



SEC Announces Final Rules Implementing The Dodd-Frank Whistleblower Program

May 26, 2011

Yesterday, the SEC announced the long-awaited final rules implementing the sweeping whistleblower program included in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). While Dodd-Frank enacted a framework for the new whistleblower program, it explicitly left it to the SEC to adopt specific rules and procedures for implementing the program. In November 2010, the SEC released proposed rules and extensive commentary and solicited comments, prompting a flurry of letters from business interests and whistleblower advocates, especially over the question of whether the SEC should require that whistleblowers report wrongdoing through internal corporate compliance channels before becoming eligible for bounties under the whistleblower program. The rules answer many of the uncertainties about the Dodd-Frank whistleblower program that have been lingering since the Dodd-Frank Act was signed into law last summer.

THE DODD-FRANK WHISTLEBLOWER PROVISIONS

The whistleblower provisions of the Dodd-Frank Act, which amended both the Securities Exchange Act of 1934 and the Commodity Exchange Act, are broad. They extend to people who share information with the Securities and Exchange Commission (“SEC”) or Commodity Futures Trading Commission (“CFTC”) concerning any misconduct that falls within the jurisdiction of these agencies.¹

The Dodd-Frank whistleblower provisions contemplate the SEC and/or CFTC providing cash rewards for original information where such information leads to a judicial or administrative action that results in monetary sanctions exceeding \$1 million. Under these provisions, whistleblowers are eligible to receive between 10 and 30 percent of any penalty recovered in the judicial or administrative action resulting in penalties exceeding \$1 million. A key condition, however, is that the tip is “derived from the independent knowledge or analysis of the whistleblower” and was not known to the government from any other source. The SEC and CFTC have discretion to decide the exact amount of the award based on the “significance” of the information and the level of assistance provided by the whistleblower. Because the “significance” of the information in part drives the amount of a reward, the Act incentivizes people to disclose the most serious conduct about which they have information. Dodd-Frank enables whistleblowers to report misconduct under the cloak of anonymity by reporting tips

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 748, 922, 124 Stat. 1376, 1739-46, 1841-49 (2010).

through their lawyers and not disclosing their identities unless and until it has been confirmed that they will receive an award.²

THE FINAL RULES

On May 25, 2011, the SEC adopted final rules to implement the Dodd-Frank whistleblower program. The final rules are contained in a release (the “Release”) that is now posted on the SEC’s website, www.sec.gov.³

The new rules and the related commentary contained in the Release resolve a number of issues that had been left in suspense pending the final SEC action. The rules provide that whistleblower status is predicated upon an individual or group of individuals (an organization or other entity cannot have whistleblower status) possessing a reasonable belief that the information provided relates to a possible violation of the U.S. federal securities laws that has occurred, is ongoing, or is about to occur. The SEC rejected proposals by commentators that a materiality standard be imposed and instead the final rules contemplate that similar actions can be aggregated to satisfy the \$1 million monetary sanction requirement for recovery of a whistleblower award.

The final rules provide that a whistleblower will be protected by the anti-retaliation provisions of the rules regardless of whether it is determined that the reported conduct constituted a violation of the federal securities laws and regardless of whether the whistleblower is ultimately determined to be entitled to an award under the program.

As enacted, Dodd-Frank extended eligibility for whistleblower rewards to a sweepingly broad class of people. With some limited exceptions, the Act made anyone eligible for its bounty program and anonymity protections. That meant that virtually anyone who had dealt with a company – including employees, suppliers, and customers in far-flung parts of the world – was a potential Dodd-Frank whistleblower. However, the SEC’s final rules exclude certain individuals from receiving awards, including:

- Officers, directors, trustees, or partners of an entity, when those individuals learned of information about the misconduct in question from another person or in connection with the company’s processes for identifying potential illegal conduct.
- Employees whose main job functions involve compliance or internal audit, or persons who are employed by a firm hired to (a) perform audit or compliance functions or (b) investigate possible violations of the law.

² *Id.* Dodd-Frank also prohibits retaliation against an employee-whistleblower for providing information to the SEC or CFTC, and creates a federal cause of action under which an employee who has suffered retaliation can sue his or her employer for reinstatement, back pay with interest and special damages. *Id.*

³ Securities and Exchange Commission, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Release No. 34-64545, available at <http://www.sec.gov/rules/final/2011/34-64545.pdf>.

- Employees of public accounting firms performing an engagement required by the securities laws, when the information relates to a violation by the client or the client's officers, directors, or employees.

There are two important limitations to these exclusions in the final rules:

- These individuals are still eligible for a Dodd-Frank award if they have a reasonable belief that disclosure to the SEC is necessary to prevent the company from engaging in conduct that could cause substantial injury to investors, or if they have a reasonable belief that the company is acting in a way that would interfere with an investigation of the misconduct.
- These individuals are eligible to report information as a whistleblower if 120 days have passed since they escalated the information to their company's audit committee, legal/compliance officer, or supervisor, or if 120 days have passed since they received the information and the circumstances indicate that the audit committee, legal/compliance officer, or supervisor was already aware of the information.

In addition, individuals with a pre-existing contractual or legal duty to report their original information to the SEC or to certain other authorities, or individuals who have such a duty arising from a court or administrative order, are ineligible to receive an award under the whistleblower program.

Despite the chorus of requests from companies over the last several months that the SEC adopt rules requiring employees to report problems internally to management before qualifying for rewards under Dodd-Frank,⁴ the final rules do not require internal whistleblowing. Nonetheless, the rules do try to encourage internal reporting in several ways:

- Under the rules, a whistleblower who reports wrongdoing to the SEC within 120 days of lodging a complaint through internal corporate channels will be considered to have provided the information to the SEC as of the date of the original internal disclosure.
- If a whistleblower reported original information internally before or at the same time that the whistleblower reported it to the SEC, and the company later discloses to the SEC the whistleblower's information or the results of an investigation initiated by the whistleblower's information, and this information leads to a successful enforcement action, the whistleblower will receive full credit for the information provided by the company and will be eligible for an award (even if the information the whistleblower

⁴ Earlier this month, a New York congressman proposed draft legislation that would amend the whistleblower provisions of Dodd-Frank to require internal reporting as a prerequisite for an award. The proposal would also require the SEC to notify a company that will be the subject of an enforcement action based on employee whistleblower information before filing the action, thereby giving the company an opportunity to investigate and take corrective action. The draft legislation would give the SEC discretion to grant an award of up to thirty percent of monetary sanctions imposed in an enforcement action, but would remove the current requirement of an award of at least ten percent. See Congressman Michael Grimm Legislative Proposal, Discussion Draft, available at http://financialservices.house.gov/UploadedFiles/GRIMM_040_xml.pdf

originally provided to the company would not have led, by itself, to a successful enforcement action).

- When deciding whether to increase the amount of a whistleblower's award, the SEC will consider whether the tipster reported through internal compliance channels and assisted in any internal corporate investigation. Similarly, in reducing the amount of an award, the SEC will consider whether the whistleblower interfered with internal reporting systems or made any false statements that hindered any investigation.

LOOKING AHEAD

The SEC's final whistleblower rules will be effective 60 days after being submitted to Congress or published in the Federal Register, which has not yet occurred. But already, Dodd-Frank's expansive whistleblower program has imposed new challenges for companies that identify wrongdoing within their ranks and that wish to position themselves for leniency in the resolution of the issues with regulators.

In announcing the new rules yesterday, the SEC chairwoman reported that Dodd-Frank's whistleblower provisions have already had a noticeable impact because "the quality of the tips we have received has been better" since Dodd-Frank was enacted last summer. Indeed, the SEC chairwoman added that she has "heard stories from our investigators about how whistleblowers have saved us weeks of investigation time because of the specific, credible and timely information they provided."

Beyond enhancing internal compliance measures designed to identify misconduct, these new rules make it more important than ever before for companies to promptly investigate all claims of wrongdoing and reinvigorate their internal whistleblower procedures. That way, companies can maximize the opportunity, after remediating any problems, to self-report to regulators – all before a Dodd-Frank whistleblower gets to the government first.

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