# The Dodd-Frank Whistleblower Program: Mutiny over the Bounty

BY STANLEY A. TWARDY JR. AND DOREEN KLEIN

The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed with great fanfare in the House of Representatives in December 2009, and six months later in the Senate, as ushering in a new era of regulatory reform in response to the financial crisis that has gripped the nation in recent years. As usual, however, the devil is in the details. One year later, Dodd-Frank is showing the strain of inconsistency with executive branch priorities, for its provisions are at cross-purposes with regulators' vigorous enforcement efforts and persistent calls for companies to create and maintain robust internal compliance programs.

The act's bounty program requires the Securities and Exchange Commission (SEC) to pay rewards to whistleblowers who provide tips leading to successful enforcement actions. It also contains strict liability clawback provisions requiring issuers to seek recovery of executive incentive-based compensation in the event of restated financials, even absent personal misconduct. Thus, employees are incentivized to report perceived violations to the SEC rather than to their employers, while corporate executives who set a tone of compliance from the top may be financially penalized for encouraging vigorous investigation into possible corporate misconduct.

These provisions were enacted against the backdrop of increased enforcement initiatives under the Foreign Corrupt Practices Act (FCPA), the violation of whose books-and-records provisions constitute securities-law violations, thereby bringing it within the ambit of the Dodd-Frank bounty program. The aggressive upsurge in prosecutions under the FCPA in recent years has resulted in numerous high-profile cases netting multimillion-dollar fines. The government's increased attention to FCPA prosecutions, combined with the financial rewards of the Dodd-Frank bounty program, promises to result in an increase in whistleblower activity in connection with the FCPA.

Moreover, the Dodd-Frank whistleblower provisions are an unprecedented expansion of what historically has been relatively limited civil statutory incentives to report fraud. A primary tool of the government to promote reporting of fraud is the False Claims Act, 31 U.S.C. §§ 3729–3733, which dates back to the Civil War and gives rise only to civil claims for fraud in connection with government contracts. The IRS's Reward Program, created in December 2006 in keeping with the effort to guard the public fisc, allows individuals to claim a reward if they provide information about underpayments of taxes to the U.S. government. The SEC's only pre-existing bounty program was restricted to insider-trading tips. The SEC's inspector general recently noted that the 20-year-old program had received very few applications, made very few payments, and was not widely recognized inside or outside the SEC. Office of Inspector General, Office of Audits, U.S. Securities and Exchange Commission, *Assessment of the SEC's Bounty Program*, Report No. 474 (March 29, 2010).

In the new scheme under Dodd-Frank, whistleblowers who provide tips leading to successful enforcement actions are entitled to a hefty percentage of the fines that the SEC collects from securities-law violators of any kind. In the broadly worded provisions of the new bounty program, included are those who run afoul of the FCPA. Because violations of the FCPA inevitably trigger violations of its books-and-records provisions, which in turn constitute violations of the securities laws, Dodd-Frank promises increased whistleblower tips regarding alleged FCPA violations.

## The FCPA

In broad strokes, the FCPA makes it unlawful for domestic corporations to pay money or offer anything of value to foreign government officials to obtain or retain business for the corporation. In addition to these anti-bribery provisions, the FCPA has a books-and-records component, under which a publicly held company must "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer" and must devise and maintain adequate internal accounting controls to ensure that all transactions comply with generally accepted accounting procedures. 15 U.S.C. § 78m(b)(2)(A), (B). The Department of Justice (DOJ) generally enforces the anti-bribery provisions, while the SEC typically enforces its books-and-records requirements. However, the DOJ can and does criminally prosecute the latter as well, for payments to foreign officials in violation of the anti-bribery provisions are often concealed on the company's books and records with false accounting entries.

It is at these books-and-records provisions that the FCPA and Dodd-Frank intersect, at a time when enforcement of the FCPA has become more aggressive. In 2004, the DOJ charged two individuals under the FCPA and collected approximately $11 million in fines. In contrast, between 2009 and 2010, the DOJ charged over 50 individuals and to date has collected nearly $2 billion. Assistant Attorney General Lanny A. Breuer, Speech at the 24th National Conference on the Foreign Corrupt Practices Act in National Harbor, Maryland (Nov. 16, 2010) (transcript available at www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html).

Reinforcing its "take no prisoners" approach, the DOJ has rejected the creation of an amnesty program in FCPA prosecutions, discarding a tangible inducement to self-report. In recent testimony before the Senate Subcommittee on Crime and Drugs, Acting Deputy Assistant Attorney General Greg Andres compared a proposal for an FCPA amnesty program to a bank robber getting immunity just for disclosing the robbery. This approach contrasts with the DOJ's Leniency Program in antitrust matters, which it characterizes as "its most

important investigative tool for detecting cartel activity" and where those who self-report "can avoid criminal conviction, fines, and prison sentences" if they meet the program's requirements. U.S. Dep't of Justice Antitrust Division, *Leniency Program*, justice.gov, www.justice.gov/atr/public/criminal/leniency.htm (last visited Dec. 7, 2010).

## The Dodd-Frank Act Whistleblower Provisions

Section 922 of Dodd-Frank, 15 U.S.C. § 78u-6, requires the SEC to pay whistleblowers who voluntarily provide "original information" leading to successful SEC enforcement actions—either judicial or administrative—that result in monetary sanctions exceeding $1 million. The award to the whistleblower is statutorily set between 10 and 30 percent of the monetary sanctions. This section affords whistleblowers statutory protection from any form of retaliation, 15 U.S.C. § 78u-6(h)(1), requires the SEC to keep their identity confidential, 15 U.S.C. § 78u-6(h)(2), and provides for a private right of action in the event of retaliatory conduct. 15 U.S.C. § 78u-6(h)(1)(B)(i). In the current environment, in which the SEC resolved seven FCPA cases in November 2010 alone, resulting in $80 million in civil fines, the FCPA provides irresistible financial incentives for potential whistleblowers.

The SEC's proposed rules are intended "not to discourage whistleblowers who work for companies that have robust compliance programs to first report the violation to appropriate company personnel," *Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934,* SEC Release No. 34-63237 (Proposed Rules), 75 Fed. Reg. 70488, 70488 (Nov. 17, 2010). Notwithstanding, the SEC has made a judgment that whistleblowers are not required to use internal compliance processes as a prerequisite to eligibility for an award. While the SEC "considered" that approach, they ultimately rejected it, reasoning that some employers lack "established procedures and protections." Proposed Rules at 70496. Instead, the SEC reserved for itself the option of contacting a company upon receipt of a whistleblower complaint to give the company an opportunity to "investigate the matter and report back." *Id.* And, in a laundry list of permissible considerations that the SEC affords itself in determining the *amount* of the award (as opposed to whether to grant one at all), the SEC lists as the last of such considerations "whether, and the extent to which, a whistleblower reported the potential violation through effective internal whistleblower, legal or compliance procedures before reporting the violation to the [SEC]." Proposed Rules at 70500. Even there, the SEC notes that

> [t]his last consideration is not a requirement for an award above the 10 percent statutory minimum and whistleblowers will not be penalized if they do not avail themselves of this opportunity for fear of retaliation or other legitimate reasons. The [SEC] will consider higher percentage awards for whistleblowers who first report violations through their compliance programs.
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> *Id.*

As opposed to programmatically supporting internal compliance processes, the Proposed Rules seem primarily designed to protect a whistleblower's status and entitlement to an award. They preclude persons to whom wrongdoing is reported from seeking whistleblower awards based upon the information that is reported to them, *see* Proposed Rules at 70493–94, and preserve the whistleblower's status through the grant of a 90-day grace period to those who provide information about potential violations to persons involved in compliance or similar functions but who then, within 90 days, report the alleged wrongdoing to the SEC. *See* Proposed Rules at 70495–96.

Mindful of the tension that its bounty system creates, the SEC has asked for comment on whether it should consider a rule that "in some fashion, would require whistleblowers to utilize employer-sponsored complaint and reporting procedures." Proposed Rules at 70496. Comments on the Proposed Rules were due in December 2010. However, absent that requirement, and with potential financial rewards reaching into the multimillions, the incentive is for employees to race to the SEC—rather than the company—to lodge complaints, placing the company in the SEC's crosshairs without an opportunity to conduct an investigation pursuant to its internal compliance protocols. The company may therefore find itself responding to a lengthy and costly investigation rather than proactively investigating a complaint through its own compliance process.

## The Dodd-Frank Act Strict-Liability Clawback Provisions

Moreover, to the extent that compliance emanates from the upper tiers of the corporate hierarchy, Dodd-Frank arguably subverts that vital "tone from the top," for it has strict-liability clawback provisions that require the company to seek recovery of its executives' incentive-based compensation, even absent personal misconduct, if the company restates its financials due to material noncompliance with financial reporting requirements. Dodd-Frank adds a new section, 15 U.S.C. § 78j-4, which requires public companies to develop and implement policies to recover "incentive based compensation" (including stock options) from any current or former "executive officer" (a term that is undefined) of the issuer who received such compensation during the three-year period preceding any restatement of its financials. Absent such policies, the exchanges are prohibited from listing the company, which would put it out of business.

These clawback provisions expand upon the recoupment provisions set forth in section 304 of the Sarbanes-Oxley Act, 15 U.S.C. § 7243, which require reimbursement by the chief executive officer or chief financial officer for incentive-based compensation and profits from the sale of securities received during the 12-month period following the filing or issuance of the improper financial document. Recently, the SEC has been successful in extending the reach of section 304 to individuals not charged with any wrongdoing. *See SEC v. Jenkins*, No. CV-09-01510, 2010 U.S. Dist. LEXIS 57023 (D. Ariz. June 9, 2010) (order denying CEO's motion to dismiss SEC application for order compelling recoupment and rejecting CEO's contention

that section 304 required an element of personal misconduct); *SEC v. O'Dell*, No. 1:10-cv-00909 (D.D.C. filed June 2, 2010) (where retired CEO settled the case by agreeing to return cash bonuses and stock options, even though he was not charged with misconduct).

These instances of what have come to be known as "no fault clawback" prosecutions seem modest in the wake of Dodd-Frank. As with the new judicial gloss on section 304, there is no requirement that the executive be responsible for the noncompliance or have engaged in any wrongful conduct. But going one step further, Dodd-Frank does not require that the restatement have been brought about by any misconduct at all. Moreover, not only does the provision reach beyond the CEO and the CFO, but the term "executive officer" is not defined, and the section explicitly encompasses current and former officers. Finally, the clawback period under Dodd-Frank is three years, rather than the one-year period of Sarbanes-Oxley. Given these aggressive provisions, it is noteworthy that Dodd-Frank does not authorize the SEC to move to compel disgorgement of the excess as permitted under Sarbanes-Oxley. Rather, the SEC's authority is limited to directing the national securities exchanges to prohibit the listing of the securities of a public issuer should it fail to develop and implement policies for disgorgement of incentive-based compensation predicated upon erroneous data.

## Essential Elements of an Effective Internal Compliance Program

The financial incentive for whistleblowers to take aim at companies for violations of the FCPA and its books-and-records provisions, the clawback provisions of Dodd-Frank, and the rejection of an amnesty program in FCPA prosecutions, all work at cross-purposes with the effort to ensure that companies have effective internal compliance programs. Notwithstanding that tension, recent FCPA settlements demand that companies have compliance programs in place to protect against FCPA violations and explicitly set forth necessary elements of those programs.

On November 4, 2010, the SEC and the DOJ announced settlements with seven companies in the oil-services industry arising out of allegations that the companies violated the FCPA by paying millions of dollars in bribes to foreign customs officials in 10 different countries to obtain preferential treatment. *SEC Charges Seven Oil Services and Freight Forwarding Companies for Widespread Bribery of Customs Officials*, SEC Release No. 2010-214 (Nov. 4, 2010) (available at www.sec.gov/news/press/2010/2010-214.htm); *Oil Services Companies and a Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More Than $156 Million in Criminal Penalties*, DOJ Release No. 10-1251, (Nov. 4, 2010) (available at www.justice.gov/opa/pr/2010/November/10-crm-1251.html). The seven companies collectively paid a total of approximately $156.5 million in criminal fines and penalties to the DOJ, and approximately $80 million in disgorged profits and civil penalties to the SEC, totaling approximately $236.5 million. Five of the companies entered into deferred-prosecution agreements with the DOJ, one received a non-prosecution agreement from the DOJ, and the last escaped criminal proceedings altogether but paid a civil fine in the related SEC enforcement action.

All of the DOJ agreements required that the companies have in place internal controls, policies, and procedures that included enumerated elements. Based upon the terms of these settlement agreements, it is clear that the government expects a company's internal compliance program to comprise specific components, including the following:

- a clearly articulated, visible policy against violations of the FCPA and visible management support for such policies
- standards and procedures to reduce and address violations of the FCPA and the company's compliance code, including an internal reporting system for suspected violations
- development of a risk-assessment addressing the foreign bribery risks facing the company
- review and testing of the company's anti-corruption standards and procedures, with senior executives assigned to be responsible for oversight of those procedures
- a system of financial and accounting procedures reasonably designed to ensure the maintenance of fair and accurate books and records
- communication of the company's anti-corruption policies to all directors, officers, employees, and, where appropriate, agents and business partners
- due-diligence and compliance requirements pertaining to the retention and oversight of all agents and business partners, including standard contract provisions reasonably calculated to prevent FCPA violations

While these agreements provide expected requirements for the structure of an effective corporate compliance program, the irony is that a robust compliance program is of no value if the financial incentives of Dodd-Frank entice employees to bypass the compliance program in favor of seeking financial rewards by filing a whistleblower complaint directly with the government. The challenge for a company in the wake of Dodd-Frank therefore does not end with the creation of an internal compliance program. Rather, it now appears to include an added but unspoken element of encouraging employees to use those processes in lieu of, or at least prior to, registering complaints with the SEC. While that is not the intended result of Dodd-Frank, it may prove to be a lasting legacy. ■

*Stanley A. Twardy Jr. is a partner and Doreen Klein is senior counsel with Day Pitney LLP in Stamford, Connecticut.*