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Lessons From The SEC Whistleblower Report

Law360, New York (November 26, 2012) -- On Nov. 15, 2012, the U.S. Securities and Exchange Commission released its Annual Report on the Dodd-Frank Whistleblower Program. The report — which was prepared by the Commission's Office of the Whistleblower to satisfy its annual reporting obligations under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Securities Exchange Act of 1934[1] — summarizes the Office of the Whistleblower's activities during fiscal year 2012 and demonstrates an increase in enforcement activity.

The SEC's Office of the Whistleblower

President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] on July 21, 2010. While the Act's implementation and the extensive rulemaking process continue to garner headlines to this day, the securities enforcement bar took immediate note of Section 922, which added to the Exchange Act Section 21F — the Act's whistleblower provisions. Among other things, the whistleblower provisions require the SEC to make monetary awards in exchange for the voluntary submission of original information about any securities law violation, where the tip leads to a successful enforcement action resulting in a recovery of more than $1 million.

Section 924(d) of the Dodd-Frank Act directed the Commission to establish an Office of the Whistleblower ("OWB" or the "Office") to administer the new whistleblower program, and the final rules for the program became effective on Aug. 12, 2011. The Office is led by Chief Sean X. McKessy and Deputy Chief Jane A. Norberg, who are assisted by eight attorneys and additional support staff, and is sure to grow in the months and years ahead. The Office provides guidance to would-be whistleblowers, handles tips and complaints and helps SEC Enforcement Division staff determine the size of each whistleblower award, which range from 10 percent to 30 percent of the monetary sanctions collected.

The 2012 Report

The Office received 3,050 hotline phone calls from members of the public in fiscal year 2012, a sharp increase over the 650 phone calls received during the five months of the hotline's operation in 2011. OWB received 3,001 formal whistleblower tips via submission of Form-TCR (tips, complaints and referrals) by mail, fax and online. (While the actual number of tips exceeds 3,001, the report excludes tips received from those who neglected to submit the requisite paperwork or are otherwise ineligible to receive awards.)

The tips most frequently concerned corporate disclosures and financials (547 tips, 18.2 percent), offering fraud (465 tips, 15.5 percent) and manipulation (457 tips, 15.2 percent). More than 23 percent of submitters selected "other" as the allegation category, indicating that their tip did not fit into any of the nine categories available on Form-TCR.

While the 115 complaints related to the Foreign Corrupt Practices Act[3] amount to only 3.8 percent of the year's total, that share may rise in the future, along with the increasing focus on anti-corruption enforcement and the emphasis on whistleblower protections, as highlighted in the SEC's and U.S. Department of Justice's new guidance on the criminal and civil enforcement provisions of the FCPA, entitled "A Resource Guide to the U.S. Foreign Corrupt Practices Act."[4]

While the sheer volume of tips received underscores the sizeable impact the whistleblower program has had on enforcement activities in just its first full year of operation, the striking diversity of whistleblowers is also noteworthy. Any concerns about the Commission's ability adequately to publicize its whistleblower program have seemingly been laid to rest by OWB's receipt of tips from individuals in all 50 states and the District of Columbia, as well as Puerto Rico.

The largest number of tips emanated from California (435 tips, 17.4 percent), New York (246 tips, 9.8 percent) and Florida (202 tips, 8.1 percent). 324 tips — or 10.8 percent of the total — originated abroad during the 2012 fiscal year. The Office received tips from whistleblowers in 49 countries outside the United States; 74 tips originated in the United Kingdom, 46 tips originated in Canada, 33 tips originated in India and 27 originated in China.

The Office posts a Notice of Covered Action for each SEC enforcement action in which a final judgment or order results in monetary sanctions exceeding $1 million. The Commission posted 143 Notices of Covered Action during the 2012 fiscal year. By posting a notice, the SEC does not make any determination that a whistleblower tip led to an investigation or that a tipster will receive an award. The onus is on the whistleblower to apply for an award by completing and submitting to OWB Form WB-APP within 90 calendar days of the posting. Applications are reviewed by the claims review staff.

To date, the SEC has issued only one award under the whistleblower program — an Aug. 21, 2012, award of $50,000 to an anonymous tipster who helped uncover a multimillion dollar fraud. (The tipster was recently awarded another $500, and is eligible to collect additional award funds as additional sanctions are collected.) But OWB staff members are actively reviewing additional

tips and applications for awards, which may soon result in additional awards.

With the current balance of the SEC's Investor Protection Fund — from which whistleblower program awards are paid — at over $450 million, the Office clearly has the financial wherewithal to grant significant headline-grabbing bounties soon. And the quality of tips submitted by whistleblowers vying for a piece of the awards pie is expected to rise as sophisticated counsel — many of whom have significant experience assisting whistleblowers in connection with the False Claims Act,[5] upon which the Commission has modeled its own program — recruit and vet tipsters and help craft impressive whistleblower submissions.

Preventative Measures

Both potential whistleblowers and SEC personnel need only look at the staggering government recoveries and whistleblower bounties awarded in the False Claims Act arena to appreciate the vast enforcement potential the new whistleblower program represents. And the program is in its infancy.

Eager to secure their own share of the enforcement pie, other regulators will likely be close on the SEC's enforcement heels in using whistleblowers to expose wrongdoing. For example, the Commodity Futures Trading Commission has made clear that it is eager to flex its enhanced enforcement muscles and reap the benefits of its own whistleblower program, [6] also established under the Dodd-Frank Act.

But executives and management need not sit idly by while girding themselves for an enforcement wave that may be precipitated by their own whistleblowing employees. Disaster preparedness in the age of the whistleblower — including prudent planning and proactive steps, as well as a focused plan of actions to take at the first sign of trouble — can lead to significant benefits.

Issue Avoidance

The best way to "remediate" issues is to ensure that they never arise. Proactive training regarding legal, compliance and ethical obligations — delivered regularly and customized by industry, region and responsibility — can pay enormous dividends. So, too, can a board of directors' attention to compliance programs and emphasis on selecting executives who will set an appropriate tone at the top.

Real-Time Issue Identification and Remediation

Rather than waiting for issues to come to them, managers should actively explore potential problems through frank discussions and solicitation of information during divisional meetings and employee review sessions. And companies should go beyond standard reporting hotlines and use our ever-changing technology to ferret out misconduct in real-time. When an issue is identified, it should be promptly investigated and remediated. Crafting a compliance investigation action plan that can immediately be customized as needed — and publicizing

remediation, including resultant disciplinary action when appropriate — will demonstrate that a company is serious about compliance and expects no less from its employees.

Focus on International Operations

Companies that focus on domestic compliance and governance while neglecting their overseas operations do so at their own peril. Indeed, in the age of ever-increasing FCPA enforcement by multiple government entities, many companies have learned the hard way that neglecting compliance abroad is unwise, and can be quite costly. Customizing compliance materials by geography and language and delivering training while addressing the unique characteristics of, and challenges facing trainees in, each geographic area, will cost more in the short-term but can pay significant dividends in the longer term.

Incentivize Internal Whistleblowing

Many whistleblowers are more comfortable taking their complaints to a supervisor than to an outside party like the SEC. Companies should capitalize on this by making internal whistleblowing the easiest course, via flexible reporting mechanisms, prompt investigations with regular briefings to whistleblowers and internal recognition for bringing compliance issues to management.

Conclusion

Commenting on the 2012 Report, SEC Chairman Mary L. Schapiro said, "In just its first year, the whistleblower program already has proven to be a valuable tool in helping us ferret out financial fraud."[7]

Given the significant resources devoted to establishing the whistleblower program and the volume of tips generated to date, the SEC is sure to use this new tool to enhance and increase its enforcement activities in the 2013 fiscal year and beyond. Prudent executives and managers will take steps now to prepare for this activity and mitigate its impact on their companies. There's no time like the present for enforcement disaster preparedness.

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[1] 15 U.S.C. § 78a, *et seq.*

[2] Pub. L. No. 111-203.

[3] 15 U.S.C. § 77dd-1, *et seq.*

[4] *Available at* http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf.

[5] 31 U.S.C. § 3729, *et seq.*

[6] 76 Fed. Reg. 53,172 (Aug. 25, 2011).

[7] Press release, SEC, *SEC Receives More Than 3,000 Whistleblower Tips in FY2012*, (Nov. 15, 2012), *available at* http://www.sec.gov/news/press/2012/2012-229.htm.

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Steven S. Goldschmidt is counsel in the New York office of Ropes & Gray and a member of the firm's Government Enforcement and Securities Enforcement practice groups. Steven concentrates his practice on white-collar criminal defense and enforcement actions involving federal and state regulators and administrative agencies.

Steven has extensive experience representing corporate and individual clients in matters involving health care fraud and abuse, securities fraud, Foreign Corrupt Practices Act violations, anti-kickback violations, off-label marketing practices, antitrust abuse, and in response to Congressional investigations and federal and state regulatory inquiries. He has led numerous internal investigations for clients in the financial services, healthcare, insurance, entertainment, legal, retail products and other industries.

Steven has worked with clients to design and implement compliance programs and has advised clients about the compliance implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act. He is a member of the firm's E-Discovery Committee and regularly advises clients in matters involving complex electronic discovery and information management. Steven also handles employment counseling and litigation.

Steven has served as counsel on numerous trials in federal and state court as well as before arbitration panels and administrative bodies.

Representative Clients and Matters

- Representing a major pharmaceutical company in a Department of Justice and FDA investigation that resulted in hundreds of thousands of dollars in restitution paid to the client;
- Representing a medical device manufacturer in a Department of Justice investigation and federal False Claims Act matter that resulted in closure of the government investigation and voluntary dismissal of the *qui tam* complaint;
- Conducting a compliance assessment for an international pharmaceutical company;
- Representing an international insurance broker in an SEC investigation of alleged violations of the Foreign Corrupt Practices Act;
- Representing a national hospital system in Department of Homeland Security, Department of Justice, and Congressional investigations of alleged healthcare fraud;
- Representing an international pharmaceutical company in wide-ranging Department of Justice, FDA and Congressional investigations into fraudulent marketing and promotional practices;
- Representing a financial services company in an SEC investigation of allegedly improper trading activities;
- Representing a prominent money manager in a securities arbitration;
- Representing an international law firm in a federal employment litigation that resulted in complete summary judgment in favor of the client.

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