Overview of Dodd-Frank Whistleblower Law and Practice

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Statutory Overview: Section 21F of the Securities Exchange Act of 1934

- The SEC whistleblower regime is mandated by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created Section 21F of the Securities Exchange Act of 1934.

- Section 21F(b) requires the SEC to pay a whistleblower bounty to any person "who voluntarily provided original information to the Commission that led to . . . successful enforcement" in a judicial or administrative proceeding.

  - "Original information" is defined as information "derived from the independent knowledge or analysis of a whistleblower" that "is not known to the Commission from any other source." Under the statute, "original information" may not be "exclusively derived" from public-record information (*e.g*. media reports or information from government proceedings) unless the whistleblower was an original source of the information. *See* § 21F(a)(3).

- The amount of the whistleblower payment is to be determined in the SEC's discretion, but it must be between 10% and 30% of the total monetary sanctions collected by the SEC or by another enforcement agency in a "related action." *See* §§ 21F(b)(1), 21F(c)(1).

  - "Monetary sanctions" includes penalties, disgorgement, and prejudgment interest. *See* § 21F(a)(4).

  - The whistleblower is only entitled to receive a payment after the monetary sanctions have actually been collected by the Commission (and not merely when they have been ordered). *See* § 21F(b)(1).

  - Whistleblower payments are to be made from the Securities Exchange Commission Investor Protection Fund (the "Fund"), which is used to pay whistleblower awards and to fund the SEC's Office of Inspector General suggestion program. *See* § 21F(g)(2).

    - The Fund is composed of amounts collected by the Commission in enforcement proceedings (excluding amounts to be paid out to investors as part of a Sarbanes Oxley Fair Fund) up to a maximum of $300 million,

plus additional sums paid into a Fair Fund but not ultimately distributed to investors. *See* Section 21F(g)(3).

  - "Related action" includes any proceeding brought by the DOJ, an "appropriate regulatory authority," a self-regulatory organization, or a criminal case brought by a state attorney general if the related action is "based upon the original information provided by a whistleblower . . . that led to the successful enforcement of the Commission action." *See* §§ 21F(a)(5), 21F(b)(1), 21F(h)(2)(d)(i).

- In determining whether to approve a whistleblower payment, the SEC is required to consider the following factors: (1) "the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action"; (2) "the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action"; (3) the SEC's "programmatic interest" in using the whistleblower program to deter violations of the securities laws; and (4) other factors to be set forth in SEC rules.

  - The SEC is *not* permitted to consider the total balance remaining in the Fund. *See* § 21F(c)(1)(B).

- The following individuals are ineligible for whistleblower awards:

  - Employees of the SEC, other regulators, SROs, the PCAOB, the Department of Justice, or law enforcement;

  - Persons who are convicted of a crime in relation to the information for which they seek a whistleblower payment;

  - Individuals who obtain information in connection with an audit of an issuer's financial statements; and

  - Individuals who make false statements or submit false documents in connection with a whistleblower disclosure. *See* §§ 21F(c)(2), 21(i).

- Whistleblowers may remain anonymous if they are represented by counsel. However, the whistleblower must disclose his/her identify before receiving any payment. *See* 21F(d).

- Section 21F incorporates extensive provisions to protect whistleblowers:

  - The Commission may disclose the whistleblower's identity to other regulators, law enforcement, or SROs, but the Commission (and any agency to which the Commission discloses the whistleblower's identity) must refrain from identifying the whistleblower to a private party except as required in litigation. *See* § 21F(h)(2).

- The whistleblower's employer is prohibited from taking any adverse action against the whistleblower because of his/her provision of information to the SEC or assistance with the SEC's investigation. *See* 21F(h)(1)(A).

- The whistleblower may sue his/her employer to enforce the anti-retaliation provisions of §21F(h)(1)(A). If successful, the whistleblower may recover 2X back pay plus attorneys' fees and costs and an order requiring reinstatement. *See* §§ 21F(h)(1)(B), 21F(h)(1)(C).

- The text of the statute is somewhat unclear on this point, but § 21F(h)(1)(A)(iii) can be read to prohibit retaliation against a whistleblower who raises concerns internally within the company, but who does not actually contact the SEC. The Commission has adopted this interpretation, and the Second Circuit has agreed, but the Fifth Circuit has held that, under the statute, the anti-retaliation provisions of § 21F(h)(1)(A) apply *only* if a whistleblower has contacted the SEC. *See infra* at 9-10 for further discussion.

SEC Regulations: 240 C.F.R. §§ 21F-1 through 21F-17

- Effective August 12, 2011, the SEC adopted rules to implement the whistleblower provisions of Dodd-Frank. The rules fill in a number of important gaps in the statutory framework.

- *Definition of whistleblower*: the rules define a "whistleblower" as an individual who provides the SEC with information, pursuant to the procedures set forth in the regulations, that "relates to a possible violation of the federal securities laws . . . that has occurred, is ongoing, or is about to occur." 240 C.F.R. § 21F-2(a).

    - Whistleblowers must be individuals; entities are ineligible for whistleblower status. 240 C.F.R. § 21F-2(a).

    - In order to be eligible for an award, an individual must make a report to the SEC using the proper forms. Merely reporting to a company's internal compliance department will not enable the individual to collect an award. 240 C.F.R. § 21F-2; *see also* Issuing Release No. 34-64545; File No. S7-33-10, 17 CFR Parts 240 and 249, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 (Aug. 12, 2011) at 18 (hereinafter "Issuing Release).

    - Under the regulations, a whistleblower must satisfy the following requirements in order to be eligible for a payment:

    - The whistleblower must fill out SEC form TCR ("Tip, Complaint, or Referral) and sign it, under penalty of perjury;

    - The whistleblower must provide follow-up information as requested by the SEC, including testimony; and

- The whistleblower must sign a non-disclosure agreement if requested by the SEC. *See* 240 C.F.R. § 21F-8(a) and (b); 240 C.F.R. § 21F-9(a) and (b).

- *No amnesty for whistleblowers*: Whistleblowers do not receive amnesty and may become the subject of an enforcement proceeding. However, a person's status as a whistleblower may be a basis for more lenient treatment consistent with the SEC's cooperation principles. See 240 C.F.R. § 21F-15.

- *Communications between the SEC and the whistleblower*: the regulations contain provisions intended to ensure that the whistleblower's employer cannot block or disrupt the line of communication between the whistleblower and the SEC staff.

    - Under the regulations, it is unlawful to "take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement" except for agreements regarding attorney-client communications. 240 C.F.R. § 21F-17(a).

        - In recent years, the SEC has brought a series of enforcement actions against companies based on employment agreements that contain broad confidentiality provisions without a carve-out permitting employees to contact the SEC regarding potential violations of law. *See, e.g., In re Anheuser-Busch InBev SA/NV*, File No. 3-17586 (SEC Sept. 28, 2016) (company's separation agreement imposed strict confidentiality requirement with no provision allowing voluntary communication with the SEC; as a result, a whistleblower who had previously been in contact with the SEC stopped communicating with the agency after signing a separation agreement); *In re Health Net, Inc.*, File No. 3-17396 (SEC Aug. 16, 2016) (imposing $340,000 penalty because company's severance agreements contained a provision under which the employee would waive severance payments if he or she reported to the SEC); *In re BlueLinx Holdings, Inc.*, File No. 3-17371 (SEC Aug. 10, 2016) (same; imposing $265,000 penalty); *In re Merrill Lynch, Pierce, Fenner & Smith Incorporated*, File No. 3-17312 (SEC June 23, 2016) (standard separation agreement imposed strict confidentiality requirement with no carve-out for voluntary communication with the SEC).

    - If a whistleblower initiates contact with the SEC, the Staff is authorized to communicate with the whistleblower directly and is not required to seek consent from the counsel representing entity that employs the whistleblower. 240 C.F.R. § 21F-17(b).

- *Requirement that information be "voluntary"*: Pursuant to § 21F(b), the SEC can make a whistleblower payment only for information that was provided voluntarily. Under the regulations, a whistleblower submission will not be deemed "voluntary" if:

- The whistleblower has already received a subpoena, document request, or information request from the SEC or one of a number of specified agencies, *see* 240 C.F.R. § 21F-4(a)(1); or

- The whistleblower is under a pre-existing legal duty (including contractual obligations and duties imposed by a court order) to report information to the Commission or another agency. *See* 240 C.F.R. § 21F-4(a)(3).

- *Definition of "original information."* Whistleblowers are eligible to receive payment only if they provide "original information."

  - In order to qualify as "original information," the whistleblower's information must be derived from his/her "independent knowledge or independent analysis." 240 C.F.R. § 21F-4(b)(1).

  - Under the regulations, "original information" does not include information that was:

    - Obtained by a lawyer through communications that are protected by the attorney-client privilege, *see* 240 C.F.R. § 21F-4(b)(4)(i); or

    - Obtained in violation of criminal law, see 240 C.F.R. § 21F-4(b)(4)(iv).

  - In addition, information is generally deemed not to be "original information," and thus is ineligible for payment, if it comes to the SEC:

    - From an entity's officer, director, trustee, or partner, if that person learned of the information second-hand or through an internal compliance procedure, *see* 240 C.F.R. § 21F-4(b)(4)(iii)(A); or

    - From individuals who are acting in a compliance or internal audit function, *see* 240 C.F.R. § 21F-4(b)(4)(iii)(B).

  - However, these latter two exclusions do not apply (and thus information from senior individuals, compliance personnel, or internal auditors would qualify for a whistleblower payment) if:

    - The whistleblower reasonably believes that disclosure to the SEC is necessary to prevent an entity "from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors," *see* 240 C.F.R. § 21F-4(b)(4)(v)(A);

    - The whistleblower reasonably believes that the entity "is engaging in conduct that will impede an investigation of the misconduct," *see* 240 C.F.R. § 21F-4(b)(4)(v)(B); or

    - The information was reported "up the chain" to the whistleblower's supervisor, or to the entity's Chief Legal Officer, Chief Compliance

Officer, or Audit Committee and 120 days have elapsed, *see* 240 C.F.R. § 21F-4(b)(4)(v)(C).

  - In voting against the rules, one SEC commissioner noted that an individual may be able to qualify for whistleblower status even if he learns about a violation as a result of being contacted by his company's compliance department to participate in an internal investigation. *See* Speech by SEC Commissioner Troy A. Paredes, "Statement at Open Meeting to Adopt Final Rules for Implementing the Whistleblower Protection Provisions of Section 21F of the Securities Exchange Act of 1934 (May 25, 2011) (criticizing the rule because it "permits a whistleblower to knowingly bypass a company's good-faith attempts to identify and investigate alleged violations").

  - Even if the Commission already knows about the whistleblower's information from another source, the information will nevertheless be considered "original" (and thus will qualify for a payment) if it "materially adds to the information that the Commission already possesses." *See* 240 C.F.R. § 21F-4(b)(6).

- *Information that "leads to successful enforcement*."

  - Under the regulations, this requirement is satisfied if the whistleblower's information was "sufficiently specific, credible, and timely to cause the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation, and the Commission brought a successful judicial or administrative action based in whole or in part on conduct that was the subject of" the whistleblower's information. *See* 240 C.F.R. § 21F-4(c)(1).

  - The "successful enforcement" requirement is also met if the whistleblower's information "significantly contributed to the success of" an enforcement matter that was already under investigation by the SEC or another agency. *See* 240 C.F.R. § 21F-4(c)(2).

- *Disclosures to a company's internal compliance personnel*. Although whistleblowers are not required to report their information through internal compliance channels, the SEC regulations contain several provisions intended to create incentives for whistleblowers to make use of internal compliance resources before approaching the SEC. *See* Issuing Release at 5-6. This aspect of the regulations provoked significant controversy during the rulemaking process. While acknowledging "the extremely significant value that effective corporate compliance programs deliver in identifying, remediating, and deterring wrongdoing," SEC Enforcement Director Rob Khuzami explained that the final rules were created so as to leave the whistleblower with the choice whether to approach a corporate compliance officer before contacting the SEC. *See* Speech by SEC Staff, "Remarks at Open Meeting – Whistleblower Program," by Robert S. Khuzami, Director, Division of Enforcement at 2-3 (May 25, 2011). Khuzami offered two principal reasons for the decision to permit whistleblowers to

bypass the internal compliance system: (1) the main goal of the whistleblower program is to aid the SEC, not corporations; and (2) in enterprises such as boiler rooms, internal compliance processes are usually ineffective and/or corrupt. *See id.* at 2-3. However, according to Khuzami, the rules were crafted "so that the whistleblower is incentivized – not mandated, incentivized – to utilize their companies' internal compliance and reporting systems, when appropriate." *Id.* at 3. The following provisions were intended to create the incentive to follow internal compliance processes:

  - If a whistleblower makes an initial report to a company's internal compliance department and then, within 120 days, subsequently approaches the SEC, the SEC will treat the date of the initial report to the company's internal compliance department as the date of the whistleblower's disclosure to the SEC. *See* 240 C.F.R. § 21F-4(b)(7).

  - If a whistleblower makes an initial report to a company's internal compliance department and the company subsequently develops more significant information that it discloses to the SEC, the whistleblower will get the benefit of the company's more detailed information for purposes of determining whether the whistleblower's information resulted in "successful enforcement." *See* 240 C.F.R. § 21F-4(c)(3).

  - The SEC may approve a higher payment if the whistleblower made use of internal compliance resources, and assisted in "any internal investigation or inquiry concerning the reported securities violations." *See* 240 C.F.R. § 21F-6(a)(4).

  - Conversely, the SEC may approve a lower payment if the whistleblower interfered with a company's internal compliance systems, *see* 240 C.F.R. § 21F-6(b)(3).

- *Multiple whistleblowers*: the Commission may authorize payment to more than one whistleblower in the same matter, but the total payment must be between 10% and 30% of the total monetary sanctions. The Commission is responsible for allocating the recovery among multiple whistleblowers. *See* 240 C.F.R. § 21F-5(c).

- *Factors that may increase an award*. Although the SEC has discretion to determine the amount of a whistleblower award, the regulations identify a number of factors that may result in a larger award:

  - The significance of the information, including whether the "reliability and completeness of the information . . . resulted in the conservation of Commission resources" and whether the information "supported one or more successful claims brought in the Commission or related action." *See* 240 C.F.R. § 21F-6(a)(1)

- The degree of assistance provided by the whistleblower, including whether he or she:

  - "provided ongoing, extensive, and timely cooperation and assistance by, for example, helping to explain complex transactions, interpreting key evidence, or identifying new and productive lines of inquiry," see 240 C.F.R. § 21F-6(a)(2)(i);

  - Made a timely initial report to the SEC or to internal compliance department, *see* 240 C.F.R. § 21F-6(a)(2)(ii);

  - Encouraged others to cooperate with the SEC, *see* 240 C.F.R. § 21F-6(a)(2)(iv);

  - Made efforts "to remediate the harm caused by the violations, including assisting the authorities in the recovery of the fruits and instrumentalities of the violations," *see* 240 C.F.R. § 21F-6(a)(2)(v); or

  - Suffered unique hardships or harms as a result of being a whistleblower, *see* 240 C.F.R. § 21F-6(a)(2)(vi).

- The extent to which a payment advances the SEC's law enforcement interests, which involves an assessment of:

  - Whether the award will encouraging others to come forward, *see* 240 C.F.R. § 21F-6(a)(3)(i) and (ii);

  - "Whether the subject matter of the action is a Commission priority, whether the reported misconduct involves regulated entities or fiduciaries, whether the whistleblower exposed an industry-wide practice, the type and severity of the securities violations, the age and duration of misconduct, the number of violations, and the isolated, repetitive, or ongoing nature of the violations," *see* 240 C.F.R. § 21F-6(a)(3)(iii); and

  - "Dangers to investors or others presented by the underlying violations involved in the enforcement action, including the amount of harm or potential harm caused by the underlying violations, the type of harm resulting from or threatened by the underlying violations, and the number of individuals or entities harmed," *see* 240 C.F.R. § 21F-6(a)(3)(iv).

- The extent to which the whistleblower made use of internal compliance resources, including making a timely report and assisting in "any internal investigation or inquiry concerning the reported securities violations." *See* 240 C.F.R. § 21F-6(a)(4).

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- *Factors that may decrease an award*. The regulations also identify factors that may result in a smaller award:
    - The whistleblower's culpability, which requires an assessment of the following factors:
        - "The whistleblower's role in the securities violations";
        - "The whistleblower's education, training, experience, and position of responsibility at the time the violations occurred";
        - The degree to which the whistleblower acted with scienter;
        - "Whether the whistleblower financially benefitted from the violations";
        - "Whether the whistleblower is a recidivist";
        - "The egregiousness of the underlying fraud committed by the whistleblower"; and
        - "Whether the whistleblower knowingly interfered with the Commission's investigation of the violations or related enforcement actions." *See* 240 C.F.R. § 21F-6(b)(1).
    - Any unreasonable delay in reporting the allegations, *see* 240 C.F.R. § 21F-6(b)(2).
    - Interference by the whistleblower with a company's internal compliance systems, *see* 240 C.F.R. § 21F-6(b)(3).
- *Offsets for penalties based on the whistleblower's own conduct*. In calculating the amount of total monetary sanctions that underpin an award, the SEC must exclude any monetary sanctions that the whistleblower is ordered to pay, or that are "based substantially on conduct that the whistleblower directed, planned, or initiated." *see* 240 C.F.R. § 21F-16.
- *Anti-retaliation provisions*. The SEC regulations contain important details regarding the scope of the anti-retaliation protections that are conferred on whistleblowers.
    - An individual is treated as a whistleblower for anti-retaliation purposes if he/she reasonably believes that the information relates to a possible securities law violation, even if he/she does not ultimately qualify for an award. 240 C.F.R. § 21F-2(b)(1); *see also* Issuing Release at 16.
    - If an individual has contacted the SEC, he/she cannot be subject to retaliation and can assert a claim for significant relief against the employer (2X back pay plus attorneys' fees and costs and an order requiring reinstatement). *See* 240 C.F.R. § 21F-2; *see also* Issuing Release at 18; *Asadi v. G.E. Energy (USA),*

LLC, 720 F.3d 620 (5th Cir. 2013); *Berman v. Neo@Ogilvy LLC, WPP Group USA, Inc.*, 801 F.3d 145 (2d Cir. 2015).

- There has been significant controversy over whether an employee can invoke the Dodd-Frank anti-retaliation protections if he or she reports concerns internally within the company but does not actually contact the SEC.

  - Under the SEC's regulations and as clarified in interpretive guidance issued by the Commission in August 2015, the answer is "yes." *See* 240 CFR § 21F-2(b)(1); Release No. 34-75592, "Interpretation of the SEC's Whistleblower Rules Under Section 21F of the Securities Exchange Act of 1934" (Aug. 15, 2015) (hereinafter "Interpretive Guidance"). In the Interpretive Guidance, the SEC noted that a narrower anti-retaliation provision would incentivize whistleblowers to contact the SEC immediately, and thus would tend to undermine internal compliance programs. *See* Interpretive Guidance at 7-8 ("Providing equivalent employment retaliation protection for both situations removes a potentially serious disincentive to internal reporting by employees in appropriate circumstances").

  - To date, the federal courts are split on this question. In *Berman*, the Second Circuit, finding § 21F(h)(A) of the statute to be ambiguous, deferred to the SEC's interpretation of the statute's anti-retaliation provisions. *See* 801 F.3d 145. By contrast, in *Asadi* the Fifth Circuit found Section 21F(a) of the statute to require unambiguously that a whistleblower actually contact the SEC in order to be able to claim the benefit of the anti-retaliation provisions. *See* 720 F.3d 620.

- In 2016, the SEC brought its first stand-alone enforcement case against a company for violating Dodd-Frank's anti-retaliation rules. *In re Int'l Game Technology*, File No. 3-17596 (SEC Sept. 29, 2016). As alleged in the SEC's order, a whistleblower who worked in company's accounting department raised concerns internally about potential financial statement misstatements relating to a cost accounting model. (The whistleblower also reported his concerns to the SEC, removing any issue under Section 21F(h)(A)). The company undertook an internal investigation and concluded that the whistleblower's concerns were unfounded. However, and although the whistleblower had previously received favorable performance evaluations, he was subject to adverse employment action – including reduced responsibilities and subsequent termination – in the immediate aftermath of his internal whistleblower report. The SEC found that the company violated the Dodd-Frank anti-retaliation provisions and ordered the company to pay a $500,000 penalty.

The SEC Office of the Whistleblower FY 2016 Annual Report

- In November 2016, the SEC Office of the Whistleblower ("OWB") issued its most recent annual report. U.S. Securities and Exchange Commission, "2016 Annual Report

to Congress on the Dodd-Frank Whistleblower Program" (Nov. 2016) (hereinafter "2016 OWB Annual Report"). In the report, the SEC described 2016 as a "historic" year and asserted that the whistleblower program has had a "transformative effect" on the agency's overall enforcement effort.

- During FY 2016, there were eighteen full-time employees in the OWB, including the Director, eleven staff attorneys, plus paralegals and administrative staff. 2016 OWB Annual Report at 6. OWB's activities include intake of whistleblower tips, communications with whistleblowers, assessing award applications, and public outreach and education. 2016 OWB Annual Report at 6-9.

- Reflecting the increasing awareness of the whistleblower program, the SEC continues to receive an increasing number of tips. In FY 2016, the SEC received more than 4,200 tips, a significant increase since the program's first year in 2012. *Id.* at 23. The most common categories were corporate disclosures and financials (22%), offering fraud (15%), and manipulation (11%). *Id.*

    - Other categories of interest include insider trading (6%) and FCPA (6%). *See id.*

    - In the years since the program was established, the number of FCPA tips has increased every year, growing from 149 in 2012 to 238 in 2016. *See id.* App'x A.

- In 2016, the SEC received whistleblower reports from 67 foreign countries, including many countries that have been associated with FCPA enforcement: China (35 tips), Mexico (29 tips), India (20 tips), Taiwan (13 tips), and Russia (6 tips). *Id.* App'x C.

- As of the end of FY 2016, the SEC had paid out a total of $111 million in awards to 34 whistleblowers in the years since the program was established. *Id.* Eight of the whistleblowers who received awards – nearly 25% -- were foreign nationals. *Id.* at 10, 17-18. In 2016 alone, the SEC paid out more than $57 million in whistleblower awards. *Id.* at 1.