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Whistleblowers: A Dilemma For The Defense

Law360, New York (December 18, 2012, 1:00 PM ET) -- Without a doubt, the advent of the U.S. Securities and Exchange Commission's whistleblower bounty program prompted a drastic increase in the number of individuals providing information of potential wrongdoing to the SEC. Some of these individuals may just be tipsters, but others will become key witnesses in investigations and trials. The prevalence of whistleblowers in cases in greater numbers than ever before and the special protections offered to them creates special challenges for defense attorneys and the companies they represent surrounding the identification, investigation and questioning of whistleblowers.

The Whistleblower Bounty Program

Under the whistleblower bounty program, an individual who voluntarily provides the SEC with original information that leads to the successful enforcement by the SEC of a federal court or administrative action in which the SEC obtains monetary sanctions totaling more than $1 million, is eligible for an award of between 10 percent and 30 percent of the monetary sanctions collected. The SEC rules do not require internal reporting.

The SEC program is in its infancy, but already has resulted in a massive influx of tips, complaints and referrals from individuals residing in all 50 states and around the world. The SEC's recently released Annual Report on the Dodd-Frank Whistleblower Program revealed that the program generated 3,001 whistleblower tips and 3,050 hotline phone calls in fiscal year 2012. It is not yet apparent, however, whether the influx of tips will lead to an increase in SEC enforcement activity.

According to its Fiscal Year 2012 Agency Financial Report, during the first complete year during which the whistleblower program was in effect, the SEC brought 734 enforcement actions — one fewer than the 735 it filed in 2011. Of the enforcement actions brought in 2012, 150 were designated "National Priority Cases," which signifies the Enforcement Division's most important and complex cases. This number represents an approximately 30 percent increase over 2011.

Challenges Presented by Whistleblower Witnesses

The SEC and other regulators and prosecutors historically have received tips and referrals from whistleblowers who, at times, became witnesses in investigations and trials. The principal witnesses in investigations, however, more often were "cooperators;" culpable participants who entered into agreements with the government to share information regarding their own misconduct and the wrongdoing of others in exchange for leniency. A cooperator generally pleads guilty to a crime or enters into a settlement with the government. Cooperators are vulnerable to attack by defendants who typically question cooperators' credibility by accusing them of being untrustworthy transgressors and the sole wrongdoers. Defendants also typically argue that cooperators accuse others solely to obtain a better outcome for themselves.

On the other hand, although a whistleblower may be a culpable participant, he often is a blameless third-party who observed or discovered misconduct. An innocent whistleblower is inherently more reliable than a cooperator and not subject to attack on the basis of having conformed his story to obtain a more favorable sentence or administrative suspension. But even an innocent whistleblower is open to attack based on his desire to reap the financial incentive offered under Dodd-Frank. The hope for a rich financial reward potentially could cause a whistleblower to exaggerate a defendant's wrongdoing to maximize the amount of sanctions awarded and thus increase the whistleblower's financial reward. Indeed, in cases involving substantial fraud undertaken in large corporations, the potential for financial gain is significant.

The problem with this line of attack is that Dodd-Frank has set the bar for the whistleblower's receipt of an award fairly high, requiring sanctions be awarded against a defendant of over $1 million and then leaving largely to the SEC's discretion the decision of whether the whistleblower should even participate in the award in an amount of 10 percent to 30 percent of any sanction actually collected. Under some scenarios, therefore, an examination of motivation may result in the whistleblower actually appearing heroic, having suffered the threat of employment retaliation and ridicule for the possibility of spending years involved in litigation that could reap him little to no money at all.

Dodd-Frank's requirement that the whistleblower provide "original information" also limits the bases for undermining the reliability of documentation or testimony. In addition, SEC insiders suggest that they are receiving tips about conduct immediately after it occurs and sometimes even before it happens. The immediacy with which people are reporting events of which they have personal and direct knowledge makes unavailable methods that defendants historically have used to undermine witnesses' testimony. When conversations are fresh, a defendant's ability to credibly question a witness's recollection is limited. Moreover, contemporaneous "original" documentary evidence and testimony likely will be more difficult to challenge than stale, second and third generation reports of wrongdoing.

Another challenge for defendants and for the SEC is the protection afforded whistleblowers to remain anonymous or to have their identity remain confidential. In some cases, even the SEC will not be aware of the whistleblower's identity. Pursuant to 17 C.F.R. § 240.21F-7(b), a whistleblower may submit a tip to the SEC anonymously by following the procedures set forth in Section 240.21F-9. Section 240.21F-9(c), requires that the whistleblower retain an attorney to whom he submits a Form TCR (Tip, Complaint or Referral) signed by the whistleblower under penalty of perjury. The attorney must certify that he has verified the whistleblower's identify; reviewed the Form TCR for completeness and accuracy; and determined that the information contained in the Form TCR is true, correct and complete to the best of the his knowledge, information and belief.

In addition, the attorney must obtain the whistleblower's nonwaivable consent and agree to be legally obligated, to provide the signed Form TCR to the SEC within seven days upon request, which may be demanded in circumstances regarding concerns over the truth of the representations. Except for these situations, an anonymous whistleblower need not disclose his identity to the SEC until the whistleblower seeks payment of a bounty. Since a whistleblower does not seek payment unless and until the SEC obtains an award for sanctions of over $1 million, a case can be concluded before the whistleblower's identity is revealed to the SEC. Moreover, the public may never be entitled to know the whistleblower's identity. In fact, when the SEC issued its first award under the program in August 2012, the whistleblower's identity remained confidential.

Not all whistleblowers submit tips anonymously, however. Although the SEC generally is forbidden from disclosing information that reasonably could be expected to reveal a whistleblower's identity, a limited exception permits disclosure when it is required in connection with a federal court or administrative action or other public proceeding filed by the SEC or an agency to which the SEC passed on the information. The commentary to the rules notes that disclosure might be required in an action brought by the Department of Justice in light of the Sixth Amendment's confrontation requirement.

Doubtless, however, such disclosure is not required unless and until the government affirmatively decides to present the whistleblower as a witness. In civil actions, Federal Rule of Civil Procedure 26(1)(A)(i) requires disclosure of the names of any "individual likely to have discoverable information … that the disclosing party may use to support its claims or defenses." Presumably, in a civil enforcement action, this rule may require the SEC to disclose the name of a whistleblower, although not necessarily identify him as the person who blew the whistle.

The SEC also is exempted from the confidentiality requirement when it is necessary to accomplish the purposes of the Exchange Act and to protect investors. Under these circumstances, the SEC may provide a whistleblower's information to other government agencies that are subject to the same confidentiality requirements as the SEC. Finally, Section 21F(h)(2)(C), explicitly states that the confidentiality requirements do not limit the ability of the attorney general to "present such evidence to a grand jury or to share such evidence with potential witnesses or defendants in the course of an ongoing criminal investigation."

Public policy reasons exist for permitting whistleblowers to remain anonymous — such as encouraging reporting by reluctant employees who fear retaliation — but, the involvement of anonymous whistleblowers complicates cases not only for the SEC but also for attorneys seeking to defend companies and individuals under government scrutiny. In the traditional cooperation scenario, the government would be in a position to meet with and evaluate, face-to-face, the credibility of cooperators; however, how can the government effectively evaluate tips from anonymous whistleblowers?

Some commentators have suggested that the SEC and other government agencies have and are using other methods to judge credibility, such as interviewing anonymous whistleblowers by telephone or having them meet with the government through screens that protects their identities. These procedures still prevent prosecutors from conducting basic examinations of whistleblowers' facial expressions to determine whether they appear to be telling the truth. And, even further removed from that scenario will be the defense attorney, who will not even have the benefit of examining the whistleblower through a screen or who may never even be able to learn the identity of the person who first brought the information to the authorities nor ever have the ability to try to probe that person's motivation for blowing the whistle.

The SEC whistleblower program has been in effect for just over a year. As the SEC develops cases premised upon information from whistleblowers, it will be interesting to see how the SEC, defense attorneys and eventually the courts navigate and address the nuances of the whistleblower rules. It also remains to be seen whether the program will result in an increase in SEC enforcement actions and create even more complications for defense attorneys than those identified above.

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