SIMPSON THACHER MEMORANDUM

The Sweeping Whistleblower Provisions Tucked Inside Dodd-Frank: Why And How Companies Should Prepare For a New Era of Corporate Whistleblowing

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In announcing their blockbuster $750 million settlement with GlaxoSmithKline last month, federal officials described the case as proof that the Department of Justice is committed to cracking down on health care fraud.[1] What the official announcement left out was that the investigation into drug safety concerns at Glaxo began more than six years ago not with a subpoena or a customer who fell ill, but when a former Glaxo employee blew the whistle on quality control problems at a Glaxo plant. In return for that information, the former employee will receive $100 million from the government — the largest whistleblower award ever paid in this country. But the record set by the Glaxo award might not last long.

Tucked in the middle of the recently-enacted 848-page Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") is a series of groundbreaking whistleblower provisions. They dramatically expand the incentives and protections offered by the federal government to tipsters with information about a broad array of corporate wrongdoing – from accounting fraud in the home office to bribery in a remote location. Combined with the government's renewed focus on punishing corporate misconduct, Dodd-Frank is a signal to companies in the United States to brace themselves for an era of increased whistleblowing to government regulators. And this is not just speculation: tips under Dodd-Frank reportedly have already begun rolling into federal office buildings.[2]

By enticing tipsters with a share of up to 30 percent of any future judgment, Dodd-Frank has put federal regulators in direct competition with efforts by companies to self-police for wrongdoing through corporate compliance programs and internal whistleblower hotlines. Self-policing and self-reporting misconduct to the government, however, remain critical factors in determining whether federal regulators extend leniency to companies for corporate misconduct. To address this new challenge from Dodd-Frank's bounty program, management should redouble its efforts to identify, investigate, and remediate wrongdoing internally — before a tipster seeking a large bounty approaches the government.

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1 Tony West, Assistant Attorney General, Civil Division, Department of Justice, Speech at the GlaxoSmithKline Press Conference (Oct. 26, 2010), http://www.justice.gov/civil/opa/pr/speeches/2010/civ-speech-101026.html.

2 Ashby Jones & Joann S. Lublin, *Critics Blow Whistle on Law*, WALL ST. J., Nov. 1, 2010, *available at* http://online.wsj.com/article/SB10001424052702304879604575582603173894296.html.

1. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The whistleblower provisions of the Dodd-Frank Act, which amended both the Securities Exchange Act of 1934 and the Commodity Exchange Act, are broad. They extend to people who share information with the Securities and Exchange Commission ("SEC") or Commodity Futures Trading Commission ("CFTC") about any misconduct that falls within the jurisdiction of these agencies.[3] Dodd-Frank's financial rewards and other incentives cover information about virtually every type of financial fraud and bribery of foreign officials.[4]

The rewards for information that proves useful are large as well: whistleblowers are eligible for between 10 and 30 percent of any penalty recovered in a judicial or administrative action as a result of the whistleblower's information (provided the penalties exceed $1 million).[5] A key condition, however, is that the tip is "derived from the independent knowledge or analysis of the whistleblower" and was not known to the government from any other source.[6] The SEC and CTFC have discretion to decide the exact amount of the award based on the "significance" of the information and the level of assistance provided by the whistleblower.[7] Because the "significance" of the information in part drives the amount of a reward, the act incentivizes people to disclose the most serious conduct about which they have information. Dodd-Frank also enables whistleblowers to report misconduct under the cloak of anonymity by reporting tips through their lawyers and not disclosing their identities unless and until it has been confirmed that they will receive an award.[8]

Like the scope of wrongdoing that is covered, the class of people eligible for financial rewards under Dodd-Frank is sweepingly broad. With few exceptions, anyone is eligible for Dodd-Frank's bounty program and anonymity protections.[9] That means anyone who has dealt with a company — including employees, suppliers, and customers in far-flung parts of the world — could be a potential Dodd-Frank whistleblower. Even officers, directors, and others with fiduciary duties to a company are potential whistleblowers under Dodd-Frank, although the SEC's proposed rules, issued on November 3, 2010, would exclude individuals with legal, compliance, supervisory and audit responsibility from receiving awards based on information

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3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 748, 922, 124 Stat. 1376, 1739–46, 1841–49 (2010).

4 By contrast, the False Claims Act, 31 U.S.C. §§ 3729–3733, which has long authorized whistleblowers to file lawsuits on behalf of the federal government in return for some or all of the recovery, is far narrower: it applies only to wrongdoing that involves fraud on the government.

5 Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 748, 922.

6 *Id.*

7 *Id.*

8 *Id.* Dodd-Frank also prohibits retaliation against an employee-whistleblower for providing information to the SEC or CFTC, and creates a federal cause of action under which an employee who has suffered retaliation can sue his or her employer for reinstatement, back pay with interest and special damages. *Id.*

9 *Id.* ("The term 'whistleblower' means any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the [law] to the [government].").

communicated to that individual for the purpose of responding to wrongdoing.[10] Until those rules are final, however, few limitations restrict who is eligible to collect for reporting information.

Despite a growing chorus of requests from companies that the SEC require employees to report problems internally to management before qualifying for rewards under Dodd-Frank,[11] the current proposed rules do not include any provision requiring internal whistleblowing.[12] Nonetheless, the rules do modestly encourage internal reporting by making internal whistleblowers eligible for a reward under Dodd-Frank as long as they report wrongdoing to the SEC within 90 days of their internal complaints.[13] In addition, when deciding the size of a whistleblower's award, the proposed rules would allow the SEC to assign credit to tipsters who first reported the matters internally.[14]

2. Competing With Dodd-Frank: How Companies Can Position Themselves To Obtain Leniency From The Government When Misconduct Does Occur

Two years ago, an attorney for a whistleblower who collected $67 million for disclosing improper marketing at a pharmaceutical company made a prediction: that his reward marked the dawn of a new "collaborative investigation model" in an "age of shrinking government budgets" — a model in which tipsters collaborate with government investigators to build cases against corporations.[15] That attorney might not have appreciated how prescient his comment

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[10] Securities and Exchange Commission, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Proposed Rule 21F-4(b)(4)(iv), http://www.sec.gov/rules/proposed/2010/34-63237.pdf. Internal legal, compliance and audit staff would be able to act as a whistleblower, and receive an award, if the company does not disclose the information to the SEC within a reasonable time or if the company otherwise acts in bad faith. *Id.*; *see also* Jessica Holzer & Ashby Jones, *SEC Proposes Rules for Bounty Program*, WALL ST. J., Nov. 4, 2010, *available at* http://online.wsj.com/article/SB10001424052748703506904575592533100919998.html?KEYWORDS=ashby+jones. The SEC is required to issue rules for the whistleblower program within 270 days of the act's July 21, 2010 enactment. *SEC Enforcement Director Acknowledges 'Challenges' in Writing of Whistleblower Rules*, BNA SECURITIES LAW DAILY, Oct. 27, 2010.

[11] Ashby Jones & Joann S. Lublin, *Critics Blow Whistle on Law*, WALL ST. J., Nov. 1, 2010, *available at* http://online.wsj.com/article/SB10001424052702304879604575582603173894296.html.

[12] Kaja Whitehouse, *Whistle-blahing*, N.Y. POST, Nov. 4, 2010, *available at* http://www.newyorkpost.com/p/news/business/whistle_blahing_N0PUUJnzMBTEkcJMOLW2wO.

[13] Securities and Exchange Commission, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Proposed Rule 21F-4(b)(7), http://www.sec.gov/rules/proposed/2010/34-63237.pdf; Jessica Holzer & Ashby Jones, *SEC Proposes Rules for Bounty Program*, WALL ST. J., Nov. 4, 2010, *available at* http://online.wsj.com/article/SB10001424052748703506904575592533100919998.html?KEYWORDS=ashby+jones.

[14] Securities and Exchange Commission, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 at 51, http://www.sec.gov/rules/proposed/2010/34-63237.pdf; *see also* Jessica Holzer & Ashby Jones, *SEC Proposes Rules for Bounty Program*, WALL ST. J., Nov. 4, 2010, *available at* http://online.wsj.com/article/SB10001424052748703506904575592533100919998.html?KEYWORDS=ashby+jones.

[15] *Merck Pays More Than $400 Million to Settle Federal, State Medicaid Fraud Investigation Sparked by Qui Tam Whistleblower Case Detailing Marketing Schemes for Vioxx, Zocor, Several Other Drugs*, PR NEWSWIRE, Feb. 7, 2008, *available at* http://www.prnewswire.com/news-releases/merck-pays-more-than-400-million-to-settle-federal-

was. After all, it was made before Congress adopted Dodd-Frank's unprecedented whistleblower program. It was made before the Internet was plastered with advertisements for lawyers claiming specialties in whistleblower reports under Dodd-Frank.[16] And it was made before headlines publicized the record-breaking $100 million award to a woman who simply blew the whistle on GlaxoSmithKline.

So what can companies do today to fortify themselves against this risk of increased whistleblowing to the government? The best strategy for avoiding regulatory enforcement actions has always been and remains the same: maintaining a culture of integrity and accountability. Training and compliance programs that emphasize the importance of conducting business lawfully and ethically remain critical to discouraging employees from breaking the law while on the job. When employees do not engage in wrongdoing, a company has little need to seek leniency from the government and even the most determined whistleblower will have little to report – no matter how lucrative the potential reward.

Of course, the reality is that even in companies with the strongest commitment to lawful and ethical business practices, misconduct by employees is not always possible to prevent. So companies need to prepare for the day when wrongdoing does occur. In addition to encouraging whistleblowers to report misconduct internally instead of to the government, companies must seek to minimize the fallout when people pursuing large financial bounties blow the whistle externally. A company remains best positioned to obtain leniency from the Department of Justice, the SEC, and other government agencies when it discovers a problem through self-policing, remediates it, and then self-reports it to the government — all before a whistleblower does. As one senior DOJ official recently reiterated, companies that self-report receive "very real credit" from the government: "If you self-report, you will be treated significantly and materially differently. And if you do not self-report and we learn about it through undercovers, through your competitors, all of which are happening and will continue to happen, you will be treated very, very differently."[17] In addition, the United States Attorney for the Southern District of New York recently emphasized that Dodd-Frank's whistleblower regime makes self-reporting even more important, suggesting that, in deciding whether to prosecute a company, the government might take into account how much time has elapsed between when a whistleblower reported information and when the company self-reported to the government.[18]

Above all, companies should ensure their compliance programs are functioning as effectively as possible. By helping ferret out wrongdoing internally, compliance efforts can enhance a company's ability to self-police and self-report to the government, positioning the company to

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state-medicaid-fraud-investigation-sparked-by-qui-tam-whistleblower-case-detailing-marketing-schemes-for-vioxxr-zocorr-several-other-drugs-56862087.html.

16 *See, e.g.*, http://www.whistleblowerlawyerblog.com/ (last visited Nov. 22, 2010).

17 *DOJ Gives 'Real Credit,' Treats Companies Who Self-Report Very Differently, Breuer Says*, SECURITIES REGULATION & LAW REPORT, Nov. 8, 2010 (quoting Assistant Attorney General Lanny Breuer, Criminal Division, Department of Justice).

18 *DOJ to Prosecute Whistleblowers Who Fabricate Information, Bharara Says*, SECURITIES LAW DAILY, Nov. 15, 2010.

receive as much leniency as possible from regulators for misconduct that has not been avoided. It is equally critical, however, for companies to investigate every report of illegal or unethical behavior promptly — no matter the source. While every publicly-traded company is required under Sarbanes-Oxley to maintain anonymous and confidential procedures — generally in the form of "hotlines" — for employees to report compliance concerns,[19] now is the time for companies to breathe new life into these procedures and ensure that employees feel as comfortable and confident as possible with them so that they actually use them. That means making the hotlines easy to use and reminding employees that reports can be made anonymously.

Another way for companies to encourage hotline use is by making sure that all internally-reported tips are taken seriously and promptly investigated. In addition to fostering employee confidence in hotline programs, this is important because even when a complaint is made internally, nothing prevents the employee from reporting the very same complaint to the government. In fact, under proposed SEC rules, internal whistleblowers remain eligible for bounties under Dodd-Frank as long as they contact the SEC within three months of making their internal complaint. The more companies can do to treat every internal complaint with care and sensitivity, the less likely the whistleblower will be inclined to take the same tip to the government.

Last month's massive Glaxo settlement paints a cautionary tale for companies that do not respond to internal reports of possible wrongdoing. Beginning in 2002, a longstanding Glaxo employee, Cheryl Eckard, notified Glaxo management about quality control problems involving several Glaxo-manufactured products.[20] Eckard repeatedly told her superiors about these issues, which the FDA had not discovered in a recent inspection.[21] Eckard recommended that Glaxo notify the FDA of these problems and temporarily stop producing certain products.[22] Glaxo management failed to act on any of Eckard's concerns[23] and ultimately terminated her — ostensibly as part of a head-count reduction.[24] Instead of walking away quietly, she prompted a federal investigation into Glaxo by filing a whistleblower lawsuit against the company under the False Claims Act. That litigation culminated last month with the Department of Justice's $750 million settlement with Glaxo.[25] The Glaxo lawsuit and settlement are stark proof that the consequences of ignoring an internal complaint can be tremendous.

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19 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §301, 116 Stat. 745, 775–77 (2002).

20 Third Amended Complaint at 5, 34–35, *United States ex rel. Eckard v. SmithKlineBeecham Corp.*, No. 04-cv-10375 (JLT) (D. Mass. Oct. 17, 2008).

21 *Id.* at 32–36, 39–40.

22 *Id.* at 34–35.

23 *Id.* at 36.

24 *Id.* at 45.

25 *See* United States Notice of Intervention at 1, *United States ex rel. Eckard v. SmithKlineBeecham Corp*, No. 04-cv-10375 (JLT) (D. Mass. Oct. 26, 2010).

And now that Dodd-Frank has given potential whistleblowers a powerful new set of tools, some observers in the corporate governance field have asked whether companies should begin trying to entice employees to report misconduct to management in the same way as the government — with money.[26] On the one hand, offering financial rewards to internal tipsters might not discourage everyone with information about wrongdoing from contacting the government. But to the extent that they incentivize even some tipsters to report wrongdoing internally instead of to regulators, an internal reward program could improve management's ability to investigate and remediate problems and then decide whether to self-report to the government.

Conclusion

Almost overnight, Dodd-Frank's expansive whistleblower program has imposed new challenges on the ability of companies to identify wrongdoing within their ranks and position themselves for leniency from the government when misconduct does occur. Beyond enhancing internal compliance measures designed to identify misconduct, companies should promptly investigate all claims of wrongdoing and reinvigorate their internal whistleblower procedures. That way, companies can have the opportunity, after remediating any problems, to self-report to regulators — all before a Dodd-Frank whistleblower gets to the government first.

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[26] *See* Ashby Jones & Joann S. Lublin, *Critics Blow Whistle on Law*, WALL ST. J., Nov. 1, 2010, *available at* http://online.wsj.com/article/SB10001424052702304879604575582603173894296.html.

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