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“The SEC as the Whistleblower’s Advocate” What You Need to Know About Chair White’s Speech and Recent SEC Whistleblower Developments

by Gregory D. DiMeglio, Jeffrey E. McFadden and Zachary T. Knepper

Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in 2010 and the subsequent creation of the Office of the Whistleblower within the U.S. Securities and Exchange Commission (SEC or Commission) in 2011, the SEC has been increasingly vocal about its support for whistleblowers. The Commission has backed this up with a string of monetary awards to whistleblowers and enforcement actions against companies for, among other things, stifling potential whistleblower complaints and retaliating against whistleblowing employees. In a speech last week about the whistleblower program, SEC Chair Mary Jo White underscored the high profile of the program, calling it a “game changer.”¹ This article provides a brief summary of Chair White’s speech and related commentary from the SEC staff, highlights certain enforcement actions related to whistleblowers and identifies some key takeaways.

Whistleblowers have become a cornerstone of the SEC’s enforcement program.

The title of Chair White’s speech – “The SEC as the Whistleblower’s Advocate” – speaks volumes. And just in case anyone missed it, Chair White stated at the outset of her speech, “we at the SEC increasingly see ourselves as the whistleblower’s advocate.” SEC Enforcement Director Andrew Ceresney has described the whistleblower program as “transformative,” saying whistleblowers have “alerted us to conduct that we would otherwise have been unaware of, allowed us to expedite our investigations, and provided us with a detailed roadmap for misconduct.”² According to Director Ceresney, the whistleblower program has also “changed the calculus” for companies considering self-reporting misconduct to the SEC.³ Companies that choose not to self-report are “taking a huge gamble” because if the Commission learns of misconduct from a whistleblower, the result for the company will be “far worse” than if the company had self-disclosed.

The quantity and quality of whistleblower tips are on the rise.

The number of tips to the SEC has increased every year the whistleblower program has been in operation.⁴ As Chair White noted in her speech, the SEC received over 3,600 tips (or more than 10 per day) in fiscal year 2014. The rate of tips has further increased in the current fiscal year; in the first quarter of fiscal 2015, the rate of tips was 20 percent above the rate from the same quarter in 2014. The scope of tips spans the spectrum of potential securities violations, and tips originate from sources throughout the United States and internationally.

Chair White credited tips as being of high quality as well. Tips have served as the bases for investigations and have helped the Commission identify and stop ongoing or imminent frauds. Whistleblowers have also provided the SEC with invaluable assistance, such as

testifying at temporary restraining order or asset freeze proceedings and encouraging other witnesses to come forward with information, she said.

Whistleblower awards are following suit.

As the SEC's whistleblower tips have improved, the SEC has also been "making substantial and more frequent awards" to whistleblowers, according to White. Under Dodd-Frank, an individual who voluntarily provides original information to the Commission leading to a successful SEC enforcement action that results in over \$1 million in monetary sanctions is eligible for a whistleblower award of between 10 and 30 percent of the amount recovered. To date, the SEC has issued awards to 17 claimants. In its 2014 fiscal year, the Commission issued awards to more people – and awarded more money – than in any previous year. Chair White expects this trend to accelerate still further.⁵ The largest award to date was more than \$30 million, given in September 2014 to a whistleblower who pointed the Commission to an ongoing fraud that the Commission acknowledged would have been otherwise very difficult to detect. In addition to this award, there have been two other whistleblower awards of more than \$1 million.⁶

The SEC continues to bring cases involving company officers and internal compliance and audit professionals who blow the whistle.

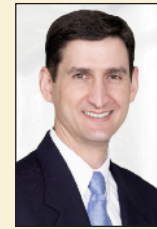
The SEC's whistleblower rules limit the ability of officers and directors and internal compliance and audit personnel to qualify for whistleblower awards. A corporate officer or director cannot receive a whistleblower award for tipping the SEC about information that arose through an internal compliance program, and compliance and internal audit professionals are generally prohibited from receiving awards.⁷ There are exceptions to these prohibitions, though. In March 2015, the Commission applied one of these exceptions in granting a whistleblower award of approximately \$500,000 to a company officer who learned about misconduct and reported the misconduct to the SEC at least 120 days after responsible compliance personnel were also aware of it.⁸ In April 2015, the Commission applied a different exemption (which had no waiting period), awarding over \$1.4 million to a compliance officer who notified the SEC about misconduct that the officer had a reasonable basis to believe was likely to cause substantial financial harm to the company or investors.⁹ This was the second award to an internal audit or compliance professional. Last year, the Commission awarded over \$300,000 to an internal audit and compliance employee who reported misconduct to the SEC 120 days or more after first reporting it internally.¹⁰



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The SEC is on the lookout for companies that are "taking steps to silence potential whistleblowers."

According to Chair White, the SEC is scrutinizing confidentiality agreements and corporate policies and procedures for any indications that they may "impede" whistleblowing. On April 1, the Commission brought its first enforcement action against a company for using a confidentiality agreement that stifled employee whistleblowing.¹¹ The SEC found that the company unlawfully impeded potential whistleblowers when it required witnesses in internal investigation interviews to sign confidentiality statements that included a warning that the witness could face discipline if he or she discussed the subject matter of the interview with outside parties absent prior approval of the firm's legal department.¹² Speaking about the matter, Chair White cautioned companies to "speak clearly" in their employee confidentiality provisions "so that employees, most of whom are not lawyers, understand that it is always permissible" to report potential securities violations to the SEC.

The SEC reportedly has sent letters to several companies requesting years of nondisclosure agreements, employment contracts and other documents as part of the agency's investigation into whether companies are improperly muzzling potential whistleblowers.¹³ The Office of the Whistleblower is actively working with SEC enforcement staff to identify any attempts by employers to prevent or impede employees' ability to bring information to the SEC's attention.¹⁴ Chair White noted in her speech that as the Commission has intensified its focus in this area, a number of other concerns have come to its attention, including that some companies may be trying to require employees to sign agreements that would mandate they forgo a whistleblower award or that represent, as a precondition to obtaining a severance payment, that the

employee has not made a prior report to the SEC. “You can imagine our Enforcement Division’s view of those and similar provisions,” she said.

The SEC is “cracking down” on companies that retaliate against whistleblowers.

The Commission brought its first anti-retaliation case in June 2014 when, as part of a settled enforcement action against a hedge fund advisory firm and its founder for executing certain improper trades on a principal basis, it also sanctioned the firm for retaliating against a former employee who had blown the whistle to the SEC on the unlawful transactions.¹⁵ The firm and its founder agreed to pay over \$2.1 million in disgorgement, interest and penalties to resolve the matter. Moreover, just last week, the SEC awarded the whistleblower the maximum amount possible, 30 percent of the amount the SEC recovered. The chief of the SEC’s Office of the Whistleblower said about this award: “My hope is that the award today encourages potential whistleblowers to come forward in light of our

demonstrated commitment to protect them against retaliatory conduct and make significant financial awards to whistleblowers who suffer employment hardships as a result of reporting possible securities law violations.”¹⁶ The Commission is looking to bring additional anti-retaliation cases. According to the chief of the Whistleblower Office, the SEC currently has a “healthy inventory of investigations” regarding potentially unlawful retaliation.¹⁷

Key takeaways.

The SEC’s whistleblower program is becoming more robust and is here to stay. Companies interested in increasing the likelihood that employees will report potential misconduct internally (rather than going straight to the SEC)¹⁸ and reducing the risk of an enforcement action or at least minimizing its consequences should consider:

- Ensuring that the tone at the top of the organization is supportive of internal compliance systems related to whistleblowers;

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- Taking a fresh look at the company’s internal policies and procedures regarding the handling of tips and complaints and employee confidentiality and severance agreements for any procedures or provisions that could be viewed as potentially impeding an employee’s ability to contact the SEC;
- Assessing whether the organization’s confidentiality and privilege warnings to employees in internal investigations (*i.e.*, its *Upjohn* warnings) are appropriate;
- Carefully but swiftly investigating and appropriately remediating potential misconduct that arises out of a whistleblower or other internal tip or complaint; and
- Self-reporting any such potential misconduct.

¹ Mary Jo White, The SEC as the Whistleblower’s Advocate (Apr. 30, 2015), *available at* <http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html>.

² Andrew Ceresney, Remarks at 31st International Conference on the Foreign Corrupt Practices Act (Nov. 19, 2014), *available at* <http://www.sec.gov/News/Speech/Detail/Speech/1370543493598>.

³ Andrew Ceresney, FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry (Mar. 3, 2015), *available at* <http://www.sec.gov/news/speech/2015spch030315ajc.html>.

⁴ See U.S. Securities and Exchange Commission, 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program, p. 20 (Nov. 17, 2014), *available at* <http://www.sec.gov/about/offices/owb/annual-report-2014.pdf>.

⁵ The pace of whistleblower awards is not without criticism. *The Wall Street Journal* recently reported that data it had obtained shows that of the 297 individuals who have applied for whistleblower awards, 247 – or roughly 83 percent – have not yet received a decision from the SEC as to whether they will receive an award. Some claimants have been waiting for a decision from the Commission for over two years. See Rachel Louise Ensign and Jean Eaglesham, *SEC Backlog Delays Whistleblower Awards*, *Wall St. J.* (May 4, 2015), *available at* <http://www.wsj.com/articles/sec-backlog-delays-whistleblower-awards-1430693284> (subscription required).

⁶ See SEC Announces Million-Dollar Whistleblower Award to Compliance Officer, SEC Press Release 2015-73 (Apr. 22, 2015), *available at* <http://www.sec.gov/news/pressrelease/2015-73.html>; SEC Awards More Than \$14 Million to Whistleblower, SEC Press Release 2013-209 (Oct. 1, 2013), *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258>. The April 22, 2015 award is discussed in the next paragraph of this alert.

⁷ See 17 C.F.R. § 240.21F-4(b)(4)(iii)(A), (B) (2015).

⁸ See Order Determining Whistleblower Award Claim, SEC Release No. 34-74,404, n.1 (Mar. 2, 2015), *available at* <http://www.sec.gov/rules/other/2015/34-74404.pdf>.

⁹ See Order Determining Whistleblower Award Claim, SEC Release No. 34-74,781, n.1 (Apr. 22, 2015), *available at* <http://www.sec.gov/rules/other/2015/34-74781.pdf>.

¹⁰ See Order Determining Whistleblower Award Claim, SEC Release No. 34-72,947, n.1 (Aug. 29, 2014), *available at* <http://www.sec.gov/rules/other/2014/34-72947.pdf>.

¹¹ See Companies Cannot Stifle Whistleblowers in Confidentiality Agreements, SEC Press Release 2015-54 (Apr. 1, 2015), *available at* <http://www.sec.gov/news/pressrelease/2015-54.html>.

¹² *In re KBR, Inc.*, SEC Release No. 34-74619 (Apr. 1, 2015), *available at* <http://www.sec.gov/litigation/admin/2015/34-74619.pdf>. Chair White elaborated in her speech that KBR’s confidentiality agreement ran afoul of SEC rules by, among other things, “covering underlying facts.”

¹³ See Rachel Louise Ensign, *SEC Probes Companies’ Treatment of Whistleblowers*, *Wall St. J.* (Feb. 25, 2015), *available at* <http://www.wsj.com/articles/sec-probes-companies-treatment-of-whistleblowers-1424916002> (subscription required).

¹⁴ See Yin Wilczek, *McKessy: SEC to Bring Actions on Whistleblower Retaliation, ‘Pretaliation,’* *Bloomberg BNA Sec. Reg. & L. Rep.*, 47 SCLR 691 (Mar. 31, 2015).

¹⁵ See SEC Charges Hedge Fund Adviser with Conducting Conflicted Transactions and Retaliating Against Whistleblower, SEC Press Release 2014-118 (Jun. 16, 2014), *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542096307>.

¹⁶ SEC Announces Award to Whistleblower in First Retaliation Case, SEC Press Release 2015-75 (Apr. 28, 2015), *available at* <http://www.sec.gov/news/pressrelease/2015-75.html>.

¹⁷ See Wilczek, *supra* note 14.

¹⁸ The SEC’s whistleblower rules incentivize employees in two ways to report potential misconduct internally before contacting the SEC. First, a whistleblower’s participation in internal compliance systems is a factor that will generally increase the size of a whistleblower award, whereas interference with those systems will decrease any potential award. Second, a whistleblower who internally reports, and at the same time or within 120 days reports to the SEC, will receive credit for any information the company subsequently self-reports. See White, *supra* note 1 (discussing the relevant SEC rules).