Whistleblowers

How to mitigate the multiplying threats to your business.

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Introduction: From the headlines

- **Eli Lilly (2009)** - Whistleblowers filed claims alleging Lilly illegally marketed a drug not approved by the FDA. Eli Lilly was fined US$1.415 billion (US$515 million criminal fine/US$800 million civil settlement). The four whistleblowers shared a US$78.87 million award.
- **Glaxo Smith Kline (2012)** - Former employee awarded US$96 million for reporting on faults in manufacturing at one of Glaxo's plants.
- **Dodd-Frank SEC awards** - In September 2014, SEC awarded US$30 million to a whistleblower who provided original information that led to a successful SEC enforcement action.
- **Retaliation suits** - "Morgan Stanley Hit With US$20M Retaliatory-Firing Suit," *Law360*, 8/27/2015.
- "NJ Toy Co. Faces Whistleblower Suit From Ex-Sourcing Worker," *Law360*.

Whistleblowing has become big business

- Organizations and plaintiffs' attorneys actively advertise for whistleblowers and facilitate reporting potential violations of law for monetary gain.
- Wealth of literature available to provide step-by-step guides to employees on whistleblowing for monetary gain.
- Whistleblowers can find a wealth of resources to assist their efforts on the Internet.
- Plaintiffs' firms are constantly trolling for whistleblowers, both in the US and internationally.

Overview of whistleblower statutes

- Panoply of federal whistleblower programs built into more than 24 separate statutes
- OSHA is responsible for protecting whistleblowers under 22 separate federal statutes
- Key whistleblower statutes:
  - False Claims Act
  - Dodd-Frank
  - Sarbanes Oxley
  - Foreign Corrupt Practices Act (FCPA)
  - Consumer Financial Protection Act (CFPA)
  - Commodities Futures Trading Act
  - Occupational Safety and Health Act

Overview of whistleblower statutes (cont.)

- Environmental statutes (Clean Water, Toxic Substances, Solid Waste Disposal Act, Clean Air Act, CERCLA)
- Energy
- Transportation
- Consumer safety (covers employees of consumer product manufacturers, importers, distributors, retailers, and private labelers)
- Food safety
- Affordable Care Act
- State statutes

Key provisions of whistleblower statutes affecting employers

- **Cash rewards** for recovery based on whistleblower complaints create incentives for employees to report wrongdoing to government agencies without giving companies sufficient opportunity to address complaints.
- **Anti-retaliatory provisions** protect whistleblowers and expose employers to liability for perceived "adverse action" taken against whistleblower.
- **Companies are prohibited from taking any action to impede** (discourage) a whistleblower from reporting wrongdoing to a government agency, including traditional confidentiality agreements and policies that would limit disclosure.

Cash rewards offered to whistleblowers

- FCA - Permits government or private qui tam actions
- FCPA - Cash awards by DOJ
- Dodd-Frank - Expands whistleblower awards but keeps agency in control
  - SEC, CFTC
- Focus on SEC for this presentation because:
  - Broad coverage
  - Strong cash incentive program
  - Strong anti-retaliatory and identity protection provisions
  - Strong regulations requiring modification of confidentiality policies to avoid impeding whistleblowers
  - SEC has adopted role of whistleblower advocate; SEC established an Office of the Whistleblower with its own director and dedicated staff – 9 lawyers and 3 paralegals

Who can be whistleblowers?

- Individuals
  - Any employee
  - Compliance officers
  - Internal auditors
  - External auditors
  - Attorneys
  - Doctors
  - Consultants
  - Scientists
  - Professional relators
  - QC/QA personnel
- Government employees?
- Corporations
  - Business partners
  - Business associates
  - Competitors
- Lawyers/law firms?

SEC Whistleblower Statute

- Dodd-Frank added Section 21F to the Securities Exchange Act of 1934 establishing the SEC's comprehensive whistleblower program.
- Program rewards whistleblowers who share high-quality original information that results in an SEC enforcement action or other law enforcement action with monetary sanctions exceeding US$1 million.
- Awards can range from 10% to 30% of any sanction collected.
- "Monetary sanctions" is defined broadly to include disgorgement, penalties and prejudgment interest.
- Rules apply to information regarding any securities law violation – not limited like previous program to insider trading.
- Money paid to whistleblowers comes from an investor protection fund established by Congress at no cost to taxpayers or harmed investors. The fund is financed through monetary sanctions paid by violators to the SEC.

SEC Whistleblower Statute

- Four most common categories of tips involve:
  - Corporate and financial statement disclosures
  - Offering fraud
  - Stock manipulation
  - Insider trading

Number of whistleblower tips and awards has increased each year

- Number of tips:

2011	334 tips
2012	3,001 tips
2013	3,238 tips
2014	3,620 tips

- 14 awards so far have been made – 1 in 2012, 4 in 2013 and 9 in 2014.
- Expect the number to continue to grow – average length of an SEC investigation is 2–4 years.

Awards are significant and growing

- August 12, 2012 – first award
  - Less than US$50,000 to whistleblower who helped stop an unidentified multimillion dollar fraud
- October 2013
  - US$14 million to whistleblower whose information resulted in recovery of substantial investor funds
- August 29, 2014
  - US$300,000 to whistleblower with compliance or internal audit responsibilities
- July 13, 2014
  - US$400,000 to whistleblower who reported to SEC after company failed to act
- September 22, 2014
  - US$30 million award – information regarding ongoing fraud otherwise difficult to detect

Who are whistleblowers?

- By statute the identity of whistleblowers is confidential
- According to the Office of the Whistleblower
  - 40% have been current or former employees
  - 20% have been contractors or consultants
  - Remainder are victims of the fraud reported, professionals working in the same or similar industry, or someone who had a personal relationship with entity/person reported

Who qualifies as a whistleblower under Dodd-Frank?

- Natural person – not a company
- Does not have to be an employee
- Need not be within or from the US
  - 11% of FY13 tips from outside US
  - Recent US$30 million award to non-US whistleblower
- May be culpable (to a degree) – but culpability reduces award
- Can include attorneys, auditors and compliance personnel – if they first report internally and 120 days have elapsed with no action by company
- Must come forward with information before receiving a formal or informal request from the SEC, FINRA, federal or state law enforcement regulators

What is original information?

- Must be derived from “independent knowledge” or “independent analysis.”
  - Not from public sources
  - Doesn’t need to be first-hand knowledge
- Generally, information subject to attorney-client privilege is excluded.

Obligations to protect whistleblowers - overview

- Company cannot **impede** the right of whistleblowers to talk to government authorities and report wrongdoing.
- Company cannot **retaliate** against a whistleblower or suspected whistleblower.

Obligations to protect whistleblowers

- **Obligation not to impede** reports of wrongdoing interpreted broadly by SEC
  - Potential liability for standard confidentiality agreements
  - KBR decision
- **Anti-retaliation provisions**
  - Protects any employee, contractor or agent Whistleblower protected if discharged, demoted, suspended, threatened, harassed or in any other way discriminated against in the terms and conditions of employment
  - Discrimination or adverse action may include a broad category of conduct, including disclosing identity to other employees and subjecting whistleblower to harassment

Obligation to protect whistleblowers and facilitate reporting to governmental authorities

- No person may impede whistleblowing
- Whistleblower rights trump confidentiality obligations
- SEC Rule, § 240.21F-17(a) expressly prohibits confidentiality agreements that would impede whistleblowing:
  - "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, **including enforcing, or threatening to enforce, a confidentiality agreement** (other than agreements dealing with information covered by § 240.21F-4(b)(4)(i) and § 240.21F-4(b)(4)(ii) of this chapter related to the legal representation of a client) with respect to such communications." [emphasis added]

Confidentiality agreements - KBR decision

- SEC brought enforcement action against KBR for requiring witnesses in internal investigation interviews to sign a confidentiality agreement that warned the employees that they could face discipline if they discussed the matters with outside parties without the consent of the legal department.
- In April 2015, SEC announced a consent decree in which KBR agreed to pay a US$130,000 fine, to amend its confidentiality agreements and to cease and desist from committing or causing any future violations of Rule 21F-17.
- After extensive negotiations with the SEC, KBR agreed to amend its confidentiality agreement to make it explicitly clear that the employee was free to report wrongdoing to any government agency without informing KBR or its legal department.

Confidentiality agreements - KBR decision

- The SEC found that by requiring pre-notification of reporting, KBR potentially discouraged employees from reporting securities violations.
- KBR's agreement provided "I understand that to protect the integrity of tis review, **I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview**, without prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment." [emphasis added]
- KBR took the position that it never intended to prevent employees from reporting wrongdoing to government authorities and that it never would have disciplined an employee for doing so.
- KBR contended that the confidentiality provisions were designed to protect the attorney-client privilege.
- There was no evidence that any employee was ever discouraged from reporting wrongdoing or that KBR tried to enforce the provision.

SEC puts employers on notice of need to change agreements and policies

- SEC interprets its mandate under rule 21F-17 broadly.
- In its press release announcing the KBR enforcement action, the SEC announced that it would "vigorously enforce" Rule 21F-17 that prohibits "employers from taking measures through confidentiality, employment, severance or other types of agreements that may silence potential whistleblowers before they can reach out to the SEC."
- SEC put all employers on notice that they need to review and likely revise their agreements: "Other employers should similarly review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC."

SEC puts employers on notice of need to change agreements and policies

- KBR agreed to adopt the following language as part of all confidentiality agreements:
  - "Nothing in this Agreement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the KBR's legal counsel to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures."
- Some commentators have viewed this language as excessive and unnecessary.
- Dentons advises clients on various formulations.

SEC guidance regarding appropriate contract language

- SEC has repeatedly refused to give clear guidance on what responses by employers or language will be satisfactory under SEC Rule 21F-17.
- SEC has even refused to treat the language approved in the KBR consent decree as a Safe Harbor - appropriate language depends on the particular facts and circumstances.
- Note that the SEC expects employers to not only revise agreements going forward but also to "review and amend" existing agreements with current employees and historical agreements.
- SEC's position would require employers to revise agreements (or take similar remedial action) with regard to agreements with former employees.
- SEC has stated informally that it also believes any Codes of Conduct or other employment policies imposing confidentiality obligations should be similarly revised.

SEC Whistleblower advocate

- SEC Chair Mary Jo White: Whistleblower protection is a high priority for the SEC, and the SEC will vigorously enforce whistleblower rights.
- In a presentation entitled "The Whistleblower's Advocate," Chair White stated that the SEC views it as the responsibility of the company to craft the appropriate language that will "speak clearly in and about confidentiality provisions, so that employees, most of whom are not lawyers, understand that it is always permissible to report possible securities laws violations to the [SEC]."
- The SEC is giving itself a wide amount of latitude to second-guess the language used by employers.
- Employers also have flexibility to argue that the language adopted in their confidentiality agreements meets the goal of SEC Rule 21F-17 of not impeding an individual from communicating directly with SEC staff about a possible securities law violation.

Protection of attorney-client privilege and trade secrets

- SEC has stated that it does not intend to invade the attorney-client privilege by requiring language permitting disclosure to government authorities.
- Distinction can be made between disclosing facts and prohibiting disclosure of communications with company attorneys.
- Trade secrets are at risk if employees are permitted to disclose trade secrets relating to potential unlawful activity.
- Uniform Trade Secret Act requires employer to take reasonable pre-cautions to protect the confidentiality of trade secrets—exception for reporting wrongdoing should be treated as reasonable as long as other confidentiality requirements are in place and enforced.
- Employees should normally not have to disclose trade secrets to report wrongdoing—illegal business activities are likely not protectable.

Theft of trade secrets or confidential business information disqualifying?

***Vannoy v. Celanese Corp.* 2008-SOX-64 (ARB Sept. 28, 2011)**

- Enforcement policy may trump protection of confidential information.
- To the extent Vannoy took employee data (1,600 employee SSNs) as part of his efforts to facilitate his complaint to the IRS, SOX is intended to protect all "lawful" conduct to disclose misconduct. Police did not bring charges against Vannoy for misappropriating the SSNs, indicating to the ARB that conduct must have been lawful.
- "There is a clear tension between a company's legitimate business policies protecting confidential information and the whistleblower bounty programs created by Congress to encourage whistleblowers to disclose confidential company information in furtherance of enforcement of tax and securities laws." "Vannoy's allegations must be viewed in light of these significant enforcement interests."

Whistleblower statutes do not immunize employee theft of confidential information

***State v. Saavedra* (NJ Supreme Court 2015)**

- Whistleblower took highly confidential student educational and medical records.
- Employer reported theft and grand jury indicted individual.
- The NJ Supreme Court upheld the indictment. Court rejected notion that its prior holding in *Quinlan* permits "self-help as an alternative to the legal process in employment discrimination litigation."
- Court further concluded that *Quinlan* did not "bar prosecutions arising from an employee's removal of documents from an employer's files…".

Breach of attorney-client privilege can block whistleblower suit under FCA

United States v. Quest Diagnostics Inc., 734 F.2d 154, 157 (2d Cir. 2013)

- Former general counsel violated state legal ethics rules by disclosing privileged information beyond what was necessary to pursue FCA suit.
- Dismissal of lawyer-relator's suit was affirmed.

United States ex rel. Holmes v. Northrup Grumman Corp., No. 13-cv-85 (S.D. Miss. June 3, 2015)

- Court dismissed attorney-relator who sued former client's adversary, as attorney violated duties of confidentiality and loyalty to his own client.

Avoiding retaliation claims

- Almost all whistleblower statutes have anti-retaliation provisions.
- Similar language in almost all federal whistleblower statues, but with different rules and procedures for how whistleblowers can assert claims.
- Two major forums for anti-retaliation actions:
  - Enforcement action by agency
  - Individual action by employee
    - After exhaustion of administrative remedies
    - Direct private cause of action—right to sue in court without exhausting administrative remedies

Enforcement actions by agencies

- SEC brought its first anti-retaliation case in June 2014. *Paradigm Capital Management, Inc.*, Rel. Nos. 34-72393, No. 3-15930 (June 16, 2014). The SEC charged that, upon learning that the whistleblower reported potential securities law violations to the SEC, Paradigm engaged in a series of retaliatory actions that ultimately resulted in the whistleblower's resignation.
- Some commentators have expressed the view that the Dodd-Frank Act does not give the SEC the right to enforce the retaliation provision or other aspects of Section 21F, but most companies will likely choose to avoid disputes with the SEC in the future by modifying the language of their confidentiality agreements and avoiding conduct that could be interpreted as retaliation.

Private right of action under Dodd-Frank amendments

- New Section 21F of the Exchange Act: "Employer may not discharge, demote, suspend, threaten, harass, or take any other action against an employee who either:
  - (i) provides information about his or her employer to the SEC in accordance with the whistleblower rules;
  - (ii) initiates, testifies in, or assists in an investigation or judicial or administrative action; or
  - (iii) makes disclosures that are required or protected under SOX, the Exchange Act, or any other law, rule, or regulation subject to the jurisdiction of the [SEC]."

Private right of action under Dodd-Frank amendments

- Section 21F(h) grants an automatic private right of action in federal court without the need to exhaust administrative remedies prior to filing.
- Right of action not limited to employees of publicly traded companies and subsidiaries (covers any person who reports covered activity).
- Remedies include:
  - Reinstatement at same seniority
  - Double back pay
  - Litigation costs and attorney fees

Anti-retaliation protections

- Examples of adverse action against employee that can be viewed as retaliation.
- In *Paradigm* case, the employer removed the whistleblower from his head trader position, tasked him with investigating the very conduct he reported to the SEC, changed his job function from head trader to a full-time compliance assistant, stripped him of his supervisory responsibilities and otherwise marginalized him.
- Did not terminate him or reduce his pay.

Retaliation claims - law has developed to favor complainants

- The whistleblower protection law developed under SOX since the early 2000s is instructive.
- The DOL Administrative Review Board (ARB) adopted a broad construction of protected conduct:
  - SOX complainants need only show they *reasonably believed* the conduct violated law.
  - Don't have to wait for conduct to occur if employee "reasonably believes that the *violation is likely to happen*."
  - Actual fraud not required—reasonable belief of *violation of any SEC rule or regulation sufficient.*
  - Complainant need not explain why beliefs are reasonable.
  - SOX complainants no longer need to show that disclosures "definitely and specifically" relate to relevant laws.
  - Complainant does not need to establish criminal fraud.

Retaliation claims - law has developed to favor complainants

- Employer can defend on grounds that the complainant's belief that a law was violated was not "objectively reasonable."
- But according to the Sixth Circuit, objective reasonableness should be decided as a matter of law on summary judgment "only when no reasonable person could have believed that the facts amounted to a violation or otherwise justified the employee's belief that illegal conduct was occurring." *Rhinehimer v. US Bancorp Investments, Inc.,* No. 13-6641, 2015 WL 3404658, at *11 (6th Cir. May 28, 2015).
- Protected whistleblower activity need only be "a contributory factor" in employer's adverse action.
- SEC, the Second Circuit (*Berman v. Neo@Ogilvy LLC*), and a majority of district courts have construed Dodd-Frank to cover internal whistleblowing. Fifth Circuit has ruled to the contrary setting up split, potentially to be addressed by Supreme Court.

How to respond to a whistleblower complaint

- Whistleblowers not required to report internally first.
  - However, the SEC's rules at least incentivize internal reports
    - "Place in line" preserved for 120 days
    - Extra credit for reporting internally when determining award
    - Gets credit for everything the company's internal investigation discovers
  - Incentives are working – according to the SEC's Office of the Whistleblower, 80% of whistleblowers first raised their concerns internally and only reported to the SEC when the entity failed to take steps to address or remedy the situation.

How to respond to a whistleblower complaint (cont.)

- Assume the whistleblower is right—don't dismiss him or her as a chronic complainer or disgruntled employee.

- Chairman White:

  "You may well have doubts about the bona fides of a particular whistleblower—perhaps because his or her prior 9 tips have not proven to be true or management tells you that the would-be whistleblower is a disgruntled employee. But always think—because it is so—that her tenth tip may be right on target … it is a mistake to not take all tips from whistleblowers seriously."

How to respond to a whistleblower complaint (cont.)

- Conduct a prompt, thorough investigation—interview witnesses and review documents.
  - Be proactive and as fast as possible.
    - Demonstrates to the whistleblower that you are taking the complaint seriously (lessens likelihood of reporting to SEC).
    - If you end up self-reporting, demonstrates to the government that you are taking the complaint seriously.
- Decide who will conduct the investigation.
  - Less serious allegation/involving lower ranking figures—in-house counsel or human resource professionals.
  - More serious allegations/senior management/government program risk—outside counsel or independent counsel.
  - Very serious allegations/senior management or directors/government program risk—independent outside counsel—will lend credibility to the process and ultimate conclusions.

How to respond to a whistleblower complaint (cont.)

- Document review
  - Issue a litigation hold for relevant types of documents and circulate broadly.
  - Suspend routine document destruction practices that could affect relevant documents.
  - Identify document custodians and document locations.
  - Decide how to collect potentially relevant documents (imaging servers and computers, physically securing paper documents).
  - Consider early retention of electronic document recovery experts to help with the document collection.

How to respond to a whistleblower complaint (cont.)

- Interview witnesses (at least two interviewers per witness).
- Identify individuals with potentially relevant information.
- If interviews conducted by counsel, give *UpJohn* warnings.
  - Attorney represents corporation, not the individual.
  - The interview is protected by the attorney-client privilege, and the privilege belongs to the corporation.
  - The corporation is sole decision-maker as to whether to waive the privilege and disclose the contents of the interview to the government, the whistleblower or other third parties.

How to respond to a whistleblower complaint (cont.)

- Decide how to deliver results of investigation to management, the board or audit committee.
  - Consider the likelihood of litigation if the substance of complaint becomes known—shareholder or derivative actions.
  - Consider avoiding written reports, which may become discoverable in litigation, in favor of oral presentation.

How to respond to a whistleblower complaint (cont.)

- Whether and when to report to SEC – fact-specific inquiry.
  - Depends on severity of facts alleged.
  - Depends on who is involved – senior management and directors.
- Has the whistleblower already reported to SEC?
  - If so, consider letting the SEC know that you are investigating.
  - May give you an opportunity to continue your investigation, and therefore maintain more control, with regular reporting to the SEC.
- Has the whistleblower only reported internally?
  - If so, may want to report within 120 days.
  - Generally better for the SEC to learn about conduct from the company.
  - May give you an opportunity to control the investigation.
  - May be eligible for self-reporting credit under the SEC's cooperation guidelines.

How to respond to a whistleblower complaint (cont.)

- Risk of self-reporting
  - Waiver of the attorney client privilege and private lawsuits
  - Significant monetary penalties
  - Reputational harm

How to respond to a whistleblower complaint (cont.)

- Don’t forget the whistleblower.
  - Determine how to communicate with the whistleblower so she/he knows concerns being addressed.

Planning for the future

- Adopt clear reporting and investigation policies.
  - Legal oversight
  - Capable investigators
  - Notification and escalation guidelines
  - Anti-retaliation and reporting facilitation policies
- Review existing codes of conduct, confidentiality agreements and separation agreements for best practices and Rule 21F-17 compliance.
- Promote value of internal reporting.
- Take action within 120-day investigative period to mitigate external reporting.
- Implement training programs.

Questions?

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