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# Whistleblower Provisions of the Dodd-Frank Act

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## Today's Presenters



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## SEC and Corporate Response to Whistleblower

Samuel ("Sandy") J. Winer  
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## Whistleblower Precipitated SEC Investigations Under SEC's New Rules

- SEC Staff debriefs whistleblower
  - information subject to SEC routine uses and FOIA
  - potential referrals to DOJ and other federal and state law enforcement authorities
- SEC decides on whether to defer its investigation pending company's investigation
  - document hold
  - notification of board
  - consideration of possible internal investigation and disclosure

## Internal Investigation

- Scope and characteristics of effective internal investigation depend on facts
- Appointment of independent directors to oversee investigation
- Retention of independent counsel
- Public disclosure
- Periodic consultation with SEC Staff
- Alacrity versus comprehensiveness
- Prompt remediation
- Report of results
  - Full board
  - SEC Staff
  - Markets

## SEC Investigation

- Document requests or subpoenas
- Investigative testimony
- Representation of witnesses
- Pre-Wells process
- Wells process
- Pre-filing settlement

## SEC Action

- Enforcement proceeding against company and individuals
- SEC referrals to and cooperation with other law enforcement authorities
- SEC sanctions and relief
  - penalties
  - disgorgement
  - independent consultant

## Private Litigation

- Securities class action
- Shareholder derivative action
- ERISA action
- Action by disgruntled employees

## Conclusion

- A pre-existing robust securities compliance program and
- A cooperative and meaningful corporate response
- Often significantly mitigate the fall out from whistleblower action

## Overview of Bounty Provisions

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## 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 successful SEC enforcement actions, resulting in collections of \$1 million
  - in an amount equal to not less than 10 percent and not more than 30 percent of the sanctions collected

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## Highlights of the Bounty Rules

- Voluntary
- “Original information”
- Exclusions to “original information” requirement that seek to prevent unintended consequences

## Voluntary

- Submission of information is not voluntary if a request specified by Rule 21F-F(a) was directed to the whistleblower or the whistleblower’s representative
- A request is covered by that Rule only if the request relates to the subject matter of the whistleblower’s submission and was issued
  - By The Commission
  - By the PCAOB in connection with an investigation, inspection or examination
  - By Congress, any other authority of the federal government, or a state Attorney General or regulatory authority, in connection with an investigation

## Original Information

- “independent knowledge” or “independent analysis”
- not already known to the SEC and
- not derived exclusively from public sources

## Exclusions to “Original Information”

- Attorneys
- Individuals who obtained information in connection with processes for identifying and addressing violations of law
- Individuals associated with public accounting firms
- Violators of criminal law
- Others



## Exceptions to Certain Exclusions

- Attorneys
- Compliance
  - Reasonable basis to believe disclosure of information necessary to prevent entity from engaging in conduct likely to cause substantial injury to financial interest or property of entity;
  - Reasonable basis to believe that disclosure of information necessary to prevent entity from impeding an investigation of the misconduct; or
  - At least 120 days have elapsed since supervisors or CCO or CLO or Audit Committee received information

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## Additional Reason for Time Pressure

- If an individual reported original information through an entity's internal procedures and the entity later provides to the SEC either that information or the results of an audit/investigation initiated in response to that information, the SEC will consider the individual to have provided original information that led to a successful enforcement action, if:
  - the individual submitted the information to the SEC within 120 days of providing the information to the entity; and
  - the information provided to the SEC either:
    - Caused the Staff to commence an examination/investigation and the SEC brought a successful action based in whole or in part on conduct that was the subject of the individual's original investigation or
    - Significantly contributed to the success of such an action.

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## Internal Investigations

- Concern re individuals who learned of potential violation through interviews or document collections conducted in connection with internal investigations
- Under rules as adopted, if an employee learns about possible violation as the result of an internal investigation, then under Rule 21F-4(b)(4)(iv) in tandem with other exclusions set forth in Rule 2F-4(b)(4), the employee will not be eligible for a bounty unless an exception to the exclusion applies
  - Some comfort that the internal investigations will not generate whistleblowers

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## Incentive for whistleblower to report internally before reporting to SEC

- Before reporting to SEC
- Simultaneously with reporting to SEC

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## Implications

- Review structure of compliance programs
  - Attorneys
  - Effective compliance programs
    - Reduce likelihood of violation
    - Increases likelihood that entity will detect violation
    - Might reduce likelihood of whistleblower going to SEC
    - Might result in lower monetary sanctions if SEC brings enforcement action
- Be ready for internal investigations
  - Templates for document retention, etc.
  - Delegation memorandum
  - Adequate staffing of internal audit or compliance function
  - Selection of special counsel in advance

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## Meeting with the Government

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## Meeting With The Government

- Determine which agency / agencies
- Choose an approach
  - Self-reporting
  - Pitching
  - Responding to a whistleblower
  - Accepting an “invitation”
- Document all efforts to comply with reasonable response
- Be prepared to answer questions government needs to present to its chain

## Principles of Federal Prosecutions of Business Organizations

- The “Filip” Memo
- USAM 9-28
- Criminal: required
- Civil: recommended
- All agencies: thorough roadmap

## (1) Nature and Seriousness of the Offense

- Was the public harmed?
  - Lost shareholder value? Altered marketplace? Abuse of non-public information?
  - Be prepared to present data
- Amount of loss?
  - To whom is any money owed
- Most egregious violator?
  - Apportioning responsibility where appropriate

## (2) Pervasiveness of Wrongdoing

- Many violators or condoned by corporate management:
  - Charge / sue corporation
- Single act by rogue employee(s):
  - Charge / sue individual(s)
- In either case, look to role and conduct of management
- Good reason to have independent director oversee internal investigation

### (3) Past History

- Easy to look forward, or narrow scope
- Persons and entities are expected to learn from their mistakes
- USAOs *must* consider:
  - Non-criminal guidance
  - Warnings
  - Sanctions
  - Previous charges
- USAOs *may* consider:
  - Corporate structure, divisions, affiliates, etc.
- Gather corporate documents

### (4) Timely and Voluntary Disclosure / Cooperation

- Willingness to provide full, truthful information
- Identify all relevant actors, through documents or interviews?
- Who was ultimately responsible for conduct
  - Promoted? Fired? Transferred? Quit?
  - Why? Explain.
- Used to be a goal; now it's expected
  - False Claims Act
  - Dodd-Frank
- Government cannot compel privileged information
  - But mitigating circumstances
  - Advice of counsel

## (5) Existence and Effectiveness of Pre-existing Compliance Program

- Find any person, document which can be considered part of:
  - Training
  - Compliance
  - Remediation
- Does it have teeth?
  - Well designed / suited to the company?
  - Followed?
  - Applied earnestly and in good faith?
- Does management know and understand it?

## Seven Components of an Effective Program

- Contains standards and procedures
- Governing authority is on board
- Excludes criminals as decision-makers
- Communicates standards and procedures
- Reasonably ensures program is followed, effective and anonymous
- Includes incentives and disciplinary measures
- Takes reasonable steps to respond to and remedy problems

## (6) Remedial Actions

- Implement compliance program
- Improve existing compliance program
- Replace responsible management
- Discipline or terminate wrongdoers
  - Difficult task
  - But DOJ expects employees are held to highest ethical standards
  - Internal discipline is a powerful deterrent
- Pay restitution
- Cooperate

## (7) Collateral Consequences

- Harm to shareholders, pension holders, employees, others not culpable
- Impact on the public
- Debarment
- Pitch a non-prosecution agreement or DPA
  - Helps restore integrity of company's operations
  - Preserve financial viability of corporation



## (8) Adequacy of Alternate Remedies

- Criminal goals:
  - Deterrence
  - Punishment
  - Rehabilitation
- Gather facts to pitch satisfaction of one or more goal

## Whistleblower's Role and Recovery

- Issues precluding / minimizing recovery amount
  - Significance of information
  - Degree of assistance provided by whistleblower
  - Participation in internal compliance system
  - Civil / criminal culpability or other involvement
  - Narrow view of corporation, limited knowledge of wrongdoing
  - Corporation's response
  - Settlement terms (e.g., DPA, CIA)
- Retaliation and other personal claims

## Whistleblower Retaliation Protection

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## Dodd-Frank § 922: Retaliation Prohibited

- “no employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment *because of* any lawful act done by a whistleblower –
  - in providing information to the Commission ...
  - in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or
  - in making disclosures that are required or protected under SOX, the Securities Exchange Act of 1934, 18 U.S.C. § 1513(e) “and any other law, rule, or regulation subject to the jurisdiction of the Commission.”

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## Who Is Eligible For Whistleblower Retaliation Protection

- Statutory definition:
  - “any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission.”
- Standards to be eligible for bounty include:
  - voluntary submission
  - of original information
  - that leads successful SEC enforcement with at least \$1M recovery
- Standard for retaliation protection is different: Does the person have a “reasonable belief” that he or she is providing information about “a possible securities law violation that has occurred, is ongoing, or is about to occur ...”
  - statute says “violation.” Proposed Rule 21F-2 added “potential violation.”
  - the determination whether a person is a whistleblower for retaliation purposes is made when information is submitted
  - retaliation protection is not dependent upon satisfying the conditions to qualify for a bounty

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## Who Is Eligible For Whistleblower Retaliation Protection

-continued-

- Are persons other than the whistleblower protected?
  - *Thompson v. North American Stainless LP*. Supreme Court announces “associational retaliation” concept stating “we think it obvious that a reasonable worker might be dissuaded from engaging in protected activity if she knew that her fiancé would be fired.”
  - zone of interests test
  - how close does the relationship need to be?
  - firing a family member – yes
  - mere acquaintance – “almost never”
  - man working for vendor was fired when wife/employee of vendor’s client filed discrimination claim – Florida federal court “maybe”
  - “associational retaliation” expressly included in Dodd-Frank § 1079B re False Claims Act, but not § 922
  - “zone of interest” for Dodd-Frank is broad

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## What Conduct Might Constitute Actionable Retaliation?

- Adopting Release confirms that only adverse action by an employer “because of” protected whistleblower activity is prohibited
- Adopting release refers to the “well-established legal framework” in employment law for case-by-case analysis
- General employment discrimination/retaliation framework:
  - employee shows:
    - engaged in protected activity
    - suffered adverse employment action
    - causal connection – could simply be temporal proximity
  - employer shows legitimate, non-retaliatory basis for action
  - employee must show pretext

## What Conduct Might Constitute Actionable Retaliation?

-continued-

- What have the courts said?
  - Could the employer’s conduct “dissuade a reasonable worker from making or supporting a charge of discrimination?” *Burlington Northern & Santa Fe Railway Co. v. White*, 548 U.S. 53 (2006)
    - per Justice Breyer, a schedule change or excluding employee from an important professional advancement activity could be retaliation
    - disabling access to security key fob, voicemail or work email
    - warning of possible termination even if no adverse action actually taken. *EEOC v. Chrysler Group LLC*, No. 08-C-1067 (E.D. Wis. Feb. 17, 2011)
  - How will the “dissuade a reasonable worker” standard apply when a potentially sizeable SEC bounty is at stake?

## Dodd-Frank Court Guidance

- *Egan v. TradingScreen, Inc.* 2011 WL 1672066 (S.D.N.Y. May 4, 2011)
  - first reported case to consider anti-retaliation provisions
  - employee informed president that CEO was diverting company assets. President informed independent directors who hired outside counsel to investigate. Investigation confirmed allegations. CEO then fired the plaintiff.
  - TradingScreen moved to dismiss because employee did not report information to SEC and whistleblower definition refers to a person who provides information “to the Commission.”
  - court held that providing information to company president, outside counsel and independent directors could be sufficient under whistleblower definition to be “acting jointly” with another to provide information to the SEC
  - court also discussed that that Act protects those disclosing to the SEC **and** four other categories of disclosure that do not require disclosure to SEC
  - court interpreted potential ambiguity in the statute to expand employee rights.

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## Dodd-Frank v. Sox Retaliation Protection

- Immediate private action in federal court vs. DOL exhaustion
- Six-year S/L (or 3 years after violation discovered) v. 180 days to DOL
- Double back pay vs. back pay
- SEC also has authority to enforce

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## Preparing For And Responding To Retaliation Complaints

- Need strong written anti-retaliation policy
- Demonstrable compliance
- Training to recognize what retaliation is
- Factors when considering adverse employment action:
  - strong documentation of basis for proposed action
    - complainant and decision maker may no longer be with company 6 years later
  - objective vs. subjective performance concern
  - how were others treated who are similarly situated?
- upon receiving complaint of retaliation
  - obtain written statement of conduct complained of
  - prompt investigation
  - confirm that counsel/investigator not acting "jointly" with complainant per *Evans*
  - determine whether decision maker knows complainant is a whistleblower
  - determine whether adverse action is proposed concerning others close to whistleblower

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## Questions & Answers

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