

Cynthia M. Krus, Partner  
Allegra J. Lawrence-Hardy, Partner  
Holly H. Smith, Partner

Sutherland Asbill & Brennan LLP  
June 22, 2011

---

# Whistleblower Initiatives: Implementing the SEC's Reward Program

SUTHERLAND

© 2011 Sutherland Asbill & Brennan LLP

*All Rights Reserved. This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.*

[www.sutherland.com](http://www.sutherland.com)

# Speakers

SUTHERLAND



**Cynthia M. Krus**

Partner

202.383.0218

[cynthia.krus@sutherland.com](mailto:cynthia.krus@sutherland.com)



**Allegra J. Lawrence-Hardy**

Partner

404.853.8497

[allegra.lawrence-hardy@sutherland.com](mailto:allegra.lawrence-hardy@sutherland.com)



**Holly H. Smith**

Partner

202.383.0245

[holly.smith@sutherland.com](mailto:holly.smith@sutherland.com)

[www.sutherland.com](http://www.sutherland.com)

©2011 Sutherland Asbill & Brennan LLP

# Agenda

---

SUTHERLAND

- Recap: January 2011 Webinar
- Whistleblower Rewards: The Final Rules
- Regulatory Overlap for Broker-Dealers
- New Challenges for Employers

## RECAP: JANUARY 2011 WEBINAR

# RECAP: Dodd-Frank—Building on SOX

SUTHERLAND

- SOX provides whistleblower protections to employees of all public companies who report corporate wrongdoing
  - Few claims have resulted in successful enforcement actions
- To encourage further whistleblowing, Dodd-Frank
  - Enhances protection from employer retaliation
  - Promises significant rewards to certain whistleblowers
- Dodd-Frank left certain details to the SEC
  - SEC Final Rules (“Rules”) implementing Whistleblower Reward Program released May 25, 2011, effective date is August 12, 2011
  - Formation of SEC “Whistleblower Office,” headed by Sean McKessy



# RECAP: Dodd-Frank—Before and After

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

# RECAP: Dodd-Frank Expansion of SOX

SUTHERLAND

- Subsidiary coverage now explicit
- Arbitration agreements now unenforceable
- Jury trials now available
  - Previously unavailable because back-pay and restitution are equitable remedies
  - Now available after exhausting administrative remedies
- Statute of limitations doubled
  - Previously 90 days from retaliatory act
  - Now 180 days from employee's discovery of retaliation
- Damages for SEC whistleblower doubled
  - Restitution, attorney's fees, and *double* back-pay with interest

# Whistleblower Protection: Dodd-Frank Anti-Retaliation Provisions

SUTHERLAND

- **Whistleblower**
  - Under anti-retaliation provisions, a whistleblower is any individual possessing a reasonable belief that the information he or she provides relates to a possible securities law violation that has occurred, is ongoing, or is about to occur
  - Anti-retaliation provisions may apply even to a whistleblower who ultimately is ineligible for a reward
- **New causes of action**
  - Private right of action
  - Statute of limitations: 6 years from date of violation or 3 years after employee should reasonably have known of violation, but in any event no longer than 10 years after date of violation
  - Damages: double back-pay (plus reinstatement, attorney fees, litigation costs, and expert witness fees)
- **Inhibits enforcement of confidentiality agreements**
- **Enforcement authority**
  - Rules provide that the SEC has enforcement authority over violations of anti-retaliation provisions

# WHISTLEBLOWER REWARDS: THE FINAL RULES

# Whistleblower Rewards: The Final Rules

- 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
  - Potentially larger rewards to whistleblowers who utilize internal reporting programs and lesser amounts to culpable whistleblowers or those that impede internal investigations
  - “For an agency with limited resources like the SEC, it is critical to be able to leverage the resources of people who may have first-hand information about violations of the securities laws.”
    - SEC Chairman Mary L. Schapiro

# Whistleblower Rewards: Basic Requirements

- “Whistleblower”
  - “Any natural person who alone, or jointly with others, provides information to the SEC relating to potential securities laws violations”
    - Objective standard
    - Reasonable belief
    - No need to make a materiality determination
  - Excludes entities and the following individuals
    - Employees of the DOJ, PCAOB, self-regulatory organizations, law enforcement organizations, and certain regulatory agencies
    - Those with a pre-existing legal or contractual duty to report information
    - Foreign government officials and members of foreign financial regulatory authorities
    - Those who are criminally liable, or knowingly making a false statement, with respect to an enforcement action
- “Voluntarily Provide”
  - Whistleblower not deemed to provide information “voluntarily” if received request or demand from SEC or other designated authority
  - Exclusion does not apply when
    - Request made to employer and not employee
    - Employer requests information as part of internal investigation, even if prompted by the SEC

# Whistleblower Rewards: Original Information

- Derived from whistleblower's independent knowledge or analysis
- Exclusions
  - Attorneys and accountants
  - Compliance personnel
  - Information obtained through illegal means
  - Information obtained from excluded individual
- Exception to exclusions
  - Prevent substantial injury
  - Conduct impeding an investigation
  - Company fails to self-report within 120 days

# Whistleblower Rewards: Successful Action and Sanction Threshold


SUTHERLAND

- “Leads to a Successful Enforcement Action”
  - Significance of the information in opening an investigation and role played in success of an action
  - Investigations already open—information must “significantly contribute” to an action’s success
- “Sanctions Exceeding \$1 Million”
  - Calculation includes penalties, civil and criminal fines, and disgorgement, in addition to interest
  - Aggregation of two or more smaller actions that arise from the “same nucleus of operative facts”
  - Culpability deduction

# Whistleblower Rewards: Reporting

SUTHERLAND

## Whistleblower reporting—one-step process

- Submission of information
    - Form TCR – tip, complaint or referral; or
    - SEC’s Electronic Data Collection System
    - Signed under penalty of perjury
  - Streamlined submission process, combines two-step process outlined in proposed rules in response to comment letters
- 
- “The number of ‘high-value’ tips on fraud and other violations of securities law numbered about two dozen a year before the law. But since July, the agency has sometimes been receiving one or two a day.”
    - Thomas Sporkin, Chief of SEC Office of Market Intelligence
    - 30,000 whistleblower tips expected each year, with experts predicting that roughly half of those will result in monetary claims
  - Anonymity
    - Whistleblower can remain anonymous and make filings and representations through attorney

# Whistleblower Rewards: Reward Determination

- Multi-factor calculation
  - Increasing and decreasing factors
    - Increasing:
      - Significance of information
      - Assistance provided by the whistleblower
      - Law enforcement interest in deterring violations by making a whistleblower reward
      - Use of internal compliance systems
    - Decreasing:
      - Culpability
      - Unreasonable delay in reporting
      - Interference with internal compliance and reporting systems
  - Four required criteria:
    - Significance of information
    - Degree of assistance provided
    - Programmatic interest in deterring violations through rewards
    - Rewards enhancing SEC's ability to enforce federal securities laws
  - Eleven optional considerations, including, among others:
    - Authorizing or encouraging others to assist the SEC
    - Steps taken to prevent or correct the violation
    - Proportionality of information to success of an action

# Impacts: Internal Reporting and Compliance Programs

- Possibly undermine internal programs
  - Rules do not require internal reporting
    - SEC concerned that some companies lack established procedures and confidentiality protections for internal reporting
  - Internal compliance and audit personnel eligible to become whistleblowers
  - Rules authorize SEC to communicate with whistleblowers of an entity that has counsel if whistleblowers initiate contact
  - “[The Rules] significantly underestimate the negative impact on internal compliance programs and significantly overestimate our capacity to effectively triage and manage whistleblower complaints.”
    - SEC Commissioner Kathleen Casey

# Impacts: Internal Reporting and Compliance Programs

- Rules attempt to encourage internal reporting
  - Increased awards for using internal mechanisms; decreased awards for impeding investigations
  - Additional information discovered and reported to the SEC by a company credited to an internally reporting whistleblower
  - 120-day “place holder”
    - Whistleblowers deemed to have reported to the SEC as of the date of their internal report provided they go to the SEC within 120 days
- In “appropriate cases,” the SEC will contact a company about a report and give the company an opportunity to investigate and report back on the matter

# Impacts: Incentives for Plaintiff Attorneys

- Is this the “decade of the whistleblower”?
- [www.secsnitch.com](http://www.secsnitch.com)
  - “New Law - Lets SEC Whistle Blowers Get Rich for doing the Right Thing”
- [www.whistlebloweradvisor.com](http://www.whistlebloweradvisor.com)
  - “Our whistleblower lawyers can provide protection from retaliation, and help whistleblowers receive compensation for the huge risks they take.”
- [www.whistleblowerlawyerblog.com](http://www.whistleblowerlawyerblog.com)
  - “We urged that the Senate change the tepid House version [of Dodd-Frank], which provided no meaningful rewards to whistleblowers, in favor of an enforceable right for SEC and CFTC whistleblowers to a significant reward. Fortunately, that approach is now the law.”

# REGULATORY OVERLAP FOR BROKER-DEALERS

- Self-Reporting to the SEC vs. FINRA
  - Advantages for the whistleblower
  - Advantages for the broker-dealer
- Practical Realities of Different Regulatory Standards
  - Increased training for compliance, supervisory and management personnel
  - Coordinated decision making
- Don't Forget the States

- **FINRA and its Office of the Whistleblower**
  - In March 2009, Financial Industry Regulatory Authority (FINRA) created the Office of the Whistleblower
  - FINRA's Office of the Whistleblower is fully staffed and located within FINRA's Office of Fraud Detection and Market Intelligence (OFDMI)
- **FINRA's Office of the Whistleblower**
  - Does not award a bounty to the informant
  - However, FINRA disciplinary sanctions can count towards an SEC award

- Whistleblower Incentives to Report to the SEC and FINRA
  - Under the new SEC Whistleblower Incentive Program, the award can be based on the amount collected in an SEC enforcement action AND in any *related proceeding* if the related proceeding
    - Is based on information that the whistleblower provided to the SEC and
    - Is brought by an SRO (like FINRA), the DOJ, an appropriate regulatory authority or a state Attorney General
  - Results in an incentive to blow the whistle to the SEC, FINRA and other regulators
- Companies must consider the likelihood of employees whistleblowing to multiple regulatory authorities, particularly if they are represented by an attorney

- When Must a Broker-Dealer Self-Report to FINRA?
- FINRA Rule 4530 Reporting Requirements
  - Replaces and consolidates NASD Rule 3070 and NYSE Rule 351 (effective July 1, 2011)
  - Requires FINRA 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 a potential widespread impact to the firm, its customers or the markets
    - Conduct that arises from a material failure of the firm's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts
    - Conduct that has a significant monetary result on a member firm, its customers or the markets (for associated person violations)
    - Multiple instances of any violative conduct (for associated person violations)

- Potentially Broader Duty to Self-Report to FINRA than to the SEC
  - SEC can't bring an action for a violation of foreign law, but a broker-dealer may be obligated to self-report a violation of foreign law to FINRA
- Timing Issues
  - 30 days (FINRA); 120 days (SEC)
- FINRA's "reasonably should have concluded" standard
- FINRA's requirement to determine who within the broker-dealer is responsible for reaching conclusions regarding reporting under Rule 4530

# NEW CHALLENGES FOR EMPLOYERS

- **Maintaining effective compliance programs**
  - How can companies avoid violations that would lead to SEC bounties?
- **Encouraging internal reporting**
  - How can employers ensure participation in their internal compliance programs?
- **Avoiding liability for retaliation**
  - What are the best ways to avoid inadvertent exposure to retaliation liability?
- **Preventing employee abuses and misconduct**
  - What can employers do to maintain discipline in their workforces?

# Maintaining Effective Compliance Programs

SUTHERLAND

- Create straightforward and comprehensive written compliance policies
  - Express a commitment to integrity and full compliance with the securities laws
  - Clearly explain the procedures for reporting, investigating, and correcting potential violations of the law
  - Focus on supervisors
- Provide specific employee training about company compliance resources and procedures
  - Explain who, what, when, where, and why
  - Emphasize the importance of internal reporting

# Encouraging Internal Reporting

SUTHERLAND

- Make internal reporting easy
  - Establish several options for in-person reporting
  - Consider additional options for anonymous reporting
    - Hotlines
    - Interactive web forms
- Foster employee confidence in the compliance process
  - Acknowledge employee complaints and respond quickly
  - Try to keep employees who report problems informed of the company's response

# Internal Reporting: More Aggressive Strategies

SUTHERLAND

- Create financial or other rewards for employees who make good-faith reports of suspected misconduct
  - Compete for information
  - Public rewards vs. quiet rewards
  - Consider non-cash rewards
  - Evaluate employees on their efforts to support the company's compliance program
- Train company supervisors

- One of Dodd Frank's major goals was to increase whistleblower protection
  - SEC whistleblowers, in particular, are eligible for double back pay (with interest), reinstatement, and attorneys' fees
- Anti-retaliation policies should be unequivocal
  - Implement disciplinary policies that not only prohibit but also *deter* retaliation
  - Training is key
- Err on the side of caution
  - *Egan v. TradingScreen, Inc.* (S.D.N.Y. May 4, 2011)

- Whistleblower statutes are not designed to shield employees from legitimate disciplinary action
  - “By no means can the policy [in favor of whistleblowing] fairly be said to authorize disgruntled employees to pilfer a wheelbarrow full of an employer’s proprietary documents . . . merely because it might help them blow the whistle on an employer’s violations of the law, real or imagined.” *JDS Uniphase Corp. v. Jennings*, 473 F. Supp. 2d 697, 702 (E.D. Va. 2007).
- Employers have defenses to retaliation claims
  - It’s not retaliation if the employer would have done it anyway
  - Don’t be afraid of your employees

# Next Steps

- Internal reporting structures
- Parent-subsubsidiary relationships
- Third-party / vendor contractual relationships
- Document retention programs
- Board processes

# Questions?

SUTHERLAND



**Cynthia M. Krus**

Partner

202.383.0218

[cynthia.krus@sutherland.com](mailto:cynthia.krus@sutherland.com)



**Allegra J. Lawrence-Hardy**

Partner

404.853.8497

[allegra.lawrence-hardy@sutherland.com](mailto:allegra.lawrence-hardy@sutherland.com)



**Holly H. Smith**

Partner

202.383.0245

[holly.smith@sutherland.com](mailto:holly.smith@sutherland.com)