



Blowing the Whistle under Dodd-Frank

On May 25, 2011 the SEC adopted the final rules implementing the Dodd-Frank whistleblower program. The regulations provide an incentive to report violations of federal securities laws by offering an award for original information that leads to a successful enforcement action. The rules require the SEC to award whistleblowers 10–30% of the aggregate money, over a \$1 million threshold, recovered by the SEC in an enforcement action. The law aims to encourage internal reporting and to protect whistleblowers, however, some commentators argue that the program may, in fact, undermine and hinder corporation's internal compliance systems.

More Information:

The Dodd-Frank whistleblower program applies to a broad range of individuals. Essentially, any individual who provides the SEC or the Commodities Futures Trading Commission with qualifying information (e.g. fraud or disseminating material misinformation) regarding a violation of securities law that they reasonably believe has occurred, is ongoing, or is about to occur, can be eligible for an award if the reported information leads to a successful enforcement action. A whistleblower can be an employee, agent, independent contractor, consultant, joint venture partner, sales agent or person involved with a wholly owned subsidiary consolidated in a publicly traded entity's balance sheet. However, an individual is not eligible to receive an award under the program if they have a contractual duty to report violations, or if the individual is an officer or director, lawyer, auditor or compliance personnel.

A Whistleblower must provide qualifying information in order to be eligible for an award. The information provided must be original. In other words, the whistleblower must obtain the information independently, from independent knowledge or analysis, and the information cannot be derived from a publicly available source. Additionally, the whistleblower cannot have obtained the information through an attorney/client relationship or through their audit responsibilities unless the person has (1) a reasonable basis to believe that disclosure is necessary to prevent substantial injury to the financial interest or property of the company or its investors; (2) a reasonable basis to believe that the company is engaged in conduct that will impede an investigation of the misconduct; or (3) 120 days have elapsed since such person either reported the violation to the appropriate compliance personnel or received information that such personnel were already aware of the violation.

There is widespread concern that this program will undermine internal compliance efforts and/or that the exceptions made for information obtained through the attorney/client relationship may swallow the rule. The program does not require initial internal reporting, but instead encourages the use of those systems by increasing the award for whistleblowers that first use internal reporting systems and decreasing an award for whistleblowers that interfere with internal investigations. Regardless, the program raises challenging issues regarding internal compliance programs and existing corporate governance procedures, and many corporations fear that an

employee's incentive to receive personal gain will outweigh their loyalty to their employer. To minimize these risks companies should, at minimum, review their existing compliance programs, implement some form of employee training about internal reporting procedures, and conduct exit interviews for departing employees to understand why they are leaving the company and whether they know of any possible violations of securities laws.

Schuchat, Herzog & Brenman lawyers have closely followed the Dodd-Frank Act and regulations implementing the Act. Our lawyers represent public companies, investment companies and investment advisers impacted by the Act.

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Our updates are general information that may not apply in all situations. Please contact us for specific legal advice based on particular situations rather than relying on any of our updates. We'd be happy to help.

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