



THE DODD-FRANK WHISTLEBLOWER PROVISIONS: WHAT'S NEXT FOR INTERNAL COMPLIANCE PROGRAMS?

*Presented by:
Bryan House and David Froiland*

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Overview

- Dodd-Frank is the Congress' response to the financial crisis of 2008, Bernie Madoff, etc.
- The new law contains a robust whistleblower provision.
 - Provides handsome rewards (“bounties”) for whistleblowers who make meritorious complaints regarding securities law violations.
 - Protects whistleblowers from retaliation based on reporting securities related violations and other federal fraud crimes.
- Thus, in addition to traditional regulation by the SEC, Congress is also trying to regulate from within the Company – enlisting help from employees who should be well-positioned to spot violations of the securities laws.
- Proposed regulations issued on November 3. SEC is looking for comments by December 17. Final rules in April.

What People Are Saying...

- “We’ve gotten some high quality tips.”
SEC official Steven Cohen
- “It’s not only a different ballpark, it’s an entirely different galaxy.”
Plaintiff’s lawyer Erica Kelton
- “In the last three weeks, I’ve had many more whistle-blowing calls than I had in the last three years.” Plaintiff’s lawyer Rebecca Katz

The Statute – Section 922 of Dodd-Frank

- The Securities and Exchange Commission
 - shall pay an award or awards to whistleblowers
 - who voluntarily provide original information
 - that leads to the successful enforcement action, resulting in a penalty of \$1 million
 - amount equal to not less than 10 percent and not more than 30 percent of the sanctions imposed
- SEC's investor protection fund – \$452 million
- No consideration of role of internal compliance

The Whistleblower Provision

- Not the first whistleblower statute (False Claims Act/IRS whistleblower statute)
- By far the most broad, affecting public companies, financial services firms and any other company that could be the subject of an SEC action.
- Sarbanes-Oxley 301 set up requirement for collecting and acting on complaints, as well as receiving anonymous tips *internally*.
- Dodd-Frank creates a whole new incentive to complain to the SEC and begs the question:
 - *Why would employees complain internally when they stand to make so much money by complaining to the SEC instead?*

Anti-Retaliation Provision

- Not first anti-retaliation statute. SOX prohibited retaliation for those reporting complaints internally
- Dodd-Frank protects a broader range of disclosures internally and protection for whistleblowers going to the SEC
- Direct access to district court—no administrative law requirement as in SOX
- Statute of limitations 6 years after violation or 3 years after knowledge versus 180 days after violation/knowledge in SOX
- Remedy of two years back pay

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Unintended Consequences

- Attorneys as whistleblowers
- Compliance/internal audit personnel as whistleblowers
- Incenting whistleblowers to bypass internal compliance programs
- Whistleblowers not barred by their involvement in the violation (absent conviction)

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Highlights of the Proposed Rules

- “Original information”
 - based on whistleblower’s “independent knowledge” or “independent analysis”
 - not already known to the SEC and
 - not derived exclusively from public sources
- Exclusions to “original information” requirement meant to prevent unintended consequences
 - Attorneys—Information obtained in privileged communication or gained through legal representation
 - Auditors—Information obtained in course of an audit
 - Violation of law—Information obtained in manner violating criminal law

Highlights of the Proposed Rules

- “Compliance personnel” exclusion
 - Person with legal, compliance, audit, supervisory or governance responsibilities who receives information about potential violation with expectation of causing a response (or one who obtains information through one of these functions) does not have “original knowledge”....unless
 - entity does not disclose to SEC in a reasonable time
 - if entity proceeds in bad faith

Highlights of the Proposed Rules

- Designed to “strike a balance” between goals of effective internal compliance and allowing awards if company does not respond appropriately.
 - “Reasonable time” – described as “flexible concept” that could include “almost immediate”
 - “Bad faith” – are there affirmative steps to hinder timely and appropriate investigation or preservation of evidence.
- 90-day “first in line” rule
 - If a person providing information to legal, compliance, audit, supervisory or governance personnel submits the same information to the SEC within 90 days, the SEC will consider it submitted as of the date provided internally.

Highlights of the Proposed Rules

- 90-day “first in line” rule (con’t)
 - This provision “is to support, not undermine, the effective functioning of company compliance and related systems.”
 - The SEC “considered [but did not adopt] the possible approach of requiring potential whistleblowers to utilize in-house complaint and reporting procedures.”
- SEC says internal processes won’t be bypassed
 - SEC may “contact the company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back.”
 - Company’s response to be considered in accordance with the 2001 Statement on Cooperation (Seaboard Report)

Highlights of the Proposed Rules

- Request for comment:
 - Seeking ideas to “strike the right balance” between effective whistleblower program and preserving robust structures for self-policing and self-reporting.
 - Should a rule require whistleblowers to utilize employee-sponsored complaint and reporting procedures?
 - Would the proposed rules frustrate internal compliance structures and systems that many companies have established in response to 301 of SOX?

Highlights of SEC's Proposed Rules

- Damage Awards – 4 “criteria,” including significance of information, degree of assistance, programmatic interest, and enhancing ability to enforce securities laws
- Many “considerations,” including whether the violation was reported through effective internal legal or compliance procedures before reporting to the SEC
 - No penalty for not reporting internally “for fear of retaliation or other legitimate reasons”
 - SEC will consider higher awards for whistleblowers who first report violations internally
- Request for comment: Should consideration of reporting violation internally be an “official” criterion in the rules?

Practical Impact

- Employees will report more potential violations externally to the SEC.
 - More meritorious complaints
 - More non-meritorious complaints
- If the internal process is bypassed, the violation might continue as the SEC investigation begins without company knowledge
- New considerations for Company
 - When deciding whether to disclose problem discovered or reported internally, the SEC is now more likely to know (because employee may have already contacted SEC)
 - Company may want to get “cooperation” credit by disclosing before hearing from the SEC

Practical Impact

- More pressure to self-disclose to avoid compliance/governance personnel from being deemed to have “original information”
- Very difficult questions regarding disclosure of meritless or borderline violations
- Delicate dealing with employees who have reported potential violations internally

Practical Impact

- Accelerated timelines for Companies to disclose a violation to the SEC
 - May be “immediate”
 - Need to avoid anything suggesting “bad faith” or other delay in investigation
 - If you can get an investigation done in 90 days, you might be able to get to the SEC before the employee does
- More calls from the SEC following employee tips

What Might House-Froiland Look Like?

- Potential whistleblower must first report internally
- Company must consider complaint and provide response in 120 day
- If the whistleblower is unsatisfied, he or she may report to the SEC
- Greater discretion with respect to whether awards are paid
- Scien~~er~~/state of mind requirement?

How Companies Can Meet the Challenge

- Fortify internal audit procedures
- Promote culture of compliance
- Develop procedures for prompt self-reporting to SEC

Fortify Internal Audit Procedures

- Review and strengthen internal audit and compliance policies
 - Catch problems before whistleblowers do
 - Catch problems before they become big enough to satisfy bounty-hunter thresholds
- Develop process for regularly improving audit procedures, taking into consideration problems identified in most recent 6 or 12-month cycle.
- Develop SWAT Team mechanism for handling internal investigations, whether based on internal complaints or calls from the SEC

Develop Culture of Compliance

- Open Door Policies
- Whistleblower Hotlines
- Policy for disciplining violators
- Internal bounty programs
 - Gift certificate?
 - Lunch with CEO or other executive?
 - Compliance employee of the month award?
- No retaliation against complainers, even for claims found not to be meritorious
- Presentations to employees educating them about what is a violation and what isn't

Develop Culture of Compliance

- Open Door Policies
 - Sometimes fine line between “whistleblowers” (involving protected activity) and mere “complainers” (non-protected activity)
 - Executives and managers must understand the world has changed – need to take good faith complaints seriously.
 - Treatment of whistleblowers
 - Thank them for raising concerns.
 - Investigate concerns.
 - Consider educating whistleblowers on legal/illegal.
 - Develop process for getting back to them with results or findings.

Develop Culture of Compliance

- Compliance Hotline Policy
 - All employees have obligation to report actual or potential wrongdoing.
 - Call Human Resources Department or compliance hotline.
 - Company will investigate.
 - No retaliation against employees who report.
 - Confidentiality, where possible, informing only those personnel who have a need to know or as is necessary to conduct an appropriate investigation.
 - Process for getting back to employees who make a complaint.

Develop Procedures for Prompt Reporting

- Be ready for internal investigation
 - In-house experts or outside counsel
 - Develop templates for document retention, etc.
 - Privilege issues, delegation memorandum
- Eliminate any argument that the company did not disclose the information in a reasonable time or otherwise acted in bad faith
- Make sure the scope of review is sufficient and disclosure/waiver issues are considered carefully
- Educate senior management and board

Q&A

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