

# Investigating Whistleblower Allegations Reported to the Board:

## “Whistleblower in the Board Room”

November 10, 2016

# Panelists

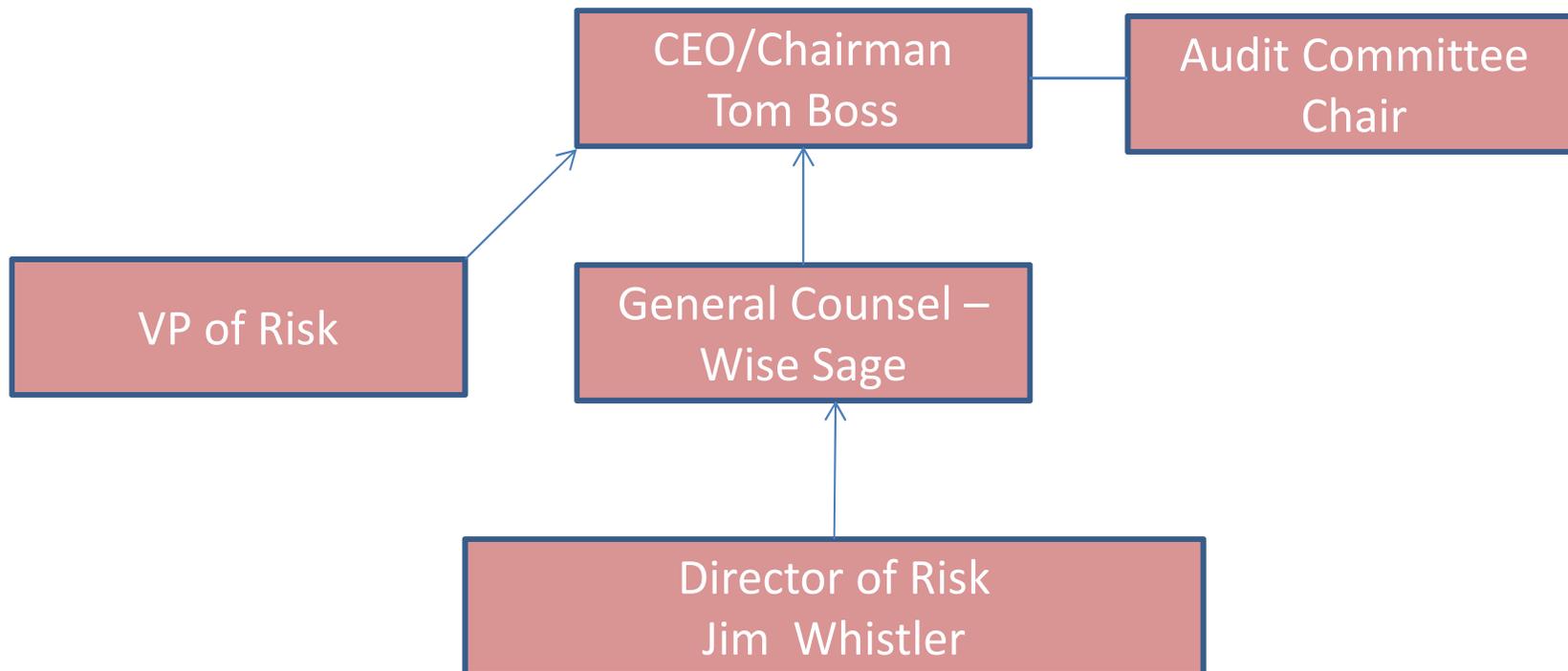
- Jodi Caro – Vice President, General Counsel & Secretary, Ulta Beauty, Inc.
- Scott Shaffer – Forensic & Valuation Services Wisconsin Practice Leader, Grant Thornton LLP
- Alice Peterson, founder and former CEO of Syrus Global
- William Hall, General Partner, Procyon Advisers
- Bryan House, Partner, Foley & Lardner LLP

# The Players

- Best Bet Insurance, Inc. is a U.S. public company (NYSE: BEST) engaged in a variety of insurance related businesses in the U.S. and overseas.
- Jim Whistler is Best Bet's Director of Risk and is responsible for, among other things, its vast investment portfolio and decisions relating to that portfolio.
  - Whistler provides reports at board and committee meetings.
  - Whistler has an open invitation to speak with the Audit Committee Chair prior to Board/Committee meetings, but he has not done so.
- Best Bet's General Counsel is Wise Sage.
- Tom Boss is Best Bet's founder, Chairman and CEO.
- Best Bet's primary law firm is Dewey, Cheatem & Howe.

# The Players

Best Bet (NYSE: BEST)



# The Problem

- Whistler is concerned that Boss, the CEO, has engaged in insider trading:
  - Over a period of one year, Boss approached Whistler three times with the suggestion that Best Bet buy shares of other public insurance companies and sought Whistler's view.
  - Whistler's typical analysis suggested one of the companies seemed like a decent value; the other two were not. Boss demanded that Whistler buy all three for Best Bet anyway, adding in two cases that he was purchasing shares for his own portfolio as well.
  - Company 1 and Company 3 were acquired within weeks, stock prices jumped, and Boss directed that the shares be sold at a profit.
  - Boss knows the CEOs at Company 1 and Company 3 well; Boss's brother works for Company 2.

# The Problem

- Prior to last quarter's Board/Committee meetings, Whistler expressed concerns to Sage. At the time, Boss had directed the purchases in Company 1 and Company 2, and Company 1 had just announced that it was being acquired.
- Sage told Whistler that Whistler had only speculation/innuendo about wrongdoing, but nothing concrete.
  - Whistler learned from Boss's assistant that Boss had lunch with the CEO of Company 1 two weeks before the purchase of Company 1 stock.
  - Whistler also said the pressure he faced from Boss supported his concern.
  - Whistler's subordinates who placed the trades were concerned too. The consensus in his group was "where there is smoke there is fire.'
- Sage told Whistler on more than one occasion to be "very careful" in making any accusations about the CEO.
- Whistler's concerns were not raised in that quarter's meetings.

# The Problem

- As the next Board/Committee meetings approached, Whistler remained concerned.
  - Since the last meetings, Boss directed the purchase of the stock of Company 3, which was purchased shortly thereafter with Best Bet again making a significant profit.
- Whistler approached Sage again, saying that it was time to bring this to the attention of the Board. Sage continued to disagree because there is no evidence of wrongdoing. Whistler wanted Sage to raise the issue, but Sage said he would not do it.
- Sage was concerned about what Whistler might do and reiterated to Whistler, “If you know what is good for you, you won’t raise this issue. Do what you think you have to do, but be very careful.”

# Whistler Raises the Issue

- At the Audit Committee meeting (attended by Boss, Sage, and the auditor) Whistler is upset by Sage's failure to raise Whistler's concerns regarding insider trading.
- Just as the meeting is about to end, Whistler tells the Board and the auditor about his insider trading concerns and his conclusion that: (1) the securities laws have been violated; and (2) Whistler has been pressured to not raise concerns, which has prevented the Board from being fully informed.
- Whistler demands a full investigation by an independent third party, and he says Dewey Cheatem & Howe is not independent.

# Questions

- What should be the Audit Committee's/Board's first move ?
- What issues should the Board be thinking about?
- Is an investigation needed?
  - If so, is outside counsel needed?
  - Should Dewey Cheatem & Howe be involved?
  - Who should be in charge? Audit Committee? Special Committee? Full Board?

# The Investigation Begins

- The Audit Committee hires a law firm with no prior connection to Best Bet.
  - AC Chair reminds law firm partner that the 10-Q has to be filed in ten days.
- Law firm puts litigation hold in place, including issuing hold to directors, and begins collecting documents and preparing for interviews.
- With the 10-Q filing coming up, the auditor is very interested in: (1) any material liability Best Bet might face due to a government investigation; and (2) the obvious concern about tone at the top.
  - Unless the situation is wrapped up soon, the 10-Q might be delayed.

# Questions

- What role, if any, should Sage play in the investigation? Can Sage be “kept in the loop”?
- What about Boss? Can he be “kept in the loop” about the investigation?
- How does Best Bet coordinate with the auditor? What are the concerns associated with that coordination?
  - Does this situation warrant forensics work or consulting expert?

# Managing the Whistleblower

- The law firm's first interview is with Whistler, who shows up well prepared. He cites all the relevant whistleblower laws, including the Dodd-Frank and SOX anti-retaliation provisions.
- Whistler says he doesn't trust the law firm (or the company), and he wants regular updates regarding what other witnesses are saying, so he can provide a rebuttal.
- Management is steaming and wants Whistler terminated, not because he raised concerns but due to the "incredibly poor judgment" he showed in the way he raised the issue to the Audit Committee with no notice to anyone.

# Questions

- Can Best Bet terminate Whistler for exercising “poor judgment” in the way he handled the Audit Committee meeting?
- Can Best Bet put him on administrative leave pending the outcome of the investigation?
- How can Best Bet manage Whistler’s desire to be involved in the investigation?

# The Investigation Proceeds

- Whistler acknowledges how uncomfortable the situation has become at the office and reluctantly agrees to be placed on paid leave during the investigation.
- The investigation proceeds smoothly, and the law firm interviews the relevant Best Bet employees, the CEOs of Company 1 and Company 2, and Boss's brother, who works at Company 3.
- The law firm has daily calls to update auditor about the investigation and the facts discovered.
- The Audit Committee Chair expresses concern that Whistler may have gone to the SEC to try to collect a Dodd-Frank whistleblower "bounty."

# Questions

- What, if any, impact does the possibility that Whistler has gone to the SEC have on the investigation?
- What if the SEC contacts the company in the middle of the investigation?

# Investigation Wraps Up

- The law firm completes its investigation and finds no evidence that Boss had material nonpublic information or otherwise engaged in insider trading.
  - There were no documents suggesting wrongdoing.
  - Boss had a good explanation for why he liked the three companies and thought they were a good buy.
  - The other CEOs denied sharing any information with Boss.
- The law firm also finds that there was no improper effort to prevent Whistler from coming forward with his allegations.
- The auditor gets comfortable and 10-Q gets filed on time.

# Questions

- How should Best Bet communicate the results to Whistler?
- Can Best Bet fire Whistler now, in light of the investigation's conclusion about the merits of the allegation?
  - Can it negotiate an amicable departure?
- If law firm can negotiate a severance agreement with Whistler, can Best Bet incorporate language preventing Whistler from going to the SEC with his allegations?

# Takeaways

- Take all whistleblowers seriously and treat them with respect.
- Resist knee-jerk reaction to punish whistleblower for “poor judgment” in manner in which issues were raised.
- Mishandling the whistleblower can lead to worse consequences than any alleged misconduct. Assume the SEC is watching.
- Take precautions early to be as independent as possible.
- If the situation requires it, directors may have to step up and be directly involved in an investigation by working with internal personnel or outside counsel.
- Keep an open mind and go where the facts take you.

# Takeaways

- Keep your auditor in the loop. This is a critical relationship and being at odds with your auditor can cause tremendous problems because these things always seem to arise before a significant public filing.
- If you are in a high-scrutiny business, have a team ready to go for internal investigations and have a plan. Document the investigation and how it is going to be handled.
- Learn from these experiences. Expect management to learn from them as well.

# Thank You For Attending