



Whistleblowing in the Corporate World Series: Part V

Corporate Lawyers as Whistleblowers

Presenters

www.SECwhistlebloweradvocate.com



[Professor Nancy J. Moore](#) is Professor of Law and Nancy Barton Scholar at Boston University School of Law, where she teaches Professional Responsibility and Torts. She has been teaching and writing in the Professional Responsibility field for over thirty years and is the author of numerous articles on attorney and judicial ethics.

Recent articles include "Is the Appearance of Impropriety an Appropriate Standard for Disciplining Judges in the Twenty-First Century?" 41 *Loy. U. Chi. L. J.* 285 (2010); "Mens Rea Standards in Lawyer Disciplinary Codes," 23 *Geo. J. Legal Ethics* 1 (2010); "The American Law Institute's Draft Proposal to Bypass the Aggregate Settlement Rule: Do Mass Tort Clients Need (or Want) Group Decision-making?" 57 *DePaul L. Rev.* 395 (2008); "Regulating Law Firm Conflicts in the 21st Century: Implications of the Globalization of Legal Services and the Growth of the 'Mega Firm'" 18 *Georgetown J. Legal Ethics* 521 (2005); "Who Should Regulate Class Action Lawyers?" 2003 *U. of Ill. Law Rev.* 1477; and "Regulating Self-Referrals and Other Physician Conflicts of Interest," 15 *Healthcare Ethics Forum* 134 (2003). Professor Moore was Chief Reporter for the ABA Commission on Evaluation of the Rules of Professional Conduct ("Ethics 2000") and is Chair of the Multistate Professional Responsibility Examination Drafting Committee, which tests applicants on a variety of matters concerning legal and judicial ethics. She has served twice as Chair of the Association of American Law Schools' Section on Professional Responsibility and was an Adviser to the American Law Institute's Restatement of the Law Governing Lawyers.

email: nmoore@bu.edu

t: 617-358-0501

**Labaton
Sucharow**

© 2012 Labaton Sucharow LLP. All rights reserved.

2

Presenters

www.SECwhistlebloweradvocate.com



[Jordan A. Thomas](#) is a partner at Labaton Sucharow LLP and chairs its Whistleblower Representation Practice. Labaton Sucharow is one of the country's premier private securities litigation firms and the first law firm in the country to establish a practice exclusively focused on protecting and advocating for SEC whistleblowers. Prior to entering private practice, Jordan spent more than 15 years in federal law enforcement, as both a Trial Attorney at the Department of Justice and an Assistant Director in the Enforcement Division of the Securities and Exchange Commission. While at the SEC, Jordan played a leadership role in the development of its Whistleblower Program. He is also the Editor of SECwhistlebloweradvocate.com, a website dedicated to helping responsible organizations establish a culture of integrity and courageous whistleblowers to report possible securities violations—without personal or professional regrets.

email: jthomas@labaton.com

t: 212-907-0836

f: 212-883-7536

**Labaton
Sucharow**

© 2012 Labaton Sucharow LLP. All rights reserved.

3

CORPORATE CHALLENGE

Recent Survey Findings I

- KPMG, Integrity Survey, 2009
 - 74% of employees personally observed/had firsthand knowledge of wrongdoing during previous 12 months
 - 47% didn't believe they would be protected from retaliation if they reported misconduct
 - 61% didn't believe they would be satisfied with outcome if they reported misconduct
 - 60%, in the banking/finance industry, reported that the wrongdoing they observed could cause "a significant loss of public trust if discovered."
- Littler Mendelson, Whistleblower Survey, November 2011
 - 96% report concern about whistleblower claims
 - 73% reported this as an emerging risk area
 - 67% predicted that whistleblower claims increasing
 - 65% reported being "only moderately" prepared
- Ethics Resource Center, National Business Ethics Survey, January 2012
 - 45% witnessed misconduct at work
 - 42% reported that their employer had a weak ethical culture
 - 22% of employees who reported misconduct perceived retaliation

Recent Survey Findings II

www.SECwhistlebloweradvocate.com

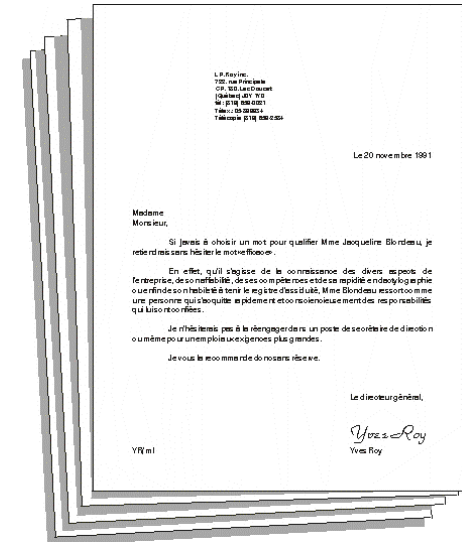
- Labaton Sucharow, US/UK Financial Industry Survey, July 2012
 - 39% believed competitors had engaged in illegal or unethical conduct
 - 26% had observed or had first-hand knowledge of misconduct in workplace
 - 24% believe you have to engage in illegal or unethical behavior to succeed
 - 16% would engage in illegal behavior—insider trading—if they could get away with it
 - 94% would report wrongdoing given the protections and incentives of the SEC Whistleblower Program
- Labaton Sucharow, Ethics & Action Survey, September 2012
 - 54% had observed or had firsthand knowledge of misconduct in workplace
 - 84% had a positive perception of whistleblowers that report illegal or unethical conduct
 - 83% would report wrongdoing given the protections and incentives of the SEC Whistleblower Program

SEC WHISTLEBLOWER PROGRAM

Dodd-Frank Act

www.SECwhistlebloweradvocate.com

- Dodd-Frank Wall Street Reform and Consumer Protection Act enacted July 2010
- Act required the SEC to establish a whistleblower program which offers:
 - Anonymous reporting
 - Robust employment protections
 - Significant monetary awards
- The implementing rules for the program became effective in August 2011



SEC Whistleblower Defined

www.SECwhistlebloweradvocate.com

- Any individual who, alone or jointly with others, provides information to the SEC relating to a possible violation of the securities laws that has occurred, is ongoing, or is about to occur.
- Only individuals, not companies, are eligible for the whistleblower protections and incentives in Dodd-Frank.

Anonymous Reporting— Overview

www.SECwhistlebloweradvocate.com

- Confidential nature of SEC investigations
- Statutory representation requirement
- Practical reality

Employment Protections— Overview

Section 922

- PROHIBITION AGAINST RETALIATION—
 - (A) IN GENERAL—No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower...because of any lawful act done by the whistleblower—
 - (i) In providing information to the Commission in accordance with this section...
 - (ii) In making disclosures that are required or protected under Sarbanes-Oxley Act of 2002..., and any other law, rule, or regulation subject to the jurisdiction of the Commission.

Employment Protections— Protected Conduct

www.SECwhistlebloweradvocate.com

- Providing information about possible securities violations to the SEC
- Participating in any SEC investigation or related enforcement action
- Making disclosures to the SEC required by law

Employment Protections— Regulatory Requirements

www.SECwhistlebloweradvocate.com

- Reasonable belief
- Compliance with SEC rules

Employment Protections— Avenues for Relief

www.SECwhistlebloweradvocate.com

- Private right of action in federal district court
- No administrative exhaustion requirement
- Unwaivable right to a federal jury trial
- Reinstatement with equivalent seniority
- Two times back pay with interest
- Attorney's fees and related expenses

Employment Protections— Statute of Limitations

www.SECwhistlebloweradvocate.com

- Six years after the date the retaliation occurred;
or
- Three years after discovering retaliation
- ...but in no event longer than 10 years after the date of violation

Monetary Awards— Overview

Subject to the eligibility requirements, the Commission will pay an award or awards, 10-30% of the monetary sanctions collected, to one or more whistleblowers who:

- Voluntarily provide the SEC
- With original information
- That leads to the successful enforcement by the Commission in a federal court or administrative action
- In which the SEC obtains monetary sanctions totaling more than \$1 million

The SEC will also pay an award based upon amounts collected in certain related actions.

Key Definitions— Voluntarily Provide

www.SECwhistlebloweradvocate.com

- No pre-existing legal duty or agreement to provide such information to the SEC
- Information provided to SEC *before* receiving a request, inquiry or demand relating to the same subject matter from the SEC or other select federal, state and self-regulatory organizations

Key Definitions— Original Information

www.SECwhistlebloweradvocate.com

- Information is "original" if it is...
 - not already known to the SEC;
 - not exclusively derived from allegations in a judicial or administrative proceeding; and
 - provided to the SEC for the first time after July 21, 2010
- Information can be derived from a whistleblower's...
 - independent knowledge
 - independent analysis

Key Definitions— Leads to Successful Enforcement Action

www.SECwhistlebloweradvocate.com

- The SEC will consider the information that you provided to have led to a successful enforcement action if:
 - the information was sufficiently specific, credible, and timely to cause the staff to commence an examination, open/re-open an investigation, or inquire into different conduct as part of a current examination or investigation
 - the information significantly contributed to the success of an ongoing examination or investigation

Key Definitions— Monetary Sanctions

- All monies, including penalties, disgorgement, and any interest, ordered to be paid and money deposited into a disgorgement fund or other fund pursuant to Section 308(b) of Sarbanes-Oxley
- To meet the \$1 million minimum threshold, monetary sanctions from actions that arise out of the same nucleus of operative facts may be grouped together

Criteria for Determining Amount of Award

- Factors that may increase an award include:
 - Significance of the information provided
 - Degree of assistance provided
 - Law enforcement interest in making the award
 - Participation in internal compliance systems
- Factors that may decrease an award include:
 - Culpability or involvement in the reported misconduct
 - Unreasonable reporting delay
 - Interference with internal compliance systems

Whistleblowers Ineligible for an Award

www.SECwhistlebloweradvocate.com

- Individuals criminally convicted for related misconduct
- Members, officers and employees of the SEC and other enumerated organizations
- Family members and those that reside with an SEC member or employee
- Members, officers and employees of a foreign government
- Individuals that knowingly or willfully provide false information to the SEC

Whistleblowers with Qualified Eligibility for an Award

www.SECwhistlebloweradvocate.com

- Attorneys
- Accountants
- Officers, directors, trustees, and partners
- Employees or contractors whose duties involve compliance or internal audits
- Individuals retained to conduct an internal investigation involving possible violations
- Individuals who obtain information about violations from an ineligible individual

Attorney Eligibility for a Monetary Award

- **General Rule:** The implementing rules for the SEC Whistleblower Program prohibit attorneys from using information obtained through a communication protected by the attorney-client privilege or through the representation of a client to qualify for a monetary award.
- **Exception:** However, the rules permit an attorney to receive a monetary award if:
 - Attorney-client privilege has been waived; or
 - Disclosure of the otherwise confidential information is permitted by the applicable attorney conduct rules or SEC Rule 205.3.

LAWYERS' RIGHTS AND RESPONSIBILITIES

- ABA Model Rule 1.13(a)---L employed by or retained by organization represents organization, acting through its duly authorized constituents
- Special issues for in-house lawyers
 - L often serves in both legal and nonlegal capacities
 - L may perform legal services even when in ostensibly nonlegal capacity (e.g., compliance officer)
 - L should clarify when serving in legal/nonlegal role
 - Default test for a/c relationship---did corporation reasonably believe that L was performing legal services on behalf of corporation?

Duty of Confidentiality— Two Sources

www.SECwhistlebloweradvocate.com

- **Attorney-client evidentiary privilege**
 - states: common law or codification
 - federal: common law (see FRE 501)
- **Professional rule of confidentiality**
 - state rules of professional conduct (RPC)
 - Rule 1.6 (state rules often differ from ABA Model Rule)

—Procedural Differences

www.SECwhistlebloweradvocate.com

A/C privilege---narrow

- rule of evidence
- prevents testimony, document production in judicial proceedings

Rule of confidentiality---broad

- any use or disclosure of client information
- not limited to judicial proceedings

—Substantive Differences I: Prima Facie Protection

www.SECwhistlebloweradvocate.com

A/C privilege---narrow

- confidential communication
- between client (or client rep) and L (or L rep)
- for purpose of securing legal advice or services
- corporation's privilege---limited to certain constituents
 - control group/scope of employment/*Upjohn*

Rule of confidentiality---broad

- current client: Rule 1.6(a)---**all information related to representation, regardless of source**
- corporate client---no limitation on source of information
- former client: Rule 1.9(c)---same as duty to current client except for **generally known** information

—Substantive Differences II: Exceptions Under A/C Privilege

www.SECwhistlebloweradvocate.com

- joint clients
- crime-fraud
- breach of duty by L to client or client to L
- claimants through deceased client
- client waiver (including failure to object)

—Substantive Differences II: Exceptions Under Confidentiality

www.SECwhistlebloweradvocate.com

Rule 1.6 (state rules vary considerably)

- informed consent of client
- impliedly authorized to carry out representation
- prevention of death or serious bodily harm
- **prevention of substantial economic harm through client crime or fraud in which L's services were used**
- **rectification of substantial economic harm through client crime or fraud in which L's services were used**
- **controversy between L and client**
- secure advice concerning L's compliance with Rules
- required by law or court order

Special Rules for Corporate Lawyers---MR 1.13/ SEC Rule 205.3

www.SECwhistlebloweradvocate.com

- Both require “up-the-ladder” reporting within corporation
 - SEC Rule limited to credible evidence of fraud or other material securities violation
- Both permit “reporting out” under certain circumstances
 - SEC Rule---L may disclose to SEC if L reasonably believes disclosure is necessary to
 - prevent material violation likely to cause substantial financial injury to issuer or investors
 - prevent issuer from committing or suborning perjury, or perpetuating fraud on Commission; or
 - rectify consequences of material violation, in furtherance of which an attorney’s services were used
 - MR 1.13(c)---disclosure beyond that permitted by 1.6 *only to prevent harm to corporation itself* and only if reporting up is unsuccessful.

- General Rule: Under the law of federal preemption, a law or regulation enacted by the federal government preempts conflicting state law.
- Application: Dodd-Frank, including incorporation of SEC Rule 205.3, preempts state rules of professional conduct that have narrower disclosure provisions
 - E.g., CA and RI---prohibit disclosure to prevent financial harm to others as result of client crime or fraud

Conflicts of Interest: Rules of Professional Conduct

www.SECwhistlebloweradvocate.com

- L currently representing corporation---Rule 1.7

Without informed consent of client, L may not represent a client if

- representation will be directly adverse to corporation
- there is a significant risk that representation of corporation will be materially limited by L's responsibility to another client or by personal interest of lawyer

- Corporation as former client---Rule 1.9(a)

Without informed consent of client, L may not represent another person in same or substantially related matter in which new client's interests are materially adverse to interests of former client.

Federal Preemption issues under Dodd-Frank provisions for anonymous disclosure

www.SECwhistlebloweradvocate.com

Dodd-Frank preempts conflicting state ethical rules, leaving the following questions:

- May L currently representing corporation report anonymously if MR 1.7 conflict rules require disclosure and consent? If so, must L then immediately withdraw from representation?
- Is anonymous disclosure consistent with MR 1.4, which requires keeping a client reasonably informed with respect to the representation? What should L do after anonymously reporting?

COMMON QUESTIONS

What constitutes a security?

- **Section 2(a)(1) of the Securities Act of 1933:**

"any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security'"

- **Similar definitions can be found in other federal securities statutes, including Section 3(a)(10) of the Securities and Exchange Act of 1934**

- *SEC v. W. J. Howey Co.* test:
 - An investment contract is a "security" if "the person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)
- Elements of the test:
 - An investment in money
 - A common enterprise
 - Expectation of a profit
 - Solely from the effort of others

What is the international reach of the U.S. securities laws?

Reach of the SEC Whistleblower Program

www.SECwhistlebloweradvocate.com

- With few exclusions or qualifications, a whistleblower can be any individual or group of individuals – regardless of citizenship.
- Eligible securities violations may occur anywhere in the world
- Potential international violators can be individuals or organizations (public or private)
- Jurisdictional Nexus: investors, investments, operations, employees or clients in the United States
- International Information Sharing

Registration of Securities Offerings

- Public offerings to U.S. investors by foreign issuers are subject to the registration requirements of the Securities Act.
- Foreign purchasers of securities issued in the U.S. have the same rights as U.S. purchasers.
- U.S. issuers may issue classes of securities to foreign investors that are restricted from U.S. investors without registering under the Securities Act.

Application of Section 10(b) and Rule 10b-5 thereunder

www.SECwhistlebloweradvocate.com

- *Morrison v. National Australia Bank*
 - Holding: As a general rule, the anti-fraud provisions of the Exchange Act apply only to transactions in securities listed on domestic exchanges and domestic transactions in other securities.

What are the most common
types of securities law violations?

Common Securities Violations

www.SECwhistlebloweradvocate.com

- Market Manipulation
- Offering Fraud
- Financial Fraud
- Insider Trading
- Trading and Pricing
- Foreign Corrupt Practices Act
- Municipal Securities Fraud

Market manipulation is the interference with the free and fair operation of the market by engaging in transactions and other practices that create or maintain an artificial price for a security. Examples include:

- **Churning**
 - Placing of both buy and sell orders for the same security at about the same price in order to create the appearance of increased trading activity, thereby increasing its price
- **Pooling**
 - An agreement among a group of people delegating authority to a single manager to trade in a specific stock, for a specific period of time, and then to share in the resulting profits or losses
- **Pump and Dump**
 - Spreading false information to increase the price of a security, then selling shares at the increased price

Offering fraud involves making material misrepresentations and/or omissions to potential investors in connection with an offering of securities. Examples include:

- **Unregistered Offering**
 - The securities being sold are not registered with the SEC as required under the Securities Act
- **Ponzi Scheme**
 - Investors are paid returns from their own money or from the money invested by subsequent investors, rather than from any actual profit earned
- **Affinity Fraud**
 - Targets members of an identifiable group, such as religious or ethnic communities, in order to induce those members to invest in a fraudulent investment opportunity

- Financial fraud occurs when a public company files materially false or misleading financial statements with the SEC. Examples include:
 - Misleading disclosures
 - Misclassifications
 - Improper recording of transactions
 - Overstatements
 - Understatements

Insider trading is the buying or selling of a corporate security while in possession of material information about that corporation that is not known to the public.

Two theories of insider trading:

- **Classical Theory**
 - Involves corporate insiders who have access to material, nonpublic information based on their positions inside a corporation
- **Misappropriation Theory**
 - Involves third parties who acquire material, nonpublic information about a corporation based on some relationship of trust with the source of the information

Trading and pricing violations involve any number of trading techniques that are illegal under the securities laws. Examples include:

- **Market Timing/Late Trading**
 - When a mutual fund permits select customers to purchase shares in the fund after trading has closed for the day
- **Wash Trades**
 - Involve the buying and selling the same security for the purpose of generating activity and increasing the price
- **Marking the Close**
 - Buying or selling a security near the close of the day's trading in order to affect the closing price
- **Front Running**
 - Buying or selling a security while knowing that another investor is about trade, or an analyst will make a recommendation, that will influence the price of the security

Foreign Corrupt Practices Act (FCPA)

www.SECwhistlebloweradvocate.com

- The FCPA prohibits the offer, payment, or promise to pay money or anything of value—i.e., a bribe—to any foreign official in an effort to win or retain business from that foreign official's government.
- Affirmative Defenses:
 - The payments are legal under the written laws of the country in which the payments are made; or
 - The payment is a reasonable expenditure directly related to the conducting of business with a foreign government.

- Municipal securities fraud occurs when materially false or misleading statements are made to investors in connection with the purchase or sale of debt securities issued by state and local governments in the United States.

What is the statute of limitations for bringing an SEC enforcement action?

- 28 U.S.C. § 2462:
 - A "catch all" statute of limitations for actions brought by federal agencies in federal court
 - SEC has five years to bring an enforcement action seeking civil penalties from the date that the claim first accrued

- **Discovery Rule**
 - Common law rule that applies only to fraud claims
 - Holds that the statute of limitations for a fraud claim does not accrue until the fraud is discovered, or could have been discovered with reasonable diligence
- **Fraudulent Concealment/Equitable Tolling**
 - Temporarily suspends the statute of limitations clock, even though a claim has already accrued, if the defendant took affirmative steps to conceal the wrongful conduct
 - Applies to non-fraud claims also
 - SEC or private plaintiff must plead facts establishing that the defendant took affirmative steps to conceal the wrongful conduct

What steps can my organization take to deter and detect securities violations?

5 Tips For Every Responsible Organization

www.SECwhistlebloweradvocate.com

1. Invest in compliance
2. Have a game plan
3. Self-report
4. Communicate more
5. Establish a culture of integrity

What should every potential lawyer whistleblower know?

7 Insider Tips For Potential Attorney Whistleblowers

www.SECwhistlebloweradvocate.com

1. Consider addressing the problem internally first.
2. Consult with independent counsel.
3. Know the odds.
4. Attempt to identify violations.
5. Legally collect evidence.
6. Remember to comply with state attorney conduct rules that are not in conflict with Dodd-Frank.
7. Report anonymously.

5 Insider Tips For Potential SEC Whistleblowers

www.SECwhistlebloweradvocate.com

1. Know the odds
2. Attempt to identify violations
3. Legally collect evidence
4. Be prepared
5. Timing matters

Where can potential whistleblowers and other interested parties learn more about the securities laws and the SEC enforcement process?

Additional Resources

www.SECwhistlebloweradvocate.com

SECWhistleblowerAdvocate

WHISTLEBLOWER PROGRAM | CORPORATE ETHICS | RESOURCES | ABOUT US

REQUEST CASE EVALUATION



In this era of corporate scandal, the world needs more truth tellers. History has consistently shown that law enforcement authorities cannot effectively and efficiently police the marketplace without the assistance of private individuals and entities. Labaton Sucharow is dedicated to helping responsible organizations establish a culture of integrity and courageous whistleblowers to report possible securities violations—without regrets.

SEC Insider's Guide

SEC Whistleblower Program Handbook

Securities Law Primer

SEC Whistleblower Eligibility Calculator

SEC Whistleblower Sanctions Database

Recent Op-Ed in USA Today Examines Ethical Breakdown in Financial Services Industry

Jordan Thomas - Monday, September 10, 2012

On September 5th, nestled between columns dissecting the presidential political drama as it unfolds, *USA Today* made space for another critical topic: *How Wall Street Creates Criminals*. In this column, Cornell Law professor Lynn Stout and I address how and why the financial services industry has lost its moral compass, and the necessary first step for recovery: accountability. Building on data gathered in Labaton Sucharow's recent survey of the US & UK Financial Services industry, *Wall Street, Fleet Street, Main Street: Corporate Integrity at a Crossroads*, we argue that Wall Street has to admit that it has a corporate ethics problem and then take bold measures to change it.

Comments (0) | Trackbacks (0) | Permalink



A Powerful Partnership in Full Swing: SEC Issues First Award to Whistleblower

Jordan Thomas - Thursday, August 23, 2012

In the News

- Bloomberg Law—The SEC Whistleblower Program's Annual Report
- Fox Business—Will Whistleblower Rules Help SEC Investigations?
- Labaton Roundtable—Global Impact of U.S. Financial Reforms

VIEW ALL NEWS

For the People,
By the People:
The SEC Whistleblower
Program & Establishing
a Culture of Integrity



Whistleblowing in the Corporate World Series: Part V

Corporate Lawyers as Whistleblowers

Jordan A. Thomas
Labaton Sucharow LLP
140 Broadway
New York, NY 10005
(212) 907-0700
jthomas@labaton.com