

SEC Proposes Rules on Whistleblower Provisions of Dodd-Frank Act

On November 3, 2010, the Securities and Exchange Commission announced proposed rules to implement the whistleblower provisions of Section 21F the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*. The Act directs the SEC to pay awards of between ten and thirty percent to whistleblowers who voluntarily provide the SEC with original information about a violation of securities laws that leads to a successful enforcement action with monetary sanctions exceeding \$1,000,000. The SEC's proposed rules clarify the eligibility of potential whistleblowers, as well as the procedures for making an award claim under Section 21F.

Prior to passage of Dodd-Frank, the SEC's whistleblower program was limited to insider trading cases, and the amount of an award was limited to ten percent of the agency's recovery. Under the expanded whistleblower provisions, companies should anticipate increased submissions of information by employees to the SEC. Companies should educate themselves concerning the most significant aspects of the SEC's proposed rules, including the following:

Whistleblowers Must Be Original Sources to Qualify

Whistleblowers will be eligible only if they provide original information, which must be derived from independent knowledge or independent analysis and must not be previously known to the SEC. As such, only the first person to submit relevant information to the SEC will be eligible for a whistleblower award, creating a strong incentive for whistleblowers to submit information without delay.

Internal Disclosure Encouraged, but SEC Disclosure Required within 90 Days

In an effort to discourage employees from bypassing their employer's internal compliance programs, the internal disclosure of information to legal, compliance, audit, or supervisory personnel within a company will function as the date of disclosure for purposes of determining if information is original. However, to be eligible for an award, a whistleblower must still disclose the information to the SEC within 90 days of reporting it internally. Employers can thus expect that concerns or allegations raised internally by an employee might also be disclosed to the SEC within such a 90-day window, and should structure and schedule their internal inquiries and reactions appropriately.

Company Delays During Investigation Will Expand Whistleblower Eligibility

In general, it will be much more difficult for a whistleblower to recover an award once an investigation has been commenced by the SEC or another government agency. However, a company's delay in responding to government inquiries will have the effect of expanding eligibility for a whistleblower award. For example, information provided by a whistleblower will not be deemed to be provided voluntarily – and thus cannot serve as the basis for an award – if that information falls within the scope of any request or inquiry from any government agency (or a self-regulatory organization). However, if an employer were to fail to provide

documents or information to the requesting authority “in a timely manner,” an employee can be eligible for a whistleblower award for subsequently providing that information to the SEC. Similarly, a whistleblower who discloses information obtained during a compliance review, legal investigation, audit, or internal report will generally not be eligible for an award – unless the employer fails to disclose that information to the SEC within a reasonable time or is deemed to have acted in bad faith.

Impeding a Whistleblower’s Communications with SEC Will Be Prohibited

Persons will be prohibited from taking any action to impede a whistleblower from communicating directly with the SEC about a potential securities law violation. In investigating or responding to potential violations, employers must take care not to take any action that could be interpreted as impeding whistleblower-SEC communications. The proposed rules specifically characterize the actual or threatened enforcement of a confidentiality agreement as an action that could impede whistleblower-SEC communications, although confidentiality agreements relating to attorney-client relationships are generally exempted.

SEC Can Communicate with Whistleblower Without Consent of Counsel

The SEC will be authorized to communicate directly with whistleblowers who are affiliated with a represented entity – such as directors, officers, employees, or agents – without seeking the consent of the counsel to that entity.

Wrongdoers Will Be Eligible To Be Whistleblowers

Persons who are responsible for violations of securities laws will be eligible for whistleblower awards despite their culpability, although anyone convicted of a crime in connection with these violations will be ineligible. In addition, any sanctions based substantially on conduct that the whistleblower directed or planned will be excluded from the calculation of that whistleblower’s award. In a speech announcing the proposed rules on November 3, 2010, SEC Commissioner Luis Aguilar expressed a level of ambiguity about these provisions, and specifically requested comments concerning how awards to culpable individuals should be limited or prohibited.

The SEC has characterized these proposed rules as providing a “simple, straightforward procedure” and a “transparent process” for whistleblowers to provide valuable information and assert award claims. The proposed rules require the SEC to publicize enforcement actions that are eligible for whistleblower awards and describe the procedures under which claims will be evaluated by the SEC’s Whistleblower Office and reviewed by the Commission. Included in the proposed rules are mechanisms for a whistleblower to review the relevant materials collected by the Whistleblower Office and to contest the Preliminary Determination of a claim. In part, these procedures may be an effort to correct the deficiencies identified by the SEC’s Inspector General in a March 29, 2010 report that criticized the SEC’s longstanding but rarely used program to compensate whistleblowers in insider trading cases as poorly publicized and inadequately supported.

The SEC’s proposed rules to implement the whistleblower provisions of Section 21F of the 2010 Dodd-Frank may be found at the SEC’s web site [here](#). The SEC is accepting comments on the proposed rules until December 17, 2010.

If you would like to discuss these or any other issues pertaining to securities enforcement, please contact any member of Ropes & Gray’s [Government Enforcement](#) or [Securities Litigation](#) practices.