New York Law Journal
A NEW YORK LAW JOURNAL SPECIAL SECTION
Internal Investigations
An ALM Publication
WWW.NYLJ.COM
MONDAY, NOVEMBER 10, 2014

Enforcement Trends Change the Dynamics Of Investigations

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BIGSTOCK

Recent developments in how the government investigates and prosecutes enforcement actions have created new challenges for handling internal investigations. The size of government bounties awarded to whistleblowing employees are breaking records, and the government has made clear that it highly values inside information to advance its enforcement efforts. In particular, the government now is seeking to use whistleblowing awards as a lure for compliance personnel, who often are directly involved in internal investigations. At the same time, the government has been using perceived inadequacies in internal investigations to justify increased penalties for corporate wrongdoing and has punished employees involved in compliance and internal investigations for failing to respond adequately to reports of misconduct. These developments call for increased care in managing internal investigations.

Skyrocketing Whistleblower Awards

The U.S. Securities and Exchange Commission (SEC) first obtained statutory authority to create a whistleblower program in 2010, when Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1] It issued its first whistleblower award of "nearly $50,000" in August 2012.[2] Since then, reported whistleblower awards have been increasing in value at a dizzying pace. In September of this year, the SEC announced that it planned to award more than $30 million to a whistleblower who provided information that led to a successful enforcement action.[3] The award set a new record for the SEC's whistleblower program, surpassing the previous record of $14 million announced less than a year earlier. As the director of the SEC's Division of Enforcement explained, the "record-breaking award sends a strong message about our commitment to whistleblowers and the value they bring to law enforcement."[4]

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The trend is not limited to SEC enforcement actions. Recent recipients of False Claims Act (FCA) whistleblower awards have reached even higher amounts. For instance, earlier this year, a whistleblower who provided information on alleged frauds perpetrated against the Department of Housing and Urban Development and the Department of Veterans Affairs was awarded a total bounty of nearly $64 million.[5] The government's approach to FCA cases is similar to that followed by the SEC in securities fraud cases, where whistleblowers can be paid between 10 and 30 percent of the total recovery.

Eliminating Caps On Whistleblower Awards

To the extent that whistleblowers reporting violations of other statutes are not so handsomely rewarded, the winds of change are blowing decisively in their favor. In recent comments given at the NYU School of Law, Attorney General Eric Holder spoke glowingly of the "unique ability of cooperating witnesses to help federal authorities," and in this regard noted that the Department of Justice had recovered more than $22 billion in FCA actions since 2009, often as a result of what he referred to as the "strong whistleblower amendment" that allows FCA whistleblowers to receive up to 30 percent of the total recovery.[6]

Holder then went on to lament that the whistleblower provision in the Financial Institutions Reform, Recover, and Enforcement Act (FIRREA)—a statute increasingly relied upon by the government to prosecute financial fraud—provides that awards are functionally capped at $1.6 million, which he described as "a paltry sum" when considered in the context of financial sector compensation.[7] This led Holder to propose amending FIRREA—"perhaps to False Claims Act levels"—to increase incentives for individual whistleblower cooperation.[8]

Compliance Personnel As Whistleblowers

In yet another recent development, in August of this year the SEC announced a whistleblower award of more than $300,000 to a company employee who performed audit and compliance functions.[9] It was the first award for a whistleblower with an audit or compliance function at a company, but the SEC made clear that it will not be the last. The chief of the SEC's Office of the Whistleblower stated that individuals who "perform internal audit, compliance, and legal functions for companies are on the front lines in the battle against fraud and corruption" and "often are privy to the very kinds of specific, timely, and credible information that can prevent an imminent fraud or stop an ongoing one."[10]

The award was made possible by a provision in the SEC's Whistleblower Rules that allows compliance or internal audit personnel, who otherwise are excluded from becoming whistleblowers, to become eligible for an award if 120 days have elapsed since the whistleblower provided the information through the company's internal reporting system. A compliance employee therefore becomes eligible to receive a whistleblower award 120 days after reporting misconduct, even if the corporation responds promptly and appropriately to the report of misconduct. In addition, the 120-day waiting period does not apply if the employee has a reasonable basis to believe either that: (1) disclosure is necessary to prevent the company from engaging in conduct that is likely to cause substantial financial injury to the company or investors; or (2) the company is engaging in conduct that will impede an investigation of misconduct.[11] Compliance professionals therefore face an easy hurdle to clear before using information obtained in the course of performing their duties to seek a whistleblower award.

Investigation Practices Driving Penalties

At the same time that the government is inviting compliance professionals to become whistleblowers, it is using alleged shortcomings in compliance practices and internal investigations to drive up penalties imposed on corporations. For example, in May of this year the Department of Justice announced a deal under which Credit Suisse agreed to pay a total of $2.6 billion and to plead guilty to conspiring to aid U.S. taxpayers in filing false income returns and other documents with the Internal Revenue Service.[12] As part of the that deal, Credit Suisse stipulated that it had ineffectual compliance policies, training, and audits and that it delayed an internal investigation into wrongdoing until after evidence was destroyed and witnesses were unavailable, which "encumbered the scope and progress" of the government's investigation.[13] These failings, which the government emphasized in the factual stipulation, clearly drove up the size of the imposed fine.

The government again linked penalties to a company's response to reported misconduct just two months later, when various state and federal agencies announced their landmark agreement with BNP Paribas. As part of its guilty plea, the bank agreed to a staggering $8.9 billion settlement.[14] BNP Paribas pled guilty to violating the International Emergency Economic Powers Act and the Trading With the Enemy Act by concealing billions in transactions involving Sudanese, Iranian and Cuban clients subject to U.S.

sanctions.[15] In addition, the bank was required to stipulate to facts concerning its conduct, including that, after initiating an internal investigation in 2010, it delayed producing certain relevant materials to the government until 2013, which "significantly impacted the Government's ability to bring charges against responsible individuals, Sudanese Sanctioned entities, and the satellite banks."[16] Similarly, BNP Paribas was required to stipulate that despite receiving information concerning the misconduct from a whistleblower in 2006, it "did not disclose information to the Government about the whistleblower … until December 2011, almost two years after [BNP] began its internal investigation."[17] By requiring these admissions, the government again emphasized the significance of these factors in determining the appropriate penalty for criminal conduct.

Imposing Penalties On Compliance Officers

Another noteworthy aspect of the BNP Paribas settlement was that it included the requirement that the bank fire specific employees, including compliance officers. Indeed, the New York Department of Financial Services (DFS) issued a press release announcing that "13 individuals were terminated by or separated from" BNP Paribas as a result of the investigation, and 45 employees were disciplined in connection with the investigation.[18] The DFS even publicly named specific individuals who were fired, including the Head of Ethics and Compliance for North America and the former Group Head of Compliance.[19]

Requiring that compliance employees be publicly fired or disciplined is the stick to the whistleblower award carrot. By issuing a press release announcing that it is requiring a compliance employee to be fired, the government renders that employee virtually unemployable as a compliance officer. This creates a powerful incentive to report misconduct to the government separate and apart from the possibility of a whistleblower reward. By reporting misconduct or assisting the government with its investigation, a compliance employee presumably reduces the risk of being publicly condemned by the government.

How to Respond

Among the lessons to be learned from these recent developments is that companies need to be hyper-aware of their compliance practices and personnel. And the lesson is double-barreled.

First, when responding to reports of misconduct, companies must keep in mind that employees who receive these reports and assist in the internal investigation into the misconduct are themselves potential whistleblowers. The government has made clear that it is seeking to use these employees to generate and assist in enforcement investigations, and it has powerful tools at its disposal to make this happen. Indeed, the whistleblower awards have grown so obscenely large that it would not be surprising to see a jump in false and exaggerated whistleblower allegations. The possibility of receiving a whistleblower award large enough to fund a handsome retirement will tempt employees to overstate employer misconduct to increase the likelihood and size of such an award.

Second, recent announcements make clear that the government is basing corporate penalties in part on how companies respond to reports of misconduct, including the timeliness and thoroughness of internal investigations. The advice to corporations—implement robust compliance policies, staff the compliance department with effective people, heed their counsel, and react quickly when misconduct is reported (among other things, by quickly initiating a sufficient internal investigation)—has not changed in this regard. But the stakes have. With penalties regularly reaching ten figures, there are quite literally billions of reasons to heed the long-held wisdom, especially in light of the government's efforts to enlist corporate gatekeepers as government witnesses.

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3. See generally, "Lawyers Weigh In on SEC's Record Whistleblower Award" (Sept. 22, 2014), available at http://www.law360.com/articles/579823/lawyers-weigh-in-on-sec-s-record-whistleblower-award.
4. Press Release, SEC, "SEC Announces Largest-Ever Whistleblower Award" (Sept. 22, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543011290.
5. *United States ex rel. Edwards v. JP Morgan Chase Bank, NA*, 13 Civ. 220, Stipulation and Order of Settlement and Dismissal, Dkt. No. 15 (S.D.N.Y. March 7, 2014).
6. Attorney General Holder Remarks on Financial Fraud Prosecutions at NYU School of Law (Sept. 17, 2014), available at http://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law.
7. Id.
8. Id.
9. Tammy Whitehouse, "When Compliance and Audit Executives Blow the Whistle" (Sept. 16, 2014), available at http://www.complianceweek.com/news/news-bulletin/when-compliance-and-audit-executives-blow-the-whistle.
10. Press Release, SEC, "SEC Announces $300,000 Whistleblower Award to Audit and Compliance Professional Who Reported Company's Wrongdoing," (Aug. 29, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542799812.
11. 17 CFR 240.21F-4(b)(4)(v).
12. *United States v. Credit Suisse AG*, 14-CR-188, Plea Agreement, Dkt. No. 13 (E.D. Va. May 19, 2014).
13. *United States v. Credit Suisse AG*, 14-CR-188, Statement of Facts, Dkt. No. 13, at ¶ 72 (E.D. Va. May 19, 2014).
14. Jaclyn Jaeger, "BNP Paribas Debacle Offers Lessons in Compliance," (July 22, 2014), available at http://www.complianceweek.com/news/news-bulletin/bnp-paribas-debacle-offers-lessons-in-compliance.
15. Press Release, DOJ, "BNP Paribas Agrees to Plead Guilty and to Pay $8.9 Billion for Illegally Processing Financial Transactions for Countries Subject to U.S. Economic Sanctions," (June 30, 2014), available at http://www.justice.gov/opa/pr/bnp-paribas-agrees-plead-guilty-and-pay-89-billion-illegally-processing-financial.
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17. Id. at ¶ 73.
18. Press Release, N.Y. Dep't of Fin. Servs., "Cuomo Administration Announces BNP Paribas to Pay $8.9 Billion, Including $2.24 Billion to NYDFS, Terminate Senior Executives, Restrict U.S. Dollar Clearing Operations for Violations of Law," (June 30, 2014), available at http://www.dfs.ny.gov/about/press2014/pr1406301.htm.
19. Id.