

VOICES PLAYS NOTICEABLE ROLE IN FINAL SEC WHISTLEBLOWER RULES

On December 17, 2010 Voices for Corporate Responsibility (VOICES) submitted a letter to the SEC that outlined its stance on the proposed rules. This submission contained commentary regarding potential negative effects that would hinder whistleblowers' ability to receive awards and also contained suggestions on how to avoid these problems. VOICES' letter was reviewed by the SEC during its rule commentary period and referenced substantially throughout the final rule release.

On May 25, 2011 the SEC voted in a 3-2 decision in favor of adopting final rules implementing the whistleblower provisions of the Dodd-Frank Act. The final rules include significant revisions made to the proposed rules the SEC published for comment on November 3, 2010 regarding, among others, internal compliance, procedures for submitting information and claims, aggregation of smaller actions to meet the \$1,000,000 eligibility threshold, and exclusions from award eligibility for certain persons and information.

VOICES played a noticeable role in the provisional changes referenced below through its commentary, advocacy efforts and collaborations with other organizations.

Internal Compliance Programs Are Encouraged But Not Required

The final rules do not include an internal compliance reporting requirement.¹ However, in an effort to appease commenters on both sides regarding the role of internal compliance programs, the Commission has made changes to the proposed rules to ensure that potential whistleblowers have adequate incentives to use internal compliance systems while also preserving the ability to report directly to the SEC.² Key rule changes are described below:

- A 120 day look-back period gives employees who initially report to internal compliance systems the opportunity to use the internal reporting date when submitting a claim to the SEC.³ An employee reporting the same potential violation to the Commission within 120 days is afforded the benefit of using the earlier recording date with the SEC. This approach promotes the use of internal reporting systems while preserving the whistleblower's rights under the SEC reporting system.⁴ The commission specifically recognizes that whistleblowers are in the best position to assess whether reporting violations through internal compliance systems or reporting directly to the SEC would be effective in their particular case.⁵
- Another provision allows for credit to be given to a whistleblower when their company reports a violation to the SEC based on information the whistleblower reported to the company's internal compliance system. The whistleblower is also given credit for any information that was substantially pursued by the company's own internal investigation even if the original information provided to the internal compliance program would not have satisfied the SEC's requirement that the information specifically lead to a successful enforcement action.⁶

¹ SEC Final Rules Background and Summary: Internal Compliance at page 5

² Rule 21F-4(b)(7) at page 91

³ *Id.* at page 89

⁴ *Id.* at page 90

⁵ *Supra* note 2

⁶ Rule 21F-4(c)(3) at page 101-102

- The Dodd-Frank act provides for an award ranging between 10 and 30 percent of the total monetary sanctions collected from companies in violation of SEC securities laws. These awards are given to whistleblowers that voluntarily provide original information that lead to a successful enforcement action. The final rules adopt an analytical framework that provides for the mandatory consideration of certain criteria that either increase or decrease the amount of the award. Factors that decrease award amounts include whistleblower culpability, unreasonable report or delay by the whistleblower and whether a whistleblower interferes with internal compliance programs. Factors that will increase the amount of the award include the significance of the information provided, the assistance provided by the whistleblower, law enforcement's interest in granting whistleblowers an award, and the whistleblowers participation in internal compliance programs.⁷ With this framework the SEC indicates that the good faith use of internal compliance systems is weighted heavily in whistleblower award calculations. Internal compliance programs' required consideration strikes a good balance between SEC and internal compliance reporting systems. Although there is no internal compliance reporting requirement whistleblowers are incentivized to do so by the potential increase in award amount. This provision mitigates some commenters' fears that internal compliance programs would not be respected in this reporting process. The SEC's solution pays homage to internal compliance programs while also preserving whistleblower SEC rights and paying deference to whistleblowers' determination of whether reporting potential securities violations internally would be appropriate or desirable.⁸

Whistleblower Submission of a Claim

Successful submission of a claim requires the reporting of original information discovered by the whistleblower and the whistleblower's independent analysis or knowledge of that information that leads to successful enforcement of SEC securities laws.⁹ The SEC defines original information as information that is derived from the independent knowledge or analysis of the whistleblower that is not already known by the SEC or derived from other judicial or administrative proceedings.¹⁰ "Independent analysis" includes the whistleblower's own examination and evaluation of information that may be generally available but reveals information not generally known to the public.¹¹ The SEC specifically referenced commentary made by VOICES, and others, identifying the need to clarify that 'independent analysis' can be based on publicly available sources.¹² The final rule now provides that publicly available sources can be submitted as part of a whistleblowers' "independent analysis" of that information. This clarification has the effect of making the claims process easier for whistleblowers to understand and broadening their basis for information that can be used to submit a claim.

Successful Enforcement Based on Whistleblower Claim Information

The proposed rules established a significantly higher standard than the final rules for information regarding conduct under investigation or examination that would be considered to have led to successful enforcement of SEC rules. Under the standard of the proposed rules, a whistleblower would need to demonstrate that the information would not have otherwise been obtained and was essential to the success of the action. After reviewing several comments in opposition to this unreasonably high standard, the SEC was persuaded to clarify its requirements and lower the proposed standard due in part to VOICES and others' arguments. In their explanation for allowing

⁷ Rule 21F-6 at pages 122-126

⁸ *Id.* at page 125 footnote 274

⁹ Rule 21F-3 at page 21

¹⁰ Rule 21F-4(b) at page 39

¹¹ Rule 21F-4(b)(3) at page 48

¹² *Id.* at pages 49-50

these lower standards the SEC referenced VOICES, and others', criticism that the proposed standards were too high and ambiguous.¹³ The Commission also pointed to VOICES and other commenters' arguments regarding the requirement that information submitted "significantly contribute" to the success of the action and the difficulty of whistleblowers to show that their information would "not have otherwise been obtained" and was "essential to the success of an action".¹⁴ Specifically, VOICES' argument that, given SEC funding issues, the Commission should not condition awards on the theoretical possibility that the whistleblower office staff could uncover evidence in the normal course of investigation was quoted in a footnote.¹⁵ Persuaded by these and other arguments, the SEC adopted lower standards and omitted its requirement that information must have "significantly contributed" to the success of the action in an effort to make the standard easier for whistleblowers to satisfy.¹⁶

Confidentiality Agreements Will Not Bar Reporting to the SEC

The final rules prevent the use of confidentiality agreements to preclude potential whistleblowers from reporting violations directly to the SEC.¹⁷ Although heavily opposed, this rule was adopted as proposed due in part to the support the rule was given by VOICES and other groups. Referenced in the SEC's rationale for adopting the proposed language, VOICES was quoted arguing that whistleblowers should not be prevented from communicating directly with the Commission staff by actions such as enforcing, or threatening to enforce, a confidentiality agreements because such actions would "conflict with the purpose of the statute."¹⁸ The Commission used these and other comments to provide support of their position to leave the proposed rule unchanged in the face of opposition from many other commenters.¹⁹ This decision ensures that signing a confidentiality agreement will not impede on a whistleblower's right to file a claim with the SEC.

Procedures for Submitting Claims and Information

The final rules streamline the process for submission of claims and information in an effort to make the process easier for potential whistleblowers. The proposed two-step process is simplified in the final rules.²⁰ The rules combine the proposed two required forms into one and the final claims application form is made less burdensome for whistleblowers by several features that are included to improve efficiency without being burdensome.²¹ These features include:

- Claim applications that allow for joint submissions by more than one potential whistleblower
- Exclusion of the proposed rule that required whistleblowers to disclose how they obtained their information
- Inclusion of a question asking whether the whistleblower reported the activity to the company's internal compliance system
- Inclusion of a question giving whistleblowers the opportunity to identify any documents or information that they believe could reveal their identity.
- An express provision absolving reporting attorneys (in cases in which the whistleblower chooses to remain anonymous) of accountability as long as the attorney has a good faith belief that the information is accurate

¹³ Rule 21F-4(c) at page 98-99

¹⁴ *Id.* at page 94

¹⁵ *Id.*

¹⁶ *Id.* at page 97

¹⁷ Rule 21F-17 at page 201

¹⁸ *Id.* at page 199

¹⁹ *Id.* at pages 201-203

²⁰ Rule 21F-9 at page 154

²¹ *Id.* at pages 154-158

- Exclusion of the need to perfect whistleblower status by re-submission if the action was reported before the date of the final rule enactment

Aggregation of Smaller Actions

Additionally, the final rules allow for multiple cases that arise out of a common nucleus of operative facts to be considered as a single action for purposes of determining the payment of an award.²² This rule allows aggregating the amount of the monetary sanctions recovered from multiple actions to calculate the \$1,000,000 threshold required for eligibility for an award. The proposed rule provided that each action brought by the Commission needed to lead to the recovery of more than \$1,000,000 to allow the whistleblower to receive an award. Considered criteria to determine similarity of claims include the following:

- Same or similar parties
- Same or similar factual allegations
- Same or similar alleged violations of the federal securities laws
- Same or similar transactions or occurrences²³

Whistleblower awards will be paid out of the total monetary sanctions collected. Whistleblowers will also receive credit for subsequent actions that the SEC itself brings, as long as the new action arises from a common nucleus of operative facts.²⁴ With this change the SEC ensures that the whistleblower will be compensated if separate actions are pursued by the SEC based on the whistleblower's submission.

Treatment of High Level Executive Whistleblowers

The final rules make clear that the SEC does not want to broadly exclude all high level executives and other key personnel (such as officers, directors, trustees, partners, supervisors, auditors and compliance personnel) from being able to bring forth claims under the whistleblower program.²⁵ The final rule only excludes key personnel from whistleblower status if they obtain their information from another employee reporting to the company's internal compliance system or if the information reported by the executive was originally from another person.²⁶ Otherwise, executives are not prevented from reporting potential violations as long as they reasonably believe that disclosure to the SEC will prevent prohibited company conduct or prevent a company's impediment of an SEC investigation.²⁷

Incentives for the use of internal compliance systems also apply to high level executives and are suggested for executive who have a fiduciary duty to the company. Additionally, the SEC affords the opportunity for officers, directors, auditors, compliance personnel and other persons in similar roles to report potential violations to the SEC after at least 120 days have elapsed since the information was reported to the company's internal compliance program.²⁸

Ultimate Impact of Whistleblower Program Final Rules

The SEC sought to broaden eligibility standards required for whistleblower status in an effort to be more inclusive and make the process for bringing claims easier and more streamlined.

²²SEC Final Rules Background and Summary: Aggregation of Smaller Actions to Meet \$1,000,000 Threshold at page 7

²³*Id.* at page 110

²⁴*Id.* at page 111

²⁵ Rule 21F-4(b)(4)(iii)(A)-(C) at page 69

²⁶Rule 21F-4(b)(4)(iii)(A)at page 71

²⁷Rule 21F-4(b)(4)(v) at pages73-75

²⁸*Id.* at pages75-77

SEC Whistleblower Provision Final Rules can be found at the following link
<http://www.sec.gov/rules/final/2011/34-64545.pdf>

SEC Whistleblower Provision Proposed Rules can be found at the following link
<http://www.sec.gov/rules/proposed/2010/34-63237.pdf>

VOICES' submission to the SEC can be found at the following link
<http://www.sec.gov/comments/s7-33-10/s73310-162.pdf>