

New SEC Whistleblower Program and Added Disclosure Rules in Dodd-Frank Act: Will These New Regulations Help or Hinder FCPA Compliance Efforts?

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Two provisions in the 2010 Dodd-Frank Act ("Dodd-Frank" or the "Act") could pose new challenges to U.S. companies dealing with the Foreign Corrupt Practices Act ("FCPA") risks. Under Dodd-Frank, whistleblowers have been given powerful financial incentives to bypass internal reporting and compliance departments to instead report suspected securities law violations (including FCPA violations) directly to the U.S. Securities and Exchange Commission. In return for providing the SEC with "original information," a whistleblower can receive between 10-30 percent of any monetary sanctions exceeding \$1,000,000 that the SEC or other law enforcement agencies ultimately recover. Given the large FCPA settlements in recent years, this figure could literally amount to tens of millions of dollars. Dodd-Frank also gives whistleblowers stronger protections against retaliation. In addition, the Act imposes new disclosure requirements on publicly traded energy and mining companies to report information about payments they make to U.S. and foreign governments. These added disclosure requirements could trigger potential securities law violations if the disclosures are not made timely, contradict other accounting entries, or are not provided in the manner required by the SEC.

These provisions of Dodd-Frank may require companies to spend additional resources on internal controls and FCPA compliance efforts and

may also affect how companies interact with their employees. Corporations will need to develop new ways to incentivize compliance and internal reporting, and they may need to adopt new approaches in dealing with those who report issues internally, regardless of whether the report of wrongdoing is accurate or false, well-intentioned or not.

This article will summarize the whistleblower and disclosure provisions of Dodd-Frank, discuss their potential implications, and provide practical advice on what companies can do to safeguard themselves against whistleblower claims and to remain FCPA compliant.

Dodd-Frank Gives Whistleblowers Financial Incentives and Enhanced Protections

Section 922 of Dodd-Frank gives financial incentives and broad protections to whistleblowers who report securities law violations to the SEC.¹ Whistleblowers who provide the SEC with "original information" are eligible for a financial award of 10-30 percent of the total amount recovered by U.S. authorities and their foreign counterparts (including disgorgement, penalties, and pre-judgment interest). "Original information" is defined as information "derived from the independent knowledge or analysis of a whistleblower" that "is

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not known to the Commission from any other source."²

Not everyone is eligible to receive such an award. Whistleblowers cannot work for law enforcement or other regulatory agencies or organizations; they cannot be criminally convicted of an offense related to the matters that form the basis of their report; they cannot provide false statements or documents; and they cannot have gained "the information through the performance of an audit of financial statements required under the securities laws . . ."³ Whistleblowers are, however, permitted to make reports *anonymously* or through counsel. But in order to collect an award, they must disclose their identities and provide other information as the SEC requires.⁴

The SEC's whistleblower program is broad. It is available to anyone (except as noted above) who comes forward with evidence that a publicly traded company, or individual, has committed a securities law violation. The whistleblower program includes employees of subsidiaries whose financial information is included in the consolidated financial statements of the parent company.⁵ Thus, a potential whistleblower may be an employee, a competitor or other third party. Finally, Section 922 has retroactive application — meaning whistleblowers can receive awards even if the alleged securities law violation happened before the Act was passed.⁶

While Section 922 covers any violation of the federal securities laws, FCPA claims will likely generate the more lucrative awards given their priority enforcement status and high settlement values. In the first half of 2010, the government imposed sanctions of over \$1.2 billion for FCPA related offenses, up from the over \$600 million in FCPA sanctions imposed in all of 2009.⁷ Given the huge financial sanctions in recent FCPA cases, some commentators are calling Section 922 "the FCPA bounty program."⁸ Moreover, the U.S. government has indicated that the FCPA is one of its highest enforcement priorities and has dedicated significant

resources to the effort.⁹ The SEC, for example, has created a special FCPA unit and staffed more than two dozen lawyers to work solely on FCPA cases, and the U.S. Department of Justice has approximately 24 prosecutors and a team of 8 Federal Bureau of Investigation agents dedicated to prosecuting FCPA cases. The SEC has also announced a new cooperation program in January 2010 that utilizes some of the same features used at the DOJ, including non-prosecution and deferred prosecution agreements, and cooperation credit for individuals and corporations who self-report wrongdoing.¹⁰

Unlike the Sarbanes-Oxley ("SOX") whistleblower program, which covers only accounting matters and has no financial award component,¹¹ the new SEC whistleblower program provides enormous financial incentives. Before Section 922, the only SEC whistleblower program that provided any financial reward was the SEC Insider Trading Program, which was used sparingly over the years and only recently has awarded a large payout (\$1 million).¹² Prior to this award, the total amount awarded to SEC whistleblowers in the past 11 years was less than \$160,000, which was paid to five claimants.¹³

In addition to the possibility of receiving a significant monetary award, whistleblowers cannot be fired or discriminated against by their employer for filing a report with the SEC or for cooperating in any SEC or other law enforcement investigation stemming from that report.¹⁴ The Act creates a new cause of action for whistleblowers who are discharged in violation of these provisions. Whistleblowers generally have up to six years to make a claim in federal court (or up to 10 years in certain cases), and can seek reinstatement to the same position, double back pay, and reasonable attorney's fees and other costs. The Act also extends the statute of limitations for SOX whistleblower claims from 90 days to 180 days and includes employees of nationally recognized rating agencies like Moody's Investors Service and Standard & Poor's in the protected whistleblower class.¹⁵ The Act nullifies any contractual provisions

or arbitration clauses that attempt to abridge or waive the rights and remedies under Section 922. As a harbinger of things to come, Section 922 also requires a study of the SEC's new whistleblower program to determine whether it should be extended to include a private right of action for whistleblowers to bring suit against individuals who have committed securities fraud.¹⁶

New Disclosure Rules for Energy and Mining Companies

Section 1504 of Dodd-Frank requires "resource extraction issuers" to disclose payments they make to foreign governments and the Federal Government in annual reports that they file with the SEC and on their websites. A "resource extraction issuer" is defined as "an issuer that — (i) is required to file an annual report with the Commission; and (ii) engages in the commercial development of oil, natural gas or minerals."¹⁷ "Payments" are those that are not *de minimis* and, among other things, are "made to further the commercial development of oil, natural gas, or minerals," as well as "taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits."¹⁸

While Section 1504 appears intended to bring more transparency to the issue of payments made by energy and mining companies to the U.S. and foreign governments, there are aspects of this provision that will need clarification. For example, what does it mean to "further the commercial development of oil, natural gas, or minerals?" The Act defines "commercial development" to include the "exploration, extraction, processing, export, and *other significant actions* relating to oil, natural gas, or minerals, or the acquisition of a license for any such activity, as determined by the Commission."¹⁹ Thus, disclosures under Section 1504 are clearly required for a publicly traded U.S. energy or mining company. However, what about a manufacturer of parts or a company that provides services or labor to an intermediary or subsidiary of an energy company that ultimately uses these goods or

services in their operations? Whether these companies are engaged in the "commercial development of oil, natural gas or minerals" or have otherwise taken a "significant action relating to oil, natural gas, or minerals" such that they need to track and publicly disclose government payments they have made is an area that will need to be more closely examined by the SEC.²⁰

It should be noted that while the FCPA is confined to illegal payments or bribes to foreign officials, Section 1504 is broader and requires the disclosure of all payments to foreign governments — including payments that are legal. This distinction is important because companies that have adopted comprehensive FCPA compliance programs to minimize their FCPA risks already spend significant time and resources to ensure compliance with the FCPA. The additional disclosure obligations under Section 1504 may require U.S. energy and mining companies to track additional data on U.S. and foreign government payments, which will likely further increase their compliance costs.

Implications of the New Dodd-Frank Whistleblower and Disclosure Requirements

These provisions represent the latest effort by the federal government to root out securities fraud and corruption and to increase transparency in corporate America. The lure of large financial rewards, added protection for whistleblowers, and new disclosure requirements are intended to encourage more employees to report FCPA and other securities law violations, and for companies to continue to promote compliance among their employees. Whether these changes will have their intended impact, however, remains unclear.

The new whistleblower provisions may adversely affect the relationships between companies and their employees. The SEC's new whistleblower program may alter the loyalty of employees in ways that are counter-productive. Employees are now encouraged to blow the whistle in the first instance to the government without any requirement that

the issue first be raised within the company. Instead of driving home the message of compliance, these rules may work to encourage some employees to work secretly against their companies to first report corruption and fraud claims to the government without giving the company a chance to address the issue.

Given the hefty financial incentives and potential sanctions at stake, Dodd-Frank has likely created an unhealthy "race to cooperate." Employees now have strong incentives to rush to the government and be "the first in the door" when they may not have full or accurate information about the issue raised, and have not provided the company with an opportunity to investigate, remediate, or even respond. Likewise, with the threat that any of its employees could at a moment's notice run to the government, a company may feel it cannot afford to wait to ascertain whether it has violated the law. Companies may have incentives to self-report even the smallest infractions, or rush to self-report issues that they do not yet understand, in the hopes of stemming a larger, more invasive government investigation, or receiving cooperation credit — a critical factor in settlements with the government.

Whether the large potential whistleblower awards will lead to more *reliable* claims for the government to investigate is also an unknown. Given the size of the financial inducement involved in FCPA cases, the quality of whistleblower information is not a given, and such a reward mechanism may have the unintended result of causing more unreliable claims to be reported. This would only serve as a drain on government and corporate resources to investigate false or unreliable claims.

How Companies Can Incentivize Compliance and Internal Reporting

So how can companies incentivize compliance while encouraging internal reporting? In addition to focusing on training and having a well-publicized and easy-to-understand compliance policy in place, companies may want to consider taking time to

review their overall compliance program to make sure their internal controls are strong and their policies, practices and procedures are consistently applied and endorsed by the employees.

There are many ways a company can achieve employee buy-in into its compliance plan. Creating a culture of compliance within the organization is key. Some ways to accomplish this include setting the tone from the top, rewarding compliance-driven individuals, and ensuring that the rules are well defined, known, and enforced. Companies may want to consider including compliance goals in their managers' annual performance evaluation metrics and rewarding those managers who achieve their goals with higher compensation. Another approach may be to tie a portion of the compensation of managers to the views regarding ethics and compliance of the employees who report to them, which can be measured through anonymous surveys or tip lines. Those managers who yield the best results from their teams could receive higher compensation or other tangible rewards. Rewarding lower-level employees who are compliance-driven is another approach. For example, companies may want to consider giving employees who report issues early, or seek guidance on proposed transactions, special incentives or other benefits to reward them for their efforts.

The same kinds of inducements can be used to generate more internal reporting. Internal recognitions or other inducements (e.g., bonuses, time-off awards, special trips) can be given to employees who raise important issues internally with the company or who help cultivate a culture of compliance. Special incentives can also be used to encourage employees to raise compliance-related questions to compliance staff early in a deal or long before a product is launched. Employees need to feel assured that reporting suspected violations will not result in any adverse action against them. Use of anonymous hotlines, surveys or other blind reporting methods are good ways to gain more candid feedback from employees. Anti-retaliation is

a topic companies may also want to include in employee training sessions.

If a company provides positive re-enforcement of the various aspects of the compliance plan, coupled with strong enforcement, employees are more likely to feel that compliance is a top priority for the company and will more likely operate within the confines of the law, and report problems or concerns internally.

U.S. companies should also take stock of their FCPA compliance programs to determine whether they are adequate. In practical terms, the best way to prevent an FCPA problem is to ensure the company has a strong anti-corruption compliance program in place. Making sure that employees, strategic business partners, and other third parties are aware of and agree to abide by a company's anti-corruption policies is of vital importance (e.g., companies may want to consider the use of certifications of FCPA compliance and FCPA related representation and warranty clauses in third party contracts).

Companies with international operations may also want to consider beefing up FCPA training for their employees. Regular training — preferably live, in the local language or conducted by a local person, and using specific examples — will go far toward ensuring a more compliant workforce. While Dodd-Frank may lead to rising compliance costs, the risk of not having a strong compliance plan in place is far outweighed by the threat of a potential enforcement action stemming from maintaining too lax a program.

What Companies Need to Know when Dealing with Whistleblowers

Since any employee may be a potential whistleblower, companies need to be mindful of how they deal with employees who raise concerns or who are identified as, or suspected to be, whistleblowers. To avoid potential exposure under Dodd-Frank's strict anti-retaliation provisions,

companies should make sure that their compliance policies contain strong anti-retaliation language and that employees know that no adverse employment actions will be based on a report of wrongdoing. Companies also need to investigate claims promptly and separate good faith claims from those brought by employees with less than pure motives. To insulate themselves against liability, companies should document all claims investigated (whether they were made in good faith or not) and all interactions with a whistleblower, particularly any actions taken that could be considered adverse to that person's employment at the company. Having well-documented and contemporaneous business rationale to support all decisions made with respect to a potential whistleblower is necessary in light of Dodd-Frank's anti-retaliation provisions.

Conclusion

Dodd-Frank's whistleblower and disclosure provisions pose new and challenging compliance issues. Companies should consider undertaking immediate steps, such as a thorough review of existing policies and procedures, and implementing changes as needed to limit their exposure.

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¹ The Act also provides similar protections to whistleblowers who report wrongdoing to the U.S. Commodity Futures Trading Commission under Section 748. This article focuses exclusively on Section 922, which deals with the SEC whistleblower program.

² Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. §§ 922(a)(a)(3)(A) & 922(a)(a)(3)(B) (2010).

³ *Id.* § 922(a)(c)(2)(C).

⁴ The SEC is given discretion to determine whether, to whom, and in what amount to make awards. The amount of an award is not subject to appeal. *See Id.* § 922(a)(f).

⁵ *Id.* § 929A.

⁶ *Id.* § 924(c).

⁷ Bethany Hengsbach, "Proposed Whistleblower Provision Could Dramatically Increase FCPA Risk," Government Contracts Blog (May 12, 2010), available at <http://www.governmentcontractslawblog.com/2010/05/articles/fcpa/proposed-whistleblower-provision-could-dramatically-increase-fcpa-risk/>.

⁸ Michael Kohler, "Dodd-Frank Reform Bill Contains Major and Unnecessary Compliance Headaches," Corporate Compliance Insights (July 16, 2010), available at <http://www.corporatecomplianceinsights.com/2010/dod-d-frank-financial-reform-bill-compliance-headache/>.

⁹ McDermott Will & Emery, "DOJ and SEC Will Significantly Increase FCPA Enforcement Efforts," McDermott Newsletter (Mar. 10, 2010), available at http://www.mwe.com/index.cfm/fuseaction/publication.s.nldetail/object_id/c2bea4e1-2573-4e83-b0bf-8086e0001d96.cfm.

¹⁰ U.S. Securities & Exchange Commission, *SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations*, Press Release No. 2010-6 (Jan. 13, 2010).

¹¹ *See* 18 U.S.C. § 1514A (2010).

¹² On July 23, 2010, the SEC awarded its first million dollar award for a whistleblower's report of information regarding insider trading charges involving hedge fund adviser Pequot Capital Management, Inc. and related individuals. *See* U.S. Securities & Exchange Commission, *SEC Awards \$1 Million for Information*

Provided in Insider Trading Case, Lit. Release No. 21601 (July 23, 2010).

¹³ *See* Finch McCraine, LLP, "Does SEC Whistleblower Award of \$1 Million Signal A New Attitude Toward Wall Street Whistleblowing" (Whistleblower Lawyer Blog Aug. 8, 2010), available at www.whistleblowerlawyerblog.com, at 2.

¹⁴ H.R. 4173 § 922(h)(1)(A).

¹⁵ *Id.* §§ 922(b) & 922(c).

¹⁶ *Id.* § 922(d)(1)(G).

¹⁷ *Id.* § 1504(q)(1)(D).

¹⁸ *Id.* §§ 1504(q)(1)(C)(i) and 1504(q)(1)(C)(ii).

¹⁹ *Id.* § 1504(q)(1)(A) (emphasis added).

²⁰ The SEC has 270 days to finalize rulemaking under Sections 922 and 1504.