

## Whistle While You Work...All the Way to the Bank

*A discussion of the impact of the new SEC Whistleblower Rules added under the Dodd Frank Act*

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In the wake of the economic crisis that hampered everything from the financial markets on Wall Street to the grocery markets on Main Street, on July 21, 2010, President Obama signed the Dodd-Frank Act into law, attempting to institute financial reform to stabilize the United States' economy and spur investor and consumer confidence. The Act includes regulations that apply to whistleblowers.

Section 922 of the Dodd-Frank Act authorizes the Securities and Exchange Commission (the SEC) to provide payments to whistleblowers that provide information concerning violations of the federal securities laws. Recently, the SEC adopted a final rule entitled "Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934" (the Whistleblower Rule). The Whistleblower Rule authorizes the SEC to pay rewards to whistleblowers that provide the SEC with original information that leads to a successful enforcement resulting in monetary recoveries by way of sanctions in excess of \$1 million and is somewhat of an add-on to legislation that was in place prior to enactment of the new legislation.

In response to financial reporting scandals, the federal government implemented the Sarbanes-Oxley Act of 2002 (SOX) to encourage reports of fraud. SOX applies to employees of publicly-traded companies, requires internal reporting and provides protection for whistleblowers that, following disclosure, suffer retaliatory action from the "covered company." The Whistleblower Rule takes SOX further in a manner that adds both volume and pitch to the "whistle."

Compared to SOX, a notable fishing boat in the vast sea of alleged corporate malfeasance, the Whistleblower Rule increases the size of the net and adds financial incentive for the biggest catch. Unlike SOX, the Whistleblower Rule is not limited to whistleblowers of public companies, but its list of "covered companies" also includes subsidiaries of public entities as well as "nationally recognized statistical rating organizations." Under the Whistleblower Rule, a whistleblower can be an employee, former employee, vendor, agent, contractor, client, customer or competitor of the foregoing entities. Further, whistleblowers that make anonymous submissions through an attorney still qualify for a bounty award. In such instance, whistleblowers' identity will not become known until it becomes necessary to make a bounty payment, which, as part of the Whistleblower Rule, is 10% to 30% of any qualifying monetary sanctions. As such, the scope of the Whistleblower Rule stretches far beyond that of SOX and in doing so, extends the purview of disclosure well beyond the skyscrapers of Wall Street.

Under the Dodd-Frank Act, the disclosures by employees of "covered companies" must be made voluntarily, which requires that the submission be made prior to any request or demand by the SEC or in connection with regulatory investigations. The information reported must be obtained by independent knowledge, must include information not already known by the SEC and must not be derived from public sources. In addition, in order for a whistleblower to "whistle all the way to the bank," under the Whistleblower Rule, a disclosure to the SEC must lead to the successful enforcement of a federal court or administrative action resulting in sanctions which exceed \$1 million<sup>[1]</sup>.

As indicated, a successful "whistle" may lead to a nice payday for reporting employees. The bounty award amount is required to be between 10 % and 30% of any qualifying monetary sanctions collected in the

SEC's action or any related action such as in a criminal case, subject to the SEC's discretion. The SEC's discretion permits the SEC to consider a variety of factors when assessing the extent of the bounty award, including whether or not the whistleblower first reported the conduct internally (even though the Whistleblower Rule does not require internal reporting as a condition precedent to the recovery of a bounty). While the Whistleblower Rule requires disclosure to the SEC within 120 days of any internal reporting, the size of the bounty amount will reward those that exhaust their company's respective internal reporting policies first. Additionally, if a whistleblower follows company guidelines, internally reports the fraudulent conduct and the company reports to the SEC first, the whistleblower will still receive credit for the report and any bounty award stemming therefrom. As such, it is clear that the SEC is attempting to encourage whistleblowers to take advantage of internal reporting policies prior to SEC disclosure.

Similar to SOX, the Whistleblower Rule has protections in place for those that make disclosures to the SEC. Specifically, the Dodd-Frank Act expressly prohibits retaliation by employers against whistleblowers and provides them with a private cause of action in the event that they are discharged or discriminated against by their employers in violation of the act. As such, in addition to refraining from taking adverse action against whistleblowers, employers should update internal policies to ensure that whistleblowers are adequately protected, both from a theoretical standpoint and as a practical matter. Logistically speaking, this may require implementing certain measures, including keeping the identity of whistleblowers confidential and having employment decisions concerning the whistleblower be made without considering the whistleblower's history of disclosure. Further, as the Dodd-Frank Act does not require compliance with internal reporting procedures before blowing the whistle, companies will need to revise reporting policies so as to avoid prohibiting employees from disclosing information directly to regulatory agencies. While these are all procedures that a company may seek to follow in the wake of disclosure, it is important that "covered companies" also implement pro-active measures.

From a human resources standpoint and a financial point of view, companies should create a corporate culture of compliance and one that encourages internal reporting of any non-compliance. Specifically, we recommend that employers incentivize internal reporting and that such incentives be reflected in the company's reporting policies and employment manuals. To avoid legal battles stemming from adverse employer conduct following a whistleblower's disclosure, employers should provide options for internal reporting, adopt a formal no-retaliation policy, inform their employees of such policy and assure employees that internal reporting will be handled professionally and confidentially. In addition to these employment issues, by increasing compliance and internal reporting, employers will also be able to impact their bottom line. The SEC has indicated that companies that self-report will receive credit for cooperating with the SEC, which may lead to a decrease in the ultimate fine. As such, by instituting formal procedures that deal with non-compliance in an efficient manner, companies may be able to take advantage of assessment "discounts" if they self-report before the whistleblower. Therefore, a detailed review of internal reporting policies is likely necessary for companies looking to limit liability in a wide variety of matters, including employment disputes and SEC assessments.

Consistent with recent political campaign rhetoric, it appears that the Whistleblower Rule is part of a legislative scheme designed to bring Wall Street back to Main Street. While the ultimate impact of the Whistleblower Rule remains to be discovered, in light of the financial incentives available to whistleblowers, it is prudent to review your company's internal policies and practices to ensure compliance.

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[1] The SEC will aggregate two or more claims which "arise from the same nucleus of operative facts" in order to determine whether the \$1M threshold is met.

For more information:

<http://www.bloomberg.com/news/2012-05-31/woman-who-couldn-t-be-intimidated-by-citigroup-wins-31-million.html>  
<http://finance.yahoo.com/news/bank-america-whistleblower-receives-14-232819912.html?l=1>

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