Securities Litigation ADVISORY

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SEC Approves Final Rule for Whistleblower Provisions of Dodd-Frank Act[1]

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which was signed into law on July 21, 2010, included a provision establishing a program to pay an award to eligible whistleblowers who provide the Securities and Exchange Commission (SEC) and/or other government authorities with original information that leads to successful enforcement of federal securities law violations that result in monetary sanctions in excess of $1 million. Pub. L. No. 111-203, § 922.

On November 3, 2010, the SEC issued its Proposed Rule for implementing the whistleblower provisions. Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, Exchange Act Release No. 34-63237, File No. S7-33-10 (Nov. 3. 2010) (to be codified at 17 CFR pts. 240 and 249). The Proposed Rule solicited comments through December 17, 2010. *Id*.

On May 25, 2011, by a 3 to 2 vote, the SEC adopted the Final Rule for implementing the Dodd-Frank Act whistleblower provisions. Exchange Act Release No. 34-64545, File No. S7-33-10 (May 25, 2011) (to be codified at 17 CFR pts. 240 and 249). This new whistleblower program aims to incentivize individuals to report violations early and directly to the SEC by providing rewards and protection from employer retaliation.

The Final Rule adopts much of the Proposed Rule, with several key changes regarding internal compliance and exclusions for award eligibility. The SEC received 240 comment letters and over 1,300 form letters on the Proposed Rule. The Final Rule discusses many of the comments considered by the SEC in modifying the Proposed Rule and the reasoning behind each change. Below is a summary of some of the relevant provisions of the Final Rule and the statute.

- **Whistleblower:** A whistleblower is any individual who provides the SEC with original information related to a possible violation of federal securities law that "has occurred, is ongoing, or is about to occur." SEC Final Rule, 17 CFR § 240.21F-2(a).
- **Award:** Where all the conditions of the Final Rule are met, a whistleblower is entitled to between 10-30 percent of the total monetary sanctions of more than $1 million collected in successful SEC or other enforcement actions. The Final Rule clarifies that the size of the award lies in the discretion of the SEC. SEC Final Rule, 17 CFR § 240.21F-5. In making an award determination, there are several required criteria that the SEC must consider that will influence whether to increase or decrease the whistleblower's percentage.

[1] This advisory updates Alston & Bird LLP's November 30, 2010, advisory entitled "**SEC Issues Proposed Rule for Whistleblower Provisions of Dodd-Frank Act**."

- The criteria that will ***increase*** a whistleblower's percentage award include the significance of the information provided by the whistleblower, law enforcement interest in the action, the degree of assistance provided by the whistleblower and whether the whistleblower participated in internal compliance procedures prior to contacting the SEC. *Id*. at § 240.21F-6. This last factor is one of the most significant changes in the Final Rule. After much debate about whether the SEC should require a whistleblower to first participate in the company's internal compliance process, the Final Rule includes no such requirement. Instead, as noted above, the SEC made the whistleblower's participation in the company's internal compliance process a factor that could increase their award percentage.
- The criteria that will ***decrease*** a whistleblower's percentage include culpability, unreasonable delay and interference with internal compliance procedures. Note that culpability does not exclude a whistleblower from receiving an award, but is instead just one factor that the SEC will consider in determining the appropriate percentage.

- **Anonymity of Whistleblower:** Whistleblowers are entitled to remain anonymous. They must, however, be represented by an attorney and disclose their identity before collecting any award. SEC Final Rule, 17 CFR § 240.21F-7(b). The SEC notes in the Summary of the Final Rule that it has declined to include a rule on attorneys' fees, and instead leaves that determination up to state bar authorities and private agreements.
- **Exclusions for Award Eligibility:** Individuals with a pre-existing legal or contractual duty to report securities law violations to the SEC or other government authorities are ineligible to collect the award. SEC Final Rule, 17 CFR § 240.21F-4(a)(3) & (b)(4). In a departure from the Proposed Rule, however, the Final Rule provides that the SEC will not exclude individuals with a duty to report to their employer or a third party from the possibility of collecting whistleblower awards. The SEC explains that "employers should not be able to preclude their employees from whistleblower eligibility by generally requiring all employees to enter into agreements that they will report evidence of securities violations directly to the [SEC]." In sum, individuals and information ineligible for the award include:
  - Individuals under a "**pre-existing legal or contractual duty** to report securities violations" to the SEC or other enumerated government authorities. SEC Final Rule, 17 CFR § 240.21F-4(a)(3) [emphasis added].
  - Information based on a communication that was subject to the **attorney-client privilege**. This exclusion applies to attorneys and non-attorneys in possession of the privileged information. SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(i) [emphasis added].
  - Information gained as a result of **legal representation**. This exclusion applies to all attorneys, "whether specifically retained or working in-house." SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(ii) [emphasis added].
  - An entity's **officers, directors, trustees or partners** "if they obtained the information because another person informed them of allegations of misconduct, or they learned the information in connection with the entity's processes for identifying, reporting, and addressing potential non-compliance with law." SEC Final Rule 17 CFR § 240.21F-4(b)(4)(iii)(A) [emphasis added]. If, however, an officer discovers information indicating that "other members of senior management are engaged in securities violations," they are not excluded from reporting to the SEC and becoming eligible for the whistleblower award. *Id*.

- Compliance Officers or "employees whose principal duties involve compliance or internal audit responsibilities, as well as employees of outside firms that are retained to perform compliance or internal audit work for an entity." SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(iii)(B).
- Employees or other persons retained to conduct internal investigations or inquiries into possible violations. SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(iii)(C).
- Independent public accountants performing duties required under the securities laws if the information relates to a violation by an engagement client or the client's directors, officers or other employees. SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(iii)(D).
- Information gathered by means or in a manner that is determined by a domestic court to violate applicable federal or state criminal law. SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(iv). The exclusion does not cover information obtained in violation of civil or domestic foreign law, or judicial or administrative protective orders. *Id*.
- ***However***, if certain circumstances are present, an excluded individual in any of the above categories may be eligible to receive a whistleblower reward using otherwise excluded information:
  - If the person has a **reasonable basis** to believe that the disclosure is **necessary** to prevent the relevant entity from committing **substantial harm**. SEC Final Rule, 17 CFR § 240.21F-4(b)(4)(v).
  - If the person has a **reasonable basis** to believe that the entity is engaging in **bad faith** conduct that will impede an investigation (*e.g.*, shredding documents, influencing witnesses). *Id*.
  - If 120 days have elapsed since the whistleblower reported the information internally, an officer, director or compliance officer may then report the information to the SEC and become eligible to receive a whistleblower award. *Id.*

- **Eligibility for Award:** Employees may be deemed to provide "original information" and, therefore, qualify as whistleblowers if, after reporting the information internally, the employee provides the same information to the SEC within 120 days. SEC Final Rule, 17 CFR § 240.21F-4(b)(7). While the SEC extended this "look-back period" from 90 days to 120 days, it again emphasized that it is not requiring whistleblowers to participate in companies' internal compliance procedures.
- **Credit for Employer's Information:** In addition to extending the time period, the Final Rule includes an important incentive for individuals to report internally. A whistleblower who internally reports information that leads to successful enforcement under the Final Rule's criteria before or at the same time as he or she reports that information to the SEC will "receive full credit for the information [the organization] reports to [the SEC] as if the whistleblower had provided the information to [the SEC]." SEC Final Rule, 17 CFR § 240.21F-4(c)(3).
- **Whistleblower Protection:** Section 922 of the Dodd-Frank Act protects whistleblowers against retaliation from employers. Pub. L. No. 111-203, § 922 Sec. 21F(h). "No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower" providing

information to the SEC, initiating or participating in an action, or in making disclosures to the SEC. Pub. L. No. 111-203, § 922 Sec. 21F(h)(1)(A). This protection applies (i) regardless of whether the whistleblower procedurally qualifies for an award and (ii) even if it is ultimately determined that the conduct identified by the whistleblower does not constitute a violation of the securities laws. SEC Final Rule, 17 CFR § 240.21F-2(b)(1). However, the whistleblower must have a "reasonable belief that the information he is providing relates to a possible securities law violation . . . that has occurred, is ongoing, or is about to occur." *Id*.

- **Statute of Limitations for Actions Against Retaliatory Employers:** A whistleblower may bring an action against an employer either within six years after the date on which the retaliatory action occurred or within three years after the date when the whistleblower becomes aware or should have become aware of the retaliatory action, but not later than 10 years after the date of the retaliatory action. Pub. L. No. 111-203, § 922 Sec. 21F(h)(1)(B).
- **Expanded Jurisdiction:** A whistleblower can bring a cause of action for retaliation in U.S. District Court. Pub. L. No. 111-203, § 922 Sec. 21F(h)(1)(B)(i). Previously, whistleblowers were required to file retaliation claims at the administrative level.
- **Remedies of Aggrieved Whistleblower:** A whistleblower who is successful against an employer on a retaliation claim is eligible for reinstatement with the same seniority he or she otherwise would have had and can recover double back pay, litigation costs and reasonable attorneys' fees. Pub. L. No. 111-203, § 922 Sec. 21F(h)(1)(C).

What to Do Now:

- Reexamine and reevaluate your internal compliance procedures and policies to ensure consistency with the new rules and to encourage compliance.
- Review and reevaluate your record-keeping procedures and policies for capturing, evaluating, investigating and resolving tips and complaints. Create a response plan that enables the company to stay on top of, and hopefully ahead of, any related investigation.
- Consider expanding your employee hotline to consultants, customers and suppliers and other business partners.
- Regularly train and communicate with employees about internal compliance procedures. Be clear that the company does not restrict their ability to go directly to the SEC. Make sure they understand there will be no retaliation and that utilizing the company's procedures does not interfere with a whistleblower's ability to receive a bounty and may, in fact, increase any ultimate award.

The Final Rule will be effective 60 days after it is submitted to Congress or published in the *Federal Register*.

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