

The background of the slide is a dark green field filled with various financial data visualizations. At the top, there are candlestick charts for currencies like ITL, DEM, BEF, FRF, MLC, and RUS, with price changes such as -0.44, -31.26, +0.16, -0.01%, +0.04, and -0.03% respectively. Below these, a world map is visible, overlaid with a large green arrow pointing from the left towards the right. Further down, more currency codes like JPY, EUR, CHF, GBR, SEK, and CAD are listed. At the bottom, there are bar charts and line graphs, with specific values like RMY 18.68 - 0.7% and DTR 31.48 - 0.0% visible. The overall theme is global finance and public company regulation.

Morgan Lewis

**GLOBAL PUBLIC COMPANY ACADEMY**

# **WHEN THE SEC COMES CALLING: A PRIMER ON DIVISIONS OF CORPORATION FINANCE AND ENFORCEMENT**

Peter K. M. Chan  
Celia A. Soehner

May 2, 2018

The background of the slide is a dark green field filled with various financial data visualizations. At the top, there are candlestick charts for currencies including ITL, DEM, BEF, FRF, MGO, and RUS, with associated price changes like -0.44, -31.26, +0.16, -0.01%, +0.04, and -0.03%. Below these, a row of currency codes JPY, EUR, CHF, GBR, SEK, and CAD is visible. Further down, more candlestick charts are shown for RMY (18.68 - 0.7%) and DTR (31.48 - 0.0%). At the bottom, there are bar charts and line graphs, with one bar chart showing values like 13.28 - 1.2%. A large, semi-transparent green arrow originates from the left side and points towards the right, passing behind the main title.

**Morgan Lewis**

**GLOBAL PUBLIC COMPANY ACADEMY**

# **SECURITIES AND EXCHANGE COMMISSION OVERVIEW**

# SEC Leadership: Chair and Commissioners



**Kara M. Stein**  
Commissioner  
Since 2013



**Jay Clayton**  
Chair of SEC  
Since 2017



**Michael S. Piwowar**  
Commissioner  
Since 2013

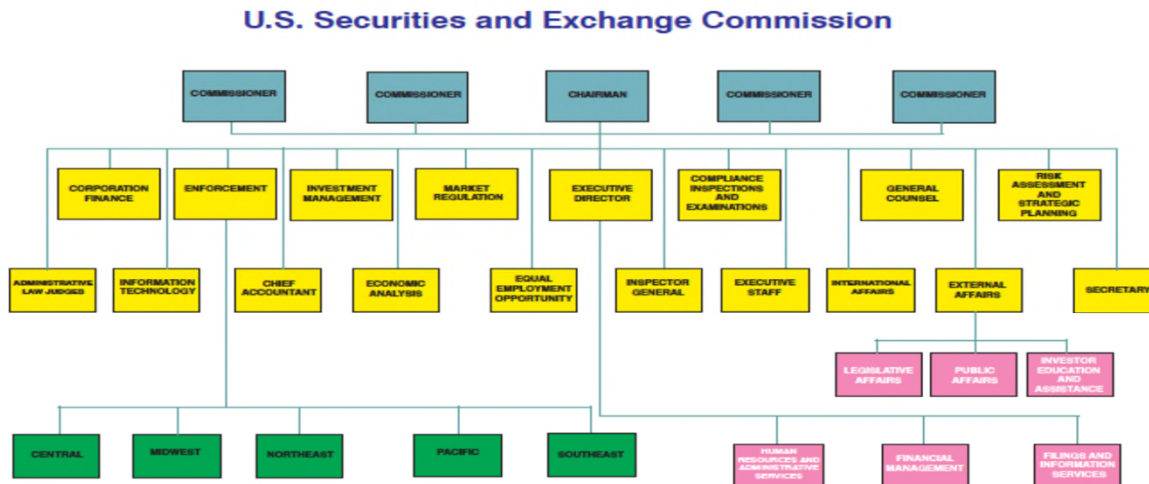


**Robert J. Jackson Jr.**  
Commissioner  
Since 2018



**Hester M. Peirce**  
Commissioner  
Since 2018

# SEC Organizational Chart





The background of the slide is a dark green color with a faint world map. Overlaid on the map are various financial charts, including candlestick charts and line graphs. Two large, thick green arrows originate from the left side of the map and point towards the right, one above the other. The text is overlaid on this background.

**Morgan Lewis**

**GLOBAL PUBLIC COMPANY ACADEMY**

**DIVISION OF  
CORPORATION FINANCE**

# Corp Fin Overview

- **Division of Corporation Finance (“Corp Fin”)**

- Corp Fin is charged with ensuring that issuers comply with the SEC’s disclosure rules and requirements
  - Ensure that investors are provided with material information in order to make informed investment decisions, both when a company initially offers its securities to the public and on an ongoing basis as it continues to give information to the marketplace
  - Corp Fin also has legal policy and accounting offices that provide interpretive assistance with respect to SEC rules and forms and make recommendations to the Commission regarding new rules and revisions to existing rules
- The Corp Fin population is made up of attorneys and accountants
  - Division of labor between legal and accounting is much less “siloe” than it used to be”
  - Staffers work together to review disclosure documents that are filed with the SEC and, if necessary, issue comment letters to the company seeking clarification or changes to such disclosure

# Structure of Corp Fin

- **Disclosure Ops**

- Disclosure Operations is divided into 11 industry-based offices, commonly known as “AD offices”
- Each AD office is led by an Assistant Director, with management and staffers bifurcated between the accounting and legal teams
- Disclosure Ops staffers coordinate with the Division’s front office and specialty offices (of which there are several) on an as-needed basis

# Structure of Corp Fin (cont.)

AD Office	Representative Companies
Office of Health Care and Insurance - AD1	Merck, Pfizer, Johnson & Johnson, Chubb
Office of Consumer Products - AD2	Walmart, Amazon
Office of Information Technology and Services - AD3	VMware, Alphabet, Facebook, Adobe
Office of Natural Resources - AD4	ExxonMobil, Chevron, ConocoPhillips
Office of Transportation and Leisure - AD5	McDonalds, UPS, Boeing
Office of Manufacturing and Construction - AD6	Home Depot, Colgate Palmolive, DowDupont
Office of Financial Services - AD7	JPMorgan, PNC, BlackRock, American Express
Office of Real Estate and Commodities - AD8	Crown Castle International, Simon Property, Marriott
Office of Beverages, Apparel and Mining - AD9	CocaCola, CVS, TJX, Constellation Brands
Office of Electronics and Machinery - AD10	GE, Thermo Fisher Scientific, Caterpillar, 3M
Office of Telecommunications - AD11	Verizon, T-Mobile, Comcast



# Structure of Corp Fin (cont.)

- **Front Office** (Division Director and supporting positions; Associate Directors)
- **Office of Chief Counsel (OCC)**
  - Answers questions from companies and investors on all the overall applicability of federal securities laws, including questions relating to:
    - Form 8-K
    - Form eligibility under the Securities Act and Exchange Act
    - Securities Act Rule 144
    - Exchange Act Section 16 and beneficial ownership reporting on Forms 3, 4, and 5
    - Executive compensation disclosure
    - Trust Indenture Act of 1939
  - OCC also considers requests for no-action (including under Rule 14a-8) relief, interpretive guidance, and exemptive letters.

# Structure of Corp Fin (cont.)

- **Office of Chief Accountant (OCA)**

- Responds to questions about financial statements and other financial information required to be included in SEC filings
- Addresses registrants' pre-filing submissions on the application of GAAP and IFRS

- **Office of Mergers and Acquisitions (OMA)**

- Handles disclosure and other issues arising in business combinations and change-of-control transactions, including mergers, acquisitions, proxy contests, exchange offers, tender offers, Rule 13e-3, or "going private" transactions
- FAQs fielded by OMA include those relating to: Regulations 13D-G and Schedules 13D and 13G; tender offer rules; rules relating to cross-border transactions; and proxy contests

- **Office of International Corporate Finance (OICF)**

- Responses to questions on Reg S and offshore offerings, Securities Act Rule 144A, ADRs, foreign governmental securities, the MJDS for Canadian issuers, and other matters involving foreign issuers

# Structure of Corp Fin (cont.)

- **Office of Capital Markets Trends**

- Responds to questions about macro and micro capital markets trends and new or novel securities and derivatives issues (think: ETNs)
- Also reviews shelf registration statements takedowns

- **Office of Small Business Policy (OSBP)**

- Advises on issues relevant to smaller companies, including those designated as “smaller reporting companies,” and small business capital formation
- Also provides interpretive guidance limited, private, and intrastate offerings of securities

- **Office of Rulemaking**

- Answers questions about rulemaking involving Corp Fin, including questions about proposed rules, recently adopted final rules and rulemaking petitions

## Structure of Corp Fin (cont.)

- Important takeaway: these offices work together on the myriad issues that arise in connection with SOX reviews, companies going through an IPO process or proxy contests, and companies with unique disclosure issues
- Both Disclosure Ops and the legal and policy offices maintain open lines of communication with issuers and are available to answer questions

The background of the slide is a dark green field filled with various financial market data. It includes candlestick charts, line graphs, and bar charts. Currency codes such as ITL, DEM, BEF, FRF, MGF, RUS, JPY, EUR, CHF, GBR, SEK, CAD, RMY, and DTR are scattered across the image. Some data points include values and percentage changes, such as 'DIN 16.28 - 2.2%', 'BOY 1.49 - 0.5%', 'RMY 18.68 - 0.7%', 'DTR 31.48 - 0.6%', and 'DIN 13.28 - 1.2%'.

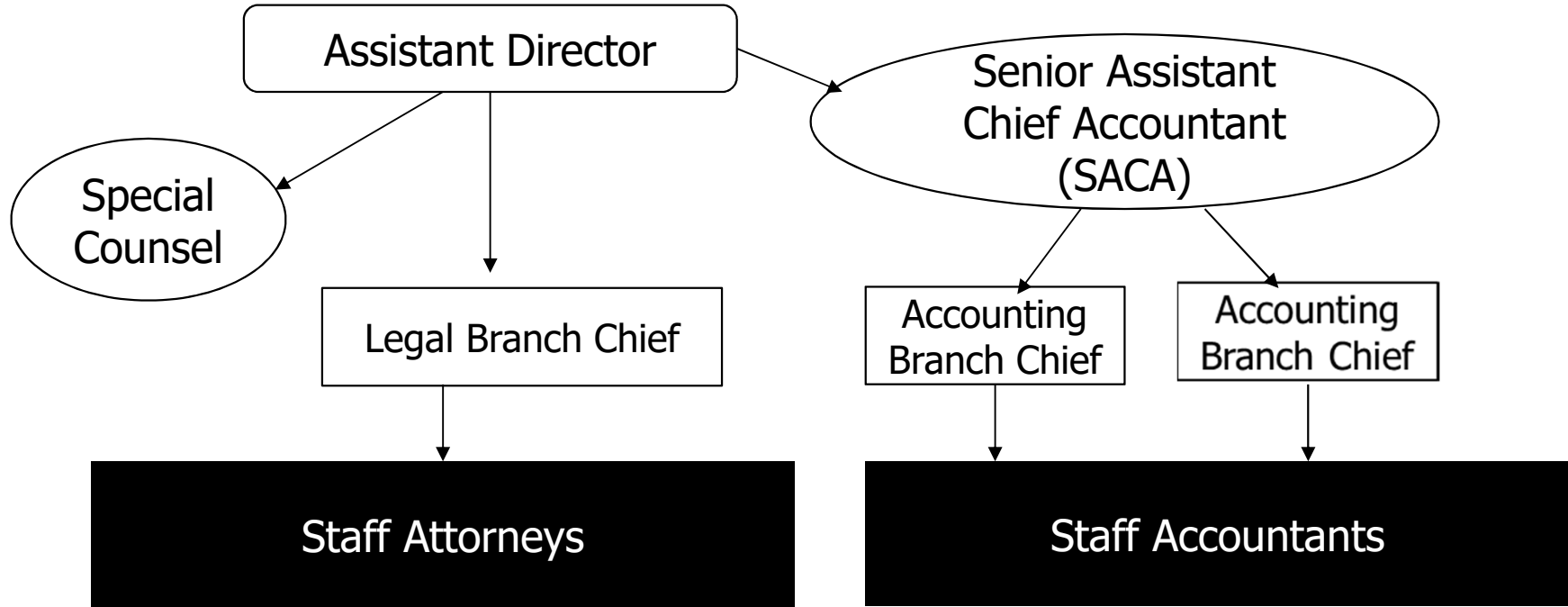
**Morgan Lewis**

**GLOBAL PUBLIC COMPANY ACADEMY**

# **REVIEW AND COMMENT LETTER PROCESS**



# Structure of an AD Office



# Categories of Review

Two primary “buckets” of review:

- Sarbanes-Oxley-mandated Exchange Act review
  - Section 408 of SOX requires the SEC to review periodic disclosures (including financial statements) made by U.S. and foreign reporting companies on a regular basis
  - Each issuer being reviewed no less frequently than once every three years (although could be more frequent)
- Selective review process for transactional filings
  - Type of transaction/disclosure/circumstances dictate the level of review

# Categories of Review (cont.)

- **Triennial SOX Reviews** (although could be more frequent)
- **'33 Act Registration Statement Reviews** (IPOs, S-4s, S-3s filed by non-WKSIs)
- **'34 Act Registration Statement Reviews** (Forms 10)
- **Preliminary Proxy Statements and Merger Proxies**

# Review Process



# Levels of Review

- Full Review
  - Corp Fin Staff will review the entire filing for technical and legal compliance with the SEC rules and regulations
  - For transactional filings, a full review triggers a 30 day wait period for comments
- Targeted or “Monitor” Review
  - Filing will be reviewed for a discrete, targeted issue
  - For transactions, a “monitor” might look at form eligibility, Rule 415 compliance issues, enforcement issues or unique facts and circumstances
- Financial or “Limited” Review
  - Review is limited to solely the financial statements and MD&A
- No Review

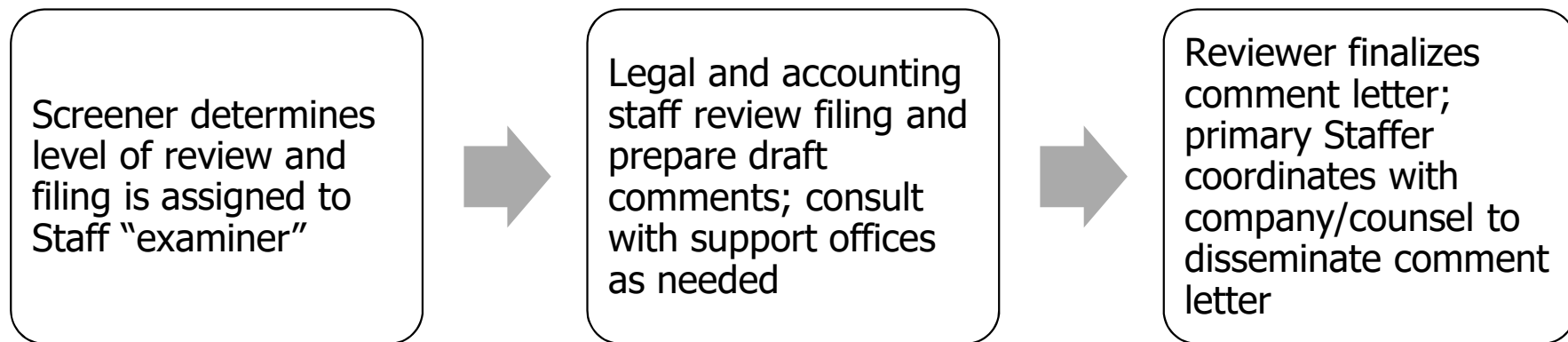


# Review Determination

The level of review depends on several factors:

- SOX Section 408
- Type of filing or transaction
- Quality of disclosure/immediately apparent issues
- The company itself
- Staff workload

# Review Process



# Anatomy of a Review

- Examiner conducts initial review of filing and prepares draft comments
  - Review is not confined to four corners of the filing; Staff will review news information, stock performance, analyst reports, and earnings call transcripts
  - If review relates to periodic filing (e.g., a Form 10-K), other periodic filings and current reports also will be reviewed as part of the overall process
- Disclosure Ops will liaise with support offices as needed
  - Disclosure indicative of contacts with state sponsors of terrorism — coordinate with Office of Global Security Risk
  - Disclosure or transaction raises unique questions — coordinate with OCC
  - Proxy contest — coordinate with OM&A
  - Foreign private issuer matters — coordinate with OICF

# Anatomy of a Review (cont.)

- Attorneys and accountants may work together on intertwined/overlapping issues (such as MD&A or disclosure issues raised by financials)
- Once draft comments (or recommendation to issue no comments) are finalized, a senior level reviewer (oftentimes a branch chief) will conduct a secondary level of review
  - May determine not to issue comments because of immateriality
  - Recent trend toward fewer comments
- Unique/high profile issues may necessitate involvement of the front office

# Anatomy of a Comment Letter

For a SOX review, the introductory paragraph will indicate the level of review (transactional reviews differ – company already will be aware of level of review before comments go out)



# Anatomy of a Comment Letter (cont.)

Indicates full review



We have reviewed your filing and have the following comments. In some of our comments, we may ask you to provide us with information so we may better understand your disclosure.

Indicates limited review and describes scope of the same



We have limited our review of your filing to your contacts with countries that have been identified as state sponsors of terrorism, and we have the following comments. Our review with respect to this issue does not preclude further review by the Assistant Director group with respect to other issues. In our comments, we ask you to provide us with information so we may better understand your disclosure.

# Anatomy of a Comment Letter (cont.)

## Form 10-K cover page

1. We note from your Form 10-K that the aggregate market value of your common stock held by non-affiliates was approximately \$37.8 million at June 30, 2016. We further note that you indicated you are a non-accelerated filer rather than a smaller reporting company. Please provide us with your analysis as to why you do not believe you are a smaller reporting company. Refer to Exchange Act Rule 12b-2 and Item 10(f)(2)(iii) of Regulation S-K.

Typical comment asking for analysis (but likely means the company made an error)

## Item 1. Business, page 4

2. You disclose that you address “many industries, including the semiconductor, consumer electronics, aerospace and automotive industries.” Revise your future filings to clarify whether you have derived a material amount of revenues from the development of technology related to any of the markets you disclose.

Typical legal “futures” comment

# Anatomy of a Comment Letter (cont.)

You may contact Eric Atallah at (202) 551-3663 or me at (202) 551-3662 if you have questions regarding comments on the financial statements and related matters. Please contact Caleb French at (202) 551-6947 or Amanda Ravitz, Assistant Director, at (202) 551-3412 with any other questions.

Names listed first are the primary contacts (here, accounting and legal, respectively). These are who you should call with questions about the review.

Sincerely,

/s/ Kevin J. Kuhar

Kevin J. Kuhar  
Accounting Branch Chief  
Office of Electronics and Machinery

# Anatomy of a Comment Letter (cont.)

You may have  
questions regarding  
Caleb French and  
any other ques

If you don't understand what a comment means,  
call and ask!

Names listed first are the primary  
contacts (here, accounting and legal,  
respectively). These are who you should  
call with questions about the review.

Sincerely,

/s/ Kevin J. Kuhar

Kevin J. Kuhar  
Accounting Branch Chief  
Office of Electronics and Machinery

# Frequent Areas of Comment – SOX Reviews

- Non-GAAP Measures
- MD&A
- Revenue Recognition
- Income Taxes
- Executive Compensation/CD&A
- Contacts with countries that are state sponsors of terrorism

# Sample Non-GAAP Comments

1. Revise future filings to consistently use the same titles for the non-GAAP measures presented. We note, for example, that you present the same non-GAAP measures on pages 6 and 109 but use the title “industrial revenues” on page 6 and the title “adjusted industrial revenues” on page 109. In addition, please revise your presentation of non-GAAP measures to comply with Item 10(e)(1)(ii)(E) of Regulation S-K which requires you to use titles that are not the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.
  1. Throughout this section you present measures that exclude the effect of one or both of (i) the PAAL acquisition and (ii) foreign currency translation but you do not identify these measures as non-GAAP, nor do you provide the reconciliations to the most directly comparable GAAP measures and the qualitative disclosures required by Item 10(e) of Regulation S-K. Please revise your presentations in future filings to comply with that guidance.

# Practice Points

- Stay abreast of comment “trends”; monitor comments issued to peer companies
- Pay attention to response deadlines, and ask for extensions if needed
- If providing revised or draft disclosure, provide redlines
- Facts and circumstances may warrant pushing back on a comment – sometimes the Staff will reconsider their position
  - Can appeal “up the chain” if needed (should be reserved for appropriate situations)
- “Tandy” language no longer required in response letters



The background of the slide is a dark green color with a complex pattern of financial data. It includes various candlestick charts, line graphs, and bar charts in shades of green. Scattered throughout are currency codes and their corresponding percentage changes, such as 'DIN 16.28 - 2.2%', 'JPY EUR CHF GBR SEK CAD', 'RMY 18.68 - 0.7%', 'DTR 31.48 - 0.6%', and 'DEM BEF FRF MLO RUS'. A large, semi-transparent green arrow points from the bottom left towards the top right, passing behind the main title.

Morgan Lewis

**GLOBAL PUBLIC COMPANY ACADEMY**

# RELATIONSHIP BETWEEN CORP FIN AND ENFORCEMENT



# Office of Enforcement Liaison

- The Office of Enforcement Liaison (OEL) coordinates matters between the Corp Fin and the Division of Enforcement
  - Handles referrals from Corp Fin
  - Assists in the development of Enforcement cases relating to disclosure matters (e.g., accounting fraud)
- OEL also processes waiver requests for “ineligible issuer” status, or so-called “WKSI waiver” requests, that may arise under Rule 405 of the Securities Act



Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY

DIVISION OF ENFORCEMENT

# Types of Enforcement Cases Affecting Public Companies

- Financial Reporting and Internal controls
- Disclosures of material information
- Focus on individuals and gatekeepers
- Cybersecurity
- Whistleblowers
- Insider Trading
- FCPA

# 2017 SEC Enforcement Statistics

Type of Case	Number of Independent Actions	Percentage
Issuer Reporting/Audit & Accounting	95	21%
Securities Offering	94	21%
Investment Advisers/Investment Companies	82	18%
Broker-Dealer	53	12%
Market Manipulation	41	9%
Insider Trading	41	9%
Public Finance Abuse	17	4%
FCPA	13	3%
Miscellaneous	7	2%
Transfer Agent	3	1%

# Tone at the Top: A Tougher Enforcement Approach

- Specialized Units –now entrenched
- More Former Criminal Prosecutors in Leadership Positions (Regional Directors include: SF, Boston, Chicago, Salt Lake, Ft. Worth) = SEC looking more like DOJ
  - Cooperation programs, Non prosecution agreements, Deferred Prosecution Agreements

# Sources of Investigations

- **Self-Reporting—New Developments**
- **Whistleblowers—Continuing Increase**
- Referrals from Other SEC Divisions
- Referrals from Other Regulators
  - Other Federal Regulators
  - State Regulators
  - International Regulators
- Self-Regulatory Organizations
  - NASDAQ
  - FINRA
- PCAOB
- Press or Other Reports

# SEC Investigation Process

- Informal v. Formal Investigation
- Investigatory Process
  - Documents
  - Testimony
- Coordination with DOJ
- Wells Process
- Settlement
- Litigation
  - Administrative Proceeding
  - Federal District Court

The background of the slide is a dark green field filled with various financial market data. It includes candlestick charts, line graphs, and bar charts. Currency codes such as ITL, DEM, BEF, FRF, MGO, RUS, JPY, EUR, CHF, GBR, SEK, CAD, RMY, and DTR are scattered across the image, often followed by numerical values and percentage changes. A large, semi-transparent green arrow points from the bottom left towards the top right, passing behind the main title.

Morgan Lewis

**GLOBAL PUBLIC COMPANY ACADEMY**

# FINANCIAL REPORTING AND ISSUER DISCLOSURE



# They're Back on the Rise: Accounting and Disclosure Cases

- Between 2003-2005, accounting and disclosure cases accounted for 25% of enforcement actions; 2013 accounted for only 11%.
- Renewed Focus Began in 2013 & Continues
  - July 2, 2013: Creation of “Financial Reporting and Audit Task Force” (now referred to as the Financial Reporting and Audit Group or “FRAud Group”).

# New SEC Enforcement Detection Tool: Big Data

- “Accounting Quality Model”
  - Analyzes financial statements for factors indicating or inducing earnings management
  - Includes textual analysis of MD&A—looks at the words, not just the numbers
  - Compares with peer-level metrics



# New SEC Enforcement Detection Tool: Big Data

- 1<sup>st</sup> generation tool: Accounting Quality Model (AQM)
  - Isolate discretionary accruals and identify outliers to peers
  - Statements are processed and assigned a risk score by AQM within 24 hours of filing with the SEC
  - Sample risk-indication factors
    - Choice of accounting policy
    - Interactions with/replacement of independent auditors
  - Sample risk-inducement factors
    - Loss of market share
    - Lower profitability
    - 9/10/14 SEC press release about the late Form 4 filer sweep: “Using quantitative analytics, we identified individuals and companies with especially high rates of filing deficiencies....”
- FRAud Group: “[P]roactively detect financial reporting issues.”
  - *Andrew Ceresney, Enforcement Director, January 25, 2016*

# New SEC Enforcement Detection Tool: Big Data

- 2<sup>nd</sup> generation tool: Corporate Issuer Risk Assessment program (CIRA)
  - “CIRA is essentially the Accounting Quality Model on steroids”
    - SEC Director of the Division of Economic and Risk Analysis, June 2015
  - CIRA dashboard contains over 100 custom metrics to compare firms and look for anomalies
  - AQM now incorporated in CIRA
  - CIRA enables SEC staff to look, for example, at how inventory at a manufacturing company is moving relative to reported sales
    - SEC staff who saw increased inventory and declining sales may flag the company as ripe for fraudulent accounting adjustments
  - Data comes from XBRL filings and commercial databases

# Financial Reporting Hot Buttons

- Improper Revenue and Expense Recognition
- Disclosure of Executive Perks in Proxy
- False or Inadequate Disclosures
- Earnings Management
- Internal Controls
- Valuation (particularly of illiquid assets) and Goodwill write-downs

# Example of SEC Enforcement Actions Involving Accounting Improprieties

## **In the Matter of Maxwell Technologies et al. (March 27, 2018)**

- Allegation that Company prematurely recognized revenue from the sale of ultracapacitors - small energy storage and power delivery products - in order to better meet analyst expectations.
- A former Maxwell sales executive and corporate officer, allegedly inflated the company's revenues by entering into secret side deals with customers and by falsifying records in order to conceal the scheme from Maxwell's finance and accounting personnel and external auditors.
- Former CEO and former controller also were charged for failing adequately to respond to red flags.
- Civil penalties, disgorgement, O&D bar (against sales executive), clawback of incentive-based compensation.

# Disclosure Fraud

- **Theranos Inc et al. (March 14, 2018)**

- SEC alleged that charged Silicon Valley-based private company Theranos Inc., its founder and CEO Elizabeth Holmes, and its former President Ramesh “Sunny” Balwani with raising more than \$700 million from investors through an elaborate, years-long fraud in which they exaggerated or made false statements about the company’s technology, business, and financial performance.
- Holmes agreed to pay a \$500,000 penalty, be barred from serving as an officer or director of a public company for 10 years, return the remaining 18.9 million shares that she obtained during the fraud, and relinquish her voting control of Theranos by converting her super-majority Theranos Class B Common shares to Class A Common shares.

The background of the slide is a dark green field filled with various financial data visualizations. At the top, there are several currency codes (ITL, DEM, BEF, FRF, MLO, RUS) followed by their respective values and percentage changes. Below these, a world map is visible, overlaid with a grid of green lines. Two large, thick green arrows originate from the center of the map and point towards the right side of the slide. The overall aesthetic is professional and data-driven, typical of a corporate financial presentation.

Morgan Lewis

**GLOBAL PUBLIC COMPANY ACADEMY**

# INCREASED EMPHASIS ON INTERNAL CONTROLS



# Increased Emphasis on Issuer Compliance and Controls

- Cases brought which indicate that
  - Issues were not discovered
  - Issues were not escalated
  - Management ignored pushback from the compliance staff
  - Internal controls or accounting resources were insufficient for size of company's risk
  - Accounting personnel not sufficiently knowledgeable
  - Management leaves impression that issues not important

The background of the slide is a dark green color with a faint world map. Overlaid on the map are various financial charts, including candlestick charts and line graphs. Text labels for various currencies and their values are scattered across the background, such as 'ITL DEM BEF FRF MLO RUS', 'JPY EUR CHF GBR SEK CAD', 'RMY 18.68 - 0.7%', and 'DTR 31.48 - 0.0%'.

Morgan Lewis

**GLOBAL PUBLIC COMPANY ACADEMY**

# FOCUS ON INDIVIDUALS AND GATEKEEPERS

# Individual Targets – Not Just CEO and CFO

- Outside Directors
- General Counsel
- Treasurer
- Mid-level Managers (e.g. Saba Software, Sept. 2014)
- Outside Auditors
- For regulated entities, CCOs

**Morgan Lewis**

**GLOBAL PUBLIC COMPANY ACADEMY**

**CYBERSECURITY**

# Cybersecurity

- **Altaba (formerly Yahoo!)**
  - **\$35 million civil penalty**
  - **Alleged failure to have controls and procedures in place to assess cyber-disclosure obligations.**
  - **Allegations included amount of time between breach and ultimate disclosure.**
- **R.T. Jones Capital Equities Management (Sept. 22, 2015)**
  - 1<sup>st</sup> SEC cybersecurity enforcement case.
  - SEC found that Investment Adviser R.T. Jones failed to establish required cyber policies and procedures under Regulation S-P in advance of a breach that exposed PII of approx. 100,000 individuals.
  - \$75,000 penalty.
- **Morgan Stanley (June 8, 2016)**
  - SEC concluded that Morgan Stanley failed to adopt written policies and procedures reasonably designed to protect customer data.
  - Former employee improperly accessed and transferred data from over 700,00 accounts to his personal server, which was then hacked by a third party.
  - Morgan Stanley paid \$1 million penalty.
  - Former employee was criminally convicted.

# Cybersecurity (cont.)

- SEC is focused on several issues for public companies
  - Internal controls to prevent breaches and protect the integrity of the financial reporting process.
  - Disclosure in periodic filings of risks to the issuer's business of a breach, and what controls exist to prevent.
  - Disclosure of threats and incidents
    - *Question is when and how to disclose*
    - *Materiality*
- What you should do now:
  - Board of Directors must proactively oversee cyber policies and procedures.
  - Create (or update) rapid response team to deal with breaches. Include expert in SEC disclosure and dealing with SEC enforcement inquiries.
    - Internal investigation protected by attorney-client privilege



Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY

WHISTLEBLOWERS

# SEC Whistleblower Program

– courtesy of sec.gov





# **Dodd-Frank Act – Whistleblower Bounty Provision Rules**

- Person who voluntarily provides SEC with original information that leads to successful enforcement action resulting in sanctions greater than \$1 million may be entitled to 10 – 30% of the funds recovered.
- Effective Date – August 12, 2011.
- Covers tips provided to SEC from July 21, 2010 to present.
- Office of Whistleblower established.

# Dodd-Frank Whistleblower Rules

- Persons who may qualify as a “Whistleblower”
  - Employees, consultants, agents, vendors, competitors, customers, etc.
  - Excluded persons: Entities, govt. employees, person knowingly making false statement or convicted of crime related to the action.
  - MAY include, if certain conditions met: Attorneys, auditors, internal compliance staff, officers/directors who learn through compliance.
    - *If report to audit committee, chief legal officer or chief compliance officer and 120 days lapse*
    - *Entity impeding investigation*
    - *Necessary to prevent substantial injury to investors*
  - ***Based on recent US Supreme Court Decision in Digital Realty Trust, Inc. v. Somers, for purpose of anti-retaliation provisions, an employee is not a whistleblower at time of termination if he or she had not reported to the SEC.***

# 2017 SEC Statistics – Whistleblower Program

- In FY 2017, the SEC's Office of the Whistleblower received 4,484 tips, complaints, and referrals.
  - Increase of 266 (or approximately 6%) from FY 2016.
  - Most significant areas for TCRs: corporate disclosure and financials (21.3%); offering fraud (16.9%); and manipulation (10.4%).
  - Tips from every state (highest number from California, New York, Texas, Florida and New Jersey); highest number of non-US tips came from the UK, Canada and Australia.
- Last year, the SEC paid nearly \$50 million in awards to 12 whistleblowers.
  - More than \$20 million paid to one individual, the third-highest award in the history of the program.

# Current Environment for SEC Whistleblowers

- Significant Monetary Awards issued to date.
- General profile of whistleblower award recipient.
  - Over 40% were current or former employees; 20% were contractors or consultants.
  - 80% of the current or former employees raised issue internally before reporting to SEC.

## First SEC Retaliation Case

- SEC Rule 21F-17(a) Prohibits Employers From Doing Anything that Impedes or Discourages WB From Going to the Government, Specifically **Including “enforcing, or threatening to enforce, a confidentiality agreement....”**
- June 2014: SEC brought first retaliation case against Paradigm Capital Management.
  - SEC alleged that, among other things, employer marginalized whistleblower by modifying responsibilities following report of wrongdoing.
  - 4/28/15: SEC awarded \$600,000 – the maximum payment of 30% of amounts collected as penalties to the employee WB.

# SEC Enf. Action Against KBR Alleges Confidentiality Agreement Had Potential to Dissuade Whistleblower Reporting

- April 2015: SEC charged KBR, Inc. with violating whistleblower rules because it required witnesses to sign confidentiality agreements which warned that a witness could face discipline if he/she discussed the matters with third parties without prior approval.
  - KBR paid a \$130,000 penalty.
  - No evidence that any witness was ever in fact dissuaded from going to SEC –only the potential.
  - Upshot: every public company needs to examine confidentiality agreements with its employees with the assistance of counsel and redraft if the agreements can be read to dissuade or chill employees from becoming a whistleblower.
    - Consider putting in agreements specific statement like: “nothing in this agreement prohibits any person from reporting concerns to the SEC or other governmental agency”.
  - Be particularly sensitive to these issues when negotiating a severance agreement with employee who is, or you have reason to believe, might be a WB.

# SEC Action against BlueLinux for Monetary Recovery Waiver in Severance Agreements

- On Aug. 10, 2016 Atlanta-based building products distributor settled charges that it violated whistleblower protection rule by using severance agreements that required outgoing employees to waive their rights to monetary recovery should they file a charge or complaint with the SEC or other federal agencies.
- BlueLinux Holdings Inc. agreed to pay a \$265,000 penalty.
- Also agreed: (1) to amend its severance agreements to make clear that employees may report possible securities law violations to the SEC and other federal agencies without BlueLinux's prior approval and without having to forfeit any resulting whistleblower award, and (2) to make reasonable efforts to contact former employees who had executed severance agreements after Aug. 12, 2011 to notify them that BlueLinux does not prohibit former employees from providing information to the SEC staff or from accepting SEC whistleblower awards.

# How to Lessen Exposure to Whistleblower Allegations

- Create a Whistleblower-friendly environment
  - Appropriate tone at the top
  - Adequate resources dedicated to compliance
  - Communicate internal reporting outlets/hotlines
  - Respond timely
  - Follow-up with whistleblower
  - Develop a plan to deal with anyone who reports within the company
  - Guard against retaliation – deal with the issue, not the messenger



# Balancing Whistleblower Rights with Protection of Company

- A whistleblower does NOT have any right to be informed of developments with respect to their tip.
  - But could be beneficial for evaluating results of investigation.
  - May go a long way to lessen the concerns of the employee.
- Retaliation is not allowed.
  - It is illegal to discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower.
  - Violating these provisions 1) gives rise to a private right of action by the whistleblower; and 2) subjects the company to potential criminal liability or SEC sanctions.

Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY

BIOGRAPHIES

# Biographies



**Peter Chan**

**Partner**

Chicago

+1.312.324.1179

[peter.chan@morganlewis.com](mailto:peter.chan@morganlewis.com)

Peter K.M. Chan brings two decades of experience at the US Securities and Exchange Commission (SEC) to his litigation and counseling work. He represents public companies, financial services firms, and other organizations in litigation, investigations, and regulatory actions by federal agencies. Former head of the SEC Chicago office's Municipal Securities and Public Pensions Unit, Peter also advises clients on compliance and regulatory matters impacting the municipal securities markets and investments by public pensions and other institutions.



**Celia Soehner**

**Associate**

Pittsburgh

+1.412.560.7441

[celia.soehner@morganlewis.com](mailto:celia.soehner@morganlewis.com)

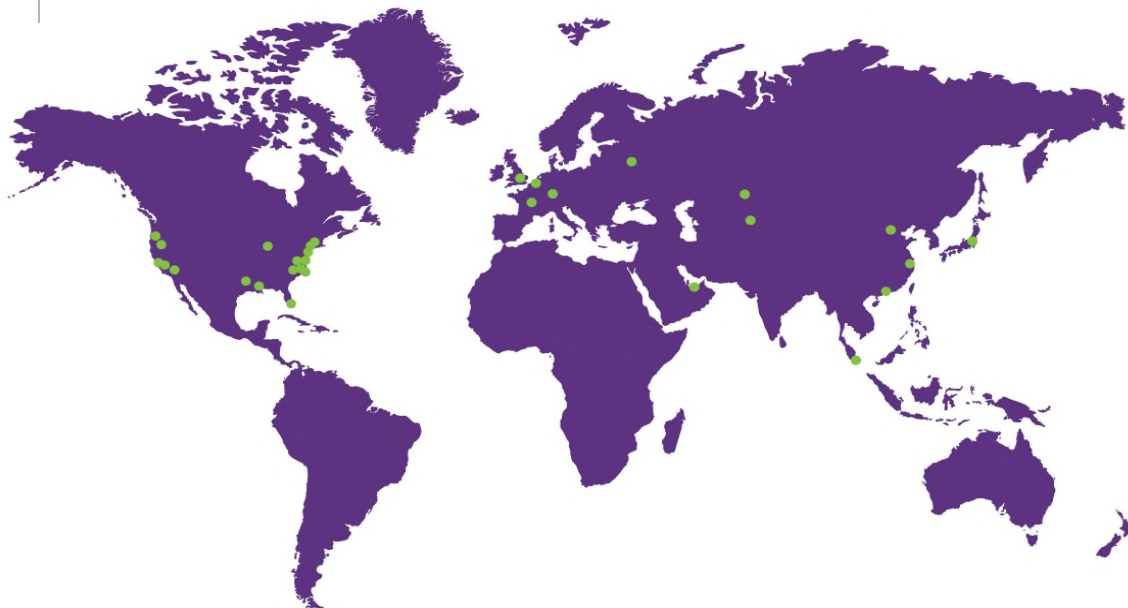
Celia A. Soehner focuses her practice on advising public companies with respect to corporate governance, federal securities laws, stock exchange and executive compensation matters. She also advises clients in connection with mergers and acquisitions and capital market transactions.

## Our Global Reach

Africa  
Asia Pacific  
Europe  
Latin America  
Middle East  
North America

## Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



# Morgan Lewis

\*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

# THANK YOU

© 2018 Morgan, Lewis & Bockius LLP  
© 2018 Morgan Lewis Stamford LLC  
© 2018 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

\*Our Beijing office operates as a representative office of Morgan, Lewis & Bockius LLP. In Shanghai, we operate as a branch of Morgan Lewis Consulting (Beijing) Company Limited, and an application to establish a representative office of the firm is pending before the Ministry of Justice. In Hong Kong, Morgan Lewis has filed an application to become a registered foreign law firm and is seeking approval with The Law Society of Hong Kong to associate with Luk & Partners.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes.  
Attorney Advertising.