



SEC ADOPTS DODD-FRANK WHISTLEBLOWER RULES

The new rules described below pose new and significant challenges to public companies and other SEC-regulated entities by providing whistleblowers (i) the potential for large financial rewards, and (ii) anti-retaliation protection.

On May 25, 2011 the SEC approved, by a 3-2 vote, new rules to implement Section 21F “Securities Whistleblower Incentives and Protection” of the Securities Exchange Act of 1934 (the “Exchange Act”). These rules were adopted to put into effect the whistleblower bounty provisions of The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), which became law in July 2010. Section 21F of the Exchange Act requires the SEC to pay monetary awards, subject to conditions and limits, to “whistleblowers” who provide the SEC with original information about a violation of the securities laws that leads to the successful enforcement of a judicial or administrative action resulting in monetary sanctions exceeding \$1 million. The final rules will be effective on August 12, 2011.

Section 21F defines a whistleblower as an individual, alone, or with others (not a company), who provides the SEC with information that relates to a possible violation of federal securities laws. Any individual who satisfies the requirements will be eligible for a reward. The new rules mandate that the SEC pay each whistleblower an award between ten and thirty percent of the total monetary sanctions issued, but the amount of each reward will be determined on a case-by-case basis; there is no limit on the total amount of an award an individual can receive. Dodd-Frank also encourages whistleblowers to come forward by prohibiting retaliation by employers against whistleblowers who provide the SEC with information about possible violations of securities laws.

ELEMENTS REQUIRED FOR COLLECTING A REWARD

The information provided to the SEC must be original information, which is defined as information not already known by the SEC that is generated by the reporter’s independent knowledge (so long as the knowledge is not derived from publicly available sources) or independent analysis. In cases where the SEC already has some information about a matter, information can qualify as original information if it materially adds to the information the SEC possesses. To protect the integrity of the new reporting system, any information that is subject to (i) attorney-client privilege, (ii) learned in connection with the legal representation of an entity, (iii) obtained through a violation of state or federal criminal law, or (iv) learned in connection with an entity’s internal compliance processes or reviews does not qualify as original information. The only exceptions to these restrictions allow information learned in connection with an entity’s internal compliance processes or reviews to qualify as original information if an individual has a reasonable basis to believe the entity’s conduct will cause substantial injury to the financial interest or property of the entity or its investors, has a reasonable belief the entity is engaging in conduct that will impede an investigation, or if at least 120 days have elapsed since the information was first reported internally.

The information provided to the SEC must be provided voluntarily. Information is considered to have been reported voluntarily when the reporter does not have a pre-existing duty to report the information and it has not previously been the subject of a request, inquiry, or demand directed toward the reporter. Through these provisions the rules effectively preclude individuals from benefiting themselves by concealing information from the SEC only to come forward with it later in an attempt to claim a reward.

The information must lead to the successful enforcement of a judicial or administrative action. Information leads to the successful enforcement of a judicial or administrative action if it is sufficiently specific, credible and timely to cause the SEC to initiate or reopen an investigation or it significantly contributes to an investigation that is already open. For purposes of determining whether an individual is eligible for an award, the rules treat two or more administrative or judicial proceedings brought by the SEC that arise out of the same nucleus of operative facts as a single action.

EFFECT ON INTERNAL REPORTING POLICIES AND PROCEDURES

The new rules attempt to strike a balance that promotes the use of companies' internal compliance mechanisms while simultaneously ensuring important information is reported to the SEC. The potential for whistleblowers to receive such significant rewards may encourage individuals to bypass a company's internal reporting programs and procedures to instead report information directly to the SEC.¹ In response to that concern several provisions in the new rules attempt to encourage individuals to report suspected wrongdoing first through a company's internal whistleblower procedures and hotlines. If an individual files a report internally pursuant to company policies and procedures and the company subsequently files a report with the SEC that leads to a successful action, the individual who initially reported the matter internally will be credited with all the information included in the company's report and becomes eligible for a reward based on that report. In addition, when determining the amount of a whistleblower's reward, the SEC will consider the individual's participation in internal compliance programs as a factor that "may" increase the amount of an award. Finally, the new rules include a look-back provision which states that if an individual first reports a matter internally but within 120 days reports it to the SEC, the whistleblower will be treated as if they reported the information directly to the SEC on the date of the internal report.

¹ Both of the dissenting Commissioners expressed concern that the new rules will undermine the effectiveness of a company's internal compliance programs.

PRACTICE POINTERS

While it will take time to observe how the new whistleblower rules will affect companies and the SEC's enforcement practices, companies should consider how to address the new rules through their internal compliance programs. Companies should continue to establish a corporate culture that emphasizes legal and regulatory compliance and ethical business practices. In addition, companies should review their internal reporting programs (whistleblower hotlines, et al.) and refresh their efforts to publicize and encourage the use of those programs.

ADDITIONAL INFORMATION

For more information regarding the SEC's whistleblower rules, please get in touch with your Tucker Ellis & West LLP contact or one of the following attorneys:

Bob Loesch 216.696.5916
robert.loesch@tuckerellis.com

Glenn Morrical 216.696.3431
glenn.morrical@tuckerellis.com

Robert J. Hanna 216.696.3463
robert.hanna@tuckerellis.com

Jennifer Berlin 216.696.5482
jennifer.berlin@tuckerellis.com

© Tucker Ellis & West LLP 2011

1150 Huntington Building
925 Euclid Avenue
Cleveland, OH 44115
www.tuckerellis.com

This Client Alert has been prepared by Tucker Ellis & West LLP for the information of our clients. Although prepared by professionals, this Client Alert should not be utilized as a substitute for legal counseling in specific situations.

Readers should not act upon the information contained herein without professional guidance.