

Minimizing Your Risks  
Under the  
Dodd-Frank Whistleblower Provisions

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## Dodd-Frank Whistleblower Provisions

- Create substantial monetary incentives for reporting potentially illegal conduct to SEC/CFTC
  - Require SEC and CFTC to pay bounties under certain conditions
  - Prohibit retaliation against whistleblowers
- Impacts:
  - Likely to undercut corporate compliance and corporate governance efforts
  - May effectively end discretion not to self-report
  - Place a high premium on prevention and detection of illegal conduct



Background:

*False Claims Act and Qui Tam*

## Brief History of False Claims Act and *Qui Tam*

- 1863 – False Claims Act or “Lincoln’s Law” - 31 U.S.C. 3729-3733
  - Allows private citizens (“relators”) with knowledge of government contractor fraud on the government to file a *qui tam* suit against the contractor and share in the proceeds of the recovery.
- 1943 Amendments: Eviscerate the FCA.
- 1986 Amendments: Revive the FCA and added anti-retaliation provisions to protect whistleblowers.
- 2009 Amendments: Expand anti-retaliation provisions.
- 2010 Amendments: Broaden ability of relators to bring claims without being the “original source.”

## The Expansion of False Claims Act Cases

- There is real money at stake – over \$3 billion in False Claims Act recoveries in FY 2010. More than 80% of those cases were brought by whistleblowers and their attorneys.
- Approximately **\$24 billion in recoveries** since the 1986 amendments.
- Traditionally, the health care industry has been the most active sector for False Claims Act cases, approximately 80%
- Also used in the government procurement and contract fraud sector. It has been used more recently in connection with Department of Defense contractors in connection with wartime spending.

## The Expansion of False Claims Act Cases: Use in Criminal Cases

- Used not only in civil cases, but can be used to proceed *criminally* for significant penalties:
- Approximately **20%** of the top 100 False Claims Act cases contained a criminal fine. Some examples include:
  - 2009 case against Pfizer—**\$1.3 billion** in criminal fines in addition to a \$1 billion under the FCA.
  - 2009 case against Eli Lilly – **\$615 million** in criminal fines and forfeiture and \$800 million under the FCA
  - 2010 case against GlaxoSmithKline –**\$150 million** in criminal fines and forfeiture and \$600 million under the FCA.

## The Expansion of False Claims Act Cases: State False Claims Act Cases

- Finally, approximately 30 states and D.C. have some version of a False Claims Act with *qui tam* enforcement regimes.
  - Potential impact is significant – a State may decide to intervene and prosecute a case for a relator when the federal government will not.

## The Evolution of Whistleblower Protection

- Government employee whistleblowers got protection from:
  - Civil Service Reform Act of 1978
  - Whistleblower Protection Act of 1989
  - False Claims Act whistleblower protection (1986 amendments) in the rare cases in which the government employee is a relator in a *qui tam* case.



## The Evolution of Whistleblower Protection

- Until 2002, private employees got protection from various State employment laws, and from federal law in very discrete areas (public health and safety, civil rights).
- **Sarbanes-Oxley Corporate Reform Act of 2002**
- With SOX, internal and external whistleblower protection was expanded significantly to officers and employees of a publicly traded company, its contractors, subcontractors, or agents in an effort to promote the disclosure of financial frauds.

## The Evolution of Whistleblower Protection

- SOX's main components regarding whistleblowers:
  - **Made it illegal to "discharge, demote, suspend, threaten, harass, or in any manner discriminate against" whistleblowers**
  - **Established criminal penalties of up to 10 years for executives who retaliate against whistleblowers**
  - **Required Board Audit Committees to establish procedures for hearing whistleblower complaints**
  - **Allowed the Secretary of Labor to order a company to rehire a terminated employee with no court hearing**
  - **Gave a whistleblower the right to a jury trial, bypassing months or years of administrative hearings.**

\* From "Encouraging Internal Whistle blowing in Organizations," by Lilanthi Ravishankar, Markkula Center for Applied Ethics, Santa Clara University



*Dodd-Frank Whistleblower*  
*Provisions*

## Dodd-Frank Whistleblower Provisions

- New Exchange Act Section 21F
- “Securities Whistleblower Incentives and Protection”
  - Enacted July 21, 2010
  - Implementing regulations required by April 2011
    - SEC regulations proposed Nov. 3, 2010
      - Comment period ends Dec. 17, 2010
    - CFTC regulations on Nov. 10, 2010 agenda

## Bounty Provisions: Overview

- Require payment of 10 to 30 percent of monetary sanctions obtained
  - **To eligible whistleblowers**
  - **Who voluntarily provide**
  - **Original information about a violation of the federal securities laws**
    - **Whistleblower must be first in the door**
    - **A broad range of legal violations can be characterized as securities law violations**
  - **Leading to enforcement action with sanctions exceeding \$1 million**

## Bounty Provisions: anonymous reporting

- Ability to report anonymously through counsel
  - **Counsel must reveal identity to agency before bounty can be paid**
  - **No requirement that whistleblower ever be identified publicly**
  - **Counsel already advertising for whistleblowers**

## Providing Information “Voluntarily”

- Information must be reported in advance of receiving a request from the SEC or other authorities
  - Includes formal and informal requests
  - Exception:
    - *Employees become eligible for bounty if the company does not provide the requested material in a timely manner*

## Excluded Persons

Who is not eligible for a bounty?

- Regulatory and law enforcement personnel
- Independent public accountants (for information obtained in course of an audit)
- Other persons with “pre-existing duty” to report
- Foreign government officials
- Non-natural persons

No exclusion for persons involved in misconduct

- But no amnesty for whistleblowers



## Excluded Information

- What information does not qualify for a bounty?
  - Information obtained by:
    - Attorneys in the course of representation
    - Corporate legal or compliance personnel
  - Information obtained in violation of federal or state criminal law (but not civil law)
  - SEC seeking comment on whether to exclude information:
    - **Subject to other privileges (spousal, physician, clergy)**
    - **Obtained in violation of foreign law or judicial or administrative order**

## Procedures for Submission of Reports

- Reports to be made under penalty of perjury
- Substantial paperwork required for eligibility
  - Form WB-DEC

## Protections for Whistleblowers

- Employer may not discharge, demote, threaten or discriminate against whistleblower
- Whistleblower has federal right of action to enforce this provision
- Remedies include:
  - Reinstatement
  - 2 x back pay
  - Costs

## *Qui Tam as Precedent*

- SEC release notes similarity to False Claims Act provisions
- FCA guidance informative but not controlling

# Issues

## A Race to Report

- Only the first to report will be eligible for a bounty
- Companies will be concerned to report first to obtain cooperation credit
- *Changing the calculus of the self-reporting decision*

## Tension with Corporate Compliance Efforts

- SEC rule proposal recognizes this issue
  - Seeks to address by “not discouraging” employees from first reporting to the company
  - SEC considered but rejected requirement that whistleblower be required to first use internal reporting mechanisms
    - SEC cites variation in quality of corporate compliance efforts
  - SEC will consider higher percentage awards for those who first report internally

## Tension with Corporate Compliance Efforts

- Internal investigations
  - Company personnel who learn of an issue by being questioned in an internal review can qualify for bounty
    - SEC rationale: no assurance that employer will ultimately disclose potential violations identified
  - Legal and compliance personnel become eligible for bounties where company fails to report to SEC in a “reasonable time”
- *An end to discretion not to self-report?*



## Tension with Attorney-Client Relationship

- Attorneys can become eligible for bounties
  - Where SEC “up the ladder” or state ethics rules would permit disclosure without client consent
    - Potential federal/state conflict

## Potential for Abuse

- Will employees facing imminent termination seek to use whistleblowing rules to “lock-in” their employment status?
  - SEC seeking comment on provisions that should be considered to prevent this from occurring

## Proactive steps

- How can the company be the first to know of a problem?
  - Encouraging internal reporting
    - Promotion of expectation that potential wrongdoing will be reported
      - To supervisors and compliance personnel
      - Via hotlines
  - Enhancing the credibility of internal reporting
    - Prompt investigation of legitimate reports
    - Appropriate remedial actions
    - Protection from retaliation

## Proactive steps

- Enhancement of corporate compliance systems
  - More proactive / less passive
  - Risk assessments
  - Active monitoring of compliance
  - Retrospective auditing of compliance

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## *Employment Protections*

## Employment Protections

Employment Protections are very broad

- Similar to retaliation provisions of Title VII, other federal anti-discrimination laws, and some state whistleblower statutes
- But potentially broader and more difficult for employers.

## Actionable Retaliation

- protected activity
- adverse employment action
- causation

## Protected Activity

“any lawful act done by the whistleblower –

- in providing information to the Commission in accordance with this section;
- in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission; or
- in making disclosures that are required or protected under
  - the Sarbanes Oxley Act of 2002 (15 U.S.C. 7201 et seq.)
  - the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), including Section 10A(m), Section 1513(e) of Title 18, United States Code, and
  - any other law, rule, or regulation subject to the jurisdiction of the Commission.”



## Protected Activity

- Does not include the reasonable and good faith requirement of other retaliation statutes
- But perjurious information presumably not protected
- There need not be an actual violation of law

## Adverse Action

- Any Change in the Terms and Conditions of Employment
- Concrete Actions like “discharge, demote, suspend”
- Also less concrete actions, much more difficult to police and defend “threaten, harass, directly or indirectly, or in any manner discriminate against, a whistleblower in the terms and conditions of employment.”

## Causal Connection

- The Adverse Action must be because of the protected activity
- Timing is everything
  - inference of causation if close enough
  - difficult to overcome
- Where no temporal proximity
  - did the decision-maker know about the whistleblowing?
  - what was the timing of the whistleblowing? Did it closely follow a bad performance review, notice of termination, etc?
  - did something significant change between the whistleblowing and the adverse employment action?

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*Avoiding and Responding to  
Retaliation Claims*

# **1. Implement Appropriate Internal Reporting Procedures**

- easy to use
- well-publicized
- anonymous reporting permitted

## 2. Make Internal Reporting Mandatory

- don't reference external reporting – this is a separate track that does not interfere with or impact external reporting
- if mandatory reporting required, important that anonymous reporting be permitted
- maintaining a robust internal reporting system is consistent with the SEC's stated goals

### **3. Endorse Policy at the Highest Levels of the Company**

- policy statement signed by/issued by top executive
- appearance of high level executives at training sessions

## **4. Investigate Every Complaint and Maintain Adequate Records**

- this may be important evidence in defending employee retaliation claims



## **5. Limit the Number of Individuals Aware of the Identities of Whistleblowers**

- managers who don't know an employee is a whistleblower can't retaliate against him

**6. Do not Make Efforts to Identify Anonymous Whistleblowers**

## 7. Require Annual Certifications from Employees

- Aware of no violations of law or company policy that are not described in the certification or otherwise reported to the company, including anonymously

## 8. Provide Training

Focus on:

- policy of full compliance with laws and regulations
- the mandatory obligation to report
- policy of non-retaliation

Do not exempt high-level executives from training

## **9. Adhere to Best Practices for Employee Performance Evaluation**

- document fully and accurately
- review performance honestly and timely
- don't take adverse action without adequate documentation
- require HR approval of all significant employment actions

## **10. Exercise Extra Caution With Employees Who May Use Whistleblowing as an Offensive Strategy**

- of course this will happen
- no universal answer
- good human resources policies, consistently applied, will be key

## 11. Improvement of Compliance Systems

- More proactive / less passive
  - Risk assessments
  - Monitoring of compliance
  - Auditing compliance

## 12. Other Potential Approaches

- Make hotlines available to third parties
- Train line managers to recognize and handle complaints
- Financial incentives for reporting internally?
- Sanctions for not reporting internally?



## Thank You!

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