

Small Business Securities Bulletin

A periodic bulletin keeping small businesses informed about current developments in securities law and related matters

November 2010 (No. II)

Penny Somer-Greif

410.347.7341

psomergreif@ober.com

SEC Proposes Rules Implementing the Whistleblower Provisions of Dodd-Frank

Earlier this month the Securities and Exchange Commission (SEC) [proposed rules \[PDF\]](#) to implement the whistleblower and anti-retaliation provisions of Section 21F of the Securities Exchange Act of 1934, which was added by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). Consistent with Dodd-Frank, the proposed rules generally provide that persons 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 it obtains monetary sanctions totaling more than \$1 million is entitled to an award of between 10% and 30% of the amount collected. The SEC, who will determine the actual percentage amount of the award based on several factors enumerated in the proposed rules and proposing release, will also pay an award based on amounts collected in certain related actions. The proposed rules define relevant terms, including "voluntarily" and "original information"; provide a procedure for submitting information to the SEC, including anonymously through counsel, and making a claim for an award; and outline categories of persons who are ineligible for an award, including company auditors and counsel, members of law enforcement agencies including the SEC, and, unless the company does not report the information to the SEC within a reasonable timeframe, company compliance personnel. Whistleblowers who participated in the violation they report and are criminally convicted with respect to such violation will also not be eligible for an award. Persons who are convicted solely in a civil matter with respect to such violation, however, including in an action brought by the SEC, could still collect an award under the proposed rules if he or she complied with all of the other requirements of the rules, but

any penalty paid by the whistleblower would not count towards the \$1 million minimum or the total amount of sanctions on which their award is based.

The proposed rules define a whistleblower as one who provides information to the SEC relating to a "potential violation" of securities laws. The specific reference to a "potential" violation is to make clear that whistleblowers are protected from the anti-retaliation provisions of Section 922 of Dodd-Frank (with remedies including reinstatement or front pay, two-times back pay and litigation expenses) even if there is no final determination that the conduct reported actually constituted a securities law violation. Such protection similarly applies to persons who provide information to the SEC regardless of whether they satisfy the requirements to be eligible for an award.

As noted in the proposing release, the proposed rules attempt to balance "a number of potentially competing interests in implementing" Section 922 of Dodd-Frank, including "the potential for the monetary incentives provided to whistleblowers by Section 21F of the Exchange Act to reduce the effectiveness of a company's existing compliance, legal, audit and similar internal processes for investigating and responding to potential violations of the federal securities laws." As a result, the proposed rules include provisions intended to not discourage potential whistleblowers from first reporting information with respect to potential violations to company personnel. These include preserving such a potential whistleblower's status as the "original source" of the information, and therefore still eligible for an award, if they provide the information to the SEC within 90 days of reporting it to company personnel, and allowing the SEC to consider whether the whistleblower first reported the information through an "effective company compliance program" in determining whether to award a higher percentage award. The proposed rules do not, however, mandate that whistleblowers first report potential violations through a company's internal compliance procedures in order to qualify for an award. The proposing release does ask for comment, however, on whether the SEC should consider such a requirement, as well as "other ways to promote continued robust corporate compliance processes," consistent with Dodd-Frank. In light of these proposed rules, as well as Section 922 of Dodd-Frank, companies should start considering whether any improvements to their internal compliance processes, in particular the manner in which such processes operate in practice, may be appropriate. While Section 922 and the proposed rules present the possibility of a huge windfall for some whistleblowers, such a payoff is far from guaranteed and being a whistleblower entails significant potential drawbacks as well. Companies will want to leverage this reality to ensure that company personnel who become aware of potential violations report them to the company, rather than to the SEC, first; it is to the company's advantage to learn of potential violations before the SEC does, rather than first learning such information in the context of an SEC enforcement action. While no internal reporting system can provide an ironclad guarantee that an employee will not bypass such a system in favor of going to the SEC, we believe that

employees who become aware of potential securities law violations within their company generally will be more likely to report them internally, rather than going directly to the SEC or other law enforcement entities, if they believe that their concerns will be taken seriously, that the company will take appropriate follow-up action, and that they will not be subject to harassment or other forms of retaliation for reporting such potential violations. Now is the time to make sure you have an adequate and robust internal compliance system in place, that employees are adequately aware of these procedures (and, if not, consider training) and that management is setting an appropriate "tone at the top" with respect to these matters. In addition, unlike the whistleblower protections adopted under the Sarbanes-Oxley Act of 2002, the Dodd-Frank whistleblower provisions apply to employees of subsidiaries of public (i.e. SEC reporting) companies, even if the subsidiary is itself non-public. Therefore, you should ensure that your internal compliance reporting procedures and practices are adequate throughout your entire organization.

About Me

I am a former SEC attorney who also has prior “big firm” experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you. Visit my bio at www.ober.com/attorneys/penny-somer-greif.

About Ober|Kaler

Ober|Kaler is a national law firm that provides integrated regulatory, transaction and litigation services to financial, health care, construction and other business organizations. The firm has more than 120 attorneys in offices in Baltimore, MD, Washington, DC and Falls Church, VA. For more information, visit www.ober.com.

This publication contains only a general overview of the matters discussed herein and should not be construed as providing legal advice. If you have any questions about the information in this publication or would like additional information with respect to these matters, please contact me at 410.347.7341 or psomergreif@ober.com.

Feel free to – and please do – forward this publication to anyone that you think might be interested in it. If you did not receive this publication from Ober|Kaler directly, you may sign up to receive future publication like this via e-mail at: marketing@ober.com.

Copyright© 2010, Ober, Kaler, Grimes & Shriver