

Morgan Lewis

Whistleblowers and the SEC

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Whistleblowers and the SEC

- The Dodd-Frank Wall Street Reform and Consumer Protection Act added Sec 21F of the Securities Exchange Act of 1934 (the whistleblower bounty provisions)
 - Sec 21F authorizes the SEC to award whistleblowers who are individuals between 10-30% of any monetary recovery
 - for voluntarily providing – i.e., before government or certain others ask for it
 - to the SEC
 - “original information,” i.e., information derived from independent knowledge or analysis not already known to SEC

Whistleblowers and the SEC

- leading to successful SEC enforcement of securities laws with monetary sanctions of more than \$1 million
- the SEC has proposed rules to implement the whistleblower provisions
- SEC seeking comments on its proposals
- whistleblowers are protected from retaliation (even if they are wrong) – double back-pay remedy plus interest, legal costs and fees and ability to go directly to federal court

Whistleblowers and the SEC

- What about Company Compliance Programs?

The SEC tries to address potential adverse consequences of direct reporting to the SEC through exclusions to when the SEC will consider information to be “original information,” such as the following:

- *to address concerns about chief compliance officers becoming whistleblowers, there is an exclusion if the individual obtained the information because he is a person with legal, compliance, etc., responsibility and the information was conveyed with reasonable expectation that the individual would cause the entity to respond appropriately to the violation, unless the entity did not disclose the information to the SEC within a reasonable time or proceeded in bad faith. (neither of which is defined)*

Whistleblowers and the SEC

- *to address concerns regarding attorneys, the SEC proposed exclusions for information subject to the attorney client privilege or that the attorney obtained through representing the client.*
- *to address concerns about accountants becoming whistleblowers, the SEC proposed an exclusion for information obtained through an engagement required under federal securities laws.*
- *to address concerns that the bounty provisions might encourage unlawful conduct, there is a proposed exclusion for information obtained in a manner that violated federal or state criminal law.*

Whistleblowers and the SEC

- in addition to the above exclusions, to address concerns about false or fictitious claims, the whistleblower will be required to make sworn declarations and would be subject to prosecution and be ineligible for an award if he knowingly and willfully makes false, fictitious or fraudulent statements.
- to encourage internal reporting, the SEC indicated it expects to give credit in determining the amount of awards to whistleblowers who use internal procedures to report complaints about misconduct.
- SEC also proposed that if individual does use the internal reporting processes, the individual will be treated as having reported to the SEC on the day of the initial disclosure, as long as he reports to the SEC within 90 days (the “90 day lookback”).

Whistleblowers and the SEC

- Practical Consequences
 - there is no substitute for effective corporate compliance programs.
 - the above exclusions and proposals probably don't provide sufficient incentive to prevent individuals from reporting to the SEC, thus undermining internal compliance programs.
 - while there is some encouragement to report internally in the above provisions, there is no requirement that a whistleblower do so. In addition, fear of retaliation and the ability to report to the SEC anonymously may discourage internal reporting.

Whistleblowers and the SEC

- try to encourage internal reporting through training
- internal bounties for internal reporting? will that help?
- quarterly certifications? do they help?
- the race to the SEC – but do you have to go and when do you go?
- react quickly to potential securities violations
- under Dodd Frank need to extend your compliance program to consolidated subsidiaries

Whistleblowers and the SEC

- waiver and arbitration agreements don't work
- the corporate blackmail problem – will lead to more claims
- plaintiff's attorneys are swarming.
- get ready for more internal investigations
- more need to investigate using outside counsel and involving the audit committee to gain credibility with the SEC and to protect privileges
- as a practical matter it will help to use a firm that has contacts at the SEC
- more expense and more time

Whistleblowers and the SEC

- anti-retaliation policies and retaliation claims – don't retaliate
- extended statute of limitations under Dodd Frank (3/6/10 years) for retaliation claims
- more litigation and media attention likely as plaintiffs bypass the administrative process before OSHA and the DOL under SOX and go to federal court with retaliation claims. More spin off lawsuits come with allegations of fraud.
- be sure to focus on the FCPA (and commercial bribery) and insider trading compliance programs.

Whistleblowers and the SEC

- the SEC likes industry wide sweeps so it may not be you who kicks off a big inquiry. The weakest link in your industry could start an inquiry.
- the funds paid out by the SEC can be very large
- bottom line – there are no secrets – be forewarned