

# A Whistleblower in Your Midst: Preparing for a Post Dodd-Frank World

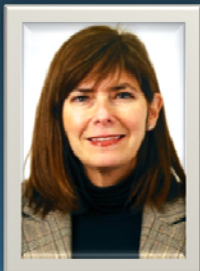
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Amy L. Bess, Shareholder, Vedder Price P.C.  
Joseph M. Mannon, Of Counsel, Vedder Price P.C.  
Jeannette L. Lewis, Principal, Deloitte & Touche LLP

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## Jeannette L. Lewis



Deloitte & Touche LLP  
111 South Wacker Drive  
Chicago, Illinois 60606  
312-486-2151  
jealewis@deloitte.com

Jeannie is a Principal in the Governance, Regulatory, and Risk Strategies practice of Deloitte & Touche LLP. She specializes in providing regulatory compliance, risk management, litigation support, and business advisory services to investment advisers, investment companies, service providers, financial intermediaries, hedge funds and private equity firms.

Prior to Deloitte, she was the Assistant General Counsel of Driehaus Capital Management LLC. Jeannie has substantial SEC experience, having served in the Chicago Regional Office for over 18 years; spending eight years in the Regulation Division, with the last three years as Associate Regional Director of the Investment Management Examination Program, and 11 years in the Enforcement Division.

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**Amy L. Bess**



Shareholder  
202-312-3361  
abess@vedderprice.com

Amy L. Bess is a Shareholder in the Washington, D.C. office of Vedder Price P.C. and a member of the firm's Labor and Employment Practice Area.

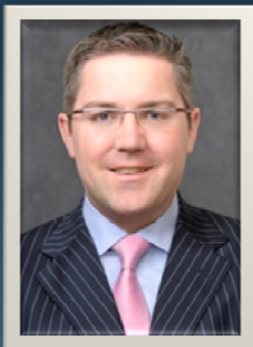
Her employment litigation experience includes the representation of employers before state and federal courts and administrative agencies, defending against claims of race, sex, disability and age discrimination, sexual harassment, whistleblowing, restrictive covenant disputes, wrongful termination and wage and hour violations. She regularly counsels clients in all of these areas, drafts and negotiates employment and severance agreements, conducts on-site workplace investigations, presents training seminars and speaks to employer groups on avoiding workplace problems.

Ms. Bess has first-chair bench trial, jury trial and arbitration experience and is regularly involved in mediations. She also is experienced in the defense of complex class action litigation, including pattern or practice litigation brought by the U.S. Equal Employment Opportunity Commission.

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**Joseph M. Mannon**



Of Counsel  
312-609-7883  
jmannon@vedderprice.com

Joseph M. Mannon is a member of Vedder Price P.C.'s Investment Services Group.

Mr. Mannon focuses his practice on legal and compliance matters for investment advisers, mutual funds, closed-end funds and unregistered vehicles such as hedge funds, hedge fund of funds and other investment entities. With regard to unregistered vehicles, he frequently counsels clients on fund formation and structuring matters for funds organized both in the United States and abroad. He also counsels clients on issues relating to commodity trading advisers and commodity pool operators.

Prior to rejoining the firm in 2011, Mr. Mannon served as an in-house counsel for a fund of hedge fund manager and prior to that served as an attorney for the Division of Enforcement of the U.S. Securities and Exchange Commission from 2001 to 2004. At the Commission, he litigated federal district court actions and conducted numerous investigations, including complex financial fraud investigations.

In 2000, Mr. Mannon served as a judicial intern to the Honorable John W. Darrah, U.S. District Court for the Northern District of Illinois.

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## Pre-Dodd-Frank Sarbanes-Oxley Act of 2002 (“SOX”)

- ✦ Passed to protect whistleblowers in publicly-traded companies and public accounting firms in the wake of Enron, WorldCom, Tyco, etc.
- ✦ Who is covered?
  - Current and former employees (now includes employees of subsidiaries)
  - Contractors, subcontractors and agents
- ✦ What is protected?
  - Reports of fraud, securities fraud or fraud against shareholders
  - A “reasonable belief” of a violation is required
  - Whistleblower is protected even if allegation ends up being incorrect
- ✦ No preemption of state law protections

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## Pre-Dodd-Frank SOX—Employee Reporting

- ✦ Up-the-chain reporting
- ✦ Disclosure first must be made to employee’s supervisor, or persons in the company who investigate misconduct
  - Report to the board of directors if management is involved in the fraud
  - Can report to federal regulatory agency with authority to investigate the conduct
  - Can also report to any member of Congress

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## Pre-Dodd-Frank SOX Retaliation Protection— Section 806

- ✦ A “covered company” cannot take retaliatory action against a whistleblower
  - Also protected if refuse to partake in the unlawful conduct
  - Complaints must be lodged with OSHA within 90 days (Dodd-Frank expands this to 180 days)
- ✦ Whistleblower may sue for retaliation
  - Reinstatement and back pay
  - Mental pain and suffering
- ✦ SOX whistleblower retaliation claim process viewed as ineffective

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## Pre-Dodd-Frank SOX—Examples of Retaliation

- ✦ Cannot fire, suspend, demote, threaten, harass or take other action that would dissuade someone from reporting
  - Includes creating a hostile work environment
  - Does not need to directly impact a term or condition of employment or impact an employment decision
  - Test would a reasonable employee or applicant be dissuaded from making a complaint had the employer’s response been known
  - Treatment of similarly situated employees is very relevant
  - “Minor disruptions and annoyances” are not enough
  - Supreme Court has ruled that close associate of whistleblower (fiancé) of whistleblower also protected

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## State Law

- ◆ Illinois Whistleblower Act - employers cannot enforce any rule or policy that prevents an employee from disclosing information in good faith about a violation of a federal, state or local law to a governmental or law enforcement agency
  - No retaliation
  - Employee also protected if refuse to partake in the unlawful conduct
  - Violation a Class A misdemeanor and can result in reinstatement and damages, including back pay, litigation costs and attorney's fees

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## Dodd-Frank Wall Street Reform and Consumer Protection Act

- ◆ Signed into law July 21, 2010
- ◆ Whistleblower provisions effective June 22, 2010 (yes, last year)
- ◆ What are the major changes under Dodd-Frank?
  - Applies to violations of securities (including FCPA) and commodities laws
    - ▶ CFTC yet to adopt whistleblower rules
  - No longer limited to publicly traded companies
  - Bounty incentivizes employees to report to SEC
  - Shorter time period for companies to evaluate complaints
    - ▶ The race to report

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## Who Is a Whistleblower Under Dodd-frank?

- ✦ Employees
- ✦ Employees involved in misconduct?
  - Yes, unless convicted
  - SEC may consider conduct in determining bounty
- ✦ Former Employees
- ✦ Vendors
- ✦ Agents
- ✦ Contractors
- ✦ Clients
- ✦ Customers
- ✦ Competitors

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## Who Is Not a Whistleblower?

- ✦ Those informed of allegations of misconduct
  - Officers
  - Directors
  - Trustees
  - Compliance
- ✦ Except when necessary to prevent substantial injury (i.e., financial harm)
- ✦ Lawyers
  - Outside counsel
  - In-house counsel
  - Auditors
- ✦ Foreign government officials
- ✦ Those with pre-existing obligations to report violations

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## To Whom Can the Whistleblower Report?

- ✦ **No requirement to report internally to receive bounty**
- ✦ Whistleblower can go directly to the SEC
- ✦ **Internal Reporting**
  - Incentives to report internally first as may be eligible for a larger bounty
  - Deemed to have reported to SEC if report to SEC within 120 days of internal report
  - Bounty amount based in part on internal reporting/cooperation

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## Bounty Provision Explained

- ✦ SEC shall pay an award to a whistleblower who:
  - Provides voluntarily
  - Original information
  - Leading to a successful enforcement action resulting in the collection of  $\geq$  \$1 million in sanctions
    - Hard to get award if investigation already underway
- ✦ Award
  - 10% to 30% of the sanctions collected
- ✦ Whistleblower anonymity unlikely

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## Bounty Provision Explained

- ✦ “Voluntarily”
  - Prior to request by SEC or various other regulators (PCAOB, FINRA, Congress, state attorney general, etc...) for such information “directly” from the whistleblower
  - SEC will use Seaboard factors to evaluate whether information was voluntarily submitted

## Bounty Provision Explained

- ✦ “Original Information”
  - Not known to SEC
  - Derived from independent knowledge
    - ▶ Not from public sources
    - ▶ Can be from other employees, clients and vendors
    - ▶ Not necessarily direct first hand knowledge
  - Not derived from allegations in judicial or administrative hearings
  - Can even be obtained illegally!



## Whistleblower Protections

- ✦ Prohibited Retaliation
  - Discharge
  - Demote
  - Suspend
  - Threaten
  - Harass
  - Discriminate
- ✦ Protected Conduct
  - Reporting to SEC
  - Participation in SEC investigation
  - Making disclosures required or protected under any law or regulation within SEC's jurisdiction

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## Employee Retaliation Suits

- ✦ Six years to bring a claim
- ✦ Back pay doubled
- ✦ No need to seek administrative relief (SOX) before bringing suit in federal court
- ✦ *Potential for SEC enforcement action against employer for retaliatory actions against employee*

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## What Should Employers Do?

- ◆ Encourage internal reporting
  - Why?
    - ▶ Sentencing guidelines/SEC may give credit
  - Educate about bounty program
    - ▶ Explain employee can still receive bounty if report internally
    - ▶ Explain employee may receive more \$ if report internally first
    - ▶ Explain that SEC will look favorably on internal reporting/cooperation in setting bounty
  - Explain risk of false reporting
  - Remind employees about confidentiality obligations
    - ▶ Can't talk with third parties (other than government and counsel)

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## How are Firms Responding to Dodd-Frank?

- ◆ Reviewing internal reporting requirements
  - Developing robust training programs that include training managers on avoiding retaliation
  - Creating a detailed exit interview process
- ◆ Implementing hotlines—anonymous hotlines for employees and others
  - Developing internal multi-disciplinary response SWAT team
  - Reviewing internal audit and audit committee functions

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## Responding to Internal Complaints

- ◆ Firm Culture of Compliance
  - Employee more likely to report if believe complaint will be taken seriously
- ◆ Create the swat team
  - Senior management
  - In-house counsel
  - Compliance
  - Outside counsel (pre-selected)
  - Outside consultants (pre-selected)
- ◆ Conduct prompt and thorough investigation (does not necessarily need to be done in 120 days)

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## Responding to Internal Complaints

- ◆ Use results of investigation to satisfy whistleblower and avoid SEC reporting
- ◆ Consider self reporting (preempt a whistleblower)
  - The reporting race

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## Responding to Regulators

- ✦ If the whistleblower goes to the SEC, what do you do?
  - Understand the seriousness of the alleged conduct
    - ▶ Fraud versus non-scienter based conduct?
  - Preferable to conclude internal investigation before responding
- ✦ How to do deal with the whistleblower?
  - Don't retaliate
  - Keep whistleblower generally informed of progress of investigation and ensure dealing with it seriously
  - If whistleblower is anonymous, attempt to carefully identify whistleblower
  - Review company procedures and determine if any procedures were violated