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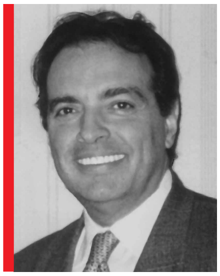
WHISTLE BLOWERS:
A Risk Management View

ELIMINATE THE CAUSALITIES OF RISK. LIMIT THE UNITS OF EXPOSURE. CUT COSTS.

[FOREWORD] Steve Acunto



Gentlemen and Scholars.

If ever there were a gentleman in the legal community it's **Allen Roberts**, whose feature article written together with his partner **Stuart Gerson** appears on our pages. Allen is well known in the legal community and in the community of those who support humane treatment of animals. He is well known, too, in the New York social world, where parties at his Park Avenue address are highly prized among New York's silk stocking district's residents. This article should prove sharp and incisive reading…

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By Allen B. Roberts and Stuart M. Gerson [COVER]

WHISTLE BLOWERS:
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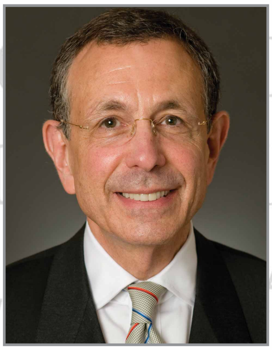
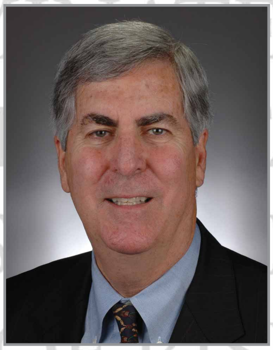


Allen B. Roberts



Stuart M. Gerson

Corporate compliance programs function on the basic premise that individuals possessing critical information will disclose that information to the organization so that it can assess it and, if called for, undertake corrective activity to avert or minimize risk. When such individuals come forward, they can perform a valuable service as "whistleblowers," sharing information internally for the good of the organization. Less altruistically, and increasingly because of expanding federal and state laws which encourage them to undertake lawsuits, some whistleblowers may be motivated not by corporate well-being, but opportunistically by self-interest and financial gain.

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Much has been published in the general and financial press about policy choices of Congress and the executive branch that give businesses in virtually every industry reason to reevaluate the potential for liability under whistleblower regimes. Underwriting risk as a companion to corporate liability arising from whistleblower disclosures merits similar front-burner attention. Such risk might exist as something embedded in an existing insurance policy or as a new opportunity by way of rate adjustment or an innovative product offering.

Congressional and Executive Action Define Whistleblower Risk in Ways that Affect Coverage

In the period between 2009 and 2010, Congress acted to override administrative and judicial decisions that were considered mainstream, but unfriendly to whistleblower entitlements and protections. In that same period, the Obama administration has affected policy by its appointments to key positions within agencies having interpretive and enforcement authority. Now, newly empowered and energized administrative agencies are utilizing the framework of existing legislation (some of it recent enactments) to pursue and reinterpret corporate liability and whistleblower entitlements. As a consequence of those game-changers, liabilities might exist for organizations and their D&O and EPLI carriers that are not necessarily evident on the face of policy coverage terms, statutory references and definitions.

In this article, we examine the changed architecture and mechanics of whistleblower bounty awards and protections that impact how risk needs to be perceived – and then assumed, managed, controlled, or transferred.

Laying the Ground – Laws Deliver Awards and Protections to Whistleblowers

Fundamentally different purposes are served within the structure of whistleblowing legislation. Some statutes create economic incentives for informants who provide tips and then participate by leading or cooperating in activity that results in recovery of government funds or the imposition of monetary sanctions. As a separate and distinct feature, some whistleblower legislation prohibits adverse employment action or other reprisals against those who engage in statutorily-defined protected activity; those protections can be a companion to monetary awards or they might exist independently.

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The federal False Claims Act (FCA) has, since the Civil War, been the historic cornerstone of federal-level whistleblowing. Its focus is on direct or indirect providers of goods and services to the government or its beneficiaries – now virtually every program that touches federal dollars – and it is accompanied by recently-expanded whistleblower protection against retaliation. FCA whistleblowers, known as *qui tam* relators, may bring claims in the name of the United States and, if they or the government, which can intervene, prevail, these relators reap enormous awards – 15 percent to 30 percent of any monetary recovery. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) takes a slightly different tack on economic incentives; it creates bounty awards whereby a monetary award – of not less than 10 percent and not more than 30 percent – may be granted to one or more whistleblowers who voluntarily provide original information or analysis leading to the successful enforcement of a judicial or administrative action brought by the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC) or certain regulatory and enforcement authorities that results in monetary sanctions exceeding $1 million. The award to a successful FCA informant is rooted in payments made by the government on a false or fraudulent claim, with the recovery in which the whistleblower may share potentially increased by a multiple of three as a sanction; the reward to a Dodd-Frank tipster is a portion of the sanction the government imposes as a penalty or deterrent for unlawful activity. Thus, under both regimes, the whistleblower recovers a portion of "sanctions," but the basis of the FCA recovery is the federal government's entitlement to restitution.

An array of federal and state laws protects whistleblowers against discharge or other adverse employment actions, but there is little uniformity among them. Substantive protections, prerequisites to claiming protection, the available forum, burdens of proof to establish a claim or defend against one, and remedial schemes all vary depending upon the particular statute invoked. Even as a single legislative enactment, Dodd-Frank inconsistently varies the definition and application of identical terms and the controlling statutes of limitations of the whistleblower protections it establishes.

Changes Brought in the Legislative Arena

The widely publicized "Health Reform" law and the "Wall Street Reform" law serve as logical starting points for examining new legislation – not merely for their reported and understood significance, but notably for the widespread and erroneous belief that these laws concern only the targeted health and financial services industries. In reality, any risk manager reading the Patient Protection and Affordable Care Act (PPACA) or Dodd-Frank simply as someone else's problem should carefully re-examine those statutes for both the sweep of their entirely new coverage and their material substantive and procedural revision of established law. PPACA amends whistleblower provisions of the FCA in ways not restricted to health care, while Dodd-Frank amends whistleblower provisions of the FCA, the Sarbanes-Oxley Act, the Securities Exchange Act of 1934, and the Commodity Exchange Act, in ways that affect businesses having nothing to do with financial services.

Landmark Health Reform Legislation Is Not Just about Patient Protection

PPACA provided additional tools for the whistleblower by amending the FCA, and did so on the heels of amendments made the previous year through the enactment of the Fraud Enforcement and Recovery Act of 2009 (FERA). FERA's most-significant expansion of the law was in its reversal of a Supreme Court decision that had limited actionable claims to those paid directly by the federal government. Now, an actionable claim may be premised upon any payment that includes federal funds, no matter who makes it. The reach of the law now clearly touches indirect providers of goods and services, including subcontractors.

PPACA expands the FCA still further, extending liability to one who not only "knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government" but to one who "knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government." Thus, if the government pays too much, but the recipient fails to return it (notionally, within 60 days after the payment is "identified"), the recipient is subject to FCA liability.

PPACA did not merely expand the field of actionable claims; it amended the FCA's public disclosure bar and original source exception, making it significantly harder to disqualify a relator from proceeding where the government declines to intervene in an FCA action. Before PPACA, a court lacked jurisdiction over an FCA matter that had been based on the public disclosure of allegations in a "criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media," unless the person bringing the action was the Attorney General or was the "original source" of the information. However, PPACA removed the jurisdiction bar to a relator's proceeding with a matter that had been publicly disclosed where the government opposes its application. Moreover, while previously an "original source" had to possess "direct and independent knowledge" of the information, PPACA relaxes that requirement and allows one with knowledge that "is independent of and materially adds to the publicly disclosed allegations or transactions" to satisfy the standard.

These amendments also make it easier for a claim to be brought. They leave to the government's discretion whether a case, based on publicly disclosed allegations and not brought by an original source, may proceed. They also narrow the potential public sources subject to preclusion and expand the definition of who can qualify as an original source. The end result of these changes: greater opportunity for potential relators and more risk areas for businesses.

Most certainly, governmental bounties have the appeal of luring those who possess critical information valuable to the business to report their information to enforcement agencies, instead of directing that information through established internal channels.

Landmark Wall Street Reform Is Not Just about Financial Services

Any company that could potentially be investigated and sanctioned by the SEC or CFTC is exposed to the bounty awards of Dodd-Frank. Said differently, the rich bounty awards available since Dodd-Frank was enacted incentivize whistleblowers to create significant risk by reporting to enforcement authorities corporate activity that could lead to SEC or CFTC sanctions, and to do so outside of internal reporting channels. The potentially enormous payments to reward whistleblowers are subject to criticism for their distortion of priorities, expected by many to drive individuals away from established corporate compliance channels in the quest of personal gain. Dodd-Frank represents a conspicuous congressional policy choice to circumvent internal reporting – even if mandated by corporate compliance programs – in favor of tips to the SEC and CFTC.

At a time when it could have become a partner of well-intentioned businesses by reinforcing corporate compliance programs and providing a thoughtful set of positive and negative incentives, Congress elected instead to position the federal government as a competitor. And in its role as a competitor to internal corporate compliance programs, the government has a lopsided advantage, holding a purse that no business can compete with – or should want to. Most certainly, governmental bounties have the appeal of luring those who possess critical information valuable to the business to report their information to enforcement agencies, instead of directing that information through established internal channels. Against that force, businesses are left to identify other non-economic bases on which to appeal to loyalty and sense of obligation as incentives for individuals to come forward with vital information essential to the operation of an effective corporate compliance program.

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The problem for businesses is compounded further by the potentially fertile areas that whistleblowers may target. Securities fraud and insider trading may be the most obvious items subject to SEC sanctions that could induce tipsters to seek bounty awards. But a powerful contender is the Foreign Corrupt Practices Act (FCPA). The FCPA contains two types of provisions: (i) anti-bribery provisions, which prohibit corrupt payments to foreign officials, political parties, or political candidates to assist in obtaining or retaining business or securing an improper advantage, and (ii) accounting provisions, which impose certain record-keeping and internal control obligations on companies whose securities are registered in the U.S. or that are required to file reports with the SEC. The FCPA is jointly enforced by the Department of Justice (DOJ) and the SEC. The DOJ has primary responsibility for enforcing the anti-bribery provisions, while the SEC acts as the civil enforcement authority that enforces the accounting provisions.

Changes Brought by Newly Empowered Administrative Agencies

Like other major legislative reforms, SOX was enacted responsive to an extreme situation, in this instance to address shareholder and securities frauds. Outrage resulting from corporate scandal surrounding the Enron collapse yielded a law of general applicability to publicly traded and registered companies. For nearly a decade, covered businesses have adapted to SOX, with guidance from legal and accounting professionals, as rule-making and interpretive decisions of enforcement agencies established the contours of obligations and risks.

In the whistleblower arena, recent administrative interpretations of SOX protections have moved the needle significantly beyond shareholder and securities frauds, the inspiration and predicate for SOX whistleblower protections. With the change of administrations in 2009, the Department of Labor has a newly constituted Administrative Review Board (ARB) that has redefined keystone terms of whistleblower protection, overturning established precedent. This change has created new risks for business that set their compliance activities on the basis of those precedents and for insurers underwriting those risks.

In breakthrough decisions applauded by advocacy groups, the ARB has reinterpreted – and reinvented – SOX whistleblower protections to reach far beyond core, threshold concerns for the "innocent investor." The swing started in February 2011with an ARB opinion holding that a Lockheed Martin Director of Communications engaged in activity protected by SOX when she reported (1) concerns that a vice president to whom she reported had developed paramours through Lockheed's Pen Pal Program, which was created to facilitate communications between Lockheed employees and U.S. soldiers serving overseas, and (2) her belief that costs associated with the vice president's travel and expensive hotels to rendezvous for intimate relations with soldiers, limousines and purchase of sex toys – not quantified in the decision – were charged to the federal government under an existing contract for the Pen Pal Program. The vice president had used the mail to send letters soliciting prospective paramours, and her billing of items to the U.S. government as part of the Pen Pal Program occurred by mail or wire. The ARB affirmed a decision of an administrative law judge, finding that the employee engaged in protected activity for reporting misconduct related to mail fraud and wire fraud. The ARB made it clear that it did not consider itself constrained to interpret SOX protections in the context of post-Enron concerns for the innocent investor.

Leveraging from its Lockheed expansion of SOX, the ARB laid out its new formulation of SOX whistleblower protections a few months later in a decision going to core business activity – substantially beyond shareholder fraud and protection of innocent investors. Parexel International is a publicly-traded company that tests drugs for drug manufacturers and others. As SOX complainants, a manager having responsibility to ensure that data adhered to the Food and Drug Administration's "Good Clinical Practice" standards and a nurse responsible for reporting accurate clinical data claimed that they suffered unlawful reprisals for their internal reports that time points were not recorded accurately, resulting in false clinical data. Although no shareholder fraud was alleged, the false data was alleged to have been communicated through the U.S. mails and by wire communications such as the Internet. Addressing the protected activity, the ARB showed how expansively it intends interpreting SOX whistleblower protections, ruling that:

- fraud against shareholders ranks as only one of six categories of violations enumerated in SOX Section 806: mail fraud, wire, radio and television fraud, bank fraud, securities fraud, any rule or regulation of the SEC, or any provision of federal law relating to fraud against shareholders;
- a complaint of shareholder or investor fraud is not required to establish SOX-protected activity; and
- requiring a complainant to prove or approximate the specific elements of a securities law violation would contradict SOX's requirement that an employee have only a reasonable belief of a violation of the enumerated statutes.

The Parexel opinion also establishes that a SOX whistleblower can assert a successful claim to statutory protection even without alleging – much less proving – materiality or shareholder reliance or loss.

Together Lockheed and Parexel re-set the bar of administrative construction of SOX whistleblower protections. There is no assurance that their holdings will be upheld if subject to review by an appellate court, but administrative interpretations of statutes receive a fair measure of deference on judicial review. Moreover, during the term of the current administration, it should be anticipated that those groundbreaking decisions will be followed, and possibly expanded further, by the ARB. This portends significantly more whistleblower claims by employees who observe and report incidents of compliance breaches and later suffer adverse employment actions that they claim are linked to their whistleblowing. It also makes it far more likely that the administrative arena will be the whistleblowers' forum of choice and that whistleblowers' attorneys will be reluctant to exercise the option of taking their cases into federal courts for de novo trials

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where outcomes may be less favorable.

Conclusion

At bottom, whistleblowing really is not about risk from external sources or events – it has to do with organizational misconduct that could create liability. That makes it uniquely applicable to risk management processes designed to detect misconduct, correct it and prevent repetitions of it. Potential windfalls await informants and tipsters bent on sharing in FCA recoveries and Dodd-Frank bounty awards. By incentivizing individuals with knowledge of a compliance breach to go outside an organization to an enforcement agency, those awards threaten the viability of otherwise effective corporate compliance programs.

From both the legislative arena and the administrative forum, the challenge to risk managers and underwriters is teed up. Compliance programs reliant upon valuable information that could avert risk may be undermined by legislative schemes and administrative action that actually divert information from the place where risk can be best addressed most effectively and immediately – at its source within organizations.

Because government action has materially changed the compliance environment, insiders having information critical to organizational interests may be less reliable as a resource. As a counterweight, businesses need to adopt measures assuring that they receive in an appropriate and timely manner information necessary to sound and lawful operations and functions. Risk managers concerned with the effectiveness of corporate compliance programs should be active participants in that process. For their part, insurance underwriters may need to re-evaluate not only underlying risk, but also risk avoidance mechanisms newly impacted by legislative and administrative action that may deprive policy holders of access to information essential to the management of certain insured risks or confer whistleblower status for newly created or newly interpreted protected activity. [IA]

The Parexel opinion also establishes that a SOX whistleblower can assert a successful claim to statutory protection even without alleging – much less proving – materiality or shareholder reliance or loss.

__ALLEN B. ROBERTS__ is a Member of Epstein Becker Green and co-chair the Firm's Whistleblowing and Compliance Subpractice Group.

Mr. Roberts represents public and privately held domestic and international businesses and not-for-profit organizations in developing and effectuating strategy and policies in employment law and labor relations matters, employment agreement formulation and enforcement, employment policy audits, employment due diligence for mergers and acquisitions, and union relations and maintaining union-free status. He leads the Firm's representation of several national and multinational clients, counseling on labor and employment compliance, litigation avoidance and strategy, and case management.

Consistent with the breadth of his practice, Mr. Roberts has lectured and written on such diverse employment law topics as mergers and acquisitions, facility closings and relocations, Equal Employment Opportunity, and disabilities accommodation and compliance; and he taught employment law as an adjunct professor at New York University. In addition, Mr. Roberts speaks and writes on compliance, management of investigations, and related governance and whistleblower issues. Mr. Roberts' publications include the Labor & Employment Part of Clark Boardman Callaghan's Attorney's Desk Library, and he is a co-creator of the Whistleblowing & Compliance Law Blog (http://www.whistleblowingcompliancelaw.com/), to which he contributes regularly.

Mr. Roberts is named in The Best Lawyers in America and Super Lawyers, Corporate Counsel Edition.

Since 1995, Mr. Roberts has been chair of the board of Aging in New York Fund, Inc., a not-for-profit organization established by the New York City Department for the Aging to promote productive aging and enhance the quality of life of older New Yorkers and their families. With his wife, Heidi, Mr. Roberts is a founder of the U.S. Friends of Hoedspruit Endangered Species Centre, Inc., supporting programs in South Africa for breeding, care, and research for individual animals and entire species and for outreach to South African schools and community organizations.

__STUART M. GERSON__ is a Member of the Firm in the Litigation and Health Care & Life Sciences Practices in the firm's Washington, DC and New York offices. He concentrates on the defense of complex civil and criminal fraud cases, antitrust and securities cases, and class action litigation generally. Mr. Gerson has successfully tried many complex cases before judges and juries, and also has acted as settlement counsel, mediator, and arbitrator.

Mr. Gerson's fraud case experience is extensive in both private and public practice and includes:

- *Lead participation in most of the largest defense, health care and financial institution fraud actions brought by the government in the 1990's*
- *Current involvement in the defense of cases under the federal securities and antitrust laws, the False Claims Act (including the defense of qui tam cases) and anti-kickback laws, in cases related to trade secrets and the development of high technology, and in internal corporate compliance investigations on*

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behalf of companies and their officers and directors.

His experience in these matters include:

- *Recently obtaining an important affirmance from the U.S. Court of Appeals for the Third Circuit in a complex antitrust matter involving an alleged price-fixing conspiracy in the bond industry*
- *Representing the broker of the World Trade Center property insurance program in ongoing 9/11 cases in the U.S. District Court for the Southern District of New York*
- *On behalf of a large investment bank, serving as a principal negotiator with the Antitrust Division in resolving the Justice Department's massive NASDAQ case*
- *Serving as lead counsel in the defense of a series of class action securities cases.*
- *Mr. Gerson was Acting Attorney General of the United States at the beginning of the Clinton Administration. And, as head of the Civil Division of the Department of Justice from 1989 to 1993, Mr. Gerson served as the federal government's chief litigator in all major matters, including those related to financial institution fraud, defense fraud, health care reimbursement, food and drug law, and health care fraud. Additionally, he was the government's principal counsel in the environmental and mass tort litigations involving Exxon-Valdez. Mr. Gerson also represented the United States in significant class actions.*

Mr. Gerson served as the observer-delegate of the United States to the Council of Europe Ministers of Justice. He also was a member of the Bush Administration's National Health Policy Working Group as head of its Medical Malpractice Reform Working Group and as its spokesman on matters of civil justice reform.

During the 1988 Presidential election, Mr. Gerson was a senior advisor to the campaign of George H.W. Bush on matters including debate preparation, comparative research and surrogate speaking on criminal justice, judicial, health policy and defense issues. He later was a Transition Team leader in the Office of the President-elect with regard to international banking agencies. He also served in the presidential transition of President George W. Bush.

Mr. Gerson has served as an adjunct professor of law at Georgetown University Law Center. He is a frequent guest on CNBC, NBC, Fox News and other broadcast outlets, commenting on important business litigation, antitrust, health care and justice issues. Mr. Gerson's commentaries have been published in law journals and in newspapers, including The Wall Street Journal, and The Los Angeles Times.

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