

DODD-FRANK WHISTLEBLOWER PROGRAM: WHISTLEBLOWER PREVENTION STRATEGIES, CRITICISMS, AND FUTURE IMPLICATIONS

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Abstract

Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorized the SEC to create a committee that would be responsible for promulgating and enforcing rules to reward whistleblowers. Such rewards are to be paid from the Investor Protection Fund, which is embodied in SEC Rule 21F. The whistleblower provision is meant to promote corporate whistleblowing by incentivizing the prevention of financial abuse. Critics contend, however, that the whistleblower program fails to encourage corporations to strengthen internal compliance programs; instead, corporations will put more effort into whistleblower prevention strategies in order to prevent SEC enforcement actions.

SEC Rule 21F does not require whistleblowers to first utilize internal corporate compliance procedures before reporting alleged wrongdoing to the SEC; however, the SEC provides more incentives for a whistleblower who does first utilize such corporate compliance programs. Dodd-Frank supporters assert that corporations already implement legal strategy in order to prevent future enforcement actions and whistleblowing. However, with the enactment of Section 922, whistleblowing is expected to increase; therefore, advocates can expect corporations to develop and utilize more innovative whistleblower prevention strategies.

Article

On July 21, 2010, in response to the financial abuses that occurred in 2008, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank” or the “Dodd Frank Act”),¹ the most reformative piece of financial legislation since the Sarbanes-Oxley Act of 2002. Among the many provisions in the new legislation, Section 922 of the Dodd-Frank Act calls for the U.S. Securities and Exchange Commission (the “SEC”) to establish a whistleblower committee and to develop rules that allow whistleblower rewards to be paid from a newly created Investor Protection Fund, which is embodied in

1. See Jesse Lee, *President Obama Signs Wall Street Reform: “No Easy Task”*, WHITE HOUSE BLOG (July 21, 2010, 2:22 PM), <http://www.whitehouse.gov/blog/2010/07/21/president-obama-signs-wall-street-reform-no-easy-task>.

SEC Rule 21F.² Although the purpose of the new Dodd-Frank whistleblower provision is to provide more incentive for those who assist the SEC in preventing financial abuse,³ critics contend that the new rules fail to properly emphasize internal compliance initiatives.⁴ Given the criticisms surrounding SEC Rule 21F, along with the federal government's continuous support for corporate whistleblowing,⁵ lawmakers should expect corporations to continue utilizing whistleblower prevention strategies instead of effectively strengthening their internal compliance programs.

Looking to the debate surrounding SEC Rule 21F, critics challenge the rule's treatment of corporate internal compliance programs. While supporters celebrate that the new rules have corporations running scared, critics believe that the final requirements for SEC Rule 21F will only discourage the efforts by corporations in improving their internal compliance programs since whistleblowers do not need to report to them to claim a reward offered by the SEC.⁶ Mainly, critics root their frustrations to the SEC's recent rejection of a proposition to SEC Rule 21F, which would have required a whistleblower to bypass an internal compliance program before being deemed eligible to receive a reward.⁷

Outraged by the SEC's rejection, critics premise their dissatisfaction on the basis that corporations spend millions of dollars annually to improve their internal compliance programs and to regulate themselves. According to an independent study conducted in January 2011 by the Ponemon Institute, the average cost for internal compliance by corporations amounts to 3.5 million dollars annually.⁸ Moreover, based on a survey conducted by Ernst & Young, which lasted from 2009 to 2010, over two-thirds of all companies utilize internal compliance programs to which forty-four percent use such programs to conduct a fraud-risk assessment every six months.⁹ In light of these numbers, Ken Springer, an expert in corporate fraud prevention, has characterized the new whistleblower provision as "a real slap in the face" for companies that have taken drastic measures in strengthening

2. See The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 748 (2009) [hereinafter Dodd-Frank]; 19 C.F.R. § 240.21F-6 (2011).

3. See Dodd-Frank § 922; Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 ("Final Rules"), Release No. 34-64545, File No. S7-33-10, 16 (Aug. 12, 2011), available at <http://sec.gov/rules/final/2011/34-64545.pdf> [hereinafter Final Rules]; 17 C.F.R. §§ 240.21F *et seq.* (2011).

4. See GIBSON, DUNN, & CRUTCHER, SEC ADOPTS FINAL RULES IMPLEMENTING WHISTLEBLOWER PROVISIONS OF DODD-FRANK 4 (May 31, 2011), available at <http://www.gibsondunn.com/publications/Documents/SECAdoptsFinalRulesImplementingDodd-FrankWhistleblowerProvisions.pdf>.

5. See Jesselyn Radack & Kathleen McClellan, *The Criminalization of Whistleblowing*, 2 LAB. & EMP'T L. F. 57 (2011).

6. Final Rules, *supra* note 3, at 5; see, e.g., *New Whistleblower Law Has Corporations Running Scared* PAGE PERRY, LLC, INV. FRAUD LAWYER BLOG (Feb. 25, 2011), http://www.investmentfraudlawyerblog.com/2011/02/new_whistleblower_law_has_corp.html.

7. Final Rules, *supra* note 3, at 5.

8. Brian Prince, *Enterprise Compliance Costs Hit \$3.5 Million, Study Finds*, EWEEK (Jan. 31, 2011), <http://www.eweek.com/c/a/Security/Enterprise-Compliance-Costs-Hit-35-Million-Study-Finds-794631/>; see generally Press Release, Tripwire, Inc., Tripwire and Ponemon Institute Reveal Economic Impact of Non-Compliance Exceeds Spend on Enterprise Compliance Initiatives 8 (Jan. 31, 2011), available at <http://www.tripwire.com/en/apac/company/news/pressrelease/tripwire-and-ponemon-institute-reveal-economic-impact-of-noncompliance-exceeds-spend-on-enterprise-compliance-initiatives/>.

9. David L. Stulb, *Driving Ethical Growth—New Markets, New Challenges*, ERNST & YOUNG 11TH GLOBAL FRAUD SURVEY 8 (2010), available at [http://www.ey.com/Publication/vwLUAssets/EY-11th_Global_Fraud_Survey/\\$file/ey_11th_Global_Fraud_Survey.pdf](http://www.ey.com/Publication/vwLUAssets/EY-11th_Global_Fraud_Survey/$file/ey_11th_Global_Fraud_Survey.pdf).

their internal compliance divisions.¹⁰ As other critics tend to agree, Springer mentions that the advantage in promoting corporate internal hotlines is that “the company has the ability to proactively and immediately respond to the reported problems and then take the necessary measures to rectify any legitimate wrongdoing.”¹¹

Despite these points, although utilization of internal compliance programs by whistleblowers is not a requirement for reward eligibility, it is important to note that SEC Rule 21F does provide incentives for whistleblowers who utilize such programs before reporting to the SEC or other regulatory bodies.¹² Among the incentives found in SEC Rule 21F is a 30-day time extension from the original 90-day period provided for whistleblowers who first report to an internal compliance program before reporting to the SEC.¹³ Additionally, SEC Rule 21F calls for the SEC to consider increasing the amount of a whistleblower’s reward when he first reports to an internal compliance program.¹⁴ Justifying the measures taken by the SEC, Chairwoman Mary Schapiro has stated that giving whistleblowers the option to come directly to the SEC “makes sense because it is the whistleblower . . . who is in the best position to know which route is best to pursue.”¹⁵

Not surprisingly, Dodd-Frank supporters defend the final rules on the basis that internal compliance programs function inefficiently.¹⁶ More specifically, based on the grounds that senior leadership appoints internal compliance committees, supporters argue that there is a conflict of interest due to the fact that one of the main functions of the committee is to monitor the behaviors of corporate senior leadership.¹⁷ Further emphasizing this conflict of interest, Tom Sabatino, a former lawyer for Schering Plough and United Airlines, sarcastically states, “Every company, from Enron on down, has a great looking compliance program on paper.”¹⁸

Nevertheless, recent events suggest that corporations are already resorting to other legal strategies to prevent future enforcement actions and whistleblowing.¹⁹ In fact, many corporate legal firms have prepared whistleblower prevention strategies for their clients and have already added these strategies into the curriculum of their corporate client education programs.²⁰ Some of these

10. Joelle Scott, *Dodd Frank’s Whistleblower Provision: Who Benefits?*, FORBES (June 27, 2011, 11:39 AM), <http://blogs.forbes.com/corporateresolutions/2011/06/27/dodd-franks-whistleblower-provision-who-benefits/>.

11. *Id.*

12. 19 C.F.R. § 240.21F-6 (2011).

13. Final Rules, *supra* note 3, at 5–6.

14. *Id.*

15. See generally Michael W. Hudson, *In Setback for Corporate Lobbyists, Whistleblowers Can Take Tips First to Government Investigators*, NAT’L L. REV. (May 26, 2011), <http://www.natlawreview.com/article/setback-corporate-lobbyists-whistleblowers-can-take-tips-first-to-government-investigators>.

16. John R. Engen, *Failure to Communicate: Walking a Fine Line with Whistleblowers*, CORPORATE BD. MEMBER 3 (2011), available at https://www.boardmember.com/MagazineArticle_Details.aspx?id=6240&terms=walking+a+fine+line+with+whistleblower.

17. *Id.* at 4.

18. *Id.*

19. Tom Devine, *An Excellent Analysis of the Dodd-Frank Whistleblower Provisions*, WHISTLE BLOGGER (June 16, 2011), <http://www.whistleblower.org/blog/31-2010/1196-an-excellent-analysis-of-the-dodd-frank-whistleblower-provisions->.

20. See generally Amy Goodman, *et al.*, *The New SEC Whistleblower Rules: How to Prepare Your Company*, GIBSON DUNN (June 8, 2011), available at <http://www.gibsondunn.com/publications/Documents/WebcastSlides-NewSECWhistleblowerRules-6.8.11.pdf>.

strategies involve: screening prospective new hires within the limits of federal and state law in order to detect for whistle-blowing characteristics, regularly reminding employees that they are required to promptly report all code of conduct violations, and using attorneys to conduct interviews so that all of the information obtained becomes subject to the attorney-client privilege as well as so deemed as not “original” and thus, ineligible for an SEC whistleblower reward.²¹

Given these strategies, whistleblower advocates assert that the new measures advised by corporate legal teams will fail to pass judicial scrutiny.²² For example, some whistleblower lawyers challenge the screening of prospective new hires as a practice that is not only discriminatory, but also not tolerated by most courts.²³ In addition, others believe that the use of an attorney to conduct an interview will not pass the judicial test concerning “whether the attorney’s participation was for the purpose of, and actually involved, giving legal advice to and answering legal questions of managers.”²⁴ Finally, many speculate that the advice requiring employees to promptly report to internal compliance programs will result in disparate treatment of a whistleblower while others also believe that few corporations will adopt such measures.²⁵

Ultimately, despite these concerns, under Rule 21F, corporations are expected to focus their efforts in utilizing whistleblower prevention strategies as a result of the federal government’s continuous and increasing support for corporate whistleblowing.²⁶ For example, President Obama’s 2012 budget plan is set to allocate money for forty-five new positions in order “to expand investigation of tips received from whistleblowers.”²⁷ In addition, through Dodd-Frank’s new whistleblower provisions,²⁸ Congress increased the whistleblower reward percentage that was originally proscribed by section 806 of Sarbanes-Oxley.²⁹ Now, unlike section 806 of Sarbanes-Oxley where the government was limited to awarding whistleblowers up to ten percent of all penalties collected in a resulting enforcement action,³⁰ section 922 of Dodd-Frank allows for rewards up to thirty percent of all penalties collected in an enforcement action.³¹ Finally, as recently demonstrated by *Egan v. Trading Screen, Inc.*, courts have given their endorsement by allowing Sarbanes-Oxley whistleblowers to obtain Dodd-Frank rewards.³² In *Egan*, the New York Federal District Court held that where an employee-whistleblower makes an internal disclosure that the corporation then

21. *Id.* at 38.

22. See Thad M. Guyer, *Final Dodd-Frank Whistleblower Rules: Are You Prepared?*, WHISTLE BLOGGER 26 (June 15, 2011), available at <http://www.whistleblower.org/storage/documents/Guyer.pdf>.

23. *Id.*

24. *Id.*

25. *Id.*; see, e.g., Devine, *supra* note 19.

26. See Dave Ebersole, *Blowing The Whistle on the Dodd-Frank Whistleblower Provisions*, 6 ENTREPREN. BUS. L.J. 123, 125–28 (2011) (summarizing the increasing whistleblower protections since 1978).

27. Laura Walter, *FY 2012 Budget Request Includes \$583 Million for OSHA*, EHS TODAY (Feb. 15, 2011), <http://ehstoday.com/standards/osha/budget-request-includes-millions-osha-0215/>; see Engen, *supra* note 16; see Hudson, *supra* note 15.

28. See Dodd-Frank, H.R. 4173, 111th Cong. § 748 (2009).

29. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 806 (codified at 18 U.S.C. § 1514A (2002)).

30. *Id.*

31. See Dodd-Frank, H.R. 4173, 111th Cong. § 922 (2009).

32. *Egan v. Trading Screen, Inc.*, 2011 U.S. Dist. LEXIS 47713, 8–40 (S.D.N.Y. May 4, 2011).

self-reports, the whistleblower may be considered a joint provider of that information, and thus eligible for an award assuming he applies for one.³³

When considering section 806 of Sarbanes-Oxley, Congress found insider trading was one of the largest problems associated with the rise in corporate scandals involving Enron, Tyco International, Adelphia, Peregrine Systems, and WorldCom.³⁴ As a result, section 806 of Sarbanes-Oxley was implemented to address this issue. Nearly eight years after creating incentives for corporate whistleblowers under Sarbanes-Oxley, Congress faced the challenge of responding to some of the largest recorded financial abuses in American history. Among the more notable financial abuses was the practice by major financial institutions, like Goldman Sachs, to trade faulty subprime mortgage-backed securities while utilizing irresponsible lending techniques.³⁵ Moreover, after being bailed out by taxpayers due to fears of a market collapse, major executives like Edward Liddy of AIG had been caught using bailout money to pay themselves high-end bonuses.³⁶

Incidentally, recent comments made by regulators and the projected increase in settlements with the SEC further bolsters the federal government's unsurprising and continuing support for corporate whistleblowing. According to agency officials inside the SEC's whistleblower office, the volume of whistleblower reports have substantially increased since Dodd-Frank's passage.³⁷ Moreover, while expecting the current trend to continue, Mary Schapiro states, "[w]hile the SEC has a history of receiving a high volume of tips and complaints, the quality of the tips we have received has been better since Section 922 [of the Dodd-Frank Act] became law."³⁸ Evidencing the merits behind these comments, a recent study conducted by economists indicates that the SEC is on pace to settling claims with 688 defendants in 2011, which was an increase from the 681 defendants in 2010.³⁹ Furthermore, as of June 23, 2011, the number of company settlements has risen by 43% to 114, an annual pace of 228, compared with 160 for the entire 2010 fiscal year.⁴⁰

Not surprisingly, although not resulting from whistleblower reporting, many financial firms settled with the SEC even before section 922 was enacted. Among the more notable settlements, Goldman Sachs agreed to pay \$550 million dollars in order to quash claims of alleged violations of major federal securities

33. *Id.*

34. John Patzakakis & Victor Limongelli, *Internal Computer Investigations: Critical Control Activity Under Sarbanes-Oxley*, BUS. F., <http://www.bizforum.org/whitepapers/guidance-2.htm> (last visited Nov. 8, 2012); Kevin Rubinstein, *Internal Whistleblowing and Sarbanes-Oxley Section 806: Balancing the Interests of Employee and Employer*, 52 N.Y.L. SCH. L. REV. 637, 638 (2007-08) (citations omitted).

35. Leslie Wayne, *Goldman Pays to End State Inquiry into Loans*, N.Y. TIMES (May 11, 2009), http://www.nytimes.com/2009/05/12/business/12lend.html?_r=0.

36. Laurie Bennett, *Edward Liddy Caught in the Middle of AIG Storm*, MUCKETY (Mar. 15, 2009, 9:42 AM), <http://news.muckety.com/2009/03/15/edward-liddy-caught-in-the-eye-of-aig-storm/13111>.

37. *See* Engen, *supra* note 16.

38. *See* Hudson, *supra* note 15.

39. Jon Larsen, Elaine Buckberg, & James A. Overdahl, *Company Settlements Jump in Number; Individuals Make Top Payments*, SEC SETTLEMENT TRENDS: 1H11 UPDATE 1 (June 23, 2011), available at http://www.nera.com/nera-files/PUB_SEC_Settlements_Trends_1H11_0611.pdf.

40. *Id.*

laws.⁴¹ These results indicate that whistleblowing is expected to increase given the enactment of section 922.

Given these results while looking to the future, advocates can expect corporations to develop and utilize more innovative whistleblower prevention strategies. Considering that the U.S. Court of Appeals for the District of Columbia recently rejected the “Proxy Access” rule under Dodd-Frank,⁴² one strategy for corporations may be to challenge the legality of section 922’s whistleblower provision.⁴³ Republican Senator Charles Grassley recently commented that the Dodd-Frank whistleblower program includes undefined terms that are vague or overbroad.⁴⁴ However, while advocates can expect new strategies, questions regarding the specifics of these strategies remain uncertain. Regardless of this uncertainty, one thing remains clear going forward: as long as the federal government continues to promote corporate whistleblowing, corporations can be expected to utilize whistleblower prevention strategies in order to avoid future enforcement actions by the SEC.

41. Kurt Schulzke, *Did Dodd-Frank Spur the SEC’s \$550M Goldman Sachs Settlement?*, WHISTLEBLOWER CENT. (July 24, 2010), <http://whistleblowercentral.com/2010/07/24/did-dodd-frank-spur-the-secs-550m-goldman-sachs-settlement/> (citing alleged violations of Section 17(a) of the Securities Act of 1933 (15 U.S.C. § 77q(a)), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5).

42. *Business Roundtable v. SEC*, 674 F.3d 1144 (D.C. Cir. 2011); *Dodd-Frank Update: Appeals Court Vacates SEC Proxy Access Rule*, CORPORATE L. REPORT (Aug. 19, 2011), <http://corporatelaw.jdsupra.com/post/9125244838/dodd-frank-court-vacates-proxy-access>.

43. See Sarah N. Lynch, *SEC Denied Rule Making It Easier for Shareholders to Exercise Control Over Corporate Boards*, HUFFINGTON POST BUS. (July 22, 2011, 5:00 PM), http://www.huffingtonpost.com/2011/07/22/sec-rule-is-denied-by-court-failed-dodd-frank_n_907254.html.

44. See James Hamilton, *Senator Grassley Says SEC Dodd-Frank Whistleblower Proposals Are Overbroad; Urges SEC to Follow IRS Model in Crafting Whistleblower Office*, JIM HAMILTON’S WORLD OF SEC. REGULATION (May 22, 2011, 2:44 PM), <http://jimhamiltonblog.blogspot.com/2011/05/senator-grassley-says-sec-dodd-frank.html>.