

SEC INSIDER

COMMISSION ISSUES LARGEST AWARD IN HISTORY TO LABATON CLIENTS

In March, the SEC [announced](#) that it will award a group of whistleblowers more than \$83 million, the largest awards announced since the [SEC Whistleblower Program](#) was established seven years ago. Represented by Labaton Sucharow, the whistleblowers' tips led to a landmark enforcement action that resulted in [Merrill Lynch paying \\$415 million](#) to settle charges that it misused customer cash to generate profits for the firm and failed to safeguard customer assets.

The whistleblowers tipped the SEC to long-running misconduct at Merrill Lynch, which over numerous years, executed complex options trades that lacked economic substance and artificially reduced the required deposit of customer cash in the reserve account. Through the reckless conduct, Merrill Lynch violated the SEC's Customer Protection Rules and put billions of dollars of customer funds at risk in order to finance its own trading activities.

The award is a wake-up call for Wall Street. With its protections, incentives and the ability to report anonymously, the SEC's program empowers every citizen to be its eyes and ears. This is only the beginning of a revolution in ethical action for Corporate America. Bad actors are on notice.

—Jordan Thomas, Chair of Labaton's Whistleblower Representation Practice

DASHBOARD

FAST FACTS FROM THE ECI'S 2018 STATE OF ETHICS & COMPLIANCE IN THE WORKPLACE

47% of employees said that within the last 12 months they observed conduct that either violated organizational standards or the law.

69% of employees reported the misconduct that they observed.

16% of employees experienced pressure to compromise standards.

"Conduct in US workplaces continues to shift. Based on historic findings and current indications, ECI suggests that leaders brace for employee conduct to worsen in the days ahead."

44% of employees who reported misconduct experienced retaliation, double the figure in 2013.

40% of employees believed that their company has a weak or weak-leaning ethical culture.

3x Employees in weak cultures are 3x more likely to say they observed misconduct and 41% less likely to report it.

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THE WHISTLEBLOWER DOCKET

FEELINGS ARE FAIR GAME

In 2011, researchers released the [results](#) of a study on nurses who acted as whistleblowers or were bystanders in a whistleblowing incident at work. The alarming reports of depression, distress, panic attacks, anxiety and increased reliance on cigarettes and alcohol, underscores that reporting wrongdoing in the workplace can cause serious emotional distress. Nevertheless, those damages can be difficult to quantify and prove at trial. Two recent cases show that some judges and juries are beginning to understand the toll blowing the whistle can take on employees, but challenges remain.

In March, the Supreme Court of Pennsylvania upheld a \$3.2 million verdict in favor of a whistleblower plaintiff. Half of that verdict—\$1.6 million—was for emotional distress damages. In that case, the plaintiff was the Manager of Financial Systems and Reporting for the state’s turnpike authority, where he had worked for a decade. When he raised questions about the propriety of a particular contract award, the turnpike authority terminated him in what it claimed was a reduction in force. They walked him out of the building with all of his belongings in a cardboard box. At trial, the judge heard testimony from the plaintiff and his wife, who described the devastation and humiliation he felt after losing his job, the sleeplessness and tearfulness it caused, and the anguish and guilt he experienced when he told his father-in-law he “was no longer a provider for his daughter and his grandchildren.” The Supreme Court concluded that it was reasonable to infer that the plaintiff’s emotional distress was commensurate with the economic distress he suffered, and upheld the trial court’s award of \$1.6 million for each category. Significantly, the opinion formally held for the first time that non-economic damages—like those for emotional distress and reputational harm—were available under the state’s whistleblower law.

Recent Emotional Distress Awards for Whistleblowers Show Fact-Finders Understand the Impact of Speaking Out

Things did not go as well in a recent, similar case in New York. A former J.P. Morgan Chase private wealth manager sued the company for retaliation under Sarbanes-Oxley for terminating her employment after she raised questions about one of her client’s activities. A jury found for the plaintiff and awarded her \$563,000 in back pay and \$563,000 in emotional distress damages. The plaintiff testified that she suffered from extreme anxiety and sleeplessness and that she had to take Xanax and sleeping pills. Although the court acknowledged that emotional distress damages are available under the statute, the judge cut them down to a range between \$20,000 and \$50,000. In doing so, the judge noted that the plaintiff did not offer any medical testimony or documents about her emotional distress, and that a family tragedy seven months after the termination of her employment could have exacerbated or caused the symptoms she described in court. The judge held the jury’s decision to give the same amount of money—\$563,000 for the economic and \$563,000 for non-economic damages—was evidence that the jury “acted out of passion” in favor of the plaintiff or had a “prejudice” against J.P. Morgan.

It’s tricky to prove emotional distress damages. As the cases cited above indicate, these damages require a very fact-intensive inquiry.

There is no question that whistleblowing can be hard on an individual’s emotional health, but there remain questions around how much a person can recover for it. The initial awards in the Pennsylvania and New York cases show that fact-finders understand that blowing the whistle can be especially traumatic and there is a remedy available to address it.

SAGE COUNSEL

Q: *What violations qualify for the SEC Whistleblower Program?*

A: An SEC whistleblower may report any violation of the federal securities laws that has occurred, is ongoing, or is about to occur. The reported misconduct may occur anywhere in the world. In most cases, SEC enforcement actions involve manipulative and deceptive practices associated with the purchase or sale of a security. Beyond stocks and bonds, the federal securities laws have interpreted "security" broadly to include investment contracts, notes and other non-traditional investments.

Q: *When should SEC whistleblowers report to the Commission?*

A: We can't say it enough: Timing matters...The early bird really does get the worm. Similar to other bounty programs, the SEC Whistleblower Program was designed to encourage prompt reporting by rewarding whistleblowers who report "original information." To that end, only the first whistleblower to report a securities violation will be eligible to receive an SEC Whistleblower Program award, unless subsequent whistleblowers are found to have significantly contributed to the success of the enforcement action. Even in cases where this higher standard is met, the Commission regularly reduces monetary awards to SEC whistleblowers for unreasonable delay in reporting.

SPOTLIGHT

A CONVERSATION WITH DR. PATRICIA HARNED

In March, Jordan Thomas spoke with Dr. Patricia J. Harned, CEO of the Ethics & Compliance Initiative (ECI). Dr. Harned oversees ECI's research agenda and its networking and conference events. She also directs outreach efforts to policymakers and federal enforcement agencies in Washington, D.C and advises CEOs and directors on effective ways to build an ethical culture and promote integrity in the workplace.

In 2014, the Ethics Resource Center formed a strategic alliance with the Ethics & Compliance Officer Association. As the CEO of the new organization, the Ethics & Compliance Initiative, can you tell us about the ECI and your vision for the future??

Our goal in aligning the two non-profits was to bring together the thought leadership of the ERC and the members of the ethics and compliance community. Not only did we aim to provide more access to the latest research, we wanted to have more practitioners involved in the development of our research strategy. In essence, we created a best practice community of organizations dedicated to creating high quality ethics & compliance programs.

Since 1994, the ECI has conducted the definitive study of workplace ethics, which is closely followed by academics, corporations and media outlets. Can you tell us about the Global Business Ethics Survey and its new direction this year?

Historically our organization has fielded a biennial survey among U.S. employees. In 2016, we expanded our focus to establish global benchmarks and created a first-of-its kind study of workplace conduct in 13 countries around the world. This year we combined both the US and the global studies under one name; the Global Business Ethics Survey. In our latest report, we shared recent data on U.S. employees and data for global benchmarks. Going forward, we will release a new report on the global data every quarter.

When developing the SEC Whistleblower Program, corporate America expressed concern that the program would undermine corporate compliance programs. What, if anything, has your research shown?

We've done significant research into employee reporting of misconduct and what we've seen consistently is that the vast majority of employees first report internally. Most go to an immediate supervisor or someone within management. It's only after they've reported internally, often multiple times, that the employee turns to the SEC or another government agency. Their motivation is not financial reward; it's really to try to get someone to stop the problem.

Your recent study presented an alarming finding—the rate of retaliation against individuals who report misconduct has doubled in the past two years. What are your thoughts on that?

It's alarming in large measure because we know from prior research that when there's an increase in retaliation and the company develops a reputation for widespread retaliation, it has a silencing effect on employees. People won't come forward to raise concerns. So we note in the current report that even though key metrics are positive—misconduct is down, and reporting is up—the fact that retaliation has doubled is very concerning.

Your study demonstrated that pressure to compromise standards is also at an all-time high. Can you talk a bit about why pressure matters when examining workplace ethics?

Pressure as a metric actually doesn't change much over time; it's usually a fairly flat number. So the fact that we've seen an uptick is worrisome for two reasons. First, when employees feel significant pressure to just get the job done, they're much more likely to compromise their standards and engage in wrongdoing. In addition, 87% of people who experience pressure also observe some kind of misconduct happening in the workplace. Where there's smoke, there's fire. If pressure is on the rise, then misconduct probably will be too.

A strong corporate culture is the most effective way to reduce misconduct, increase reporting, minimize pressure and eliminate retaliation.

In the past, your research has shown that the best way to combat misconduct is to build an ethical culture. In what ways does culture matter and how is it tied to reporting rates?

A strong corporate culture is the most effective way to reduce misconduct, increase reporting, minimize pressure and eliminate retaliation. Typically, it's achieved by establishing a high-quality ethics & compliance program. But culture is really about 'tone from the top'; employee experiences with supervisors; and whether leadership is supportive of the standards and encourages employees to raise concerns. It is a measure of employees' willingness to bring bad news forward and whether there's accountability in an organization. In our industry, we say that culture trumps compliance every day of the week. You can have a terrific compliance program, but if you have an organizational culture where the rules don't really matter, you might as well not have a program at all.

For the last two decades, you've been at the forefront of the corporate ethics movement. How has it evolved and where do you think it's going?

It has been interesting to watch the industry evolve. Corporate ethics really expanded after Sarbanes-Oxley. The field has grown more complex with various regulations, international influence and enforcement efforts, which impact how practitioners go about doing their jobs. Within the next five years, a significant wave of retirements are expected in the industry. The next generation of ethics & compliance leaders will look very different. We also are beginning to see greater reliance on data analytics to monitor an organization's culture and risks for non-compliance. These things will force us to re-examine the purpose of an ethics & compliance program, and who's qualified to oversee and shape it.

What are common mistakes that organizations make when dealing with whistleblowers?

When whistleblowers report a serious violation of the law, they can't be treated differently than any other employee who comes forward to report wrongdoing. If whistleblowers are treated in a way that is inconsistent with other reporting

efforts, they can actually perceive the process itself as retaliatory. Second, many organizations immediately assume that a whistleblower is a disloyal employee. To the contrary, most of our research has shown that reporting misconduct is an act of great loyalty. So the way companies think about employees who come forward, especially the way they define whistleblowers and treat them; these are often areas of concern.

Now, a related question—what advice do you have for responsible organizations that want to properly handle whistleblower matters?

First, we recommend that organizations have an ombuds or advocacy program of some fashion so that whistleblowers have a way to seek guidance and support. They also have a means to stay apprised of the reporting/investigation process. Second, companies should implement an anti-retaliation program to monitor employee whistleblowers and ensure they are protected and successful. Finally, in my view, it is mission-critical for every organization to review its reporting process to ensure that there is consistency and fairness in the way the organization handles employee reports of suspected misconduct.

SEC WATCH

PROPOSED WHISTLEBLOWER RULE AMENDMENTS COULD IMPACT AWARD AMOUNTS

In a meeting held late last month, the SEC proposed potential changes to the monetary award amounts for eligible whistleblowers. Currently, the Whistleblower Program established under Dodd-Frank in 2010 allows for “the SEC to make monetary awards to eligible individuals who voluntarily provide original information that leads to successful SEC enforcement actions resulting in monetary sanctions over \$1 million and successful related actions...in an amount equal to 10 to 30 percent of the monetary sanctions.” The proposed changes would allow for the Commission to “establish a discretionary award mechanism” which may result in increased award amounts for smaller sanctions and decreased amounts for larger sanctions. The public comment period will be open for 60 days (from June 28th).

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A leader in securities law for more than five decades, Labaton Sucharow’s whistleblower team, led by a principal architect of the SEC whistleblower program, combines nearly a century of federal law enforcement experience. A practice run exclusively by partners aided by world-class in-house investigators and analysts, the team has won precedent-setting awards for courageous whistleblowers across the country, including the largest award in the history of the SEC’s program.

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