SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
Government Contracts Law BLOG
For the latest updates on laws affecting government contracts

Government Contracts Blog

Posted at 6:11 AM on May 12, 2010 by Sheppard Mullin

Proposed Whistleblower Provision Could Dramatically Increase FCPA Risk

By Bethany Hengsbach

An often-overlooked provision in the financial reform legislation now before Congress would allow employee whistleblowers to receive a reward of up to 30% of the fines collected by the U.S. Securities and Exchange Commission ("SEC") and the U.S. Department of Justice ("DOJ") from corporations who violate the Foreign Corrupt Practices Act ("FCPA"). We have reported in this blog on several occasions the increase in FCPA enforcement by the government in recent years. The passage of a bill containing this proposed whistleblower provision could lead to even more government enforcement, as well as multi-million dollar awards to whistleblowers.

The legislation would require the SEC to award whistleblowers a percentage of the fines collected by the government in exchange for providing the SEC with "original information" regarding violations of the securities laws, including books and records violations under the FCPA. The proposed provision also extends the reward to actions taken by other prosecuting agencies based on the reported information, and thus would apply to actions initiated by the DOJ and foreign law enforcement agencies. "Original information" would be limited to information independently known to the whistleblower and not already known by the government or derived from material uncovered in existing investigations. The information must lead to a successful enforcement action or judicial proceeding as well as a recovery from the corporation. The Senate and House bills differ somewhat – for example, the Senate version includes a 10% minimum and 30% maximum award, while the House version provides for a 30% maximum but no minimum. However, it seems increasingly likely that some compromise version of the provision will be incorporated and approved by Congress.

If the False Claims Act and the tax whistleblower provisions contained in section 7623 of the Internal Revenue Code are any guide, this proposed provision could lead to a cottage industry in which plaintiffs' law firms gladly jump at the chance to represent potential whistleblowers, guiding them through the process of turning over information to the SEC in the hopes of securing a lucrative reward once sanctions are brought against the corporation. At least theoretically, a whistleblower could come into a huge windfall based on the proposed formula. For example, if a whistleblower had been eligible for a 30% reward in the case of Siemens AG, which paid a grand total of $1.6 billion in monetary sanctions to the SEC, DOJ and the German government in 2008, the whistleblower would have been awarded $496 million.

While whistleblower provisions are nothing new, this proposed provision is particularly striking given the way in which FCPA allegations made by the government are typically resolved. Because the doctrine of *respondeat superior* makes corporations vicariously liable for crimes committed by employees at any level acting within the scope of their employment, corporate defendants find it increasingly difficult to defend themselves against allegations of FCPA-related misconduct. It is often more cost-effective, and more predictable, to settle an FCPA enforcement action, even though settled actions do not necessarily represent a triumph of the government's position. Given this construct, the proposed provision could reward a whistleblower for uncovering conduct that may not have even violated the statute. To make matters worse, employees would be incentivized to work in secret, building a case against the corporation from the inside.

The proposed legislation must be analyzed in context. It comes amid a rash of staggering fines against corporations for FCPA violations, and prison terms for individuals guilty of violating the statute. A quick recap is instructive. The government has collected $1.2 billion in FCPA sanctions in just the first few months of 2010, after collecting $627 million in 2009. In March 2010 alone, BAE Systems, Innospec and Daimler AG announced sanctions of $400 million, $25.3 million, and $185 million, respectively. In January, 2010 the government charged 22 individuals with FCPA violations as part of a sting operation that spanned nearly two years, and relied heavily on the involvement of the FBI, as well as foreign law enforcement agencies. In April, 2010, a federal judge in Virginia handed down a prison sentence of 87 months for an FCPA violation, the longest-ever in FCPA history. The DOJ is said to currently have over 140 open FCPA investigations, including recent investigations reported by Avon and Hewlett Packard. Five companies announced possible FCPA settlements in the first quarter of 2010, including ABB (reserve of $850 million) and Alcatel-Lucent (reserve of $137.4 million).

Particularly against this backdrop, the proposed whistleblower provision underscores the need for corporations to implement and maintain rigorous FCPA compliance programs and a quick and thorough response to allegations of FCPA-related misconduct. If the whistleblower provision becomes law, the decision whether and when to self-report FCPA violations will become ever more complicated, and will add a new wrinkle to an already dangerous landscape.

Authored By:

Bethany Hengsbach
(213)617-4125
bhengsbach@sheppardmullin.com