



Client Alert

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New SEC Rules Pay Rewards to Whistleblowers

On May 25, 2011, the Securities and Exchange Commission (the "SEC") adopted rules to pay rewards to whistleblowers for information that might reveal or prevent securities law violations. The controversial rules, which implement the whistleblower provisions of the Dodd-Frank Act, passed by a 3-to-2 vote. Of particular concern to companies is the fact that the new rules allow potential whistleblowers to bypass internal compliance programs and report directly to the SEC. The question of whether to require a potential whistleblower first to report to his or her company's internal compliance program was a source of significant debate and the subject of heavy lobbying by companies during the rule-making process.

Requirements for Whistleblower Awards

Under the new rules, the SEC may pay an award to an eligible whistleblower¹ under the following circumstances:

- The whistleblower gives information to the SEC voluntarily and before that information is requested directly by the government or any other agency;
- The information provided is original, meaning that it is independently obtained and not derived from information that is either publicly available or already known to the SEC;
- The information leads to a successful enforcement action. This requirement can be satisfied by the opening of a new investigation, the reopening of a closed investigation, the discovery of a new line of inquiry in an existing investigation, or a significant contribution to the success of an ongoing investigation; and
- The SEC ultimately recovers monetary sanctions in an amount equal to or greater than \$1 million.

Remaining Incentives to Use Internal Reporting Procedures

Although the new rules permit whistleblowers to report directly to the SEC, certain aspects of the new rules encourage continued use of internal compliance programs as the primary avenue of reporting potential securities law violations. The new rules provide that:

- A whistleblower's use of his or her company's internal compliance program may result in a larger award, and interference with internal procedures may result in a smaller award;
- A whistleblower who makes an initial report through internal channels will receive credit for *all* information relating to the same matter ultimately provided by the company to the SEC; and
- Any whistleblower information initially reported internally but subsequently reported to the SEC within 120 days will be deemed to have been reported to the SEC on the date of the initial internal report.

Preserving the Effectiveness of Internal Compliance Programs

The possibility that, under the new rules, certain whistleblowers will choose to approach the SEC directly cannot be avoided completely. Companies can, however, effectively encourage the use of their internal reporting channels by making internal procedures visible and user-friendly. The newsworthy issuance of the new SEC rules presents an opportunity for companies to re-emphasize to their employees both the existence and the mechanics of their internal compliance programs, and to reassure employees that any information reported through internal channels will be received with appropriate seriousness, confidentiality, and protection from retaliation.

Companies should be aware that, even in the absence of monetary incentives, employees may be reluctant to use internal reporting programs if the procedures for using those programs are in any way unclear, if employees perceive that management's willingness to hear employee concerns is lacking, or if personnel responsible for addressing internal reports

appear to be slow to respond. All companies, and especially those who find that their internal reporting programs are infrequently used, may wish to evaluate and, if need be, improve the clarity, genuineness, and promptness with which employee concerns are addressed.

¹Persons with pre-existing or contractual duties to report violations, attorneys who obtain information from clients, persons who obtain information illegally, officials of foreign governments, and key personnel of entities who obtain information through participation in internal compliance procedures generally are not eligible to receive whistleblower awards.

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