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EXPERT ANALYSIS

Dos and Don'ts Under the SEC Whistleblower Rules

By David Nelson, Esq., and Eli Glasser, Esq.
Boies, Schiller & Flexner

Since the implementation in 2010 of the U.S. Securities and Exchange Commission's whistleblower regulations, they have been the topic of endless speculation, fascination and analysis by the securities defense bar. But their practical impact so far has been relatively muted.

According to the SEC website, there have been about four whistleblower actions a year.[1] Despite the protections in place, whistleblowers apparently still fear loss of confidentiality and retaliation. And these risks loom larger because awards rarely provide the whistleblower with the option of completely "walking away" from the industry.[2]

On the other hand, recent events have received plenty of publicity and may incentivize and embolden other employees to come forward. These events include the $30 million "bounty" paid to a whistleblower[3] and the SEC's first action based on overly restrictive language in confidentiality agreements with the potential to stifle whistleblowing.[4]

The net result may be a long-anticipated increase in the number of actions the SEC has initiated as a result of whistleblower complaints.

While every lawsuit filed against a company presents a disruption, an action filed by the SEC premised on particularized information that a whistleblower provides can be especially problematic, leading to a storm of litigation including follow-on private suits.

To effectively deal with such a scenario, companies need plans and key players in place to navigate a response on every front.

This commentary discusses what steps companies should take to soften the impact of a potential whistleblower claim. The steps include:

- Creating a corporate culture that encourages internal reporting.
- Discussing how companies can prepare for the impact that reporting such information to the SEC or other outsiders will have.
- Interacting productively with the SEC once an investigation is started or a complaint is filed.
- Effectively managing the multiple fronts on which litigation is likely to arise.

OVERVIEW OF THE SEC'S WHISTLEBLOWER PROGRAM

Under the Dodd-Frank whistleblower pro-gram, 15 U.S.C. § 78u-6(b), a whistleblower who provides information leading to a successful SEC enforcement case that results in sanctions exceeding $1 million is eligible for awards of between 10 percent and 30 percent of the money collected.

Moreover, under 15 U.S.C. § 78u-6(h)(1)(A) whistleblowers who report potential violations of federal securities laws are protected from, among other things, retaliation for providing information to the SEC or assisting in an SEC investigation or enforcement action.

The SEC's whistleblower program went into effect in July 2010 when the Dodd-Frank Wall Street Report and Consumer Protection Act was signed into law.

PLANNING AHEAD

While a whistleblower "event" is not a common occurrence, the failure to have policies and procedures in place can quickly turn such an event into a disaster. There is no single template for a reaction plan as variations must be made to suit the organization and the particular issues in play. But several common critical elements exist.

Most importantly, the procedures and policies must be robust and well publicized within the company. An important goal, among others, is to earn the trust of employees so they will feel confident that their concerns will be considered and addressed if they make use of internal means. It is said often (because it is true) that an internal reporting program's success hinges greatly on the "tone at the top."

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Every effort must be made to both ensure employees that senior executives are committed to these principles and to clearly communicate them down the supervisory chain. An emphasis on early and effective internal reporting is critical to getting ahead of issues that can present significant challenges for the company.

Unless there is a compelling reason not to, the company's policies and procedures should require that the chief legal officer in the company be informed of any whistleblower complaint. If the organization is too large for the CLO to handle the matter directly, he or she should be informed promptly and fully of any developments. The CLO should continue to have overall supervisory responsibility for any investigation or inquiry. The importance of reporting upward is not limited to senior executives. Procedures should be instituted to confirm that the need for prompt and accurate reporting up the chain is acknowledged at all supervisory levels.

Part of the remediation undertaken in the aftermath of a whistleblower's revelation is to show the public company's primary regulator, the SEC, that the company undertook in advance significant steps to foster a culture that would be receptive to and act on information from employees. Accordingly, the procedures should be carefully and fully documented because the company will want to demonstrate that any failure to fully address a whistleblower complaint resulted from isolated failures within an otherwise effective and responsive system.

This is an important prong in demonstrating to regulators that they can rely on the company's response because the company had a process in place that served to surface, elevate and address legitimate internal complaints.

Other issues, less directly related to "reporting up the chain," ought to be considered during the planning stage as well:

- Evaluate the board. Before a crisis, senior management should take stock of the roster of current board members and key committee chairs. Can key members be counted on to respond to a crisis in a measured and effective manner? Will independent directors get engaged and provide credibility to company decisions and direction? Will the board and its committees have a measured response that includes substantiating management's version of events? Can they be counted on to make good decisions that benefit the company and its shareholders?

- How is management's "bench strength?" What are the overall capabilities of the management team? If the nature of a whistleblower's allegations requires temporarily or permanently removing a key executive, will the company be able to survive such a loss?

- Develop a "short list." A further pre-crisis consideration for the company and its senior management team is whether management and the board (specifically the audit committee) can confer and agree on a short list of candidate law firms for internal investigation. This is necessary to create a "buy in" that proves the process will be both fair and quickly implemented. Will the company put a "crisis firm" on retainer (or speed dial) to handle press? If this process is undertaken, clearly the company will want to identify firms that have sufficient familiarity with the company and resources to carry out a potentially complicated and multi-dimensional inquiry. On the other hand, the familiarity by definition has to be limited. Candidates for the short list must have the requisite objectivity and neutrality that will resonate with regulators.

Establishing a framework for whistleblower responses is an important component of navigating the complaint and investigation process. The company is best served if the procedures and protocol are regularly refined and updated, particularly taking into account the latest developments in whistleblower practices and the law.

REACTING TO A COMPLAINT: NONPUBLIC PERIOD

Dealing with the whistleblower

Upon being served with a complaint or when first learning of an investigation a whistleblower initiated, a company must take immediate steps to protect the whistleblower from any real or perceived retaliation and also must maintain his or her anonymity.

Document retention

One of the first steps companies must take when responding to a complaint is to send out appropriate document-retention notices. Management needs to get an early handle on what's involved in terms of documents and people. Employees holding potentially relevant information must be quickly advised to cease all routine destruction policies. Companies must ensure that their C-suite execs understand the importance of maintaining records for their own protection and for appearances' sake.

The destruction of potentially relevant evidence, even if unintentional, can complicate investigations and create the appearance that the company has something to hide. To avoid engaging in damage control and refuting allegations of spoliation, the company will need to get ahead of these situations with timely and clear document-retention notices circulated to all potential custodians. The company must also have policies in place to ensure the notices are being reviewed and followed.

Representation issues

In addition to retaining a law firm to assist the company in responding to the complaint, management must evaluate whether separate counsel is needed for current or former executives who will be involved in the litigation. The company must maintain current contact information for all relevant ex-employees so that these former employees have contact with company counsel and are forewarned about possible approaches by the government. Former employees should know to direct all communication with government agents and others to company counsel.

Internal investigation

A company must move decisively and deliberately on an internal investigation. A whistleblower has 120 days to go to the SEC to preserve rights to an award. During this period the company's outside counsel (in consultation with in-house counsel) must devise a timeline on when a sufficient understanding of issues has been obtained to report to the SEC and present an investigative plan. If the company appears to be acting responsibly and diligently, the SEC will generally await a final report.

Proactive and early communications with the agencies heading the investigation are important opportunities to show the government that the matter is being taken seriously and handled competently.

SHORT-TERM CONSIDERATIONS

Once the whistleblower complaint becomes widely known within the organization, particularly after the work of the investigation begins, the company must promptly take further steps to protect and insulate the whistleblower from any recriminations. This protects both the company and the complainant's immediate and up-line supervisors. On the other hand, the firm must take care not to overreact by isolating the whistleblower so that the company is open to a charge that it has retaliated against the whistleblower by making him or her a pariah.

At least two meetings should be held (one with and one without the whistleblower's supervisor) to clarify that the complaint is being addressed, that it is unavoidable that others will learn about it, and that the company is committed to ensuring that the whistleblower's employment situation remains as normal as possible.

Also the company must clearly demonstrate that the complainant has an open channel to report anything untoward. These steps should be taken in the presence of in-house counsel, and the attending lawyers should thoroughly document them. Depending on the seriousness and sensitivity of the complaint, outside counsel (including a representative from the firm retained as an independent investigator) might also attend.

The company should designate a single person to act as the clearinghouse for communications with the government and vet the messages for accuracy and completeness.

The company should be prepared to handle employee questions, as there will be plenty. It should strive for a balance between preserving the confidentiality of employees' conversations with in-house counsel with its ability to provide information as needed to the SEC. Conversations that occur as part of an internal investigation will need to be qualified with so-called *Upjohn* warnings, in which employees are clearly informed that company counsel represents the company's interests — not the employee's.[5]

While these are sometimes referred to as "internal Miranda warnings" because of the potential chilling effect they can create, with some effort they can be delivered in a manner that informs the employee without shutting down all lines of communication.

As the internal investigation takes shape, management should reinforce the message to employees regarding what's at stake when they consent to informal interviews. They should be carefully informed that their statements could be part of a written investigation, and the company holds and can waive privilege and present to government investigators the substance of employee interviews. From time to time, this will inevitably raise the sticky issue of the consequences for an employee who wishes to not cooperate with the internal investigation.

Because the factual circumstances are so varied, that topic itself could occupy an entire commentary. Suffice it to say that the situation needs to be carefully vetted with securities and employment counsel.

In addition to the question of non-cooperation, other knotty issues will arise and need to be addressed. A prime example is deciding which employees are entitled to their own counsel. For obvious reasons, it will generally be the most senior people in the organization who were closest to the issues the complainant raised. However, as the investigation develops, management will want to be sensitive to corollary or even new issues that might arise, and change the complexion of discussions about personal counsel for executives. The company will also need to decide when and how to communicate with employees and, prior to reporting to the SEC, what to say to the press.

The preferred course is to make early contact with the SEC, before press accounts arise, even if only to provide a very broad picture. As a general rule, during the investigation "less is more" in terms of public statements, and much thought and effort must be put into any press releases during this time. Given the many shoals to navigate, this is not always an easy stage for a public company. The company should consider whether it wants to deploy a public relations or crisis firm as mentioned above.

REPORTING OUT TO THE SEC AND JUSTICE DEPARTMENT

Proactive and early communications with the agencies heading the investigation are important opportunities to show the government that the matter is being taken seriously and handled competently. Although early reports will be preliminary and general, the company should emphasize the details of the plan going forward.

Early meetings should cover the logistics of communications with the agencies. For instance, the company should confirm that requests for documents and employee interviews should be made to company counsel. This will minimize disruption and allow in-house counsel to deal with issues such as scope and privilege. Government agencies will generally find this arrangement acceptable if the company has convinced them that it is handling the situation responsibly.

Throughout the investigation, the company should provide the government with regular updates. This may seem obvious but it's not always done. The company should designate a single person to act as the clearinghouse for communications with the government and vet the messages for accuracy and completeness.

SETTLING IN FOR THE LONG HAUL

While the company must exercise restraint with its public statements during the investigation, it must also immediately begin to consider when it will be necessary to "go public." Will this be done in stages? Is it appropriate to make a preliminary disclosure of the issues with any restatements of financials coming much later, perhaps after the investigation?

Detailed public reporting of the internal investigation's findings should be postponed until the company has a high level of confidence in their accuracy and completeness. Any delays in reporting can be mitigated by accurate forecasts of when additional information will be available. Public disclosure will have consequences, but so does uncertainty.

In addition to government interest, class action and derivative suits will spring up immediately after public disclosure. Other civil suits might arise over any drop in the stock price that could be associated with the public disclosures. Attempting to consolidate the actions will generally be a good idea. In addition, coordination of the legal teams involved (such as making sure executives' personal lawyers are talking to company counsel) is key to managing the process.

And when dealing with a serious govern-ment investigation, particularly when there is the potential for criminal proceedings, it is often wise to try to resolve other civil actions early and prior to any government-related discovery or adverse findings.

GOING FORWARD

The jury is still out on the long-term impact of the whistleblower provisions. Stories of multimillion-dollar payments to whistleblowers clearly will attract a lot of attention, but the effect will be tempered by the multiple instances in the program's short history when whistleblowers have had their identities revealed or been the subject of retaliation.

While to date the numbers are not what might have been expected when the program was rolled out, that calculus may change. Moreover, recent litigation and court decisions in the area of retaliation reinforce the need for companies to focus on these issues in advance.

In the meantime, it is never a mistake to prepare for a corporate crisis around the surfacing of unflattering information about a company either from a whistleblower or from any other source. The time to take measure of procedures is clearly before the need arises to implement them.

NOTES

[1] According to the SEC's website, only 11 of 34 dispositive orders on whistleblower applications have been granted through March 2, 2015. *See* https://www.sec.gov/about/offices/owb/owb-final-orders.shtml.

[2] William D. Cohan, *High Risk but Little Reward for Whistle-Blowers,* N.Y. TIMES, Mar. 26, 2015, *available at* http://www.nytimes.com/2015/03/27/business/dealbook/high-risk-but-little-reward-for-whistle-blowers.html?_r=1.

[3] Sarah N. Lynch, *U.S. SEC to pay $30 million-plus in largest whistleblower award,* REUTERS, Sept. 22, 2014, *available at* http://www.reuters.com/article/2014/09/22/us-sec-whistleblower-idUSKCN0HH2EM20140922.

[4] Press Release, Sec. & Exch. Comm'n, Companies Cannot Stifle Whistleblowers in Confidentiality Agreements (Apr. 1, 2015), *available at* http://www.sec.gov/news/pressrelease/2015-54.html.

[5] *Upjohn Co. v. United States,* 449 U.S. 383 (1981).

David Nelson (L) and **Eli Glasser** (R) are counsel in the Fort Lauderdale, Fla., office of **Boies, Schiller & Flexner**. From 2000 to 2009 Nelson served as regional director of the Securities and Exchange Commission Southeast regional office, now known as the Miami regional office.