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Final Dodd-Frank Whistleblower Rules: Are you prepared?

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TeleBriefing

Whistleblower Perspective

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Overview of the Whistleblower Perspective

Broader than the whistleblower provisions of Section 806 of the Sarbanes Oxley Act, the Dodd Frank Act whistleblower provisions set forth in Section 922 need not be related to shareholder protection in any way. Instead, a Dodd Frank whistleblower may receive awards and anti-retaliation protections connected with “any judicial or administrative action” brought by the SEC, or specified “related actions” brought by the Department of Justice and other specified federal agencies, self-regulatory organizations, and even state attorney generals. The Act provides:

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 21E the following:

“SEC. 21F. SECURITIES WHISTLEBLOWER INCENTIVES AND PROTECTION.

“(a) DEFINITIONS.—In this section the following definitions shall apply:

“(1) COVERED JUDICIAL OR ADMINISTRATIVE ACTION.—The term ‘covered judicial or administrative action’ means any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding \$1,000,000.

“(5) RELATED ACTION.—The term ‘related action’, when used with respect to any judicial or administrative action brought by the Commission under the securities laws, means any judicial or administrative action brought by an entity described in subclauses (I) through (IV) of subsection (h)(2)(D)(i) that is based upon the original information provided by a whistleblower pursuant to subsection (a) that led to the successful enforcement of the Commission action.

As to “related actions” for which a whistleblower may receive awards and protections, Subsection (h)(2)(D)(i) provides:

“(i) IN GENERAL.—Without the loss of its status as confidential in the hands of the Commission, all information referred to in subparagraph (A) may, in the discretion of the Commission, when determined by the Commission to be necessary to accomplish the purposes of this Act and to protect investors, be made available to—

“(I) the Attorney General of the United States;

“(II) an appropriate regulatory authority;

“(III) a self-regulatory organization;

“(IV) a State attorney general in connection with any criminal investigation; ***

These administrative, civil and criminal actions are generically referred to in the final rules and comments as “enforcement actions” or as any “successful enforcement by the Commission of a federal court or administrative action” Rule 21F-3(a) (3). If a whistleblower has

provided “information relate[d] to a possible violation of the federal securities laws (including any rules or regulations thereunder)” that results in penalties or recoveries by the SEC or agencies, then that whistleblower is eligible to receive from 10 to 30 percent of that penalty or recovery. The bulk of final Rule 21F sets forth the conditions, processes and exceptions of eligibility for these rewards.

The SEC’s rules will be effective 60 days after they are submitted to Congress or published in the Federal Register.

Section 1. Differences Between the Proposed and Final Rules of the Dodd Frank Whistleblower Program

There are significant differences between the proposed and final Dodd Frank rules.

A. Encouragement of Internal Reporting

The final rules added incentives to encourage employee-whistleblowers to first or simultaneous report violations internally to their companies before contacting the SEC by (a) allowing the SEC to consider resort to internal compliance system in determining the amount of the award; and (b) extending the “look back” time from 90 days to 120 days after which a whistleblower may report a violation to the SEC following an internal report but be treated as if the internal report date was the official “original information” report date to the SEC.

B. Broadening the Definition of Whistleblower

The proposed rules qualified a whistleblower as reporting “potential” violations of the securities laws. But under the final rules, the definition was broadened to require only a report of a “possible” violation that that may simply be “about to occur.” Additionally, such a possible violations need not constitute “material” disclosures, as the SEC comment states that “a facially plausible relationship to some securities law violation” is sufficient for whistleblower status. Additionally, the final rules make clear that the whistleblower’s allegations need not be accurate, so long as he had a “reasonable belief” that a possible violation that has occurred or is about to occur. The SEC comments expressly adopt this liberal approach to whistleblowing from U.S. Department of Labor whistleblower precedents that value the flow of information to the government more than the accuracy of that information, so that the SEC can decide the merits rather than have whistleblowers screen themselves out because they are unsure about securities law.

C. Protecting Company Auditors, Lawyers and Compliance Whistleblowers

Under the final rules, auditing, legal and compliance personnel can be protected if they had a reasonable belief that whistleblowing was necessary: (a) to prevent substantial injury to the financial interests of the company or its shareholders; or (b) that that the company was about to impede an investigation of the misconduct; or (c) that 120 days had passed since the whistleblower reported (or officials already knew about) the possible violations to the company’s audit committee, chief legal officer, chief compliance officer or to the whistleblower’s supervisor. This contrasted significantly from the proposed rules which denied these categories

of whistleblowers awards unless the company failed to self-report “within a reasonable amount of time” or otherwise acted in bad faith.

Below are key excerpts from the Final Rule and the SEC comments support it.

A. EXCERPTS OF TEXT OF FINAL REGULATIONS

(1) § 240.21F-3 Payment of awards [in Related Actions Such as False Claims Act or Fraud Prosecutions].

(b) Related actions: The Commission will also pay an award based on amounts collected in certain related actions. (1) A related action is a judicial or administrative action that is brought by:(i) The Attorney General of the United States; (2) In order for the Commission to make an award in connection with a related action, the Commission must determine that the same original information that the whistleblower gave to the Commission also led to the successful enforcement of the related action ***.

(2) § 240.21F-4 Other definitions.

[Independent Analysis Source of Whistleblower Information]

21F-4(b)(3) Independent analysis means your own analysis, whether done alone or in combination with others. Analysis means your examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.

[Presumptive Ineligibility of Compliance, Audit and Legal Employee Whistleblowers]

21F-4(b)(4)(iii) The Commission will not consider information to be derived from your independent knowledge or independent analysis in any of the following circumstances:*** In circumstances not covered by paragraphs (b)(4)(i) or (b)(4)(ii) of this section, if you obtained the information because you were: (A) [A compliance, audit or legal employee and] you learned the information in connection with the entity’s processes for identifying, reporting, and addressing possible violations of law;

[Exceptions for Compliance, Audit and Legal Employee Whistleblowers]

21F-4(b)(4)(v) Exceptions. Paragraph (b)(4)(iii) of this section shall not apply if:(A) You have a reasonable basis to believe that disclosure of the information to the Commission is necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors; (B) You have a reasonable basis to believe that the relevant entity is engaging in conduct that will impede an investigation of the misconduct; or (C) At least 120 days have elapsed since you provided the information to the relevant entity’s audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor, or since you received the information, if you received it

under circumstances indicating that the entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor was already aware of the information.

[Whistleblower Disclosures to Other Agencies or Internal Compliance Program Before to SEC]

21F-4(b)(7) If you provide information to the Congress, any other authority of the federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, or to an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law, and you, within 120 days, submit the same information to the Commission pursuant to § 240.21F-9 of this chapter, as you must do in order for you to be eligible to be considered for an award, then, for purposes of evaluating your claim to an award under §§ 240.21F-10 and 240.21F-11 of this chapter, the Commission will consider that you provided information as of the date of your original disclosure, report or submission to one of these other authorities or persons.

[Self-Reporting Constituting Joint Disclosures with the Whistleblower]

21F-4(c)(3) Information that leads to successful enforcement. The Commission will consider that you provided original information that led to the successful enforcement of a judicial or administrative action in any of the following circumstances: *** You reported original information through an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law before or at the same time you reported them to the Commission; the entity later provided your information to the Commission, or provided results of an audit or investigation initiated in whole or in part in response to information you reported to the entity;

(3) § 240.21F-5 Amount of award.

(b) *** The amount will be at least 10 percent and no more than 30 percent of the monetary sanctions that the Commission and the other authorities are able to collect.

(4) § 240.21F-6 Criteria for determining amount of award.

21F-6(a)(2)(ii) Assistance provided by the whistleblower. The Commission will assess the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the Commission action or related action. In considering this factor, the Commission may take into account, among other things:(ii) The timeliness of the whistleblower's initial report to the Commission or to an internal compliance or reporting system of business organizations committing, or impacted by, the securities violations, where appropriate;

(5) 21F-6(a)(4) Participation in internal compliance systems.

The Commission will assess whether, and the extent to which, the whistleblower and any legal representative of the whistleblower participated in internal compliance systems. In considering this factor, the Commission may take into account, among other things: (i) Whether, and the extent to which, a whistleblower reported the possible securities violations through internal whistleblower, legal or compliance procedures before, or at the same time as, reporting them to the Commission; and (ii) Whether, and the extent to which, a whistleblower assisted any internal investigation or inquiry concerning the reported securities violations.

21F-6(b) Factors that may decrease the amount of a whistleblower's award. In determining whether to decrease the amount of an award, the Commission will consider the following factors, which are not listed in order of importance. *** (3) Interference with internal compliance and reporting systems. The Commission will assess, in cases where the whistleblower interacted with his or her entity's internal compliance or reporting system, whether the whistleblower undermined the integrity of such system. ***

(6) § 240.21F-7 Confidentiality of submissions.

(a)(2) When the Commission determines that it is necessary to accomplish the purposes of the Exchange Act (15 U.S.C. 78a) and to protect investors, it may provide your information to the Department of Justice, an appropriate regulatory authority, a self regulatory organization, a state attorney general in connection with a criminal investigation, any appropriate state regulatory authority, the Public Company Accounting Oversight Board, or foreign securities and law enforcement authorities.

(7) § 240.21F-13 Appeals.

[Claimant Can Appeal only Denial of Award, Not the Amount]

(a) Section 21F of the Exchange Act (15 U.S.C. 78u-6) commits determinations of whether, to whom, and in what amount to make awards to the Commission's discretion. A determination of whether or to whom to make an award may be appealed within 30 days after the Commission issues its final decision to the United States Court of Appeals for the District of Columbia Circuit, or to the circuit where the aggrieved person resides or has his principal place of business. *** [T]he Commission's determination regarding the amount of an award (including the allocation of an award as between multiple whistleblowers, and any factual findings, legal conclusions, policy judgments, or discretionary assessments involving the Commission's consideration of the factors in § 240.21F-6 of this chapter) is not appealable.

[The Company is Not Referenced as a Potential Party to Appeal]

(b) The record on appeal shall consist of the Preliminary Determination, the Final Order of the Commission, and any other items from those set forth in § 240.21F-12(a) of this chapter that *either the claimant or the Commission* identifies for inclusion in the record. [Emphasis added].

(8) § 240.21F- 14 Procedures applicable to the payment of awards.

(a) Any award made pursuant to these rules will be paid from the Securities and Exchange Commission Investor Protection Fund (the “Fund”).

(b) A recipient of a whistleblower award is entitled to payment on the award only to the extent that a monetary sanction is collected in the Commission action or in a related action upon which the award is based.

(9) § 240.21F-17 Staff communications with individuals reporting possible securities law violations.

[Company May Not Interfere with or Condition Employee Contact with the SEC]

(a) No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement *** with respect to such communications.

[Company May Not Require Clearance of Communication Through Legal Department]

(b) If you are a director, officer, member, agent, or employee of an entity that has counsel, and you have initiated communication with the Commission relating to a possible securities law violation, the staff is authorized to communicate directly with you regarding the possible securities law violation without seeking the consent of the entity’s counsel.

B. EXCERPTS OF SEC COMMENTS TO FINAL RULE

1. NO MATERIALITY REQUIREMENT

We have not added a requirement that the information relate to a “material” violation of the securities laws. We believe that, rather than use a materiality threshold barrier that might limit the number of submissions to us, it is preferable for individuals to provide us with any information they possess about possible securities violations (irrespective of whether it appears to relate to a material violation) and for us to evaluate whether the information warrants action.

2. ANTI RETALIATION ENFORCEMENT ACTIONS

We are also adding Rule 21F-2(b)(2), which expressly states that the Commission may enforce the anti-retaliation provisions of Section 21F(h)(1) of the Exchange Act and any rules promulgated thereunder.

Rule 21F-2(b)(2) states that Section 21F(h)(1) of the Exchange Act, including any rules promulgated thereunder, shall be enforceable in an action or proceeding brought by the Commission. Because the anti-retaliation provisions are codified within the Exchange Act, we agree with commenters that we have enforcement authority for violations of Section 21F(h)(1) by employers who retaliate against employees for making reports in accordance with Section 21F.40

3. INTERNAL WHISTLEBLOWING PROTECTED BY INCORPORATION OF SOX SECTION 806 ANTI-RETALIATION PROVISIONS

Employees who report internally in this manner will have anti-retaliation employment protection to the extent provided for by Section 21F(h)(1)(A)(iii) of the Exchange Act, which incorporates the broad anti-retaliation protections of Sarbanes-Oxley Section 806, see 18 U.S.C. 1514A(b)(2).

4. ADOPTION OF U.S. DEPARTMENT OF LABOR REASONABLE BELIEF STANDARD

Rule 21F-2(b) states that anti-retaliation employment protection will be provided to whistleblowers who have a “reasonable belief” that the information they provide reveals a possible securities law violation.

We believe that requiring a “reasonable belief” on the part of a whistleblower seeking anti-retaliation protection strikes the appropriate balance between encouraging individuals to provide us with high-quality tips without fear of retaliation, on the one hand, while not encouraging bad faith or frivolous reports, or permitting abuse of the anti-retaliation protections, on the other.³⁴ This approach is consistent with the approach followed by various courts that have construed the anti-retaliation provisions of other federal statutes, including the False Claims Act ***.

By its terms, the statute only prohibits adverse employment actions that are taken “because of” any lawful act by the whistleblower to provide information; adverse employment actions taken for other reasons are not covered. Moreover, there is a well-established legal framework for making this factual determination on a case-by case basis, and we see no indication that Congress intended to depart from this framework here.

Regarding the comments that we should categorically provide that employees who make whistleblower reports to us may be disciplined for reasons independent of their whistleblowing activities, we think this is unnecessary.

5. ROLE AND EFFECT OF INTERNAL COMPLIANCE PROGRAMS

While we did not propose a requirement that whistleblowers report through internal compliance processes as a prerequisite to eligibility for an award, we requested comment on this topic ***. After considering these different viewpoints, we have determined not to include a requirement that whistleblowers report violations internally, but we have made additional changes to the rules to further incentivize whistleblowers to utilize their companies’ internal compliance and reporting systems when appropriate.

[T]he final rules expressly provide: first, that a whistleblower’s voluntary participation in an entity’s internal compliance and reporting systems is a factor that can increase the amount of an award ***.

The final rules contain a provision under which a whistleblower can receive an award for reporting original information to an entity's internal compliance and reporting systems, if the entity reports information ***.

On the one hand, the Commission's primary goal, consistent with the congressional intent behind Section 21F, is to encourage the submission of high-quality information to facilitate the effectiveness and efficiency of the Commission's enforcement program. For this reason, we are not requiring that a whistleblower utilize an available internal compliance program prior to submission to the Commission, and we are not providing for a lookback period as long as requested by some commenters. Because of our strong law enforcement interest in receiving high quality information about misconduct quickly we have chosen a lookback period shorter than the 180 days or more that some commenters requested.

And, in determining whether to give a company the opportunity to investigate and report back, we may consider a number of factors, including, but not limited to, information we have concerning the nature of the alleged conduct, the level at which the conduct allegedly occurred, and the company's existing culture related to corporate governance. We may also consider information we have about the company's internal compliance programs, including what role, if any, internal compliance had in bringing the information to management's or the Commission's attention.

Moreover, as further described below, internal compliance programs are not substitutes for rigorous law enforcement. However, we believe that internal compliance programs play an important role. While we are not requiring whistleblowers to report misconduct internally before reporting to us, we agree that the incentives to do so should be strengthened. Accordingly, the Final Rule includes a provision for a new standard applicable to a whistleblower who reports information internally.

Additional incentives to encourage reporting through internal compliance programs. *** Paragraph (3) of Rule 21F-4(c) is a new provision that has been added, in response to comments, to create a significant financial incentive for whistleblowers to report possible violations to internal compliance programs before, or at the same time, they report to us. *** Rule 21F-4(c)(1): Standard for information concerning conduct not under investigation or examination.

6. "SIGNIFICANT CONTRIBUTION" DROPPED AS REQUIREMENT FOR REWARD

We have decided to lower the standard applicable to information that concerns conduct not under investigation or examination. As noted above, the Proposed Rule required that the information must have "significantly contributed" to the success of the action. In the Final Rule, we have deleted "significantly contributed" from the standard. Under the Final Rule, information will be considered to have led to successful enforcement when it is sufficiently specific, credible, and timely to cause the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation, and the Commission brings a successful judicial or administrative action ***.

Section 2. History of SEC Enforcement Leading to the Dodd Frank Whistleblower Program

To understand how vigorous the SEC is likely to be in administering the Dodd Frank Whistleblower Program, some historical perspective should be useful. Below are excerpts from Thomas Gorman of Dorsey & Whitney LLP, a former senior counsel in the SEC Division of Enforcement, in a blog posted January 3, 2011 regarding SEC Enforcement Trends 2011. This is the first in a series of articles that will be published periodically analyzing the direction of SEC enforcement:

The Securities and Exchange Commission was born of scandal, created by congress in the wake of the 1929 market crash. The hearings which lead to the creation of the agency chronicled swindles, frauds, rigged deals and other fraudulent tactics of a shadowy Wall Street. For a considerable period of time the SEC enjoyed a well deserved reputation as one of the best regulators in government. As the recent market cash unfolded all this changed. The impact of years of deregulation and no regulation became apparent. Suddenly everyone was reading about esoteric financial products which few even on Wall Street understood. CDS, CDO, synthetic securities and analphabet soup of esoteric financial products became the topic of conversation not just on Wall Street but on Main Street. For the SEC the crisis was more than one about regulating the markets. The agency itself became a central cause for concern and criticism. The once highly respected and perhaps feared Enforcement program was charged with being ineffective and inept. The agency became the target of lawsuits filed by investors claiming it failed to protect them from fraudsters such as Bernard Madoff and Robert Allen Sanford.

Clearly significant steps and progress has been made. New Commissioners have been appointed. Dozens of new regulations have been issued. Many more have been put out for comment. More are on the way. Congress has given the SEC more authority in the Dodd-Frank Act as well as new directives to write even more regulations. The largest reorganization in history has been completed. New personnel have been added. New positions created. New initiatives to facilitate and speed investigations have been announced.

Section 3. SEC Statements Explaining the Final Rule of May 25, 2011

In understanding the final rule, and in projecting how the SEC is likely to administer it, the policy statements, reports and releases from the SEC may prove invaluable. Below are excerpts of four SEC publications that serve this purpose.

**(1) “SEC Adopts Rules to Establish Whistleblower Program”, RELEASE 2011-116
Washington, D.C., May 25, 2011**

“For an agency with limited resources like the SEC, it is critical to be able to leverage the resources of people who may have first-hand information about violations of the securities laws,” said SEC Chairman Mary L. Schapiro. “While the SEC has a history of receiving a high volume of tips and complaints, the quality of the tips we have received has been better since Dodd-Frank became law. We expect this trend to continue, and these final rules map out simplified and transparent procedures for whistleblowers to provide us critical information.” Prior to the Act, the agency’s bounty program was limited to insider trading cases and the amount of an award was capped at 10 percent of the penalties collected in the action.

Certain people generally will not be considered for whistleblower awards under the final rules. These include compliance and internal audit personnel. However, in certain circumstances, compliance and internal audit personnel as well as public accountants could become whistleblowers when the whistleblower believes disclosure may prevent substantial injury to the financial interest or property of the entity or investors. In addition, the rules make it unlawful for anyone to interfere with a whistleblower’s efforts to communicate with the Commission, including threatening to enforce a confidentiality agreement.

The final rules do not require that employee whistleblowers report violations internally in order to qualify for an award. However, the rules strengthen incentives that had been proposed and add certain additional incentives intended to encourage employees to utilize their own company’s internal compliance programs when appropriate to do so.

The Office of the Whistleblower, now headed by Sean McKessy, works with whistleblowers, handles their tips and complaints, and helps the Commission determine the awards for each whistleblower.

(2) SEC Speech, “Opening Statement at SEC Open Meeting”, by Chairman Mary L. Schapiro-May 25 2011

Many issues were raised in the 240 comments and more than 1,300 form letters we received.

For example, the proposed rules limited the ability of lawyers, auditors and internal compliance personnel to improperly use their positions to claim a reward. Today’s final rule recognizes that we might have initially sought to exclude too many important, potential whistleblowers. So, the proposal narrows some of those exclusions and, more importantly, creates appropriate exceptions to ensure sufficient avenues for vital information ultimately to get to the SEC.

We have sought to leverage compliance officers who can help protect investors by keeping companies on the straight path. But many commenters vigorously asserted that these programs would only survive if the Commission required whistleblowers to first report internally before coming to us. This view, however, was countered by many other commenters who strenuously argued that mandating internal compliance reporting is inconsistent with the statute. They noted that such a mandate would dissuade whistleblowers from coming forward. However, the final rules would give credit to a whistleblower whose company passes the information along to the Commission, even if the whistleblower does not. This could create an opportunity for a whistleblower to obtain an award through internal reporting where the whistleblower might not otherwise have qualified for an award because the information was not sufficiently specific and credible.

(3) SEC, “Dissent by Commissioner Casey Adoption of Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934”, May 25 2011

The whistleblower provisions of the Dodd-Frank statute are particularly challenging to implement because of the important and sometimes conflicting public policy interests that are at stake: in particular, between promoting robust internal compliance reporting programs and encouraging high quality tips from whistleblowers. An inherent risk of the approach adopted in the final rule, is that the monetary sums at stake will provide a significant enough incentive for whistleblowers to completely bypass internal reporting in favor of coming straight to the Commission. As a consequence, the public investigative process can be substantially more ponderous and time-consuming than private investigative processes. And there is a danger in not addressing matters quickly and decisively. By diverting tips and complaints from private channels to the Commission, we may end up permitting violations to last longer and grow more serious.

Indeed, I fear the Commission has elected to implement a whistleblower program that favors a pound of cure over an ounce of prevention.

The staff has assured me that they’ll be able to handle the incoming flow of complaints, but I fear they are not being adequately circumspect. A better course, in my view, would have been to adopt some form of contemporaneous reporting to both the Commission and to internal compliance programs, thereby ensuring a greater degree of confidence that potential securities law violations would be timely detected and acted upon without sacrificing the prerogative of the Commission to act as it sees fit in any given case

This exception [allowing compliance, audit and legal department employees to be whistleblowers] utterly swallows the rule. Many, if not most, potential securities law violations can be characterized as threatening substantial financial injury to investors and our natural instinct will be to interpret this provision liberally. Thus, this exception to the attorney exclusion will have the effect of allowing attorneys

to breach their duties of trust and confidence to their clients, thereby undermining the very privilege that the rule purports to protect.

(4) SEC October 26, 2010 “Whistleblower Report to Congress”

Section 922 of the Dodd-Frank Act established the Securities and Exchange Commission Investor Protection Fund (“Fund”) to provide funding for the Commission’s whistleblower award program, including the payment of awards in related actions. See Exchange Act §21F(g)(2)(A). As of September 30, 2010, the Fund was fully funded, with an ending balance of \$451,909,854.07. The SEC plans to invest the Investor Protection Funds in short-term Treasury securities, whenever practicable. As the funds are collected, the SEC will hold them in a special receipt fund account and may invest them in overnight and short-term market-based Treasury bills through a facility provided by the Bureau of the Public Debt (“BPD”), pending their distribution. No sanction collected by the Commission can be deposited into the fund if its balance exceeds \$300 million.

Section 4. Policy Arguments Considered by the SEC Against the Proposed Rules

To anticipate how the SEC will construe and apply the final rule regarding the effects of a whistleblower’s prior cooperation with a company’s internal ethics and compliance program, it is essential to understand what policy arguments the SEC has already considered. Below are excerpts from the comments of the Association of Corporate Counsel (“ACC), a bar association for attorneys employed in the legal departments of corporations and private-sector organizations worldwide, having more than 26,000 members in over 75 countries, employed by over 10,000 organizations. The ACC’s comments were expressly on behalf of in-house counsel and their client organizations. The co-signers are professionals responsible for the compliance and reporting functions within their companies, and many have direct or supervisory responsibility for the implementation of both reporting systems and whistleblower protection programs within their often multinational companies. Yet, almost all of the ACC’s arguments were rejected by the SEC, as was the ACC’s views of the selfish motivations of whistleblowers.

Comments of the Association of Corporate Counsel (“ACC) on the Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, File No. S7-33-10 (December 15, 2011)

The vast experience of the thousands of companies with excellent records of compliance due to robust internal reporting procedures teaches us the practical reality that creating a culture of compliance requires a substantial effort. These efforts include the need to communicate and inculcate a shared value that all employees are responsible for ensuring that the company operates within the bounds of the law and ethics.

Compliance systems are the principal vehicles for educating employees about what the law requires, particularly given rapid, complex, and multijurisdictional legal obligations that managers with all kinds of responsibilities in the company must navigate. But none of these important compliance mechanisms work if

employees are not vested in and do not feel they will be protected in fulfilling their roles in reporting wrongdoing. The sine qua non requirement for these programs to work and for companies to comply with the law is the expectation that employees will report misconduct internally so that the company can timely address and correct problems reported.

The Commission's proposed rules disincent employees from looking for ways to improve or correct corporate behaviors, and incent them to find ways to profit from corporate wrongdoing. Fraudulent misconduct, the bane of good compliance systems, then becomes the gold mine, rather than an impetus for companies with effective compliance systems to address the underlying issues. Given their integral importance to the success of compliance programs, policies articulating employee responsibilities for helping the company to comply with the law and requiring cooperation with internal investigations have been incorporated into employee handbooks directly in many sophisticated companies. Employees who fail to comply with these policies can be subject to termination or other forms of discipline.

The Commission's proposed approach invites employees to focus on timing their report so as to maximize the bounty they'll receive in permitting the misconduct to fester in order to allow them to more easily evidence their claim or increase the damages caused by the misconduct (by which their bounty will be calculated) before approaching the Commission. Companies confronted with a report can more timely address the underlying situation, and, if necessary, self-report to the Commission; knowing that employees with legitimate complaints can take their concerns to the Commission if the company does not respond.

While we commend the Commission for acknowledging that the bounty program could undermine corporate compliance regimes, the proposed rule's approach is not sufficient. We note three particular concerns: Prospective whistleblowers will quickly learn that waiting to allow the problem to fester and then to report directly to the Commission will yield a better award than reporting to their compliance officials soon after learning of the misconduct. Second, the Commission's proposal to reduce the eventual award to an individual who does not make use of internal reporting systems is a good idea, but it is merely mentioned in the commentary without being listed in the rule. If the company refused to address the issue, the individual, after waiting a reasonable period of time (we suggest 180 days), could submit their allegations directly to the Commission. Some have argued that Dodd-Frank did not give the Commission the ability to require a whistleblower to exhaust the internal compliance route first. That proposition is flatly incorrect. In defining "whistleblower," Congress specifically required covered individuals to submit their allegations "in a manner established, by rule or regulation, by the Commission."

Third, the Commission also suggests that it would, in its discretion, contact the company after learning of the allegation to allow the company to conduct an

internal investigation and obtain cooperation credit. In addition to failing to make clear how its discretion would be exercised, the Commission would place the company in the unenviable position of learning of alleged wrongdoing via a phone call from Commission staff.

We recognize the valid concern that some employees will fear retaliation for blowing the whistle. The solution to that problem is not, however, a scheme to undermine important and effective internal compliance and reporting systems; rather, employees who fear retaliation may rely on the anti-retaliation provision contemporaneously enacted by Congress. By doing so, the Commission will separate out the good corporate actors from the bad. From our perspective and based on the traditional understanding of the term, an individual who merely learns of a problem and heads for Door Number 1 to recover a large award is not a whistleblower. Instead, the archetypal whistleblower is an individual who attempts to solve the problem within an organization. The Commission should adopt a better definition of “whistleblower” by requiring those who would wear the title to earn it by reporting internally first.

Whistleblower advocates strongly contested the kinds of views expressed by the ACC. Below are excerpts from one of the more thorough comments submitted to the SEC by whistleblower advocates.

National Whistleblower Center Report to SEC, “Impact of Qui Tam Laws on Internal Compliance”, December 2010

Moreover, in the area of whistleblowing, in-house counsels have actively and aggressively undermined internal compliance programs for over 25 years. As early as 1984, corporations and their attorneys have consistently argued that employees who report to internal compliance programs are not whistleblowers and are not protected under whistleblower laws. Corporate attorneys have aggressively argued that contacts with internal compliance programs are not protected activities. This is why organizations such as the National Whistleblowers Center have consistently urged Congress to amend existing whistleblower laws to ensure that internal reporting is protected.

Under the banking law, numerous cases have examined whether employees who report to managers or compliance departments are protected. All of the surveyed decisions demonstrate that internal disclosures are not protected. Banks have successfully urged court after court to undermine internal reporting structures and they have obtained rulings that reports to compliance officials about violations of law are not protected. The only protected disclosures were those made to the government.

Our review of the False Claims Act revealed a similar result. Reviewing published retaliation cases from 2007-2010 demonstrate that, in all but two cases, corporate attorneys and their clients argued that internal disclosures were not protected. The court rulings are evenly split as to whether a qui tam relator is protected for disclosures made to internal compliance, but the position of

corporate counsel is uniformly against protection. For example, the Rand Center for Corporate Ethics and Governance published “Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know,” Rand Institute for Civil Justice Center (2009)(Michael D. Greenberg).

In the context of the False Claims Act, the United States took steps to ensure that compliance programs moved from simply being “window dressing” to becoming more substantive tools in the anti-fraud program. The United States determined that existing compliance programs were not effective, and instituted rulemaking proceedings within the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council to mandate stronger and more ethical compliance programs. On November 12, 2008 the United States published these final rules, entitled, “Federal Acquisition Regulation; FAR Case 2007-006, Contractor Business Ethics Compliance Program and Disclosure Requirements,” See 73 Federal Register 67064, 67065 (November 12, 2008). Significantly, the FAR Case 2007-006 rules explicitly cover all violations of the False Claims Act. In enacting these rules, the United States did not undermine the qui tam provisions of the FCA, and did not place any limits on employees filing FCA complaints.

On March 29, 2010, the SEC’s Office of Inspector General (OIG) published a comprehensive analysis of the SEC’s pre-Dodd-Frank whistleblower rewards program. OIG Recommendation # 8 was: Incorporate the best practices from the Department of Justice and the Internal Revenue Service. This is perhaps the single most important recommendation. Under the False Claims Act, the Department of Justice has significant experience in working with whistleblowers in a reward-based program.

Section 5. Battle of Empirical Data Presented to the SEC Regarding the Effects of and Deference to Corporate Compliance Programs

In addition to qualitative policy arguments from both industry and whistleblower advocates, each side also submitted empirical studies to support their positions on the whether the SEC final rule should formalize some requirement for whistleblowers to work within a company’s internal ethics and compliance programs before going to the government. Below are two key “studies” from each side of this debate. It appears that the SEC in the final rule found the study of whistleblower advocates to be more persuasive.

ERC Ethics Resource Center- “Blowing the Whistle on Workplace Misconduct Study”, December 2010, submitted to the SEC in ERC Comment S7-33-10, December 17, 2010

During 2009, 82 percent of top management said they reported misconduct. That number has been relatively steady throughout the past decade, dipping below 80 percent only in 2005, a year in which all levels of workers and managers say they were less diligent in reporting bad behavior. Almost seven in ten middle managers

(69 percent) and two thirds of line supervisors also reported misconduct in 2009, compared to 55 percent of all nonmanagement personnel.

Among the most important indicators of how individuals respond to wrongdoing is personal beliefs. The data show that those with a stricter personal code of workplace conduct are more likely to report than those who are more comfortable with “gray area” behavior. More than seven of ten workers who feel “very well prepared” by company training say they report wrongdoing, while only 25 percent who say they are very poorly prepared will blow the whistle on a co-worker. In our experience, internal communication about ethics and compliance, including the opportunity for institutional leaders to build confidence by an aggressive response to bad behavior, is an invaluable opportunity to enhance ethical culture and make clear that acting with integrity is a core job responsibility for every employee.

We urge the Commission to revisit the proposed rules and identify ways to build support for E&C programs and encourage whistleblowers to avail themselves of internal E&C reporting in addition to the whistleblowing provisions. Internal E&C programs must deal with a wide gamut of misconduct not covered by this proceeding. For example, one major company said in response to an ERC inquiry that it receives almost 5,200 calls to its ethics hotline a year, but that on average only two of these calls relate to possible securities fraud. A second company informed us that during 2010 it has averaged 634 hotline reports a month, including a total of three that raised concerns about securities law issues. The 2009 National Business Ethics Survey prepared by the ERC found that about 15 percent of employees who reported misconduct perceived some retaliation. Much of the payback was in the form of subtle snubs and abuse by co-workers and may not rise to the level of an actionable offense.

National Whistleblower Center Report to SEC, “Impact of Qui Tam Laws on Internal Compliance”, December 2010

The existence of a qui tam or whistleblower rewards program has no negative impact whatsoever on the willingness of employees to utilize internal corporate compliance programs or report potential violations to their managers. Based on a review of qui tam cases filed between 2007-2010 under the False Claims Act (FCA), the overwhelming majority of employees voluntarily utilized internal reporting processes, despite the fact that they were potentially eligible for a large reward under the FCA. 89.7% of employees who would eventually file a qui tam case initially reported their concerns internally, either to supervisors or compliance departments. 10.3% of employees who would eventually file a qui tam case reported their concerns directly to the government. 4.7% of employees who would eventually file a qui tam case worked in compliance departments. 0.9% of employees who would eventually file a qui tam case worked in compliance, and did not initially contact their supervision prior to contacting the government.

In its May 13, 2010 issue, the New England Journal of Medicine published a “Special Report” examining the behaviors of qui tam whistleblowers who won large False Claims Act judgments against the pharmaceutical industry. This report also found that “nearly all” of the whistleblowers “first tried to fix matters internally by talking to their superiors, filing an internal complaint or both.” In fact, 18 of the 22 individuals in the control group initially attempted to report their concerns internally. The four individuals who reported their concerns to the government were not employees of the defendant companies (i.e. they were “outsiders” who “came across” the frauds in the course of their business), and therefore had no “internal” avenues through which to voice their concerns. The Journal’s conclusion that “nearly all” of the whistleblowers try to report their concerns internally is entirely consistent with the larger study conducted by the NWC and stands squarely contrary to the baseless concerns raised by industry that “greedy” employees will avoid internal compliance programs in pursuit of “pie in the sky” rewards.

4.7% of Plaintiff Employees worked in compliance. Only one Plaintiff Employee contacted a Government Agency without first raising the concern within the corporation. When the compliance department itself is engaged in misconduct, where else could this whistleblower have gone?

Section 6. Relevant History of Corporate “Ethics and Compliance Programs”

The SEC was undoubtedly aware that internal ethics and compliance programs in U.S. companies do not have any widely accepted record of success. These compliance programs normally have formal procedures, staffing and reporting lines, but they are not governed by any uniform or prescribed quality standards as to the training and expertise of compliance staff, investigative techniques, forensic methodologies and analytical and testing practices. The SEC was presumptively aware that even in companies having formal ethics and compliance departments, there are wide variations in their quality. The excerpts from the article below state the view of many that ethics and compliance programs are of recent origin. The author is a New York-based freelance writer formerly a writer and editor at The Wall Street Journal.

James C. Hyatt, “The Birth of The Ethics Industry”, August 2005,

A lot of companies are singing the compliance blues these days, as they struggle to cope with the complexities of Sarbanes Oxley legislation, passed in 2002 in the wake of financial scandals. Complaints about the cost and time involved are common, but there's another effect of Sarbanes Oxley less remarked upon. Corporations are rushing to learn ethics virtually overnight, and as they do so, a vast new industry of consultants and suppliers has emerged. The ethics industry has been born. Consider a few examples of recent mushrooming attention to ethics. At Goldman Sachs, CEO Hank Paulson will moderate 20 forums this year on ethics, for the bank's entire staff of managing directors. Citigroup is adding annual ethics training for all 300,000 employees, and The New York Times Co. is doing likewise. The New York Times signed a multi-year agreement with LRN,

an 11 year old Los Angeles based firm that helped advise the U.S. Sentencing Commission on effective compliance programs.

Recruiting for the ethics army is vigorous. Craigslist, the free community search engine, recently listed 64 jobs in San Francisco and 50 in Boston that included the word "Sarbanes." Monster.com, a broader job search engine, tallies more than 1,000 and, on a recent check, 158 posted in "the last 24 hours."

Kerry D. Moynihan, a managing partner at recruiting firm Christian & Timbers, reports "more and more work" helping companies find executives to handle compliance issues, with job titles ranging from chief compliance officer or general counsel to vice president of human relations. At financial companies, in particular, such officials are called upon to be "much more accountable to boards and to federal regulators." And more companies "are creating offices around things like corporate social responsibility officer."

There was a time, he says, when compliance duties landed in the lap of "the green eyeshade people you didn't want as front men. Now they are much more front of the house, three doors down from the chief executive." Ethics officers often wear more than one hat. At Lubrizol Corp., in Wyckliffe, Oh., Mark Meister has been vice president for human relations as well as chief ethics officer since 1994. He finds the duties have expanded substantially over the years.

Kaplan says what's driving the ethics boom is not so much the SOX legislation, as the increased tendency of prosecutors and regulators to take ethics programs into account when considering charges. In this new era of growth, established ethics-related businesses are re-creating themselves. Global Compliance Services, in Charlotte, N.C., the largest hotline provider, traces its business to AlertLine, set up in 1981 to help defense contractors identify fraud. The business eventually became part of the Pinkerton security company, and it now provides services to half of the Fortune 500. David Gebler, president of Working Values Ltd., a decade old Boston based business ethics consulting firm, says in the new climate, "it's often hard for organizations to make the leap to an ethical culture because they are unsure of where to start." He adds: "It is not enough to merely ask whether controls are in place or if everyone has attended a class or signed a code. The organization has to understand what the drivers of behavior are," and how those align with integrity goals.

Section 7. The Effect of Federal Criminal Sentencing Guidelines on Evolving and Defending Corporate Compliance Programs

As referenced above in James Hyatt's article, the threat of criminal consequences has proven to be one of the most compelling drivers toward enhancement of corporate ethics and compliance programs. Amendments that became effective in late 2010 were based on the views of courts and prosecutors that these programs still require substantial improvement if they are to serve as sentence mitigators for corporate criminal punishment. The SEC was presumptively aware of this and other points made in the following excerpts.

**“Effective Compliance and Ethics Programs Under The Amended Sentencing Guidelines”,
by Paula A. Tuffin, Mayer Brown, LLP**

The Amendments to the United States Sentencing Guidelines Manual (“USSG”), set to take effect on November 1, 2010, further enhance the role of Chief Compliance Officer (“CCO”) in business organizations. The 1991 implementation of the Business Organizations section of the USSG formalized the sentencing credit a company could receive if it had in place an effective compliance and ethics program and in doing so encouraged companies to raise the stature of their CCO. The description of the components of the compliance program, however, did not mandate that a program had to follow a specific format to be considered effective. Up to now, companies have used a variety of formats to structure their compliance programs. Some house the compliance function in the legal department, others in finance. Some require direct reporting to the Board of Directors, others do not.

USSG Compliance and Ethics Programs

It is also true that the Department of Justice (“DOJ”) looks to the same factors in determining whether to prosecute corporate entities. Business organizations, consequently, look to the USSG for instruction on how to best protect themselves from the harm that would be caused by a criminal prosecution. To date, the best protection a business organization can have to avoid a negative prosecutorial result is to institute a compliance and ethics program consistent with §8B2.1 of the USSG. §8B2.1(b) lists the seven factors that must exist for a compliance and ethics program to be considered “effective”. These include:

- * High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.
- * The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the individuals referred to in subdivision (B) by conducting effective training programs and otherwise disseminating information appropriate to such individuals respective roles and responsibilities.
- * The organization shall take reasonable steps: (A) to ensure that the organization’s compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct; (B) to evaluate periodically the effectiveness of the organization’s compliance and ethics program;
- * The organization’s compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate

incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

The Amendments: Anticipated Changes To Compliance And Ethics Program

The significance of this amendment cannot be understated. The Commission says, in unequivocal terms, that persons performing the chief compliance officer function must have “direct reporting obligations” to the company’s governing authority or a subgroup of the governing authority. It is well known that up to this point, a compliance program could be considered effective under the guidelines if the CCO reported to the General Counsel or other high-level personnel in the organization or had dotted line access to the Board of Directors or another governing authority. The Society of Corporate Compliance and Ethics conducted a survey that reported that only 41% of publicly traded companies have their CCO report directly to the Board of Directors. The survey also showed that in other compliance programs, the CCO reported to the General Counsel, the Chief Financial Officer and other senior positions within a company. Even if a particular company does not believe that it will ever require the three point reduction contemplated by this limited exception there is no doubt that the Commission has determined that a well designed compliance and ethics program will have its CCO report directly to the Board of Directors.

Section 8. Expected Corporate Whistleblower Defenses and Control Strategies in Response to Final Rules, and Expected Counter Strategies by Whistleblower Advocates

Corporations can be expected to approach the SEC’s Dodd Frank initiatives with an offensive against the legality of the final rule, and with caution in their dealings with employees. Excerpts from the materials below may provide a preview.

A. Court Challenge to the Final Rule Under the Administrative Procedures Act:

“The Pace of Rulemaking Under the Dodd-Frank Act”, Letter to Congress from Committee on Capital Markets Regulation, December 15, 2010

The Committee on Capital Markets Regulation is a non-partisan group co-chaired by Glenn Hubbard, Dean of Columbia Business School, and John L. Thornton, Chairman of the Brookings Institute. Its Director is Hal S. Scott, the Normura Professor and Director of the Program on International Financial Systems at Harvard Law School. The letter is signed by each and addressed to Senators Christopher Dodd and Richard Shelby and Representatives Barney Frank and Spencer Bachus. The Committee believes the regulatory process may have been legally flawed.

We believe that the current rulemaking process is sacrificing quality and fairness for apparent speed, risking lengthy court challenges and poor rules that will damage our financial system and hinder economic recovery. Dodd-Frank requires federal agencies to write at least 230 new rules, and many more may be issued

after that. These are no ordinary rulemakings—this is almost a complete rewrite of the rules governing the country’s financial markets. The Securities and Exchange Commission (SEC), which in 2005 and 2006, before the financial crisis, issued on average fewer than ten new rules a year, must now issue approximately one hundred new rules, some sixty of which must be written by July 2011, one year after Dodd-Frank was enacted.

This push for speed can be traced to the August pledge Secretary of the Treasury Geithner made in response to charges that regulatory uncertainty would hinder economic recovery. Glenn Hubbard and Hal Scott published an op-ed in the Wall Street Journal shortly thereafter pointing out that Secretary Geithner’s pledge “ignores the basic legal requirement for deliberative and rational regulatory implementation” but regulators seem to have missed the message.

The Administrative Procedure Act (APA) requires an informed rulemaking process that is transparent and responsive to the public and affected parties. Indeed, the D.C. Circuit has noted that even if the Congress “vest[s] broad rulemaking authority in an agency...[and]charge[s] the agency with swiftly and effectively implementing a national policy,...the agency remains bound by the APA’s notice and comment requirements.” Providing meaningful comments on proposed rules is made even more difficult by Dodd-Frank’s requirements for joint rulemaking and coordination between agencies. Unfortunately, this coordination has been sorely lacking. In the field of securitization, for example, the Office of the Comptroller of the Currency, the Federal Reserve System, the FDIC, the SEC, the Secretary of Housing and Urban Development, and the Federal Housing Finance Agency are charged with joint rulemaking, yet the SEC and the FDIC have each already released proposed or final rules, conflicting with each other, in advance of the joint process. Similarly, the SEC and CFTC have proposed conflicting rules in other areas.

The breakneck speed of implementation that we have seen so far is precisely the type of “arbitrary and capricious” practice that the APA forbids. The SEC and the CFTC are required by statute to perform detailed cost/benefit analysis. The FSOC is required to consider costs and benefits in some of its studies regarding systemic risk, and would also likely be subject to the APA when it promulgates rules. Its rules may even be subject to OIRA review, with the strict cost-benefit requirements that review entails.

B. Internal Whistleblower Control Strategies and Damage Control:

Amy Goodman, Jason Schwartz, John Sturc, and F. Joseph Warin, “The New SEC Whistleblower Rules: How to Prepare Your Company”, Gibson Dunn, June 8, 2011

1. Screen prospective new hires to identify and properly vet any red flags, consistent with applicable federal and state laws.

2. Incorporate adherence to code of conduct, including use of internal reporting procedures, into employee evaluations. For example, companies should consider: (a) Using an employee's commitment to fostering a culture of ethics and accountability among the criteria used to evaluate performance— employees who take additional compliance training programs, demonstrate leadership in compliance areas, and actively and candidly participate in investigations should be recognized; and (b) Including the reporting of potential misconduct as a positive performance criterion.
3. Evaluate training programs provided to managers and supervisors on how to react and respond to employee reports of possible violations and add or revise new training programs if necessary.
4. Respond promptly to troubled working relationships.
5. Review procedures in place for dealing with known whistleblowers to make sure they comport with the anti-retaliation provisions and consider whether they should be revised. Managers and supervisors should receive training. There may be instances where disciplinary action against a whistleblower is appropriate and warranted; however, to reduce the likelihood of a successful retaliation claim, companies should document their investigation of a whistleblower and create a clear record of any adverse employment action. Identity of whistleblowers, when not anonymous, should be shared only on need-to-know basis. Counsel should be consulted before taking action against whistleblower to make sure company properly addresses any potential legal issues.
6. Obtain confirmation from departing employees that they have disclosed to the company any misconduct of which they are aware so that it can be addressed and remedied. Separation agreements should include acknowledgments of employee rights to file charges, provide truthful information, and otherwise assist governmental authorities so they are not misinterpreted as impeding these rights, while at the same time waiving individual relief to the maximum extent permitted. Whistleblower retaliation claims under SOX (as amended by Dodd-Frank Act) and CFTC provisions of Dodd-Frank Act cannot be included within pre-dispute arbitration agreements.
7. For internal investigation practices, consider having an attorney conduct or participate in interviews. All information obtained through a communication that is subject to attorney-client privilege is not considered "original information," and thus generally is not eligible for an award. Provide Upjohn warnings before all employee interviews to protect privilege. See, *United States ex rel. Fair Laboratory Practices Associates v. Quest Diagnostics Inc.* (S.D.N.Y. Apr. 5, 2011) (Lawyer's participation as plaintiff in qui tam lawsuit against former corporate client violated conflicts and confidentiality rules, requiring dismissal of action).

8. Consider supplementing policies regarding privileged and confidential information. Rules appear to permit attorneys and others in possession of information protected by company's attorney-client privilege or work product doctrine to disclose that information to SEC under some circumstances. Whistleblowers may disclose confidential and proprietary business information to government without corporate authorization. Companies should seek to preserve confidential status of their information.

9. Employees should be required to promptly report internally all violations of code of conduct and be regularly reminded of this requirement.

10. As part of annual certification, companies should consider having employees acknowledge that they are not aware of any potential violations that have not already been reported to company.

C. Potential Responses from the SEC and Whistleblower Advocates:

1. Screening prospective new hires to identify whistleblowers may be discriminatory under both SOX section 806 and the Dodd Frank whistleblower protection provisions, as well as a variety of state laws.

2. Incorporating adherence to code of conduct, including use of internal reporting procedures, into employee evaluations will be problematic if this results in lower performance ratings for whistleblowers. Companies will be required to show that these new performance expectations are uniformly applied, not just used against whistleblowers once they are identified.

3. For internal investigation practices, having an attorney conduct or participate in interviews may not provide attorney-client or work product privilege. Whistleblower lawyers and courts are alert to such strategies, and tend to disallow the assertion of privilege unless the attorney's participation was for the purpose of, and actually involved, giving legal advice and answering legal questions to managers. Additionally, unless legal counsel is assigned to all compliance investigations, not just to potential whistleblower cases, this may be prima facie evidence of disparate treatment toward whistleblowers.

4. Requirements that all employees must promptly report internally all violations of code of conduct will likely result in disparate treatment of whistleblowers that is easy to prove if they are punished for violating this policy. Valid claims of disparate treatment will arise in companies that don't enforce the policy against all violations, but just selective against suspected whistleblowers. Few companies and managers will actually want all employees to report all suspected violations of the code of conduct, and few will have the resolve to uniformly enforce such a policy. Instead, such a policy will more likely be used against whistleblowers who upon reporting a violation, will be disciplined for not having reported it sooner.

5. If as part of annual certification, companies require employees to acknowledge that they are not aware of any potential violations that have not already been reported to company, the same legal liabilities will arise as referenced above in number 4.

Section 9. Anticipating SEC Enforcement Priorities Impacting the Whistleblower Program

If the following observers are correct in identifying SEC enforcement trends, then it is likely that these will be reflected in the types of cases pursued by the new Dodd Frank Office of the Whistleblower. Indeed, according to the following article, the SEC has reorganized its enforcement unit to pursue its new strategic visions:

Thomas Gorman, “SEC ENFORCEMENT TRENDS 2011: REORGANIZATION”, January 6, 2011 (excerpts).

The second key facet of the reorganization was the creation of specialty groups. Those units focus on asset management, market abuse, structure and new products, the FCPA and municipal securities and public pensions. *** [A] key part of the reorganization in the future may be the new initiatives to encourage cooperation. In new Sections to the Enforcement Manual, the Division added provisions to incentivize individuals and corporations to cooperate with on-going investigations. Modeled after techniques long used by the Justice Department in criminal cases, the new initiatives offer a potential defendant the prospect of avoiding prosecution through either a non-prosecution or a deferred prosecution agreement.

ABA White Collar Crime Committee’s Securities Fraud Subcommittee, “DOJ, the SEC and Financial Fraud: Emerging Enforcement Trends”, CLE agenda for June 8, 2011 (excerpted).

Business organizations, directors, CEOs and CFOs have been in the focus of financial fraud cases for years. Following the formation of two government task forces which include the SEC and DOJ, financial fraud now appears to be a top level priority.

[F]ocus on key enforcement trends includ[es] the liability of directors and officers, the impact of the SEC’s strict liability approach to SOX 304, and CEO and CFO liability for the repayment of incentive compensation, and the emerging securities fraud action for holding officers responsible for failure to monitor.

Thomas Gorman, “SEC ENFORCEMENT TRENDS 2011: MARKET REFORM”, January 4, 2011 (excerpts).

In recent testimony before Congress, SEC Chairman Mary Schapiro listed eight different areas in which rules had recently been adopted. They cover a variety of topics including [1] custody and control of assets for investment advisers, [2]

proxy enhancements, [3] short selling and failure to deliver, [4] money market funds, [5] central clearing for credit default swaps, [6] credit rating agencies, [7] pay-to-play and [8] municipal securities disclosures.

While many of these rules do not directly impact the enforcement division and its program, other provisions of Dodd-Frank add to its authority. Those include provisions: (1) an enhancement of the antifraud provisions under Exchange Act Sections 9, 10(1), and 15; (2) an expansion of the extraterritorial jurisdiction of the antifraud provisions; (3) extending aiding and abetting authority for the Commission under the Securities Act, the Investment Company Act and the Investment Advisers Act; (4) clarifying the SEC's authority over formerly associated persons of regulated entities; and (5) imposing joint and several liability on control persons in SEC actions.

Section 10. Combining Whistleblower Initiated Self-Reporting and SOX 806 to Obtain Dodd Frank Awards: *Egan v. TradingScreen, Inc.* (S.D.N.Y. May 4, 2011)

A preview of whistleblower plaintiff strategies may be seen in the recent “case of first impression” using a combined SOX-Dodd Frank approach in New York, *Egan v. TradingScreen, Inc.* (S.D.N.Y. May 4, 2011). The major holdings of the case are that: (1) any SOX-protected complaints fall within scope of Dodd-Frank Act's whistleblower provisions, whether or not the employee reports to SEC; (2) reporting of misconduct to the employer and participation in an internal investigation can be sufficient to “jointly provide information” to SEC if the employer (or third party law firm hired to investigate) subsequently reports to SEC, triggering section 922's anti-retaliation provisions; and (3) even without knowing if the matter was so reported to the SEC, the whistleblower can plead his or her “information and belief” that the SEC was notified by the employer's self-reporting.

Egan may additional inspiration to whistleblower lawyers when considering the above text and comments (*supra* Section 1) from the Final Regulation, which (a) were not published at the time this case was decided, and (b) expanded the proposed whistleblower protection regulations significantly. Specifically, the following is now provided by the rules and comments:

- (1) Unlike the wording of *Egan*, Dodd Frank whistleblowers, like the new ARB decision in *Sylvester v. Parexel International* (ARB May 25, 2011), have no obligation to allege or prove the “materiality” of their disclosures;
- (2) Under Dodd Frank, only a reasonable belief in “possible securities law violation” is required;
- (3) The Dodd Frank whistleblower protections apply even if the whistleblower cannot allege or prove that he or she would have been eligible for an enforcement award;
- (4) Retaliation against whistleblowers is now an independent “securities law violation”, and therefore both SOX and Dodd Frank whistleblowers can plead claims simply on the basis that they were retaliated against, without regard to any other allegations of securities fraud, internal controls, etc. violations; and

- (5) Similarly, both SOX and Dodd Franks whistleblowers can have claims based solely on the employer trying to impede or punish their right to contact the SEC through any kind of job retaliation.

EXCERPTS: *Egan v. Tradingscreen, Inc.*, 2011 U.S. Dist. LEXIS 47713 (S.D.N.Y. May 4, 2011)

1. Facts:

* In particular, Plaintiff alleges that Buhannic was using TradingScreen employees to do unpaid work for SpreadZero, cannibalizing TradingScreen's customer lists, [*5] and invoicing SpreadZero at below-market rates for various services. Compl. ¶ 30. By late 2009, Plaintiff concluded that Buhannic's behavior was costing TradingScreen hundreds of thousands of dollars and posing a threat to the existence of TradingScreen's business.

* In January 2010, Plaintiff reported Buhannic's behavior to the President of TradingScreen, Michael Chin, who passed the information to those members of TradingScreen's Board of Directors who were not controlled by Buhannic (the "Independent Directors"). Compl. ¶ 36. The Independent Directors hired the law firm of Latham & Watkins LLP ("Latham") to conduct an internal investigation. Id. In March 2010, Latham issued a report confirming Plaintiff's allegations.

* On March 19, David Roscoe and Piero Grandi, two of the Independent Directors, sent Plaintiff an email assuring him that he would not be fired without the approval of the Board of Directors. Compl. ¶ 51. Buhannic [*6] fired Chin on June 2, 2010 and fired Plaintiff on August 2, 2010, without first informing the Board.

2. Dodd-Frank Act Claims

* In his Second Cause of Action, Plaintiff asserts that he is entitled to relief under the Securities Whistleblower Incentives and Protection provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78u-6, passed in July 2010. Most of these provisions are concerned with a "bounty" program that allows whistleblowers who report violations of the securities laws to the Securities and Exchange Commission ("SEC" or "Commission") to receive portions of money recovered by the Commission. However, the statute also contains a private cause of action for whistleblowers alleging retaliatory discharge or other discrimination. Id. § 78u-6(h)(1)(B)(i). Relief includes reinstatement, double the back pay owed, and costs and fees. Id. § 78u-6

* Plaintiff argues that he may bring an action against Buhannic and TradingScreen under these anti-retaliation [*9] provisions. Defendants contend that Plaintiff is not covered by these provisions because he never personally contacted the SEC to report Buhannic's conduct.

* Defendants argue that the plain text of this statutory definition requires that a whistleblower [*10] report to the SEC in order to invoke the anti-retaliation provisions of the Act. Plaintiff replies that this interpretation would result in an unreasonable reading of the statute, and that he

is covered by other provisions that do not require reporting to the SEC. 11 This is an issue of first impression in the federal courts.

* Here, the anti-retaliation provisions of the Dodd-Frank Act explicitly prohibit retaliation against whistleblowers who provide information and testimony to the SEC. 15 U.S.C. § 78u-6(h)(1)(A)(i)-(ii). However, they also protect whistleblowers who make disclosures falling into one of four categories: "disclosures that are required or protected under the Sarbanes-Oxley Act . . . the Securities Exchange Act of 1934 . . . section 1513(e) of title 18, United States Code, and any other law, rule, or regulation subject to the jurisdiction of the Commission." Id. §78u-6(h)(1)(A)(iii). [*11] This latter provision does not require that disclosure be made directly to the SEC.

* Therefore, a literal reading of the definition of the term "whistleblower" in 15 U.S.C. § 78u-6(a)(6), requiring reporting to the SEC, would effectively invalidate §78u-6(h)(1)(A)(iii)'s protection of whistleblower disclosures that do not require reporting to the SEC.

* Therefore, Plaintiff must either allege that his information was reported to the SEC, or [*14] that his disclosures fell under the four categories of disclosures delineated by 15 U.S.C. §78u-6(h)(1)(A)(iii) that do not require such reporting: those under the Sarbanes-Oxley Act, the Securities Exchange Act, 18 U.S.C. § 1513(e), or other laws and regulations subject to the jurisdiction of the SEC.

* However, the whistleblower provisions of section 806 apply only to publicly traded companies with securities registered under section 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78l, or public companies required to file reports under section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d). [Defendants here are not publicly traded.]

3. Joint Action and SEC Disclosure Under the Dodd-Frank Act

* If the whistleblower protection [*20] provisions of the Dodd-Frank Act require reporting to the SEC, Plaintiff argues that he is still protected by these provisions because he acted jointly with the attorneys from Latham to reveal Buhannic's alleged malfeasance. He contends that by initiating the inquiry into Buhannic's conduct and disclosing information in interviews with the Latham attorneys conducting the investigation, he was acting jointly with the Latham attorneys. Compl. ¶¶36-37. Moreover, he alleges that he expected Latham to report his information to the SEC, and that Latham passed his information to the SEC.

* Defendants dispute Plaintiff's interpretation of the term "acting jointly" under 15 U.S.C. § 78u-6(a)(6). They argue that the Act only extends anti-retaliation protections to those who report personally and directly to the SEC, and that Plaintiff's actions with the Latham attorneys do not constitute the joint action covered by the statute. Plaintiff's claim poses the following question: is a prospective whistleblower covered by the Dodd-Frank Act if he gave information to attorneys who he alleges on information and belief reported it to the SEC? 4

* Defendants contend that the Latham attorneys merely interviewed Plaintiff, and that the Complaint does not state that he was a source of substantial information, that he hired the Latham attorneys, or directed their actions. This argument would effectively rewrite the phrase

"acting jointly" in the Dodd-Frank Act to require leadership, hiring, or direction of any investigation or effort to report information to the SEC. Defendants provide no reason for such an interpretation. The plain text of the statute merely requires that the person seeking to invoke the private right of action have acted with others in such reporting, not that he or she led the effort to do so.

* In other words, Latham was retained on Plaintiff's initiative, and his disclosures provided the basis for its investigation. Under these specific allegations, Plaintiff has adequately pleaded his contention that he acted jointly with Latham, Chin, and the Independent Directors

* The Proposed Rules states, "You are a whistleblower if, alone or jointly with others, you provide the Commission with information relating to a potential violation of the securities laws." 75 Fed. Reg. at 70519 (to be codified at 17 C.F.R.240.21F-2(a)). Recognizing that this Proposed Rule was issued after Plaintiff was fired, and that it has not yet been enacted by the SEC, Defendants cite it to show the agency's interpretation of the statute, which they claim should be [*24] afforded great weight.

* However, the agency here has not spoken on the precise question involved in this case. The SEC's definition of the term "whistleblower" does not clarify the question of whether direct personal reporting is required, for the Proposed Rule and its discussion merely restate the statutory definition.

* Obviously, a whistleblower must directly report to the SEC to receive a bounty award from the SEC, but the agency has not extended this prerequisite to the private right of action in the anti-retaliation provisions.

4. Pleading Information and Belief:

* The Court finds that Plaintiff has adequately alleged that he acted jointly with the Latham attorneys, in an effort to provide information to the SEC regarding Buhannic's alleged misconduct. This finding does not assume that Plaintiff has adequately pleaded the allegation that Latham provided and the SEC actually received this information.

* Plaintiff argued that under these circumstances, it was almost certain that these board members directed the Latham attorneys to report Buhannic's conduct to the SEC, and that he would obtain direct evidence of such reporting during discovery. These claims support Plaintiff's allegation [*29] on information and belief that the Latham attorneys reported Buhannic's conduct to the SEC.

* Here, [*30] Plaintiff has raised factual allegations that support his original pleading "on information and belief" that his information concerning Buhannic's conduct was reported to the SEC. 8 Compl. ¶ 91. Accordingly, Plaintiff is granted leave to amend the Second Cause of Action in the Complaint to plead facts supporting his knowledge, heretofore on information and belief, that Buhannic's conduct was reported to the SEC.

APPENDICES

Appendix 1 COMPARISON TABLE FOR DODD FRANK AND FALSE CLAIMS ACT VIOLATIONS

	Whistleblower Bounties 1	Compliance Program Mitigation 2	Self Reporting Mitigation 3	Administrative Enforcement Mechanism 4	Civil Penalties Prescribed in Act 5	Criminal Penalties Prescribed In Act 6	Parallel SEC-DOJ Civil and Criminal Enforcement 7	Settlement Authority 8
Dodd Frank Violations	yes	yes	yes	yes	yes	yes	yes	yes
False Claims Act Violations	yes	yes	yes	no	yes	no	yes	yes

Notes

1. Both laws provide for whistleblower bounties based on a percentage of the recovery. Under both the FCA and Dodd Frank, the percentage cap is 30%.

2. Both Dodd Frank and the FCA allow the SEC and/or DOJ respectively to reduce the civil and criminal penalties based upon the corporation's demonstration of having had and adhered to an internal ethics-compliance program designed to prevent the violations. In criminal prosecutions for SEC or FCA fraud violations, the federal sentencing guidelines allow penalty reductions based on the robustness of the corporation's internal ethics-compliance programs.

3. Both Dodd Frank and the FCA allow the SEC and/or DOJ respectively to reduce the civil and criminal penalties based upon voluntary self-reporting of the violations by the corporation.

4. The SEC operates an internal administrative enforcement process, including adjudications with administrative law judges. The DOJ does not, and conducts enforcement in the federal courts through civil and/or criminal actions.

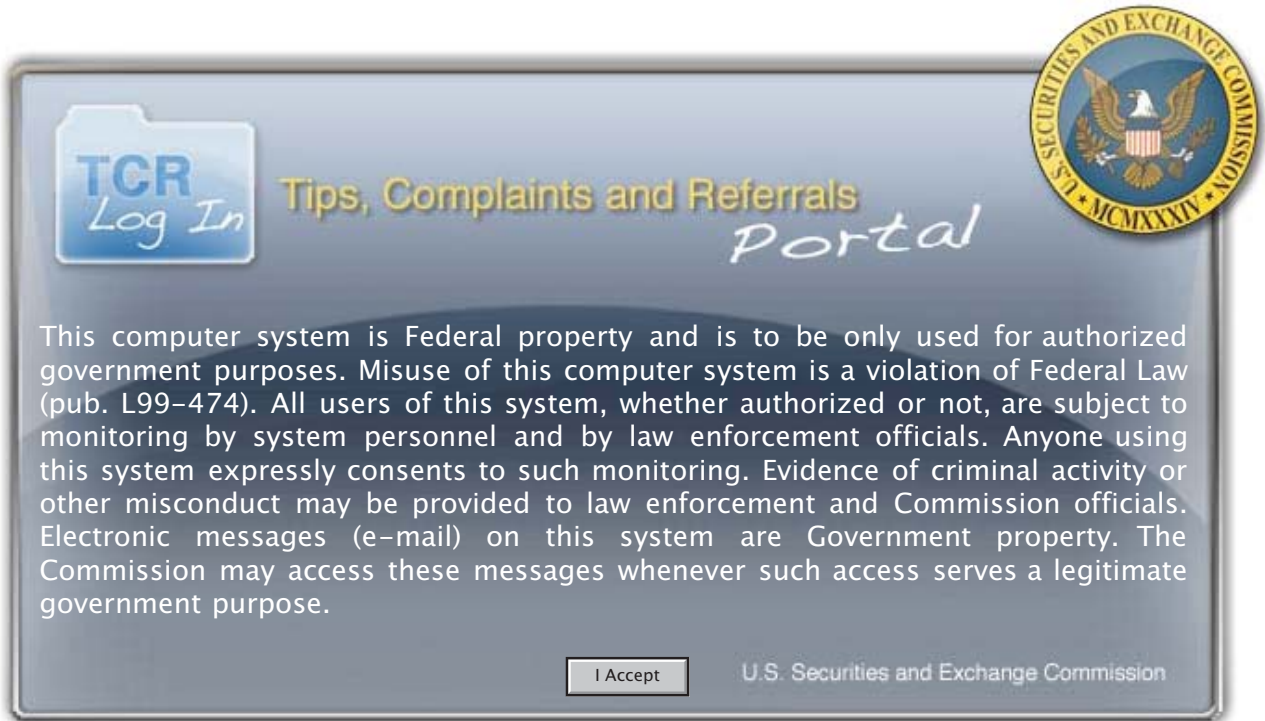
5. The FCA and SEC statutes both prescribes civil penalties.

6. The FCA does not prescribe criminal penalties, and DOJ prosecutions are based on separate criminal laws for fraud. Dodd Frank and SEC statutes provide prescribe both criminal and civil penalties, although criminal penalties can be pursued only the DOJ. The SEC has no direct power to bring criminal prosecutions, as Congress has declined its requests for such power.

7. Parallel civil and criminal proceedings are allowed for the same unlawful conduct.

8. Both the SEC and the DOJ resolve the vast majority of SEC and FCA legal violations by civil or administrative settlements.

Appendix 2: SEC Office of Whistleblower Online Application (Screen Shots)



The screenshot shows a disclaimer page for the SEC Office of Whistleblower Online Application. At the top left is a blue folder icon labeled "TCR Log In". To its right is the text "Tips, Complaints and Referrals" in yellow, with "portal" written in a white script font below it. In the top right corner is the official seal of the U.S. Securities and Exchange Commission, featuring an eagle with wings spread, holding an olive branch and arrows, with a shield on its chest. The seal is circular with the text "U.S. SECURITIES AND EXCHANGE COMMISSION" and "MCMXXXIV" around the perimeter.

This computer system is Federal property and is to be only used for authorized government purposes. Misuse of this computer system is a violation of Federal Law (pub. L99-474). All users of this system, whether authorized or not, are subject to monitoring by system personnel and by law enforcement officials. Anyone using this system expressly consents to such monitoring. Evidence of criminal activity or other misconduct may be provided to law enforcement and Commission officials. Electronic messages (e-mail) on this system are Government property. The Commission may access these messages whenever such access serves a legitimate government purpose.

I Accept U.S. Securities and Exchange Commission

Tips, Complaints and Referrals



Questionnaire

Previous Next

Add Documents

Tell us about your complaint

Who are you complaining about?

Products Involved

About you

Does your complaint involve?

- A fraudulent investment scheme such as a Ponzi scheme or the promise of high-yield returns?
- An unregistered securities offering?
- General trading practices or pricing issues?
- Manipulation of a security?
- Insider trading?
- A company's corporate disclosure deficiencies, financial fraud or failure to file?
- Municipal securities transactions or public pension plans?
- Bribery of, or improper payments to, foreign officials (Foreign Corrupt Practices Act Violations)?
- A specific market event or condition?
- If your complaint does not fit in any of the categories above, please explain here:

Please select the category that best describes your complaint

***REQUIRED** Tell us more about your complaint:

Tips, Complaints and Referrals



Questionnaire

Previous Next

Add Documents

Tell us about your complaint

Who are you complaining about?

Products Involved

About you

Are you complaining about an individual or a firm?

- Individual
- Firm

Select the title that best describes the individual (or firm) that you are complaining about:

Are you having or have you had difficulty in contacting the firm or individual?

- Yes
- No
- Unknown

Street Address:

Address (Continued):

City:

State / Province:

Zip / Postal Code:

Find: enforcement action

Next Previous

Highlight all

Match case

Done

Tips, Complaints and Referrals

Home Questionnaire Accessibility



Questionnaire

Previous Next

Add Documents

Tell us about your complaint

Who are you complaining about?

Products Involved

About you

Select the type of product involved in your complaint:

- Annuities and Insurance Products
- Banking and Consumer Finance Products
- Commodities
- Debt Securities
- Derivatives
- Equities
- Funds
- Real Estate
- Retirement Accounts and Products
- Other

Please select the category that best describes your Security Product:

Enter the CUSIP number:

Enter the security/ticker symbol:

Enter the product name(s):

Find: enforcement action

Next Previous

Highlight all

Match case

Done

Tips, Complaints and Referrals



Questionnaire

Previous Next Submit Add Documents

Tell us about your complaint | **Who are you complaining about?** | **Products Involved** | **About you**

Title:
 Mr. Mrs. Ms.

First Name:

Middle Name:

Last Name:

Street Address:

Address (Continued):

City:

State / Province: