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Recent Whistleblower Case Law Developments

Orrick's Whistleblowing Blog

Mike Delikat

Orrick, Herrington & Sutcliffe LLP
51 West 52nd Street
New York, NY 10019
Tel. 212-506-5230
mdelikat@orrick.com

www.orrick.com

Three's Company: SEC Awards Nearly $2 Million to Whistleblower Trio

Posted on March 9, 2016
by Renee Phillips and Michael Disotell

In March 8, 2016, the Securities and Exchange Commission (SEC) issued an order awarding a trio of whistleblowers a bounty of almost $2 million.

One whistleblower will receive the lion's share of the bounty — $1.8 million — for providing the original information that led to the SEC initiating the investigation and for providing valuable information to the agency throughout the process. The other two whistleblowers will receive just over $65,000 each for providing information after the SEC's investigation had commenced.

In making this award, the SEC adopted the preliminary determination of its Claims Review Staff. The SEC explained that it based the award on the factors outlined in Rule 21F-6 and considered the "relative contribution of the Claimants to the success of the Covered Action." Notably, the Claims Review Staff in its preliminary determination also denied a fourth individual's award claim because it concluded the claimant had knowingly and willfully made false, fictitious, or fraudulent representations to the SEC over a period of several years.

Sean X. McKessy, Chief of the Office of the Whistleblower, added in an SEC press release, "We're seeing a significant uptick in whistleblower tips over prior years, and we believe that's attributable to increased public awareness of our program and the tens of millions of dollars we've paid to whistleblowers for information that helped us bring successful enforcement actions." Since the whistleblower program's inception in 2011, the SEC has now paid more than $57 million to 26 whistleblowers.

Where Have You Gone Dennis Kozlowski? Third Circuit Dismisses Tyco Employee's Whistleblower Claim Over Excessive Corporate Spending

Posted on February 8, 2016
by Mike Delikat, Renee Phillips and Annabelle Chan

On February 2, 2016, the Third Circuit affirmed the dismissal of a long-running SOX whistleblower suit filed by Jeffrey Wiest, a former accounts payable manager for Tyco Electronics. The decision is the first in which the Third Circuit has defined the "contributing factor" causation standard for SOX retaliation cases and provides helpful guidance on the issue.

Plaintiff Jeffrey Wiest alleged that Tyco terminated his employment in retaliation for complaining about the company's excessive spending on corporate retreats in June and October 2008. Tyco, no stranger to allegations of excessive spending, saw its CEO Dennis Kozlowski convicted in 2005 for looting nearly $100 million from Tyco, including lavish spending at company retreats. For purposes of the appeal, the Third Circuit assumed that Wiest's complaints were protected under SOX.

The key question on appeal was whether Wiest had identified any evidence in the record from which a jury could conclude that Wiest's complaints were a "contributing factor" in the termination of his employment. Recognizing that it had not yet addressed the contributing factor element in a SOX retaliation case, the Third Circuit adopted the standard articulated by the Fourth, Fifth, and Tenth Circuits: "any factor, which alone or in combination with other factors, tends to affect in any way the outcome of the decision." The court further explained that circumstantial evidence in the form of close temporal proximity between protected activity and an adverse action could establish causation, and that, conversely, causation could be severed by the passage of a significant amount of time, or by a legitimate intervening event.

Applying the standard to Wiest's claim, the Third Circuit held that there was no genuine issue of material fact as to whether Wiest's complaints were a contributing factor in his termination 10 months later. Not only did temporal proximity not support Wiest's claim, several legitimate intervening events undermined it: (1) he received "praise and commendations" both during and after his protected activity; (2) in 2009, several employees complained that Wiest had used inappropriate sexual language and had engaged in inappropriate sexual activity with subordinates; (3) the HR professional who investigated the complaints against Wiest, and ultimately recommended Wiest's dismissal, had no knowledge of Wiest's protected activity; (4) Wiest's colleagues in the accounting department who participated in the same protected activity as Wiest did not receive any negative treatment; and (5) the employees who Wiest claimed were frustrated with him due to his protected activity were no longer employed by Tyco at the time of HR's investigation, as Tyco had sold the business unit. These undisputed facts, according to the Third Circuit, negated any inference that Wiest's protected activity was a contributing factor in his termination as a matter of law.

The Third Circuit further held that, even if Wiest could establish that his protected activity was a contributing factor in his termination, Tyco met its burden to demonstrate by "clear and convincing evidence" that it would have terminated Wiest's employment even in the absence of the protected activity. The court rejected Wiest's only challenge to Tyco's defense—that termination was an unreasonably severe punishment for his transgressions, and that, but for his protected activity, he would have received a more lenient form of discipline—stating that it would not second-guess human resources decisions, and Wiest had failed to come forward with any evidence "casting doubt on the integrity of the investigation."

The Third Circuit's decision in *Wiest* provides useful guidance to companies defending SOX or Dodd-Frank whistleblower cases because it lays out a number of different arguments that employers may use to negate an inference that an employee's alleged whistleblowing was a contributing factor in an adverse employment action.

As many whistleblower claims ultimately are subject to motions for summary judgment, this Court provides a thoughtful roadmap as to what an employer must demonstrate to avoid trial and win a case on summary judgment.

On My Whistle: Are You Up to Speed in the UK with the Financial Conduct Authority's New Rules on whistleblowing?

Posted on December 4, 2015
by Nicola Whiteley, Mandy Perry and Rachel Easter

Relevant firms in the UK have until March 7, 2016 to appoint a "whistleblowers' champion," who then has until September 7, 2016 to oversee their firm's readiness for the new whistleblowing regime.

The new whistleblowing regime: why make the change?

Since the 2013 Parliamentary Commission on Banking Standards recommendations were published in the UK, the Financial Conduct Authority ("FCA") has been examining ways to ensure that individuals working in financial services feel able and encouraged to speak up when they have concerns to avoid the same financial scandals of the past.

At the same time as they are encouraging openness and challenge through whistleblowing, the FCA are imposing new requirements on individuals aimed at holding them accountable for their actions. This comes in the form of the Senior Managers (or Senior Investment Managers, as applicable) and Certification Regime, and Conduct Rules, each coming into effect March 7, 2016. Whatever level of responsibility an individual in a relevant firm holds, the new whistleblowing rules will be relevant to them.

We note that, despite some umming and aahing on the topic, there is no current sign of the FCA adopting the whistleblower bounty approach of the SEC; perhaps it heard that the SEC received the highest number of foreign tip-offs under the programme from the UK in Fiscal Year 2015!

Who is affected by this development?

The new rules will affect "relevant firms," i.e. (i) UK deposit-takers with assets of £250m or greater (including banks, building societies and credit unions), (ii) Prudential Regulation Authority designated investment firms, and insurance and reinsurance firms within the scope of the Solvency II regime and to the Society of Lloyd's and managing agents.

Whilst the initial rollout may be relatively small, however, the FCA has plans to consult with UK branches of overseas banks about these rules "soon," and intends to consider in due course whether or not the rules would be effective and useful in other firms regulated by the FCA, including investments firms, stockbrokers, insurance and mortgage brokers, and consumer credit firms. Given comparative past experience in the UK, this expansion seems likely and will widen the catch considerably.

We're not a relevant firm, do we need to do anything?

Take into consideration that the rules will still be non-binding guidance for other FCA regulated firms and notably they also state that firms not otherwise subject to them "may nonetheless wish to adopt the provisions…as best practice." Gauntlet thrown down.

If you want to read more about our best practice guidance for relevant firms and other FCA regulated firms, and practical suggestions on how to get ready for this change, click here.

For Whom The Whistle Blows: SEC Whistleblower Office Issues Its 2015 Annual Report

Posted on November 20, 2015
by Mike Delikat, Renee Phillips and Michael Disotell

The SEC released its Fiscal Year 2015 Annual Report (the "Report") to Congress on the Dodd-Frank Whistleblower Program on November 16, 2015. The Report analyzes the tips received over the last twelve months by the SEC's Office of the Whistleblower ("OWB"), provides additional information about the whistleblower awards to date, and discusses the OWB's efforts to combat retaliation against whistleblowers.

Breakdown of Tips Received in FY 2015

The OWB received whistleblower tips and complaints from all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Domestically, the largest number of whistleblower complaints and tips were from California (646), New York (261), Florida (220), and Texas (220). Notably, California tips were up by over 16% year over year. Additionally, the OWB received whistleblower tips from individuals located in 61 foreign countries. Of these, the countries from which the most numbers of tips originated were the United Kingdom (72), Canada (49), the People's Republic of China (43), India (33), and Australia (29) with Brazil, Chile, Ireland, and Mexico being other countries from which the SEC received more than 10 tips.

The OWB reported a modest increase in the number of whistleblower tips and complaints that it received in 2015 – 3,923 tips in 2015 compared to 3,620 tips in 2014. Overall, the 2015 whistleblower tips were similar in number and type of whistleblower tips reported in 2014. As in 2014, the most common types of allegations in 2015 were: Corporate Disclosure and Financials (17.5%), Offering Fraud (15.6%), and Manipulation (12.3%). Most whistleblowers, however, selected "Other" when asked to describe their allegations.

2015 Whistleblower Awards

Overall, the SEC awarded more than $37 million to whistleblowers in 2015, bringing the total payout under the program to over $54 million. The number of whistleblower award claims has also continued to increase each year, which the OWB attributes to "the increased public awareness of the SEC's whistleblower program and in response to the tens of millions of dollars that have been paid to whistleblowers under the program."

The SEC issued eight whistleblower awards in FY 2015, including one award for the maximum 30% bounty to a whistleblower whom the SEC determined was a victim of retaliation for his reporting activity. The OWB reported it reached its decision to award the maximum after considering the unique hardships the whistleblower faced, such as: (1) being stripped of his or her position; (2) tasked with investigating the very conduct the whistleblower reported to the SEC; and (3) being otherwise marginalized at his or her company.

Also, 2015 marked the first time the SEC utilized the "substantial injury" exception to the Whistleblower Rules excluding individuals whose principal duties involve compliance or internal audit responsibilities. Further, the SEC issued its first award to a company officer. In doing so, the SEC utilized an exception to the Whistleblower Rules which makes corporate directors and officers eligible to receive an award if he or she reports information to the SEC more than 120 days after other responsible compliance personnel possessed the information but failed to adequately address the situation. Finally, the SEC paid out its record $30 million bounty it awarded in September 2014. The whistleblower's information from this action also led to several successful related actions, so the whistleblower received additional payments in 2015 based on amounts collected.

Profiles of Bounty Recipients

The OWB reports that almost half of award recipients were current or former employees of the company about which they reported violations. Of those, approximately 80% either raised their concerns internally first or knew that the company was otherwise aware of the issues before they reported the violations to the SEC. The award recipients who were not current or former employees obtained their information either because they were (i) victims of the fraud, (ii) professionals in a related industry, or (iii) had a personal relationship with the alleged wrongdoer. Approximately 20% of award recipients submitted their tips to the SEC anonymously.

The OWB noted that approximately 20% of the SEC bounty awards made to date were reduced because of what the SEC determined to be an unreasonable reporting delay by the recipients. Such delays were particularly problematic in the OWB's view when they led to a continuation of securities law violations and an increase in ill-gotten gains.

Retaliation and Confidentiality Agreements

In addition, OWB has been continuing to work to identify employee confidentiality, severance, and other types of agreements that may interfere with an employee's ability to report potential wrongdoing to the SEC. The SEC brought its first enforcement action against KBR in April, 2015 for its use of confidentiality agreements; ultimately, the company settled the action for $130,000 and agreed to amend its confidentiality statements to comply with SEC guidance. Based on this success, the SEC noted assessing confidentiality agreements for compliance with Rule 21F-17(a) will continue to be a top priority for OWB in FY 2016.

Internal Reporting

Finally, the OWB filed amicus curiae briefs in several cases in FY 2015 to urge courts to hold, in deference to the SEC's rule, that individuals are entitled to employment retaliation protection if they report information about a possible securities law violation internally at a company, regardless of whether they have separately reported the information to the SEC. There is currently a split of authority on this issue. In addition, the SEC issued interpretive guidance reiterating its position in this regard.

So You Want to Accept That Board Position? One More Reason to Pause: Directors Can Be Personally Liable Under Sarbanes-Oxley and Dodd-Frank

Posted on November 17, 2015
by Tim Long, Alexandra Pavlidakis and Alexandra Stathopoulos

On October 23, 2015, in a suit filed by Bio-Rad's former general counsel Sanford Wadler, the United States District Court for the Northern District of California issued a decision granting in part and denying in part Defendants' motion to dismiss in *Wadler v. Bio-Rad Labs, Inc.* (No. 15-CV-02356-JCS, 2015 WL 6438670 (N.D. Cal. Oct. 23, 2015), holding, among other things, that corporate directors may be held personally liable for retaliating against a whistleblower under both the Sarbanes-Oxley Act of 2002 (SOX) and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).

Plaintiff Wadler was Bio-Rad's general counsel for nearly 25 years. He claims that from 2011 to 2013, he raised concerns that certain of Bio-Rad's sales practices in China violated the Foreign Corrupt Practices Act ("FCPA"). He alleges Bio-Rad's management was not receptive to his concerns, and so he reported his concerns to the board of directors' audit committee. The board hired a law firm to investigate. Wadler contends that in March 2013, the law firm reported at a meeting with Bio-Rad that it had not found any violations of the FCPA regarding the company's China sales, and he challenged the firm's conclusion at the meeting. Wadler then alleges that, shortly after that meeting, in June 2013, after a vote of Bio-Rad's entire board of directors, Bio-Rad terminated Wadler.

Wadler filed an administrative complaint with the DOL's OSHA Division and filed suit against Bio-Rad in U.S. District Court, alleging that Bio-Rad had violated both SOX and Dodd-Frank by terminating him in retaliation for raising concerns about Bio-Rad's potential FCPA violations. Wadler's SOX and Dodd-Frank retaliation claims named the company and all individual directors on the board, including the CEO. Bio-Rad moved to dismiss Wadler's claims against the individual directors, claiming, among other things, that both SOX and Dodd-Frank do not provide for corporate directors to be held individually liable.

Although Wadler's SOX claims against the individual board members other than the CEO were ultimately dismissed because of lack of adequate notice, in reaching its decision, the District Court held that both SOX and Dodd-Frank do allow corporate directors to be held personally liable for retaliating against a whistleblower. The District Court noted that SOX imposes liability on an employer's "officers, employees, contractors, subcontractors or agents" who retaliate against whistleblowers, and while the statute is ambiguous as to whether a corporate "director" who is not an officer or an employee can be an "agent," holding Bio-Rad's directors personally liable as "agents" is consistent with SOX's central statutory purpose of protecting whistleblowers.

As to Wadler's Dodd-Frank claim, the Court noted that "employers" who retaliate against whistleblowers can be liable under Dodd-Frank, and while the definition of "employers" is also ambiguous, Congress intended that Dodd-Frank provide for individual liability that is at least as extensive as that of SOX, and therefore, directors may be held individually liable for retaliating against whistleblowers under Dodd-Frank.

The Court's decision in *Wadler* underscores yet another risk individuals face when accepting invitations to join corporate boards: the prospect of being a defendant in a whistleblower retaliation lawsuit. While directors must oversee corporate accounting and compliance issues, they do not generally need to be involved in making employment decisions with regard to putative whistleblowers. In light of *Wadler,* directors may want to stay out of such decision-making to the extent possible.

Chief of SEC Whistleblower Office Shares Candid Assessment of Program's Results to Date and Future Direction

Posted on September 15, 2015
by Mike Delikat and Renee Phillips

On September 9, 2015, Sean McKessy, Chief of the SEC's Office of the Whistleblower (OWB) spoke at Thomson Reuters' 4th Annual Corporate Whistleblower Program in New York. With the standard disclaimer that his comments and opinions were his own and not the official comments of the agency, McKessy spoke candidly about the SEC whistleblower program's progress, challenges, and priorities as it enters FY2016.

Numbers of Tips and Awards

McKessy predicted that the number of tips filed with his Office in FY2015 would be in the range of 4,000, about a 20% uptick from FY2014. The number of applications for awards is also up. The office is handling the increase by adding two lawyers to its team, for a total of thirteen lawyers and five paralegals by October.

McKessy expects the SEC to pay a total of eight bounty awards in FY2015 (nine including one award from last year that was not paid until this year). In response to criticisms that, with over 10,000 tips over the life of the Dodd-Frank whistleblower tip program and less than 20 bounties paid, the program has not met its objectives, McKessy's view is that the success of the SEC's bounty program goes beyond the number and amount of awards paid. The small number of awards is partly attributable to the fact that tips have resulted in a number of actions with recoveries of under $1 million, which is below the threshold for making bounty awards. Also, some whistleblower reports have led to enforcement actions by FINRA, other federal agencies, or state attorneys general instead of the SEC. In all, McKessy estimates that OWB is tracking or has tracked about 1000 matters across the nation in connection with whistleblower tips, which accounts for about 10% of the tips received by OWB since the program's inception.

Recent Bounty Awards to Compliance Professionals and a Company Officer

While certain categories of individuals, including company officers and compliance professionals, are generally ineligible for bounties, the SEC has recently made three awards to such individuals, invoking exceptions to the exclusions. The three exceptions may be applied when such individuals (1) have a reasonable basis to believe the report is necessary to prevent "substantial injury" to the company or investors; (2) have a reasonable basis to believe the company is impeding an investigation; or (3) wait 120 days after either reporting the issue to the company or after the company is otherwise aware of the issue.

McKessy attempted to allay concerns of some audience members about the awards of bounties to compliance professionals, explaining,

"I am a former in house attorney. I was not in my current role when the rules were proposed. I understand why the initial thought process is that these people should not be paid. I understand that. In the first instance when a compliance professional or officer or attorney [makes a report to our office] there is a presumption that they will not get paid. They have to overcome that. Reasonable minds can disagree as to when the exceptions apply. But in the real world, the exceptions recognize when things are not going the way they ought to. If someone in their company is shredding documents or destroying hard drives, I hope they would come to us. This happened in Enron and WorldCom, and people would have wished they had run to the SEC. We should all be able to agree that people with important jobs should be able to come forward with that. Second, where a company is actively engaged in conduct that will do long term harm to investors, I hope people will raise their hands. And they don't have to wait 120 days to report under those circumstances."

McKessy provided context on a recent SEC bounty award to a compliance professional under the "substantial injury" exception. In awarding this bounty, the OWB did not just take the whistleblower at his/her word that substantial injury would result in the absence of his/her report. Rather, the Office sought and received specific information from the whistleblower that the company had thought it had been let off the hook for certain misconduct and was about to engage in additional misconduct.

McKessy further noted that the ambiguity inherent in the substantial injury exception makes it not his "favorite exception" and recognized it is an exception that could "swallow the rule."

"I understand that, and I am not anxious to look for that as our vehicle. The one time we accepted that, we asked and received concrete examples of the company's intentions to engage in [illegal] activity. It is an exception that we have to view very narrowly."

As for a recent award to a compliance employee who invoked the "120-day" exception, McKessy explained that this employee was told consistently not to continue reporting the issue; he continued to pursue it; the person was right; and the person waited well over 120 days before reporting to the SEC, and only after there were adverse employment consequences.

McKessy confirmed that there has not yet been an award made to a compliance professional under the "impeding an investigation" exception.

Challenges: Serial Filers and Case Backlog

McKessy said that his Office is attacking its backlog (reported by the Wall Street Journal to be over 200+ claims) and pointed out that two serial filers caused the majority of that backlog. Those two serial filers have now been banned from the program for life, leaving more time and resources to devote to legitimate claims. The Office issued over 100 preliminary determinations on whistleblower award claims over the summer, but it can take up to seven months for those preliminary determinations to work their way through the appeals process and become final. According to McKessy, all claims at the OWB have now been either disposed of or assigned to be disposed of.

Confidentiality Agreements that "Muzzle" Individuals from Assisting the SEC: A Continuing Priority

One of the OWB's priorities for FY2015 has been to look for confidentiality agreements that may impede individuals from making reports to the SEC in violation of Rule 21F-17, which provides that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement…." The SEC brought its first Rule 21F-17 case in April 2015 against KBR. In addition, in February 2015, the SEC opened a sweep investigation on this issue, sending broad document requests to a number of companies seeking all of their severance agreements and confidentiality policies since the promulgation of the Rule in August 2011. In response to an audience question, McKessy would not comment on the status of the investigation.

McKessy confirmed that this issue will continue to be an OWB priority in the coming year, stating, "I can definitively say KBR is not the last case we will bring on the issue." McKessy said he understands that companies have legitimate reasons for having confidentiality agreements with employees, such as to protect trade secrets, and the SEC "is not interested in those." Nor is the SEC is interested in attorney-client privileged communications, but, McKessy explained, *Upjohn* warnings can be confusing to an average person, and it is critical that an average person be able to understand that nothing prevents him/her from sharing facts with the SEC.

Overall, the OWB is “looking for companies taking positions by actions or in agreements, in word or substance, that you report this to anyone other than the company at your own peril.” “Context will be everything” in evaluating these claims. “If a company has been using the same agreements for 100 years, after August 2011, the world has changed and you may need to make changes. It is not an excuse that you have been using the agreements forever.”

D.C. Circuit Confirms: Attorney-Client Privilege Applies to Internal Investigations of Whistleblower Complaints Conducted at the Direction of Counsel

Posted on August 18, 2015
by Mike Delikat, Lauri Damrell and Timothy Del Castillo

The ability to preserve privilege for highly sensitive internal investigations conducted at the direction of attorneys is alive and well. In a closely watched decision on the scope of the attorney-client privilege as applied to internal investigations, the D.C. Circuit granted defense contractor Kellogg Brown & Root's ("KBR") petition for a writ of mandamus and vacated a district court's order that privileged documents from an internal investigation must be produced.

The long standing principle that the attorney-client privilege applies to internal investigations that are directed by company lawyers stems from the Supreme Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). But the dispute in *In re KBR* did not revolve around the existence of the privilege; instead it concerned how easily that privilege can be waived.

Harry Barko worked for KBR and filed a False Claims Act complaint against KBR alleging that KBR defrauded the U.S. Government by inflating costs and accepting kickbacks while administering military contracts in wartime Iraq. During discovery in the case, Barko sought documents that were created as a part of KBR's internal investigation that resulted from his earlier complaints to the company about the same issues. The internal investigation had been conducted at the direction of KBR's legal department.

Barko argued that KBR waived privilege during a Rule 30(b)(6) deposition of KBR's person most knowledgeable about the internal investigation. KBR's witness reviewed the internal investigation documents in preparation for the deposition. The witness testified about the internal investigation generally, explaining that it was performed in response to Barko's complaint. But he refused to answer questions about the substance of the investigation, arguing that such information was privileged.

Barko also argued, and the district court agreed, that KBR has "impliedly waived" the attorney client privilege in its motion for summary judgment. KBR argued that one could infer that no wrongdoing occurred because, had KBR's investigation revealed possible wrongdoing, KBR would have reported it to the government. The district court concluded that because KBR "actively sought a positive inference in its favor based on what KBR claims the documents show," the documents should be discoverable. Even if that were not the case, the documents would still be discoverable because Federal Rule of Civil Procedure 612 allows a party to obtain documents a witness uses to refresh his or her recollection before testifying, notwithstanding any privilege or work product protection.

The D.C. Circuit strongly rejected the district court's rationale. Acknowledging that mandamus is a "drastic and extraordinary" remedy, the court nonetheless granted the petition and agreed with KBR that the district court's decision "run[s] contrary to precedent by injecting uncertainty into application of attorney-client privilege and work product protection to internal investigations." As for the district court's finding that KBR had sought a "positive inference" based on the fact that KBR did not report the results of the investigation to the government, the D.C. Circuit found it significant that KBR only set forth the facts about its investigation in the fact section of its summary judgment motion; NBR did not actually *argue* for an inference based on the investigation. The D.C. Circuit also found Rule 612 inapplicable because the deponent did not "rely" on the documents during the testimony except to state that they were privileged.

The upshot for companies is that they can continue to rely on the attorney-client and attorney-work-production protections for internal investigations conducted at the direction of counsel. Companies need not fear that

merely disclosing that an investigation occurred will result in waiving the privilege as applied to the contents of the investigation. Nonetheless, there is clearly a line that should not be crossed (i.e. making arguments based on the findings of such investigations), if an employer desires to preserve its privilege.

SEC Guidance Supports its Position That Internal Whistleblowers are Protected Under Dodd-Frank

Posted on August 6, 2015
by Jason M. Halper, Mike Delikat and Renee Phillips

On August 4, 2015 the Securities and Exchange Commission issued interpretive guidance elaborating its view that the anti-retaliation provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act apply equally to tipsters who claim retaliation after reporting internally, as well as those who are retaliated against after reporting information to the SEC. The guidance reflects that there is a split among federal courts over whether Dodd-Frank's whistleblower retaliation provisions apply to internal as well as external reporting, and recognizes that the only circuit court to decide the issue to date, the Fifth Circuit, has taken a contrary position to that of the Commission in Rule 21F, the regulation the SEC adopted to implement the whistleblower legislation, holding that internal reports are not protected by Dodd-Frank. Whether internal reports qualify for Dodd-Frank coverage has important implications because, among other things, Dodd Frank provides enhanced recoveries (including two times back pay) and longer time frames (six years) for bringing a retaliation claim than would be available under the anti-retaliation provisions in the Sarbanes-Oxley Act of 2002.

Responding to criticisms that the bounties available under Dodd-Frank for those who report to the SEC would discourage internal reporting, the SEC in its Dodd-Frank regulations adopted several provisions it believed would still encourage internal reporting. For example, the SEC has provided for a 120-day "look-back period" for whistleblowers who first report internally. Under this rule, if a whistleblower reports to the SEC within 120 days of reporting internally to the company, the whistleblower will receive 'credit' for reporting the information as of the date of the internal report. This allows the whistleblower to maintain priority status over any subsequent whistleblowers. On top of the 120-day "look-back" rule, the SEC has also said that it will consider whether a whistleblower first reported the information internally before reporting to the SEC when it is considering whether the whistleblower should receive an award and, if so, where the award should fall in the 10 – 30% discretionary range. According to the SEC, "a whistleblower's voluntary participation in an entity's internal compliance and reporting systems is a factor that can increase the amount of an award, and … a whistleblower's interference with internal compliance and reporting is a factor that can decrease the amount of an award." However, many of the bounty awards it has issued to date have not provided information as to whether there was internal reporting or whether the percentage of the award was in fact enhanced for internal reporting.

The dispute over whether internal reporting is covered by Dodd-Frank's anti-retaliation provisions is rooted in what the Commission has argued is conflicting statutory language. A "whistleblower" under the Act is defined as "any individual who provides, or two or more individuals acting jointly who provide, information relating to a violation of the securities laws **to the Commission** in a manner established, by rule or regulation, by the Commission." 17 C.F.R. § 240.21F-2(a)(6). Whistleblowers, in turn, are protected for three different categories of reporting activity: (1) providing information to the SEC; (2) assisting in an SEC investigation; or (3) making "disclosures that are required or protected" under Sarbanes-Oxley, the securities laws, and other SEC regulations. 15 U.S.C. § 78u-6(h)(1)(A). Because the third category of protected reporting activity includes laws that protect internal reporting, a number of courts have held that the statute is internally contradictory and that the best way to harmonize the conflicting provisions is to read the third category's protection of certain whistleblower disclosures not requiring reporting to the SEC as a narrow exception to section 21F's definition of a whistleblower as one who reports to the SEC.

In *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013), the Fifth Circuit disagreed with the SEC. In *Asadi*, the Fifth Circuit addressed the issue of whether Dodd-Frank applied to a GE Energy executive who reported a potential violation of the Foreign Corrupt Practices Act internally. He sued, claiming retaliation, after he was subsequently given a negative performance review, pressured to step down from his position, and

ultimately fired. The court adopted GE Energy's argument that Dodd-Frank did not protect employees against retaliation in response to internal reporting, stating that "[u]nder Dodd-Frank's plain language and structure, there is only one category of whistleblowers: individuals who provide information relating to a securities law violation to the SEC." A number of district courts outside the Fifth Circuit have followed this holding. *See, e.g., Wagner v. Bank of Am. Corp.*, No. 12-cv-00381-RBJ, 2013 WL 3786643, at *4 (D. Colo. July 19, 2013); *Banko v. Apple, Inc.*, No. CV 13-02977 RS, 2013 WL 7394596, at *6 (N.D. Cal. Sept. 27, 2013); *Englehart v. Career Educ. Corp.*, No. 8:14-cv-444-T-33EAJ, 2014 WL 2619501, at *9 (M.D. Fla. May 12, 2014); *Verfuerth v. Orion Energy Sys.*, 65 F. Supp. 3d 640, 646 (E.D. Wis. Nov. 4, 2014); *Lutzeier v. Citigroup, Inc.*, 305 F.R.D. 107, 110 (E.D. Mo. Mar. 2, 2015); *Wiggins v. ING U.S., Inc.*, Civil Action No. 3:14-CV-1089(JCH), 2015 WL 3771646, at *9-11 (D. Conn. June 17, 2015).

However, several other district courts have found that internal reports are covered by Dodd-Frank's anti-retaliation provision, some deferring to the SEC's interpretation of the statute in Rule 21F. *See, e.g., Kramer v. Trans-Lux Corp.*, No. 3:11cv1424 (SRU), 2012 WL 4444820 (D. Conn. Sept. 25, 2012); *Nollner v. S. Baptist Convention, Inc.*, 852 F. Supp. 2d 986, 995 (M.D. Tenn. 2012); *Genberg v. Porter*, 935 F. Supp. 2d 1094, 1106-07 (D. Colo. 2013); *Murray v. UBS Secs.*, LLC, No. 12 Civ. 5914(JMF), 2013 WL 2190084, at *3–7 (S.D.N.Y. May 21, 2013); *Ellington v. Giacoumakis*, 977 F. Supp. 2d 42, 45-46 (D. Mass. 2013); *Rosenblum v. Thomson Reuters (Mkts.) LLC*, 984 F. Supp. 2d 141, 148 (S.D.N.Y. 2013); *Ahmad v. Morgan Stanley & Co.*, 2. F. Supp. 3d 491, 496 n.5 (S.D.N,Y, 2014); *Khazin v. TD Ameritrade Holding Corp.*, Civil Action No. 13-4149 (SDW) (MCA), 2014 WL 940703, at *6 (D.N.J. Mar. 11, 2014); *Yang v. Navigators Grp., Inc.*, 18 F. Supp. 3d 519, 533 (S.D.N.Y. 2014); *Bussing v. CorClearing LLC*, 20 F. Supp. 3d 719, 729 (D. Neb. May 21, 2014);*Connolly v. Remkes*, Case No,:5:14-cv01344, 2014 WL 5473144, at *6 (N.D. Cal. Oct. 28, 2014); *Somers v. Digital Realty Trust, Inc.*, No. C-14-5180 EMC, 2015 WL 2354807, at *1 (N.D. Cal.May 15, 2015).

The SEC's August 4 guidance has announced its position that there are two definitions of whistleblower for purposes of section 21F: one that applies to Dodd-Frank's bounty protections, and another that applies to Dodd-Frank's antiretaliation provision. It is unclear whether this new guidance will have a substantial impact on the current split among the courts. The SEC has routinely participated as amicus in Dodd-Frank retaliation cases around the country and its views on the issue are well-known. The next major pronouncement is likely to come from the Second Circuit, which heard oral argument on the scope of Dodd-Frank's whistleblower protections in *Berman v. Neo@Ogilvy* on June 17, 2015. If the Second Circuit takes a contrary view to that of the Fifth Circuit, this is an issue that could very well make its way to the U.S. Supreme Court, where the issue

of *Chevron* deference to the SEC's interpretation will be center stage. In the meantime, the SEC has taken the position that it may itself bring retaliation cases, *see, e.g., In re Paradigm Capital Management*, and we certainly expect to see more such cases brought by the Commission in the near future.

SEC Awards Third Highest Whistleblower Award to Date

Posted on August 4, 2015
by Jennifer Nejad, James Thompson and Ken Herzinger

On July 17, 2015, the SEC announced a whistleblower award of over $3 million to a company insider who provided information that "helped the SEC crack a complex fraud." This payout represents the third highest award under the SEC's whistleblower program to date. The SEC has made two of the three highest payments to clients of the same law firm – Phillips & Cohen LLP. (The SEC paid roughly $14 million to a whistleblower in October 2013, and nearly $30 million to a foreign whistleblower represented by Phillips & Cohen in September 2014.). This latest multi-million dollar payout suggests that the SEC's whistleblower program is in full swing, and that legal representation of whistleblowers may be on the rise.

The agency's press release states that the whistleblower had provided "specific and detailed information" that "comprehensively laid out the fraudulent scheme which otherwise would have been very difficult for investigators to detect." The amount of the award had been increased to reflect that the whistleblower's initial tip had "led to related actions," but decreased because the whistleblower had delayed in reporting the conduct. Specifically, the SEC stated that "due consideration was given to Claimant's unreasonable delay in reporting the illegal conduct to the Commission, although [the SEC had] not applied this factor as severely here as [it] otherwise might have done had the delay occurred entirely after the whistleblower award program was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act." Chief of the SEC's Office of the Whistleblower, Sean McKessy, commented that the award represented "another testament to the agency's commitment to reward those who provide high-quality information that leads to successful enforcement actions and related actions."

Public sources indicate that the whistleblower was represented by Phillips & Cohen, which also represented the whistleblower who received the $30 million payment last September. In both cases, the whistleblowers chose to remain anonymous. According to an attorney for Phillips & Cohen, "The SEC acted quickly as a result of the information and assistance our client provided," and "[t]he fraud was such that it's unlikely that it ever would have been detected if our client hadn't come forward." Id.

Since the inception of the whistleblower program in 2011, more than $50 million has been paid to 18 different individuals. As of the end of fiscal 2014, the SEC had roughly $437.8 million available for funding the Commission's whistleblower program, including the payment of whistleblower bounty awards. Director of the SEC's Division of Enforcement, Andrew Ceresney, remarked that the program "continues to be profoundly effective in helping [the SEC] protect investors and hold wrongdoers accountable."

Sixth Circuit Affirms $250K Victory to SOX Whistleblower and Provides Broad Interpretation of SOX

Posted on June 11, 2015
by James McQuade, Renee Phillips and Lindsey Connor Hulse

On May 28, 2015, the Sixth Circuit in *Rhinehimer v. U.S. Bancorp Investments, Inc.* affirmed a $250,000 jury verdict in favor of a former financial advisor for U.S. Bancorp Investments ("USBII") who alleged that he had been terminated in violation of the Sarbanes-Oxley Act ("SOX") whistleblower provisions. In doing so, the Sixth Circuit rejected the "definitively and specifically" standard for proving protected activity under SOX and abrogated its prior SOX decision in *Riddle v. First Tennessee Bank Nat'l Assoc.*, 497 F. App'x 588 (6th Cir. 2012) to the extent it relied upon the standard.

Background

Michael Rhinehimer, a certified financial planner and former financial advisor for USBII, alleged that a co-worker had made trades on behalf of one of his elderly clients that were unsuitable while Rhinehimer was on a disability leave. Rhinehimer asserted that, when he complained to a superior about the unsuitable trades, management threatened the loss of his job, placed him on an aggressive performance improvement plan, and terminated him when he failed to meet the plan's goals.

Rhinehimer sued under SOX, and a jury awarded Rhinehimer $250,000 in economic loss and emotional distress damages. USBII appealed, arguing that Rhinehimer failed to prove that he had engaged in protected activity as a matter of law.

Analysis

The Sixth Circuit analyzed whether Rhinehimer demonstrated a reasonable belief that his co-worker engaged in unsuitability fraud and held that the evidence submitted in the case was "more than sufficient" to sustain the judgment. According to the court, the evidence demonstrated that Rhinehimer (1) knew the structure of the client's long-held estate plans; and (2) learned of trades that a reasonable investment professional would recognize as inconsistent with those plans. Rhinehimer was also aware of the client's diminished faculties due to his age and was familiar with his co-worker's incentives to place the trades. Viewing the evidence in the light most favorable to Rhinehimer, the court also assumed that the co-worker placed the trades after Rhinehimer warned him of the client's diminished capacity and asked the co-worker not to make any trades for him.

The court recognized that Rhinehimer had no specific knowledge of whether his co-worker omitted or misrepresented material information from the client, or that he did so intentionally or with reckless disregard, but these facts did not change the court's conclusion. Rather, the court stated that SOX "protects employees who reasonably but mistakenly believe that the conduct at issue constitutes a violation of relevant law." The court did not require Rhinehimer to establish a reasonable belief of each element of a fraud to establish a reasonable belief that his co-worker committed unsuitability fraud.

Conclusion

The Sixth Circuit's holding in *Rhinehimer* is just the latest in a string of circuit court decisions since 2011 (including the Second, Third, and Tenth Circuits) to reject the "definitively and specifically" standard. In light of these cases, employers should operate under the assumption that employee complaints may be protected under SOX even if they do not "definitively and specifically" relate to one of the six enumerated violations under SOX (i.e., mail fraud, wire fraud, bank fraud, securities fraud, violation of rule or regulation of the SEC, or

violation of federal law relating to fraud against shareholders). In addition, although a $250,000 jury verdict may not seem very high, prevailing plaintiffs are also entitled to attorneys' fees under SOX, so Rhineminer's actual recovery could be significantly higher.