Conducting In-house International Whistleblower Investigations: Tips, Best Practices, and Lessons Learned

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I. Introduction[1]

Whether they are called whistleblowers or "speak up employees" or "internal reporters," an employee that chooses to bring forward issues of potential corporate misconduct can be a company's best friend. But that employee may also be a poor performer already subject to a performance management plan or complicit in the conduct under investigation. They may be well meaning or revenge seeking. They might be a victim of retaliation or subject to termination. Or, they could be all of the above.

Most internal reports come first to someone inside the company. And the initial triage and review of that internal report will be done by company staff – in human resources, legal, or compliance departments. This paper addresses many of the issues confronted by company personnel when faced with managing a review into an internal report.

This paper provides an update on the U.S. Securities and Exchange Commission's 2017 Annual Report to Congress on the Dodd-Frank Whistleblower Program authored by the Office of the Whistleblower, followed by a quick look at recent U.S.-based survey data, and an update on recent U.S. developments.

A. Update on External Reporting under Dodd-Frank

In the SEC's 2017 Annual Report to Congress on the Dodd-Frank Whistleblower Program, the staff of the Office of the Whistleblower ("the Office") made these key points:

- In 2017, the Commission paid nearly $50 million in whistleblower awards to 12 individuals.
- Since the beginning of the program in 2012, the SEC has paid approximately $160 million in whistleblower awards to 46 individuals.
- In 2017, the Office received over 4,400 tips, a nearly 50% increase over 2012.
- In 2017, the Office returned nearly 3,200 phone calls from members of the public.
- Tips came from all 50 states and the District of Columbia (accounting for 88% of total) and 72 countries outside the United States (accounting for the remaining 12% of total).

[1] An earlier version of this paper was presented at a Minnesota Continuing Legal Education program in 2016.

- California, New York, Texas, Florida and New Jersey accounted for the largest numbers of reports from inside the U.S. The UK, Canada, Australia, PRC, Mexico, and Russia accounted for the largest numbers outside the U.S.

- There are over 700 matters being tracked by the Office based on whistleblowers' tips that caused an inquiry or investigation to be opened.

- In December 2016 and January 2017, the SEC brought several enforcement actions against companies for using restrictive language in separation and severance agreements. Rule 21F-17 provides that companies may not take action to impede an individual from communicating directly with the SEC about a possible securities law violation. The SEC found that the companies used the separation and severance agreements to impede whistleblowers from reporting violations to the SEC in violation of Rule 21F-17.

- In November 2017, the SEC awarded more than $20 million to a whistleblower, the third-highest award made since the program issued its first award in 2012.

- In August 2015, the SEC released guidance clarifying that individuals can make reports regarding potential securities law violations internally and still be protected from retaliation even if they have not reported the conduct to the SEC in a manner that would qualify for an award under the rules. The SEC's guidance created a federal circuit split on the issue of whether the Dodd-Frank anti-retaliation protections apply to employees who report potential violations of the securities laws internally without also reporting directly to the SEC.[2] Recently, one of these cases, *Somers v. Digital Realty Trust, Inc.*, reached the U.S. Supreme Court. On February 21, 2018, the Supreme Court held that employees must report a suspected violation of securities laws to the SEC in order to qualify as a protected "whistleblower."[3]

B. Update on Recent Internal Reporting Survey Data

NAVEX Global's 2017 Ethics & Compliance Hotline Benchmark Report includes the following findings regarding internal hotline reporting:[4]

- The report notes a 56% increase in the number of reports per 100 employees since 2010. The reporting rate rose in 2016 to a median of 1.4 reports per 100 employees. The report comments that this steady increase in reporting over the last seven years suggests that increased reporting is not an anomaly.

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[2] *See, e.g.*, *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013); *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015).

[3] 138 S. Ct. 767 (2018).

[4] NAVEX Global, 2017 NAVEX Global Ethics & Compliance Hotline Benchmark Report. See page 2 of the report for a description of its methodology.

- Using the median rather than the average, 2% of reports related to Accounting, Auditing and Financial Reporting issues; 14% to Business Integrity issues; 72% to HR, Diversity and Workplace Respect issues; 7% to Environment, Health and Safety issues; and 5% to Misuse, Misappropriation of Corporate Assets issues.[5]

- The overall substantiation rate remains high at 40%.

- Median substantiation rates by allegation category vary; HR-related claims substantiate at about a 38% rate while complaints involving financial, environmental, business integrity, and misappropriation of assets run at a higher 43%-55% substantiation rate.

- Anonymous reports substantiate at a lower rate than non-anonymous reports, but still at substantial rate of 35% (versus a 46% substantiation rate for non-anonymous reports and a 40% overall substantiation rate).

- Only 30% of anonymous reporters follow-up on their reports, which may explain the lower substantiation rates for anonymous reports.

- Reports of retaliation are low (less than 1% of all reports) but the substantiation rate on retaliation claims remains at 26%.

The perception that retaliation remains an issue is supported by these numbers—more than one in four retaliation claims (when made) are substantiated. One wonders whether retaliation is reported in the same way as other misconduct and at the same rate. Some data suggests that once retaliated against, employees may be opting out of the reporting system. For example, a National Business Ethics Survey reported that in 2013 "more than 1 in 5 U.S. workers who reported misconduct said they experienced retaliation. That is about 6.2 million Americans."[6]

The National Business Ethics report also included information about who is reportedly engaging in the misconduct being reported. In that survey, respondents indicated "[m]anagers—those expected to act as role models or enforce discipline—are responsible for a large share of workplace misconduct (60 percent) and senior managers are more likely than lower-level managers to break the rules."[7]

II. <u>Developments under the Sarbanes-Oxley Act</u>

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[5] See definitions of each category in the report.

[6] *See National Business Ethics Survey 2013 Key Findings*, Ethics & Compliance Initiative (2013), http://www.ethics.org/newsite/research/eci-research/nbes/nbes-reports/nbes-2013.

[7] *Id.*

A. Retaliation against whistleblowers

- In *Kantin v. Metropolitan Life Insurance Co.*, 696 F. App'x 527 (2d Cir. 2017), the Second Circuit affirmed the dismissal of a Sarbanes-Oxley Act retaliation claim because the Plaintiff lacked a reasonable belief that his former employer engaged in any fraudulent conduct. Under the Sarbanes-Oxley Act, a plaintiff must have a reasonable belief that the conduct in question violated one of the enumerated provisions. The reasonable belief must contain both objective and subjective components. The Second Circuit held that the Plaintiff failed to demonstrate both an objectively and subjectively reasonable belief that any of the conduct complained of constituted a violation. For example, he admitted that he himself did not believe the commission payments he complained of were illegal.

- In *Trusz v. UBS Realty*, No. 09-00268, 2016 WL 1559563 (D. Conn. Apr. 18, 2016), the court denied both cross motions for summary judgment. Plaintiff, the head of Defendant's valuation unit, raised concerns over the company's valuation procedures and highlighted valuation mistakes that had been made. He alleged that Defendant retaliated against him, violating the Sarbanes-Oxley Act. Defendant claimed that they terminated Plaintiff after deciding to outsource his position. The court held that there was a genuine issue of material fact as to whether Plaintiff's complaints were protected under the Sarbanes-Oxley Act and if so, whether the protected activity led to his firing.

- In *Hartzman v. Wells Fargo & Co.*, No. 14-808, 2016 WL 634659 (M.D.N.C. Feb. 17, 2016), the court dismissed all but Plaintiff's retaliation claim under the Sarbanes-Oxley Act. Plaintiff worked for Wells Fargo as a financial advisor for nearly ten years. During his employment, Plaintiff repeatedly raised concerns that Wells Fargo had violated its SEC reporting requirements and was later terminated. Wells Fargo sought to dismiss the retaliation claim, arguing that a non-retaliatory reason was the primary factor underlying Plaintiff's termination. The court rejected that argument, noting that Plaintiff only needed to show that his whistleblowing was a "contributing factor," even if another non-retaliatory reason "played a more primary role." *Id.* at *11.

B. Protected conduct under Sarbanes-Oxley

- In a significant victory for Sarbanes-Oxley whistleblowers, the Sixth Circuit in *Rhinehimer v. U.S. Bancorp. Invs., Inc.*, 787 F.3d 797 (6th Cir. 2015), expanded the scope of protected conduct under Sarbanes-Oxley. Rejecting the Fourth Circuit's earlier more restrictive view, the court sided with the Labor Department's Administrative Review Board's decision in the *Sylvester v. Parexel International* case, holding that a Sarbanes-Oxley complainant need only show that he reasonably believed the conduct he complained about violated a relevant law (and not each element of a particular statute). *Id.* at 811-12.
    - For commentary, see http://www.law360.com/articles/662659/6th-circ-hands-a-landmark-victory-to-sox-whistleblowers

- *Rhinehimer* highlights the split in federal courts over what constitutes a "reasonable belief":[8]
    - The First, Fourth, Fifth, and Ninth Circuits have concluded that an employee's theory of his employer's violation of the laws must relate "definitively and specifically" to an enumerated law and "at least approximate the basic elements" of the violation. *Day v. Staples, Inc.*, 555 F.3d 42, 55 (1st Cir. 2009).
    - The Second, Third, Sixth, and Eighth Circuits have rejected the "definitively and specifically" standard, concluding that an employee need only have a reasonable belief as to the *unlawful conduct* and not each element of the suspected violation. *See Rhinehimer*, 787 F.3d at 811-12.

III. Developments under the Dodd-Frank Act

A. Extra-territorial application of whistleblower protections

- In an August 2014 decision, the Second Circuit in *Liu Meng-Lin v. Siemens AG*, 763 F.3d 175, 183 (2d Cir. 2014), held that Dodd-Frank's whistleblower protections against retaliation do not extend to tipsters outside the United States. The court found that Congress did not intend for the law's whistleblower protections to have extraterritorial application. Commentators note that the decision may discourage whistleblowers outside the United States from bring FCPA claims.
    - See the following commentary:
        - http://www.law360.com/articles/567320/overseas-tipsters-not-shielded-by-dodd-frank-2nd-circ-says
        - http://www.law360.com/articles/567805/2nd-circ-leaves-foreign-fcpa-tipsters-high-and-dry
        - http://www.law360.com/articles/569327/inside-2nd-circ-ruling-on-overseas-whistleblower
    - The SEC has reaffirmed its authority to apply whistleblower award provisions extraterritorially.

- In January 2018, the Second Circuit cited *Liu Meng-Lin* in ruling that the district court properly dismissed the Plaintiff's claims under Dodd-Frank and Sarbanes-Oxley. *Ulrich v. Moody's Corp.*, 2018 WL 357539 (2d Cir. Jan. 11, 2018). The court found that the Plaintiff was an overseas permanent resident working for a foreign subsidiary of a U.S.-based company, and the alleged wrongdoing and protected activity took place outside the United States. Under those circumstances, *Liu* required dismissal of the Plaintiff's claims.

B. Relation between timing of tip and whistleblower award

- In a March 2015 decision, the Second Circuit affirmed the SEC's determination that information provided to it before the enactment of the Dodd-Frank Act on July 21, 2010

[8] Ziyi He, *Recent Developments in Whistleblower Litigation*, Association of Corporate Counsel (July 12, 2016), http://www.acc.com/legalresources/quickcounsel/developments-in-whistleblower-litigation.cfm.

could not form the basis for a whistleblower award. *Stryker v. SEC.*, 780 F.3d 163 (2d Cir. 2015).

C. Supreme Court decides whether anti-retaliation protections only apply if information is reported to SEC

- In *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013), the Fifth Circuit held that the Dodd-Frank Act's anti-retaliation protections only apply to a person who reports on possible securities law violations to the SEC. *Id.* at 625, 630 (stating that whistleblowers under Dodd-Frank are "individuals who provide information relating to a securities law violation to the SEC").

- In *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015), the Second Circuit reached the opposite conclusion, holding that a person who reports information to his employer, "despite not having reported to the" SEC, is entitled to Dodd-Frank's anti-retaliation protections. *Id.* at 155. In doing so, the Second Circuit deferred to the SEC's rules, which support the *Berman* interpretation. *Id.* at 153.

- In 2018, the U.S. Supreme Court stepped in to resolve this circuit split. *Somers v. Digital Realty Trust, Inc.*, 138 S. Ct. 767 (2018). The Plaintiff, Paul Somers, claimed that the company terminated him soon after he reported suspected securities law violations to senior management. Somers did not provide information to the SEC. Somers brought a claim of whistleblower retaliation under Dodd-Frank in federal district court. The company, Digital Realty, argued that the internal complaints by Somers were not protected under Dodd-Frank because they were not reported to the SEC. Relying on a final rule promulgated by the SEC, the district court held that a "whistleblower" does not have to bring information to the SEC to benefit from Dodd-Frank's anti-retaliation provision, and the U.S. Court of Appeals for the Ninth Circuit affirmed.[9] The Ninth Circuit's decision conflicted with the Fifth Circuit's prior *Asadi* decision, which held that employees must provide information to the SEC to become "whistleblowers" under Dodd-Frank's anti-retaliation provision. Digital Realty appealed to the Supreme Court. The Supreme Court unanimously reversed the Ninth Circuit and ruled in favor of the employer, Digital Realty. Justice Ginsburg authored the opinion for the Court. She wrote that Dodd-Frank's plain definition of "whistleblower" unequivocally requires an employee to provide information to the SEC. The Court rejected the SEC's contrary interpretation of "whistleblower" as including employees who report suspected violations only internally. Because Somers did not meet the "government-reporting requirement" and "tell the SEC" about the suspected violations, he could not seek redress under Dodd-Frank for his employer's alleged retaliation

D. Restrictive language in confidentiality and severance agreements

- The SEC announced an action against KBR, Inc. on April 1, 2015. That action marks the first time the SEC initiated an enforcement action against a company "for using improperly

[9] *Somers v. Digital Realty Trust, Inc.*, 850 F.3d 1045 (9th Cir. 2017).

restrictive language in confidentiality agreements with the potential to stifle the whistleblowing process." The SEC took issue with the fact that "KBR required witnesses in certain internal investigations interviews to sign confidentiality statements with language warning that they could face discipline and even be fired if they discussed the matters with outside parties without the prior approval of KBR's legal department." The SEC noted that KBR "agreed to pay a $130,000 penalty to settle the SEC's charges." KBR amended its confidentiality statement to make "clear that employees are free to report possible violations to the SEC and other federal agencies without KBR approval or fear of retaliation."

  - SEC's press release: http://www.sec.gov/news/pressrelease/2015-54.html

  - KBR's prior agreement included this language:

    I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.

  - As part of its settlement, KBR agreed to modify that language as follows:

    Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.

- More recently, the SEC reached settlement agreements with companies, in part based on language in each company's severance agreements that discouraged whistleblowing.

- In June 2016, the SEC announced a $415 million settlement with Merrill Lynch that was based in part on the company's violation of Rule 21F-17. The company's severance agreements "operated to impede employees from voluntarily providing information to the SEC." The agreements allowed former employees to disclose confidential information pursuant to an order from a court or regulatory agency, but did not "include a carveout allowing individuals to voluntarily give confidential information to government agencies."

  - SEC's press release: https://www.sec.gov/news/pressrelease/2016-128.html

  - See the following commentary:
    - https://www.law360.com/articles/810228

        - https://www.law360.com/articles/827561/sec-shows-no-patience-for-muzzling-whistleblowers

- In August 2016, the SEC announced a $265,000 settlement with BlueLinx Holdings, Inc. due to similarly restrictive language in its severance agreements. The agreements violated securities laws by requiring "outgoing employees to waive their rights to monetary recovery should they file a charge or complaint with the SEC or other federal agencies." In addition to the payment, BlueLinx agreed to "amend its severance agreements to make clear that employees may report possible securities law violations to the SEC and other federal agencies without BlueLinx's prior approval and without having to forfeit any resulting whistleblower award."

    - SEC's press release: https://www.sec.gov/news/pressrelease/2016-157.html

    - See the following commentary:
        - http://www.law360.com/corporate/articles/827958?nl_pk=a4cb7441-68db-4e6a-9680-96d059c3c3ea&utm_source=newsletter&utm_medium=email&utm_campaign=corporate
        - https://www.law360.com/articles/827561/sec-shows-no-patience-for-muzzling-whistleblowers
        - http://www.fcpablog.com/blog/2016/8/15/david-j-marshall-sec-breaks-new-ground-bans-employer-imposed.html?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+fcpablog%2FsLbh+%28The+FCPA+Blog%29

IV. <u>Developments under the False Claims Act</u>

A. Materiality

- In a June 2016 decision, *Universal Health Servs. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016), the Supreme Court held that the implied false certification theory can be a basis for liability under the False Claims Act where the claim does not merely request payment, but also makes specific representations about the goods or services provided, and a failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths. Resolving a circuit split, the Court clarified that liability for failing to disclose violations of legal requirements is not limited to those requirements that are expressly designated as conditions of payment, but that a misrepresentation about compliance with a statutory, regulatory, or contractual requirement must be material to the Government's payment decision in order to be actionable, and that identifying a provision as a condition of payment is relevant, but not automatically dispositive of materiality.

- In a November 2017 decision, *United States ex rel. Spay v. CVS Caremark Corp.*, 875 F.3d 746 (3d Cir. 2017), the Third Circuit extended the Supreme Court's *Escobar* decision to pre-2009 claims, holding that the False Claims Act had always included a materiality

element (with the 2009 amendments merely making the element explicit), and that the definition of "material," which was derived from the common law and was enshrined in the statute itself in 2009, had not changed.

- In a September 2017 decision, *United States ex rel. Harman v. Trinity Indus.*, 872 F.3d 645 (5th Cir. 2017), the Fifth Circuit held that the federal government's continued payment of claims after learning of the alleged fraud substantially increased the burden on the relator to establish materiality.

B. Public information and disclosures

- In a September 2017 decision, *United States v. Solvay Pharm., Inc.*, 871 F.3d 318 (5th Cir. 2017), the Fifth Circuit held that a relator's disclosure to the government must "suggest an FCA violation." *Id.* at 327. Thus, a disclosure that fails to "connect direct and independent knowledge of information about [the defendant's] conduct to false claims submitted to the government" is insufficient. *Id.*

- In an October 2017 decision, *United States ex rel. Ibanez v. Bristol-Myers Squibb Co.*, 874 F.3d 905 (6th Cir. 2017), the Sixth Circuit held that a prior enforcement action would not trigger the public disclosure bar where "the scheme either continued . . . or was restarted" after an initial agreement with the government, because it could not "be assumed that the government [was] aware" of a continuing fraudulent scheme "simply because it had uncovered, and then resolved, a similar scheme before." *Id.* at 919.