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SEC ADOPTS FINAL WHISTLEBLOWER RULES – CREATING STRONG INCENTIVES FOR WHISTLEBLOWERS AND EXPANDING WHISTLEBLOWER PROTECTION FROM RETALIATION

On May 25, 2011, the Securities and Exchange Commission (the "SEC"), in a divided 3-2 vote, adopted final rules to implement the whistleblower bounty program and anti-retaliation provisions enacted as a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The final rules will become effective 60 days following their publication in the Federal Register.

The Dodd-Frank Act added a new Section 21F to the Securities and Exchange Act of 1934 that requires the SEC to pay a bounty to eligible whistleblowers who voluntarily provide the SEC with original information leading to the successful enforcement of a federal court or administrative action by the SEC under the securities laws which results in monetary sanctions in excess of $1 million. If these criteria are met, a whistleblower could be eligible for an award ranging between 10 percent and 30 percent of the amount of monetary sanctions obtained in the action and in certain related actions.

The new provisions also prohibit employers from retaliating against whistleblowers. These provisions create an enforcement mechanism that is stronger than and in addition to the existing Sarbanes-Oxley anti-retaliation regime, which itself was strengthened by the Dodd-Frank Act.

Whistleblowers Not Required to Report Internally, Although Some Incentives Provided

The final rules reflect the SEC's stated position to encourage, rather than require, whistleblowers to comply with a company's internal compliance procedures prior to reporting a possible violation to the SEC. Under the final rules:

- voluntary participation in an internal reporting program will be a factor considered by the SEC to increase the percentage of the recovery to be awarded to a whistleblower, while interference with an internal reporting program can decrease the award;
- a whistleblower making an internal report (within 120 days before, or at the same time as, reporting the same information to the SEC) will be credited with any information provided to the SEC by the company as if it had been provided directly by the whistleblower; and
- a whistleblower who reports internally first, and then submits the same information to the SEC within 120 days, will be deemed to have made disclosure to the SEC on the date of the internal report, even if someone else reports the information to the SEC within the interim period.

The SEC believes that this approach will encourage companies to continue to strengthen their internal compliance programs because whistleblowers will be more likely to respond to these incentives by reporting internally when there is a good internal compliance program that employees trust.

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Award Eligibility

Whistleblower. The rules define a whistleblower as a natural person (and not an entity), whether acting alone or with others, who provides information to the SEC regarding "possible violations" of federal securities laws that have occurred, are ongoing, or are about to occur. A possible violation exits where information indicates a "facially plausible relationship to some securities law violation." The violation need not, however, be material to satisfy this standard.

Among the categories of persons excluded from whistleblower eligibility are: (i) employees of the SEC, Department of Justice, PCAOB, and certain other authorities; (ii) individuals convicted of criminal violations related to an action for which they would otherwise be eligible to receive an award; (iii) auditors to the extent a whistleblower submission would be contrary to the requirements of Section 10A of the Securities Exchange Act of 1934 (which require the auditor under certain circumstances to file a report of an illegal act with the SEC's Office of Chief Accountant); (iv) individuals acquiring information from someone ineligible for an award; and (v) individuals who knowingly make false or fraudulent statements in whistleblower submissions or other communications to the SEC.

Voluntary. Submission of information is considered voluntary if a whistleblower acts prior to the time a request, inquiry, or demand is made upon the whistleblower or his/her representative (i) by the SEC; (ii) in connection with an investigation, inspection, or examination by the PCAOB or any self-regulatory organization; or (iii) in connection with an investigation by Congress, any other authority of the federal government, or a state attorney general or securities regulatory authority. The SEC rejected a comment that the submission not be considered voluntary if the whistleblower was aware there was an ongoing governmental or internal investigation, or if the employer had been issued a request or subpoena for information from the government.

Original information. Original information is derived from a whistleblower's "independent knowledge" or "independent analysis" that is unknown to the SEC and is reported for the first time after the enactment of the Dodd-Frank Act (although it can relate to action that occurred prior to the enactment). "Independent knowledge" is defined as information not derived from publicly available sources, while "independent analysis" means a person's analysis done alone or in combination with others which may be based on publicly available information. Notwithstanding the foregoing, information regarding an alleged violation that is obtained by the SEC through another source (including a whistleblower's employer) may still be deemed to have originated from the whistleblower to the extent the information he or she provides is derived from his or her independent knowledge and "materially adds" to the information previously known by the SEC.

The final rules contain an exclusion for information obtained by means of a communication subject to attorney-client privilege, unless disclosure is permitted under SEC and state rules governing attorney conduct. Additionally, certain submissions by officers, directors, auditors, and compliance personnel are excluded from whistleblower award eligibility unless one of three conditions exists: (i) the person has a reasonable basis to believe that disclosure of the information is necessary to prevent the company from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the company or its investors; (ii) the person has a reasonable basis to believe that the company is engaging in conduct that will impede an investigation of the misconduct; or (iii) 120 days have elapsed since the

whistleblower provided the information to the company's audit committee, chief legal officer, chief compliance officer (or their equivalents,) or to the whistleblower's supervisor, or 120 days have elapsed since the whistleblower received the information at a time when the above-listed persons were already aware of the information.

Led to successful enforcement. A whistleblower's information will be deemed to have "led to successful enforcement" when it is sufficiently specific, credible, and timely to cause the SEC to commence an investigation, open an investigation, reopen a closed investigation, or inquire concerning different conduct as part of a current examination or investigation, and the SEC brings a successful judicial or administrative action. With respect to ongoing investigations, the final rules require that the information "significantly contribute" to the success of the action in order to be award eligible.

Monetary sanctions. In order for a whistleblower to qualify for an award, monetary sanctions in the SEC action must exceed $1 million. Monetary sanctions include any money, including penalties, disgorgement, and interest. If a whistleblower is ordered to pay monetary sanctions in connection with an enforcement action, or where an entity's liability is based substantially on the whistleblower's conduct, the SEC will exclude such amounts from the determination of whether the $1 million threshold is met. In response to comments to the proposed rules, the final rules allow the SEC to aggregate two or more smaller claims that are based on the same nucleus of operative facts for the purpose of satisfying the $1 million threshold.

Amount of Award

If a person meets all of the requirements to qualify for an award, the final rules require the SEC to award the whistleblower an amount that is not less than 10 percent and not greater than 30 percent of the monetary sanctions collected in the SEC action and certain related action(s). Related actions are judicial or administrative actions brought by the Attorney General of the United States, certain regulatory authorities, a self-regulatory organization, or a state attorney general in a criminal case, that are based on the same information the whistleblower provided to the SEC and that led the SEC to obtain monetary sanctions totaling more than $1 million. In the case of multiple whistleblowers, the SEC will determine a percentage award for each whistleblower, with the aggregate amount awarded to all whistleblowers falling within the statutory range of 10 percent and 30 percent of the amounts collected.

The final rules list factors that could increase an award: (i) significance of the information provided; (ii) the whistleblower's assistance; (iii) law enforcement's interest in the matter; and (iv) the whistleblower's participation in the company's internal compliance systems. Conversely, the final rules provide factors that could decrease an award: (i) the whistleblower's culpability; (ii) unreasonable reporting delay; and (iii) the whistleblower's interference with internal compliance and reporting processes.

Anti-Retaliation Provisions

Section 21F prohibits employers from discharging, demoting, suspending, threatening, harassing, or otherwise discriminating against whistleblowers who provide information or assistance to the SEC in accordance with the

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whistleblower provisions, or who make disclosures required or protected under laws subject to the jurisdiction of the SEC. Whistleblowers experiencing retaliation may go directly to federal court and sue for reinstatement, double back pay with interest, costs, and attorney's fees. The SEC has enforcement authority for violations. The statute of limitations is no more than six years after the violation, or three years after facts material to the right of action are known or reasonably should have been known by the employee.

In an attempt to allay companies' fears about people submitting frivolous claims and receiving the benefits of the anti-retaliation provisions, the final rules require that a whistleblower have a "reasonable belief" that the information reported relates to a possible violation of securities laws, meaning the person must have a "subjectively genuine belief that the information demonstrates a possible violation, and that this belief is one that a similarly situated employee might reasonably possess." The anti-retaliation protections apply whether or not the individual satisfies the requirements to qualify for an award under the bounty program.

Additionally, the final rules prohibit employers from interfering with a whistleblower's communications with the SEC (including by attempting to enforce a confidentiality agreement).

Foreign Corrupt Practices Act Implications

Because the provisions of the Foreign Corrupt Practices Act ("FCPA") are part of the federal securities laws, the whistleblower bounty and anti-retaliation provisions will also apply to reports of violations or possible violations of the FCPA. Enforcement of the FCPA has been a major focus of the DOJ and SEC, resulting in numerous recent record-breaking penalties. Accordingly, the final rules will very likely result in a significant increase in tips relating to alleged bribery of foreign officials in violation of the FCPA.

Effect of and Response to Whistleblower Rules

The SEC says that it has already experienced, and is likely to continue to experience, an increase in the volume of quality tips. In response to the new rules, companies should take steps to ensure they have an effective internal compliance program in place, including:

- Promote employee awareness of and use of internal reporting mechanisms. Ensure that internal reporting mechanisms function smoothly. Respond proactively and promptly to all reports, with a view to being required to defend the response to the SEC.
- Implement or enhance employee internal certification mechanisms. Consider requiring employees to provide periodic certifications that they are not aware of any actual or possible violations of law except as disclosed in the certification, and that they have reported any such actual or possible violations internally in accordance with company policy.

- Make sure your anti-retaliation policy is strong, well-publicized, and adhered to by all employees. Document interactions with whistleblowers as well as the rationale for all decisions made with respect to whistleblowers. Make sure employee evaluations accurately reflect problems, as disgruntled employees are often a source of unwarranted whistleblower claims.
- Review compliance procedures and internal controls to ensure they are effective in preventing and detecting violations of law.
- Review internal investigations procedures to ensure they enable the company to promptly investigate reported violations and implement appropriate remedial measures in a timely manner.
- Ensure that the company's document preservation procedures effectively prevent the destruction of documents related to reports of possible violations.
- Have procedures in place for responding to inquiries from the SEC.

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Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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