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# SEC Announces Proposed Rules on Dodd-Frank Whistleblower Program

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Rules recently proposed by the U.S. Securities and Exchange Commission define the scope and procedures of the whistleblower provisions under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

On November 3, 2010, the U.S. Securities and Exchange Commission (SEC) issued proposed rules regarding the whistleblower provisions under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The SEC's proposed Regulation 21F defines critical terms, outlines procedures and generally explains the scope of its new whistleblower program. The proposed rules also address the important issue of whether whistleblowers should report suspected violations to their internal compliance and legal departments before making such reports to the SEC and how such internal reporting will affect their ability to receive a financial award under the program.

The Dodd-Frank Act authorizes the SEC to pay financial rewards to whistleblowers for reporting violations of the federal securities laws. To receive an award, the whistleblower must voluntarily provide the SEC with original information that leads to a successful enforcement action that results in monetary sanctions exceeding $1 million. The Dodd-Frank whistleblower provisions have been criticized for encouraging employees to bypass internal compliance and legal departments, and instead report suspected violations directly to the government. This has led to concerns the new whistleblower program will undermine, rather than support, the critical role that compliance programs play in rooting out corporate fraud and wrongdoing in America's public companies. (See "New SEC Whistleblower Program and Added Disclosure Rules in Dodd-Frank Act: Will These New Regulations Help or Hinder FCPA Compliance Efforts?"). In addition, there are concerns that offering such large financial incentives may not lead to more reliable claims or better corporate compliance.

The proposed rules attempt to address some of these concerns by giving whistleblowers the option of reporting suspected violations internally to a company's legal, compliance, audit or other department before reporting the violation to the government. Provided the whistleblower submits the same information to the SEC within 90 days, the individual remains eligible to receive an award and the SEC "will consider that [the whistleblower] provided information as of the date of [the] original disclosure, report or submission to one of these other authorities or persons." Proposed Rule 21F-4(b)(7). In the Supplementary Information accompanying the proposed rules, the SEC also contemplates an increase in the amount of the award for whistleblowers who first utilize a company's internal reporting program. However, the SEC will not penalize whistleblowers for not filing an internal report based on a fear of retaliation or other legitimate reasons.

By allowing a 90-day waiting period, the SEC seeks to provide a company with "a reasonable period of time to investigate and respond to potential securities laws violations (or at least begin an investigation) prior to reporting them to the Commission or an appropriate regulator." Proposed Rule 21F, Supplementary Information, at 112. The SEC further realizes that this grace period may also result in cost savings by eliminating false or unreliable claims. These proposed rules attempt to encourage employees to use their internal resources first (where practicable) and acknowledge the importance of "fostering robust corporate compliance programs." Id. at 34.

A related concern was whether whistleblower status should be conferred on individuals with a duty of loyalty to the company or who have access otherwise to privileged or confidential information. In response, the SEC's proposed rules would disallow whistleblower claims from outside counsel, independent auditors and internal legal, audit and compliance personnel. For internal legal, audit and compliance personnel, however, information submitted to the SEC may still qualify for a whistleblower claim if the entity did not disclose the information to the SEC "within a reasonable time or proceeded in bad faith." Proposed Rule 21F-4(b)(4)(iv). The SEC does not define "reasonable time" to mean any one fixed period, but instead indicates that it will be "a flexible concept that will depend on all of the facts and circumstances of the particular case." Proposed Rule 21F, Supplementary Information, at 26. The SEC has also invited comments on whether these proposed exclusions should be extended to other types of privileged communications or other professionals with access to confidential information.

As with many other provisions of the Dodd-Frank Act, the SEC's rule-making process is moving very quickly. Comments on the SEC's proposed Regulation 21F are due to the commission by December 17, 2010. Any company that deals with regulatory compliance issues involving securities laws should immediately consider whether and how to weigh in on these proposed rules.