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Whistleblower Incentive Program

What it Will Mean to You

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Dodd-Frank: Building on SOX

- In 2002, the Sarbanes-Oxley Act (SOX) provided whistleblower protections to employees of all public companies who report corporate wrongdoing
 - Few claims have resulted in a successful enforcement action
- To encourage further whistleblowing, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank):
 - Enhances protection from employer retaliation
 - Promises potentially huge bounties to certain whistleblowers
- Dodd-Frank left certain details to the discretion of the Securities and Exchange Commission (SEC)
 - SEC proposed rules on November 3, 2010 (the Proposed Rules)
 - Proposed formation of SEC “Whistleblower Office”

Dodd-Frank: Before and After

	Before	After
Businesses subject to anti-retaliation penalties	<ul style="list-style-type: none">• Government contractors (FCA)• Publicly traded companies (SOX)	<ul style="list-style-type: none">• Government contractors• All companies subject to the securities laws• CFTC-regulated firms• Providers of consumer financial services• NRSROs
Whistleblower bounties (of up to 30%)	<ul style="list-style-type: none">• False Claims Act	<ul style="list-style-type: none">• False Claims Act• SEC whistleblowers• CFTC whistleblowers

Dodd-Frank: Expansion of Whistleblower Protection

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- Subsidiary Coverage
- Arbitration Agreements
- Jury Trial
- Procedural Changes
- Damages

Dodd-Frank Whistleblower Rewards

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- Whistleblower must *voluntarily* provide the SEC with *original information* that leads to a successful SEC enforcement action resulting in monetary sanctions exceeding \$1,000,000
 - Award can be 10% to 30% of the total sanction amount
 - SEC has discretion to determine the percentage within the range
 - If multiple eligible whistleblowers, the total award to all whistleblowers as a group will still fall within the 10% to 30% range
- As of September 30, 2010, the SEC had \$452 million reserved for the reward program¹
 - Largest bounties may come from FCPA cases

¹ SEC Annual Report on Whistleblower Program (http://www.sec.gov/news/studies/2010/whistleblower_report_to_congress.pdf)

Dodd-Frank Whistleblower Rewards: The Fine Print

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- *Voluntarily* – Must be provided before whistleblower subject to external inquiry
- Must be *original information*
 - Derived from whistleblower's *independent knowledge or analysis*
 - Not known to the SEC from another source, and not exclusively derived from allegation made in other venues (unless the whistleblower is a source of the information)
- The following do not have *independent knowledge or analysis* (per Proposed Rules)
 - Attorneys and accountants who obtain information from engagements
 - Those who learn about violations through a company's internal compliance program, unless the entity fails to report the information to the SEC within a reasonable time or proceeds in bad faith
 - Those who obtain information through illegal means
- Others not eligible for awards
 - Employees of the DOJ, PCAOB, self-regulatory organizations, law enforcement organizations, and certain regulatory agencies
 - Those who have a pre-existing legal or contractual duty to report information
 - Foreign government officials and members of foreign financial regulatory authorities
 - Those who are convicted of a crime, or knowingly making a false statement, related to an enforcement action

Dodd-Frank Whistleblower Rewards: The Fine Print

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- Whistleblower reporting—two-step process
 - 1. Submission of information
 - Form TCR – tip, complaint or referral; or
 - SEC’s Electronic Data Collection System (still pending)
 - 2. Submission of Form WB-DEC – declaration concerning original information
 - Whistleblower must attest that the information provided is true, correct and complete
 - Whistleblower is subject to prosecution for knowingly making false statements
- Anonymity
 - Whistleblower can remain anonymous and make filings and representations through attorney

Dodd-Frank Whistleblower Rewards: SEC Discretion

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- Factors the SEC must consider in determining award amount
 - Significance of information and degree of assistance provided
 - Programmatic interest of SEC in deterring violations through awards
 - Other factors in the SEC's discretion
 - Whether whistleblower authorized or encouraged others to assist the SEC
 - Extent to which whistleblower took steps to prevent or correct the violation
 - The culpability of the whistleblower
 - Whether the information provided by the whistleblower related to only a portion of the successful claims
 - The extent to which a whistleblower used internal compliance procedures before reporting the violation to the SEC

- **FINRA and its Office of the Whistleblower**
 - In March 2009, Financial Industry Regulatory Authority (FINRA) created the Office of the Whistleblower
 - As of December 2010, FINRA's Office of the Whistleblower is fully staffed and located within FINRA's Office of Fraud Detection and Market Intelligence (OFDMI)
 - Provides accelerated review and analysis of important tips by senior FINRA staff
 - Is part of FINRA's overall effort to restore investor trust in the financial markets and regulatory system
- **Office of the Whistleblower's track record**
 - In 2010, OFDMI referred more than 500 matters to the SEC and other federal law enforcement agencies for further investigation (from insider trading to Ponzi schemes)

- **FINRA compliance and reporting efforts**
 - Broker-dealers already investigate and report many types of potential misconduct that are the subject of the SEC's Proposed Rules to FINRA and other SROs
- **Example: FINRA Rule 4530 reporting requirements**
 - Replaces and consolidates NASD Rule 3070 and NYSE Rule 351 (effective date pending)
 - Requires members to report violations of any securities, insurance, commodities, financial or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, SRO or business or professional organization
 - Conduct that has potential widespread impact to the firm, its customers or the markets
 - Conduct that arises from a failure of the firm's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts

What Employers Are Saying

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- Proposed SEC rules
 - Emphasis on “balancing” employer and government interests
 - Possible consideration of internal reporting in determining award size
- Employer comments
 - *Require* internal reporting by whistleblowers
 - Limit whistleblower award eligibility

Dodd-Frank Whistleblower Rewards: Unintended Consequences

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- Many are concerned that huge whistleblower rewards will cause
 - Tipsters to go straight to regulatory authorities in lieu of utilizing internal compliance programs
 - Bypassing SRO reporting rules and whistleblower programs
 - Corporate wrongdoing to uncover or create issues
 - False, opportunistic or poorly substantiated tips
 - Other effects
 - Race to report
 - Plaintiffs' attorneys

- Proposed Rules do not require internal reporting prior to whistleblowing
 - SEC concerned that some companies lack established procedures and confidentiality protections for internal compliance programs
- Proposed Rules encourage internal reporting by
 - Holding out the possibility of greater awards to those who first report internally, and
 - Preserving a “place in line” for those who first report internally
 - Tipster deemed to have reported to the SEC on the date of internal report if tip is submitted to the SEC within 90 days
 - Commenters uniformly recommend increasing to 180 days to ensure adequate internal investigations
 - Although this opens the window for additional tipsters to share in the award
- In “appropriate cases,” the SEC will contact the company about the report and “give the company an opportunity to investigate the matter and report back”

Bypassing SRO Reporting Rules and Whistleblower Programs

- Will SEC whistleblower rewards adversely affect existing SRO whistleblower programs?
 - FINRA has already established a well-functioning Office of the Whistleblower
 - SROs conduct more inspections, examinations and cases against broker-dealers than does the SEC
 - SEC resource constraints
- Industry leaders suggest that the SEC should support rather than replace SRO whistleblower programs
 - If a whistleblower first reports to an SRO, then the whistleblower should still be eligible for a whistleblower award
 - If a company reports potential misconduct to an SRO, then that information should not qualify as “original information” if a whistleblower later reports to the SEC

- Proposed Rules only prohibit rewards to those who are convicted of a crime, or knowingly make a false statement, related to an enforcement action
 - Although SEC may amend the base award amount to exclude portion of fines resulting from whistleblower's actions
- Companies fear this may cause employees to
 - Ignore issues until they fester enough to warrant \$1 million fine
 - Snoop around company files in the hopes of uncovering an issue
 - Breach company data restrictions and possess non-public customer information, thus increasing costs of preventing and detecting data breaches and notifying customers
 - Create non-criminal securities violations and later report them
- Companies also concerned that anti-retaliation provisions protect culpable whistleblowers regardless of award eligibility

- Tipsters may remain anonymous, and act through attorney, until SEC confirms reward
- Tipsters only required to “provide information to SEC relating to *potential* violation of securities laws”
- Opportunistic or unsubstantiated tips
 - Tenuous tips to stimulate SEC investigation
 - Tips from vendors, third-party consultants or their colleagues
- False tips to secure employment
 - Commenters fear employees anticipating adverse employment action will submit false tips to secure whistleblower status
 - But,
 - SEC and DOJ intend to prosecute false tipsters
 - Information must be provided with sworn declaration of truthfulness

- Proposed Rules may create race to report
 - Employees incentivized to report first so as to provide “original information”
 - Company also incentivized to report before employee to receive SEC cooperation credit
- Consequences
 - Less thorough internal investigations prior to self-reporting
 - Registrant confusion regarding self-reporting duties and timelines

Other Effects: Incentives for Plaintiffs' Attorneys

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- “Decade of the whistleblower”?
- www.secsnitch.com

- New questions after Dodd–Frank
 - How can employers encourage their employees to report suspicions of misconduct to the company instead of a regulatory agency?
 - How can companies reduce their exposure to liability for “retaliating” against purported whistleblowers?
 - How can employers minimize the costs of compliance in a post-Dodd–Frank world?

Minimizing Employer Costs

- Reevaluate and strengthen compliance efforts
- Create and publicize robust policies for avoiding and responding to potential misconduct
 - Stress a commitment to full compliance with the law
 - Draft a written policy outlining procedures for reporting, investigating, and correcting any violations
 - Implement training programs to ensure that employees are aware of internal-reporting resources and proper procedures
 - Emphasize the importance and efficiency of internal reporting mechanisms

Minimizing Employer Costs

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- Create effective avenues for *internal* “whistleblowing”
 - Establish several options for in-person reporting
 - Consider anonymous reporting mechanisms
 - Possible hotline strategies
- Build confidence in your internal procedures
 - Respond quickly to reports of misconduct
 - When possible, keep internal whistleblowers informed of the company’s response

Minimizing Employer Costs

- Dodd–Frank’s retaliation penalties can be harsh
 - Reinstatement, back pay with interest, attorney’s fees
 - New coverage for subsidiaries and financial services
- Adopt aggressive anti-retaliation policies
 - Publicly commit to protecting employees from any form of retaliation for reporting corporate misconduct
 - Implement disciplinary policies that not only prohibit but also *deter* retaliation
- Train your employees

More Aggressive Strategies

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- Create financial or other rewards for employees who make good-faith reports of suspected misconduct
 - Compete for information
 - Public rewards vs. quiet rewards
- Require employees to internally disclose potential violations of company policy
 - Specific requirements vs. general duties
 - Be careful not to discourage internal reporting by employees who didn't disclose at the first opportunity

Questions?

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