GIBSON DUNN

SEC Amends Whistleblower Rules

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On Wednesday, September 23, 2020, the Securities and Exchange Commission approved—on a 3-2 vote—amendments to its whistleblower program. Democratic members Allison Herren Lee and Caroline Crenshaw voted in opposition. These amendments, in particular those pertaining to the determination of whistleblower award amounts, have attracted considerable public attention. Although the award amount provisions have been the most eye-catching, there are other critical changes contained in the amendments that warrant mention. Below, we survey and summarize the most significant new provisions and offer some key takeaways for consideration.

- Revised whistleblower definition: In accordance with the Supreme Court's holding in *Digital Realty Trust, Inc. v. Somers*, the amendments provide whistleblower protections against retaliation only for individuals who make reports, in writing, to the SEC.
- Measures to address frivolous claims: The amendments include provisions designed to facilitate faster resolution of plainly non-meritorious whistleblower claims.
- Clarification on the types of resolutions that can be predicates for awards: The amendments clarify that various types of resolutions, including deferred prosecution agreements ("DPAs") or non-prosecution agreements ("NPAs"), can serve as the basis for a whistleblower award.
- Interpretive guidance on independent analysis: The SEC is publishing interpretive guidance clarifying that "independent analysis" means "evaluation, assessment, or insight beyond what would be reasonably apparent to the Commission from publicly available information."
- Amendments/guidance on award determinations: The amendments grant the Commission authority to adjust small awards upward and also clarify the Commission's discretion in determining awards.

The cumulative effect of these amendments—and whether they meet their stated goals—remains to be seen. But several outcomes appear likely. On the one hand, truly frivolous whistleblower claims may decrease in light of the Commission's new procedure for summarily disposing of meritless tips. Nevertheless, total whistleblower activity—including for lower-stakes cases—may increase. That is because the amendments (consistent with the 2018 decision in *Digital Realty*) reinforce the incentive to prioritize reporting directly to the SEC over reporting internally to receive whistleblower protections under the rules. This in turn could discourage internal reporting and complicate companies' internal efforts to prevent and detect misconduct. Moreover, the Commission's revised rules on award determinations suggest a willingness to issue a greater volume of smaller awards, which could incentivize increased reporting. Thus, companies should be vigilant and continuously evaluate and improve their internal compliance reporting and investigations protocols, as well as auditing and monitoring controls to prevent and detect potential misconduct.

Whistleblower Program Background

The SEC's whistleblower program was established in 2010 to incentivize individuals to

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report high-quality tips and to help the Commission detect wrongdoing. Since the program's inception, "[o]riginal information provided by whistleblowers has led to enforcement actions in which the Commission has obtained over $2.5 billion in financial remedies, most of which has been, or is scheduled to be, returned to harmed investors."[1] Along the way, the SEC has awarded more than $500 million to whistleblowers.[2] Seven of the ten largest whistleblower awards were made in the last three years, with the largest individual award on record—$50 million—made in June 2020.[3]

Critical Changes Under The Final Rule

1. *Revised Definition of "Whistleblower" For Anti-Retaliation Provisions*

The amendments to the rule limit the SEC's whistleblower protections to individuals who report information in writing directly to the SEC. The previous rule applied anti-retaliation protections both to internal reports and to reports to the SEC, and the SEC did not define the manner of providing information to qualify for retaliation protection.

This amendment brings Rule 21F-2 in line with the Supreme Court's 2018 ruling in *Digital Realty Trust, Inc. v. Somers*, where the Court found that under the plain language of the statute, an individual is a Dodd-Frank Act "whistleblower" for purposes of the Act's anti-retaliation provision only if she reports information directly to the SEC.[4] Therefore, under *Digital Realty* and the amended Rule 21F-2(d)(4), an individual who only reported alleged misconduct internally is not protected from retaliation under these regulations. (The existing rule already limits the availability of whistleblower awards to such individuals.)

Critics of the amendment argue that it will negatively impact the integrity of internal compliance programs and will further chill internal reporting. Moreover, Commissioner Crenshaw criticized the Commission's decision to limit the "anti-retaliation protections to whistleblowers who submit information in writing," thus failing "to protect those who cooperate with [its] exams and investigations," for example, "through interviews or testimony."[5]

The SEC will issue interpretive guidance defining the scope of retaliatory conduct prohibited by Section 21(h)(1)(A), which may provide much needed clarity for companies as they navigate complex employment and disciplinary determinations when addressing potential whistleblower issues. In the meantime, companies should bear in mind that internal reporting (made prior to written reporting to the SEC) may still be protected under the Sarbanes-Oxley Act and other federal and state laws with whistleblower provisions. And companies should also brace themselves for the possibility that the requirement that whistleblowers report to the SEC to avail themselves of Dodd-Frank's anti-retaliation provision, though already announced in *Digital Realty*, could incentivize complainants to make written reports to the SEC sooner, more frequently, and at the same time as internal reports.

2. *Measures to Increase Efficiency of Claims Review Process*

Two changes were made to increase efficiency in processing whistleblower award applications. First, new rule 21F-8(e) allows the SEC to bar individuals from submitting whistleblower award applications where they have been found to have submitted false information to the SEC, and allows the SEC to bar individuals who have made three frivolous claims in SEC actions. The latter provision is particularly important because frivolous claims lead to significant expenditures of time and resources both for the Commission and corporate compliance departments.

Second, new rule 21F-18 creates a summary disposition procedure for certain types of award applications, including untimely applications, applications that involve a tip that was

provided in the incorrect form, and applications where the claimant's information was never provided to or used for the investigation. As Jane Norberg, chief of the SEC's Office of the Whistleblower, explained, "some individuals [] submit claims that have absolutely no connection to the enforcement action. Under our current rules, we're unable to quickly address clearly nonmeritorious claims and known serial frivolous submitters."[6]

These changes could enable the SEC to more expeditiously dispense with nonmeritorious claims, including any uptick in such claims due to the potential increase in lower-dollar-value awards.

3. *Broadening Array of Resolutions That Can Serve as Predicates for Awards*

The amendments also resolve an open question as to the types of resolutions that qualify for awards. The Commission can issue awards to whistleblowers who contribute to the successful enforcement of "covered judicial or administrative actions" brought by the Commission and certain "related actions."[7] However, prior to the amendments, the Commission's rules were silent as to whether certain resolutions, such as DPAs or NPAs entered into by the Department of Justice ("DOJ") or state attorneys general in criminal cases, qualified for awards. NPAs presented a particular dilemma, because—unlike DPAs—NPAs are *not* filed in court and thus did not squarely fit within the concept of a "judicial or administrative action[]." The rules were also silent as to whether the Commission's own NPAs and DPAs were outside of a judicial or administrative action.[8]

In closing this gap, the Commission took the view that "Congress did not intend for meritorious whistleblowers to be denied awards simply because of the procedural vehicle that the Commission (or the other authority) has selected."[9] As a result, the Commission's revised definitions make clear that a broad array of resolutions can serve as predicates for whistleblower awards.

Specifically, the Commission's amendments change the definition of "action" in Rule 21F-4(d) to include (i) DPAs/NPAs brought by DOJ or state attorneys general in a criminal case, and (ii) a settlement with the Commission, even if brought outside of a judicial or administrative proceeding. The amendments also clarify that a "required payment" made under a DPA, an NPA, or an SEC settlement outside of a judicial or administrative proceeding, is a "monetary sanction[]" under Rule 21F-4(e), on the basis of which the amount of a resulting whistleblower award can be determined. And "required payments" now include funds "designated as disgorgement, a penalty, or interest," or funds "otherwise required as relief" in resolving a covered action.

These additions may prove significant because DOJ and some regulators rely heavily on DPAs and NPAs in reaching resolutions with corporate defendants, and because DOJ and the SEC continue to conduct parallel investigations in key areas.[10]

4. *Interpretive Guidance on Independent Analysis*

In addition to the proposed amendments to the rules, the SEC included proposed interpretive guidance to help clarify the meaning of "independent analysis" as defined in Exchange Act Rule 21F-4. Under the whistleblower program, (1) the whistleblower must have provided "original information" to the Commission; and (2) such information must have "led to" the successful enforcement of an action. Congress defined "original information" as information that is derived from either a whistleblower's "independent knowledge" or the whistleblower's "independent analysis." The SEC's guidance clarifies that "independent analysis" means "evaluation, assessment, or insight beyond what would be reasonably apparent to the Commission from publicly available information."[11]

In the final rule, the Commission added that, subject to Section 21F(a)(3)(C) of the Exchange Act, the Commission may determine that a whistleblower's examination and

evaluation of publicly available information reveals information that is "not generally known or available to the public"—and therefore is "analysis" within the meaning of Rule 21F-4(b)(3)—where: (1) the whistleblower's conclusion of possible securities violations derives from multiple sources, including sources that, although publicly available, are not readily identified and accessed by a member of the public without specialized knowledge, unusual effort, or substantial cost; and (2) these sources collectively raise a strong inference of a potential securities law violation that is not reasonably inferable by the Commission from any of the sources individually.[12]

The Commission noted that they expect to treat as "independent analysis" highly probative submissions in which the whistleblower's insights and evaluation provide significant independent information that "bridges the gap" between the publicly available information itself and the possibility of securities violations.[13] This amendment raises the bar for whether an individual's provision of information to the SEC will qualify them for a whistleblower award.

5. *Provisions Regarding Award Amounts*

a. *Upward Adjustments for Smaller Awards*

Under the current whistleblower program, a whistleblower who provides information that leads to a successful enforcement action against a company can be eligible for an award of between 10% and 30% of an overall monetary sanction over $1 million. Within that range, Rule 21F-6(a) and (b) identifies four criteria that may increase an award percentage, and three that may decrease it.[14]

The amendments add a new paragraph (c) to the 21F-6 framework, giving the SEC the discretion to apply upward adjustments to awards of $5 million or less. In addition to other limitations, such as the negative award factors described above, the Commission would not be permitted to use any upward adjustment to raise the award payout above $5 million, or to raise the total amount awarded to all whistleblowers in the aggregate above 30%.

In the June 2018 proposed amendments, the SEC had suggested allowing upward adjustments only to awards to a single whistleblower under $2 million. In the final rule, the SEC made a number of modifications to the proposed rule, including, but not limited to, the following:

- The SEC selected $5 million, rather than $2 million, as the ceiling for upward adjustments. From August 2012 to July 2020, 74% of awards were less than $5 million, of which 56% were less than $2 million.[15]
- In the final rule, the SEC noted that unreasonable delay under Rule 21F-6(b)(2) will not automatically disqualify individuals from receiving enhancements.
- Subject to exceptions, the new rule embodies a presumption that, where the statutory maximum is $5 million or less in the aggregate, the Commission will pay a meritorious claimant the statutory maximum amount where none of the negative award criteria specified in Rule 21F-6(b) are implicated and the award claim does not trigger Rule 21F-16. The Commission may determine that an otherwise eligible claimant will not receive the statutory maximum if it determines that the claimant's assistance was limited or providing the statutory maximum to the claimant would be inconsistent with the public interest, investor protection or the objectives of the program.

Although the amendments to the rules have yet to officially go into effect, the implications are already being felt. On Friday, September 25, 2020, the Commission awarded over $1.8 million to a whistleblower for providing a tip about overseas conduct that formed the basis for an SEC action against the company involved.[16] The Commission wrote that

after considering the administrative record and applying the award criteria in Rule 21F-6 to the facts and circumstances, it chose to increase the award amount to the whistleblower above the preliminary determination by the Claims Review Staff.

These amendments reflect the Commission's belief that bringing meritorious whistleblowers forward is critical to the program's success. Although the effects remain to be seen, the prospect of upward increases in smaller awards is likely to lead to an increase of whistleblower claims.

b. *Clarifying SEC Discretion Regarding Awards*

In the commentary to the final rule, the SEC noted that the comments in response to proposed rules Rule 21F-6(c) and (d) illuminated a disconnect between the SEC's and the public's understanding of the SEC's discretion to consider the dollar amount of monetary sanctions collected, as opposed to focusing exclusively on a percentage amount (i.e., between 10% and 30%) in the statutory range, when applying the award factors and setting the award amount. To clarify the Commission's discretionary authority, the final rules modify Rule 21F-6 to state that the Commission may consider only the factors set forth in Rule 21F-6 in relation to the facts and circumstances of each case.

The original 2018 proposal reflected a belief that the Commission would be unable to consider the application of the award criteria in dollar terms and adjust the "award amount downward if it found that amount unnecessarily large for purposes" of achieving the program's goals.[17] Commissioner Lee objected to the final rule because she believed that instead of providing the Commission with a limited ability to adjust the award amounts downward based on their size, with which she also disagreed, with the new clarification to Rule 21F-6 the SEC now "claim[s] that we do not need a new rule at all, that we've had this discretion all along."[18] Commissioner Lee added "the new rule is even more problematic than the proposal because we are no longer even restricted to the largest awards."[19] It remains to be seen how the Commission will exercise this discretion in future awards.

Conclusion

The new rules will become effective 30 days after their publication. As described above, the amendments aim to resolve open interpretive questions, to streamline the award process, and to provide improved incentives for future whistleblowers. Whether these goals are achieved remains an open question, but both proponents and skeptics of the amendments will be eager to see whether future developments bear out their predictions.

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[1] Press Release, Sec. & Exch. Comm'n, SEC Adds Clarity, Efficiency and Transparency to Its Successful Whistleblower Award Program (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-219.

[2] Sec. & Exch. Comm'n, Whistleblower Awards Over $500 Million for Tips Resulting in Enforcement Actions, https://www.sec.gov/page/whistleblower-100million (June 4, 2020).

[3] Press Release, Sec. & Exch. Comm'n, SEC Awards Record Payout of Nearly $50 Million to Whistleblower (June 4, 2020), https://www.sec.gov/news/press-release/2020-126.

[4] *Digital Realty Trust Inc. v. Somers*, 583 U.S. __ (2018).

[5] Public Statement, Caroline Crenshaw, Comm'r, Sec. & Exch. Comm'n, Statement of Comm'r Caroline Crenshaw on Whistleblower Program Rule Amendments (Sept. 23,

2020), https://www.sec.gov/news/public-statement/crenshaw-whistleblower-2020-09-23.

[6] Al Barbarino, SEC's Whistleblower Chief Reflects After $500M Milestone, Law360 (July 28, 2020), https://www.law360.com/articles/1294863/sec-s-whistleblower-chief-reflects-after-500m-milestone.

[7] 15 U.S.C. 78u-6(b)(1).

[8] Press Release, Sec. & Exch. Comm'n, SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations (Jan. 13, 2010), https://www.sec.gov/news/press/2010/2010-6.htm.

[9] Whistleblower Program Rules, Rel. No.34-89963, at 14.

[10] *See* Gibson Dunn, 2020 Mid-Year Update On Corporate Non-Prosecution Agreements And Deferred Prosecution Agreements (July 15, 2020), https://www.gibsondunn.com/wp-content/uploads/2020/07/2020-mid-year-npa-dpa-update.pdf

[11] Whistleblower Program Rules, Rel. No.34-89963, at 115.

[12] Whistleblower Program Rules, Rel. No.34-89963, at 121-122.

[13] Whistleblower Program Rules, Rel. No.34-89963, at 122.

[14] The criteria that may increase an award percentage are: (1) significance of the information provided by the whistleblower; (2) assistance provided by the whistleblower; (3) law enforcement interest in making a whistleblower award; and (4) participation by the whistleblower in internal compliance systems. Rule 21F-6(a). The criteria that may decrease the percentage are: (1) culpability of the whistleblower; (2) unreasonable reporting delay by the whistleblower; and (3) interference with internal compliance and reporting systems by the whistleblower. Rule 21F-6(b).

[15] Whistleblower Program Rules, Rel. No.34-89963, at 139.

[16] SEC Whistleblower Award Proceeding, Release No. 34-89996, https://www.sec.gov/rules/other/2020/34-89996.pdf.

[17] Whistleblower Program Rules, Rel. No. 34-83557, at 45.

[18] Public Statement, Allison Herren Lee, Comm'r, Sec. & Exch. Comm'n, June Bug vs. Hurricane: Whistleblowers Fight Tremendous Odds and Deserve Better (Sept. 23, 2020), https://www.sec.gov/news/public-statement/lee-whistleblower-2020-09-23.

[19] *Id.*

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