

Client Alert

Latham & Watkins Litigation Department

Update on the SEC Whistleblower Award Program

The US Securities and Exchange Commission has yet to pay an award to a whistleblower under the program that became effective nearly two years ago with the passage of the Dodd-Frank Act, so US and foreign-based companies subject to SEC jurisdiction might be tempted to avoid or delay putting in place procedures to deal with potential whistleblowers. That would be a mistake, based on information recently provided by a senior SEC enforcement official. The SEC's Office of Market Intelligence is receiving two to three tips every day that are worth pursuing, and is farming them out to staffers in the enforcement division for investigation. SEC officials are eager to pay out and publicize the first whistleblower awards, the senior official said. Once the first award is publicized, tips to the SEC from disgruntled employees are almost certain to increase substantially.

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Background

The Dodd-Frank Act and the SEC's whistleblower rules require the SEC to pay whistleblowers awards of between 10 and 30 percent of the aggregate monetary recoveries by the SEC, US Department of Justice, and certain other authorities in situations where one or more whistleblowers voluntarily provide original information regarding a violation of the securities laws and where the information leads to one or more SEC enforcement actions that result in monetary sanctions exceeding US\$1 million.

Dodd-Frank also includes new anti-retaliation provisions that expand existing protections of whistleblowers. For instance, it extends the statute of limitations to bring retaliation claims from 90 days to six years, exempts whistleblower claims from pre-dispute arbitration agreements, and provides not only for reinstatement and attorneys' fees, but also for double back-pay. Dodd-Frank also expressly extends whistleblower protections to employees of consolidated subsidiaries of publicly-traded companies (not just employees of the publicly-traded parent company).

What To Do Now: Encourage Internal Reporting and Develop Speedy-Response Procedures for Potential Whistleblower Issues

Under the SEC's whistleblower rules, companies that encourage whistleblowers to report internally and that react quickly to complaints have distinct advantages

over companies that do not. When a whistleblower reports internally, it gives the company a chance to react effectively before the SEC staff has developed a one-sided view of the facts, possibly colored by erroneous perceptions of the whistleblower. For that reason, companies need to redouble their efforts to encourage employees to report their concerns about possible securities law violations through internal channels. Moreover, if serious violations have actually occurred, a company that has had an opportunity to conduct a thorough investigation and self-report may be in a far better position to avoid or reduce sanctions against it than it would if the SEC first learned of the matter from a whistleblower.

Companies should understand that when they learn of a potential compliance problem, a speedy response is critical, as the risk of a whistleblower alerting the SEC before the company has been able to conclude its review will be ever-present. That means companies should prepare a detailed action plan that can be taken off the shelf and implemented with little delay whenever potential violations come to light. Moreover, once 120 days have elapsed since a whistleblower reported internally, compliance and internal audit personnel become eligible to receive awards for whistleblowing. Thus, even when potential misconduct is reported first internally, the company will often be forced to assume it is in a race with unknown potential whistleblowers to report to the SEC. All of this makes a speedy-response plan essential.

Recommended Action Items

- Develop a comprehensive action plan and keep it “on the shelf” to allow the company to respond immediately to whistleblower tips. Consult with counsel experienced in investigations, compliance, and enforcement to develop appropriate contingency plans.
- Cultivate a corporate culture that emphasizes the importance of legal and regulatory compliance and ethical conduct.
- Review and update provisions in corporate compliance policies for anonymous reporting, hotlines, and anti-retaliation policies.
- Evaluate employee confidentiality agreements and other corporate policies that limit employees’ dissemination of information outside the company, to ensure that no policy purports to prohibit protected whistleblowing.
- Offer periodic training on the company’s internal reporting policy and procedures so employees know the process and appreciate the roles of the people involved.
- Consider offering employees incentives for reporting potential violations internally.
- Consider a program of periodically asking employees to certify that they are unaware of compliance problems as a means of encouraging internal reporting of legitimate concerns.
- Conduct exit interviews of relevant employees leaving the company, asking them if they suspect or know of any compliance violations. Include specific questions intended to elicit detailed answers.
- Ensure that all employees understand that retaliation against an employee for reporting potential misconduct in good faith is illegal and will not be tolerated by the company.
- In consultation with counsel, carefully communicate with internal whistleblowers to give them confidence the company is committed to getting to the bottom of the issues they have raised.
- Appropriately document the company’s response to each complaint.
- Assure that appropriate corrective action is taken where wrongdoing is found.

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