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Dodd-Frank Whistleblower Provision Proving Fertile Breeding Ground for Whistleblowers

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In a securities filing on May 1, 2014, it was announced that **Avon Products,** Inc. had reached a $135 million settlement with the **Securities and Exchange Commission** (SEC) and the **Department of Justice.** The $135 million in fines will be paid to the SEC and the DOJ by Avon to resolve violations under the **Foreign Corrupt Practices Act (**FCPA). Though a whistleblower has not been named, there has been long-standing speculation that the investigation, which began in 2008, was sparked by a whistleblower's letter to Avon's then CEO. If such a whistleblower exists, he or she may be entitled to at least $135,000, and could claim as much as $40.5 million, thanks to Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

Such awards are not wholly uncommon. In 2013 alone, over $14.8 million was paid out to six separate individuals, and over $439 million sits in a fund created by the SEC, waiting to be distributed to any number of future applicants. The SEC's Investor Protection Fund was established by Section 922 of the Dodd-Frank Act to reward individuals who assist the SEC in uncovering securities violations resulting in monetary sanctions of more than $1 million.

As the SEC has received over 6,000 whistleblower complaints since 2011, the possible effects are far-reaching. This is especially true since the Foreign Corrupt Practices Act (FCPA), as part of the Securities Exchange Act of 1934, is an offense covered under the Dodd-Frank Act Whistleblower provision. The Act applies to publicly traded companies and their subsidiaries, and to all financial services companies, regardless of whether they are publicly traded. With the rise in FCPA and accounting fraud prosecutions in recent years, individual whistleblowers are even further incentivized to report alleged misconduct externally to the regulators. Former SEC Chairman Mary Schapiro, who oversaw the implementation of the whistleblower program, stressed the significance of Dodd-Frank in the eyes of the SEC: "We get thousands of tips every year, yet very few of these tips come from those closest to an ongoing fraud. Whistleblowers can be a source of valuable firsthand information that may otherwise not come to light. These high-quality leads can be crucial to protecting investors and recovering ill-gotten gains from wrongdoers."

Dodd-Frank provides that an individual whistleblower is entitled to at least 10 percent and up to 30 percent of the monetary sanctions imposed. The higher end of this range is a significant increase from the prior 10 percent cap for insider trading whistleblowers. By way of historical context, this means that had a whistleblower been eligible in the infamous 2001 Enron Corporation case, he or

she would have been entitled to $45 to $135 million (10 to 30% of the total $450 million sanctions); in the 2002 WorldCom Inc. case, he or she would have been entitled to $75 to $225 million (10 to 30% of the total $750 million sanctions); and in the 2008 Siemens case, he or she would have been entitled to $80 to $240 million from the United States settlement alone (10 to 30% of the $800 million United States sanctions), and would arguably have been entitled to monetary penalties imposed by European countries as well. Just last month, the SEC announced that it would make yet another payout on the first whistleblower award it handed out in 2012 under Dodd-Frank, which was the result of an unnamed multi-million dollar fraud, and initially resulted in only a $50,000 whistleblower payout because the SEC had only collected $150,000 of the $1 million in penalties.

While the SEC has placed a priority on encouraging whistleblowers to come forward, and rewarding those who do, there are requirements whistleblowers must meet in order to be eligible for the rewards. The whistleblower must voluntarily provide original information (meaning information based upon the whistleblower's independent knowledge or analysis not already known to the SEC and not derived exclusively from public sources) to the SEC about a securities violation that leads to a successful enforcement action with monetary sanctions of more than $1 million. The information must 1) result in a new investigation being opened and significantly contribute to the result; or 2) be essential to the success of an open investigation. Excluded from eligibility are attorneys who gain information from client representation, independent public accountants who gain information through engagement required under securities laws, foreign governmental officials, and culpable whistleblowers. In order to encourage internal compliance programs, persons who learn about violations through such programs, such as compliance officers, are excluded. However, if a company ignores a call for action from their compliance officer or proceeds in bad faith, a compliance officer too could become a Dodd-Frank whistleblower. Further, in a minimal effort to encourage internal reporting first, the provision treats the employee as a whistleblower as of the date the employee first reports the information to an internal compliance program, so long as the employee provides the same information to the SEC within 90 days.

The full effect of this new whistleblower provision is still unclear, but one thing is certain: with the number of whistleblower applicants and the number of rewards growing, companies and their counsel must be both well-informed and proactive when it comes to compliance. Among other things, companies must ensure that there is a culture of compliance and that the tone for such a culture is set at the top of the organization and emanates throughout the middle supervisory ranks. In addition, companies must dedicate adequate resources to their compliance program and conduct effective training throughout the organization. In addition, companies would be prudent to build compliance incentives into their performance evaluations and awards processes, as well as recognize employees who appropriately "blow the whistle" internally (e.g. commending such conduct, albeit perhaps anonymously, in company newsletters or through the company intranet). Moreover, it is critical that the companies take any such internal complaints seriously and launch an internal investigation to ascertain whether there is any merit to the allegations. The internal whistleblower should be apprised as to the general nature of the company's response and the results of any such investigation. The failure to have a robust compliance program in place and to take seriously any whistleblower complaints, likely will encourage potential "internal" whistleblowers to ignore internal reporting protocol and instead march to the door of the nearest SEC office.

This article was written with contributions from *Ashley Paige Smolic.*

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