

How to Deal with Whistleblowers after Dodd-Frank

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I. Dodd-Frank Whistleblower Provisions

Section 922 requires the SEC to Pay a **reward/bounty** to individuals who

- Voluntarily provide original information to the SEC
- Resulting in monetary sanctions
- Exceeding \$1 million in civil or criminal proceedings

The **reward/bounty** will range

- Between 10 and 30 percent
- Of the amount recouped
- Penalties, disgorgement and interest count toward the \$1 million threshold
- The amount between 10 and 30 percent is at the discretion of the SEC

Reward Factors: SEC must consider several factors when making award determination:

- degree of assistance provided by whistleblower
- the significance of information provided to SEC
- SEC's interest in deterring violations of law

The award is based only on **original information**

- derived from the independent knowledge or analysis of a whistleblower, and
- is not known to the SEC from any other source, unless the whistleblower is the original source of the information, and
- is not exclusively derived from an allegation made in
 - a judicial or administrative hearing
 - a government report, hearing, audit or investigation
 - the news media (unless the whistleblower is the source of the information)

Retaliation prohibited under Section 922.

Section 748 amends the Commodity Exchange Act by adding a whistleblower reward program and whistleblower protection provision virtually identical to the SEC program

Section 1057 establishes a new private right of action and remedies to financial services industry employees for reporting violations under the jurisdiction of the new Bureau of Consumer Financial Protection.

II. SEC Rules

Adopted on May 25, 2011, with the following **clarification and comments**:

Whistleblower Definition: a person (not company) who provides

1. original information about a possible violation of the securities laws that he or she reasonably believes has occurred, is ongoing, or is about to occur.
2. to the SEC in a manner described in the whistleblowing rules.

** EX: employees, former employees, vendors, agents, contractors, clients, customers, and competitors.

Eligibility for Bounty: A person is eligible only if he or she satisfies the following criteria:

1. Individual/Natural Person (not Company): Person is an individual and was not criminally convicted in connection with conduct. Rule 21F-2.

N.B.: no *per se* exclusion for culpable individuals. A culpable person can still theoretically receive award, albeit potentially smaller due to his or her own misconduct. Rule 21F-16.

2. Voluntary Information: Information provided to SEC was voluntary (i.e., before a request, inquiry, or demand that relates to the subject matter is directed to the individual or the individual's representative by the SEC). Rule 21F-4(a)(2)

3. Original Information: The information constituted "original information" within the meaning of the SEC's rules. Rule F-4(b)(1). Original information must be based upon the whistleblower's

- a. *independent knowledge* – i.e., whistleblower's experiences, observations, or communications with third parties – or independent analysis, AND
- b. *new*, not already known to the SEC and not derived exclusively from certain public sources.

4. Information Led to Action: Original information led to the successful enforcement by the SEC of a federal court or administrative action (or non-SEC enforcement in a "related action"). Information must be sufficiently specific, credible and timely that it causes the staff to open an investigation, or significantly contributes to the success of an enforcement action. Rule 21F-4(c)(1).

5. \$1 Million Sanctions: Information led to monetary sanctions totaling more than \$1 million in a resulting enforcement action (SEC or non-SEC “related action”). Rule 21F-3. Recoveries/penalties against whistleblowers themselves do not count toward \$1 million eligibility threshold. Rule 21F-16.

N.B. Under new rules, *more will qualify as whistleblowers*, including various compliance and internal audit personnel, as long as there is a “reasonable basis to believe that disclosure of the information to the Commission is necessary to prevent the [company] from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors” or there is “a reasonable basis to believe that the [company] is engaging in conduct that will impede an investigation of misconduct.”

- Mid-Investigation Information Acceptable: Whistleblower can collect a bounty for original information provided to SEC even after the government begins an investigation and requests information from the whistleblower’s employer. Rule 21-F(a)(3).
- No Bounty if Information Directly Requested: Only if the State Attorneys General or Securities Regulators request information directly from the whistleblower is the individual ineligible for bounty.
- Information Standards Low: Information need not be about a material or probable violation, but information must have a “facially plausible relationship to some securities law violation – frivolous submissions would not qualify for whistleblower status.”

III. Reporting Internally

Use of Internal Compliance Programs Not Required: Whistleblower Need Not Participate in Internal Investigation. Rules decline to make whistleblowers ineligible for an award if they obstruct or fail to cooperate in a company’s own investigation of the alleged misconduct

- Lower End Reward for Failure to Cooperate Internally: whistleblowers should be compensated at the lower end of the 10 of 30 percent range when they fail to cooperate
- Recoveries or penalties against the whistleblowers themselves would not count towards the \$1 million eligibility threshold.
- Whistleblower is eligible to receive a bounty even if the whistleblower submits a tip to the SEC after having been contacted pursuant to an internal investigation.

Reporting Internally Encouraged: By Potential for higher rewards.

- 120 Days: Whistleblower employees who first report information internally can still receive reward, so long as they submit the same information to the SEC within 120 days.
- Relate Back: for the purposes of determining who submitted “original information” or who provided information first, SEC will consider the date of internal reporting as the official whistleblower submission date.

- Internal Participation Factor in Award Determination: i.e., whether whistleblower utilized company's corporate compliance program *or hindered* function of program
- Rules provide only that a whistleblower's bounty "*may increase*" if the whistleblower participated in the company's internal reporting and compliance system.

IV. Right to Sue for Retaliation

Protection Against Retaliation: Whistleblowers are protected from retaliation regardless of whether or not they are eligible for a bounty, and companies may not hinder a whistleblower's ability to communicate with the SEC.

- Enforcement: Commission itself or whistleblower can enforce anti-retaliation provisions.
- Unrelated Conduct not Protected: Whistleblowers may be fired or sanctioned for conduct unrelated to their whistle-blowing (case by case determination of whether something is retaliation).
- Whistleblower must have a "reasonable belief" that a violation occurred or is occurring, so that pretextual whistleblowing reports would not trigger protection against retaliation.

Private Right of Action: A new private right of action for employees who have suffered retaliation

- Federal Court Option: It may be brought in federal court
- Remedies include
 - Reinstatement
 - Double back pay with interest
 - Litigation costs, expert witness fees AND reasonable attorneys' fees
- Statute of Limitations: 6 years after retaliation occurs or 3 years after date on which facts material to right of action are known or reasonably should have been known by employee
- Jury Trial: Whistleblowers have the option of a jury trial
- Whistleblower claims are exempted from predispute arbitration agreements
- Subsidiary Employees Protected: Whistleblower protection provisions are expanded to cover employees of any subsidiaries of publicly traded companies whose financial information is included in the consolidated financial statements of the publicly traded company

This eliminates a loophole where some courts have required the whistleblower to be an employee of the public company itself.

V. Impact on Companies

- Increase of Disclosures to SEC and CFTC
- Whistleblowers may elect to go to government rather than attempt to prevent/correct problems internally.
- Increase of frivolous or unfounded claims
- Whistleblowers now have a broad range of claims
- Option to try Whistleblower claims before juries will likely increase damages awards
- Exempting Whistleblower retaliation claims from predispute arbitration agreements will enable whistleblowers to obtain broader discovery and will increase public exposure of fraudulent schemes.
- Option to bring certain whistleblower retaliation claims directly in federal court and to try SOX claims before a jury will put pressure on DOL to promptly adjudicate SOX claims and to demonstrate that it will conduct effective investigations.

Effective system: must have an effective system to

1. Discover potential violations

- Review and update compliance policies including
 - Anonymous reporting
 - Hotlines
 - Whistleblower policies
- Cultivate corporate culture that emphasizes the importance of compliance
- Ensure the compliance program has appropriate oversight at the highest levels
- Ensure that whistleblower allegations made anonymously are taken seriously
- Regular anti-corruption, compliance training to reduce chance of misguided/false reports

2. Timely respond to notice of potential violations

- Investigate and evaluate whistleblower complaints expeditiously
- Document the response to each complaint

- Assure that appropriate corrective action is taken when wrongdoing is found
 - Consider self reporting
3. Assuring that whistleblowers are protected from retaliation
 - Offer training on whistleblower policy
 4. Communicate to employees the importance of surfacing concerns internally
 - When appropriate, inform whistleblower of the fact of the investigation and the commitment to see the investigation to the end

Interviewing Employees

- Maintain strictest confidentiality over facts learned
- Limiting information provided to employees who participate in the investigation
- Questions may give information to the employee particularly when showing documents the employee may not have seen
- May give information a whistleblower may use, correctly or not
- Care should be taken in paraphrasing witnesses' statements to avoid making them worse than they might be

VI. Issues in Dealing with a Whistleblower

1. Self Report: Consider self reporting because
 - Prefer government to hear from company.
 - May or may not get credit but still probably better off.

Challenge/Issue:

- Race against whistleblower
 - May not have all the facts and answers to all the questions
 - May not know scope or seriousness of violations
2. Encourage whistleblower to cooperate with company investigating.
 - Allows company to address whistleblower's concerns.

Challenge/Issue:

- Makes whistleblower part of team
 - Raises expectations of information flow other way.
3. Evaluate Privilege Issues.
- E.g., is Whistleblower telling government what he or she said to lawyers?
 - Underlying facts not privileged (but conversations with lawyers may be).
 - Privilege belongs to Company
 - Determine whether documents reflecting information given by whistleblower (e.g. memos/reports) are privileged.
4. Share with WB: Whether to share results of investigation with whistleblower:
- If the accusations are not borne out, perhaps to explain why nothing is being done
 - Jeopardizes the confidentiality and could result in the loss of control of the information

Traditional Approach: review completed and taking appropriate action – NOT appropriate to share with whistleblower. Sharing information with whistleblower loses control of information.

Challenge/Issue with Sharing:

- Makes whistleblower part of the team and raises the expectation of flow of information the other way
 - Whistleblower probably looking for more. If not satisfied, probably would go further (perhaps to government).
5. Do NOT: Retaliate against WB:
- Termination
 - Affect compensation
 - Affect job responsibilities
 - Harassment
 - Discrimination

6. Interacting with Whistleblower:

- Usually want line managers with day to day oversight of employees to know what is going on – with whistleblower may be better to keep information from them to ensure no retaliatory activity
- Document any discipline that may have been in works to show decision making sequence. Make certain any prior consideration of discipline had been documented.