

WSGR ALERT

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SEC ADOPTS FINAL RULES REGARDING WHISTLEBLOWERS

On May 25, 2011, the Securities and Exchange Commission (SEC) adopted final rules implementing Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which adds Section 21F to the Securities Exchange Act of 1934. The new rules provide bounties and protections for whistleblowers reporting violations of securities laws to the SEC.¹ The rules will pose numerous difficult challenges for companies trying to implement effective compliance programs and internal reporting systems. We have highlighted some of the key provisions of the final rules below.

Whistleblower Provision Basics

Under the final rules, the SEC will pay an award to a whistleblower who voluntarily reports to the SEC original information that leads to a successful enforcement action in which the SEC's monetary sanctions exceed \$1 million. The SEC will award whistleblowers 10 to 30 percent of the monetary sanctions. The SEC requires original information to be based on independent knowledge or analysis that is not already available or known to the SEC. In addition, a whistleblower is protected under the rules from employment retaliation if the whistleblower reasonably believes that the information reported to the SEC relates to a "possible securities law violation." The SEC stated that it would be unlawful for companies to use confidentiality agreements as a way to prevent whistleblowers from reporting information to the SEC.

Internal Reporting Not Required

During the comments process, the most actively debated aspect of the proposed rules was that they did not require whistleblowers to report concerns through a company's internal compliance program before reporting to the SEC. Many business and legal commentators argued that without a requirement that employees first report potential violations internally, employees would be discouraged from utilizing the corporate compliance programs that companies have spent significant expense and effort creating, particularly following the enactment of the Sarbanes-Oxley Act of 2002.

The SEC declined to require that whistleblowers report potential violations through a company's internal compliance program in order to be eligible for a bounty. The final rules do, however, include provisions that are intended to encourage whistleblowers to utilize internal compliance programs, including making internal reporting a factor for the SEC to consider when determining the amount of an award²; decreasing awards for whistleblowers who interfere with internal compliance programs³; providing rewards for information reported to the SEC by a company if the source of the information was the whistleblower⁴; and lengthening the period of time—from 90 to 120 days—during which a whistleblower can wait to approach the SEC after reporting internally and still receive a bounty.⁵

While these changes improve upon the proposed rules, they likely still create incentives to report directly to the SEC and bypass internal reporting. For example, a whistleblower seeking to maximize his or her bounty may believe that reporting internally first will give a company the opportunity to investigate, remediate, and self-report to the SEC, thus earning the company cooperation credit—which ordinarily means that the SEC is less likely to impose a substantial penalty on the company. Such a credit could minimize or perhaps even eliminate any monetary sanction—and with it, any potential bounty.

Ineligible Whistleblowers

As with the proposed rules, the final rules also provide that certain people generally will not be considered for bounties because of the nature of their positions. Thus, attorneys (including in-house counsel) who use information obtained in the course of client engagements may not make whistleblower claims for themselves. Similarly, compliance and internal audit personnel and officers and directors who learn of allegations of misconduct from another person (such as an employee) or through the company's internal reporting mechanisms are not eligible to receive a bounty.

The final rules provide exceptions that likely will create uncertainty as to whether compliance or internal audit personnel can collect bounties, however. Such personnel may collect bounties if they "reasonably

¹ The final rules are available at <http://www.sec.gov/rules/final/2011/34-64545.pdf>

² See final rules, 17 C.F.R. § 240.21F-6(a)(4)(2)(ii), *supra* note 1, at 255, 257-58.

³ See final rules, 17 C.F.R. § 240.21F-6(b)(3), *supra* note 1, at 259-60.

⁴ See final rules, 17 C.F.R. § 240.21F-4(b)(5), *supra* note 1, at 250-51.

⁵ See final rules, 17 C.F.R. § 240.21F-4(b)(7), *supra* note 1, at 251-52.

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believe" that reporting information to the SEC "is necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors," or that the company "is engaging in conduct that will impede an investigation of the misconduct."⁶

Conclusion

The summary above highlights just a few of the key provisions of the SEC's release on the final whistleblower rules, which is comprised of over 300 pages. The new whistleblower rules also underscore the importance of companies examining their internal reporting policies and procedures to determine whether they can be enhanced. Indeed, developing and promoting robust internal reporting policies and procedures is now more important than ever.

Finally, although the final rules have yet to take effect, the SEC has told Congress that it already has seen an increase in the quality of tips received since the passage of the Dodd-Frank Act.⁷ The full effects of the new whistleblower rules remain to be seen, but companies should brace themselves for an increase in claims and the corresponding litigation that is sure to follow.

For any questions or for more information on these or any related matters, please contact a member of Wilson Sonsini Goodrich & Rosati's corporate securities or securities litigation practices.

⁶ See final rules, 17 C.F.R. § 240.21F-4(b)(4)(v), *supra* note 1, at 249.

⁷ SEC Chairman Mary L. Schapiro, Opening Statement at SEC Open Meeting: Item 2 – Whistleblower Program (May 24, 2011), available at <http://www.sec.gov/news/speech/2011/spch052511mls-item2.htm>.



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