank-whistleblower-program.aspx> ("Some might find the 334 of whistleblower submissions during the reporting period surprisingly low.").

⁴³ See ANNUAL REPORT *supra* note 40, at 6 (stating that the data set in 2011 is too small to make specific conclusions, but that the Agency should be able to draw such conclusions from the full year 2012).

D. Whistleblower Improvement Act of 2011 and Other Proposed Changes

The proposed Whistleblower Improvement Act of 2011 seeks to remedy the conflicts inherent in the current two-tier reporting system under the Dodd-Frank Act.⁴⁴ To be eligible to receive a whistleblower bounty under the Dodd-Frank Act, the bill would require whistleblowers to report possible securities fraud through their internal compliance systems first and then to report the alleged violation to the SEC within 180 days.⁴⁵ The bill also provides for exceptions to this requirement in cases where the employer lacks a policy prohibiting whistleblower retaliation or an anonymous reporting system, when internal reporting would not be a viable option because the alleged misconduct involves complicity of upper-level management, or when there is evidence of the employer's bad faith.⁴⁶ If adopted, this provision may help to remedy existing concerns that the Dodd-Frank Act undermines critical internal reporting systems while still providing a narrow exception to internal reporting requirements when necessary.⁴⁷

Another change proposed in this bill is to bar individuals who receive information in the course of their role in investigating or remedying alleged misconduct from collecting a bounty under the Dodd-Frank Act.⁴⁸ This provision would essentially prevent employees who work in internal compliance positions from reporting information learned in the course of this role to collect whistleblower bounties.⁴⁹

The bill also proposes to remove the minimum ten percent bounty requirement, allowing the SEC greater latitude in determining

⁴⁴ See generally H.R. 2483, 112th Cong. § 2 (2011) (proposing changes to existing whistleblower provisions, including making internal reporting mandatory for whistleblowers).

⁴⁵ *Id.* (detailing the proposed internal reporting requirement).

⁴⁶ *Id.* (establishing exception to the requirement of internal reporting before external reporting).

⁴⁷ See generally *id.* (proposing changes that require whistleblowers to report internally except in specific situations).

⁴⁸ *Id.* (proposing to bar internal compliance officers from being whistleblowers in certain situations).

⁴⁹ See generally *id.* (making an addition to the statute to bar whistleblowers who have "a legal, compliance" or contractual duty to "respond to internal reports of misconduct or violations").

the percentage to be paid to a whistleblower.⁵⁰ Removing the floor means sacrificing some of the certainty that whistleblowers will feel in gauging whether or not they will receive a substantial bounty in favor of giving the SEC greater discretion.⁵¹ In lieu of simply removing the ten percent floor, Congress could add a provision to deal with bounties above a certain size.⁵² Simply stated, Congress can choose to remove the ten percent floor (or even set a floor smaller than ten percent) when the total enforcement action penalty is above a certain amount but keep the floor for smaller enforcement actions where whistleblowers may need the additional certainty to encourage reporting.⁵³

Furthermore, under the existing provisions of the Dodd-Frank Act, whistleblowers that are criminally convicted in matters relating to the fraud are ineligible to receive whistleblower bounties, and the bill proposes to expand this section to cover civil convictions or complicity in the misconduct.⁵⁴ A final important provision covered by the proposed legislation is that it would require the SEC to notify the employer before commencing enforcement action, unless such notification would jeopardize the investigation or enforcement action.⁵⁵ If the employer responds in good faith, the SEC will treat the employer as having self-reported the violation.⁵⁶

E. Conclusion

The Dodd-Frank Act implemented substantial changes to the existing statutes governing whistleblowers, most notably SOX.⁵⁷ While the enhanced protections and remedies offered to whistleblowers under the statute are potentially beneficial, the

⁵⁰ *Id.* (proposing removal of bounty floor).

⁵¹ *See generally* Ebersole, *supra* note 6, at 167 (discussing the problem that in some cases, bounties at the ten percent floor may be wasteful in terms of marginal utility, but the SEC is still required to pay them).

⁵² *See id.* (“Congress should adopt dollar value caps on whistleblower bounties.”).

⁵³ *See generally id.* (stating that bounties should be guaranteed within a range of dollar amounts rather than within a percentage range).

⁵⁴ H.R. 2483, 112th Cong. §2 (2011) (proposing expansion of whistleblowers who are not eligible for bounties).

⁵⁵ *Id.* (proposing statutory incentive for companies to self-report).

⁵⁶ *Id.* (proposing enforcement benefit for a company that self-reports).

⁵⁷ *See* Ebersole, *supra* note 6, at 126 (“Dodd-Frank expands whistleblower protections even further than SOX . . .”).

current two-tiered system created by the Dodd-Frank Act's anti-retaliation protections threatens to undermine systems of corporate internal reporting.⁵⁸ The changes proposed in the Whistleblower Improvement Act of 2011 would help resolve the discrepancy created and should be adopted by Congress.⁵⁹

Megan Foscaldi⁶⁰

⁵⁸ See Recent Legislation, *supra* note 1, at 1835 (“[T]his potential circumvention of internal reporting could have vast costs and indeed could undermine the very goal that section 922 was enacted to promote . . .”).

⁵⁹ See generally Hesch, *supra* note 3, at 106 (“Congress should amend the Dodd-Frank Act to protect internal reporting.”).

⁶⁰ Student, Boston University School of Law (J.D. 2013).