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Davis Polk Webcast

# **SEC Whistleblower Rules: What You Need to Know**

Presented by

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**Davis Polk**

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# Today's Discussion

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- Overview of Final Rules
  - Key Changes from 2010 Proposal
- Implications for
  - Conduct of investigations
  - Dealing with the SEC
  - Corporate policies

# Presenters



## **Linda Chatman Thomsen**

Linda is a partner in our Litigation Group and practices in our Washington DC office. Her practice concentrates in matters related to the enforcement of the federal securities laws. She returned to the firm after serving for 14 years in various positions within the SEC. Linda joined the SEC staff in 1995 as Assistant Chief Litigation Counsel. In 1997, she was named Assistant Director of the Enforcement Division. She became an Associate Director in 2000, Deputy Director in 2002 and was named Director of the Enforcement Division in 2005, a position she held until 2009.



## **Angela T. Burgess**

Angela is a partner in Davis Polk's Litigation Department. She represents clients in a wide variety of criminal, regulatory, advisory and civil matters. Her white collar criminal and regulatory matters have involved allegations of securities fraud, insider trading, violations of the Foreign Corrupt Practices Act, money laundering, antitrust, fraud and other financial crimes. Ms. Burgess also advises companies on corporate governance issues and the implementation of effective compliance programs, including with respect to the Foreign Corrupt Practices Act, insider trading and anti-money laundering policies.

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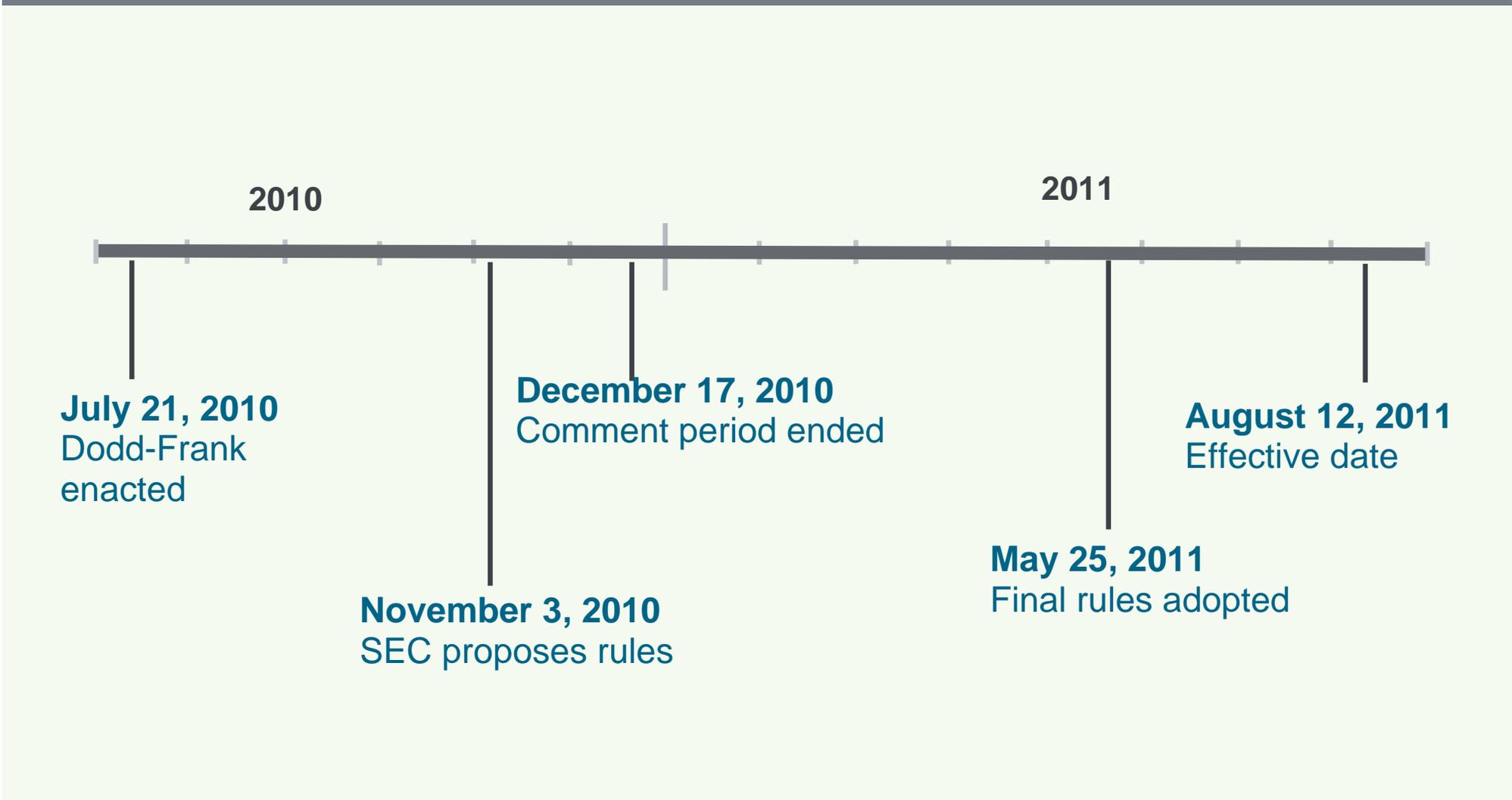
## Presenters *(cont.)*



### **William M. Kelly**

Bill is a partner in our Corporate Group and a founder of our Menlo Park office, where his practice focuses on mergers and acquisitions and corporate governance, primarily representing technology companies. Bill joined Davis Polk in 2000 from Silicon Graphics, where he spent six years as general counsel and in a variety of roles as a senior business executive.

# Whistleblower Rules: Chronology



# Key Statutory Requirements

## Mandatory awards of 10-30% when:

- One or more whistleblowers *voluntarily* provides the SEC/CFTC
- With *original information*
  - Derived from independent knowledge or analysis.
- That leads to the *successful enforcement* by the SEC/CFTC of an action
  - Which caused the staff to commence an action; or
  - Where the information would not have otherwise been received and was essential to the success of an ongoing action.
- In which the SEC/CFTC obtains monetary sanctions totaling *more than \$1 million*

# High Stakes: Recent Settlements

## FCPA

- Siemens: \$330 million
- Haliburton/KBR: \$177 million
- ENI S.p.A. and Snamprogetti Netherlands BVI: \$125 million
- Technip SA: \$98 million
- Daimler AG: \$91.4 million

## Other Recent SEC Sanctions

- Goldman Sachs – financial fraud: \$550 million
- American Skandia Investment Services – late trading: \$68 million
- General Electric – financial fraud: \$50 million

# Qualifying as a “Whistleblower”

- Rule requires that the person have a “reasonable belief” as to a possible securities law violation
  - Objective standard: more than just good faith
  - No need to make a materiality determination
- Information must be reported as required by rule
- Important not only for determining award eligibility but also for protection from retaliation
  - Anti-retaliation provisions apply even if not eligible for award.

# When is Information “Voluntarily” Supplied?

- Rule provides that information will not be deemed to have been supplied “voluntarily” by a person if that person has received a request or demand from the SEC or other designated authority, even if not legally compelled
- Exclusion does not apply:
  - Where (as is customary) request has been made to the issuer rather than to individuals
  - Where company has requested information as part of an internal investigation, even if prompted by the SEC

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# Balancing Act: Whistleblowers and Corporate Compliance Programs

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- Focus of comment process
- Corporate community concern:
  - Program will undermine corporate programs
  - Some “gatekeepers” could be unjustly enriched
  - Employees should be required to use existing corporate programs

# Changes from Proposed Rules

- Generally more deferential to whistleblowers
- Expansion of eligibility
  - Deletion of requirement that tip “significantly contributed” to successful enforcement action
  - Narrowed disqualification from reward eligibility based on whistleblower’s duty to prevent or report misconduct (lawyer, accountants, compliance personnel)
  - Monetary amounts from several smaller actions can be aggregated to meet \$1 million threshold
- Easier to report
  - Simplified reporting and form

# Impact on Internal Compliance Programs

- Rules do not require whistleblowers to use internal compliance systems first
- But do provide incentives:
  - Employees who report information internally can preserve their “place in line” so long as they disclose the information to the SEC within 120 days (versus 90 days in proposal)
  - Award can be increased or decreased based on employee’s efforts to utilize or *hinder* internal compliance systems
  - A whistleblower who reports internally may be eligible for an award even if the company passes the information along to the SEC before the whistleblower does

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# Information and Persons Ineligible for Awards

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- Information obtained through a communication subject to attorney-client privilege or as a result of legal representation
- Officers and directors, auditors, compliance personnel, and persons in similar roles

# Exception to Disqualifications: Non-Attorneys

- Auditors, compliance personnel and others, except lawyers and those with privileged information, will be eligible for an award if:
  - Disclosure is necessary to prevent substantial injury to the financial interests of the entity or investors, or
  - The entity is engaging in conduct that will impede an investigation; or
  - 120 days has passed since the whistleblower reported internally, or, in the case of information already known by senior personnel, received the information, and senior personnel has failed to report
- Attorneys or others with privileged information will be eligible for an award if disclosure is permitted under attorney conduct rules

# Exception to Disqualifications: Attorneys

- Attorneys or others with privileged information will be eligible for an award if disclosure is permitted under attorney conduct rules
- SEC attorney conduct rules permit attorney disclosure
  - To “prevent” “material violation that is likely to cause substantial injury”
  - To prevent perjury or fraud upon the Commission
  - To “rectify the consequences” of a material violation that caused or may cause “substantial injury”
  - Failure of issuer to self-report is not in itself a basis for disclosure
- Comparable rules in many states

# Restrictions on Awards for Wrongdoers

- Rules limit awards to whistleblowers who:
  - have been criminally convicted in connection with misconduct
  - have been required to pay monetary sanctions (e.g. in an SEC civil enforcement proceeding); or
  - directed, planned, or initiated conduct that has led to entities being required to pay sanctions
- Rules exclude from base recovery amount (minimum \$1 million) any recoveries tied to whistleblower's own wrongdoing.

# Anti-Retaliation Provisions

## ■ Sarbanes-Oxley

- Covers whistleblowers who report both internally and externally
- Must go to Department of Labor with complaint first

## ■ Dodd-Frank

- More generous procedurally to whistleblowers
  - Allows a claim to be filed six years after the retaliation or three years after the date when the facts about the retaliation should have been known.
  - Whistleblower may go directly to district court.
- May also be enforced by the SEC

# What's Happened So Far?

- Published reports suggest a spike in whistleblower complaints since Dodd-Frank passage in July 2010
  - Staff public position: volume is manageable and many tips are high quality
  - But no publicly available results
  - Enforcement staff will generally not inform issuers as to whether the information source is a whistleblower.
- Plaintiffs' bar is beginning to gear up
  - See, e.g., [SECSnitch.com](http://SECSnitch.com)
  - But the first team doesn't yet appear to be on the field

# Impact on SEC Enforcement Processes

- Enforcement Staff has indicated that in most cases it will refer complaints to issuers for initial response
- Staff's handling of initial whistleblower rewards will be key
- Staff will need to make it clear that:
  - Use or misuse of internal compliance systems will be a “real” factor in determining rewards
  - Reports by legal, audit and compliance personnel will only be rewarded where internal compliance systems are clearly broken
  - Staff cooperation with compliance systems and internal investigations will be a key part of the program

# Impact on Internal Investigations

- Companies should be prepared to deal with significantly greater volume and scope of internal investigations and enforcement threats
  - Enhanced time pressure for conducting investigations
- Consider staffing implications for investigations. Companies may be more inclined to use attorneys because of
  - their more limited whistleblower opportunities and
  - the exclusion, in most circumstances, of information learned through the attorney client privilege from whistleblower submissions.

# Disclosures to Enforcement Staff: How “Voluntary”?

- Dilemma:
  - Self-report to Enforcement Staff early in the process to try to get ahead of the whistleblower?
  - Or conduct preliminary investigation first?
- Will whistleblowers rely on the 120-day lookback?
- Impact of whistleblower on investigation and settlement dynamics

# Self-Reporting

***“[W]ith the enactment of the Dodd-Frank bill and the increased inducements to whistleblowers, every corporate client now faces something of a prisoner’s dilemma upon the discovery of misconduct. Prosecutors will no doubt not consider it a point in a company’s favor if its self-reporting post-dates the report of a corporate whistleblower. And so it is more important than ever to make a bee-line for the SEC and/or my office when something hits the fan.”***



– Preet Bharara, U.S. Attorney for the SDNY

# Corporate Policy Implications

- Key goal:
  - motivate employees to report internally first, but
  - avoid retaliating against them for reporting to government first
- Policy can require internal report and that employees annually certify that they have reported all known or suspected compliance violations.
- Can employer take action with respect to an employee who makes an “unreasonable” complaint?
- Impact on communication and training programs

# Contact Information

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