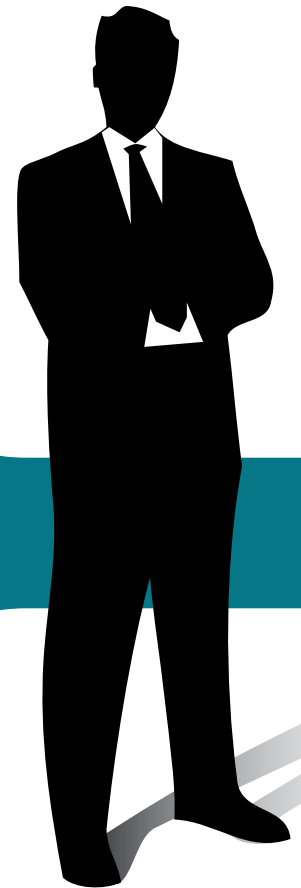


Dodd-Frank and Whistleblowers:

**Four Paths
from the Company
to the SEC**



So you've invested heavily in your SOX-mandated compliance program, and you feel reasonably shielded from harm venturing across today's risk-mined landscape? Think again. Public companies and many privately held entities face a daunting new watchtower. Incentives and protections for whistleblowers, stringent enough under SOX, will constitute a shrill new threat under the Dodd-Frank Wall Street Reform and Consumer Protection Act—making “behoove” the operative word for air-tightening your compliance program like never before. The unavoidable “rogue” factor notwithstanding, here is a decisional roadmap for silencing whistles and keeping snipers at bay.

Decision prompts

Helping the WB—and the company—decide which route to take.

Action prompts

Once the route is decided, the answers to these questions—all tied to the corporate compliance culture—help the WB decide what further action to take: go to the SEC or trust the company to do the right thing.

NEW WHISTLEBLOWER REGULATIONS UNDERMINE PROGRAMS COMPANIES WORKED HARD TO DEVISE

A **VERY** RISKY

BY JEFF HEILMAN ■ ILLUSTRATIONS BY ALEX REARDON

BYPASS

Before Sarbanes-Oxley, corporate whistleblowing was more the path to career imperilment than financial reward. Their complaints typically refuted, whistleblowers were often fired and then cast out tarred and feathered with little legal recourse; unless public safety was at stake, such as in the nuclear power or airline industries, government sanctions against the companies in question were rare. Even after whistleblowing gained national attention in exposing fraud at Enron and WorldCom, initial investigations under SOX were less than fruitful, with the majority of early cases dismissed.

Conditions are decidedly different now. Under the far-reaching Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law last summer and scheduled for finalization this April, whistleblower rewards and protection

are being profoundly strengthened—causing deep concern for public companies and their private subsidiaries and affiliates.

“The proposed rules effectively incentivize and permit whistleblowers to go straight to the government,” says Randy Fons, co-chair of Morrison & Foerster’s Securities Litigation, Enforcement, and White-Collar Defense Group and a former SEC regional director. “It’s a scary time in this area right now.”

Dodd-Frank mandates “bounty-hunter” rewards between 10 percent and 30 percent of total monetary sanctions above \$1 million, presenting companies with a dilemma: how to encourage internal reporting and foster robust compliance programs while competing with provocative paydays for individuals who go straight to the government (see gatefold, pages 14–16). And once an SEC investigation has begun, the

CHARGES

SUBPOENAS FEES



The WB goes directly to the SEC. This triggers all sorts of activity: investigations, subpoenas, disruptions, expenses (and involves all sorts of professionals: lawyers, accountants, consultants). In addition, once it's over, assuming the WB's charges are correct, it results in big money for the WB (between 10% and 30% of the monetary sanctions over \$1 million). When the WB goes to the SEC, he or she is protected from retaliation; if retaliation occurs, the WB can bring action directly to federal district court.

Action prompts:

- Are our written policies up to date?
- Are we living up to our "code of conduct"?
- Is the executive leadership talking about compliance? As much they did before?
- Are people who might have been WBers quietly "disappearing" from the company?



- Do employees believe the company wants them to follow the policy?
- Is our communication system comprehensible to all employees, regardless of generation?
- Do we have a chief compliance officer—or someone tasked with compliance?
- How many investigations have been done?
- How effective have they been?

Decision prompts:

- Are we going to do an internal inquiry?
- Who's going to do the internal inquiry?

90 DAY LOOKBACK

The WB goes to the company, but then, when he or she isn't satisfied with the results, goes to the SEC. The WB has 90 days after making the internal report to take it to the SEC and still collect the reward money; this is the 90-day lookback period. The WB is protected against retaliation as in #1.



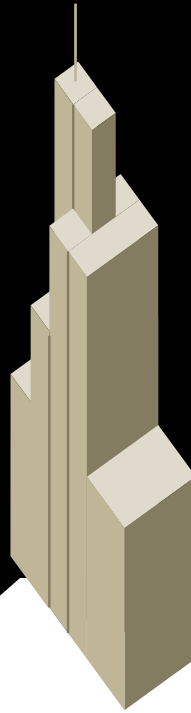


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The WB goes to the company and is satisfied with the company's action.

The matter ends there. No further action is triggered. No incentive is paid.



“Closing the loop”

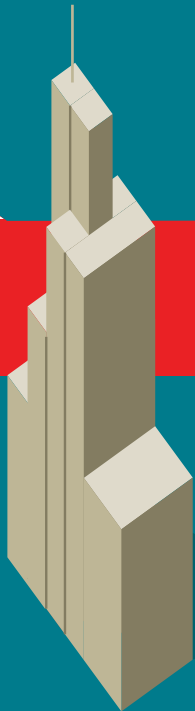
It's important to:

- Thank the employee for bringing up the matter
- Provide the employee with the company's anti-retaliation policy
- Make sure the employee feels taken seriously
- Conduct and close out the investigation with the WB in mind

It's estimated that only 5% of employees are likely to see the incentive as a big “payday” and head directly to the SEC; 95% are more inclined to try to work with the company directly (and forego the reward) if they feel the company is taking them seriously and is likely to fix the problem.

Decision prompt:
Do we report to the SEC and try to get cooperation credit?

THE COMPANY



The company decides to turn itself in to the SEC. While action is triggered, it's less severe. No monetary rewards for the whistleblower.



THE SEC

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management time and expense required to respond to it means that “regardless of guilt, you’ve probably already lost,” Fons says.

A BRIDGE TOO FAR

As mandated by SOX, public companies invested heavily in compliance programs and compliance culture, including creating internal channels for whistleblowers to anonymously report misconduct without fear of retaliation. But under Dodd-Frank, whistleblowers are also free to anonymously contact the SEC directly, typically certifying their identity via legal counsel.

“Unless a tip is ridiculous on its face, the SEC cannot afford not to look into it,” Fons says. “The SEC cannot afford another Madoff. Yet the proposed whistleblower provisions create more problems than they solve.”

“The SEC’s new enforcement dynamic encourages cooperators, informants, and whistleblowers,” says Jordan Eth, also co-chair of Morrison & Foerster’s Securities Litigation, Enforcement, and White Collar Defense Group. “The Dodd-Frank whistleblower provisions stand to only heighten this dynamic.” As Eth explains, bounties are available to individuals reporting “original information developed through independent knowledge or analysis.” And, unlike past programs, bounty payment is now mandatory, not discretionary.

“Tips can come from multiple internal and external sources, starting with officers, directors, and employees,” says Eth. “While people who obtained information through attorney-client privileged communications are among those excluded from bounties, the eligibility list includes shareholders, vendors, analysts, business partners, and acquirers.”

Encouraging employees to bypass internal compliance programs can cause problems, Fons says, beyond the hassle and expense of an external investigation. One is the danger of the employee who sits on a problem until he or she perceives it has exceeded the \$1 million threshold. Another is that the company may be the last to know about a problem that it needs to fix.

Companies, understandably, view Dodd-Frank with less than equanimity. “Recently surveyed on which Dodd-Frank regulations they think will prove to be the most detrimental, long term, to improving board governance and enhancing shareholder value, 67 percent of directors named the new whistleblower bounty program,” says Eth.


FEAR FACTORS

All of the usual suspects—such as earnings manipulation, expense fraud, false disclosures, phony balance sheet assets, and insider trading—can trigger whistleblower investigations. Striking the most fear in companies, however, are violations of the broad antibribery provisions and accounting and internal control requirements of the Foreign Corrupt Practices Act. “Penalties under FCPA can be simply staggering, potentially reaching into hundreds of millions of dollars,” says Fons. “The risk to companies, in my mind, is the appeal to potential whistleblowers of these giant rewards.”

Enacted in 1977, FCPA owes its newly sharpened teeth to the global appetite for antifraud and anticorruption enforcement. FCPA is especially tricky because often only a few people in any organization understand what qualifies as a “corrupt practice.” “The danger is when somebody outside that circle learns—or thinks they learn—something, and says, ‘Bingo, I’ve won the lottery,’” says Fons. “It can be as innocuous as overhearing that somebody took a foreign prospect out to lunch.”

Incomplete or misinterpreted information can be dangerous in any scenario. “I believe there will be many unnecessary investigations instigated by whistleblowers who are basing assumptions on seeing one extremely small piece of the pie,” says Fons. “Given the chance, many of these matters could be properly handled internally, but once the SEC is involved, you face the potential of considerable expense and disruption.”

Ultimately, the best antidote is to create a compliance structure and culture that employees trust, says Daniel Westman, a member of Morrison & Foerster’s Employment and Labor Group. Historically, most whistleblowers go outside the company not out of greed, but due to fear of retribution or because management never took them seriously. “A workforce that feels listened to when raising concerns about compliance is less likely to go outside the company than a workforce that feels disregarded or disrespected,” he says.

But the lure of big money cannot be ignored. “The SEC is essentially saying that it does not trust that employees will feel safe, or that all public companies have put into place sufficiently robust and anonymous whistleblower programs,” Fons says. “That may be, but I think these financial incentives are going to get the SEC and public companies in trouble.” 

SOX Be Darned?

Not quite, but while Dodd-Frank’s whistleblower compensation and anti-retaliation provisions dramatically expand, not replace, comparable provisions under SOX, they are seen to weaken—some say nullify—the incentive for whistleblowers to report fraud or other misconduct internally. By promoting a direct “bypass” to the government and offering potentially giant financial rewards for doing so, Dodd-Frank is also seen to threaten the vitality and integrity of SOX-driven corporate compliance programs. Here are key points of comparison between the two statutes:

Coverage

SOX: Public companies only, with limited exceptions

DF: Public companies and private subsidiaries and affiliates

Statute of limitations for bringing court action

SOX: 90 days

DF: Up to three years after learning of violation or six years after violation occurred; must file within 10 years of date of violation

Employment claims

SOX: Exhaustively pursue claim through Department of Labor

DF: Bring claim directly to federal court

Terms of reinstatement for terminated employees

SOX: Return to same position with double back pay, attorneys’ fees, and other costs.

DF: Return to same position with just back pay, attorneys’ fees, and other costs.

Whistleblower rewards

SOX: Discretionary

DF: Mandatory