BRYAN CAVE
A Broader Perspective

Alert

The Global Anti-Corruption Team and Securities Litigation and Enforcement and International Trade Client Service Groups

To: Our Clients and Friends June 22, 2011

The Implications for FCPA Enforcement of the SEC's New Whistleblower Rules

The Securities and Exchange Commission's recent adoption of rules to implement the whistleblower program mandated by the Dodd-Frank Act has particular significance for enforcement of the Foreign Corrupt Practices Act ("FCPA"). This Alert discusses the overall SEC enforcement context for the new whistleblower rules, summarizes the rules, and then discusses what we believe to be the key issues for FCPA enforcement, including recommendations for steps that companies should take now.

Current SEC Enforcement Context

These controversial rules (the Commission's vote in favor of adoption was 3-2, with vigorous dissents from Commissioners Parades and Casey) form an important part of ongoing efforts to re-energize the SEC's Division of Enforcement. Since 2010, the Division of Enforcement has flattened its traditional hierarchical structure and streamlined its procedures, instituted a cooperation initiative to further encourage "cooperation" by individuals and companies subject to investigation, and established "specialized units," including a unit devoted specifically to the FCPA.

The cooperation initiative imports to SEC investigations techniques long-common in criminal investigations. These include the availability of non-prosecution and deferred prosecution agreements and the ability to establish early in an investigation the benefits that cooperation will provide. As to creating specialized units, the Division intends to concentrate resources in areas requiring more specialized skills. As Robert Khuzami, the Director of the Division, said when announcing the formation of the specialized units:

> The Units will focus on areas with complicated organizational structures or regulatory schemes, on newly-emerging and complex markets, transactions and products, and on targeted areas we believe are deserving of enhanced enforcement activity.[1/]

Despite these intentions, uncertainty as to the federal budget has limited the SEC's staffing, which has posed significant challenges for efforts to revitalize the enforcement program. The whistleblower program is particularly important in this context, because it holds out the potential to provide

[1/] Remarks at News Conference Announcing Enforcement Cooperation Initiative and New Senior Leaders, January 13, 2010, Robert S. Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission.

meaningful shortcuts to the laborious and document-intensive process of conducting investigations. In her remarks at the Commission meeting where it adopted the new rules, Chairman Schapiro said, "[f]or an agency with limited resources like the SEC, I believe it is critical to be able to leverage the resources of people who may have first-hand information about potential violations."[2/]

Summary of New Whistleblower Rules

The whistleblower rules provide that individuals who voluntarily provide the SEC with original information that leads to a successful enforcement action resulting in monetary sanctions in excess of $1 million are entitled to receive an award of between 10% and 30% of the total sanctions. The SEC provided the following definitions of the key terms:

- Information is provided "voluntarily" if the individual comes forward prior to the SEC or other investigative authority contacting him or her. Even if a company receives a subpoena from the SEC, an individual employed by that company can claim status as a whistleblower as long as the SEC had not yet sought information from him or her.

- Information is "original" if it is then-unknown to the SEC and derived from the individual's independent knowledge of non-public information or independent analysis of public information. Importantly, persons receiving information because of their status as compliance officers, legal counsel, or others to whom information concerning potential violations is supposed to flow are not eligible for whistleblower awards unless they reasonably believe that the company will not act on the information or will impede an investigation. (Attorneys are further limited to disclosure of information where disclosure is permitted under ethical rules.)

- Information "leads to a successful enforcement action" if it is "specific, credible, and timely" in identifying an area of investigation (or a new area in an ongoing investigation).

- The $1 million threshold includes disgorgement, monetary penalties and interest collected in any administrative or judicial actions instituted by the SEC or other U.S. government agencies, including the Department of Justice. In order to not reward an individual's own misconduct, a whistleblower who is civilly culpable and who, as a result, pays a monetary sanction, will have the amount of any such payment, and the amount that the company pays attributable to that person's misconduct, deducted from the total sum for purposes of establishing whether the $1 million threshold has been reached. (Note, however, that even individuals who are civilly liable may be entitled to awards. Individuals who are criminally liable are foreclosed from awards.)

The rules describe factors that the Commission will consider in determining where within the 10% to 30% range a particular award to a whistleblower may fall. Factors that favor a higher award include: the significance of the information, the actual assistance provided by the whistleblower, the public interest in the area of regulation implicated in the misconduct and the extent to which the whistleblower sought to involve the company's internal compliance program. Factors that favor a lower award include the individual's own culpability, delays in the individual's reporting the misconduct and whether the individual went around or sought to undermine the company's own compliance program.

As to this last point, the possibility that the whistleblower program could undermine corporate compliance programs was subject to extensive commentary. After all, why would an individual with knowledge of wrongdoing trigger an internal process that could result in the situation being corrected if doing so would obviate a potential award? The SEC tried to address this issue by enabling individuals to identify the issue both to the company and the government, and by including the whistleblower's use of internal compliance procedures as a factor potentially increasing an individual's award.

[2/] Opening statement at SEC Open Meeting, May 25, 2011, Chairman Mary L. Schapiro, U.S. Securities and Exchange Commission.

Importantly, whistleblowers are entitled to an award if their information led to a company's internal investigation, which, in turn, led to a successful enforcement action.

Finally, central to the new program, companies are forbidden from retaliating against those claiming whistleblower status.

According to senior SEC officials, in the year since the passage of the Dodd-Frank Act, the number of whistleblower reports to the SEC has increased dramatically. The adoption of the rules for the program is likely to increase that number further.

Implications for FCPA Enforcement

We expect that a significant portion of purported whistleblowers will report perceived violations of the FCPA. Monetary penalties in FCPA actions tend to be large—often in the tens and sometimes in the hundreds of million dollars—so the monetary incentive could be significant. In addition, in a geographically dispersed company, an individual may believe that he or she uniquely possesses some discrete bit of information that could lead to a successful prosecution and may believe that there is a greater likelihood that he or she will be "first in line" or otherwise more likely to receive an award. And, because FCPA investigations are exceedingly difficult to pursue absent a detailed roadmap that only a well-situated individual may be in a position to supply, we believe that the SEC may give priority to FCPA matters for payment of whistleblower awards.

In light of these developments, what should a company with substantial business interests outside of the U.S. do?

- *Ensure that internal controls and FCPA compliance programs are sound and implemented appropriately.* Although the new rules may increase incentives to such an extent that whistleblower reports of alleged FCPA (and other) problems may be inevitable, preventing improper conduct in the first place, to the extent possible, is the best way to obviate whistleblower complaints or to ensure that any subsequent investigation is resolved promptly and favorably.

- *Rehearse how to respond.* Companies should establish a mechanism for responding when the SEC or other authority contacts them as the result of a whistleblower report. What resources will be available to conduct an investigation? In what circumstances will outside counsel or forensic accountants be involved?

- *Weigh the possibility of whistleblowers in determining whether to self-report.* Whenever the company discovers improper conduct as the result of allegations made through internal channels, the company must now seriously consider whether a whistleblower has or will report the improper conduct to the government in determining whether the company should make a voluntary disclosure to the government.

- *Ensure no retaliation.* Establish an unequivocal "no retaliation" policy and ensure that it is understood at all levels within the organization.

For more information, please contact a member of Bryan Cave LLP's Global Anti-Corruption Team, the Securities Litigation and Enforcement Group, or the International Trade Group.

Paul Huey-Burns, Partner
(202) 508-6010
paul.huey-burns@bryancave.com

Mark Srere, Partner
(202) 508-6050
mark.srere@bryancave.com