

Incentive Awards for Whistleblowers under Dodd-Frank

On May 25, 2011, SEC adopted rules implementing Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), mandating that the SEC establish a program to pay awards to eligible whistleblowers reporting federal securities law violations. Under the final rules, which will be administered by the newly created Office of the Whistleblower, persons who voluntarily provide original information to the SEC about potential violations of federal securities law that leads to successful enforcement actions in which monetary sanctions exceed US\$1 million are entitled to an award of between 10 and 30 percent of all such sanctions collected.

Largely consistent with the rules originally proposed on November 10, 2010, the most significant changes to the final rules seek to encourage whistleblowers to report internally before turning to the SEC. These changes were incorporated in an effort to ensure that the rules do not undermine company's internal compliance programs. In particular, the final rules (i) extend from 90 to 120 days the period whistleblowers have to submit information to the SEC in order to remain eligible for an award after having reported information internally, (ii) clarify that voluntary internal reporting can increase the amount of an award, and (iii) allow employees who report internally to receive awards if their company subsequently discloses to the SEC the information reported by the employee. Despite incentives to report internally, the final rules fall short of requiring mandatory internal reporting.

Along with establishing financial incentives for whistleblowers the rules expand the whistleblower protections provided by the 2002 Sarbanes-Oxley Act ("SOX").

Eligibility Requirements

Under the rules, a whistleblower is defined as an individual who provides the SEC with information relating to a possible violation of the US federal securities laws that is ongoing, has occurred or is about to occur. To be eligible for an award, a whistleblower must (i) voluntarily provide the SEC (ii) with original information (iii) that leads to the successful enforcement by the SEC of a federal court or administrative action (iv) in which monetary sanctions totaling more than \$1 million are obtained.

Voluntary Submission

Whistleblowers are eligible for awards only when they "voluntarily" provide original information to the SEC. Namely, when an individual comes forward before his or her representative is subject to a request, inquiry or demand by any governmental authority or self-regulatory organization. It is important to note, however, that the final rule does not prevent a whistleblower from making a submission after his or her employer has already received an inquiry on the matter. Individuals with a pre-existing legal or contractual duty to report securities violations are not eligible. All submissions are under the penalty of perjury and, as long as an attorney will certify to the whistleblowers identity, the submission may be made anonymously.

Original Information

To qualify for an award, a whistleblower must provide "original information" to the SEC that is derived from such person's "independent knowledge" or "independent analysis". Unless the whistleblower is the source, such information may not already be known to the SEC from any other source; not exclusively

derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit or investigation, or from the news media.

Successful Enforcement with Sanction Over \$1 million

In order to be eligible for an award the information provided by the whistleblower must have lead to a successful enforcement action where the SEC obtains monetary sanctions in excess of \$1 million.

Information is considered to have lead to a successful enforcement action when a whistleblower provided information that was (i) "sufficiently specific, credible and timely" to lead to the opening or reopening of an investigation or caused the SEC to inquire regarding different conduct as part of an existing investigation; (ii) provided information about conduct already under investigation that "significantly contributed" to the government prevailing; or (iii) submitted a complaint through his or her internal reporting mechanism, which prompted the company to conduct an internal investigation and ultimately disclose information to the SEC that is covered by (i) or (ii).

Criteria for Determining Amount of Award

As noted, the SEC will grant an eligible whistleblower a discretionary award of between 10 and 30 percent of the monetary sanctions recovered in an SEC or related action. Under the proposed rules, the SEC would make a fact-specific determination of the amount of an award based on four factors. The following factors may increase the award percentage: (i) the significance of the information provided by the whistleblower to the success of the action; (ii) the degree of assistance provided by the whistleblower in the action; (iii) the SEC's programmatic interest in deterring securities laws violations by making awards to whistleblowers who provide information that lead to successful enforcement actions, and (iv) whether, and to what extent, the whistleblower participated in internal compliance systems. Conversely, the following factors may decrease an award percentage: (i) the whistleblower's culpability or involvement in

1 Under the proposed rules, a submission was not considered voluntary if made by an employee after his or her employer had already received an inquiry on the matter misconduct to the action; (ii) whether the whistleblower unreasonably delayed reporting securities laws violations, and (iii) whether the whistleblower undermined the integrity of the internal reporting system.

Expanded Whistleblower Protection Program

The Act also expands the protections afforded whistleblowers under SOX. First, it amends the definition of companies covered to include "any subsidiary or affiliate whose financial information is included in the consolidated financial information statements" of a publically traded company. Second, the time individuals have to file claims with the Department of Labor is doubled to 180 days. And third, the Act establishes that neither pre-dispute arbitration agreements, nor waivers of employee's rights or remedies under SOX will be enforceable.