RULES FOR THE Dodd-Frank Act SEC Whistleblower Program: aggressive enforcement or discouraging whistleblowers?

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I. INTRODUCTION

The recent trend towards more expansive whistleblower protections and incentives has its roots in the massive corporate scandals of the early 2000s. Popular outrage over the greed and corruption exhibited by Enron and other companies prompted the near-unanimous passage of the Sarbanes-Oxley Act of 2002 (“SOX”). In addition to providing a detailed, comprehensive set of rules and regulations for publicly traded companies designed to prevent shareholder and accounting fraud, SOX contained a whistleblower provision to protect employees who reported corporate fraud from retaliation by their employers. See 18 U.S.C. § 1514A (“SOX 806”).

Another wave of major corporate whistleblower protections accompanied the extraordinary infusion of government funds into the private sector that addressed the sharp downturn of the housing and financial markets in 2008. That crisis was still unfolding when the Madoff scandal hit the news and educated large numbers of Americans on the shortcomings in the government’s ability to detect and prevent large-scale fraud on investors in the financial markets. The “bailout” legislation that followed included protections for whistleblowers who reported fraud, gross mismanagement, or waste of bailout funds, and in 2009 Congress amended the U.S. False Claims Act, making it easier for whistleblowing “relators” to bring qui tam actions to assist the U.S. government in recovering monies lost to fraud.

Congress passed the Dodd-Frank Act of 2010, a massive financial regulatory overhaul in order to restore confidence (and some would say sanity) in U.S. financial markets through a wide range of regulatory measures. The new law included sweeping changes to existing whistleblower protections for employees in the finance sector, and, for the first time on a broad scale, created whistleblower-incentive programs that now provide significant monetary awards for persons who report securities violations to the government. One such program is administered by the Securities and Exchange Commission (“SEC”) and the other is administered by the Commodities Futures Exchange Commission (“CFTC”). This article focuses on the SEC program.

The SEC whistleblower-reward program has received an enthusiastic welcome from employee-rights advocates and “good-government” groups, but has generated a great deal of concern among large corporations and their law firms. Consumer advocates and the whistleblower community argue that the program is necessary to prevent the sort of frauds that have damaged the economy in the last decade, largely at the expense of the nation’s working people. The whistleblower community notes that corporate employees are in the best position to identify corporate misconduct, but that many are afraid to come forward because the very real risk of derailing their careers far outweighs the rewards, which would be few in the absence of significant financial incentives.

The corporate defense bar and their clients, on the other hand, claim that the SEC whistleblower program, which they call a “bounty-hunter program,” serves only to create a perverse incentive for employees to hunt for information about potential corporate fraud or illegals, disclose nothing to the employer, and then report the information to the government only when the violations have grown to a size that would warrant payment of a large enough
“bounty” to justify the risk to their careers. Corporations claim that the program gives would-be whistleblowers no reason to use internal channels to help correct minor problems before they become major liabilities. In short, opponents of the new SEC program complain that it simply creates a situation that allows opportunistic employees and others to “cash in” and become “instant millionaires” at the expense of corporations and their shareholders.

On November 3, 2010, the Securities Exchange Commission (“SEC” or the “Commission”) issued Proposed Regulation 21F, which set forth the SEC’s proposed rules for implementing the new whistleblower program. The release of Proposed Regulation 21F for public comment has sparked an intense public debate between the whistleblower community and the corporate bar, each seeking to persuade the Commission to issue final rules that adopt its view of the proper balance between aggressive agency enforcement and corporate self-governance. This article provides an overview of some of the main tensions in the proposed rules, viewed from the perspective of lawyers who represent whistleblowers before the SEC and in other forums.

II. THE DODD-FRANK ACT

On July 15, 2010, Congress approved a massive overhaul of the nation’s financial regulatory system. President Barack Obama signed the Wall Street Reform and Consumer Protection Act of 2010 – popularly known as the Dodd-Frank Act – into law on July 21, 2010. The following are some of the key statutory provisions in Section 922 of the Act that creates the SEC Whistleblower Program.

The Securities and Exchange Commission Whistleblower Incentive Program.

Section 922 of the Dodd-Frank Act amends the Securities Exchange Act of 1934, 15 U.S.C. 78a et seq., to create a new federal program through which the SEC will reward whistleblowers who voluntarily provide original information to the SEC regarding securities violations that result in the imposition of monetary sanctions greater than $1 million. The law states:

In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the

\[^{2}\text{Taxpayers Against Fraud (“TAF”), the national organization of lawyers representing } \text{qui tam} \text{ relators in False Claims Act cases, submitted comments on the SEC’s proposed rules that provide the best and most comprehensive legal analysis of the proposed rules by an organization which is representative of the whistleblower community. See } \text{http://www.sec.gov/comments/s7-33-10/s73310-228.pdf}. \text{This article draws on some of those comments.}\]

\[^{3}\text{The Dodd-Frank Act requires the SEC to issue final rules by April 18, 2011, but the agency has indicated that it will issue the rules by April 1, 2001. This article is submitted to the D.C. Bar's Continuing Legal Education program some two weeks before the final rules are to be issued and thus cannot address their particulars, but its discussion of some of the major themes and tensions in the proposed rules should nonetheless be helpful to practitioners who will be bringing and defending whistleblower claims under the final rules.}\]
Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to—

(A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and

(B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions.

See Section 21F(b)(1). The Dodd-Frank Act defines the key terms in this provision as follows:

- Covered judicial or administrative action: Any judicial or administrative action brought by the SEC under the Securities Exchange Act resulting in monetary sanctions in excess of $1,000,000. See Section 21F(a)(1).

- Monetary Sanctions: such sanctions include any monies, including penalties, disgorgement, restitution, and interest ordered to be paid, as well as any monies deposited into a disgorgement fund or other fund pursuant to Section 308(b) of the Sarbanes Oxley Act of 2002 as a result of such action or any settlement of such action. See Section 21F(a)(4).

- Whistleblower: any individual (or individuals acting jointly) who provides information relating to a violation of the Securities Exchange Act in a manner established by rule or regulation of the SEC. See Section 21F(a)(6).

- Successful enforcement: Successful enforcement includes any settlement of covered actions. See Section 21F(a)(4)(B).

- Original Information is information that is:

  (A) derived from the independent knowledge or analysis of a whistleblower;

  (B) not known to the SEC from any other source, unless the whistleblower is the original source of the information; and

  (C) not exclusively derived from an allegation made in a (1) judicial or administrative hearing, in a (2) governmental report, hearing, audit, or investigation, or (3) from the news media, unless the whistleblower is a source of the information.

See Section 21F(a)(3).

The whistleblower’s providing of original information to the SEC triggers the entitlement to a whistleblower reward so long as the whistleblower’s original information was submitted to
the SEC after the date of enactment of the Dodd-Frank Act. However, awards issued pursuant to the SEC Whistleblower Program are available to whistleblowers who provided timely original information to the SEC even where the violation of the Securities Exchange Act (or its implementing rules and regulations) occurred prior to the enactment of the Dodd-Frank Act.

**Determining the Size of the SEC Whistleblower’s Reward**

The Dodd-Frank Act provides that an SEC whistleblower’s award shall be not less than 10 percent and not more than 30 percent of the total monetary sanctions that have been collected via the covered action or related actions. See Section 21F(b)(1). The determination of this award rests within the discretion of the SEC, which is to exercise that discretion in light of certain listed criteria:

1. The significance of the SEC whistleblower’s information to the success of the covered judicial or administrative action against the wrongdoer;

2. The degree of the SEC whistleblower’s assistance (as well as the assistance of the whistleblower’s legal representative);

3. The SEC’s programmatic interest in deterring violations of the Securities Exchange Act (and its implementing regulations); and

4. Additional relevant factors as established by a rule or regulation of the SEC.

See Section 21F(c)(1)(B).

**Grounds for Denial of the SEC Whistleblower’s Award**

For various policy reasons, the Dodd-Frank Act establishes numerous scenarios in which the circumstances of an individual’s employment will preclude that person from eligibility as a SEC whistleblower. These scenarios include:

- Any individual who is or was at the time of acquiring the original information submitted to the SEC a member, officer or employee of the following:
  - Appropriate regulatory agency;
  - The Department of Justice;
  - A registered entity;
  - A registered futures association;
  - A self-regulatory organization under Securities Exchange Act (e.g., Financial Industry Regulatory Authority [FINRA]); or
A law enforcement organization.

See Section 21F(c)(2).

The Dodd-Frank Act also disallows awards to any whistleblower convicted of a criminal violation related to the covered judicial or administrative action that precipitated the successful recovery of monetary sanctions. In addition, whistleblowers are ineligible for awards where the whistleblower submits information to the SEC based on facts underlying the covered action previously submitted by another whistleblower. Finally, the Dodd-Frank Act prohibits awards to any whistleblower when that person fails to submit information to the SEC in such a form as required by SEC rule or regulation.

The Act permits a whistleblower to be represented by counsel when making a claim for an award under the SEC Whistleblower Program. Additionally, the whistleblower may initially remain anonymous and act through her counsel, provided that the whistleblower eventually discloses her identity to the SEC prior to the payment of the award.

III. PROPOSED RULES FOR SEC WHISTLEBLOWER INCENTIVE PROGRAM

Section 924 of the Dodd-Frank Act requires that the SEC issue rules within 270 days of the statute’s enactment to implement the SEC Whistleblower Incentive Program. On November 3, 2010, the SEC released its proposed rules and forms as “Proposed Regulation 21F” and invited public comment. Citing the Dodd-Frank Act’s requirement that the SEC create “clearly defined and user friendly” rules, the Commission noted that it had endeavored to draft the rules to meet that statutory requirement.4

The SEC’s preface to Proposed Regulation 21F notes that the Commission attempted to balance competing interests when promulgating rules for the implementation of the SEC Whistleblower Program. The SEC cited its fear that the whistleblower incentive program would undermine corporate compliance, legal, audit, and related internal processes. Because of this concern, the SEC has proposed rules that limit the ability of corporate employees working in these areas to blow the whistle on securities violations, and which also encourage whistleblowers to utilize internal investigatory processes before bringing their information to the attention of the SEC. The resulting rules, as proposed by the Commission, contain a number of provisions that the authors believe will significantly impede the Dodd-Frank Act’s purpose of using whistleblower incentives to ensure that the SEC receives timely, high-quality tips about securities violations from employees and others who are in the best position to encounter such wrongdoing in the course of their employment. Some of the main problems in the proposed rules are described below:

The SEC Should Not Require Employees to Report Concerns Internally

Although the proposed rules do not require that whistleblowers report their concerns to a company’s internal compliance program before providing their information to the SEC, the

corporate bar is fiercely advocating for the addition of this requirement to the final rules. As written, the proposed rules make it clear that the Commission will consider whether an employee reported her concerns internally before bringing the information to the attention of the SEC as one factor in favor of increasing the size of a whistleblower’s award.\(^5\) The proposed rules also incentivize the would-be whistleblower to use internal reporting mechanisms by allowing for the “backdating” of a submission to the SEC where the person filing the submission has first reported her information internally. Proposed Regulation 21F-4(b)(7). Under this provision, a whistleblower who first brings the complaint to the attention of the company’s internal compliance program, and who later submits his original information to the SEC, will be deemed by the SEC to have filed the action on the date upon which she initially reported the issue to the internal reporting program. The current timeframe for the backdating period is 90 days.

While certain of these provisions represent a reasonable balance between competing interests, others go too far towards insulating corporate wrongdoing from effective law enforcement. For example, the suggestion that the SEC will likely increase rewards for persons who first report violations internally will discourage the timely reporting of violations to the SEC by a wide range of persons who may be in the best position to become aware of the violations. Mandatory internal reporting would not prevent corporate wrongdoing of this nature, but instead would tip off management and allow them to hide their wrongdoing, seriously impair the potential for the SEC to receive timely, high-quality information, and attempt to silence the whistleblower through a combination of intimidation and retaliation. Every lawyer who represents whistleblowers has seen countless employees who have faced retaliation, often losing their jobs, because they reported wrongdoing to their superiors in the misguided expectation that a company would address their concerns appropriately. This imposition of stricter internal reporting requirements in the final rules – i.e., mandating that a whistleblower internally report her concerns before she can report the issues to law enforcement – would even more seriously undermine the effectiveness of this new and very important whistleblower-incentive program.

The Definition of “Original Information” Creates a Framework for Denying Awards to Whistleblowers

The Dodd-Frank Act lists only four bases for disqualification that would prevent a whistleblower from establishing her eligibility to receive an award under the Act: (a) that the would-be whistleblower was an employee of the Department of Justice, a self-regulatory organization, the Public Accounting Oversight Board, or a law enforcement organization, or is an employee, member, or officer of an “appropriate regulatory agency” at the time she acquired the original information; (b) that the individual has been convicted of a criminal violation with a connection to the covered or related action for which she would receive the award; (c) that the person seeking a reward acquired her information through an audit required by securities law; and (d) that the individual fails to submit her information to the SEC on its required form. Section 21F(c)(2).

\(^5\) This consideration is not included in the proposed rules but appears in the accompanying staff commentary, which states that the “Commission will consider higher percentage awards for whistleblowers who first report violations through their compliance programs.” See Background Information to Proposed Rules (http://www.sec.gov/rules/proposed/2010/34-63237.pdf) at 51.
The Commission’s Proposed Rule 21F-4, however, greatly expands the bases upon which the Dodd-Frank Act declares a whistleblower ineligible. Proposed Rule 21F-4(b)(4)’s definition of “original information” is particularly troubling, as it excludes additional, broad categories of whistleblowers from eligibility and lacks any readily identifiable basis in the statutory language of the Dodd-Frank Act. More importantly, those individuals who are excluded are those who largely make up the population who are most likely to possess information about violations of the Securities Exchange Act. Without a discernible basis in the statutory language, Proposed Rule 21F-4 also allows the SEC to exercise a great deal of discretion in determining whether a whistleblower qualifies to receive an award. If Proposed Rule 21F-4 survives the rulemaking process as written, the final rule that adopts it can only reduce the effectiveness of the SEC whistleblower program by discouraging those with relevant information from coming forward.

Proposed Rule 21F-4(b)(4) erects a solid barrier to effective enforcement by mandating that “[t]he Commission will not consider information to be derived from your independent knowledge or independent analysis if you obtained the knowledge or the information upon which your analysis is based” in any of seven separate ways, among them:

- **Attorney-Client Privilege.** Proposed Rule 21F-4(b)(4)(i) prevents a whistleblower from recovering an award under the SEC Program if she acquired her information “[t]hrough a communication that was subject to the attorney-client privilege, unless disclosure of that information is otherwise permitted by § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise.” This definition lacks a solid basis in the statutory language of the Dodd-Frank Act and is also overly broad in that it bars the SEC from accepting information from individuals who may possess both privileged and non-privileged information.

In contrast to the Commission’s dismissing of such whistleblowers, the Department of Justice and the Internal Revenue Service have adopted guidelines for the handling of privileged information that allow the agencies to work around the privilege issue in a manner that protects competing interests. These agencies, which work with whistleblowers who bring suit under the False Claims Act or make use of the IRS Whistleblower Program, are very careful not to use privileged information. At the same time, they do not automatically disqualify would-be whistleblowers who may have gained some knowledge of wrongdoing through privileged communications.

- **Excluded Employees.** Proposed Rule 21F-4(b)(4)(iv) is among the most troubling provisions of the proposed rules because it potentially sacrifices a large number of high-quality tips that could lead to successful enforcement actions. This rule prevents a whistleblower from receiving an award when that person has “legal, compliance, audit, supervisory, or governance responsibilities for an entity, and the [original information] was communicated to [the whistleblower] with the reasonable expectation that [the whistleblower] would take steps to cause the entity to respond appropriately to the violation, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith.” The proposed rule not only lacks any discernible basis in the statutory language of the Dodd-Frank Act,
but it also risks disqualifying the very individuals who will have access to the best evidence of violations of the Securities Exchange Act. Despite its goal of balancing the interests of internal compliance with aggressive enforcement, Congress chose not to require persons with “legal, compliance, audit, supervisory, or governance responsibilities” to first report their information internally but chose not to, and the SEC should not issue a final rule that adds a requirement that Congress declined to include in the Act.

Moreover, the SEC rule fails to define the “supervisory responsibilities” that would disqualify an employee, leaving open the possibility that this exception will effectively render a large segment of the workforce, all the way down to line foremen, ineligible for whistleblower status. Any whistleblower with relevant information reading this proposed rule – which hardly satisfies the “clearly defined and user-friendly” requirement in the Dodd-Frank Act – will naturally question whether risking their career to come forward with relevant information will result in a disqualification from whistleblower status.

- **Excluded Functions.** Similarly, Proposed Rule 21F-4(b)(4)(v) excludes individuals from whistleblower status where they obtain their original information “from or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential non-compliance with law, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith.” Like Proposed Rule 21F-4(b)(4)(iv), this proposed rule is overly broad and lacks a sound basis in the Act. A plain reading of this language excludes anyone exposed to relevant information through legal, compliance, audit or other undefined “similar functions,” meaning that any employee who acquires relevant information through exposure to one of the foregoing proscribed sources – even if she may have acquired knowledge through other sources – risks suffering disqualification from whistleblower status unless she jeopardizes her career by first reporting the information internally. The chilling effect created by Proposed Rule 21F-4(b)(4)(v) would institutionalize strong disincentives for whistleblowers who are considering the risk of providing original information to the SEC.

This chilling effect is amplified by the vaguely-defined “reasonable time” that must pass before an employee can avoid the Commission’s internal reporting mandate and provide their information to the SEC. In explaining the term “reasonable time,” the Commission states that this term is “a flexible concept that will depend on all of the facts and circumstances of the particular case.” Such unfettered SEC discretion is not contemplated by the Dodd-Frank Act and will serve only to dissuade would-be whistleblowers from taking a chance on the timing of their disclosures.

Proposed Rule 21F-4Cb)(4)(vi) nullifies a whistleblower’s eligibility for an award under the SEC whistleblower program where that individual obtains information by a “means or in a manner that violates applicable federal or state criminal law.” This goes beyond the language of the Act, which states only that no award shall be issued to “any whistleblower who is convicted of a criminal violation related to the judicial
or administrative action for which the whistleblower could otherwise receive an award.” Dodd-Frank § 922 (b)(2)(B), only individuals convicted of a crime relating to the securities violation are disqualified under the statute. Proposed Rule 21F-4Cb)(4)(vi) grossly exceeds this statutory language and allows the SEC to exercise discretion as to whether a sufficient “violation” occurred in obtaining information – effectively eliminating Congress’s requirement that an employee be convicted by an appropriate tribunal. If SEC investigators are allowed to reach their own conclusions about the criminality of a would-be whistleblower’s conduct, and to do so without benefit of judicial fact-finding or applicable burdens of proof, the rule will likely exclude well-meaning individuals who have not committed crimes.

- Any of the above. Proposed Rule 21F-4(b)(4)(vii) also contains a catch-all disqualification for information provided by a whistleblower who has obtained her information from “any of the individuals” described above, including persons who have legal, compliance, audit, supervisory or governance responsibilities, and who happen to disclose information to the whistleblower about a company’s security violations. This suggests that an employee who learns of securities violations from a loose-lipped CEO could not expect to receive an award for providing that information to the SEC. There is no good reason for this exception, as it serves no purpose identified in the Act.


Section 922(a)(3) of the Dodd-Frank Act defines “original information” to include information “derived from the independent knowledge or analysis of a whistleblower.” Proposed Rule 21F-4(b)(2), however, defines “independent knowledge” as “factual information in your possession that is not derived from publicly available sources.” The SEC’s exclusion of publicly available information from the definition of “independent knowledge” is at odds with the language of the Dodd-Frank Act. While the Act does not sanction whistleblower claims based on the submission of original information already known to the SEC, or based exclusively on information from judicial proceedings, the media or certain other sources, it does not prohibit an award based on the whistleblower’s provision of publicly available information. See Dodd-Frank § 922(a)(3)(C). Proposed Rule 21F-4(b)(2) therefore exceeds this statutory language by adding the entire range of publicly available information. The Commission again exceeds the scope of this narrowly defined limitation on what constitutes original information and instead excludes information derived from any public source – not just information derived from the publicly available sources listed in the statute.

The Definition of “Voluntary Submission of Information” in Proposed Rule 21F-4(a) is Overly Broad and Impermissibly Vague

The Dodd-Frank Act requires a whistleblower to submit information to the SEC on a voluntary basis. The SEC has drafted Proposed Rule 21F-4(a) to define voluntary in a manner that is overly broad and could result in the unjustified disqualification of a whistleblower from consideration for an award. Specifically, Proposed Rule 21F-4(a) states that a submission to the
SEC is voluntary where the whistleblower provides the original information before she or her representative “receives any request, inquiry, demand from the Commission, the Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information in [the whistleblower's] submission is relevant.” This rule deems the whistleblower to have received a request, inquiry or demand “if documents or information from [the whistleblower] are within the scope of a request, inquiry, or demand that [the whistleblower's] employer receives unless, after receiving the documents or information from [the whistleblower], [the] employer fails to provide [the whistleblower's] documents.”

The broad range and vague nature of Proposed Rule 21F-4(a)’s language could prevent a whistleblower from recovering an award where her employer receives a generalized request that defines the employer, as most do, to include “all officer, managers, and employees” and which arguably touches on the subject matter of the whistleblower’s original information. The rule would disqualify the would-be whistleblower even where she does not know that the company’s general counsel has received a document request, or that the company is withholding information that should be provided in response to the request. Given this vague and discretionary determination, the SEC should redraft Proposed Rule 21F-4(a) to prohibit individuals from receiving whistleblower awards where their allegations are the subject of investigation, and by the specific agencies listed in the rule. To leave the rule as written introduces an unnecessary level of uncertainty that would dissuade whistleblowers from coming forward with information about violations.

**The SEC’s Discretion in Proposed Rule 21F-4(c) Confers Impermissible Discretion on the SEC to Determine the Size of Awards.**

Section 922(b)(1) of the Dodd-Frank Act provides that a whistleblower’s provision of original information must have “led to the successful enforcement of the covered judicial or administrative enforcement action” to create eligibility for an award under the SEC Whistleblower Program. In implementing this provision, Proposed Rule 21F-4(c) states that a whistleblower’s provision of original information must cause the SEC “to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning new or different conduct as part of a current examination or investigation, and [the whistleblower’s] information significantly contributed to the success of the action.” The SEC’s insertion of this “significantly contributed” language has no basis in the language of the Dodd-Frank Act and defeats Congressional intent by diluting the strength of the SEC Whistleblower Program.

Although Congress notably declined to confer discretion on the SEC as to whether the Commission could decline to issue an award to a whistleblower even where the statutory criteria were satisfied, Proposed Rule 21F-4(c) effectively does an end run around this aspect of the Dodd-Frank Act. Under Proposed Rule 21F-4(c), the Commission’s entirely discretionary determination as to whether the whistleblower’s information “significantly contributed” to the successful recovery of monetary sanctions becomes the deciding factor in whether a whistleblower will receive their award.
Whistleblowers who are aware of the SEC’s unfettered discretion will regard such uncertainty as a strong disincentive to come forward with original information regarding violations of the Securities Exchange Act. Instead of making the significance of the whistleblower’s contribution a threshold issue for award eligibility, the Dodd-Frank Act permits the SEC to factor in the significance of a contribution when calculating of the size of the award (i.e., in determining where along the spectrum, from 10% to 30%, an award be). See Dodd-Frank Act § 922 (c) (1). The SEC ignores this aspect of the Dodd-Frank Act and Proposed Rule 21F-4(c) instead gives the Commission the power to deny an award altogether based entirely on its determination as to whether the whistleblower made a “significant” contribution to the enforcement action.

The Claims Process in Proposed Rule 21F-10 is Unduly Burdensome.

Under Proposed Rule 21F-10, a whistleblower must provide notice to the Commission regarding their claim for an award at the successful completion of an enforcement action. According to the procedures detailed in Proposed Regulation 21F, the SEC will publish a “Notice of Covered Action” on the Commission’s website. The whistleblower then has 60 days from the publication of this notice to file a claim for an award under the Dodd-Frank program. If the whistleblower fails to act within the requisite time, however, Proposed Rule 21F-10 precludes that whistleblower from recovering a share of the monetary sanctions.

This burdensome procedure does not comport with the Dodd-Frank Act’s mandatory award for eligible whistleblowers who voluntarily provide original information leading to a successful enforcement action. There is no reason that the Commission cannot notify potential whistleblowers of their potential entitlement to an award. Proposed Rule 21F-10 instead places an undue burden on potentially whistleblowers to constantly monitor the Commission’s website – perhaps for years – and to understand from the wording of the SEC notice that it describes an action initiated based on their “tip.” If they miss or misinterpret the notice, then they lose their deserved reward altogether. This requirement hardly satisfies the Dodd-Frank requirement that the Proposed Regulation be “user friendly.”

The Empirical Evidence Does Not Support the Speculative Concern of the Corporate Community that the SEC Whistleblower Program Will Inhibit Internal Employee Reporting.

The corporate bar’s concern that the SEC Whistleblower Program will hinder internal employee reporting not based on the facts. Lawyers who represent whistleblowers observe that the great majority of their clients are company employees who spoke out about perceived wrongdoing internally before reporting their concerns to regulators or law enforcement. This is certainly the experience of the authors, who, along with other lawyers in their law firm, have represented hundreds of whistleblowers in a wide range of industries.

These impressions are backed up by reputable studies. For example, a recent study of qui tam cases involving health-care fraud, published in the New England Journal of Medicine, found that 82% of employees who brought qui tam suits against their employers “first tried to fix matters internally by talking to their superiors, filing an internal complaint, or both.” A.
Kesselheim, et al., “Whistle-Blowers’ Experienced in Fraud Litigation against Pharmaceutical Companies,” New Eng. J. Med. 362:19 (May 13, 2010) at 1834. The same percentage faced retaliation of one sort or another for raising their complaint, and more than half heard their employers respond by demanding that they “do what they were told.” The study further found that most of the relators interviewed had no intention of using the *qui tam* process until they consulted with lawyers, and that they visited lawyers because they faced retaliation for raising their concerns. Many were motivated to blow the whistle because of integrity and ethical standards (42%), some sought to prevent harm to the public (27%), and others wanted to see criminals prosecuted for their actions (27%). A second study, conducted by the National Whistleblowers Center, found that fewer than one percent of employees filing *qui tam* cases went directly to the government without first contacting someone inside the company.

IV. CONCLUSION

The SEC Whistleblower Program provides a unique opportunity for the federal government to enlist the help of well-intended corporate employees and others to greatly enhance the SEC’s enforcement of federal securities laws. In the interest of protecting corporate governance mechanisms that all too often do not work, the SEC has issued proposed rules for the program that erect too many barriers that will either discourage whistleblowers or turn them away altogether. The surest way to serve the purpose of the Dodd-Frank Act is for the Commission to implement the new program with a set of final rules that opens a welcoming door to individuals who would risk all in order to protect shareholders and investors against the types of fraud and wrongdoing that have grown to be a tremendous problem in U.S. financial markets.