THE CORPORATE LAWYER

The newsletter of the ISBA's Section on Corporate Law

December 2010, vol. 48, no. 4

Company whisteleblowers get new incentives and protections

By Gregory G. Thiess, Vice President and Assistant General Counsel, Robert Bosch LLC.

Background of SOX Whistleblower Protections and Incentives

Among the issues challenging companies following passage of the well known Sarbanes-Oxley statute,[1] was that statute's protections for company "whistleblowers."[2] Under SOX, employees of publicly held companies who report claimed violations of the securities laws or alleged fraud against shareholders are protected from any retaliatory actions by their employers, including efforts to discharge, demote, suspend, threaten, harass or discriminate against employees in the terms and conditions of their employment.[3] The statute also protects whistleblowers who seek to provide or assist in providing information in investigations conducted by Federal regulatory agencies, law enforcement agencies, Congress, or those empowered by an employer to investigate workplace misconduct relating to fraud against shareholders.

In addition, while SOX does not itself provide whistleblowers with financial incentives for reporting violations of securities laws, the Securities Exchange Act[4] provides for such rewards to employees who report insider trading. In addition, the False Claims Act[5] provides rewards to employees who report fraud on the federal government[6] or who, if the government decides not to pursue a claim based on their report, proceeds successfully with a private action in the name of the United States.[7]

Congressional Issues With Whistleblower Protections and Incentives

Since passage of SOX, the Department of Labor has consistently held that the whistleblower protections of the Securities Exchange Act applicable to publicly held companies do not extend to employees of non-publicly held subsidiaries of public companies.[8] While these decisions not to apply SOX whistleblower protections to private subsidiaries of public companies has drawn objections from some members of Congress,[9] the interpretation has provided non-public companies a basis to structure their whistleblower and related policies in a manner that may be less rigorous than those of public companies, and a further means to contest whistleblower claims and actions filed with regulatory agencies. Further, such privately held companies have not to date been exposed to the remedies available to whistleblowers under SOX, such as "bounty" payments to employees reporting original information about violations of securities or commodities laws that result in a government recovery.

The whistleblower and "bounty" provisions of the Securities Exchange Act and the False Claims Act were also reviewed by the Securities and Exchange Commission and Department of Justice, to assess the success of agency efforts to use whistleblower protections and bounty payments to produce reports of securities laws violations or claims of fraud against the federal government. In one such evaluation published by the SEC in March 2010, the agency found its procedures for whistleblower claims deficient

and recommended changes to its procedures for receiving and handling whistleblower reports, including establishing an "outreach" program to the general public, posting a whistleblower application form on the SEC Web site, establishing policies for formal and improved agency follow-up to whistleblower reports and developing and publishing specific criteria for awarding bounties.[10]

The availability of bounty payments received similar scrutiny in the SEC's evaluation, the agency finding that the financial reward provisions of the Securities Exchange Act, in place since 1988, have resulted in "very few payments … under the program," due to its limitation to insider trading allegations and the "broad, somewhat vague" criteria for such awards.[11] In a similar study of bounty payments under the FCA, the Department of Justice concluded that although the reward provisions of FCA have resulted in substantial recoveries for persons reporting under that law, the effect of its bounty provisions is limited because they are only available for claims of fraud on the federal government (e.g., Medicare billing fraud).[12]

Dodd-Frank Brings Increased Bounty Provisions for Whistleblowers and Whistleblower Coverage to Privately Held Affiliates of Public Companies

The recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act[13] amended current SOX whistleblower provisions to extend the protections to a new category of companies. Under these amendments, the SOX whistleblower protections now apply to "any subsidiary or affiliate whose financial information is included in the consolidated financial statements" of a publicly held company.[14] In addition, Dodd-Frank also provides new penalties and remedies for whistleblower retaliation claims, including possible double back-pay with interest for whistleblower employees claiming retaliation, and a separate cause of action for retaliation that does not require first filing a claim with the Department of Labor.[15]

Further, Dodd-Frank has dramatically expanded the availability and potential amounts of bounty payments to company whistleblowers. Under the new law bounty payments can now be made for any claim "under the securities laws that results in monetary sanctions exceeding $1,000,000."[16] In addition, a whistleblower whose report results in a monetary recovery under the expanded bounty provisions is eligible to receive a bounty payment of between 10% and 30% of the ultimate recovery.

Challenges of Dodd-Frank for Companies and Management

The Dodd-Frank whistleblower obligations will add new compliance obligations to the agendas of senior managers, board members and in-house counsel at privately held affiliates of public companies. Those private companies, which have not to date been required to implement compliance policies and procedures as rigorous as their publicly held parents, will now need to put in place the types of compliance programs that their public company counterparts have implemented in the SOX era. In particular, to protect themselves from exposure to the new and expanded SOX related whistleblower protections and bounties, those companies must: (i) educate their senior management, boards of directors, compliance/ethics officers and HR personnel about the extended requirements, and (ii) evaluate current company compliance, ethics and auditing policies or implementation of needed whistleblower policy improvements.

Publicly held companies that have operated under SOX and its whistleblower protections and incentives will also need to reassess their existing compliance programs. For those publicly held companies, Dodd-Frank brings a broader array of claims for which whistleblowers can seek bounty payments and for which retaliation is proscribed, and absent revised compliance initiatives may be exposed to different types of claims than have been common under prior whistleblower laws.

Among the approaches that companies may wish to consider as they review their compliance policies and procedures, and develop or adjust their existing programs are:

(1) Evaluation by management and company internal or external counsel of company and business unit policies to determine whether they are sufficiently rigorous to provide required protections to whistleblowers.

(2) A similar review of compliance and auditing practices to assure that a company responds appropriately to reported violations.

(3) If existing policies, compliance programs and auditing practices are found lacking, development by management and company counsel of new or modified policies and programs to assure compliance with the new requirements.

(4) Development and implementation of training and education programs covering the expanded whistleblower protections, to be provided by management or company counsel to employees whose duties may be the subject of compliance complaints or claims.

(5) Management or company counsel meetings/communications with ethics and compliance personnel, to assure maintenance of appropriate investigations and follow-ups to reported claims.

(6) Periodic evaluation (minimum yearly) of contacts to ethics and compliance "hotlines," 800 numbers or other sources where employees can report perceived legal and ethics violations, to identify any changes in frequency or content over time.

The Dodd-Frank whistleblower protections and incentives will continue to be shaped as regulatory agencies develop and implement regulations and decisions on the new requirements, but companies affected by these new provisions will be well advised to begin reviewing their compliance programs immediately to assure continued compliance as the new provisions take effect. ■

Gregory Thiess is Vice President, Assistant General Counsel of Robert Bosch, LLC, the North American affiliate of the Bosch Group, a leading global supplier of automotive, industrial, consumer and building technology products. He is General Counsel and Secretary to Robert Bosch Tool Corporation and several other Bosch Group companies and is responsible for commercial and product liability litigation, claims and recalls, commercial agreements, M&A, corporate governance, regulatory compliance, environmental claims and litigation and records management.

He is a member of the Illinois, Michigan and American Bar Associations, ACCA, IADC and DRI. He received his law degree in 1979 from the University of Detroit School of Law and his bachelors degree in 1976 from DePaul University in Chicago.

1. 15 U.S.C. §§ 7201 et seq.

2. 18 U.S.C. 1514A. The statute prohibits publicly held companies "or any officer, employee, contractor, subcontractor, or agent of such company" from any effort to "discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee (1) to provide information, cause

information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of [the Securities and Exchange Act]" or "any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by: (A) a Federal regulatory or law enforcement agency; (B) any Member of Congress or any committee of Congress; or (C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or (2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of [the Securities and Exchange Act], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

3. Id.

4. 15 U.S.C. 78u-1(e), which provides that the SEC may pay "from amounts imposed as a penalty under this section and recovered by the Commission or the Attorney General, such sums, not to exceed 10 percent of such amounts, as the Commission deems appropriate, to the person or persons who provide information leading to the imposition of such penalty. Any determinations under this subsection, including whether, to whom, or in what amount to make payments, shall be in the sole discretion of the Commission, except that no such payment shall be made to any member, officer, or employee of any appropriate regulatory agency, the Department of Justice, or a self-regulatory organization. Any such determination shall be final and not subject to judicial review."

5. 31 U.S.C. 3729.

6. 31 U.S.C. 3730(d)(1), which provides that if the government proceeds with an action resulting from a private person's report, that person may "receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action. Where the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) relating to allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, the court may award such sums as it considers appropriate, but in no case more than 10 percent of the proceeds, taking into account the significance of the information and the role of the person bringing the action in advancing the case to litigation. Any payment to a person under the first or second sentence of this paragraph shall be made from the proceeds. Any such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant."

7. 31 U.S.C. 3730(d)(2). "If the Government does not proceed with an action under this section, the person bringing the action or settling the claim shall receive an amount which the court decides is reasonable for collecting the civil penalty and damages. The amount shall be not less than 25 percent and not more than 30 percent of the proceeds of the action or settlement and shall be paid out of such proceeds. Such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant."

8. See, for example, Stevenson v. Neighborhood House Charter School, No. 2005-SOX-00087 (ALJ Sept. 7, 2005), and Paz v. Mary's Center for Maternal & Child Care, No. 2006-SOX-7 (ALJ Dec. 12, 2005) in which the respective Administrative Law Judges determined that application of the SOX whistleblower

protections is based solely on whether the company has a class of stock registered under Section 12 of the Exchange Act or whether it is required to make reports pursuant to the Act's Section 15(d).

9. See, for example, the October 6, 2010 letter of Senators Patrick Leahy and Charles Grassley, found at <http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=29506>.

10. See "Assessment of the SEC's Bounty Program," Report No. 474, published by the SEC Office of Inspector General March 29, 2010, page 2.

11. Id.

12. (DOJ Press Release November 11, 2009 ("Justice Department Recovers $2.4 Billion in False Claims Cases in Fiscal Year 2009; More Than $24 Billion Since 1986").

13. Pub. L. 111-203 (July 21, 2010.

14. Id., at Section 929(a).

15. Id., at Section 922(h).

16. Id., at Section 922)a)(1).