

Akerman Practice Update

CORPORATE

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SEC Adopts Final Whistleblower Bounty Program Rules

Jonathan Awner
jonathan.awner@akerman.com

Laura Holm
laura.holm@akerman.com

On May 25, 2011, the Securities and Exchange Commission (“SEC”), by a divided vote of 3-2, adopted the final rules (“Rules”) implementing the whistleblower program mandated by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The Dodd-Frank Act, enacted on July 21, 2010, added new Section 21F to the Securities Exchange Act of 1934, entitled “Securities Whistleblower Incentives and Protections.” Section 21F directs the SEC to pay awards, subject to certain limitations and conditions, to whistleblowers who voluntarily provide the SEC with original information about a violation of the federal securities laws that leads to the successful enforcement of an action brought by the SEC that results in monetary sanctions exceeding \$1 million. Eligible whistleblowers can earn an award between 10% and 30% of the total monetary sanctions collected in the SEC action or a related action.

On November 3, 2010, the SEC issued proposed rules to define and implement the statutory language of the whistleblower provisions of the Dodd-Frank Act. The SEC received over 240 comment letters and 1,300 form letters regarding the proposed rules from individuals, whistleblower advocacy groups, law firms, public companies, audit firms and other interested industry participants. By far, the most controversial issue was whether whistleblowers should (or could) be required



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to report violations internally through a company's compliance program before reporting to the SEC. Pursuant to the Sarbanes-Oxley Act, public companies have created robust internal compliance and reporting programs. Many business and legal advocacy groups, including the U.S. Chamber of Commerce, urged the SEC to adopt Rules which require whistleblowers to report information to their company first, or contemporaneously, with their report to the SEC in order to qualify for a whistleblower award. The Rules rejected this approach, though certain changes were made to incentivize employees to report information to their company, which are discussed below.

The Rules apply to publicly traded companies, registered investment advisers, investment companies and others subject to SEC regulation and anyone involved in a transaction subject to the jurisdiction of the federal securities laws and the regulations promulgated thereunder. The full text of the Rule is available at <http://www.sec.gov/rules/final/2011/34-64545.pdf>. This Practice Update describes the key aspects of the Rules and provides guidance on proactive steps companies can take in assessing their compliance programs.

Eligibility For An Award Under the Rules

To be considered for an award under the Rules, a whistleblower must (i) "voluntarily" provide the SEC, (ii) with "original information," (iii) that leads to the "successful enforcement" by the SEC of a federal court or administrative action (iv) in which the SEC obtains "monetary sanctions" totaling more than \$1 million. In addition, the whistleblower must submit original information to the SEC and make a claim for the award in accordance with the forms and procedures described in the Rules.

Eligible Whistleblowers

A whistleblower is any individual who, alone or jointly with others, provides information to the SEC relating to a possible violation of the federal securities laws, that has occurred, is on-going or that is about to occur. It must be emphasized that employees and former employees are not the only potential whistleblowers. Any individual, including a business competitor, joint venture partner, customer, supplier, consultant or other person who happens to come upon sensitive information, is a potential whistleblower. Whistleblowers are allowed to anonymously report information, provided it is done through counsel. However, a whistleblower must identify himself or herself to the SEC prior to collecting an award.

Certain categories of individual are ineligible for whistleblower awards, including: (i) individuals who are or were at the time they acquired the information they submitted to the SEC members, officers or employees of the SEC, the Department of Justice ("DOJ"), the Public Company Accounting Oversight Board ("PCAOB"), an appropriate regulatory agency, a self-regulatory organization, any law enforcement organization or a foreign government; (ii) a spouse, parent, child or sibling of person residing in the same household with a member or employee of the SEC; (iii) attorneys, including in-house counsel, who use information obtained from clients to make claims for themselves (except where such disclosure is permitted under SEC rules or state attorney conduct rules); (iv) individuals convicted of criminal violations related to the SEC action or a related action; (v) auditors in cases where a submission would be contrary to the requirements of Section 10A of the Exchange Act; (vi) individuals who acquired the information from someone who is ineligible for a whistleblower award or with the intent to evade any provision of the Rules; and (vii) individuals who knowingly and willfully make false or fraudulent statements or representations in whistleblower submissions or in other dealings with the SEC or other authorities.

The Rules do not exclude individuals who have engaged in fraud or

misconduct, even if it is the same fraud or misconduct the whistleblower is reporting, provided that the whistleblower has not been criminally convicted for such actions. However, the SEC will take those factors into account when determining the amount of the award. The Rules limit a culpable whistleblower's award by excluding any fines assessed against the whistleblower personally from his or her misconduct or against the entity whose liability is based substantially on conduct the whistleblower directed, planned or initiated.

Voluntarily Providing Information

A submission of information is deemed to have been made "voluntarily," if the whistleblower makes his or her submission of information before a request, inquiry or demand that relates to the subject matter of the submission is directed to the whistleblower or anyone representing the whistleblower (such as an attorney) (i) by the SEC, (ii) in connection with any investigation, inspection or examination by the PCAOB or any self-regulatory organization, or (iii) in connection with an investigation by Congress, any other authority of the federal government, or a state attorney general or securities regulatory authority. A submission is not voluntary if the would-be whistleblower

is required to report the information as a result of a pre-existing legal duty, a contractual duty owed to the SEC or another relevant authority, or a duty that arises out of a judicial or administrative order.

Original Information

A whistleblower must provide "original information" to be eligible for an award. Original information means information that (i) is derived from the independent knowledge or analysis of the whistleblower, (ii) not already known to the SEC from any other source, unless the whistleblower is the source of the information, (iii) not exclusively derived from allegations made in a judicial or administrative hearing, in a government report, hearing, audit or investigation, or from the news media, unless the whistleblower is the source of the information and (iv) provided to the SEC after July 21, 2010, the date of enactment of the Dodd-Frank Act. Independent knowledge does not require direct, first-hand knowledge of potential violations and can be derived from the observations, experiences or even communications with other employees, clients, vendors or non-parties.

Excluded from the definition of original information is information which is obtained by individuals, such as officers, directors, or partners with legal, compliance, audit, supervisory or governance responsibilities for

a company, if the information was communicated through the company's internal compliance mechanisms. However, this exclusion is not absolute and any of these individuals could become whistleblowers if he or she reasonably believes such disclosure is necessary (i) to prevent substantial injury to the company or investors, (ii) to stop the company from engaging in conduct that will impede an investigation, or (iii) if the company fails to self-report to the SEC within 120 days after discovering a suspected violation.

Information that Leads to a Successful Enforcement Action

The information provided by the whistleblower must lead to a "successful enforcement" action, which means the information must be (i) be sufficiently specific, credible and timely to cause the SEC to commence a new investigation, reopen a closed investigation or pursue an inquiry along a new channel of an ongoing investigation, (ii) significantly contribute to the success of an enforcement action concerning conduct already under investigation or (iii) be provided to the company's internal compliance system before or at the same time it is provided to the SEC and the company provides the whistleblower's information (and any additional information) to the SEC in a manner that satisfies clauses (i) or (ii). The final scenario represents a significant, new feature of the Rules which should enhance the

incentives for whistleblowers to report internally because they will receive credit and possibly a larger reward for any additional information which the self-reporting company provides to the SEC.

Incentivizing Internal Reporting

The Rules do not require that whistleblowers report violations internally in order to qualify for an award. However, the Rules contain three provisions which are intended to strengthen incentives for whistleblower to use the company's internal compliance program.

One, the Rules contain a provision under which a whistleblower can receive an award for reporting original information to a company's internal compliance system, if the company reports this information (and possibly additional information) to the SEC that leads to a successful SEC action. Under this provision, all the information provided by the company to the SEC will be attributed to the whistleblower, which means the whistleblower will get credit – and potentially a greater award – for any additional information generated by the company in its report to the SEC. This scenario would create an opportunity for a whistleblower to obtain an award through internal reporting where the whistleblower might not otherwise have

qualified for an award because his or her information was not sufficiently specific and credible.

Two, the Rules provide that the SEC may increase the amount of an award to a whistleblower if the whistleblower utilized the company's internal compliance system. Conversely, the SEC may decrease the amount of an award to a whistleblower if it determines that the whistleblower interfered with this system.

Third, the Rules extend the time for a whistleblower to report to the SEC after first reporting internally and still be treated as if he or she had reported to the SEC at the earlier reporting date. The “look back period” is 120 days after the whistleblower's internal report. This is a change from the initial rules, which would have only given the whistleblower 90 days to report the complaint to the SEC after having reported with the Company.

Monetary Sanctions exceeding \$1,000,000 in an SEC Action

The SEC must recover at least \$1 million in “monetary sanctions” in a federal court or administrative “action,” which is defined as a single captioned judicial or administrative proceeding. For purposes of determining whether the \$1 million threshold has been met, the Rules permit aggregation of multiple SEC cases that arise out of a common nucleus of operative facts

as a single action. These may include proceedings involving the same or similar parties, factual allegations, alleged violations of the federal securities laws or transactions or occurrences. As a practical matter, this will make bounties available in more cases. The calculation of the monetary sanctions includes penalties, civil and criminal fines, and disgorgement, in addition to interest.

If the SEC has recovered at least \$1 million in monetary sanctions in an action, the SEC can also pay awards to a whistleblower based on monetary sanctions that are collected from related actions. Payment based on a related action would occur if the related action is based upon the same original information that led to the successful enforcement of the SEC action, and the related action is brought by the Attorney General of the United States, an appropriate regulatory agency, a self-regulatory organization, or a state attorney general in a criminal case.

Determination of Awards

If all the conditions for an award are satisfied, the Rules provide that the award must be not less than 10% and not more than 30% of the monetary sanctions that are collected. The exact amount of the award will be determined by the SEC. The Rules permit the SEC to take into account specified criteria in determining the appropriate

percentage of a whistleblower award based on a highly fact-specific review of each case.

The Rules include four factors that may increase the amount of the award and three factors that could decrease the award. Upward factors include (i) the significance of the information provided, (ii) the whistleblower's assistance, (iii) law enforcement's interest in the matter and (iv) the whistleblower's participation in the company's internal compliance system. In contrast, negative factors include (i) the whistleblower's culpability, (ii) unreasonable reporting delay and (iii) the whistleblower's interference with internal compliance and reporting processes. Awards will vary based on the SEC's assessment of these factors. Whistleblowers can appeal the denial of an award directly to the United States Court of Appeals, but cannot appeal the determination of the amount of an award that conforms with the statutory range of to 10% to 30% of the monetary sanctions that are collected.

If the SEC rewards multiple whistleblowers in connection with the same action or a related action, the SEC will determine an individual percentage award for each whistleblower, but in any event the total amount awarded to all whistleblowers will fall within the statutory range of 10% to 30% of the monetary sanctions that are collected.

Anti-Retaliation Protection

In addition to the incentive provisions, the Dodd-Frank Act significantly enhances whistleblower protections. The Act prohibits employers from discharging, demoting, suspending,

threatening, harassing, or otherwise discriminating against whistleblowers who provide information to enforcement authorities. Aggrieved employee-whistleblowers are provided relief in the form of a cause of action in federal district court and potential relief in the form of reinstatement (with same seniority status), double back pay with interest and reimbursement for litigation fees. The statute of limitations can extend as long as ten years from the date of retaliation.

In addition, the Rules make it unlawful for any person to interfere with a whistleblower's efforts to communicate directly with the SEC about a possible securities law violation, including enforcing or threatening to enforce a confidentiality agreement. The Rules also state that the SEC may enforce the anti-retaliation provisions provided under the Dodd-Frank Act. Unlike monetary awards, retaliation protections apply whether or not a successful enforcement action ultimately results, provided the whistleblower had a "reasonable belief" that the information provided relates to a possible securities law violation.

Effective Date

The Rules will be effective 60 days after being submitted to Congress or published in the Federal Register, which has not yet occurred. The Dodd-Frank Act whistleblower provisions became effective upon adoption on July 21, 2010 so potential whistleblowers are already entitled to the general rights provided by these provisions. However, the Rules remain subject to legislative and legal challenges. For example, Representative Michael Grimm (R., N.Y.) recently introduced legislation that would amend the Dodd-Frank Act to require a whistleblower to first report fraud through an internal compliance

program before being eligible to receive an award under the program. We will keep you posted on any significant legal or legislative challenges to the Rules and interpretations of the Rules as they are adopted and implemented.

Office of the Whistleblower

In addition to whistleblower rules, the Dodd-Frank Act called upon the SEC to create an Office of the Whistleblower. That office, now headed by Sean McKessy, works with whistleblowers, handles their tips and complaints, and helps the SEC determine the awards for each whistleblower. The initial staffing of the Office of the Whistleblower has been completed and the Investor Protection Fund, which will be used to pay awards to eligible whistleblowers, has been funded.

Practical Considerations for Companies

In light of the financial incentives associated with the whistleblower provisions, companies may expect an increase in whistleblower allegations and associated investigations. Companies should review and evaluate the effectiveness of their current compliance programs to ensure that compliance is a key element of their operations and culture. Companies should make sure that their compliance programs are updated for any new legal requirements contained in the Dodd-Frank Act or other legislation and comply with all other applicable laws. Compliance programs should meet the standards of effectiveness described in the U.S. Sentencing Guidelines for Business Organizations, policy statements issued by the SEC and the DOJ and any federal, state or local regulatory requirements that are applicable to the company.

These compliance programs should include procedures for employees to

report perceived problems internally, including provisions for anonymous and confidential reporting of information, and procedures for internal investigations which ensure that potential violations are brought to the attention of management, investigated in a prompt and appropriate manner and are subject to appropriate remedial action, including decisions regarding self-reporting to the government.

Companies should ensure that they have comprehensive anti-retaliation policies that provide strong protections for employees that use the internal reporting systems. These policies should provide that all employment-related documents regarding an employee-whistleblower should be retained for the entire ten-year period during which a retaliation claim may be made by the employee. Companies may also want to establish a comprehensive exit-interview process with departing employees to discuss any compliance questions that these employees may have and confirm that they are not aware of any potential violations of law at the company.

Companies should ensure that their employees are sufficiently informed

about the existing compliance policies and internal reporting channels to ensure that these programs are being effectively utilized. Companies should provide regular compliance training programs to their employees. Informed employees in an organization with a robust internal compliance program and an appropriate “tone at the top” where senior management promotes an ethical environment are less likely to make spurious or unfounded reports to the SEC in hope of receiving an award, and more likely to report potential issues internally. Where permitted by law, companies may want to amend their codes of ethical conduct to require their employees to promptly report any potential securities law violation and certify on a periodic basis that they have complied with this requirement. Companies may also want to contractually require third

party agents to report any perceived securities law violations to them. In addition, companies may want to be proactive and conduct internal audits to identify possible areas of vulnerability and address any weaknesses before they are reported to authorities by employees or others that blow the whistle.

This Practice Alert contains a general outline of compliance issues that need to be considered by companies in connection with the adoption of the whistleblower provisions contained in the Dodd-Frank Act and the Rules and is not intended to constitute comprehensive legal advice. For additional information about the Dodd-Frank Act, the Rules or any questions that you may have, feel free to contact any attorneys in Akerman’s Corporate Practice about your company’s compliance program.

For more information, please contact a member of our Corporate practice.

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