

Chicago Daily Law Bulletin®

Volume 160, No. 167

Assessing the SEC's whistleblower program after three years in action

The U.S. Securities and Exchange Commission's whistleblower program took effect three years ago on Aug. 12, 2011. It was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted just more than four years ago on July 21, 2010.

Under the whistleblower program, an individual who voluntarily reports to the SEC original information about a possible violation of U.S. securities laws which leads to a successful SEC enforcement action resulting in monetary sanctions of more than \$1 million is entitled to a reward of 10 to 30 percent of the amount of sanctions collected. A whistleblower can submit a tip anonymously through an attorney.

Exactly 3,001 whistleblower tips were reported to the SEC in 2012. In 2013, the number increased to 3,238. To date, the SEC has made eight monetary awards to whistleblowers and has denied 16 award claims. The largest award so far, in October, was more than \$14 million.

As recently as July 31, the SEC awarded more than \$400,000 to a whistleblower who reported a fraudulent situation to the SEC after trying to correct the misconduct internally within a company. Also in July 2014, the SEC denied an award claim relating to an enforcement action resulting in an \$18 million penalty.

SEC regulations define a whistleblower as an individual who, alone or jointly with others, submits original information to the SEC. A whistleblower does not have to be an employee — he or she could be a stockholder, for example.

"Original information" means independent knowledge — i.e., not generally known to the public — or independent analysis based on data which may be available to the public but where the wrongdoing is not conspicuous. In either case, the information must not already be known to the SEC, unless the whistleblower is the original source of the information reported to the SEC by another person.

Subject to certain exceptions, several categories of people cannot be whistleblowers:

- Anyone who obtained the information in violation of any federal or state criminal law.
- A lawyer who obtained the information pursuant to attorney-client privilege or otherwise in connection with providing legal representation.
- An officer, director, trustee or partner of an entity who was informed by another person of allegations of misconduct or who learned the information in connection with the entity's process for identifying, reporting and addressing misconduct.
- An employee whose main duties involve compliance or internal audit functions or an employee or other associate of a firm retained to perform those functions.
- An employee or other associate of a firm retained to conduct an investigation into possible violations of law.
- An employee or other associate of a public accounting firm who, through performing audit functions, obtained information about possible violations by the engagement client or its directors, officers or other employees.

Provisions like these, even if unenforceable, may have a chilling effect on legal reporting by whistleblowers.

The amount of a whistleblower award is 10 to 30 percent of the amount of sanctions collected, if the amount is more than \$1 million. The award may be split among multiple whistleblowers — for example, the SEC recently divided a 30 percent award among three whistleblowers, with one receiving 15 percent, another 10 percent and the third 5 percent.

Within the required 10 to 30 percent range, the SEC has discretion to set the amount of the reward. The SEC may increase the award, within the range, based

BY ERIC FOGEL AND VIC PETERSON

Eric Fogel is co-chair of SmithAmundsen's corporate practice group and has more than 28 years of experience counseling clients in general corporate, securities, tender offers and proxy battles, mergers and acquisitions, corporate governance and financing. Vic Peterson is a partner in SmithAmundsen's corporate practice group and concentrates in the same practice areas.

on several factors:

- The significance of the information leading to the success of the enforcement action;
- The degree of the whistleblower's assistance;
- The law enforcement interest in deterring specific types of violation (e.g., the Foreign Corrupt Practices Act); and
- The whistleblower's participation in the employer's internal compliance system (which incentivizes whistleblower's to report suspected violations internally first before reporting the information to the SEC within 120 days).

The SEC may reduce the amount of an award if:

- The whistleblower was involved in the reported fraud;
- The whistleblower unreasonably delayed in reporting the fraud to the SEC; or
- The whistleblower interfered with the employer's internal compliance and reporting systems — for example, by making false statements to the compliance department that hindered its investigation into the wrongdoing.

A whistleblower may appeal the SEC's denial of an award claim but may not appeal the amount of an award that is in the 10 to 30 percent range.

The whistleblower program also adds protections to whistleblowers against retaliation by their employers. It is illegal for employers to fire, demote, suspend, harass or discriminate against whistleblowers for reporting information to the SEC or assisting the SEC in any investi-

gation or proceeding based on the information.

A whistleblower may bring a private action in federal court against an employer for retaliation. If successful, the whistleblower may be entitled to reinstatement, double back pay, litigation costs, expert witness fees and attorney fees.

The SEC may also bring an enforcement action against an employer that retaliates against a whistleblower. In a June settlement with the SEC, a hedge fund agreed to pay a \$2.2 million penalty for retaliating against a whistleblower.

Some observers describe a "growing epidemic" of retaliation against whistleblowers. According to the Ethics Resource Center, in 2013, 21 percent of employees who reported misconduct in the workplace said they faced retaliation. Over a third of those who decided not to report misconduct cited fear of retaliation as the reason.

Two rule-making petitions recently submitted to the SEC seek reforms to the whistleblower program, including enhanced protections against retaliation. The petitions express concern that employment, severance and confidentiality agreements increasingly purport to restrict whistleblowers from reporting wrongdoing to the SEC.

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The petitions also ask the SEC to issue a policy statement clarifying whether an employee who reports a suspected violation internally to the company, but who has not yet reported it to the SEC, qualifies as a whistleblower for purposes of protection against retaliation.

Although the SEC encourages internal reporting of whistleblower complaints, the 5th U.S. Circuit Court of Appeals held that reporting to the SEC is required for whistleblower anti-retaliation protection, and the 8th Circuit recently certified this issue for interlocutory appeal.