

SHOWERS, BUT NOT THE DELUGE THAT WAS FORECAST

When counting the tips received so far under the Securities and Exchange Commission's (SEC) new whistleblower bounty program, there is obviously more to be concerned about than a simple numbers game. But it appears that far fewer snitches have come forward than expected despite the new rich rewards to entice tipsters under Dodd-Frank. According to data the SEC provided under a Freedom of Information Act request, the corporate watchdog has received a "mere" 168 tips relating to corporate fraud in the 6 months of the program's existence.¹

This means that the SEC is receiving less than one tip a day – compared with the "hundreds of thousands of tips [the Commission received] each year from various sources" pre-Dodd-Frank.² But another way of viewing this is to consider the comment from the chief of the SEC's Office of Market Intelligence, that the number of "high-value" tips on fraud and other violations of securities law numbered about two dozen a year before the [new] law but since July, the SEC has sometimes received one or two a day.³

The "disappointing" number of new tips might be due to the fact that the SEC's final rules for the whistleblower bounty program have yet to be released (they are currently scheduled for release in April). A key point that will presumably be addressed in the new rules is whether the SEC will accede to the request that employee tipsters be required to first go through a company's own internal whistleblower procedures prior to filing an official complaint. This issue, as well as a number of other good suggestions filed with the SEC during its comment period on the new rules, could significantly improve implementation of the new whistleblower program.

We first discussed this issue in our **September 2010 Alert** on the Wall Street Reform and Consumer Protection Act [Dodd-Frank].

LOSING "FACE"

On a topic that we first addressed in our **December 2010 Newsletter**, in February, the National Labor Relations Board (NLRB) settled a case it had brought against an employer for



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EXECUTIVE RISKS AND THE WALL STREET REFORM AND CONSUMER PROTECTION ACT

The new Financial Reform Act will impact financial services firms in a multitude of ways, which are being addressed by our Financial Services Practice in a series of timely and topical Alerts, but there are three key areas where all public companies, including those who are not in the financial services sector, are likely to feel the changes in the area of corporate governance – something near and dear to the hearts of those interested in Executive Risk. This FR Alert addresses those three areas.

NO LONGER WHISTLING IN THE WIND

Under the new rules, anyone who alerts the Securities and Exchange Commission (SEC) to a violation of the securities laws resulting in SEC penalties of \$1 million or more can now collect 10% to 30% of the total penalty imposed. With penalties in some of these cases now in the hundreds of millions of dollars, the potential for an enormous financial windfall is now real.¹ The fact that the whistleblower themselves could have been involved in the underlying conduct and are still eligible for the new award – unless convicted of a criminal violation related to their involvement – both concerns and outrages many.

Within 48 hours of the passage of the Financial Reform Act, a law firm issued a press release announcing that it was the first firm to file a whistleblower complaint with the SEC under the new rules. That same day, another prominent plaintiff law firm issued a press release announcing that it was expanding its legal practice to include the representation of securities fraud whistleblowers.²

The Act also extends Sarbanes-Oxley's protection from retaliation for whistleblowing by employees of public companies, their subsidiaries and affiliates, to cover employees at foreign subsidiaries and affiliates.³ Many law firms are warning their clients to be prepared for an increase in bounty hunting. Much of this concern, in



date, has been speculation about what this could mean to the vestiges of Foreign Corrupt Practices Act (FCPA) enforcement, where employees at a company's foreign subsidiaries are the most likely to be aware of illegal conduct, and now are financially incentivized to share this information with the SEC.

As a result of this change, many companies both domestically and internationally, are re-evaluating their internal whistleblowing policies and procedures as well as considering the potential utility of enhancing their FCPA avoidance training.

READ MY LIPS: SAY ON PAY REGARDING EXECUTIVE COMPENSATION

At the first shareholders' meeting occurring after mid-January 2011, public company shareholders will get to vote on a resolution

In this issue we revisit past topics with updates on several critical Executive Risks issues:

- New whistleblower activity and the Securities & Exchange Commission
- New media and the workplace
- A new Employment Practices case of interest
- The continued globalization of Directors & Officers (D&O) exposures, and now, D&O insurance

discharging an employee who posted negative comments about her supervisor on her Facebook page.⁴ In its complaint, the NLRB alleged that the company “maintained overly-broad rules in its employee handbook regarding blogging, Internet posting policy and communications between employees” that contained unlawful provisions prohibiting employees from posting disparaging remarks about the company on social networking sites and further, that enforcement of this posting policy resulted in an illegal termination when it fired the employee.

Under the settlement agreement, the employer agreed to revise its allegedly “overly-broad” policy so that it no longer “improperly restrict[s] employees from discussing their wages, hours and working conditions with co-workers and others while not at work” and agreed that it would not discipline or discharge employees for engaging in this type of discussion. The settlement of this case is significant for employers, many of whom are re-thinking their internal policies relating to employees’ use of Facebook and other social media sites whether on or off the job. This is likely to be true whether or not the employer is governed by the National Labor Relations Act (and hence the NLRB).

As a result of these types of concerns, a number of Employment Practices Liability (EPL) insurers have introduced coverage clarifications providing affirmative coverage for employment-related litigation involving the use of new media in the workplace.⁵

EXPANDING BORDERS

Until now, for a successful employment action alleging harassment or discrimination in the workplace, one generally had to be a member of a protected class or engage in protected activities (like whistleblowing) as defined by the relevant federal, state or local statutes. A more expansive holding by a unanimous U.S. Supreme Court recently allowed a plaintiff to prevail who was not himself in either a protected category (like age, race or gender) or engaged in protected activities. Rather, he was engaged to someone who fell into one of these groups.⁶

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Prior to this suit being filed, the plaintiff’s fiancée had filed a gender discrimination charge with the Equal Employment Opportunity Commission (EEOC) against their joint employer. Their employer then fired him. He then filed his own charge under Title VII of the Civil Rights Act, claiming that their employer had wrongfully terminated him in retaliation for her complaint.

Prior to this matter reaching the Supreme Court, the employer had won on the District Court level (winning summary judgment) on the ground that such retaliation claims aren’t permitted under Title VII, which prohibits discrimination against an employee. The employer won again on appeal, where the Sixth Circuit reasoned that the plaintiff was not entitled to sue for retaliation because he had not engaged in any activity protected by the statute.

It was therefore fairly stunning to see this turned on its head by the finding that Title VII, does, in fact, grant the claimant a cause of action; the U.S. Supreme Court found that:

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FACE TO FACE WITH THE NEW MEDIA IN TODAY'S WORKPLACE

Facebook has become a major component in the lives of many of us, with over 500 million members, more than half of whom use it every day. Some of these users are bound to be your employees and that brings us to the workplace, where a recent legal case over an employee who was fired after posting disparaging remarks about the boss on Facebook is garnering a lot of attention.

In what seems to be a first of its kind legal action by federal authorities, the National Labor Relations Board (NLRB) has alleged that the employer illegally terminated the employee. This complaint could set a precedent for employees as many workers use social networking sites to share details about their jobs. It's the same as talking at the water cooler, according to the NLRB's acting general counsel. The point is that employees have protection under the law to talk to each other about conditions at work.

Federal law has long protected employees against reprisal for talking to co-workers on their own time about their jobs and working conditions, including remarks that may be critical of managers. But this may be at odds with the desire of some employers to police the new media in order to protect their own interests.

SURVEY ON DATA LEAKS VIA SOCIAL MEDIA: ARE FACEBOOK, YOUTUBE AND TWITTER RISKS? CAN THEY GET YOU FIRED?

■ 24% of U.S. companies have disciplined an employee for violating blog or message-board policies in the past 12 months (up from 17%), while 14% terminated an employee for such a violation (up from 9%).

In this month's publication, we are highlighting:

- Potential exposures from new forms of media
- Potential new rules and real additional (new) enforcement activities

If the facts Thompson alleges are true, his firing...constituted unlawful retaliation. Title VII's anti-retaliation provision must be construed to cover a broad range of employer conduct... It prohibits any employer action that "well might have "dissuaded a reasonable worker from making or supporting a [discrimination] charge," "... A reasonable worker obviously might be dissuaded from engaging in protected activity if she knew that her fiancé would be fired.

The EEOC recently announced that it had received just shy of 100,000 discrimination charges during its latest fiscal year, the most ever filed against private sector employers.⁷ The Court's ruling in this case signals that *virtually anyone* can fall into one or more protected classes for purposes of the federal anti-discrimination laws. This makes it more important than ever that employers implement and follow proper procedures and thorough investigations before taking what could be adverse employment actions.

THINK GLOBALLY, ACT LOCALLY

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FAQ ON GLOBAL D&O PROGRAMS, PART II

Global opportunities are increasingly important to many companies looking to grow and expand their businesses. To do this strategically means understanding both the new exposures in these markets and how best to transfer these risks - for your executives and the firm itself.

As part of our series of Alerts examining the optimal structure for Directors & Officers Liability insurance in a global environment, we offer our latest set of Frequently Asked Questions below.

Question: My local subsidiary or joint venture (a private company) do I still need local D&O coverage?

Answer: Please note that almost all of our local D&O placements are for private companies, as the local country subsidiaries are typically wholly or majority-owned subsidiaries of their parents - which means that even if the parent organization is public, the local entities are mostly private companies.

Whether the parent company is public or private generally has little impact on local country exposures. Questions (as a public company is dual listed in the local country, or float/delisted securities, but this is the exception rather than the rule.) So the answer is, "Yes, private companies have local D&O exposures as well."

Question: What if we only have employees with no local directors or officers, do we still have any local D&O risk?

Answer: Generally, from a D&O coverage standpoint, we start to analyze foreign exposures from the locations in which one has formal local operations, which usually require a local corporate partnership, joint venture or the like, organized under local law. If such exists, even if there are no individuals on the ground who are formally "officers," there are usually what we refer to as "local equivalents." These are individuals who may be called "local country managers" or "project managers" with the right to speak on behalf of the organization (partners contracts, hire/employ, etc.). So even when there are no official local officers, directors, partners or trustees on the ground, often there are "local equivalents" that might be targets of local legal actions.

Question: What if we are not incorporated or registered in a country?

Answer: As mentioned above, when considering local D&O exposures, we start with locations where the company has a local legal entity (even if this is a joint venture with a local partner organization). Where there is or was no local legal entity, we generally do not place local D&O coverage. If there is local exposure, this may be where an appropriately crafted contract of indemnification can best supplement a global D&O program.

Increasingly, companies are looking to extend their reach into new markets, which often means expanding internationally – a topic that we have repeatedly addressed over the years and most recently in our *International Alert* for **February 2011**, on how to design a D&O program so that it can respond locally to global exposures. As part of this discussion, a statistic we are frequently asked for is how many or what percentages of companies with foreign exposures purchase local D&O policies. Until now, there was no reliable industry metric available.

Fortunately, the latest Towers Watson D&O Survey of Insurance Purchasing Trends⁸ sought and obtained answers to this question. Fifty-three percent of survey respondents (excluding charities and

nonprofits) said their companies have international operations. Of these firms, 47% purchased a local D&O policy in a foreign jurisdiction.⁹ This is a **marked** increase over their 2008 survey results, when only 2% of respondents with international operations indicated that they purchased a local policy in a foreign jurisdiction! They also indicated that the larger the company, the more likely it was to buy local D&O coverage; with 68% of companies with \$10 billion or more in assets indicating that they bought local cover, while only 23% of companies with less than \$250 million in assets indicated that they did so.¹⁰

We expect these numbers to increase as companies become more aware of local insurance requirements as well as potential local exposures for their executives.

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¹ The count is from July 22, 2010, when the program was launched, through Feb. 2, 2011: **“SEC whistleblower call draws few tipsters,”** February 23, 2011.

² From **testimony by Linda Chatman Thomsen**, the Director, Division Of Enforcement U.S. Securities and Exchange Commission before the U.S. Senate Committee on Banking, Housing and Urban Affairs, January 27, 2009.

³ From the SEC Speaks event sponsored by the Practicing Law Institute as reported in **“The SEC Gets More Whistleblower Tips,”** February 5, 2011.

⁴ See the press release from the NLRB dated February 2, 2011, entitled **“Settlement reached in case involving discharge for Facebook comments.”**

⁵ The specific case that we are discussing is unlikely to be covered by most commercially available EPL insurance, as most, if not all such policies include wording excluding actions under the National Labor Relations Act.

⁶ *Thompson v. North American Stainless, LP*, No. 09–291. 567 F. 3d 804, reversed and remanded.

⁷ **Charges Pending Data from EEOC 2010.**

⁸ The pool of 496 respondents to the **2010 Survey** was weighted toward large institutions and entities. www.towerswatson.com/united-states/research/3790#.

⁹ Figure 8, page 8 of the Towers Watson Directors and Officers Liability: 2010 Survey of Insurance Purchasing Trends.

¹⁰ Figure 9, page 9 of the Towers Watson Survey.