

# PUBLICATION

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## SEC Adopts Final Dodd-Frank Whistleblower Rules by 3-2 Vote

June 1, 2011

On May 25, 2011, by a 3-2 vote, the Securities and Exchange Commission (SEC) issued final rules to implement the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rules are intended to reward individuals who volunteer “original information” to the SEC about actual or potential violations of securities laws, which information leads to a successful enforcement action by the SEC resulting in monetary sanctions in excess of \$1 million. An eligible whistleblower may be rewarded between 10 percent and 30 percent of the monetary sanction.

### Incentives for Internal Reporting

A highly controversial topic that arose during the comment period on the proposed rules was whether the SEC should require that a whistleblower first exhaust internal reporting programs to be eligible for the whistleblower reward. On October 4, 2010, prior to the adoption of the final rules, Baker Donelson attorneys met with members of the SEC to advocate in favor of this approach. Among the concerns voiced by Baker Donelson attorneys was that permitting whistleblowers to bypass internal reporting programs established by companies would undermine the purpose of these programs. Ultimately, the final rules do not require whistleblowers to report internally to qualify for an award, but are designed to encourage whistleblowers to do so. The final rules provide the following incentives to whistleblowers who report internally:

- A whistleblower whose company provides information to the SEC following his or her use of the company's internal reporting process will receive credit for the information, even if the information is more than what the whistleblower originally reported.
- A whistleblower who uses the internal reporting process and reports the alleged violation to the SEC within 120 days (as opposed to the 90 days originally proposed) will be deemed to have reported to the SEC as of the date of the internal report. This allows the whistleblower to maintain his or her “place in line.”
- The whistleblower's participation in a company's internal reporting process will be a factor in determining the amount of the award.

In its release adopting the final rules, the SEC acknowledged the concerns of Baker Donelson attorneys but ultimately chose a framework that, according to the SEC chairman, “strikes the correct balance” by encouraging whistleblowers to report internally while giving them the choice to report directly to the SEC.

### Attorneys' Fees Not Addressed

Prior to adoption of the final rules, the SEC solicited comments on whether fee limits should be imposed on attorneys representing whistleblowers. Baker Donelson attorneys urged the SEC to prohibit the use of contingency fees by whistleblowers' attorneys. Baker Donelson attorneys expressed concerns that contingency fees would result in increased instances of frivolous claims brought by attorneys hoping for a piece of the whistleblower award and would unfairly reward whistleblowers' attorneys who are not likely to have active roles in the investigation process of the whistleblowers' claims. However, the SEC declined to include any provision regarding attorneys' fees in the final rules. According to the SEC, state bar authorities and individual whistleblowers are in the best position to determine and negotiate the appropriate amount of attorneys' fees.

## Impact on Companies

The final whistleblower rules are structured to encourage tips and complaints and will likely result in a surge in SEC investigative and enforcement activity. Because the final rules do not mandate internal reporting, it is up to companies to promote and encourage employees to exhaust internal reporting programs prior to submitting complaints to the SEC. Companies should take steps to educate employees about internal reporting and compliance programs, to communicate that adherence to securities laws is a high priority goal and to convey that tips and violations will be taken seriously. In addition, companies should periodically evaluate their programs to ensure they are designed to identify, evaluate and resolve actual and potential securities violations in a timely and efficient manner. Going forward, it is imperative for companies to be prepared and have systems in place to address SEC inquiries in the event employees bypass the internal programs and report directly to the SEC.

The final rules become effective 60 days after they are published in the *Federal Register*. The SEC release regarding the final rules can be found [here](#).

If you have any questions about this or any other securities-related issues, please contact your Baker Donelson attorney.