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'A Powerful Weapon for the Plaintiffs' Bar'

Posted By News Editor On November 11, 2011 @ 11:05 pm In Magazine

David M. Murphy, a partner in the litigation department at Wachtell, Lipton, Rosen & Katz, has represented financial institutions and consumer products, pharmaceutical and other industrial firms, as well as prominent individuals, in federal and state courts. He focuses on white-collar criminal and enforcement matters, and has extensive experience with internal investigations, whistleblower allegations, special committee investigations and legislative inquiries.* NACD Directorship*'s Jeffrey M. Cunningham interviewed Murphy about the implications for corporate directors and officers of the Securities and Exchange Commission's new Office of the Whistleblower, which has begun filtering tips on possible securities law violations and offering rewards of up to 30 percent of the money the Commission collects on enforcement actions of more than $1 million in fines stemming from a tip.

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David M. Murphy

What is the greatest threat we face from the whistleblower provision?
My greatest concern is how the plaintiffs' and employment bar will respond. My view is that most conscientious, loyal employees will continue to report any suspected wrongdoing or misconduct internally, and will work with their regular compliance program as long as the programs and reporting expectations are well defined and have been communicated well in training.

Is any employee that is terminated or unhappy a risk now?
Yes, we are starting to see this already—in effect, a new market for disaffected employees whose employment lawyers are learning how to dress up various employment-related grievances into allegations of violations of the securities laws or financial reporting controls. This is perceived as a fairly powerful weapon within the plaintiffs' bar.

Does this spell the end of "business as usual" with respect to hiring and firing decisions?
It will be a challenge, especially in a large organization where your HR department may be dealing with literally tens of thousands of employees and employee-related decisions, performance reviews, promotions, transfers and the like. There is a heightened risk that ordinary performance-related decisions will be portrayed later as retaliatory because an employee will claim to have knowledge or information about "possible" violations of the securities law. And, of course, under the new law, retaliation itself is now a separate, independent violation of the securities laws and may give rise to liability even if the employee was completely wrong as to the underlying allegation.

Which department bears most of the risk?
It will not be easy to monitor how your HR department responds to employee grievances—to sensitize them and train them to be alert to the types of grievances that may escalate into an SEC whistleblower situation.

Do you think the SEC considered the prospect of frivolous complaints thoroughly?
Most laws and regulations have unintended consequences, and it takes a certain amount of time and broken glass on the floor before they are recognized. But there were some industry comments on the proposed rule that raised entirely foreseeable consequences. One of those was the industry's request for an exemption from the whistleblower bounty for legal and compliance personnel. And that is something the SEC rejected, so that gives legal and compliance personnel, especially in financial services companies, enormous personal discretion to decide whether to become a whistleblower.

Are we looking at a tsunami of claims?
There is still the real possibility that you're going to see a wave of whistleblower penalties being awarded to legal or compliance personnel who have, under these final rules, concluded that certain misconduct is sufficiently serious that it threatens to impede a government investigation or that it threatens to cause the company or its shareholders significant financial injury. If they conclude that, they may act on their own and become an SEC whistleblower.

Before we predict doom and gloom, though, there does seem to be a concept in the final rule analogous to the crime-fraud ex-ception to attorney-client privilege—that is, a lawyer should keep a client's confidence unless the client is using his or her advice in furtherance of some ongoing or future crime or fraud. So we all still hope the new whistleblower rule will not prove the death knell to attorney-client privilege in a corporate context.

If you were to counsel a company and its board on whistleblower investigations, what basic elements would you suggest be in place?
Many companies already have a robust compliance program, but I think it is essential in the wake of this new rule that companies review the details and compare their program with others that securities regulators and enforcement personnel have lauded. In addition, there's a need for an investment in training HR personnel and in creating an investigative infrastructure that will allow the company to conduct an investigation very quickly— ideally well within the 120 days the rule contemplates. That's going to pose a lot of cost and burden on companies—to identify whistleblower situations promptly, and to get counsel involved very promptly in conducting or overseeing a quick but thorough investigation. The old crisis management adage of "get it fast, get it right, get it over" is more apt than ever.

Do you believe most employees will seek internal remedies before going to the SEC?
The short answer is that despite the soft incentive in the final rule for a whistleblower to report first internally, many disaffected employees will, in fact, chose not to report their allegations internally, and will go directly to the SEC. I do think that you're going to find that quite a few simply decide to circumvent the internal reporting requirements.

One hears the charge that the SEC couldn't find Madoff, so how can they deal with thousands of whistleblower complaints?
It's a very good question. I don't know whether the volume of the complaints is going to be manageable—it's too early to say. What I do think is that this is going to cause a lot of complication in connection with employment and severance decisions. Companies will face a great deal of uncertainty as far as whether a particular employee has whistleblower status and as to whether the severance package or other employment agreement is going to be viewed with 20/20 hindsight as retaliatory.

What is your counsel to boards of directors concerned about their role in this matter?
From a director perspective, the most important priority is to make sure that the compliance and HR departments are well trained in the requirements of the new rule, and that the company has a system in place that will assure prompt, objective investigation and reporting of whatever allegations may bubble up through the company. In particular, this means there will probably need to be greater attention required by audit, risk or compliance committees of the board to such issue, including setting aside time on the agenda to hear reports from counsel on the outcome of significant investigations.

Will boards require outside counsel for certain types of whistleblower cases?
Boards have to anticipate that there will be more internal investigations by outside counsel, with reports being made either to a board committee or the full board. Unfortunately, that's

likely to require more director time….There's no way that a director can or should try to lead significant investigations into these types of allegations without experienced counsel.

What about isolated financial "regular irregularities," where the allegations are of a routine nature?
Complaints of this type need to be analyzed in terms of whether they raise internal control issues with respect to financial reporting, including whether the company's systems for detecting such irregularities worked as intended. So there are going to be fewer "routine" situations where financial reporting allegations are made.

What will be the impact of the new Consumer Financial Protection Bureau?
There are likely to be some tough first-impression questions as to whether intentional or inadvertent violations of the new consumer standards are also possible violations of the federal securities laws. Boards and management will want to seek outside legal advice on certain of these questions, and to have a system in place for raising such questions with their legal departments.

What happens when the whistleblower complaint is the result of rogue behavior on the part of a middle manager and not company policy?
There's a premium now on training and on a clear articulation of the company's expectations of its employees. When faced with misbehavior, a company wants to be able to point to very clearcut statements of policy and corporate conduct. This is essential in defending the company in any enforcement proceeding against allegations that its middle managers were inadequately trained or failed to understand or apprehend the requirements or expectations of the corporation.
