

## Blowing Your Own Whistle: Trumpeting Your Whistleblower Policies in Response to the SEC's New Whistleblower Program

July 28, 2011

The U.S. Securities and Exchange Commission ("SEC") has issued final rules (the "Rules") implementing the whistleblower incentive program (the "Program") pursuant to Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which added Section 21F to the Securities Exchange Act of 1934 (the "Exchange Act").<sup>1</sup>

The Program is designed to encourage individuals to voluntarily report possible securities law violations to the SEC by offering cash rewards of between 10% and 30% of monetary sanctions exceeding \$1 million. It also builds upon the Sarbanes-Oxley Act of 2002 ("SOX") and provides additional protections to whistleblowers. Dodd-Frank broadens SOX's anti-retaliation provisions by protecting tipsters of any company subject to the securities laws rather than simply employees of publicly-traded companies, permitting direct causes of action in lieu of administrative hearings, doubling the statute of limitations and increasing possible damages awards.

Many different types of companies are subject to the federal securities laws and must be aware of the Program and its potential effects. Any company subject to the SEC's jurisdiction may want to consider revisiting its internal reporting and compliance policies and procedures in response to the Program.

### Whistleblower Rewards

The Program creates the SEC whistleblower office to collect tips and make awards to eligible whistleblowers. Whistleblower awards will be paid out of the statutorily-created Investor Protection Fund, which currently has a balance of more than \$450 million.

A "whistleblower" is an individual that, alone or jointly with others, provides information relating to possible securities law violations that have occurred, are ongoing, or are about to occur.<sup>2</sup> Whistleblowers may receive cash rewards of between 10% and 30% of monetary sanctions for (1) voluntarily providing (2) original information to the SEC (3) which leads to a successful action (4) resulting in monetary sanctions exceeding \$1 million. In the interest of supporting internal compliance programs and protecting certain proprietary information, however, the Program excludes certain individuals from reward eligibility, including, among others, accountants, lawyers, compliance personnel and those who obtain information illegally.<sup>3</sup>

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<sup>1</sup> See Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, SEC Release No. 34-64545 (May 25, 2011), available at <http://www.sec.gov/rules/final/2011/34-64545.pdf>.

<sup>2</sup> Companies and other entities are not eligible for whistleblower awards.

<sup>3</sup> However, the SEC may lift this exclusion if: (i) the whistleblower reasonably believes that disclosure is necessary to prevent substantial financial injury to the company or its investors; (ii) the whistleblower reasonably believes that the entity is engaging in conduct that will impede an investigation; or (iii) 120 days have elapsed since the whistleblower reported the information internally.

A whistleblower will be deemed to “voluntarily” provide information unless he or she has received a request or demand for information from the SEC or other designated authority, or has a pre-existing legal obligation to report such information. The Program defines “original information” as information derived from a whistleblower’s independent knowledge or analysis, which includes collaborative efforts and examination of facts. Whether a whistleblower’s report “leads to a successful action” permits the SEC to determine the information’s significance in opening an investigation and the role the information plays in the ensuing action. Finally, in calculating whether the \$1 million threshold has been met, the SEC will aggregate the sanctions collected in two or more related actions, including penalties, civil and criminal fines, and disgorgement, in addition to interest. To limit whistleblowers benefiting from their own wrongdoing, the SEC will deduct from its threshold calculation sanctions attributable to a culpable whistleblower.

Reward determinations are made after considering a variety of increasing and decreasing factors. Increasing factors include the significance of the information provided, assistance provided by the whistleblower, law enforcement interest in deterring violations by providing a whistleblower reward, and the whistleblower’s attempted use of internal compliance systems.<sup>4</sup> Decreasing factors include whistleblower culpability, unreasonable delay in reporting, and interference with internal compliance and reporting systems. The SEC’s determination of a reward amount is final and not subject to appeal.

### Anti-Retaliation Provisions

Dodd-Frank builds upon SOX by providing additional protections to whistleblowers. Specifically, it broadens SOX’s anti-retaliation provisions by protecting whistleblowers who work for any company subject to the securities laws, doubling the statute of limitations, and increasing possible damages awards. Previously, SOX only protected employees of (i) publicly-traded companies, and (ii) subsidiaries that were the alter ego of a publicly-traded parent. Now, employees of the following entities are protected:

- All companies subject to the securities laws and subsidiaries or affiliates whose financial information is included in the consolidated financial statements of such,
- Consumer financial services providers,
- Nationally recognized statistical rating organizations, and
- Companies regulated under the Commodity Exchange Act.

Under Dodd-Frank, whistleblower-plaintiffs may also be entitled to jury trials—a right previously unavailable under SOX—and may directly file private actions in federal court. And under Section 21F, in particular, there are no administrative exhaustion requirements, and this private right of action is not limited to employees—it includes claims by any individual alleging improper treatment for engaging in protected activity. Dodd-Frank further dictates that pre-dispute arbitration agreements are no longer

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<sup>4</sup> To address commentators’ concerns that the Program will undermine established internal compliance and reporting systems, the Rules also (i) provide that the date on which a whistleblower reports misconduct to internal compliance personnel functions as the date of disclosure for reward purposes (as long as the whistleblower reports the misconduct to the SEC within 120 days of the initial internal disclosure), and (ii) provides that a whistleblower will not lose award eligibility if he reports internally and the company then self-reports.

enforceable under SOX, and SOX remedies cannot be waived by agreements, such as a general release or settlement. Whistleblowers remain protected by the anti-retaliation provisions even if they are ineligible for a reward.

## Whistleblower Action Steps

In response to the Program, we suggest that you consider taking the following action steps:

- *Review Whistleblower Policies and Procedures.* Ensure all whistleblower reports, complaints and investigations may be efficiently routed to someone in the company with authority to address the issue, and to bring appropriate issues to the attention of the company's board of directors or audit committee. Review, and revise as necessary, whistleblower policies and reporting mechanisms to include employees of subsidiaries and affiliates.
- *Promote Whistleblower Policies and Procedures.* Consider providing whistleblower education during employee orientation programs and periodic refresher trainings, posting fliers about the company's whistleblower policies and procedures, and including messages about such policies in communications from senior management.
- *Annual Employee Certification.* To further promote the importance of internal whistleblowing and anti-retaliation, ask employees to sign an annual certificate acknowledging company policies and procedures.
- *Train Supervisors.* Avoid retaliation penalties and improve employee confidence in your whistleblower procedures by ensuring supervisors adequately address complaints.
- *Test Whistleblower Policies.* Verify adequate reporting structures and effective hotlines by submitting test tips.
- *Reward Whistleblowers.* To help ensure employees first report internally, companies may consider providing rewards to internal whistleblowers. These rewards can take many forms: money, time off, mention in a company newsletter, certificate of merit, etc. In addition, companies may choose to reward internal whistleblowing by incorporating ethics and integrity into employee performance evaluations.
- *Defend Against Third Parties.* If a third party contractor has access to sensitive information, consider reviewing the third party's whistleblower reporting policies or adding contract provisions that require internal reporting prior to SEC reporting.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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