CFTC Proposes Dodd-Frank Whistleblower Rules

CFTC’s Proposed Rules for Implementing the Whistleblower Protection and Award Provisions of the Dodd-Frank Act Leave Open Issues of Concern for Employers

SUMMARY

On November 10, 2010, the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed rules under a new program enacted by Congress earlier in the year that encourages whistleblowing by providing for mandatory cash rewards to persons who report information about violations of the Commodity Exchange Act ("CEA"). As we reported in our publication of August 5, 2010, the whistleblower reward program is required under Section 748 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), and the CFTC was directed to issue implementing rules.1

The CFTC’s Proposed Rules 165.1 through 165.19 tend to track, in both structure and content, the Proposed Rules 21F-1 through 21F-16 issued by the SEC on November 3, 2010 to implement the Dodd-Frank Act’s whistleblower reward program under the securities laws. In light of the similarities between the two sets of Proposed Rules, this memorandum is devoted to highlighting particular distinctions between the CFTC’s rules and their associated commentary and those of the SEC. For a more in-depth discussion of how, in the context of the securities laws, the whistleblower program operates, please see our publication of November 12, 2010.2

The CFTC’s Proposed Rules, like those of the SEC, include some structural safeguards to allow employees to report information initially as part of a company’s internal compliance without losing eligibility for a reward. The CFTC rules, however, not only permit employees to remain eligible for the mandatory rewards even if they bypass their employer’s internal compliance procedures, but also, unlike the SEC rules, there is no discussion of any encouragement to whistleblowers to use internal processes.
BACKGROUND
Section 748 of the Dodd-Frank Act added a new Section 23 to the CEA, entitled “Commodity Whistleblower Incentives and Protection.” Section 23 established a whistleblower program that requires the CFTC to pay an award, subject to certain limitations and conditions, to whistleblowers who voluntarily provide the CFTC with original information about the violation of the CEA that leads to successful enforcement of a federal court or administrative action that results in monetary sanctions exceeding $1,000,000. Section 23 also contains provisions preserving the confidentiality of whistleblowers and prohibiting retaliation by employers against individuals who provide the CFTC with information about potential violations of the CEA.

The CFTC is directed to issue final regulations implementing the provisions of Section 23 no later than April 21, 2011.

DISTINCTIONS BETWEEN CFTC AND SEC PROPOSED RULES

A. DEFINITIONAL DIFFERENCES

The CFTC rules establish that a whistleblower is eligible for an award if he or she provides a voluntary submission to the CFTC that contains original information and which leads to the successful resolution of a covered CFTC judicial or administrative action or the successful enforcement of a related action. Proposed Rule 165.5.3

1. Definition of “voluntary submission”

Under the Proposed Rules of both the CFTC and the SEC, if an individual falls within the scope of a request or demand made of his employer, his submission of information will not be considered voluntary.

<table>
<thead>
<tr>
<th>CFTC</th>
<th>SEC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed Rule 165.2(o) If the employer fails to provide the employee’s documents or information to the requesting authority within 60 days, this limitation no longer applies.</td>
<td>Proposed Rule 21F-4(a)(2). An employee is freed from this limitation if the employer fails to provide the employee’s documents or information to the requesting authority in a “timely manner.”</td>
</tr>
</tbody>
</table>

2. Definition of “independent knowledge”

The phrase “original information” is defined, in part, as information derived from the whistleblower’s independent knowledge or analysis. The CFTC would exclude information from qualifying as independent knowledge in six circumstances, whereas the SEC lists seven. CFTC Proposed Rule 165.2(g); SEC Proposed Rule 21F-4(b)(4). The distinctions between the categories are as follows:
CFTC Proposes Dodd-Frank Whistleblower Rules
November 30, 2010

Proposed Rule 165.2(g)

Under 165.2(g)(1), there is a specifically enumerated category for the exclusion of information derived from sources generally available to the public, such as corporate filings and the media, including the internet.

The exclusions of information obtained from an entity’s internal compliance processes or information provided by persons involved in those processes are removed if the entity acts in “bad faith” or fails to disclose the information within 60 days. The CFTC provides no guidance on what it will consider when assessing “bad faith.” Proposed Rule 165.2(g)(4), (5).

Proposed Rule 21F-4(b)(4)

There is no corresponding category.

The exclusions pertaining to information obtained from an entity’s internal compliance processes or information provided by persons involved in those processes are removed if the entity acts in “bad faith” or fails to disclose the information within a “reasonable time.” In assessing “bad faith,” the SEC will, among other things, consider whether affirmative steps were taken to hinder the preservation of evidence or a timely and appropriate investigation. Proposed Rule 21F-4(b)(4)(iv), (v).

Under 21F-4(b)(4)(iii) information is excluded if obtained through the performance of an engagement required under the securities laws by an independent public accountant, if that information relates to a violation by the engagement client or the client’s directors, officers or other employees.

Under 21F-4(b)(4)(vii), the SEC would exclude any information obtained from individuals who fall within one of the other enumerated exclusions.

The CFTC Proposed Rule does not contain, as the SEC Proposed Rule does, a category excluding information obtained from all those who fall within its other enumerated exclusions. The CFTC, according to the commentary, would exclude information if passed along by a third party, but only if it were obtained from publicly available sources. The absence of such a category is troubling, because an employee, who is not himself eligible due to his position within the company, might be able to pass along information to a potential whistleblower, who would be free to make use of it.
B. DIFFERENCES IN CRITERIA FOR DETERMINING THE AMOUNT OF A WHISTLEBLOWER AWARD

<table>
<thead>
<tr>
<th>CFTC</th>
<th>SEC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed Rule 165.9</td>
<td>Proposed Rule 21F-6</td>
</tr>
<tr>
<td>The commentary is silent.</td>
<td>The SEC, in connection with this Proposed Rule, plans to take into account whether, and to what extent, a whistleblower reported a violation through the legal or compliance procedures of his employer prior to reporting the violation to the SEC. While not decisive, the SEC would potentially increase the whistleblower’s reward if he has done so.</td>
</tr>
</tbody>
</table>

In failing to state any consideration concerning the use of, or failure to use, the internal compliance processes of an employer, the CFTC has made no indication that it will provide incentives to a whistleblower who utilizes such processes, let alone penalize one who fails to do so.

C. APPENDIX MATERIALS

An additional distinction between the SEC’s and CFTC’s Proposed Rules is that the CFTC has included a Proposed “Appendix A – Guidance With Respect to the Protection of Whistleblowers Against Retaliation.” Its stated purpose is to better inform the public regarding the protections against retaliation from employers provided for whistleblowers under Section 23(h) of the CEA. In particular, it describes the possibility of bringing a federal cause of action against an employer, the time frame in which to do so, and the potential relief for prevailing whistleblowers.

* * *

ENDNOTES

1 Available at https://www.sullcrom.com/files/Publication/5d71e4ae-62ea-4a8c-8e4c-2b56190d2183/Presentation/PublicationAttachment/65561fae-42de-445a-89fa-2e31d1b2c7ba/SC_Publication_Dodd_Frank_Act_Whistleblower_Provisions.pdf.

2 Available at http://www.sullcrom.com/files/Publication/99accd0a-51a9-4e3e-a86c-1b4bf5b0ea1e/Presentation/PublicationAttachment/37854c69-23a6-47cf-9885-1e977c4d5905/SC_Publication_SEC_Proposes_Dodd_Frank_Whistleblower_Rules.pdf.

3 This tracks the statutory language. 7 U.S.C. § 23(b)(1).

Copyright © Sullivan & Cromwell LLP 2010
SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP
Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP
This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Jennifer Rish (+1-212-558-3715; rishj@sullcrom.com) or Alison Alifano (+1-212-558-4896; alifanoa@sullcrom.com) in our New York office.

CONTACTS

<table>
<thead>
<tr>
<th>New York</th>
<th>+1-212-558-3467</th>
<th><a href="mailto:rogersto@sullcrom.com">rogersto@sullcrom.com</a></th>
</tr>
</thead>
<tbody>
<tr>
<td>Theodore O. Rogers, Jr.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marc R. Trevino</td>
<td>+1-212-558-4239</td>
<td><a href="mailto:trevinom@sullcrom.com">trevinom@sullcrom.com</a></td>
</tr>
<tr>
<td>Robin D. Fessel</td>
<td>+1-212-558-3832</td>
<td><a href="mailto:fesselr@sullcrom.com">fesselr@sullcrom.com</a></td>
</tr>
<tr>
<td>John F. Fullerton III</td>
<td>+1-212-558-3906</td>
<td><a href="mailto:fullertonj@sullcrom.com">fullertonj@sullcrom.com</a></td>
</tr>
<tr>
<td>Washington, D.C.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Samuel R. Woodall III</td>
<td>+1-202-956-7584</td>
<td><a href="mailto:woodalls@sullcrom.com">woodalls@sullcrom.com</a></td>
</tr>
</tbody>
</table>