Stay Afloat During the Tidal Wave of FCPA Cases

BY ARON FRIEDMAN, MARA V.J. SENN, WHITNEY MOORE AND CHIEKO CLARKE

The whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) have already significantly impacted the FCPA landscape. According to a recent article in *The Wall Street Journal*, since July, when the provisions went into effect, the Securities and Exchange Commission (SEC) has received at least one report a day about possible foreign bribery from whistleblowers.[1]

The Dodd-Frank Act was passed by Congress and signed into law by President Obama on July 21, 2010, and contains provisions for whistleblower incentives and protections. The Dodd-Frank Act essentially transforms employees of public companies and third parties familiar with the inner workings of those companies into the eyes and ears of the SEC. It gives those who blow the whistle on potential violations of securities laws, including potential violations of the FCPA, a reward of 10 to 30 percent of the total amount recovered in a successful government enforcement action, where such recovery is at least $1 million. The rewards will be paid from the Securities and Exchange Commission Investor Protection Fund (Fund). The Fund is made up primarily of monetary sanctions collected by the SEC in actions brought by them under the securities laws.

The Dodd-Frank Act (the Act) provides new incentives for FCPA whistleblowing and is particularly problematic for companies given the FCPA's broad prohibition of bribery of foreign officials, and the hefty penalties companies have paid for FCPA violations in the past. In a time when the combined fines and penalties for a single FCPA case have reached up to $1.6 billion, the new Act will make FCPA whistleblowing a multi-million dollar business by providing large monetary incentives for not only employees, but also for anyone to blow the whistle on a company. As such, the whistleblower provisions of the Dodd-Frank Act have implications for FCPA enforcement, compliance and self-disclosure. The analysis of whether to self-disclose is complex at best, and this Act adds to, and perhaps changes, the calculus of this decision. What follows is a description of the whistleblower provisions of the Dodd-Frank Act, an analysis of some of the implications for companies subject to the FCPA, and finally, recommendations for such companies on how to deal with the new complexities added by the Dodd-Frank Act.

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Discussion of the Dodd-Frank Act

Background of the whistleblower provisions of the Dodd-Frank Act

The new whistleblower law expands the SEC's pre-existing whistleblower program, which previously applied only to insider trading cases and limited the whistleblower rewards to a maximum of 10 percent of sanctions recovered by the government. Previously, there was no mandatory minimum reward. The Dodd-Frank Act aims to motivate those with inside knowledge of securities violations to come forward and assist the government in identifying and prosecuting companies and individuals who have violated securities laws, and at the same time, recover money for victims of financial fraud.[2]

With so much **money at stake,** Congress was concerned that **illegitimate whistleblower claims** could result.

The SEC's failure to uncover the Madoff Ponzi scheme led the SEC to propose legislation that would permit rewards for whistleblowers in judicial actions brought by the SEC under securities laws.[3] The purpose of the whistleblower provisions of the Dodd-Frank Act is to provide incentive to individuals to blow the whistle on violations of securities and commodities laws to the SEC. The Senate report noted that whistleblowers face a tough choice between reporting potential violations of securities laws, and the risk of what they called "committing career suicide." Therefore, the legislators included a minimum payout of 10 percent of any monetary sanctions recovered by the government in an effort to encourage employees "to take the enormous risk of blowing the whistle in calling attention to fraud."[4] The Dodd-Frank Act was modeled after the IRS Whistleblower Program enacted into law in 2006, which has a similar minimum-maximum award level. The Dodd-Frank Act permits rewards up to 30 percent of any sanctions collected by the government in an effort to recognize that, were it not for the whistleblower's actions, there would have been no discovery of the harm to the investors and no collection of any sanctions for their benefit.

Who qualifies as a whistleblower?

The Dodd-Frank Act defines whistleblower to be "any individual" who provides information relating to a violation of securities laws. As such, anyone with insights into the workings of a company and its potential violations of federal securities laws can be a whistleblower. Potential business partners, minority partners, joint venture partners, consultants, vendors and service providers could become whistleblowers. Indeed, the legislative history shows that the legislators meant for third parties and employees to become whistleblowers. In prior versions of the Dodd-Frank Act discussing employer retaliation, the legislation provided protection for not just employees, but also contractors and agents.[5] Later versions of the Dodd-Frank Act then broadly defined whistleblower as "any individual."[6]

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- *Michele Coleman Mayes Sells Best Practices in Corporate Compliance and Ethics (Oct. 2010).* Michele Coleman Mayes, senior vice president and general counsel for The Allstate Corporation, focuses on best practices in compliance and ethics. Mayes uses compliance and ethics as a business strategy — selling Allstate's ethical corporate culture by being transparent and earning the trust of constituents. *www.acc.com/docket/t&i_mayes_oct10*
- *Building a Best-Practice FCPA Compliance System: Monsanto Company's Perspective (Feb. 2009).* This article discusses how to maintain financial integrity in a time of crisis by developing a strong FCPA compliance system, and analyzes the case of the Monsanto Company, demonstrating how a company can use its financial predicament to build a best practices compliance program. *www.acc.com/docket/compl_monsanto_feb09*

Program Material

- *FCPA Enforcement — Success Strategies (April 2008).* This Participants' Briefing Book includes a discussion outline and suggested resources on the topic of FCPA enforcement. *www.acc.com/fcpa_enfrce_apr08*

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- *Sample Foreign Corrupt Practices Act Policy (Jan. 2007).* Includes guide to pre-FCPA regulation, original enactment of the FCPA, the FCPA's 1988 amendments, the OECD's Convention on Bribery, the current FCPA and UN Convention Against Corruption. *www.acc.com/sfp/fcpa_jan07*

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- *Top Ten Ways to Enrich and Empower Your Compliance Program (Sept. 2009).* Here are 10 ways to spruce up your company's ethics and compliance program, each one of them practical and cheap. *www.acc.com/top10/enrich-compl_sep09*

Article

- *Ethics and Compliance Will Always Matter: Building Compliance Programs (Aug. 2008).* This material includes five of the best practices for a world-class compliance program that includes the entire board. It also discusses the factors contributing to increased penalties and fines for organizations that run afoul of the law and commit crimes, such as fraud. *www.acc.com/bldgcompli-prgs_aug08*

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In addition, the breadth of the provision is underscored by the fact that the Dodd-Frank Act does not restrict a qualified whistleblower to only those with US citizenship. Therefore, companies will have to ensure that their subsidiaries also have strong compliance procedures in place for employees to report any securities violations internally, along with rules against retaliation.

There are, however, a few prohibitions on who may qualify as a whistleblower under the Dodd-Frank Act. Those who report securities violations are not entitled to an award if they are or were an employee of a regulatory agency, the Department of Justice (DOJ), a self-regulatory organization, a law enforcement organization, Public Company Accounting Oversight Board or an auditor of financial statements. Those who are convicted of a criminal violation related to the whistleblower action are also prohibited from receiving an award they would otherwise be entitled to receive under the statute.

$1 million threshold

In order for a person who blows the whistle on a company committing securities fraud to receive the reward, the information provided by the individual must lead to a government action that results in sanctions exceeding $1 million. The $1 million threshold amount includes "penalties, disgorgement, restitution and interest ordered to be paid."[7] Many recent FCPA cases have included penalties in excess of $1 million, particularly for corporate defendants, and that trend shows no sign of abating. For example, in 2007, fewer than half the cases resolved that year included penalties in excess of $1 million, but in 2008 that number grew to roughly two-thirds of cases resolved that year. Likewise, in 2009, a little more than two-thirds of resolved FCPA cases included fines in excess of $1 million. Moreover, on occasion, fines for violations of the FCPA have exceeded hundreds of millions of dollars, meaning that whistleblowers stand to reap multi-million dollar rewards. Recent settlements with US authorities by KBR (and its

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Furthermore, the **Dodd-Frank Act contains express language** giving whistleblowers, **against whom retaliation has been taken,** a private right of action **against their employers.**

parent Halliburton), Alcatel-Lucent, and Seimens AG easily topped $100 million each and would have generated enormous bounties for qualified whistleblowers.[8] The US portion of the Siemens AG settlement, for example — totaling $800 million — means that a qualified whistleblower could have received between $80 million and $240 million under the Dodd-Frank Act.[9]

With so much money at stake, Congress was concerned that illegitimate whistleblower claims could result. Indeed, it is easily conceivable that the SEC will be overwhelmed by the number of whistleblower cases reported to them. As a result, the Dodd-Frank Act requires the Inspector General of the SEC to study the whistleblower provisions and decide whether the rewards are so high as to encourage illegitimate whistleblower claims and to report on those findings within 30 months.[10]

Awards from related actions

Companies should be aware that if they are subject to an SEC action, they may also be subject to a related DOJ or state criminal action, and under the Dodd-Frank Act, the SEC is allowed to share any whistleblower information with these other government agencies. Not surprisingly, whistleblowers are then entitled to a reward of 10 to 30 percent of the total monetary sanctions from government action related to the whistleblower's information. The "related action" must be based on the original information provided by a whistleblower that led to the successful enforcement of a Commission action. As a result, if the US Attorney General, an appropriate regulatory authority, a self-regulatory organization, or a state attorney general in connection with any criminal investigation brings a related government action, whistleblowers will receive 10 to 30 percent of any recovery over $1 million as well. Companies can expect the incentive for whistleblowers to be even higher as they will receive a percentage of sanctions from not only SEC actions, but any related actions as well.

Since the Dodd-Frank Act permits the SEC to direct any confidential whistleblower information to a foreign securities authority and law enforcement authority, companies can also expect a rise in related foreign government actions.

What qualifies as "original information?"

In order to qualify as a whistleblower and receive an award under the Dodd-Frank Act, the whistleblower must provide "original information." "Original information" is defined as information that is derived from the independent knowledge or analysis of a whistleblower, not known by the SEC from any other source, and not exclusively derived from an allegation made in a judicial or administrative hearing, a government report, hearing, audit, or investigation, or news media, unless the whistleblower was the source of the information.[11]

The Dodd-Frank Act contains a clause for retroactivity of either the whistleblower's information or the violation. The Dodd-Frank Act states that written information submitted to the SEC by a whistleblower is still considered "original information" regardless of whether the whistleblower submitted such information prior to the effective date of the relevant regulations, as long as the information is provided by the whistleblower again after the date of the enactment. A whistleblower is also entitled to the Dodd-Frank Act's reward regardless of whether any violation of the securities law occurred prior to the enactment of the Dodd-Frank Act.

Protection against retaliation

The Dodd-Frank Act also provides protection for employees who acted lawfully in providing information about potential securities violations to the SEC. Under the Dodd-Frank Act, employers are prohibited from discharging, demoting, suspending, threatening, harassing, directly or indirectly, or in any other manner discriminating against a whistleblower in terms of their employment, because of the whistleblower providing information on potential securities law violations to the SEC.[12]

Furthermore, the Dodd-Frank Act contains express language giving whistleblowers, against whom retaliation has been taken, a private right of action against their employers. An employee who is retaliated or discriminated against as a result of whistleblowing may sue their employer for reinstatement at the same seniority status, two times the back pay owed with interest, and litigation costs along with reasonable attorneys fees.

The Dodd-Frank Act does not require the employee to exhaust any administrative remedies. Instead, it gives a private right of action to any employee who alleges discharge or other discrimination in violation of the Dodd-Frank Act. The Dodd-Frank Act allows the employee who provided information to, or assisted with action-based whistleblower information, to file a


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complaint directly in federal court. The employee must have reported the alleged retaliation to the SEC within six years after the act, or three years after the employee should have reasonably discovered the act, but no later than 10 years after the retaliation.

Implications for companies

Self-disclosure

Whistleblower provisions of the Dodd-Frank Act have implications for FCPA enforcement and self-disclosure. Before the Dodd-Frank Act, companies sometimes avoided government investigations by opting not to self-report potential FCPA violations to the government when they thought the problem was not widespread and could be corrected. After the Dodd-Frank Act, the decision not to self-report becomes more risky as employees have huge incentives to reap the rewards of becoming a whistleblower, especially during the course of internal investigations when the company is deciding whether to self-report. The Dodd-Frank Act diminishes the potential benefit a company perceives in not self-reporting, and could easily lead to a sudden influx of self-reported cases in which companies in the midst of internal investigations decide that the risks of a whistleblower coming forward are simply too great, even if any problems appear to be minor and easily correctible. The SEC most likely is ill-equipped to handle this influx, and it may be that enforcement agencies cannot meaningfully increase their enforcement efforts because of a lack of resources.

Derivative suits

The whistleblower provision is likely to increase the number of FCPA investigations and fines. As a result, the hazards of FCPA violations will increase as well. Often, shareholder class actions and derivative suits directly follow a public announcement of an FCPA violation.[13] Derivative suits have already stemmed from settlement agreements between the government and companies for FCPA violations, even after companies have paid hundreds of millions in fines. The increase in whistleblower cases will lead to more of the same.

The whistleblower provision may also lead to a new crop of plaintiffs' lawyers specifically targeting FCPA whistleblowers, intent on sharing the bounties with their whistleblowing clients.

FCPA qui tam suits

But plaintiffs' lawyers may not need to rely solely on derivative suits; one day they may be able to bring qui tam suits, which would allow recovery through a private lawsuit in which the government may or may not participate. The Dodd-Frank Act does not contain express language giving individuals the right to sue on behalf of the government, which is allowed under the False Claims Act. The False Claims Act contains a qui tam provision that allows individuals with evidence of fraud in government contracts and programs to bring a civil suit on behalf of the government, in order to recover the fraudulently gained funds. Similar qui tam language is absent from the Dodd-Frank Act. However, Congress may discuss this consideration at a later time.

The Dodd-Frank Act requires the Inspector General of the SEC to conduct a study of the whistleblower provisions.[14] Within the study, the Inspector General is tasked with considering whether it would be useful for Congress to empower whistleblowers or other individuals who have attempted to pursue a case through the SEC to bring a private right of action to bring a suit — on behalf of the government and themselves — based on the facts the whistleblower is alleging. The Inspector General must determine whether a private right of action would be useful, would further the interests of protecting investors, and would identify and prevent fraud. As a result, although courts have held that there is no private right of action under the FCPA,[15] and the Dodd-Frank Act does not create an explicit private right of action, it is clear that Congress considered the need for a private right of action. Based on the Inspector General's report, Congress may well grant a private right of action for securities violations, including FCPA violations, in the future.

Recommendations

The possibility of multi-million dollar pay-outs will make it difficult for companies to convince employees to report potential violations internally rather than to the SEC. Therefore, it is critical for companies to proactively deal with the increased risk of exposure by having strong compliance programs in place with procedures that strongly encourage employees to quickly and discreetly report any potentially fraudulent activity.

Companies can mitigate the risks of whistleblowing by maintaining a strong compliance program, internal controls and robust training programs. Companies should take affirmative steps, such as requiring employees to first report any potential FCPA violations to the company. Companies also should have a clear chain of command for employees to anonymously report securities violations, with clear, well-publicized prohibitions against supervisors, or anyone retaliating or discriminating against an employee who internally reports a potential securities violation. The stronger the mechanism a company has for internally reporting potential violations, and the more protections a company institutes for any employee who reports violations internally, the more likely it will be that employees will

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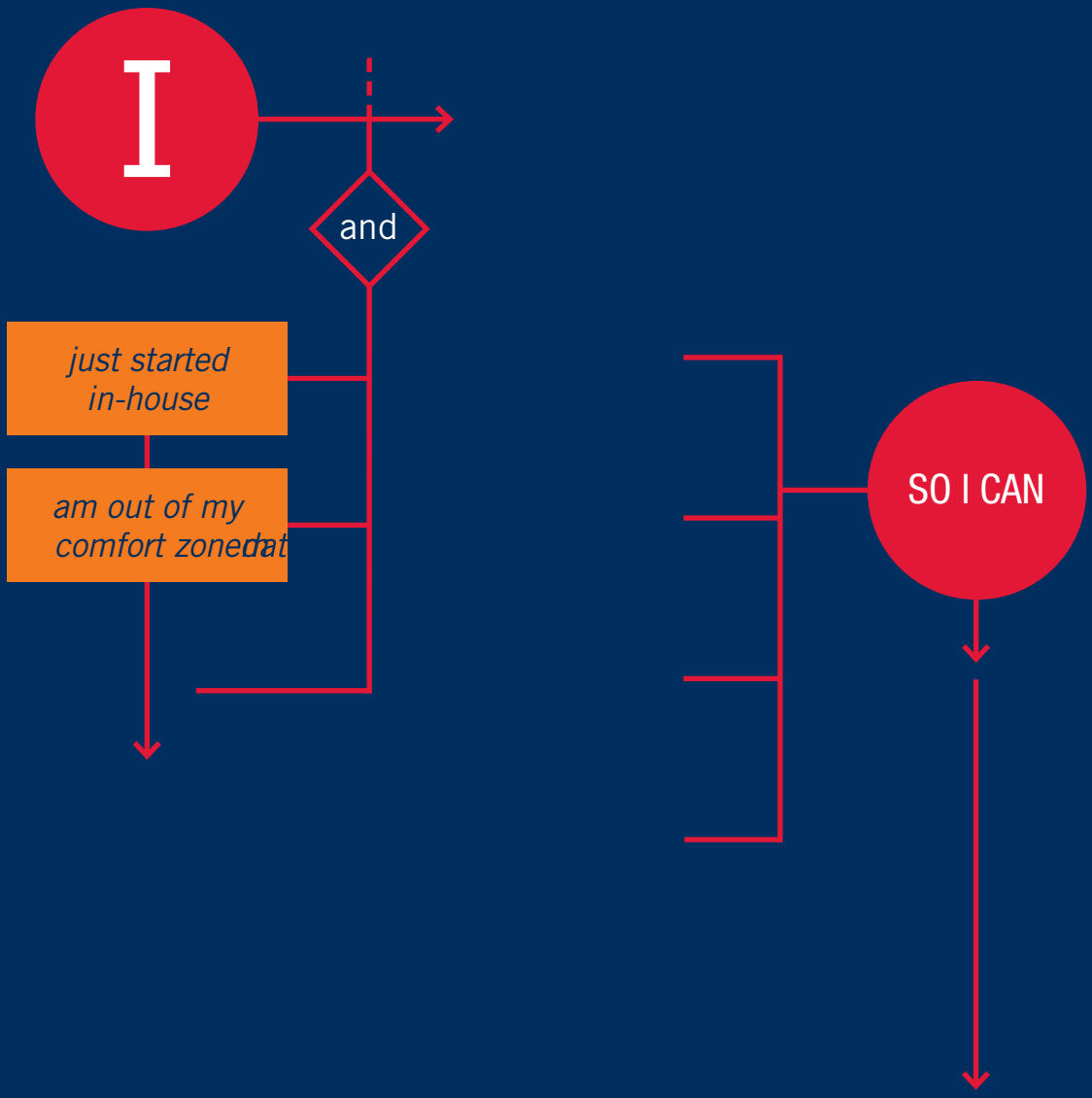

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Given the likelihood that the new law **will result in a substantial influx of new, unexamined cases** to the SEC, companies should advocate for more stringent whistleblower parameters to make it **easier for the SEC to separate the wheat from the chaff.**

feel comfortable reporting violations internally. Moreover, companies should establish clear and comprehensive procedures regarding privileged or confidential corporate information, especially during internal investigations. These mechanisms should apply to subsidiaries abroad and to employees working in the United States.

Finally, companies should take advantage of the rulemaking process, and the Inspector General's 30-month study, to raise issues and note concerns with the whistleblower provisions in the new law. The Inspector General must determine, in part, whether the final rules and regulations issued under the Dodd-Frank Act make the whistleblower protection program "clearly defined and user-friendly."[16] Given the likelihood that the new law will result in a substantial influx of new, unexamined cases to the SEC, companies should advocate for more stringent whistleblower parameters to make it easier for the SEC to separate the wheat from the chaff.

For example, those parameters could include language that requires whistleblowers to first follow their employers' internal compliance policies, with a whistleblower being equally entitled to the bounty if she blows the whistle internally, and the company ultimately self-reports and pays more than $1 million in penalties. Such a change would permit companies to perform their own internal investigations without worrying that an employee will blow the whistle prematurely, and would effectively limit the cases reported to the SEC to those with some basis in fact.

Another area for regulation may be further limiting the eligibility of whistleblowers who are implicated in the malfeasance. The law states that those who are convicted of violations that are the subject of the reported acts cannot collect whistleblower bounty. But as it currently stands, if someone is involved in the bribery, but for whatever reason is not convicted, either because the government declines prosecution or otherwise avoids conviction, the government may find itself rewarding those who caused the problem in the first place. The regulation process could mitigate these inequities by further limiting the definition of a whistleblower.

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NOTES

1 "After Dodd-Frank, SEC Getting At Least One FCPA Tip A Day," *The Wall Street Journal Blog* (Sept. 30, 2010, 11:21 AM), *http://blogs.wsj.com/corruption-currents/2010/09/30/after-dodd-frank-sec-getting-at-least-one-fcpa-tip-a-day/tab/print/.*

2 The Restoring American Financial Stability Act of 2010, S. Rep. 111-176, at 110, 111th Cong. § 922 (2nd Sess. 2010).

3 SEC Office of Inspector General, Report No. 474, Assessment of SEC's Bounty Program, at ii (March 29, 2010) available at *www.sec-oig.gov/reports/auditsinspections/2010/474.pdf.*

4 S. Rep. 111-176, at 111.

5 The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, at 1114, 111th Cong § 7203(g) (1st Sess. 2009) (introduced in House).

6 Restoring American Financial Stability Act of 2010, S. 3217, at 822, 111th Cong. § 922, (2nd Sess. 2010) (placed on Senate calendar).

7 Dodd-Frank Act, § 922(a).

8 *www.halliburton.com/public/news/pubsdata/press_release/2009/corpnws_012509.html* (Haliburton/KBR); *www.bloomberg.com/apps/news?pid=newsarchive&sid=acul2qwwzexa* (Alcatel-Lucent); *www.justice.gov/opa/pr/2008/december/08-crm-1105.html* (Siemens).

9 *www.justice.gov/opa/pr/2008/december/08-crm-1105.html.*

10 Dodd-Frank Act, § 922(d).

11 Dodd-Frank Act, § 922(a).

12 Dodd-Frank Act, § 922(a).

13 See *Christine Johnson v. Siemens AG*, No. 1:09-cv-05310 (E.D.N.Y. 2009) (securities class action filed by plaintiffs against Siemens AG after it pled guilty and paid over $1.6 billion in penalties, with private action relying on the plea agreements and other disclosures to the government); *Arnold v. Bragg*, Cause No. 2009-66082 (Tex. Dist. Ct. 2009) (derivative shareholder action against directors of Pride International, Inc., for breach of fiduciary duty, based on disclosure in SEC filings of possible FCPA violations in several countries); *Policemen & Firemen Retirement Sys. Detroit v. Halliburton Co. & KBR, Inc.*, No. 4:09-cv-01918 (S.D. Tex. 2009) (derivative shareholder suit against Halliburton and KBR, Inc., and directors, based partly on KBR's plea agreement consenting to $402 million fine and implementation of FCPA compliance program).

14 Dodd-Frank Act, § 922(d).

15 *Lamb v. Phillip Morris, Inc.*, 915 F.2d 1024 (6th Cir. 1990).

16 Dodd-Frank Act, § 922(d).

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