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FOUR KEY SEC WHISTLEBLOWER TRENDS — AND HOW COMPANIES CAN PREPARE FOR THEM

In this article, the authors identify four recent trends in the SEC's whistleblower program: a significant uptick in whistleblower bounties; awards for mid-investigation tips; the more lenient "objectively reasonable" standard for whistleblower protection from retaliation; and a continued focus on confidentiality agreements. The authors describe these trends and suggest some steps companies can take in light of them.

By Matthew T. Martens, Arian M. June, and Caroline Schmidt *

The US Securities and Exchange Commission has issued a rapid succession of high-dollar whistleblower awards in recent weeks that are certain to gain the attention of potential corporate whistleblowers. The SEC's Whistleblower Program financially rewards individuals who "voluntarily provide the SEC with unique and useful information that leads to a successful enforcement action."[1] Since the Commission launched the program in 2011, the agency has awarded 32 whistleblowers more than $85 million dollars.[2] Nearly a third of that amount has been awarded in the weeks since May 2016.

As the SEC's Whistleblower Program provides increased incentives for corporate whistleblowers to report potential wrongdoing directly to the Commission, SEC-regulated companies should be aware of the following key focus areas and take steps to enhance internal reporting and investigative procedures:

1. SIGNIFICANT UPTICK IN SEC WHISTLEBLOWER BOUNTIES

Between May and June 2016, there has been a flurry of SEC whistleblower awards. During the four-week period between May 13 and June 9, 2016, the SEC awarded five whistleblowers a total of more than $26 million.[3]

The recent SEC whistleblower bounties are significant. The highest of these recent bounties was awarded to a single whistleblower on June 9 for more

[1] SEC Press Release 2016-114: SEC Issues $17 Million Whistleblower Award (June 9, 2016).

[2] *Id.*

[3] *Id.*

* *MATTHEW T. MARTENS is a partner in WilmerHale's Securities Litigation and Enforcement practice group. ARIAN M. JUNE is a counsel in the firm's same group. CAROLINE SCHMIDT was an associate in the firm's Litigation/Controversy practice group and is now on a judicial clerkship. Their e-mail addresses are Matthew.Martens@wilmerhale.com and Arian.June@wilmerhale.com.*

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than $17 million.[4] This is the second-largest award in the program's history, trailing only a September 2014 award for $30 million.[5] The other recent awards were for $3.5 million,[6] more than $5 million,[7] and more than $450,000,[8] respectively. SEC whistleblower awards range from 10 to 30 percent of the sanctions that result from the tip and come out of an investor protection fund that is financed through monetary sanctions paid to the SEC by violators. SEC officials have signaled the agency's intent to continue doling out significant sums to incentivize other potential SEC whistleblowers to report potential securities law violations to the SEC.[9]

2. WHISTLEBLOWER BOUNTIES FOR MID-INVESTIGATION TIPS

To qualify for a financial award, a whistleblower's tip must be deemed to have "led to the successful . . . enforcement action."[10] The SEC defines this requirement broadly to include tips that open an investigation, and tips of "original information about conduct that was *already* under examination or investigation" which "significantly contributed to the success of the investigation."[11] The Commission awarded $3.5 million to a whistleblower on May 13, 2016 under this second prong for reporting information during the course of an ongoing SEC investigation. In its press release, the SEC underscored the importance of whistleblowers who come forward during an investigation, noting that "[t]his particular whistleblower's tip substantially strengthened our ongoing case and increased our leverage during settlement negotiations with the company."[12]

As the SEC's engagement in this area encourages potential whistleblowers to report to the Commission, both prior to *and during* investigations, companies should take steps to bolster internal reporting and investigative procedures, and encourage employees to utilize internal reporting mechanisms. Some of those steps include: establishing a clear process for the timely investigation of complaints of potential securities violations, providing internal whistleblowers with timely acknowledgment that complaints are being addressed, and communicating with internal whistleblowers periodically throughout the investigative process as appropriate and once a final conclusion has been reached.

3. WHISTLEBLOWERS MUST ONLY BE "OBJECTIVELY REASONABLE" TO BE PROTECTED

In early June, the Eighth Circuit joined the Second, Third, and Sixth Circuits in adopting the "*Sylvester* standard" — which was first articulated by the Administrative Review Board of the Department of Labor (ARB) — to determine "objective reasonableness" for whistleblower retaliation claims filed under Sarbanes-Oxley. Under the *Sylvester* standard, a whistleblower may be mistaken in believing that a securities violation occurred, yet still be entitled to retaliation protection if that belief was objectively reasonable.[13] In *Beacom v. Oracle Am., Inc.*, the Eighth Circuit adopted the *Sylvester* standard yet still upheld a district court's finding that a whistleblower had not shown that the basis of his retaliation claim under the Sarbanes-Oxley Act was "objectively reasonable."

[4] *Id.*

[5] *Id.*

[6] SEC Press Release 2016-88: Whistleblower Earns $3.5 Million Award for Bolstering Ongoing Investigation (May 13, 2016).

[7] SEC Press Release 2016-91: SEC Awards More Than $5 Million to Whistleblower (May 17, 2016).

[8] SEC Press Release 2016-94: Two Individuals Share Whistleblower Award of More Than $450,000 (May 20, 2016).

[9] *Id.* (statement of Sean X. McKessy, former Chief of the SEC Office of the Whistleblower) ("[W]e hope these substantial awards encourage other individuals with knowledge of potential federal securities law violations to make the right choice to come forward and report the wrongdoing to the SEC.").

[10] 15 U.S.C. § 78u- 6(b)(1).

[11] Rule 21F-4(c)(2) (emphasis added).

[12] SEC Press Release 2016-88, *supra* note 6.

[13] *Beacom v. Oracle Am., Inc.,* 15-cv-1729, 2016 WL 3144730 (8th Cir. June 6, 2016).

Plaintiff Vincent A. Beacom was formerly a Vice President at Oracle America, Inc. ("Oracle"). The thrust of Beacom's claim was that he was wrongfully terminated after he complained that his division's new forecasting methodology was inflating sales targets. For each of the first three fiscal quarters of 2012, Beacom's team missed its sales projections by $3.4 million, $7 million, and $10 million, respectively. In January 2012, Beacom expressed concerns internally that the inaccurate projections were "setting the wrong expectation for shareholders."[14] He was fired in March 2012 on the basis of poor performance and insubordination.

Beacom then brought suit against Oracle for retaliation in violation of Sarbanes-Oxley. The district court granted Oracle summary judgment on the basis that Beacom's belief that Oracle was defrauding investors was not "objectively reasonable." The Eighth Circuit affirmed. Adopting the ARB's *Sylvester* standard, the court held that Beacom must establish that "a reasonable person in his position, with the same training and experience, would have believed Oracle was committing a securities violation."[15] This standard is more lenient than the ARB's prior standard, which required whistleblowers to show "definitively and specifically" that their claim related to a fraud or securities violation, and required claimants to approximate the basic elements of the violation.[16]

Even under the less arduous standard, the Eighth Circuit affirmed the district court's finding that Beacom had not met his burden. The court reasoned that because Beacom was "an Oracle salesperson and shareholder" he would "understand the predictive nature of revenue projections."[17] Thus, the projections Beacom alleged were problematic, which were no more than $10 million per quarter, reflected a "minor discrepancy to a company that annually generates billions of dollars."[18] Beacom's belief that "Oracle was defrauding its investors was [therefore] objectively unreasonable."[19]

The Eighth Circuit's decision suggests that while the "objective reasonableness" standard may be the new normal in whistleblower retaliation cases, it is not a standard without some teeth, as the Beacom decision illustrates. Courts will evaluate whether a reasonable person in the plaintiff's circumstances, with the plaintiff's training and experience, would have believed that the conduct at issue violated the securities laws.

4. CONTINUED FOCUS ON CONFIDENTIALITY AGREEMENTS

In recent years, the SEC has focused its attention on employment agreements that potentially discourage employees from reporting potential violations of law to government officials. The SEC's 2015 annual whistleblower report emphasized the Enforcement Division's continued interest in confidentiality and other types of employee agreements that could interfere with a whistleblower's ability to report potential wrongdoing to the SEC in violation of Rule 21F-17(a).[20] That rule forbids any person from "tak[ing] any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement (other than agreements dealing with information covered by [the attorney-client privilege or attorney-client confidentiality]) with respect to such communications."

In April 2015, the SEC announced its first settlement under Rule 21F-17 against KBR Inc. KBR agreed to pay $130,000 to settle the action, which challenged KBR's use of a confidentiality agreement that prohibited witnesses in internal investigations from sharing the subject matter discussed during interviews without prior authorization.[21]

The SEC announced two more settlements in August 2016, both of which focused on severance agreements that allegedly violated Rule 21F-17. The first settlement, announced on August 10, 2016, involves a cease-and-desist order against Atlanta-based building products distributor BlueLinx Holdings Inc.[22] Among

[14] *Id.* at *2.

[15] *Id.* at *3.

[16] *Platone v. FLYI, Inc.*, ARB No. 04-154, 2006 WL 3246910 (ARB Sept. 29, 2006).

[17] *Beacom*, 2016 WL 3144730, at *3.

[18] *Id.*

[19] *Id.*

[20] SEC, 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program (Nov. 16, 2015), at p. 2 ("Assessing confidentiality agreements for compliance with Rule 21F-17(a) will continue to be a top priority for OWB into Fiscal Year 2016."), *available at* https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2015.pdf.

[21] SEC Press Release 2015-54: SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements (April 1, 2015).

[22] Order Instituting Cease-And-Desist Proceedings, *In the Matter of BlueLinx Holdings, Inc.*, No. 3-17371 at 1(SEC Aug. 10, 2016) (BlueLinx Order).

other things, the SEC's order alleged that BlueLinx used severance agreements that required outgoing employees to waive their rights to monetary recovery should they file a charge or complaint with the SEC or other federal agencies.[23] Blue Linx settled the SEC's charges by paying monetary penalties in the amount of $265,000 and agreeing to a number of undertakings, including amending its severance agreements and contacting former employees to notify them of the SEC's order.[24]

On August 16, 2016, the SEC announced another settlement, involving allegations that California-based health insurance provider Health Net, Inc. used severance agreements expressly requiring outgoing employees to waive their ability to obtain SEC whistleblower awards.[25] Notably, the SEC acknowledged that it found no evidence of any instances in which a former Health Net employee who executed the allegedly violative agreements did not communicate directly with Commission staff about potential securities law violations, nor did the SEC find any evidence that Health Net took action to enforce the waiver provisions or otherwise prevent such communications.[26] Nonetheless, the SEC concluded that both the provisions violated Rule 21F-17 by removing the financial incentive for Health Net's former employees to communicate with Commission staff concerning possible securities law violations at Health Net.[27] To settle, Health Net agreed to pay $340,000 in penalties and make reasonable efforts to notify former employees.[28]

The SEC's orders in *BlueLinx*, *Health Net*, and *KBR*, as well as statements by SEC officials regarding those cases, make it clear that the SEC applies a broad interpretation of the language in Rule 21F-17.[29] Companies should review employee severance agreements and other policies and agreements with confidentiality provisions for compliance with Rule 21F-17(a). Provisions specifying requirements for former employees who are compelled to disclose company information by law or legal proceeding, release and waiver provisions, and other provisions commonly found in severance agreements should be reviewed to confirm that they are accompanied by a clear exemption for communications with the SEC. ■

[23] *Id.* at ¶ 14.

[24] *Id.* at 5-6.

[25] Order Instituting Cease-And-Desist Proceedings, *In the Matter of Health Net Inc.*, No. 3-17396 (SEC Aug. 16, 2016) (Health Net Order).

[26] *Id.* at ¶ 13.

[27] *Id.* at 13-14.

[28] *Id.* at 4-5.

[29] For more detail and analysis on the *KBR* order, *see* William McLucas, Harry Weiss, *et al.*, "SEC Applies Whistleblower Interference Rule to Corporate Confidentiality Requirement," WilmerHale Client Alert (April 28, 2015) (*available at* https://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=17179877088). For more detail and analysis on the *BlueLinx* and *Health Net* settlements, *see* William McLucas, Harry Weiss, *et al.*, "SEC Settlements Put Severance Agreements Under Increased Scrutiny," WilmerHale Client Alert (August 17, 2016) (*available at* https://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=17179882393).