GRANT & EISENHOFER

CLIENT ALERT – JULY 2010

New Financial Reform Legislation Provides Whistleblowers with Monetary Incentives to Report Fraud to SEC

On July 15, 2010 the Senate voted 60-to-39 to adopt the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). President Obama signed the Act into law on July 21, 2010.

Under the new legislation, the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) was amended to provide whistleblowers with a bounty if they provide information to the SEC which leads to the Agency's recovery of monetary sanctions. This change in the law provides whistleblowers, including individuals, and arguably labor organizations, public interest groups, and other entities, with a substantial monetary incentive to aid the SEC's enforcement activities.

New SEC Incentives for Whistleblowers

Prior to the Dodd-Frank Act, the SEC's whistleblower program applied only to insider trading cases and limited the whistleblower bounty to a maximum of 10 percent of monetary sanctions recovered by the government.

Under a new provision, Section 21F, the voluntary submission of "original information"[1] to the Securities and Exchange Commission ("SEC") that leads to the successful enforcement of a judicial or administrative action, and that results in monetary sanctions exceeding $1,000,000, will entitle the whistleblower to an award equal to not less than 10 percent, but not more than 30 percent, of the total amount of the monetary sanctions that are recovered.

The final determination of the amount of the award is in the discretion of the SEC, but in determining the amount weight is given to the degree of assistance provided by the whistleblower and his or her counsel. Therefore, it is important for whistleblowers to consider counsel with expertise in Securities laws. Additional criteria in determining the size of the award is the significance of the information provided by the whistleblower to the success of the judicial or administrative action, the programmatic interest of the SEC in deterring violations of the securities laws by making awards to the whistleblowers, and additional factors as the SEC may establish by rule or regulation. The SEC's determination may be appealed except the determination of an award, if the award was made in accordance with subsection (b), which provides for a bounty of not less than 10, but not more than 30, percent of the total amount of the monetary sanctions that are recovered.

In contrast to the Federal False Claims Act ("FCA"), 31 U.S.C. § 3729, et seq., an SEC whistleblower cannot proceed with an action in Court if the SEC decides not to pursue judicial or administrative relief (See Section 21F). Naturally, investors who incur damages as a result of securities fraud can still proceed with their own private causes of action.

The term "whistleblower" includes any single individual who provides, or two or more individuals who jointly provide to the SEC, information relating to a violation of the securities laws in a manner established by rule or regulation by the SEC. Arguably, this broad definition of whistleblowers includes organizations which is also the case with the False Claims Act. The SEC has 270 days after the date of enactment of the Act to issue final implementing regulations.

The new law is silent on whether loss causation is a required element of the action and does not specify how the SEC will calculate monetary

sanctions. The SEC's final regulations implementing section 21F of the Securities Exchange Act of 1934, however, may contain provisions on those issues.

Of particular interest is the broad definition of "original information" that may be presented by the whistleblower. Public information may be a basis for a bounty, provided that the information leading to the SEC action is derived from the independent "analysis" of the whistleblower. The original information cannot be exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information. Likewise, the information is not "original information" as defined by the Act if it is known to the SEC from any other source, unless the whistleblower is the original source of the information.

While the Act provides whistleblower protection against retaliation, the information may be offered anonymously if the whistleblower is represented by counsel. The identity of the whistleblower must be disclosed to the SEC prior to the payment of the award.

All information provided by the whistleblower, unless and until required to be disclosed to a defendant in connection with a proceeding instituted by the SEC or by certain entities specifically identified,[2] shall remain confidential and privileged and shall not be subject to civil discovery, or other legal process, and shall not be subject to disclosure under the Freedom of Information Act ("FOIA").

The award is not limited to the violations committed after the enactment of this Act. Rather, if the violations of securities laws occurred prior to the date of enactment of the Act, the whistleblower has a right to collect the award if the information is provided by the whistleblower after the enactment.

Closing the Loopholes

Along with the new incentives, the Act also closes the anti-retaliation loopholes that exist under the Sarbanes-Oxley Act. Under the provisions of the Dodd-Frank Act, whistleblower protections now apply not only to the parent corporation but to its subsidiaries as well. In addition, the Act provides whistleblowers a private cause of action for damages stemming from retaliation.

What This Means Going Forward

The new provisions represent a great incentive for whistleblowers to assist in fighting securities violations. Prior to the Act, the SEC offered whistleblowers a program that had little reward and tremendous risk. By adding the new whistleblower provisions, the Government has provided the SEC with a powerful tool to fight fraud.

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[1] Any violation of the securities laws is covered by this new provision, and the whistleblower may report any internal fraud and untrue statement that may result in a securities violations (for example, any fraudulent accounting practice, and any fraudulent scheme artificially boosting revenues and earnings).

[2] The SEC in its discretion may determine if the information may be disclosed to certain entities, if necessary, to accomplish the purpose of the Act and protect the investors. The information, which will not lose its confidential and privileged status, may be made available to: (i) the Attorney General of the United States; (ii) an appropriate regulatory authority; (iii) a self-regulatory organization; (iv) a State attorney general in connection with any criminal investigation; (iv) a State attorney general in connection with any criminal investigation; (v) any appropriate State regulatory authority; (vi) the Public Company Accounting Oversight Board; (vii) a foreign security authority; and (viii) a foreign law enforcement authority. With respect to foreign authorities, the information shall be maintained "in accordance with assurance of confidentiality" as the SEC determines appropriate.