Minimizing Your Risks Under the Dodd-Frank Whistleblower Provisions

Rosemary Alito
Carol Elder Bruce
Matt T. Morley

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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

  - 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.
- 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 Whistleblowing 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
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 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?
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!

Questions? Please Contact:

Rosemary Alito
rosemary.alito@klgates.com
973.848.4022

Carol Elder Bruce
carol.bruce@klgates.com
202.778.9426

Matt T. Morley
matt.morley@klgates.com
202.778.9850