

## SEC ADOPTS FINAL DODD-FRANK WHISTLEBLOWER RULES

June 13, 2011

Last month, the Securities and Exchange Commission (the “SEC”) adopted, in a split 3-2 decision, final rules to implement the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).<sup>1</sup> Dodd-Frank created a new Section 21F of the Securities Exchange Act of 1934 (the “Exchange Act”), which establishes a whistleblower program requiring the SEC to pay an award of between 10 and 30 percent of monetary sanctions aggregating at least \$1,000,000 to eligible whistleblowers who voluntarily provide the SEC with original information about a violation of the federal securities laws. Section 21F of the Exchange Act also prohibits retaliation by employers against individuals who provide the SEC with information about possible securities violations.

On November 3, 2010, the SEC proposed a new Regulation 21F to implement the Dodd-Frank whistleblower provisions.<sup>2</sup> The SEC received more than 240 comment letters and approximately 1300 form letters regarding the proposed rules, which defined certain terms critical to the whistleblower program, outlined procedures for applying for awards and the SEC’s procedures for making decisions on claims, and generally explained the scope of the whistleblower program.<sup>3</sup> The SEC has indicated that the quality of tips it has received following the enactment of Dodd-Frank has generally increased, and it expects this trend to continue with the adoption of the final version of Regulation 21F. The final rules, which apply to both public and private companies, will be effective on August 12, 2011. This client alert summarizes certain key aspects of the final rules.

### Internal Compliance

Many commentators on the proposed rules voiced significant concerns regarding the potential of the Dodd-Frank whistleblower program to undermine companies’ existing internal compliance programs designed to prevent and resolve misconduct. While the proposed rules did not require whistleblowers to report potential securities law violations through the company’s internal compliance program as a prerequisite to an award, a number of commentators urged the SEC to include such a requirement in the final rules. Ultimately, the SEC determined not to include in the final rules a requirement that whistleblowers first report violations internally, but instead made changes to the rules that the SEC believes will further incentivize whistleblowers to utilize existing internal compliance and reporting systems when appropriate.

- Under the final rules, a whistleblower’s voluntary participation in the company’s internal compliance and reporting system is a factor that can increase the amount of an award; alternatively, a whistleblower’s interference with internal compliance and reporting is a factor that may decrease the amount of the award.

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<sup>1</sup> 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> Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, SEC Release No. 34-63237 (November 3, 2010), available at <http://www.sec.gov/rules/proposed/2010/34-63237.pdf>.

<sup>3</sup> Our earlier client alert on the proposed whistleblower rules can be found at: <http://www.wcsr.com/resources/pdfs/cs112210.pdf>

- The final rules permit a whistleblower to receive an award for reporting original information through the company's internal compliance program, even if the company ultimately reports the information to the SEC that results in a successful enforcement action. The whistleblower will also receive credit (and potentially a larger award) for any additional information provided to the SEC by the company because of its internal investigation of the alleged violation.
- Whistleblowers who first report suspected securities law violations through a company's internal compliance program will have up to 120 days to report the information to the SEC while still being treated as if he or she had reported original information to the SEC as of the earlier reporting date – an increase from the 90-day lookback period contained in the proposed rules.

### **Procedures for Submitting Information and Claims**

The final rules seek to simplify and streamline the process for whistleblowers to submit tips to the SEC. Under the proposed rules, a whistleblower would have been required to submit two separate forms in order to be eligible for an award. The final rules combine the two proposed forms into a single Form TCR. As in the proposed rules, the final rules provide that whistleblowers must submit tips under penalty of perjury and may report suspected violations anonymously with certification by counsel.

### **Aggregation of Actions to Meet the \$1,000,000 Threshold**

Under the proposed rules, whistleblowers would have only have been eligible for an award if the SEC successfully brought a single enforcement action resulting in monetary sanctions of more than \$1,000,000. The final rules increase the eligibility for whistleblower awards by providing that, for purposes of making an award, the SEC will aggregate two or more smaller actions that arise from a set of common facts in order to meet the \$1,000,000 threshold for an award.

### **Exclusion from Award Eligibility for Certain Persons and Information**

In an effort to prevent those bound by a duty of confidentiality and those who have a pre-existing obligation to report securities law violations to the SEC from receiving the benefit of the Dodd-Frank whistleblower program, the proposed rules contained a number of exclusions from eligibility for awards for certain categories of persons and information. The final rules attempt to narrow and clarify the scope of the exclusions applicable to attorneys, auditors and internal compliance and similar personnel. Under the final rules, whistleblowers that are under a pre-existing legal or contractual duty to report securities law violations to the SEC will not be eligible for awards. Additionally, tips consisting of information that is subject to attorney-client privilege or otherwise obtained in connection with legal representation, obtained through the performance of an audit engagement by an independent public accountant or communicated to a person with legal, compliance, audit, supervisory or governance responsibilities will not be eligible for an award. The final rules did not contain, as many commentators suggested, an exclusion for culpable whistleblowers, who may still be eligible for some amount of an award depending on their level of culpability. Like the proposed rules, the final rules deny an award to whistleblowers who initiated, planned or directed the wrongdoing.

### **Anti-retaliation Protection**

The final rules clarify that the anti-retaliation protections of Section 21F apply irrespective of whether a whistleblower has satisfied all of the procedures and conditions required to qualify for an award under the Dodd-Frank whistleblower program. Under the final rules, anti-retaliation protection will be available to any whistleblower who has a reasonable belief that the information he or she is providing relates to a possible securities law violation that has occurred, is ongoing or is about to occur. The SEC clarified in its adopting release that employers may not require employees to waive or limit their anti-retaliation rights under Section 21F.

## Recommended Actions; Contact Information

In light of the SEC's final whistleblower rules, both private and public companies should consider taking the following steps:<sup>4</sup>

- Review your documents – policies, handbooks, contracts and other important documents should be analyzed to see if the company's processes and procedures make sense in light of the new Dodd-Frank whistleblower program. In particular, consider the company's ability to address and communicate the resolution of the concern to the whistleblower within the 120-day lookback period during which the whistleblower may still report the information to the SEC.
- Promote internal reporting and demonstrate a commitment to preventing retaliation – companies with internal compliance programs that have credibility among employees are more likely to be utilized by whistleblowers before reporting directly to the SEC. A toll-free hotline or confidential reporting system can be very beneficial, and the message from the top of the organization should be that there is a commitment to the spirit of the law and retaliation will not be tolerated.
- Take effective corrective action – the SEC has emphasized that the promptness with which a company self-reports misconduct is an important factor in considering whether to grant leniency for cooperating in the SEC's investigations and enforcement actions.
- Consider how the company will respond if contacted by the SEC regarding a whistleblower complaint. The SEC has suggested that in certain circumstances it expects to allow companies to conduct their own internal investigations of whistleblower allegations prior to further SEC investigation – this option will most likely be available in situations where the SEC is assured that the company has systems and processes in place to conduct a thorough and reliable investigation of suspected securities law violations.

If you have any questions regarding the SEC's proposed rules, please contact Elizabeth C. Southern, <http://www.wcsr.com/elizabethsouthern>, the principal drafter of this alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities> or one of our Labor and Employment attorneys at the following link: <http://www.wcsr.com/profSearch?team=laboremployment>.

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<sup>4</sup> A video summary of key steps to be taken in light of the Dodd-Frank whistleblower program can be accessed at: [http://www.youtube.com/watch?v=2mIjwKxdXNQ&feature=player\\_embedded#](http://www.youtube.com/watch?v=2mIjwKxdXNQ&feature=player_embedded#).