

PHILLIPS & COHEN LLP

ATTORNEYS AT LAW

www.phillipsandcohen.com

2000 MASSACHUSETTS AVENUE NW
1st FLOOR
WASHINGTON, DC 20036
(202) 833-4567

100 THE EMBARCADERO
SUITE 300
SAN FRANCISCO, CA 94105
(415) 836-9000

October 25, 2019

Ms. Vanessa Countryman
Secretary, United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File Number S7-16-18
Proposed Amendments to the SEC's Whistleblower Program
Submitted by electronic mail to rule-comments@sec.gov

Dear Secretary Countryman:

I write at Chairman Clayton's invitation on October 23, 2019 to provide additional comments on three troubling aspects of the Proposed Amendments to the Commissioner's Whistleblower Program (34-83557; File No.: S7-16-18). The overarching concern is that the momentum of the SEC Whistleblower's Program has stalled due to the seemingly ever-increasing length of time it is taking to process award claims and pay meritorious whistleblowers. I support the proposed changes that can enhance the program's efficiency, like granting summary disposition authority to the Office of the Whistleblower for facially deficient award claims and to permanently ban "serial submitters" who operate in bad faith by submitting multiple claims in bad faith. I am opposed to the aspects discussed below because they may either unnecessarily shrink the pool of potential whistleblower who might be willing to come forward and report, or extend even further the length of time needed for the Commission to process meritorious claims for awards by unnecessarily injecting new and nebulous standards and "clarifications" of issues to address circumstances already covered by the existing rules.

The Chairman requested that I address three topics. First, a suggested revision to the proposal that would essentially impose a 30-day limitation on an individual who has provided original information to the Commission to file a Form-TCR or be disqualified for an award. Second, an explanation for concerns around the potential for uncertainty and inefficiency injected into process if the proposed change to allow for the consideration of the size of an award when assessing cases brought with sanctions exceeding \$100 million. Finally, discussion regarding the potential deleterious impact of adopting the proposed "clarification" of the definition of "original analysis." Each is discussed below:

I. The 30-day submission proposal

Here is a proposed revision to the current 30-day TCR filing rule:¹

(e) (1) You must follow the procedures specified in paragraphs (a) and (b) of this section **within thirty days** of the first time you provide the Commission with information that you rely upon as a basis for claiming an award. If you fail to do so, then you will be deemed ineligible for an award in connection with that information. ~~(even if you later resubmit that information in accordance with paragraphs (a) and (b) of this section).~~ Notwithstanding the foregoing, the Commission, in its sole discretion, may waive your noncompliance with paragraphs (a) and (b) of this section if the Commission determines that the administrative record clearly and convincingly demonstrates that you would otherwise qualify for an award and you demonstrate that you complied with the requirements of paragraphs (a) and (b) of this section within 30 days of the first communication with the staff about the information that you provided.

(2) For good cause shown the requirement in section (e)(1) shall be waived and the individual shall be considered a whistleblower under §§ 240.21F-2(a) and 240.21F-3. For purposes of this provision good cause is defined as follows:

(A) the individual provided original information to the Commission;

(B) the original information caused the Commission to commence an examination, open or reopen an investigation, or inquire into different conduct as part of a current Commission examination or investigation under Rule 21F-4(c)(1) of the Exchange Act;

(C) the original information significantly contributed to the success of a Commission judicial or administrative enforcement action under Rule 21F-4(c)(2) of the Exchange Act or that the information was otherwise relied upon by the Commission as required under 15 U.S.C. §§ 78u-6(b) and (c);

(D) the individual's information materially contributed to a sanction of over \$1 million;

(E) this exception may only be applied if the contributions of the individual are confirmed by the appropriate Commission staff who can confirm that individual's contributions as set forth in paragraphs (e)(2)(A)-(D) of this section.

(F) the deadline for applying for this good cause exception shall be at the time the individual(s) file a timely WB APP application.

¹ This draft was reviewed and approved by myself and my colleagues in the whistleblower bar Steven Kohn from The National Whistleblower Center and Jordan Thomas of Labaton Sucharow.

(G) the Commission may take into consideration the failure to file a timely TCR when evaluating the factors set forth in sections (a) and (b) in determining whether to increase or decrease an award.

This approach would allow the Commission – at the demonstration of the well-established standard of “good cause”- to use its discretion and avoid the circumstance where the equities support not disqualifying a whistleblower from award consideration simply for failure to meet the 30-day deadline to file a Form-TCR.

II. The Downward Adjustment Proposal

Second, the proposed rule that would allow the Commission discretion to adjust an award percentage downward to an amount “reasonably necessary to reward the whistleblower and to incentivize similarly situated whistleblowers” in connection with “exceedingly large” awards lacks specificity and factual support and should not be included in the final rules. In my experience, individuals considering blowing the whistle seek reasonable assurance as to how the process works and what to expect and this proposal unnecessarily injects uncertainty into the award assessment process, risking even further delays. In explaining the need for this proposed change, the Proposing Release uses nebulous language to justify a significant alteration to how high-end awards are to be processed that will make it difficult to explain to potential clients.

For example, the release includes bold but non-specific justifications like, “[t]he Commission could determine that an exceedingly large potential payout . . . was not reasonably necessary to fulfill the purposes of the program,” and “[a]n important principle underlying proposed paragraph (d) is that, as the dollar value of an award amount grows exceedingly large, there is significant potential for a diminishing marginal benefit to the program in terms of compensating the whistleblower and incentivizing future whistleblowers.” There is simply no support for these statements. The “purposes” of the program are quite simple – incentivize as many people who are aware of possible securities violations to come forward, and to provide maximum assistance to the enforcement staff to bring investigations to a successful conclusion as efficiently as possible. The best way to achieve these “purposes” is to leverage the powerful financial incentives in the current program by paying meritorious whistleblowers the maximum award justified by the facts and circumstances as quickly as possible. It is undisputed that when the Commission announces new awards – particularly high dollar awards – the program’s visibility is enhanced and more people become interested in the possibility of reporting under the program. Artificially deflating awards – even to those whom the proposing release describes as “the model whistleblower” – in no way helps advance these “purposes.”

In my view, adoption of this discretion for a downward adjustment to potential high-end awards will have the real-world implications of potentially reducing the number of people who should be incentivized to report and to reduce – rather than maximize- staff efficiency through whistleblower efforts. Uncertainty is anathema to potential whistleblowers. Under the current rules, discussions with a potential client are straightforward – if you are eligible, you enhance your chances to be considered for an award approaching the statutory maximum of 30% the more you act like a “model whistleblower” by providing significant information, assist the staff

in its investigative efforts and assist in bringing successful actions in areas of high priority. Under the proposed rules, this straightforward discussion gets murky as it must be explained that even if he/she is a “model whistleblower,” the Commission may decide to decrease a possible award based on what it deems to be “reasonably necessary” to award him/her as well as advance the interests of the program. This explanation will inevitably lead to more difficult-to-answer questions from the potential whistleblower about what “reasonably necessary” means, who will make that determination, what will we have to provide to the Commission to support what is reasonably necessary in his/her particular circumstance. An already reluctant whistleblower may well find this injected level of uncertainty sufficient confirmation to avoid taking the immense and potentially career-ending risk of blowing the whistle.

Adoption of this proposal will also lead to decreased efficiency at the investigative and award phases of the process – directly contrary to the purpose of the program. Under the current rules, if I have a whistleblower client who works overseas that is requested to leave his/her job for a few days, travel to the United States to provide either testimony or submit to a voluntary interview, I advise him/her to do so to maximize his/her “credit” under the cooperation favorable factor when applying for an award. That is, the more he/she cooperates, the better his/her argument will be for an award approaching the 30% statutory maximum. Under the proposed rule however, I would be forced to advise that same client that while cooperating is always a good thing, it will not necessarily result in an award approaching the statutory maximum if the Commission decides (many years later) that a higher percentage payout is not “reasonably necessary.” Under these circumstances, the whistleblower might well decide to forego the opportunity to further assist the staff because there may be no tangible benefit for doing so. Thus, the staff would potentially lose the opportunity to preserve resources during their investigations by capitalizing on the knowledge and background of whistleblowers.

The award claims process will similarly be further slowed incongruously for the kind of high-profile, high dollar whistleblower payouts that significantly enhance the visibility of, and interest in, the program. The claims process already requires significant time and resources for seemingly straightforward claims. The process will only be slowed further if, in addition to assessment of the eligibility criteria, allocating among several eligible whistleblowers, interpreting novel legal or factual issues, etc., the Commission takes on the added consideration of what is “reasonably necessary” to reward each individual eligible whistleblower and incentivize future similarly-situated whistleblowers. To assist the Commission in making this highly fact-intensive assessment, eligible whistleblowers will submit materials to put their current financial circumstances into a context that allows for a better assessment of what is “reasonably necessary in his/her case; meaning the Commission should expect to receive supporting evidence like bank statements, college tuition statements, divorce decrees, loan documents etc. Going down this “rabbit hole” is something that will inevitably slow the awards claims process with delays above and beyond the current delays, which are already threatening the credibility and long-term sustainability of the program.

III. Independent Analysis

Finally, the proposed “clarification” of the definition of “independent analysis” should not be included in the final rules as it does not clarify anything and will likely cause valuable outside analysts (like Harry Markopolos) to abandon the whistleblower program entirely. This aspect of the proposed rules “clarifies” that a submission from a non-insider whistleblower will not be independent analysis if the Commission determines that reported violations “could have been inferred from the facts available in public sources.” In other words, a submission based on analysis (as opposed to direct observation), will only be eligible for award consideration if, when an application for award is being assessed – many years after the tip was submitted – the Commission determines that the staff could not have inferred the information in the tip from public sources. Not that the staff did in fact infer the information – just that the staff could have done so. This proposed clarification should not be included in the final rules as it lays a standard that will be factually and operationally impossible for a non-insider to meet, thus eliminating a wide swath of potential whistleblowers with valuable information in one fell swoop.

The standard is factually impossible to meet because with the benefit of (in this case 5 to 8 years) of hindsight, literally everything that happened in the past is reasonably inferable. Think of the events in history that were most shocking at the time – the attack on Pearl Harbor, the attacks on 9/11, etc. – and each, with the benefit of hindsight and context came to be viewed as things that should have been expected – i.e., reasonably inferable. In a more pertinent context, the Madoff fraud – perpetrated and fooling even seasoned investment professionals for years and years – was quickly viewed as obvious and reasonably inferable shortly after it was exposed, regardless of the fact that it was not actually exposed while the fraud was ongoing.

The proposed standard is also operationally impossible to meet and removes all incentives for independent analysts to submit under the program. One assumes that in assessing what was “reasonably inferable” under this proposed rule change, the source for the necessary information would be the staff that worked on the investigation. This means that under the proposed new definition of “independent analysis,” staff will be put in the impossible position of having to inform the Commission whether he/she could have reasonably inferred the conduct disclosed by the whistleblower’s tip years earlier. As a practical matter, no staffer would ever inform members of the Commission that several years after the fact he/she would not have been able to infer the reported information.

The impact of the proposed clarification therefore is to completely remove any incentive for market analysts to spend the kind of time and resources it often takes to assemble a detailed whistleblower tip, lest they be deemed ineligible for an award based on what the Commission finds to have been inferable many years after the fact. This is directly contrary to the incentivizing purpose of the program. To the extent that a non-insider tip merely provides public information without specific additional color, the current definition of independent analysis already provides the Commission with necessary authority to reject a claim for award. There is simply no need to go further with this proposed fix to the program; which will do immense harm by disinviting individuals with valuable insights and skills from seeking to participate in it.

Thank you for the opportunity to provide these additional comments. While I appreciate efforts to improve and strengthen the program, I urge you to reject proposed changes that weaken it.

Sincerely,

A handwritten signature in black ink, appearing to read "Sean McKessy". The signature is fluid and cursive, with a long, sweeping tail that loops back under the name.

Sean McKessy

Partner

Phillips & Cohen

Former Chief, Office of the Whistleblower