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Expert Analysis

Preventive Measures In Response To Recent Expansions of the Whistle-Blower Retaliation Protections Under Dodd-Frank

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The Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78, signed into law in 2010, was a legislative reaction to the 2008 financial crisis and concerns regarding corporate corruption and failed internal regulations and financial controls. The act is intended to incentivize whistle-blowers, through monetary awards, as well as enhanced anti-retaliation protections, in an effort to increase transparency and enhance corporate accountability.

Recently, a judge in the U.S. District Court for the District of Connecticut issued a decision that arguably expanded the definition of who qualifies for the whistle-blower anti-retaliation protections in the act.

In *Kramer v. Trans-Lux Corp.*, No. 3:11-cv-1424, 2012 WL 4444820 (D. Conn. Sept. 25, 2012), U.S. District Judge Stefan R. Underhill decided, for what appears to be the first time, that an employee who reports or discloses information founded upon a "reasonable belief" of a "possible" unlawful practice, either internally or informally to the U.S. Securities and Exchange Commission, is covered by the whistle-blower anti-retaliation protections in the Dodd-Frank Act.

In explaining this employee-friendly decision, the judge noted that the thrust of the Dodd-Frank Act was to "improve accountability and transparency of the financial system" and "to expand upon the protections of Sarbanes-Oxley," an act passed in 2002 to promote corporate-accounting reform and responsibility.

In extending the Dodd-Frank Act to include such employees, Judge Underhill acknowledged and accepted that this expansion of coverage would permit employees to bring retaliation claims against their employers under the Dodd-Frank Act, circumventing the internal-reporting and administrative exhaustion requirements of the Sarbanes-Oxley Act, and, in its stead, would apply the six-year limitations period and potential double-damages provisions in the Dodd-Frank Act.

In short, Judge Underhill's ruling grants broad-based whistle-blower anti-retaliation protections for employees who report internally to their employer's management or the employer's board of directors so long as they have a reasonable belief that there exists a violation of any law, rule or regulation subject to the jurisdiction of the SEC.

In light of the judge's expansive ruling in *Kramer*, this article will explain recent court decisions interpreting the whistle-blower protections in the Dodd-Frank Act, discuss the effect that those decisions may have on employers, and suggest how employers may choose to react and comply with this new expansion of the law's protections to minimize the risk of liability.

THE *KRAMER* DECISION

In *Kramer*, Judge Underhill denied an employer's motion to dismiss a former employee's whistle-blower claims under the Dodd-Frank Act, ruling that, taking all the facts alleged in the complaint as true, the plaintiff qualified as a whistle-blower under the act and therefore was entitled to protection from retaliation by his employer.

The judge determined that the employee qualified as a whistle-blower because he had alleged that he expressed concerns to his superiors on multiple occasions regarding what he believed to be his employer's failure to comply with the requirements of its pension plan, had sent a letter to the SEC, and, as an alleged result, was retaliated against and eventually terminated.

The employee, who was the vice president of human resources, was responsible for oversight of his employer's ERISA-governed pension plan and charged with ensuring compliance with federal and state laws and regulations. *Id.* at *2. His employer's chief financial officer, who served on the employer's two-person pension committee along with the plaintiff and who was the sole trustee of the pension plan, supervised the employee.

The employee alleged that the pension plan required that the committee consist of three members, that the CFO's positions as a member of the committee and a sole trustee created an impermissible conflict of interest, and that certain plan amendments were not presented to the board of directors for their required approval or presented to the SEC. *Id.*

In his court complaint, the employee claimed to have repeatedly brought these concerns to the CFO, to no avail. *Id.* In addition, the employee alleged that there existed other concerns regarding the corporation's adherence to the pension plan, concerns that normally would have resulted in an "immediate penalty" to the employer.

The employee also alleged that, because of the inaction, he sent an internal email to the CFO and chief executive officer, among others, delineating those concerns. The employee alleged that the CFO and CEO dismissed those concerns again, and so he allegedly contacted the corporation's board of directors. The employee also alleged that he sent a letter to the SEC expressing those concerns. *Id.* at *3.

The employee further alleged that, immediately after his actions, he was reprimanded, his responsibilities were reduced, and barely two months after he notified the board of directors, he was terminated.

On the basis of these alleged facts, Judge Underhill determined that the employee was covered by the Dodd-Frank Act's whistle-blower anti-retaliation protections. *See* 15 U.S.C. § 78u-6(h)(1)(A).

In reaching that determination, the judge first addressed how to reconcile the definition of a whistle-blower as defined by the act with the anti-retaliation provision (see box).

Judge Underhill noted that the statutory language was not clear and, thus, he examined a rule cited by the employee and recently promulgated by the SEC, 17 C.F.R. § 240.21 F-2(b)(1). The new and arguably lenient rule by the SEC, which the judge determined was a "permissible construction" of the statute that the court must follow, required that a "whistle-blower," for the purposes of the act's anti-retaliation protections, merely possess a "reasonable belief" that the information provided relates to a "possible" securities violation.

Furthermore, under the regulation, information is deemed "provided" by "[m]ailing a regular letter," *id.* at *4, as opposed to the employer's argued interpretation that would narrowly define the word "provided" to mean submitting complaints through the SEC's website or by mailing or faxing a more formal Form TCR (tip, complaint or referral).

Simply put, Judge Underhill's decision broadly expanded the definition of a whistle-blower under the Dodd-Frank Act's anti-retaliation provisions to protect employees who merely have a "reasonable belief" of a "possible" securities law violation and who provide the information through informal means.

Arguably, the judge's ruling places employers at risk for whistle-blower liability for employees who report "possible" violations without going through their employer's internal- reporting procedures. Although the judge did not analyze the outside limits of the requirement regarding the provision of information, in the comments to the SEC's final rules, he asserted that the act's anti-retaliation provisions will protect employees who report to "a person with supervisory authority over the employee or such other person working for the employer who has authority to investigate, discover, or terminate misconduct." *See* Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 18. The broad scope of the SEC's interpretation extends the protections to employees in similar circumstances.

OTHER RECENT DODD-FRANK COURT DECISIONS

The court's ruling in *Kramer*, which is thought to be the first of its kind permitting such a claim of whistle-blower anti-retaliation to survive the motion-to-dismiss stage of the litigation process, is not the only court decision expanding the rights of employee whistle-blowers.

In *Egan v. TradingScreen Inc.*, No. 10 civ 8202, 2011 WL 1672066 (S.D.N.Y. May 4, 2011), a judge in the U.S. District Court for the Southern District of New York appeared to favor the more lenient pleadings standards allowed in *Kramer* after determining that the definition of a whistle-blower was broader with respect to the anti-retaliation provisions than it was with respect to the rest of the act.

However, the *Egan* court eventually determined that the employee was unable to allege that any information actually was provided to any law-enforcement official and

the alleged information was too "vague and inadequately pleaded" to survive the motion to dismiss. *See Egan*, 2011 WL 4344067, at *4 (S.D.N.Y. Sept. 12, 2011).

The *Egan* court also determined that the act supported liability against employers by employees who make "joint reports" of any violations and that the act's anti-retaliation protections applied to employees of private companies, even those who are not governed by the SEC. *See Egan,* 2011 WL 1672066, at *5-7.

The analysis of protections discussed but not implemented in *Egan* also was discussed in *Nollner v. Southern Baptist Convention*, 852 F. Supp. 2d 986 (M.D. Tenn. Apr. 3, 2012). In *Nollner*, the court observed that employees of public companies who make disclosures may be protected as whistle-blowers under the act's anti-retaliation provisions, even if the disclosures are not made to the SEC but rather are made to "federal regulatory or law enforcement agencies, a member or committee of Congress, or a person with supervisory authority over the employee with authority to investigate discovery, or terminate misconduct." *Id.* at 994 & n.9.

However, as with *Egan*, the factual allegations in *Nollner* did not meet the court's pleading standards, and that claim was dismissed.

Finally, just a few weeks after *Kramer*, another judge in the U.S. District Court for the Southern District of New York, in *Ott v. Fred Alger Management*, No. 11 Civ. 4418, 2012 WL 4767200 (S.D.N.Y. Sept. 27, 2012), declined to dismiss a count claiming that an employee was retaliated against in violation of the act. As in *Kramer*, the judge permitted the count based on the employee's "reasonable belief" that her employer was violating the securities laws.

SUGGESTIONS OF POSSIBLE PREVENTIVE SOLUTIONS

On the basis of these court rulings, claims under the Dodd-Frank Act are expected to increase, and employers covered under the act should educate and protect themselves in this altered legal environment. Obviously, an employer should analyze any particular proposed action carefully and implement it only after considering its ramifications on the employer's practices and business.

Internal complaint reporting procedures

Build a culture of compliance. The first step in reacting to these legal developments is to establish a robust culture of compliance with well-known and easily accessible reporting procedures to promote internal reporting and compliance. To head off possible complaints to the SEC or other agencies, employees should be advised of the reporting procedures, the procedures should be easily accessible and easily understood, and the internal reports should be taken seriously and addressed with consistency. Encouraging internal reporting will not only benefit the corporation from a litigation standpoint, but it also may bring issues to light that can be addressed and remedied before they reach the point of reporting to the SEC or other agency.

Create codes of conduct, policies and procedures for compliance. Strong documentation of complaint procedures can create confidence among employees that their complaints will be addressed and can dissuade employees from complaining instead to the SEC or another agency. No matter where the employer sets forth its policies and procedures, the documentation should be clear, easy to read and easy to use. Long documents that incorporate policies or procedures from other documents seldom are effective in promoting confidence in the employer's internal complaint

procedures and seldom are effective in dissuading employees from complaining elsewhere.

Train new employees during orientation. During new-employee orientation, employees should be provided with documents explaining the employer's internal reporting requirements and training on the complaint reporting procedures. The internal reporting procedures should be reviewed to promote compliance. Employees should receive an explanation of what happens after the employer receives an internal complaint. For example, employees should be told who gets notified of the complaint, how the complaints are reviewed, how complaints have been addressed in the past, and the standard timeline for investigating and addressing complaints. Providing information to new employees at the beginning of their employment can help foster an understanding of the process and an appreciation of the benefits of notifying the employer of any complaints before reaching to third parties outside the employer.

Create alternative vehicles for complaints. Providing employees with options for making internal complaints probably will promote more internal reporting. One simple approach would be to establish an email address for reporting and discussing concerns. Email generally establishes a written record of the complaint. Another simple approach is to have an anonymous telephone answering line where anyone can register a complaint by leaving a voicemail message. If the message is clear, this method can preserve anonymity and allow receipt of complaints that otherwise may not be reported via email. A third approach is to hire a third party to staff a resource complaint hotline where employees are directed to register any complaints. The third party would interview the complainant, ask follow-up questions to ensure the complaint is understood, log the complaint and then notify the employer of the complaint. While creating these alternatives, it should be made clear to employees that external reporting is not prohibited or discouraged and employees will not be retaliated against based on any such reporting. Employers may even want to explain an employee's statutory protections to establish the credibility of their internal reporting systems. Transparency and candor will go a long way to foster a credible internal reporting program.

Provide ongoing training, workshops and annual certifications. To enhance and demonstrate a robust culture of compliance, employers may want to hold periodic training for all employees on the complaint reporting policies and procedures. This is especially important for managers who may be the first employees to hear about complaints from their subordinates and may be the people accused of retaliating against their subordinate employees. Workshops may be an effective tool for human resources professionals and others who commonly investigate complaints. If the employer conducts annual ethics, code-of-conduct or other compliance certifications, the employer may consider including reminders of the existence of the complaint reporting procedures and confirmation that no such complaints exist that have not been reported.

Prepare an explanation of procedures to provide upon receipt of a complaint. Once a complaint is reported, the employer should provide written documentation to the employee noting the complaint, describing the procedures for investigating the complaint and explaining the timeframe for responding to the complaint.

After receipt of a complaint

Maintain contemporaneous documents. It is important to understand that, once an employer is aware that an employee has complained, either internally or externally, it is highly likely that the employer will be creating evidence necessary to respond to any future claim of retaliation. Over time, witnesses' memories may fade, helpful

witnesses may become adversaries or may disappear and once-clear recollections may become biases or subject to claims of bias. Therefore, in addition to addressing and investigating the complaint, the employer should document the receipt of the complaint, the investigation and the response to the complaint.

Interview the complainant. Unless the complaint is submitted anonymously, it will be important to gather as much information as possible from the complainant. After obtaining information from witnesses and reviewing documents, the complainant may be contacted again to clarify information, narrow the scope of the investigation, explain the absence of certain facts or demonstrate the lack of merit to the complaint.

Analyze the complaint for witnesses, documents and the scope of the investigation. When reviewing the complaint, it will be important to determine who may be witnesses to contact for more information, whether any documents should be located or reviewed and how the allegations will be evaluated. It also will be important to determine the scope of the investigation. Sometimes a complaint about one topic may lead to the investigation of a different topic, or the investigation may result in the investigation of something not contemplated at the outset. At the same time, however, the goal should be to establish the contours of the investigation so that the allegations may be investigated and the complaint may be addressed.

Ensure compliance with investigation protocols. The employer should make sure that its investigation policies and procedures are being followed. Even an arguably baseless claim should be documented, investigated and concluded. In addition to demonstrating a corporate culture that promotes internal complaints, compliance with such policies will provide evidence that the employer may rely upon to prove its complaint-reporting procedures.

Consider alerting supervisors and conducting a human resources review of the complainant. In order to minimize the risk of liability under the anti-retaliation provisions of the Dodd-Frank Act, the focus probably will be on the complainant's supervisor and the employer's human resources department for causing or allowing any adverse employment action against the complainant. As a result, it may be prudent to notify the complainant's supervisor that the employee has filed a complaint, that the supervisor is prohibited from taking any adverse action against the complainant as a result of the complaint, and that any performance or other issues should be referred to the human resources department. It also may be prudent for the employer's human resources department to review the documented performance of the complainant and to be vigilant with documentation of any counseling sessions, performance evaluations or other discipline to help create a strong record for any defense that the adverse action was non-retaliatory. To show that the adverse action was legitimate and non-retaliatory, employers often rely on the actions taken with comparable employees who did not complain. The employer's human resources department may be in the best position to determine the comparable employees and gather the evidence necessary for the employer's defense. If a whistle-blower voluntarily separates from employment, the employer's human resources department can conduct exit interviews to confirm that the departure is voluntary and not a disguised constructive termination. It also is important to note that the act prohibits any waiver of claims through separation agreements. *See* 18 U.S.C. § 1514A(e)(1).

Retain legal counsel. In light of these recent court decisions, and given the risks of substantial liability under the Dodd-Frank Act if any employee claims retaliation, employers should retain experienced legal counsel to help them enact preventive measures and respond appropriately to any complaints.

CONCLUSION

Although other courts have not had the chance to adopt or reject the reasoning of the court's decision in *Kramer*, since the thrust of the Dodd-Frank Act is one of transparency and corporate accountability, both public and private employers would be wise to begin the process of addressing these potential retaliation claims now, before having to deal with the increased risk of exposure, increased risk of damages and possible increased litigation costs associated with claims under the act.

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