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Opening the Floodgates: The Dodd-Frank Whistleblower Provisions' Impact on Corporate America

By Doug Clark, Partner (Palo Alto)

During a recent gathering of corporate directors, the whistleblower bounty provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Pub.L. 111-203, H.R. 4173 (2010), excited discussion and concern. The corporate world should watch the evolution of this bounty program closely.[1] To help set these developments in context, this article provides some background and thoughts about the future.

A Short Summary

Dodd-Frank requires the Securities and Exchange Commission (SEC), in any action in which it levies sanctions in excess of $1 million, to compensate whistleblowers who provide original information with between 10 to 30 percent of the amount of the sanctions.[2]

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[1] See http://www.sec.gov for more proposed rules in implementing the SEC's Dodd-Frank whistleblower program.
[2] To see the Dodd-Frank text, go to http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/content-detail.html.

Recent Cases Demonstrate Risks of Sharing Online Users' Data with Third Parties

By Tonia Klausner, Partner (New York)

Starting with the Facebook Beacon lawsuits more than a year ago, the plaintiffs' class action bar repeatedly has filed purported class actions against online companies and the Internet arms of brick-and-mortar establishments that enter agreements to share their users' data. Often invoking statutes with statutory-damages provisions, these actions can become bet-the-company cases when filed on behalf of all users whose data was shared.

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Client Victories

Firm Scores Summary Judgment Win for Affymetrix in Patent Infringement Suit

On December 15, 2010, the firm scored a significant victory for Affymetrix, a pioneer in the field of microarray technology used for genetic testing and genomic analysis. Illumina, a San Diego-based competitor, brought suit in 2009 accusing Affymetrix of infringing 54 claims of two patents directed to biological array formats and their methods of use. The U.S. District Court for the Western District of Wisconsin granted Affymetrix's motion for summary judgment of noninfringement. The court held that Affymetrix's arrays and related equipment do not infringe any of the asserted claims.

Summary judgment was preceded by claim construction proceedings, where Affymetrix argued that the claimed "substrate" must be interpreted with respect to the beads described in the patents. The court sided with Affymetrix based on the language of the patents' specification. In its motion for summary judgment, Affymetrix described the unique way its microarrays are made using photolithography, a process used in the semiconductor industry, and demonstrated that its products would be destroyed if they were modified to contain beads. The court agreed

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In This Issue

Small Changes, Big Rewards

How Minor Changes to Your Company's Reporting Structure Can Help Avoid Large Fines in the Future

By Leo Cunningham, Partner, and Lee-Anne Mulholland and Nema Milaninia, Associates (Palo Alto)

Recent changes to the United States Sentencing Guidelines further underscore the heightened importance of having a well-thought-out corporate compliance and ethics program overseen by an employee who has a *direct* line of communication to the board of directors or a subcommittee of the board. Companies that do not have someone in charge of compliance with this direct reporting authority should consider explicitly revising their reporting structure.

The existence of a corporate compliance program long has been an important factor for both the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) in determining whether an organization should be held liable for wrongdoing by its employees. The U.S. Attorneys' Manual, for example, lists "the existence and effectiveness of the corporation's pre-existing compliance program" among the factors relevant to whether an organization should be charged criminally. The SEC's Seaboard Report factors include an assessment of "[w]hat compliance procedures were in place to prevent the misconduct now uncovered" in determining whether the SEC will initiate an enforcement action against a company. In the same vein, the United States Sentencing Guidelines, which explicitly address only the sentence to be imposed on a criminally convicted organization but have come to play an extremely important role in discussions to head off or settle a prosecution, include a three-point reduction (which can translate to as much as a 70 percent reduction in fines) for organizations that have what the guidelines deem an "effective" compliance and ethics program.

To have an effective compliance program under the Sentencing Guidelines, an organization is expected to reasonably design, implement, and enforce a program that exercises due diligence to prevent and detect criminal conduct, and otherwise promotes an organizational culture that encourages ethical conduct and a commitment to compliance with the law. The program also must meet seven minimal elements by: (a) establishing standards and procedures to prevent and detect criminal conduct; (b) providing oversight by the company's governing authority; (c) using reasonable efforts to exclude individuals engaged in illegal or unethical conduct from positions of substantial authority; (d) taking reasonable steps to communicate the company's standards and procedures to its employees; (e) taking reasonable steps to ensure that the compliance and ethics program is followed; (f) promoting the compliance and ethics program consistently throughout the company; and (g) taking reasonable steps to respond appropriately after criminal conduct has been detected. Amendments to the guidelines clarify that a company can meet this last element by providing restitution to identifiable victims (or other forms of remediation) and by making all appropriate modifications to the compliance and ethics program to prevent similar criminal conduct.

> An organization is expected to design, implement, and enforce a program that exercises due diligence to prevent and detect criminal conduct and promotes ethical conduct and compliance.

Notwithstanding the inclusion of the three-point reduction in the guidelines, statistics published by the United States Sentencing Commission suggest that only three companies (out of 1,349) have qualified for this exception in the past 14 years. It appears that this often occurred because others were disqualified from receiving the reduction based on the government's assertion that an exception to the three-point reduction applied because an individual in a company's high-level personnel was deemed to be involved with the criminal conduct. "High-level personnel" had been defined broadly to include not only executives and directors, but also sales and local managers.

However, all this has been changed. The guidelines now state that a company can continue to be eligible for a significant reduction in fines when a high-level employee is involved, but only if an individual responsible for the company's compliance and ethics program has *direct* reporting obligations to the company's board of directors. While it is true that the guidelines also require that the compliance and ethics program detect the offense, that the company promptly report the wrongdoing to the government, and that no individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of it, all of these become important *after* a problem has been detected. Companies who want to *prevent* becoming an exception to the three-point rule should incur the minimal inconvenience of ensuring individuals responsible for corporate compliance report directly to at least a subcommittee of the company's board of directors.

U.S. Supreme Court to Review Standard for Inducing Patent Infringement

By Julie Holloway, Partner (San Francisco) and Alyssa Knutson, Associate (Palo Alto)

On October 12, 2010, the U.S. Supreme Court granted certiorari in *Global-Tech Appliances Inc. v. SEB S.A.*, No. 10-6, to decide the level of intent required for inducing patent infringement under 35 U.S.C. § 271(b). Petitioner Pentalpha is challenging the Federal Circuit's ruling in *SEB S.A. v. Montgomery Ward & Co.*, 594 F.3d 1360 (Fed. Cir. 2010), which held that inducement to infringe may be established by "deliberate indifference of a known risk" that an infringement may occur, claiming that it conflicts with the "purposeful, culpable expression and conduct" standard the Supreme Court taught in *MGM Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 937 (2005).

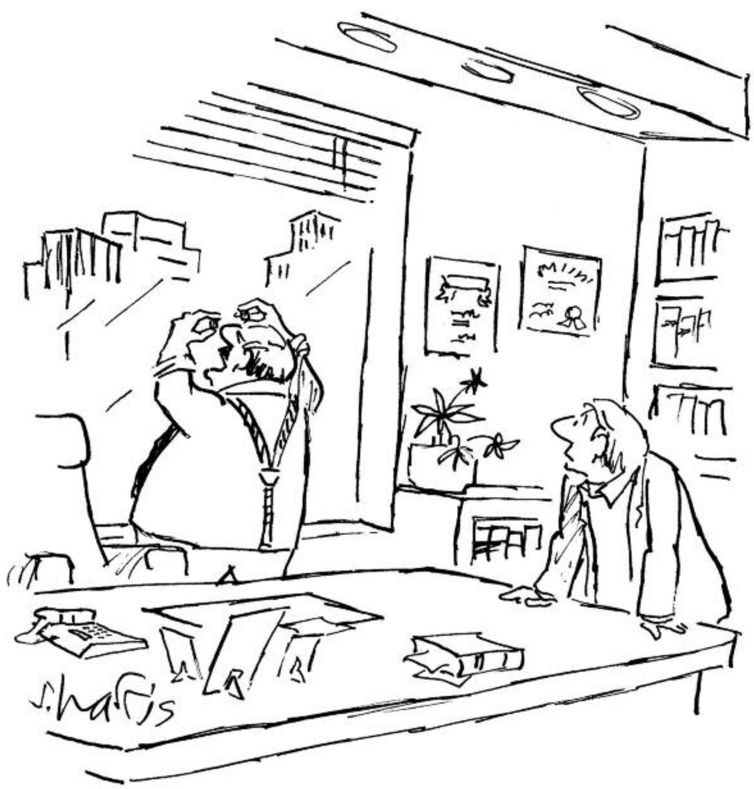
> This case provides an important opportunity for the Supreme Court to suggest guidelines for avoiding liability for induced patent infringement.

In its petition to the Supreme Court, Pentalpha argued that the Federal Circuit erred in using the "deliberate indifference" standard in finding inducement, because it conflicts with the Court's standard, articulated in *MGM v. Grokster*, that the state-of-mind element for actively inducing infringement requires "affirmative intent that the product be used to infringe." SEB responded that the deliberate indifference standard promotes a flexible standard consistent with prior Supreme Court precedent.

A group of 26 professors of law, business, and economics submitted an *amicus* brief in support of Global-Tech's petition for certiorari. The *amici* argued that the Federal Circuit has been unable to clarify its own law on the proper inducement standard and that the Federal Circuit's decision in this case not only departs from the Court's teachings in *MGM v. Grokster* and the Federal Circuit's own en banc guidance in *DSU Medical Corp. v. JMS Co., Ltd.*, 471 F.3d 1293 (Fed. Cir. 2006), but is counter to the statutory structure and history of Section 271.

> Pentalpha argued that the Federal Circuit erred in using the "deliberate indifference" standard in finding inducement, because it conflicts with the Court's standard in *MGM v. Grokster*.

This case provides an important opportunity for the Supreme Court to suggest guidelines for avoiding liability for induced patent infringement. The Court should hear oral argument this term, with a decision expected by this summer.



"You have to admit that your chip looks a lot like their chip."

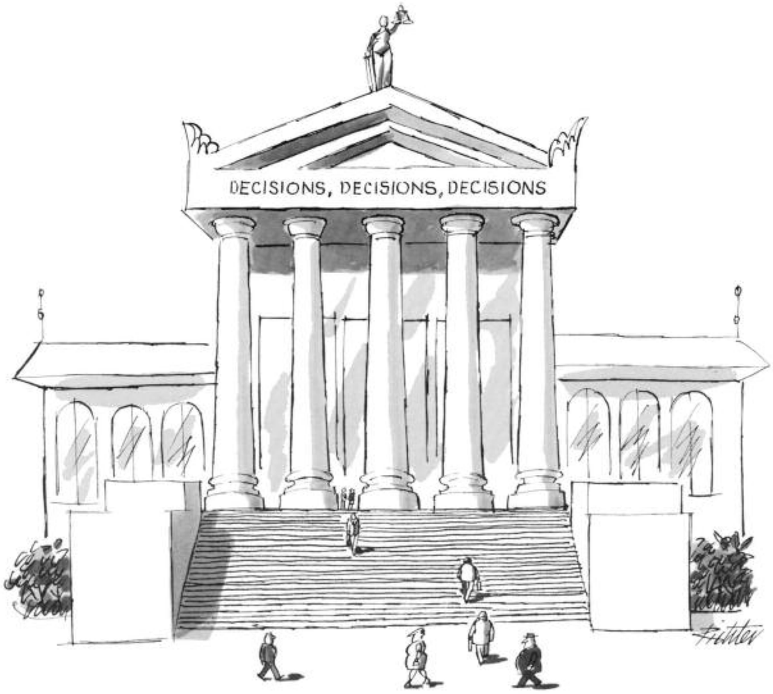
with Affymetrix that its products do not infringe any of the asserted claims because they do not contain a substrate that can be modified to contain beads, and ordered judgment in Affymetrix's favor.

The Wilson Sonsini Goodrich & Rosati team representing Affymetrix in *Illumina Inc. v. Affymetrix Inc.* includes partners Ron Shulman, Roger Chin, and Michael Berta, and associates Tom Carmack and Alyssa Knutson.

Ninth Circuit Affirms Dismissal of Class Action Lawsuit against Jones Soda

On August 30, 2010, the U.S. Court of Appeals for the Ninth Circuit affirmed the dismissal of a purported class action lawsuit brought in Seattle against Jones Soda Company and Peter M. Van Stolk, its founder and former CEO. Jones Soda markets and distributes premium beverages and is known for its unusual flavors and innovative labeling technique that incorporates photographs sent in by customers. In late 2006 and 2007, Jones Soda embarked on a long-term strategy to transform itself from a pioneer in the relatively small new-age beverage market into a major player in the $66 billion carbonated soft-drink market. Jones Soda spent approximately $9 million to have 12-ounce cans manufactured and distributed nationwide to grocery stores and mass merchants. Although Jones Soda achieved significant "all commodity volume penetration" with retailers throughout the country, it suffered disappointing earnings. Six individuals brought a purported class action in September 2007 on the primary theory that the defendants misrepresented the extent of its penetration into the retail market.

Judge Robert S. Lasnik of the Western District of Washington in Seattle dismissed the claims and, in an interesting procedural holding, required the plaintiffs to submit a proposed amended complaint for his review. Judge Lasnik found the additional amended allegations insufficient to warrant proceeding and dismissed the lawsuit. On appeal, the plaintiffs pursued a theory that the defendants misrepresented the extent and scope of their expansion efforts, allegedly using insufficient financial resources and personnel to achieve successful entry into the carbonated soft-drink market. The defendants, however, never promised the market that their expansion efforts would meet the plaintiffs' vision of what was necessary to succeed, and instead laid out clearly in their public documents the expenses and hiring of personnel that were actually undertaken.



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The Ninth Circuit, in a memorandum decision, agreed. Judges Susan P. Graber and Richard A. Paez held that the plaintiffs failed to present "factual allegations sufficient to demonstrate that the Defendants' statements regarding the canned-soda initiative were untrue. Defendants never claimed that their investments were sufficient or adequate to ensure that the canned-soda initiative would be profitable. . . . Jones Soda incurred expenses related to promotion and sales in the carbonated soft drink market, which Plaintiffs acknowledge but claim were not enough to achieve Defendants' goals." Judge Stephen Reinhardt filed a dissenting opinion. The Ninth Circuit rejected the plaintiffs' request for a rehearing en banc on October 20, 2010.

The Wilson Sonsini Goodrich & Rosati team representing Jones Soda and Mr. Van Stolk in the matter was led by partner Barry M. Kaplan, former partner Douglas W. Greene, and Of Counsel Daniel W. Turbow and Cheryl W. Foung. The case is *In re Jones Soda Company Securities Litigation*; *Burrell et al. v. Jones Soda Company and Peter M. Van Stolk.*

Firm Secures Significant Appellate Win for Nuance

On November 12, 2010, Wilson Sonsini Goodrich & Rosati scored a significant appellate victory for Nuance Communications, a leading provider of speech and imaging solutions. The U.S. Court of Appeals for the Federal Circuit reversed a district court's dismissal of foreign defendants ABBYY Production and ABBYY Software from a patent infringement action for lack of personal jurisdiction and service of process. The reversal brings these defendants back into Nuance's lawsuit against ABBYY USA Software House and Lexmark International, which is pending in the U.S. District Court for the Northern District of California.

The Federal Circuit's decision in *Nuance Communications, Inc. v. ABBYY Software House et al.* affirms the court's personal jurisdiction over foreign entities that are developers of accused products and purposefully have directed those products to the forum. The decision permits discovery to be conducted against such defendants directly, and judgment to be enforced directly, should judgment against them be entered. It also affirms that substituted service on an affiliated U.S. entity may be permitted when service on the foreign entity is not possible because a signatory to the Hague Convention has refused to cooperate.

Partner Craig Tyler, with associate Daisy Poon assisting, argued Nuance's appeal before the U.S. Court of Appeals for the Federal Circuit. Of Counsel T.O. Kong and Daisy assisted Craig with the briefing. The Wilson Sonsini Goodrich & Rosati team representing Nuance also includes partners Ron Shulman and Julie Holloway; Of Counsel Michael Song; staff attorney Scott Morris; and associates Stephen Dartt, Elise Miller, and Abraham DeLaO.

Wilson Sonsini Goodrich & Rosati Obtains Privacy Victory for Google

On September 23, 2010, the firm successfully prevented Suzlon from subpoenaing Google to produce the contents of Gmail accounts. Suzlon, an Indian wind-turbine manufacturer pursuing a fraud claim against two former employees in Australia, filed a miscellaneous action in the U.S. District Court for the Northern District of California pursuant to 28 U.S.C. § 1782, which enables parties to foreign proceedings to seek U.S.-based discovery to aid those foreign proceedings. Here, Suzlon sought leave to serve a subpoena on Google seeking the contents of Gmail accounts that Suzlon claimed the defendants in the Australian litigation had used to further their allegedly fraudulent activities.

Wilson Sonsini Goodrich & Rosati intervened on Google's behalf and argued that Suzlon's § 1782 petition should be denied on futility grounds. The team argued that because the subpoena Suzlon sought to serve would be unenforceable under the Electronic Communications Privacy Act (ECPA), the court should not authorize Suzlon to serve it. The court agreed. Magistrate Judge Trumbull found that because "Google and its servers are located within the United States . . . the ECPA applies. As such, the ECPA prohibits Google from disclosing the contents of those email accounts until it receives consents from the email account holders." As a result, the court denied Suzlon's petition as futile, rejecting Suzlon's contention that the ECPA does not apply to foreign citizens.

The Wilson Sonsini Goodrich & Rosati team representing Google in the matter included partners David Kramer and Michael Rubin, and associate Jake Veltman. The case is *In re Beluga Shipping Gmbh & Co.*

Firm Ensures Successful Completion of InfoGroup Merger

On June 25, 2010, following several months of intense litigation in multiple forums, Wilson Sonsini Goodrich & Rosati prevailed over a shareholder's efforts to enjoin the acquisition of InfoGroup by CCMP Capital Advisors. A few days later, on June 29, 2010, InfoGroup shareholders overwhelmingly approved the transaction. The firm's victory in *New Jersey Carpenters Pension Fund v. InfoGroup, et al.* was notable because the InfoGroup board's deliberations regarding a potential transaction were complicated by the actions of a director who owned 37 percent of the company. In their motion for preliminary injunction in the Delaware Chancery Court, the plaintiffs attempted to paint the entire board as conflicted and the entire process as tainted due to this director's actions, which included attempts to purchase the company himself, unauthorized public statements that the company should be sold, and public threats to file lawsuits against the board.

In its opposition brief and at oral argument, the Wilson Sonsini Goodrich & Rosati team emphasized the numerous steps the InfoGroup board had taken to neutralize the impact of the director's actions, such as the formation of a special committee, restrictions on distribution of board materials, close supervision of contact with interested buyers, and adoption of a shareholder-rights plan, among others. The firm detailed the extensive

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analysis conducted by the special committee, with the aid of its financial advisor, to evaluate the company's options, including continuing as a standalone company. The firm also highlighted the comprehensive auction process undertaken by the company to solicit the highest possible offers. Finally, the firm persuasively showed that there were no material omissions in InfoGroup's proxy disclosures. Based on this advocacy, Chancellor Chandler denied the plaintiffs' motion to enjoin the merger.

The Wilson Sonsini Goodrich & Rosati team representing InfoGroup was led by partners Steven M. Schatz and Steve Guggenheim.

VIA Technologies Victorious in Patent Infringement Appeal

On September 22, 2010, in *Computer Cache Coherency Corporation v. VIA Technologies, Inc., et al.,* the U.S. Court of Appeals for the Federal Circuit confirmed that Wilson Sonsini Goodrich & Rosati client VIA Technologies (VIA) did not infringe a patent asserted by Computer Cache Coherency Corporation (CCCC). CCCC is a wholly owned subsidiary of well-known patent troll Acacia Research. The district court had granted VIA's motion for summary judgment of noninfringement of CCCC's patent, which relates to technology for maintaining cache coherency in a computer system. CCCC appealed, arguing that the district court had misinterpreted a key claim term. The Federal Circuit upheld the district court's claim construction and its determination that VIA did not infringe.

The appeal was argued by Wilson Sonsini Goodrich & Rosati partner Julie Holloway. Former Special Counsel Monica Mucchetti Eno worked on the appellate brief, and partner Maura Rees, associate Tony Weibell, and former partner Jennifer Ochs worked with Julie on the district court case.

Biotium Prevails in Employment Litigation

On September 24, 2010, Wilson Sonsini Goodrich & Rosati obtained a significant employment litigation victory for Biotium, a leading developer and manufacturer of fluorescent reagents and other specialty biochemicals. In *Nataliya Polishchuk v. Biotium, Inc., et al.*, a former employee filed a lawsuit against Biotium and certain individual employees alleging numerous causes of action relating to the termination of her employment. Biotium filed a motion for summary judgment based upon the former employee's admissions obtained in her deposition.

After extensive briefing and a lengthy oral argument, the Alameda County Superior Court granted Biotium's motion for summary judgment as to seven of the ten causes of action, including discrimination, retaliation, wrongful termination, and intentional infliction of emotional distress. The firm also secured the dismissal of one of the individual defendants from the lawsuit. Notably, the judge modified his tentative ruling after oral argument, persuaded by Biotium's arguments that the plaintiff had not alleged sufficient facts to support a claim of intentional infliction of emotional distress, and the absence of any evidence in the record to support the plaintiff's race-related claims. The plaintiff since has agreed to settle any remaining claims.

The Wilson Sonsini Goodrich & Rosati team representing Biotium was led by litigation partner Marina Tsatalis and included associates Koray Bulut and Elizabeth Tippett.

Firm Secures Dismissal of WildTangent Lawsuit Based on Supreme Court's *Bilski* Decision

On August 13, 2010, in *Ultramercial, LLC, et al. v. Hulu, LLC, et al.,* Wilson Sonsini Goodrich & Rosati obtained the dismissal of a patent infringement suit filed against WildTangent in the U.S. District Court for the Central District of California. Nearly a year earlier, Ultramercial filed a complaint against WildTangent, YouTube, and Hulu, asserting that the companies infringed and continued to infringe Ultramercial's U.S. Patent No. 7,346,545. The '545 patent discloses a method of distributing intellectual property over the Internet by providing access to the intellectual property through watching an advertisement instead of payment.

On December 23, 2009, the defendants moved to dismiss Ultramercial's complaint based on the Federal Circuit's *Bilski* decision. The motion argued that the '545 patent was invalid on its face for failure to claim patentable subject matter. A decision on the motion was stayed pending the U.S. Supreme Court's decision in *Bilski v. Kappos*, reviewing the Federal Circuit decision, which ultimately was issued on June 28, 2010.

On August 13, 2010, Judge R. Gary Klausner granted the defendants' motion to dismiss on the basis that the '545 patent fails to disclose patentable subject matter. The court found that the "watch-or-pay" method of distributing intellectual property disclosed in the '545 patent not only fails the machine-or-transformation test, but is also an abstract idea. The court rejected Ultramercial's argument that the motion should not be decided before claim construction, stating that it would be "more appropriate for this Court to render its decision at the earliest stage so that the parties may benefit from the Federal Circuit's guidance on the issue sooner rather than later, if they so desire."

The Wilson Sonsini Goodrich & Rosati team representing WildTangent in the matter included partner-elect Rick Frenkel and associates Lisa Nguyen and Melissa Kopacz.

Scribd Wins Copyright Litigation Case

The firm obtained a copyright litigation victory for Scribd, the world's largest social reading and publishing company, in *Elaine Scott v. Scribd, Inc*. Scribd hosts a massive online library of written materials posted by users, and relies upon the Digital Millennium Copyright Act (DMCA) for protection from liability when users misuse the site by uploading documents without the copyright owner's authorization. In an effort to prevent such misuse, Scribd, in addition to complying with the DMCA, developed an industry-leading automated detection system meant to prevent unauthorized documents from being uploaded to the site.

In September 2009, the law firm of Camara & Sibley filed a class action copyright infringement lawsuit against Scribd in the Southern District of Texas. The suit sought damages on behalf of every author whose work had been posted to Scribd without their authorization, both on the grounds that Scribd directly infringed those works by incorporating information from them in its infringement-prevention system and on the grounds that Scribd indirectly infringed those works by hosting them at the request of its users. In the complaint, the plaintiff claimed that courts in the Ninth Circuit had misinterpreted the DMCA and that it was up to the Southern District of Texas to set things right.

Following aggressive advocacy by the firm, and with discovery-related cross-motions pending, Scribd achieved a resounding victory on July 12, 2010, when the plaintiff agreed to voluntarily dismiss its case with prejudice, with each side bearing its own costs.

The Wilson Sonsini Goodrich & Rosati team representing Scribd in the matter was led by associate Brian Mendonca and included partner David Kramer and associate Caroline Wilson.

Iranian Dissident Obtains United Nations Victory

On May 6, 2010, a five-delegate panel of the United Nations Working Group on Arbitrary Detention ruled in favor of firm pro bono client Isa Saharkhiz, a prominent Iranian dissident, in a dispute against the government of the Islamic Republic of Iran concerning Iran's arbitrary detention and torture of Mr. Saharkhiz following its controversial 2009 presidential elections. Wilson Sonsini Goodrich & Rosati prepared and represented Mr. Saharkhiz and his son in their submission to the United Nations.

Mr. Saharkhiz is Iran's former Minister of Culture and Education and a well-known journalist who previously was the editor in chief of two prestigious reformist news publications, the monthly magazine *Aftab* and newspaper *Akhbar-e-Eghtesad*. He was also the co-founder of the Iran Association for the Defense of Press Freedom and served on the executive committee of Iran's National Peace Council. On July 4, 2009, as part of a raid on prominent Iranian dissidents following massive opposition protests, plainclothes members of the Iranian police and Iran's Revolutionary Guard Corps arrested Mr. Saharkhiz without informing him of the charges against him or the legal basis of his detention. The agents severely beat Mr. Saharkhiz during the arrest, resulting in numerous injuries, including fractured ribs and injuries to his chest, shoulder, and wrists. The authorities subjected Mr. Saharkhiz to further abuse following his arrest, including 62 days of solitary confinement. Mr. Saharkhiz's arrest came just two days after he printed articles that criticized Iran's Supreme Leader and the Iranian government's handling of the 2009 presidential election; called the elections a "coup"; and asserted that the Iranian Constitution protects the rights to freedom of speech and peaceful assembly. Mr. Saharkhiz remains jailed in Iran's notorious Evin prison.

In its May 2010 opinion, the UN Working Group declared that Mr. Saharkhiz's detention by the Iranian government was "arbitrary" and requested that the Iranian government "order his immediate and unconditional release," "guarantee him a fair trial according to international standards," and consider reparations owed to Mr. Saharkhiz for his arrest and detention. The opinion represents the first judgment against the government of Iran for the violence following the July 2009 elections.

The Wilson Sonsini Goodrich & Rosati team representing Mr. Saharkhiz on a pro bono basis included partner Bahram Seyedin-Noor and associate Nema Milaninia.

Opening the Floodgates: The Dodd-Frank Whistleblower Provisions' Impact . . . (Continued from page 1)

Is This New News? Part I

Kind of. The SEC actually has had a bounty program in place for more than 20 years. This original bounty program rewarded whistleblowers for information leading to the recovery of a civil penalty from an insider trader, a tipper, or someone who controlled an insider trader. The bounty was limited to 10 percent of a civil penalty exacted pursuant to a court order. The decision to award a bounty, and to whom, was within the sole discretion of the SEC (as it will be under Dodd-Frank).

This bounty program was a fairly well-kept secret, as the Office of Inspector General (OIG) noted in a March 29, 2010, report: "[T]he Commission has not received a large number of applications from individuals seeking a bounty over this 20-year period. We also found that the program is not widely recognized inside or outside the Commission."[3]

In fact, the OIG determined that between 1989 and 2009, the SEC had paid a total of seven bounties to five claimants amounting to less than $160,000 and had denied five bounty applications. Consequently, the OIG made a number of recommendations to improve the bounty program, including coming up with a communication plan to raise the profile of the program, posting an application form on the SEC website, and developing specific criteria for awarding a bounty. The OIG also suggested that the SEC incorporate best practices from more successful Department of Justice (DOJ) and Internal Revenue Service (IRS) bounty programs.

For purposes of this discussion, the old bounty program is just an interesting reference point. The Dodd-Frank mandate to the SEC is broader and more lucrative for whistleblowers. The Whistleblower Incentive and Protection Program to be implemented by the SEC will not be limited to insider trading and will not cap bounties at 10 percent of a civil penalty. It's also apparent that the new bounty program will not be a secret inside or outside the commission.

Is This New News? Part II

Anyone outraged at the concept of our government paying whistleblowers for reporting unlawful activity might be surprised to find out that it's been going on for quite a while and that it's a big, lucrative business.

The False Claims Act

The False Claims Act, 31 U.S.C. § 3729, et seq., generally creates liability for persons who make false claims to or defraud the government in order to receive money from the government. For example, a defense

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contractor who knowingly submits a false invoice to the government for payment would run afoul of this act. Section 3730 permits a whistleblower—called a "relator" in False Claims Act jargon—to bring an action for the government. The procedure for initiating and maintaining such an action, called a qui tam action, is complex and beyond the scope of this article. Where the government proceeds with an action brought by a whistleblower, the whistleblower is entitled to at least 15 percent and up to 25 percent of the proceeds of an award or a settlement. If the government declines to proceed with the case and the relator proceeds with it and obtains a recovery, the whistleblower is eligible for a higher percentage.

The False Claims Act, once known as the "Lincoln Law," was enacted in 1863 to address government-contracting fraud during the Civil War. It was substantially amended most recently in 1986 (note that the old SEC bounty program went into effect in 1989). Since 1986, according to DOJ statistics, qui tam lawsuits have returned more than $15 billion to the government and have generated $2.5 billion in awards to whistleblowers. That's real money, and it has attracted real plaintiff law firms to represent whistleblowers in qui tam actions. Needless to say, the SEC's old bounty program did not spawn a thriving plaintiffs' bar.

Early indications are that the plaintiffs' securities class action and qui tam bar are acutely interested in the Dodd-Frank whistleblower provisions. For example, one of the leading False Claims Act plaintiffs' firms has dedicated a portion of its website to this opportunity, as I'm sure others have.[4] In addition, a reference to the Dodd-Frank whistleblower provisions has worked its way into the standard press releases seeking plaintiffs for securities class actions. One does

[3] See http://www.treas.gov/tigta/auditreports/2006reports/200630092fr.pdf.
[4] See http://www.phillipsandcohen.com/CM/Custom/Whistleblowers-for-SEC.asp.

not have to be an economist to see the direction in which this is heading: Plaintiffs' lawyers follow the money, and they smell money in this new law.

FCPA: Where the Real Money Is

Pursuant to the Foreign Corrupt Practices Act (FCPA), 15 U.S.C. §§ 78dd-1, et seq., anti-bribery provisions, it is unlawful for any issuer, domestic concern, or person acting in the United States to offer anything of value to members of a foreign government, international organization, or political party for the purpose of: (1) influencing duties; (2) inducing them to use their influence to affect a foreign government's or agency's decision; (3) obtaining or retaining business for anyone; or (4) directing business to anyone. Fines and penalties for violating the FCPA tend to be higher than fines for violations of other aspects of the securities laws. The reason for that is simple: The fines are driven by the profits a company makes by virtue of the wrongful conduct. The SEC has made it clear through its public statements that it intends to focus on investigating and taking action on violations of the FCPA. More importantly, the SEC has made the point clear through its enforcement program. In 2010 alone, the SEC concluded 12 FCPA investigations and assessed monetary penalties totaling more than $360 million.

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Putting aside the Goldman Sachs settlement of $550 million last year for alleged unlawful activity relating to the financial crisis, these numbers are staggering compared to standard SEC settlements. Settlements in more typical SEC enforcement matters relating to insider trading and false financial reporting in 2010 ranged from $20,000 to $28 million. While whistleblower activity under the new regulatory regime will be robust in all areas, the FCPA will be the belle of the ball.

You Can Be a Whistleblower

So can I. Anyone can. Renowned Enron whistleblower Sherron Watkins was an Enron employee and perhaps that created a perception that whistleblowers and corporate employees are one and the same. That's not an accurate association, however. Dodd-Frank defines whistleblower as "any individual who provides, or 2 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."[5] This is drafted broadly enough to encompass, for example, forensic accountants poring through public filings for perceived inaccuracies. Could a competitor or customer become a whistleblower? Sure. Anyone can be a whistleblower, assuming they can dredge up information or an analysis indicating a violation of the securities laws.

Obvious Statements about the Future

Although the SEC has work to do to flesh out the Dodd-Frank whistleblower provisions, there will be hundreds of whistleblower complaints to the SEC annually, and the Division of Enforcement and the new whistleblower office will be under a severe burden to handle them all. Numerous investigations will ensue, prompting companies to respond to the SEC investigations and, in some cases, initiate audit committee investigations about the allegations. Follow-on class and stockholder derivative actions may be filed in reaction to SEC investigations.

> Could a competitor or customer become a whistleblower? Sure. Anyone can, assuming they can dredge up information or an analysis indicating a violation of the securities laws.

A version of this article first appeared on boardmember.com on October 28, 2010. This article is used with the permission of Corporate Board Member and NYSE Euronext.

[5] See http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/content-detail.html.

Testifying Experts and Privilege: Newly Amended Rule 26's Expected Impact on Attorney Work-Product Privilege

By Abraham DeLaO, Associate (Austin)

Starting in December 2010, parties now can expect a significant expansion of the attorney work-product privilege regarding testifying expert witnesses. Under the prior version of Rule 26 of the Federal Rules of Civil Procedure, communications with testifying experts were discoverable, as were drafts of their expert reports. Under the newly amended Rule 26, which went into effect on December 1, draft reports and certain communications are protected from discovery. The amended rule also introduces a limited disclosure requirement for testifying experts who have not been retained specifically to provide expert opinion testimony at trial. These changes are expected to address some of the burdens created by the current disclosure requirements surrounding testifying experts.

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Prior to these amendments, Rule 26 required parties to produce virtually all communications with experts designated to testify at trial. In many jurisdictions, this disclosure requirement even trumped any claim of attorney-client or work-product privilege that sought to protect communications with a testifying expert. The need for such an expansive discovery requirement is based on the notion that disclosure of all materials considered by an expert is necessary in order to evaluate whether the expert's opinions have been influenced by the party retaining them. However, rather than promoting efficient discovery, the prior requirements typically encouraged cautious communications with experts and burdensome motion practice. In response, the Judicial Conference Committee on Rules of Practice and Procedure recommended several changes to Rule 26. These proposed changes were ratified by the U.S. Supreme Court, and govern all proceedings commenced on or after December 1, 2010, as well as "insofar as just and practicable, all proceedings then pending."[1]

The first change is an extension of the work-product doctrine to protect draft expert reports. Experts retained to testify at trial are still required to disclose a report that details the opinions they will be providing and the basis for these opinions. However, under the modified rules, drafts of these reports are considered attorney work-product.[2] For many, this change will bring the rules in line with existing practices, since it has become common for parties to either stipulate that drafts of expert reports will not be discoverable or refrain altogether from creating any draft reports.

The second change to Rule 26 is an expansion of the work-product doctrine to protect all communications between the attorney and a testifying expert, with three exceptions. Now, the only discoverable communications are those that: (1) "relate to compensation for the expert's study or testimony," (2) "identify facts or data" provided by the attorney that were "considered" by the expert "in forming the opinions to be expressed," and (3) "identify assumptions" provided by the attorney and "relied upon" by the expert "in forming the opinions to be expressed."[3] The prior rule required broad disclosure of all "data or other information" communicated to the expert. Many courts gradually expanded the prior rule's scope to the point that practically all communications with testifying experts were discoverable. Even though the amended rule is intended to narrow the current disclosure requirements, parties must remain vigilant for court rulings that expand these three exceptions into privileged matters.

A third change creates a new disclosure requirement for testifying experts who have not been retained specifically as expert witnesses. Under the amended rule, these particular experts will be required to produce only a limited report that discloses the "subject matter on which the witness is expected to present evidence" and "a summary of the facts and opinions to which the witness is expected to testify."[4] Examples of such experts are treating physicians, government accident investigators, and party employees providing opinion testimony based on first-hand knowledge rather than information provided by an attorney. All drafts of these disclosure reports are protected by the work-product doctrine under the new rule, the same as for full expert reports.

These changes to Rule 26 should reduce the burdens attendant with preparing testifying experts for trial. However, parties should monitor the initial judicial rulings that will define the contours of these amended discovery requirements.

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[1] 2010 U.S. Order 27 (C.O. 27), April 28, 2010.
[2] *See* FRCP §26(b)(4)(B).
[3] *Id.*
[4] *See* FRCP §26(a)(2)(C).

For example, in the Facebook Beacon lawsuits, Blockbuster.com, Zappos.com, and several other companies involved in the Beacon program allegedly shared details of customer activity on their websites with Facebook before seeking user consent. With a proposed class of roughly 3.6 million people and claims carrying potential statutory-damages awards of thousands of dollars *per violation,* the defendants' potential exposure was astronomical. Ultimately, the case settled for $9.5 million. The defendants in the more recent Flash-cookie class actions face similarly high potential exposure due to a large proposed class and statutory-damages claims. There, the allegations are that companies such as Walt Disney and Warner Brothers Records, working with Internet advertising companies, set so-called "Flash cookies" on customers' computers, thereby circumventing privacy controls customers had implemented in their web browsers. Even if the customers deleted their browser cookies, the code would save the data in the memory of plaintiffs' Adobe Flash Media Players and then "re-spawn" the cookies. The defendants face numerous statutory and common-law claims. Finally, in the recent Webloyalty class actions, MovieTickets.com and Visa face similarly large potential exposure in actions arising out of alleged sharing of customer credit-card information with Webloyalty. There already has been a settlement in a related investigation by the New York Attorney General's office for $5.2 million to be paid by Webloyalty, and payment of another $3.3 million by companies that provided user data to Webloyalty.

In light of the significant potential exposure, how can businesses share online customer data without becoming a class action defendant? Unfortunately, there is no foolproof way (other than, of course, not sharing user data). However, there are several steps that may reduce the risk.

"It's free, but they sell your information."

Clear disclosure of your data-sharing practices in a terms-of-use or privacy policy. One method that Internet businesses historically have used to disclose practices that might otherwise give rise to litigation is through terms-of-use and privacy policies. Years ago, companies relied upon so-called "browse-wrap" agreements, which were terms available to the user somewhere on the site, but which the user did not have to affirmatively agree to in order to complete a purchase. In response to cases finding such agreements insufficient to bind a website user, companies started requiring users to check a box indicating their consent to the terms of use in order to complete a transaction on the website. While courts generally have enforced such "click-wrap" agreements, there are exceptions. Requiring the user to scroll to the end of the terms of use and then click a box indicating "I have read and agree to be bound by these terms of use" provides added protection. However, when it comes to sharing user data, the FTC and various consumer groups have taken the position that disclosure in terms of use is not enough. In any event, a disclosure in a terms-of-use or privacy policy that is not complete or is unclear simply provides plaintiffs' counsel with ammunition for their complaints. On the other hand, detailed disclosures have been attacked by the plaintiffs' bar as too difficult to understand by the average Internet user. In short, clear and concise plain-language disclosures in prominently displayed terms of use that must be read and affirmatively accepted is a minimum, but by no means guaranteed, method of protection from lawsuits and investigations.

Customer agreement to arbitrate disputes with waiver of class claims on an individual basis only. Arbitration provisions often are found in customer terms of use, the theory being that arbitrations tend to be less expensive than courtroom litigation, particularly where expedited procedures are agreed to. Another benefit of requiring arbitration of disputes is that some states have upheld such provisions that foreclose class actions (note that whether such

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provisions are valid is an issue pending before the U.S. Supreme Court). However, even in a state that will enforce a class action waiver, a court still might find the entire arbitration provision unenforceable. For example, in one of the Beacon lawsuits, the court found Blockbuster's terms of service "illusory" because Blockbuster retained the right to unilaterally change them at any time. Careful drafting to maximize the chances that a court will uphold the provision is key.

Indemnification provision in agreements with company receiving data. Any company entering an agreement to share online user data would be wise to insist upon an indemnification provision in the event of a lawsuit. Ideally for the recipient, the provision would require the party providing the indemnification to indemnify it for investigation and defense costs as well as any ultimate judgment, and allow the company to control its defense including the selection of counsel of its choice. But obtaining an indemnification does not minimize the risk of being dragged into a lawsuit that could be high profile and which certainly would require the business people and in-house counsel to devote substantial time and effort to document collection, depositions, and other litigation-related tasks necessary to defend the suit. Thus, even if the third party pays pursuant to the indemnification, there still could be substantial reputational and other unavoidable costs. Additionally, plaintiffs' lawyers may challenge the indemnification provision as void and otherwise unenforceable. Finally, some of the statutes typically invoked in these types of suits have criminal penalties, which cannot be avoided through indemnification.

Clear and specific opt-in before any information is shared. For the use of user information other than a limited set of "commonly accepted practices," the FTC now is urging disclosure and a control mechanism on the page where users provide their data so that the user can decide whether or not to share their information. In the event of automatic sharing of information, clear and conspicuous notice and control should be provided at the time the user starts using the service. And if changes are made to how information is shared, a new explicit opt-in should be obtained. An opt-out (meaning that if the user does nothing, the information is shared) is also an option, but it is less likely to provide protection. The problem with opt-outs is that they are not always obvious to the user. Even if the user can figure out how to opt out, information already may have been shared, thus leaving that individual within a potential class of plaintiffs whose information was shared without authorization. For entities and practices covered by the new FTC guidance, opt-outs are not adequate for these reasons.

In sum, while there are many legitimate business reasons for website operators to share their user information with third parties, there also are substantial risks. Before entering an agreement to share user information, companies should assess the best means to protect themselves from lawsuits—and recognize the risks that remain even after taking such measures.

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