The proposed rules for implementing the Whistleblower provisions of Section 21F of the Securities Exchange Act of 1934 are a valiant effort, and show considerable thought.

Having started with praise, it should be noted that there are several weaknesses, and one major leap-of-faith.

Let's start with the leap-of-faith.

That core issue is that the SEC has decided to jumble together two very different ideas:

1. A tip line

2. A program to reward whistleblowers who bring to the SEC staff well-developed investigations and cases that put the government on the path to large frauds

The model for all whistleblower programs in the U.S. is the False Claims Act, which has returned over $30 billion (civil and criminal) to the U.S. treasury over the course of the last 25 years.

The False Claims Act is not a tip line.

Though lawyers for fraudsters like to squawk that approximately 500 False Claims Act cases a year are filed, and that the U.S. Department of Justice only joins about 100 of these cases a year, the fact that DoJ *only* receives 500 False Claims Act cases a year (and not the 30,000 cases a year that the SEC says it is expecting) is due to two factors:

1. HHS and DoD maintain separate fraud tip lines which are NOT part of DoJ's workload, and;

2. Most weak False Claims Act cases never get filed because potential whistleblowers with very poorly developed cases (or no case at all) are unable to get a competent False Claims Act lawyer to file their complaint.

Experienced False Claims Act lawyers are looking for real fraud and real evidence, and though they may be overly optimistic about the quality of their cases at times, lawyers act as a first-stage hard screen on most False Claims Act cases submitted to DoJ -- a kind of "filter against folly" – which dramatically reduces HHS, DoD and DoJ workloads.

Because filing a False Claims Act case is not as easy as simply booting up a browser on a computer, and because it is understood that a private lawyer is generally required to win a case (if not to actually file a case in many Circuits), the chance of a False Claims Act case filed-by-counsel leading to substantial recovery is quite good.

In fact, it is *very* good; the False Claims Act is the most successful fraud fighting tool in America's fraud-fighting arsenal.

The SEC, however, has decided to go another direction and do most of the initial whistleblower screening itself, and without overtly encouraging the assistance of private counsel (§ 240.21F-8(a) Eligibility at p. 135).
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This is problematic, and is likely to produce two results:

1. A low number of solid cases coming out of a massive screening process.
   The SEC itself says it expects to screen 30,000 complaints a year in order to generate 130 cases. Such a high complaint-to-success ratio is likely to be seen as a political football on both sides, with whistleblowers complaining that the SEC has cavalierly tossed out the diamonds with the dirt, while corporate fraudsters and their paid apologists suggesting that most of the resources spent on the whistleblower office are going down a rat hole.

2. Screeners unable to properly sort out the gravel from the diamonds.
   Proper screening of 30,000 securities complaints a year cannot be done with low-level staff. Frauds are complicated by definition, and securities transactions involve a wide variety of specialized sets of knowledge. In the case of the Madoff fraud, the SEC's staff in New York and Washington, D.C. simply did not understand what was being said by whistleblower Harry Markopolos. With 30,000 complaints a year flooding into the SEC whistleblower office, and an as-yet nonexistent budget for screening, the SEC may be setting itself up for more failure.

What we have discovered in the world of the False Claims Act, is that if a private lawyer will not "suit up and stand up" to develop and craft a well-framed case, then there is probably not a very strong case there to begin with.

Indeed, to the best of my knowledge, there is only ONE *pro se* case that has ever gone on to be joined by the U.S. Department of Justice and settled (*US ex rel Rocco v. NYU Medical Cente*r, 93 Civ. 8012, SDNY April 7, 1997).

Time will tell, of course, if the fraud screening process that the SEC has set up will actually work well in practice.

What the SEC has made manifestly clear at § 240.21F-8(a) Eligibility (p. 135), however is that if a whistleblower does not fill out the forms perfectly, and does not jump through all the hoops in perfect order, and within a very narrow band of time, the SEC intends to disqualify him or her from receiving a whistleblower award.

Because the process that the SEC has set out is, in fact, quite complex, I would recommend that the SEC explicitly advise prospective whistleblowers that they should consider retaining private counsel to help assemble and frame their complaint, fill out the forms, and shepherd them through the complex SEC whistleblower process.

The fact that private counsel is likely to serve as a "hard screen" for the SEC, and also work with prospective whistleblower to develop and frame cases so that they arrive at the SEC's door ready for action, is an additional benefit that cannot be gainsaid.

Other Comments

- **"Companies that have robust compliance programs…"** (p. 4):

  Let us disenthrall ourselves of the notion that corporate fraud is an accident, or that compliance programs actually work to ferret out fraud. It is simply not true.

  Corporate compliance programs can work to ferret out petty pilfering and embezzlement. They may work to throw a light on sexual harassment. But corporate compliance officers simply do NOT have the throw weight, within a corporation's hierarchy, to stop large-scale fraud planned within the highest levels of a company.

  More often than not, a compliance officer is really a *compliant officer* whose main job is to identify anyone within a company who is unhappy with the way the company is doing business, so they can be scooted out the door as quickly as possible, and before they can gather documents or talk to the Government about the fraud they are seeing.

  No less an authority on the world of business practices than Scott Adams, the author and illustrator of the Dilbert cartoon, has openly mocked the idea of going to a corporate compliant officer to report wrong-doing. Adam's original Dilbert cartoon, slightly modified and appended below, was about a product that killed people, and

was first published on [January 27, 2004]. Only a few word changes are needed, to make it about a corporate compliant officer being told about financial fraud.

More recently, CBS's Interactive Business Network (BNET.com) rather pointedly described the job of Chief Ethics Officer within a company as being among the top five "useless" corporate positions:

- **<u>Exclusion for groups with established professional obligations</u>**
  (§ 240.21F-4(b)4(i-v) Independent analysis at p. 5, page 30 and page 129)
  A small clarification in the rules may be needed here so that professionals hired to fullfill one professional obligation are not automatically excluded from being whistleblowers on other, unrelated, activities that come to their attention but which are outside the bounds of their professional obligations.

- **<u>A whistleblower award on a successful action should lie within the 10 percent to 30 percent range</u>**
  (§ 240.21F-5(a) Amount of Award at p. 10, p. 48, p. 51, p. 78, p 133 and
  § 240.21F-5(a) Amount of Award Eligibility at p. 133
  § 240.21F-6(a) Criteria for determining amount of award at p. 133)
  The SEC should clarify that, for purposes of award calculation, they intend to start their calculation by assuming that a whistleblower is due an average twenty (20) percent award. The SEC would then calculate up or down from this percentage, depending on the amount and quality of the information provided by the whistleblower and/or his or her counsel. This instruction is particularly important as, without clear instruction, whistleblowers will assume a 10% award, and will therefore be less likely to risk their careers by coming forward to report fraud.

- **<u>Information from Government employees</u>** (p. 16)
  All governmental employees should NOT be excluded from the whistleblower program. This exclusion should be limited only to those employees working for the

SEC, the IRS, the U.S. Department of Justice, or any state law enforcement office with securities oversight or enforcement actions.

- **"Reasonable time"** (pp. 25-26)
  The term "reasonable time" is not defined and the draft rules say it will "necessarily be a flexible concept." In fact, an outer limit for "reasonable" time needs to be clearly stated and framed as being no more than 90 days.

- **Information that was obtained by a means or manner that violates applicable federal or state criminal law is exluded**
  (§ 240.21F-4(b)4(vi) Independent knowledge at p. 28 and p. 30 and p. 130)
  This provision unnecessarily hamstrings the SEC in its fight against fraud. If a company wants to sue a whistleblower for being in possession of purloined documents, they are free to do so, but the source of a whistleblower's information should not be of any concern to the Securities and Exchange Commission, provided it can be shown that the documents do not come from a legal, compliance, or supervisory officer who was given the documents in expectation that he or she would take immediate steps to end the fraud or violation.

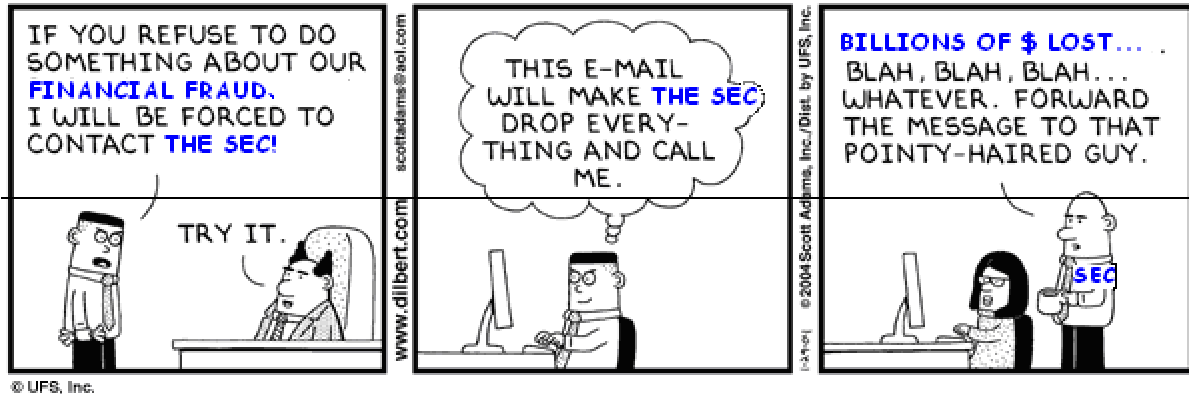
- **Information learned from others as original knowledge**
  (§ 240.21F-4(b)2 Independent knowledge at p. 28 and p. 127)
  It is entirely appropriate to include information that is not direct, first-hand knowledge as "independent knowledge." The goal here, after all, is for the Government to enter a case with as many facts as possible right from the beginning, and for people with knowledge of fraud to come forward as soon as possible.

- **Exclusion of information provided "in violation of judicial or administrative orders such as protective orders in private litigation**." (p. 31)
  Protective orders in private litigation should not be used a shield for continued or past financial chicanery.

- **A whistleblower has only 90 days to "perfect" his SEC case if he provided this same information to another authority** (p. 33 and p. 36)
  It is unclear as to why whistleblowers are being put on a very tight 30-day string to "perfect" their claim to the SEC when companies are being given a very vague (pp. 25-26) "reasonable time" standard. If a 90-day standard works for one side, it should also work for the other side as well.

- **"…our staff will, upon receiving a whistleblower complaint, contact a company, describe the allegations, and give the company an opportunity to investigate the matter and report back."** (p. 34)
  An investigation of an SEC fraud complaint should not start with a letter or email to the potential fraudster asking them to explain their side of the story. This was done with Bernie Madoff numerous times, and with little or no real follow up investigation, and the result was tragic. If the SEC continues to embrace this *modus operandi*, it will be met with extreme suspicion by whistleblowers, if not outright derision by the

public. In fact, no less an authority on the world of business practices than Scott Adams, the author and illustrator of the Dilbert cartoon, has already mocked this way of doing business. The original of the cartoon, appended below, was about a product that killed people and ran on January 29, 2004. Once again, only a few word changes were needed to make it relevant to the SEC's proposed whistleblower program.



- **Reference to Sarbanes-Oxley as a fraud-fighting mechanism** (p. 37)
The continued reference to strong "compliance" programs in the world of Securities trading, and of a nod to Sarbanes-Oxley (SOX), shows a lack of understanding of where we are, and where we have come from, in the world of securities enforcement. For the most part, SOX is a "cleaner book keeping law." It is designed to *discourage* fraud, not to reveal it. SOX has a whistleblower protection component, but it has no whistleblower awards and it does not incentivize integrity. SOX simply suggests that *after* you are fired, you *might* get back pay, etc. At best, it is a "cold comfort" law. It is worth remembering that the *entire economy of the U.S. collapsed* under subprime fraud, the Bernie Madoff fraud, and massive banking fraud, while SOX was fully in place. Simply put, SOX proved worthless at detecting fraud.