



Professional Perspective

Whistleblower Complaints and SEC Enforcement

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Whistleblower Complaints and SEC Enforcement

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Throughout the Covid-19 pandemic, multiple whistleblowers have publicly reported corporate mismanagement and misconduct regarding pandemic response. With the Securities and Exchange Commission offering large monetary awards as an incentive, it is expected that whistleblowers will contribute to the SEC's increased focus on Covid-19-related enforcement. This article reviews the SEC whistleblower program and how whistleblowers are likely to further enforcement efforts.

Numbers announced by the SEC have already signaled that a trend is taking shape. On May 12, 2020, Steven Peikin, former Co-Director of the Division of Enforcement, [announced](#) that the SEC received more than 4,000 tips, complaints and referrals from mid-March to mid-May, a 35 percent increase over the same period last year. On July 13, 2020, Jane Norberg, Chief of the SEC's Office of the Whistleblower, confirmed the increase in whistleblower tips during the Covid-19 crisis.

As of Sept. 1, 2020, the SEC has awarded approximately \$510 million to whistleblowers and pursued dozens of related enforcement actions as a result of whistleblower complaints. The year 2020 has been record-breaking for the agency's whistleblower program. In late spring/early summer, the SEC made three whistleblower awards that fell in the top 10-largest monetary awards in the program's history. The most recent was a \$50 million [award](#) on June 4, 2020, the largest individual amount ever awarded by the SEC. The SEC typically releases its year-end whistleblower reports in November, which should shed more light on whistleblower activity in 2020.

On April 16, 2020, the SEC [announced](#) a \$27 million whistleblower award, and 12 days later, another large whistleblower [award](#) of \$18 million.

Program Background

The SEC whistleblower program was established by the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#), which directed the SEC to make monetary awards to eligible individuals who voluntarily provide original information leading to successful enforcement actions resulting in monetary sanctions of more than \$1 million. [15 U.S.C. § 78u-6](#). Whistleblowers are eligible for between 10% and 30% of the monetary sanctions collected.

Under Rule 21F-6 of the [Securities Exchange Act of 1934](#), the SEC will consider the following factors when determining the amount of a whistleblower award. [17 C.F.R. § 240.21F-6](#).

- The significance of information provided to the Commission
- The assistance provided in the Commission's action
- Law enforcement interest in deterring violations by granting awards
- Participation in internal compliance systems
- Culpability
- Unreasonable reporting delay
- Interference with internal compliance and reporting systems

The whistleblower program is designed to encourage whistleblowers to report securities law violations by providing protection to whistleblowers through anti-retaliation laws and providing monetary incentives to counterbalance potential job security and reputational concerns.

Pandemic Environment

However, even with this protection, fear of retaliation, loss of job security, and reputational concerns may have prevented many individuals from reporting issues to the SEC in the past. With the Covid-19 pandemic, many of these prior concerns about blowing the whistle may no longer be as important to potential whistleblowers. In addition, many potential whistleblowers are now working from home and may feel that their employer or fellow employees are less likely to discover

that they filed a complaint with the SEC. Employees who have been furloughed or laid off because of the pandemic might not have job security concerns any longer, and may be enticed by the large rewards the SEC has granted to whistleblowers.

Remote working and other workplace changes are additional incentives, on top of the protections afforded to whistleblowers, designed to encourage whistleblower reporting. The [Dodd-Frank Act](#) prohibits retaliation against employees who file whistleblower complaints, and Congress is now trying to add additional protections regarding Covid-19 whistleblower reporting.

On June 15, 2020, Senator Kamala Harris and Representatives Jackie Speier and Jamie Raskin introduced the [Covid-19 Whistleblower Protection Act](#), which seeks to protect employees who blow the whistle on companies that received federal funds through the Covid-19 aid measures passed by Congress. If passed, the act would protect employees from retaliation by their employer for reporting misconduct related to the receipt of federal funds in connection with Covid-19. Protected individuals include employees, former employees or applicants for employment, and contractors or subcontractors. The bill was referred to the House Education and Labor and Senate Homeland Security and Governmental Affairs Committees.

Enticed by the high awards recently granted to whistleblowers by the SEC, it is likely that employees will raise complaints with the SEC that typically would have been raised in other forums. For example, because many companies are now receiving federal grant money to assist with their Covid-19 response, employees who work for such companies may file complaints with the SEC reporting fraudulent conduct that typically would be filed under the False Claims Act.

Employees also may file claims related to the health or safety of their workplace, which would generally fall under the protections of Section 11(c) of the Occupational Safety and Health Act (OSHA). Moreover, the SEC now specifically has targeted significant changes to business operations, including health and workplace safety, as potential material disclosures.

Even more, unionized employees may file complaints alleging retaliation for engaging in concerted activity such as speaking up about the lack of safety or personal protective equipment—something typically protected by the National Labor Relations Act. The SEC may eventually send these complaints to another agency, but it will surely take a hard look first to make sure none of the federal securities laws have not been violated.

COVID-19-Related Violations

The SEC has made clear that it plans to focus on Covid-19-related securities law violations. On May 12, 2020, Peikin discussed the Division of Enforcement's creation of a coronavirus steering committee comprising approximately two dozen leaders from across the division to identify key areas of potential market and investor risk. The steering committee identified insider trading, market manipulation, and accounting fraud as key areas, among others, that the Division of Enforcement will focus on in investigations and enforcement related to the pandemic.

Additionally, the Office of the Chief Accountant [identified](#) specific issues concerning financial reporting related to Covid-19 that may result in enforcement issues down the line, including how to report ramifications of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), debt modifications, hedging, consolidation, business combinations, lease concessions, revenue recognition, and income taxes. These always have been a core part of the SEC's enforcement activities, and will continue to be as the Covid-19 pandemic continues.

A focus of early enforcement thus far has been on public disclosures relating to Covid-19. During a May 4, 2020 SEC Investment Advisory Committee meeting, SEC Chairman Jay Clayton [stated](#) that the SEC intends to focus on public disclosures relating to how long a business can sustain its current operating posture in the absence of additional funding, whether supply and distribution chains have been temporarily or permanently disrupted, and how businesses plan to manage the health and safety of employees and customers as the business and other market participants seek to increase activity. These inquiries will become increasingly complex as the country continues to grapple with a pandemic that has not yet eased in many places.

While initial SEC enforcement actions during the pandemic generally have focused on egregious violations, many future enforcement actions addressing the issues identified by the Commission and the Division of Enforcement will likely take shape due to whistleblower complaints. Whistleblowers have access to information and observe improper actions taken by coworkers that are typically hard for the SEC to uncover.

With remote work becoming a long-term solution for many companies, individuals are no longer in a controlled office setting, and whistleblowers may become even more prevalent in reporting perceived improper actions taken by employees who may think their actions will not be discovered because they are working remotely. Whistleblower activity will be particularly problematic in situations where they allege companies are not disclosing perceived misconduct related to Covid-19 that could impact the financial statements. For example, an allegation of improper factory working conditions, could morph into an accounting and disclosure fraud investigation if the underlying misconduct compromises revenue projections of inventory valuations.

Focus on Social Issues Due to Violations

The pandemic also raises the possibility that whistleblowers will bring complaints to the SEC about less-traditional forms of corporate misconduct. As the pandemic continues and is escalating in certain areas, companies may attempt to limit, delay or prevent negative information from being disclosed to the market. For example, companies may seek to suppress the public dissemination of information regarding employee safety and health issues, Covid-19 infections, outbreak responses, staffing reductions, and pay cuts in order to avoid any negative impact on the company's value. Such actions likely would result in additional whistleblower filings with the SEC and therefore additional enforcement actions and whistleblower awards.

On June 23, 2020, the Division of Corporation Finance provided [guidance](#) to companies regarding the disclosures they must consider about operations, liquidity and capital resources in relation to Covid-19. Regarding operations, the SEC advised that a company's operations, including "transition to telework, supply chain and distribution adjustments; and suspending or modifying certain operations to comply with health and safety guidelines to protect employees, contractors, and customers, including in connection with a transition back to the workplace," are all adjustments that may have an effect on the company that could be material to investors.

The Division of Corporation Finance identified questions that companies should ask when evaluating whether specific facts or circumstances should be disclosed. These include how and to what extent operations have been altered, including implementing health and safety policies and returning to the workplace, and how these new changes are impacting or are likely to impact the company's financial condition. The guidance on operations disclosures seems to indicate that the SEC will be focusing on disclosures that should be made that have not historically triggered an SEC investigation or action.

Notably, the SEC has regularly pursued enforcement actions against companies for failing to disclose material events even if not linked to a company's financials, but which are otherwise critical to investors. On April 24, 2018, the SEC brought an enforcement [action](#) against Yahoo! Inc. for failing to disclose a massive data breach for two years and for filing misleading risk factor disclosures in its annual and quarterly reports.

The Commission's order stated that Yahoo legal advisers, staff and managers did not properly assess the scope and business impact or legal implications of the data breach, including whether and how the breach should have been disclosed and whether the fact of the breach made any filings misleading. The order also found that Yahoo failed to inform its auditors and legal counsel of the breach in order to avoid disclosure obligations.

The SEC has also brought actions against car manufacturers including General Motors Company and Volkswagen Aktiengesellschaft AG for failing to disclose material information regarding environmental and safety issues in their vehicles. On Jan. 18, 2017, the SEC [charged](#) GM with internal accounting controls violations for failing to disclose defective ignition switches in its vehicles. The SEC alleged that GM knew in 2012 that there were defective ignition switches causing accidents and airbags failing to deploy but did not disclose these defects until 2014 because the proper departments within GM were not informed of the issue and therefore did not properly account for potential recalls.

On March 14, 2019, the SEC filed a complaint against VW alleging that VW failed to disclose that "clean diesel" cars used defeat devices to conceal substantial emission problems in violation of environmental laws. [SEC v. Volkswagen Aktiengesellschaft AG et al.](#), No. 3:19-cv-01391 (N.D. Cal. Mar. 14, 2019). These enforcement actions are instructive on how the SEC may approach a company's failure to disclose or improperly disclose employment, health and safety issues related to the pandemic.

Importantly, the SEC and the Department of Justice have emphasized that they are watching companies closely during the pandemic. These agencies have made clear that they will focus on Covid-19-related fraud and misconduct, further incentivizing whistleblowers to raise concerns. As a result of the heightened sensitivity expressed by the SEC and the DOJ,

along with the numerous potential whistleblowing issues arising from the pandemic, there likely will be a substantial rise in whistleblower activity in the coming months.

Indeed, there already have been widespread reports of nurses and other health-care professionals filing complaints in state courts and with OSHA and the National Labor Relations Board concerning the safety and sufficiency of personal protective equipment. Moreover, on April 8, 2020, the Department of Labor released a [statement](#) reminding employers that more than 20 federal whistleblower statutes protect workers who report unsafe and unhealthful working conditions. In its statement, the DOL also directed employees to the webpage of OSHA's Whistleblower Protection Program, which provides resources on federal whistleblower protection for employees in multiple industries.

In light of the likelihood of increased whistleblower activity and enforcement actions by the SEC and other governmental agencies, companies should make sure they have robust compliance policies and procedures in place regarding whistleblowers. Companies should continue to ensure that employees are able to report concerns internally, and that any concerns that are raised are adequately investigated and effectively addressed.

Companies also should continue to require that managers are consistently adhering to anti-retaliation policies, especially as many employees are now facing potential layoffs or furloughs. It is important to note that some whistleblowers will bypass internal procedures altogether and go straight to the federal government to file a whistleblower complaint. To protect against possible whistleblower liability, companies should review their internal policies and procedures and determine whether they need to be updated to address this new and changing environment.

Conclusion

Whistleblowers have played an increasing role in SEC enforcement efforts since the creation of the Office of the Whistleblower. With an influx of federal funds to companies and increased financial pressure within companies due to Covid-19, whistleblowers will become more important than ever in helping the SEC weed out bad actors.

Due to the sheer number of companies dealing with novel issues related to the pandemic, the SEC simply will not be able to uncover by itself every improper scheme or action taken. With increasingly large awards and potentially stronger protections on the horizon, whistleblowers will be more likely than ever before to report alleged misconduct. If the initial trend announced in May 2020 is any indication, the number of whistleblower reports will continue to rise as companies continue to grapple with the implications of Covid-19.