corporate law

Offering Options To Potential Whistleblowers

Organizational ombudsmen can be in-house outlets for complaints

By CHARLES L. HOWARD

The enactment of the Dodd-Frank Wall Street and Consumer Protection Act last year and implementing regulations from the Securities and Exchange Commission earlier this year were strongly opposed by many groups, such as the Association of Corporate Counsel, because they create a bounty system for whistleblower tips made directly to the SEC rather than encourage reporting through a company's internal channels.

Dodd-Frank is only the most recent attempt by the government to ferret out reports of misconduct by giving incentives to whistleblowers; the False Claims Act (FCA) dates back to the Civil War era, and at least from the government's perspective, has been very successful, in recovering tens of billions of dollars by offering a bounty to whistleblowers.

These laws reflect a wider pattern that has emerged over the past few decades in corporate governance, as well as in employment and criminal law, in which organizations have a duty to encourage reporting, investigation, and correction of any misconduct. Yet, given the renewed fear that would-be whistleblowers will bypass internal reporting channels in favor of government bounties, perhaps it is time for a closer look at how companies can strengthen their internal systems to lessen the allure of whistleblower bounties.

It is in the best interests of corporations — and consistent with the goals of regulators — to encourage internal reporting and to protect employees who do come forward.

Whistleblower Law Limitations

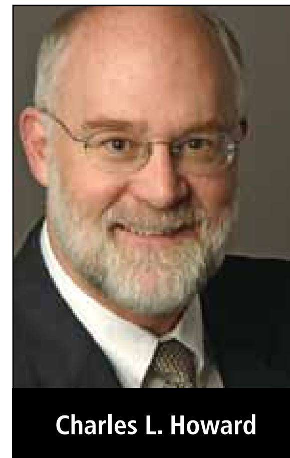
The best place to begin is by looking at the key feature of most whistleblower laws. Virtually all of them prohibit discrimination and retaliation against someone who meets that law's definition of a whistleblower. Most of them also give a whistleblower who experiences discrimination or retaliation a civil cause of action for damages and reinstatement. And finally, some of the more prominent laws, such as Dodd-Frank and the FCA, create a bounty, whereby the whistleblower may personally recover a portion of government's recovery.

Such whistleblower laws are important and necessary, but when viewed from the bottom up, that is, from the perspective of most employees, they have major limitations — and it is in responding to those limitations that companies have a great opportunity to strengthen their corporate governance systems.

The first problem is one of timing. A bounty is only awarded at the very end of a process that often takes many years from start to finish. Yet, an employee must make a decision at the very beginning of that process about whether to be a whistleblower with no assurance that he or she will ultimately qualify. The perils of uncertainty are made all the greater by complicated procedural and substantive requirements.

For example, how does a Dodd-Frank whistleblower know at the beginning whether his information is "original" or will ultimately result in the government's recovery in excess of $1 million (both are prerequisites)? Equally important is that data reflect that a bounty is not the primary motivation of most whistleblowers. The National Whistleblower Center has reported that most whistleblowers tried to raise their issues internally first but to no avail.

A second major limitation is the inability of the whistleblower law to adequately protect whistleblowers from retaliation. The Equal Employment Opportunities Commission reports that retaliation claims are at an all time high, having doubled over the past decade, and account for more claims than age, race or even gender. While good enforcement of a company's anti-retaliation policies seeks to protect employees from "adverse employment action" by or on behalf of the company, it can do little to eliminate or prevent peer retaliation or "under-the-radar" retaliation by supervisors. And yet these other types of retaliation often exist.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Moreover, efforts to encourage reporting run counter to widespread cultural conditioning and the common perception that most whistleblowers suffer adverse consequences from their reporting. If you have any doubts about these assertions, I encourage you to review an article in the May 13, 2010 edition of *The New England Journal of Medicine,* which reported conclusions from a study of *successful* FCA plaintiffs in the pharmaceutical industry, finding, among other things, that 20 of the 22 industry insiders were no longer employed in that industry.

Encourage Internal Reporting

It is in the best interests of corporations — and consistent with the goals of regulators — to encourage internal reporting and to protect employees who do come forward. But the question that becomes obvious from the above analysis is, how can companies help their employees report misconduct *so that they do not feel compelled to become a whistleblower*? It is clear that something more than good whistleblower protection policies are needed, and hotlines or help lines are not the answer. While they can also very helpful, they are rarely used and even more rarely used for the type of fraud and abuse issues that led to their creation.

What is needed is a confidential place where employees can go for information or guidance *before* they go to a formal reporting channel. Such a resource should be knowledgeable about both the internal culture of the organization and what its internal reporting processes entail.

An organizational ombudsman is just such a resource. It is a person or office — working under a charter that assures independence, neutrality, informality, and confidentiality — with whom an employee may speak confidentially, informally and off-the-record about work-related concerns or questions. Establishing an ombudsman program is a way that companies can address employees' fear of retaliation while at the same time providing a way for employees to obtain guidance about both reporting misconduct and resolving other types of workplace conflict.

While not a reporting channel themselves, organizational ombudsmen complement formal reporting channels by providing information and guidance to employees who may be reluctant to come forward through a formal channel. They also can assist employees who want to surface an issue but who do *not* want to be the whistleblower, even with the potential for reward offered by whistleblower laws such as Dodd-Frank.

There is a need for the type of confidential and off-the-record guidance offered by an organizational ombudsman because at the time an employee is considering whether to make a report, the employee may not even be sure that he or she is correct. Likewise, an employee has no assurance that a report will later qualify for the bounties provided by Dodd-Frank or the FCA.

Building an effective corporate governance system along with a culture of integrity must have more to it than merely a check-the-box approach. A closer examination reveals that it must recognize that if a company wants employees to report misconduct internally, it must find multiple ways to assist them to make this possible. For some employees, a confidential channel where they can first get some guidance is essential. Since the promise of a whistleblower bounty is uncertain at best and the fear of retaliation is so strong and pervasive, an important component of a good system should include such a resource. ■

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The Duty to Preserve: When is it Triggered?

Unequivocal notice of impending litigation one of several standards

By DENA M. CASTRICONE

In recent years, the questions of how and when to preserve information in connection with litigation has become a major focus of both in-house and outside counsel as a result of harsh sanctions courts have imposed for the failure to comply with a duty to preserve.

Disputes over the preservation of evidence most frequently surface when a party moves for sanctions based on claims of spoliation of evidence. Typically, these cases address a party's preservation efforts after the duty to preserve arises. As many courts have concluded, once the duty to preserve is triggered, a party must suspend its routine document destruction and make efforts to preserve information through a litigation hold that is proportional to the facts triggering the duty.

This article addresses the less frequently litigated question of when the duty to preserve information is triggered and focuses on federal court decisions. The highly fact-intensive inquiry prevents the creation of a bright-line test. However, as the courts begin to more regularly weigh in on the issue under a variety of factual scenarios, we can identify some guideposts that will provide a framework for the analysis.

The duty to preserve arises from the common law duty to avoid the destruction of evidence. Most courts have concluded that the duty to preserve attaches once litigation is reasonably anticipated. One noteworthy exception is in the 10th Circuit, where the standard is reasonable anticipation of "imminent" litigation — a much narrower standard. The more widely-applied standard of "reasonably anticipated litigation" is more difficult to analyze because of its breadth.

Reasonable Anticipation

Reasonableness and good faith are touchstones in analyzing whether the duty to preserve information has been triggered. Similar to other reasonableness standards in the law, the "reasonable anticipation of litigation" standard is based on foreseeability.

Foreseeability in the duty to preserve context is an objective standard that asks if a reasonable party in the same situation would have foreseen litigation, not whether the party actually foresaw litigation. The flexible, fact-drive standard permits courts to exercise the discretion necessary to confront the varied factual situations inherent in the inquiry. Its flexibility also creates uncertainty.

Through case law we know that the mere existence of a dispute between parties or the occurrence of an accident does not automatically amount to reasonable anticipation of litigation. On the other hand, a letter specifically threatening suit most likely does create reasonable anticipation of litigation. The reasonable anticipation of litigation inquiry generally surfaces in three contexts: notice, awareness of conduct likely to lead to litigation or the intention to file suit.

Unequivocal Notice

Courts uniformly have held that the duty to preserve is triggered upon unequivocal notice of impending litigation. Unequivocal notice includes a letter explicitly threatening litigation. At the other end of the spectrum, the "mere possibility of litigation" typically has not been found to be enough to trigger a duty to preserve information. The area between unequivocal notice of impending litigation and the mere possibility of litigation is vast and is cloaked in varying shades of gray, but a number of recent decisions will help with the analysis.

Generally, written notice of a potential claim or lawsuit will trigger the duty. A letter threatening litigation need not specifically identify the likely plaintiff or even explicitly state that a lawsuit will be initiated – a statement warning of "significant potential exposure" is sufficient. This includes a cease and desist letter alleging copyright infringement. It also includes a written demand for the preservation of certain information. Note, however, that even if the duty to preserve is triggered, reasonableness governs the scope of that duty, not the demand.

Letters must contain more than generalized complaints to trigger the duty to preserve. For example, a written complaint about mistreatment, mismanagement or unprofessionalism is not enough to put a party on notice of potential litigation. Such complaints are more akin to "the mere possibility of litigation" than "unequivocal notice." A letter must do more than simply identify a dispute, especially if it expresses an invitation for resolution without litigation. In contrast, an indication that the author consulted attorneys and could be "forced to litigate" is more likely to be considered notice that litigation is reasonably foreseeable.

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The threat of litigation need not be in writing to trigger the duty. Verbal complaints can also be sufficient to trigger the duty to preserve. For example, an employee's report of a racially charged incident that allegedly occurred near a surveillance camera has been found to obligate the employer to preserve the surveillance video for that particular date and time. Similarly, an internal audit ordered as a result of concern over the validity of employees' claims of management tampering with sales records and impacting commissions was found to be sufficient to establish that litigation was reasonably foreseeable. As a result, internal investigations may be sufficient to trigger the duty, and preservation measures should be considered as part of the investigation.

Notice of potential claims, whether written or verbal, requires the recipient to consider several factors: is the notice merely identifying a dispute; does it offer avenues for resolution outside of litigation; does the notice directly threaten litigation; or does it strongly imply litigation with words like "significant potential exposure"? In considering these factors, if the possibility of litigation is apparent, then the duty to preserve has likely been triggered.

Awareness Of Conduct

Because the reasonable anticipation of litigation standard asks whether a reasonable party in the same factual scenario would have reasonably foreseen litigation, there is no requirement that the other side provide notice. Evidence that a party was aware that litigation was likely can trigger the duty to preserve. The relationship between the parties is an important factor in this analysis. In general, when parties have a business relationship that is mutually beneficial and that ultimately turns sour, sparking a lawsuit, litigation will be less foreseeable than would litigation resulting from a relationship that is not mutually beneficial or is naturally adversarial.

Awareness of a potential lawsuit may be enough to trigger the duty to preserve. That awareness can be evidenced by an expression of concern over potential litigation, even long before the suit was filed. In addition, an internal meeting showing that the party is aware of the issue and the fact that litigation is likely to ensue can also cause the duty to preserve to attach. A general concern over litigation, however, will not trigger a duty to preserve evidence. Moreover, a general apprehension of lawsuits relating to a particular product, without more, does not create a duty to preserve all documents related to that product.

Intention To File Suit

While the duty to preserve analysis often focuses on the defendant, plaintiffs also have a duty to preserve relevant information before initiating the litigation. Generally speaking, a plaintiff can more readily foresee litigation as the party initiating the lawsuit. As a result, the duty to preserve for plaintiffs arises before commencement of an action. The duty for a plaintiff attaches once it believes it may file suit.

A plaintiff's intent to bring suit can be evidenced by attempts to gather information for a lawsuit even before preparing a complaint or hiring a lawyer. Intention can also be evidenced by the internal development of a strategy to bring a patent infringement action. Notably, "litigation" includes the initiation of a charge of discrimination at the agency level; therefore a plaintiff in a discrimination suit cannot discard relevant materials such as a journal after filing a charge at the agency but before initiating a lawsuit. A plaintiff's failure to comply with its duty can result is serious sanctions.

Conclusion

When analyzing a factual scenario to determine whether the duty to preserve has attached, it is important to remember that reasonableness will be the centerpiece of the court's fact-intensive analysis. Also, there is a high threshold to overturn any trial court decision on this issue because a clearly erroneous standard of review will apply to the factual determinations and an abuse of discretion standard will apply to the propriety of any remedy or sanctions ordered. Consequently, it may be best to err on the side of caution when struggling with whether a duty to preserve has been triggered.

As a final note, once triggered, the duty to preserve does not continue ad infinitum. It ends with the expiration of the applicable statute of limitations. Further, the duty can be extinguished after providing an opposing party an adequate and meaningful opportunity to inspect the evidence. ■

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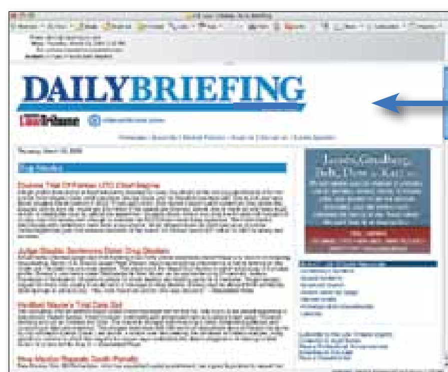

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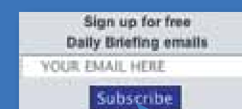

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Deadline Approaches For Retirement Plan Disclosures

Employers must notify participants about fees, investment information

By REX IACURCI

The deadline is fast approaching for plan administrators to comply with U.S. Department of Labor (DOL) final regulations regarding new disclosures to plan participants. The regulations, known as the "Participant Disclosure Regulations," govern retirement plans with participant-directed investments, such as most 401(k) and 403(b) plans.

The initial deadline — the later of May 31, 2012 or 60 days after the first day of the first plan year beginning on or after Nov. 1, 2011 — requires disclosure of detailed plan and investment-related information to all eligible employees and plan participants, beneficiaries and alternate payees ("participants"). The date, which is 45 days after the plan year quarter in which the initial plan disclosures are due (Aug. 14, 2012 for calendar year plans), marks the regulatory deadline for the disclosure of specific administrative and individual fee and expense information.

Meeting these deadlines will require advance planning, especially if the plan administrator intends to deliver the disclosures electronically. Much of the work to produce and deliver the disclosures will likely fall upon the plan's third-party administrator or record keeper. However, the responsibility for compliance remains with the plan administrator. This might be the employer, or a designated plan committee or individual.

The force of the regulations, codified at 29 CFR 2550.404a-5, is required disclosure of three different categories of plan- and investment-related information: (1) general plan identification and operational information; (2) information on plan-level and individual participant, account-related, administrative fees and expenses, and (3) investment-related information. The new fee and expense disclosures (category 2) must include the dollar amount of fees and expenses actually charged to a participant's account (e.g., accounting fees, record-keeping fees, sales charges or front-, or back-end, load fees, and loan charges), with a description of each item.

Additional disclosures include payment of any plan administrative expenses through a revenue-sharing or similar arrangement. The investment-related information (category 3) must identify each designated plan investment option (e.g., mutual fund) and, for investment options with variable returns, must provide "total return" investment performance and benchmark data in tabular format for their one-, five- and 10-year, or shorter "since inception," performance periods, updated annually. While much of the information reportable within the first two categories may be included within participant quarterly pension benefit statements or the summary plan description (SPD), the last category may require a new stand-alone document.

Following the initial deadlines, the plan-related information and investment-related information must be provided at or before a participant's first opportunity to direct investment in the plan, and annually thereafter. A description of changes to any plan-related information must be furnished 30 to 90 days in advance of the effective date. The fee and expense information must be provided quarterly.

Rex Iacurci

Electronic Delivery

The Labor Department recently provided guidance on how the new participant disclosures can be delivered electronically. Plan administrators are permitted to deliver the general plan and fee and expense information in the manner set forth in DOL Field Assistance Bulletin 2006-03 (concerning electronic delivery of quarterly pension benefit information). In that guidance, DOL authorized electronic delivery either: (1) in accordance with tax rules for electronic delivery of retirement plan notices (Treas. Reg. §1.401(a)-21), or (2) through a secure web site that provides continuous access to that information, with notice and opportunity to request a paper copy. Participant disclosures of investment-related information are not permitted to be delivered in this manner but may be delivered electronically in accordance with either the existing DOL safe harbor method (Reg.§2520.104b-1(c)), or by using a new interim method.

Generally, the safe harbor method allows for electronic delivery to participants who can effectively access documents electronically at their work location where computer use is integral to their job duties, and to other participants, beneficiaries, and alternate payees who consent to receive electronic notifications in accordance with prescribed notice and consent procedures. However, many plan administrators have found the safe harbor method burdensome and of limited use. They may find the interim method offers a more viable alternative to mailing paper versions of the required disclosures.

Generally, to comply with the interim electronic delivery method, participants must affirmatively elect to receive electronic disclosures and voluntarily provide an e-mail address for purposes of receiving the disclosure materials. Further, a plan administrator must provide participants with an initial and annual notice that (1) explains the content of the electronic disclosures; (2) requests the participant's election to receive the disclosure electronically, including a request for the participant's e-mail address to which the disclosures are to be directed; and (3) sets forth procedures by which the participant may opt-out, change the e-mail address or obtain a paper version of the disclosure materials. If the participant agrees, electronic disclosure can follow. This new interim guidance is limited to the participant fee disclosure and cannot be relied on for any other purpose. Plan administrators must take steps to ensure the electronic delivery system results in actual receipt and protects the confidentiality of personal information.

Under a special transition rule, plans may rely on a participant's prior consent to electronic delivery and provision of his or her e-mail address. To satisfy the transition rule, a notice similar to that described above must be provided to these participants 30 to 90 days before the required disclosures are actually delivered. This rule permits electronic delivery unless the participant opts-out. Evidence of the participant's use of the e-mail for plan-related purposes in the last 12 months may be required.

The safe harbor method allows for electronic delivery to participants who can effectively access documents electronically at their work location where computer use is integral to their job duties.

Employers and plan administrators should be working now with their plan record keepers to ensure complete and timely compliance with the Participant Disclosure Regulations and, if applicable, the DOL guidance concerning electronic delivery of the participant disclosures. ■

Rex J. Iacurci is an attorney in the Employee Benefits Section at Pullman & Comley LLC. Circular 230 notice: IRS rules of practice require us to inform you that any advice in this article concerning a federal tax issue is not intended or written by us to be used, and cannot be used by any taxpayer for the purpose of avoiding any tax penalties imposed by the Internal Revenue Service, or for promoting, marketing or recommending any tax-related matters addressed herein.

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