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CORPORATE & FINANCIAL
WEEKLY DIGEST

Corporate & Financial Weekly Digest

Posted at 11:03 AM on November 5, 2010 by Robert L. Kohl

SEC Issues Proposed Rules for Whistleblower Program under Dodd-Frank Act

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On November 3, the Securities and Exchange Commission issued proposed rules for implementing the whistleblower provisions added to Section 21F of the Securities Exchange Act of 1934 by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the proposed rules, the SEC will pay an award or awards to one or more whistleblowers who voluntarily provide the SEC with original information that leads to the successful enforcement by the SEC of a federal court or administrative action in which the SEC obtains monetary sanctions totaling more than $1 million.

Under the proposed rules, a whistleblower is an individual who, alone or jointly with others, provides information to the SEC relating to a potential violation of the securities laws. A whistleblower must be a natural person. A company or another entity is not eligible to receive a whistleblower award.

Under the proposed rules, whistleblowers are eligible for awards only when they provide original information to the SEC "voluntarily." Proposed Rule 21F-4(a)(1) would define a submission as "voluntary" if a whistleblower provides the SEC with information before receiving any formal or informal request, inquiry or demand from the SEC, Congress, any other federal, state or local authority, any self-regulatory organization or the Public Company Accounting Oversight Board about a matter to which the information in the whistleblower's submission is relevant. Proposed Rule 21F-4(a)(2) provides that submissions from certain individuals who have a pre-existing or contractual duty to report securities violations to the SEC will not be considered "voluntary" for purposes of Section 21F.

Under the proposed rules "original information" means information that is derived from the whistleblower's "independent knowledge" or "independent analysis," is not already known to the SEC from any other source, and is not derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information. Proposed Rule 21F-4(b)(4) provides that information will not be considered to derive from an individual's "independent knowledge" or "independent analysis" in the following circumstances:

- Attorneys who attempt to use information obtained from client engagements to make whistleblower claims for themselves (unless disclosure of the information is permitted under SEC rules or state bar rules).
- Independent public accountants who obtain information through an engagement required under the securities laws.
- People who learn about violations through a company's internal compliance program or who are in positions of responsibility for an entity, and the information is reported to them in the expectation that they will take appropriate steps to respond to the violation. This exclusion ceases to be applicable if the company does not disclose the information to the SEC within a reasonable time or acts in bad faith. In these circumstances, such persons can become whistleblowers.
- By a means or in a manner that violates applicable federal or state criminal law.

The SEC also would not pay culpable whistleblowers awards that are based upon either the monetary sanctions that such people themselves pay in the resulting SEC action, or on sanctions paid by entities whose liability is based substantially on conduct that the whistleblower directed, planned or initiated.

Under the proposed rules, a whistleblower's information can be deemed to have led to successful enforcement if (1) the information results in a new examination or investigation being reopened and significantly contributes to the success of a resulting enforcement action, or (2) the conduct was already under investigation when the information was submitted, but the information is essential to the success of the action and would not have otherwise been obtained.

The proposed rules provide that awards will range between 10% and 30% of monetary sanctions imposed, where such sanctions exceed $1 million. According to the SEC's Annual Report to Congress on the Whistleblower Program, the Securities and Exchange Commission Investor Protection Fund, established by the Dodd-Frank Act to provide funding for the whistleblower programs, including the payment of awards, had a balance of approximately $452 million as of September 30.

The proposed rules also provide the procedures for submitting "original information" to the SEC (under penalty of perjury) and making a claim for an award.

At the SEC open meeting on November 3, there was discussion about the potential negative impact the proposed rules may have on internal corporate compliance functions, with Commissioner Troy Paredes stating that he was "concerned that the Commission's proposal might not do enough to preserve the important role that corporate compliance programs serve" and that "It would be unfortunate if, as result of the Dodd-Frank whistleblower program, effective corporate compliance programs were thwarted."

In an attempt to address this concern, the proposed rules include provisions designed to discourage employees from bypassing their own company's internal compliance programs. The proposed rules would treat an employee as a whistleblower under the SEC program as of the date that employee first reports the information internally as long as the employee provides the same information to the SEC within 90 days. Thus, employees will be able to report their information

internally first while still preserving their "place in line" for a possible award from the SEC. The proposed rules also permit the SEC to consider higher percentage awards for whistleblowers who first report their information through effective company compliance programs.

Comments on the proposed rules should be submitted to the SEC on or before December 17.

Read more.

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