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Deciphering Dodd-Frank: Implications of the whistleblower award program

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Signed into law on July 21, 2010, and with proposed rules promulgated by the Securities and Exchange Commission (SEC or the Commission), the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) includes important new whistleblower provisions that could seriously challenge, and in some respects undermine, existing internal compliance programs at publicly-traded health care companies.¹ Compliance programs encourage internal reporting of suspected wrongdoing; the Dodd-Frank Act's financial awards and protections to whistleblowers provide a strong incentive to sidestep internal compliance program reporting in favor of SEC reporting.

Named after co-sponsoring Senators Christopher Dodd (D-CT) and Barney Frank

(R-MA), the Dodd-Frank Act increases the monetary award that can be paid by the SEC to whistleblowers who have original information and report suspected violations of securities laws that lead to a successful enforcement action. The Dodd-Frank Act also enhances anti-retaliation protections for those individuals who provide the Commission with information about potential securities violations. Additionally, the Dodd-Frank Act creates a new Investor Protection Fund to finance, in part, whistleblower awards—funded to the tune of over \$451 million for FY 2010.

Contours of the whistleblower award program

Section 922 of the Dodd-Frank Act adds new Section 21F, entitled "Securities Whistleblower Incentives and Protection" to the Securities and Exchange Act of 1934. Under this new authority, the SEC has the power to provide monetary rewards to individuals who provide the Commission with information that leads to recoveries of monetary sanctions in excess of \$1 million. The Dodd-Frank Act requires the SEC to promulgate final implementing regulations by April 21, 2011 that will govern the administration of the whistleblower award program. Accordingly, on November 3, 2010, the Commission issued the requisite proposed rule, Regulation 21F.

Key highlights of Regulation 21F, which allowed for public comments by December 17, 2010, are as follows.

Definition of whistleblower. A whistleblower is any natural person (companies or other entities excluded) who alone, or jointly with others, provides information to the Commission relating to a *potential* violation of the securities laws. The emphasis on "potential violation" makes clear that the anti-retaliation protections afforded to individuals under the Dodd-Frank Act do not depend on an actual finding or conclusion that a securities law has been violated.

Payment of award. To be eligible for a whistleblower award, an individual must satisfy the following criteria: (1) voluntarily provide the Commission (2) with original information (3) that leads to the successful enforcement by the Commission of a federal court or administrative action (4) in which the Commission obtains monetary sanctions totaling more than \$1 million. Here, the SEC in its proposed rule underscores once again that anti-retaliation protections are not conditioned on whether the whistleblower meets all of the requirements for payment of an award.

Voluntary submission of information. A submission will be deemed voluntary if the whistleblower provides the Commission with information before receipt of any request, inquiry, or demand from the SEC, Congress, other government authority, or the Public Company Accounting Oversight Board. Information submitted by individuals with a clear, pre-existing legal duty to report securities violations (e.g., a lawyer or independent auditor for the company) of the type at issue will not be considered voluntary.

Original information. The requirement for the submission of "original information" mandates that information be provided to the Commission after July 21, 2010, when the Dodd-Frank Act was enacted. Additionally, the "original information" must flow from the

whistleblower's "independent knowledge or analysis." The "original information" cannot already be known to the SEC from any other source and may not be exclusively derived from an allegation made in a judicial or administrative hearing, in a government report, hearing, audit, or investigation, or from the news media, unless the whistleblower is the source of the information. The proposed Regulation 21F, also excludes certain categories of information from being considered to be derived from independent knowledge or analysis, such as information obtained by lawyers and accountants from client engagements.

Is a storm brewing?

The passage of the Dodd-Frank Act ignited debate among the regulated business community, the plaintiff's bar, and whistleblower advocates about how best to balance the tensions that result from trying to encourage individuals to come forward with high-quality tips while simultaneously discouraging others from circumventing their company's own internal compliance program. By providing whistleblowers with between 10% and 30% (in aggregate) of any monetary sanctions the SEC is able to collect, the Dodd-Frank Act, as written, financially incentivizes whistleblowers to bypass well-established internal mechanisms for reporting wrongdoing, and potentially deprives companies of the opportunity to take prompt corrective action that could mitigate the effects of enforcement action. This dynamic is similar to that which has existed under the *qui tam* whistleblower provisions of the False Claims Act, making it even more challenging for compliance officers to effectively encourage employees to report suspected wrongdoing through corporate compliance programs.

The SEC acknowledged this tension in Regulation 21F and attempted to address the issue by barring the submission of information obtained by persons with legal, compliance,

audit, supervisory, or governance responsibilities who receive information based on the reasonable expectation that they will take appropriate steps to cause an entity to respond appropriately to the violation. The proposed SEC regulation also bars any information obtained from or through an entity's legal, compliance, audit, or similar functions or processes for identifying, reporting, and addressing potential non-compliance with securities laws. The goal of these two exclusions is to address the potential for monetary incentives to undermine a company's existing compliance, legal, audit, and similar internal processes; but they may not go far enough. The SEC's rule would not mandate that whistleblowers first report actual or potential violations through existing channels established by a company for disclosing fraud and abuse violations. Furthermore, the exclusions contain an escape hatch for legal, compliance, or other personnel to go directly to the government, if a company does not disclose information within a reasonable time or if the entity proceeds in bad faith. These are inherently vague standards that may invite reports from whistleblowers who do have a fiduciary, legal, compliance, or audit responsibility to the company.

Impact on the health industry

The Dodd-Frank Act and its corresponding SEC regulations were not written specifically with the health care industry in mind, but health care companies subject to the SEC's regulatory authority should not overlook its application to their operations, particularly with respect to corporate compliance. For-profit health care companies, even those with sophisticated and robust compliance programs, should pay close attention to the Commission's final rule pertaining to the whistleblower award program and enhanced whistleblower protections to determine whether changes to its internal compliance policies and procedures and training are

necessary. For instance, a company may need to strengthen its anti-retaliation language in its employee handbook, or it may need to substantially overhaul its written policies and procedures to encourage and incentivize employees to report violations in accordance with company policies by using existing company reporting mechanisms.

It is unclear how the SEC will respond to public comments from the regulated industry (and from the myriad of law and consulting firms that filed comments) for greater safeguards that will minimize the potential for bad-faith actors, such as entrepreneurial whistleblowers and lawyers looking to cash in on the bounty program by using information that lacks any indicia of reliability and specificity. Given the clear Congressional mandate to encourage the reporting of valuable information on securities law violations in exchange for rich financial rewards, however, it is unlikely the SEC will dramatically alter its approach in the final rule.

Corporate Compliance Committees and officers at health care companies should perform their own environmental scan, keeping in mind that the whistleblower provisions of the Dodd-Frank Act break in favor of the government and largely support its desire to leverage information from third parties (i.e., whistleblowers) to combat insider trading and securities fraud. Obviously, the "lionization" of whistleblowers by the government makes any perceived retaliation against a whistleblower that much riskier.

The government has bolstered its pro-whistleblower stance with strong anti-retaliation provisions within the Dodd-Frank Act that make it unlawful for any employer to "discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other

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manner discriminate against, a whistleblower in the terms and conditions of employment.”² Moreover, the Dodd-Frank Act provides that any individual who alleges retaliation thereunder may bring an action in the appropriate federal district court. The anti-retaliation protections of the Dodd-Frank Act are not entirely unfamiliar to many health care companies, because the establishment of a policy of non-intimidation and non-retaliation for good-faith participation in compliance programs has been well-touted by New York’s influential Medicaid Inspector General, James G. Sheehan, as the eighth pillar of an effective health care compliance program.

Conclusion

Litigation trends indicate that whistleblowers will continue to be an important source for detecting corporate fraud and abuse. Thus,

it goes without saying that monetary awards provided in exchange for such information will serve as a powerful inducement for individuals to come forward about fraudulent and other prohibited conduct. As such, the evolving contours of the SEC’s whistleblower award program are one to watch. In its current iteration, it is viewed by those representing whistleblower interests as a powerful tool, and, unless curtailed through rulemaking, it will likely spur increased whistleblower activity and government enforcement for publicly traded health care companies for years to come. Its broader effect throughout the health care industry remains to be seen on “best practice” anti-retaliation policies and procedures and internal compliance program reporting. ■

1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1841-49 (2010); 75 Fed. Reg. 70488, 70488-554 (Nov. 17, 2010).
2 Dodd-Frank Wall Street Reform and Consumer Protection Act §922, 124 Stat. at 1845-46.

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