

## Rise Of The Whistleblowers

*Law360, New York (August 22, 2011, 1:54 PM ET)* -- On Aug. 12, 2011, the U.S. Securities and Exchange Commission's "Office of the Whistleblower" officially opened for business. The new whistleblower office is part of the Division of Enforcement and will handle whistleblower tips and complaints, provide guidance to enforcement staff, and assist the commission in determining the size of the awards received by whistleblowers.

The office is charged with implementing the recently adopted SEC whistleblower rules, which were mandated by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Dodd-Frank overhauled the SEC's whistleblower provisions, greatly expanding its power to reward whistleblowers and vesting it with enforcement authority over employers who wrongfully retaliate against whistleblowers.

Regulators and industry observers agree that the SEC's whistleblower rules are likely to have a profound impact on enforcement activities. The SEC has estimated that it expects the new whistleblower office to receive thousands of credible whistleblower complaints each year. While the SEC may not have the resources to investigate every complaint, observers project a significant increase in whistleblower activity and expect that many complaints will result in full-blown SEC investigations. The projected increase in whistleblowing activity highlights the strong need for public companies and other regulated entities to respond quickly and comprehensively to whistleblower allegations.

### Description of the Whistleblower Rules

Section 21F requires the SEC to pay awards to whistleblowers who voluntarily provide the agency with original information regarding violations of the federal securities laws that are successfully prosecuted by the SEC and result in monetary sanctions exceeding \$1 million.[1] The rules establish other requirements that a whistleblower must meet to be eligible for an award and provide detailed explanations of these requirements, including the following:

### *Whistleblower*

Under Regulation 21F, an individual who provides the SEC with information relating to a potential violation of the federal securities laws may qualify for an award as a “whistleblower.” To qualify for an award, the individual must, alone or jointly with others, voluntarily provide the SEC with original information regarding past, present, or future possible violations of the federal securities laws.[2]

A “possible violation” means that the information submitted has a facially plausible relationship to a federal securities law violation. Frivolous submissions and submissions concerning only state or foreign securities laws do not qualify.[3]

### *Voluntary Submission*

To qualify as a “voluntary submission,” the whistleblower must submit information before a request, inquiry, or demand regarding the submission’s subject matter is directed to the individual or his or her representative: (1) by the SEC; (2) in connection with an investigation or examination by the Public Company Accounting Oversight Board or any self-regulatory organization; or (3) in connection with an investigation by Congress, any other federal authority, or a state attorney general or securities regulatory authority.[4]

A submission will also be deemed involuntary if the individual must report the information to the SEC due to: (1) a preexisting legal duty; (2) a contractual duty owed to the SEC, PCAOB, Congress, a self-regulatory organization, any other federal governmental authority, a state attorney general, or a state securities regulatory authority; or (3) a duty arising out of a judicial or administrative order.[5] A cooperation agreement with the U.S. Department of Justice requiring the individual to cooperate or provide information to the SEC, for example, would not be considered voluntary.

### *Original Information*

To qualify as original information, the submission must: (1) be derived from independent knowledge or independent analysis; (2) not be already known to the SEC from any other source (unless the individual is the original source); and (3) not be exclusively derived from allegations in judicial or administrative hearings, governmental reports, hearings, audits or investigations, or from news media (unless the individual is the source of information).[6]

To be considered “independent knowledge,” the factual information submitted may not be derived from publicly available sources. However, the “independent knowledge” requirement does not require that the whistleblower have direct, firsthand knowledge of the possible violation. Indeed, the information may be based on the individual’s experiences, communications and observations in business or social interactions.[7]

The rules define “independent analysis” as an individual’s own analysis done either alone or with others.[8] Indeed, independent analysis requires that the individual provide some additional evaluation, assessment, or insight beyond what is publicly available. The SEC, however, will not consider the following information to have been derived from independent knowledge or analysis:[9]

- Attorney-Client Privileged — information obtained through an attorney-client privileged communication unless disclosure was permissible by the attorney under SEC or state bar rules.
- Company Senior Personnel — information obtained because the whistleblower is an officer, director, trustee, or partner of an entity and another person informed him or her about the alleged misconduct, or he or she learned the information in connection with the company’s processes for identifying, reporting and addressing possible violations.
- Compliance or Internal Audit — information obtained because the whistleblower is an employee whose principal duties involve compliance or internal audit responsibilities or an individual employed by a firm retained to perform such responsibilities.
- Internal Inquiry — the whistleblower is employed by or associated with a firm retained to conduct an inquiry or investigation regarding possible violations.
- Public Accounting Firm — the whistleblower is an employee of (or associated with) a public accounting firm, the information was obtained during an engagement required of an independent public accountant under the federal securities laws, and the information related to a violation by the engagement client or its officers, directors, or employees.
- Illegally Obtained — the information was obtained in a way that violated federal or state law.

#### *Successful Enforcement Action*

Information provided to the SEC will be considered to have led to a successful judicial or administrative action under the following circumstances:[10]

- Commenced Examination or Investigation — if the whistleblower provided sufficiently specific, credible and timely information causing the SEC to commence an examination or investigation, reopen a closed examination, or inquire about different conduct regarding a current examination or investigation, and the SEC brings a successful enforcement action based in whole or in part on the information provided.

- Currently under Examination or Investigation — if the whistleblower provided information about conduct that was already under examination or investigation by the SEC, Congress, any other federal government authority, a state attorney general or securities regulatory authority, a self-regulatory organization, or the PCAOB, and the information significantly contributed to the success of the action.
- Internal Compliance System — the whistleblower will receive full credit for information reported through the company’s internal compliance procedures before or at the same time the whistleblower reported it to the SEC, if the company provided the information (or the results of an investigation prompted by the information) to the SEC; and the company’s information led to a successful SEC enforcement action under the two circumstances discussed above.

The SEC will generally not consider information to have significantly contributed to the success of an enforcement action if: (1) a law enforcement subpoena or document request was issued to an entity or individual other than the whistleblower; (2) evidence shows the whistleblower knew about the request or inquiry; and (3) the whistleblower withheld or delayed providing responsive documents before making any submission.[11] Thus, the SEC clearly does not plan to reward individuals who have obstructed ongoing investigations.

### *Monetary Sanctions*

To be eligible to receive a whistleblower award, the SEC’s enforcement action must result in monetary sanctions — penalties, disgorgement and interest — exceeding \$1 million.[12] An “action” generally means a single captioned judicial or administrative proceeding; however, two or more such proceedings will be treated as an action if they arise out of the same nucleus of operative facts.

The SEC has discretion to determine the amount awarded to whistleblowers. However, whether the award goes to one individual or to multiple whistleblowers in connection with the same action, the aggregate award amount must be at least 10 percent and no more than 30 percent of the monetary sanctions collected by the SEC and other authorities.[13] In determining the percentage of the award, the SEC may consider the following factors to increase the whistleblower’s award amount:[14]

- Significance of the Information Provided — e.g., the nature of the information and the degree to which it supported one or more successful claims.
- Degree of Assistance Provided — e.g., whether the whistleblower provided ongoing, extensive and timely cooperation; the resources conserved as a result of the assistance; whether the whistleblower encouraged the cooperation of others; remediation efforts taken by the whistleblower; any unique hardships experienced by the whistleblower due to reporting.

- Law Enforcement Interest — e.g., the subject matter relates to a priority of the SEC and enhances the agency’s ability to protect investors.
- Participation in Internal Compliance Systems — e.g., an internal report of the violation(s) was made before or at same time as the report to the SEC and the individual provided assistance during internal investigation.

The following factors, however, may decrease the award size: (1) culpability (e.g., whistleblower played a role in securities violations or was a recidivist); (2) unreasonable reporting delay; and (3) interference with the internal compliance system.[15]

## **Other Elements of the Whistleblower Program**

### *No Retaliation*

Whistleblowers are protected under the anti-retaliation provisions of the statute if they possess a reasonable belief that the information submitted concerns a possible securities violation (regardless of whether the award requisites are satisfied).[16] To meet this standard, the employee must have a subjective genuine belief that the information demonstrates a possible violation.[17]

### *No Amnesty*

The rules do not provide amnesty to whistleblowers. If their conduct violates the federal securities laws, the SEC may charge them accordingly.[18]

### *Lookback Provision*

The rules do not require whistleblowers to report internally before making a submission to the SEC. Nevertheless, an individual who first reports through a company’s internal compliance system and then reports the same information to the SEC within 120 days may still qualify as a whistleblower and receive an increased award for having participated in the company’s internal compliance system.[19]

### *Confidentiality*

The SEC may not disclose information that could reasonably be expected to reveal a whistleblower’s identity except in certain limited circumstances (e.g., to a defendant when required in a court action or to the DOJ if the SEC determines it is necessary for investor protection).[20] On the other hand, the SEC may require a confidentiality agreement regarding any nonpublic information it provides to the whistleblower.[21]

Moreover, the rules prohibit any efforts to impede whistleblower communications with the SEC staff. Indeed, it is prohibited to enforce or threaten to enforce a confidentiality agreement that would restrict such communications (unless it concerns privileged information).[22] And, despite concerns raised about undermining the attorney-client privilege, the rules permit the SEC staff to communicate directly with an officer, director, or employee of a company that has counsel if that individual first initiated communication with the SEC as a whistleblower — this communication appears to be permissible even without such counsel’s notice or consent.[23]

## Conclusion

With the adoption of the whistleblower rules, public companies and SEC-regulated entities (e.g., broker-dealers and investment advisers) must now be fully prepared for the ramifications and potential onslaught of whistleblowers motivated by large monetary awards. Increased whistleblowing activity will increase corporate risk stemming from both enforcement actions and private civil litigation. This increased risk underscores the need for companies to ensure that they have robust internal compliance programs, open and positive communication lines with employees, solid training and procedures to encourage internal reporting by employees and strong anti-retaliation policies.

Under the whistleblower program, public companies and other entities that are the target of these complaints may be required to investigate matters and report to the SEC, and may lose some of the previously available cooperation benefit of self-reporting securities violations to law enforcement. In light of these risks and the increase in whistleblower activity, it is imperative that companies quickly complete internal investigations and timely self-report violations of the federal securities law.

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*The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360. This article is for general information purposes and is not intended to be and should not be taken as legal advice.*

[1] See also 17 C.F.R. § 240.21F-3.

[2] 17 C.F.R. § 240.21F-2(a).

[3] Whistleblower Release p. 13.

[4] 17 C.F.R. § 240.21F-4(a).

[5] 17 C.F.R. § 240.21F-4(a)(3).

[6] 17 C.F.R. § 240.21F-4(b).

[7] 17 C.F.R. § 240.21F-4(b)(2).

[8] 17 C.F.R. § 240.21F-4(b)(3).

[9] 17 C.F.R. § 240.21F-4(b)(4).

[10] 17 C.F.R. § 240.21F-4(c).

[11] Whistleblower Release p. 100.

[12] 17 C.F.R. § 240.21F-4(d).

[13] 17 C.F.R. § 240.21F-5(a)-(b).

[14] 17 C.F.R. §§ 240.21F-5(b), 240.21F-6(a).

[15] 17 C.F.R. § 240.21F-6(b).

[16] 17 C.F.R. § 240.21F-2(b).

[17] Whistleblower Release p. 16.

[18] 17 C.F.R. § 240.21F-15.

[19] 17 C.F.R. §§ 240.21F-4(b)(7), 240.21F-6(a).

[20] 17 C.F.R. § 240.21F-7(a).

[21] 17 C.F.R. § 240.21F-8(b)(4).

[22] 17 C.F.R. § 240.21F-17(a).

[23] 17 C.F.R. § 240.21F-17(b).

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