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December 17, 2010

Ms. Elizabeth M. Murphy, Secretary
United States Securities and Exchange Commission
Division of Corporation Finance
100 F Street, N.E.
Washington, D.C. 20549-1090

RE: File No. S7-33-10; Release No. 34-63237; Proposed Rules Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

Dear Ms. Murphy:

I appreciate this opportunity to comment on the rules recently proposed by the United States Securities and Exchange Commission (the "Commission") in Release No. 34-63237 (the "Release") to implement Section 21F of the Securities Exchange Act of 1934 titled "Securities Whistleblower Incentives and Protection," which was added by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank") enacted on July 21, 2010.

I am writing this letter, in response to the Commission's request for comments in the Release, upon the request and to address the concerns of certain of my clients. Although the proposed rules addressed, in part, some client concerns, I believe the rules proposed in the Release could nevertheless seriously undermine corporate internal compliance programs, have the unintended consequence of undermining companies' efforts to police and remedy their compliance with the U.S. securities laws, and place the Commission in the impossible role of whistleblower hotline and compliance officer for all public (and some private) companies in the United States.

Dodd-Frank Section 922 requires the Commission to pay awards to eligible whistleblowers who voluntarily provide the Commission with original information that leads to a successful enforcement action yielding monetary sanctions of over $1 million. The award amount is required to be between 10 percent and 30 percent of the total monetary sanctions collected in the Commission's action or any related action such as in a criminal case. A whistleblower may be eligible to receive an award for original information provided to the Commission on or after July 22, 2010, but before the whistleblower rules become effective, so long as the whistleblower complies with all such rules once effective.

"Whistleblower" is defined in Dodd-Frank as "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission" (emphasis added). Accordingly, similar to many other sections of the securities laws (*e.g.*, proxy regulation), the Commission has been given a blank slate upon which to write and implement these provisions.

I believe that in promulgating the rules implementing the whistleblower provisions of Dodd-Frank, two principal considerations should be emphasized:

- To the extent that an applicable ethics and compliance program ("ECP") covers the conduct reported by the whistleblower, the whistleblower, in order to qualify for the award, must first exhaust the private complaint channels set forth in the ECP.

- Companies should be encouraged to adopt ECPs that mirror those required in order to obtain the benefits of the U.S. Federal Sentencing Guidelines (the "Guidelines"). Requiring exhaustion of remedies, as described above, will accomplish that in part; however, requiring disclosure similar to the disclosure surrounding current codes of conduct for senior financial executives and "audit committee financial experts" also would encourage adoption of ECPs.

Compliance with Internal Reporting Programs Should Be a Condition Precedent For Receiving Whistleblower Awards (Requests For Comment Nos.* 16, 18, 19 and 27*)

Many companies have ECPs in place that require employees to report possible misconduct internally through any one of a variety of mechanisms, including channels that provide for anonymous reporting. Additionally, companies often require employees to certify on some periodic basis that they have reported any such concerns of which they are aware. Public policy has long supported such internal corporate reporting mechanisms because they allow companies to promptly address wrongdoing and take appropriate remedial action, without the need to use scarce public enforcement resources to conduct lengthy, expensive and often cumbersome investigations. Accordingly, the public interest is better served by an approach that embraces and endorses these internal reporting programs. The Commission has attempted to do this, in part, through its requirement that prospective whistleblowers allow internal review processes to proceed for a period of 90[1] days before reporting to the SEC.

Fundamentally, ECPs are intended to establish corporate cultures that promote prevent, detect and resolve instances of wrongful conduct, including violations of U.S. federal and state securities law, as well as the company's ethics and other business policies. In practice, ECPs should effectively articulate and demonstrate the company's commitment to the ethics and compliance process. The existence of benchmarks that demonstrate implementation and achievements are essential to any effective ECP. Eventually, an

[1] Note below that I believe that a 90-day period is too brief and should be extended to a minimum of 180 days if this concept is to remain.

effective ECP should become part of the fabric of the company. Specifically, ECPs guide a company's governing body (*i.e*., its boards of directors), senior executives and other employees in the efficient management and operation of the company. They have been especially critical as an internal control in the healthcare reimbursement and payment areas, where claims and billing operations are often the source of fraud and abuse and, therefore, historically have been the focus of government regulation, scrutiny and sanctions.

It is incumbent upon a company's directors and executives to provide ethical leadership to the company and to ensure that adequate systems are in place to facilitate ethical and legal conduct. Indeed, many companies have adopted mission statements articulating their commitment to high ethical standards. A formal ECP, as an additional element in this process, offers a central coordinating mechanism for furnishing and disseminating information and guidance on applicable federal and state statutes, regulations and other requirements. Adopting and implementing an effective ECP requires a substantial commitment of time, energy and resources by senior management and the company's governing body.[2] Hastily constructed and implemented programs that do not include appropriate ongoing monitoring will likely be ineffective and could result in greater harm or liability to a company than no program at all. While it may require significant additional resources or reallocation of existing resources to implement an effective ECP, many believe that the long term benefits of implementing such a program outweigh the costs; however, how the Commission interlaces these ECPs with its whistleblower initiative will, no doubt, have some effect on how companies approach the implementation of ECPs in the future.

The Commission's rules are not likely to result in "not discouraging" employees from first reporting potential securities violations in accordance with a company's ECP. The most effective way to encourage whistleblowers first to report violations to appropriate company personnel is to require them to do so as a <u>condition</u> to receiving awards under the proposed rules. Such a requirement would have no negative effects on either the purpose or intentions of the proposed rules. Companies would be given an opportunity to cure or mitigate potential violations; meanwhile, the whistleblower would remain protected by the anti-retaliation provisions in Dodd-Frank. The proposed rules, however, will encourage opportunistic whistleblowers to report violations to the Commission before a company is provided the opportunity to address the matter itself.

Under the proposed rules, an employee who first provides information to the company's legal or compliance personnel must report the information to the Commission within 90 days to preserve his or her ability to receive a whistleblower award. Although the Release notes that the Commission "will consider higher percentage awards for whistleblowers who first report violations through their compliance programs," it is questionable whether such uncertain "consideration" will cause a whistleblower to jeopardize an award altogether by first reporting a violation to the company. Instead, whistleblowers are

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[2] Indeed, case law suggests that the failure of a corporate director to attempt in good faith to institute a compliance program in certain situations may be a breach of a director's fiduciary obligations. *See, e.g., In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996).

more likely to be influenced by the Commission's assurances that they "will not be penalized" for failure to first report the matter internally, so long as they are able to articulate some "fear of retaliation" or other "legitimate" excuse. The "safeguards" included in the Release "not to discourage" employees from first reporting potential violations in accordance with internal ECPs simply do not provide sufficient incentives to employees to report potential wrongdoing to the company first.

Further, although the Release notes that "in appropriate cases" the Commission "expect[s]" to give companies notice of reported violations and an opportunity to conduct an investigation and report back to the Commission before it commences an investigation, the proposed rules themselves do not contain this concept; therefore, companies have little to no certainty that they will gain notice of an alleged violation at the earliest possible time. The Commission should not be relegated to the *de facto* whistleblower hotline for every public[3] company in the United States when there is no way, with its limited resources, that the Commission will be able to differentiate credible from non-credible reports of purported violations. Corporate governance will not be served by rules that allow companies to be kept in the dark about their own alleged violations. The Commission's efforts to ensure compliance with the federal securities laws will be most effective by promulgating rules that respect and support the efficacy of internal ECPs.

Perhaps whistleblowers could be exempted from the internal reporting requirement if their company lacks a trustworthy program, or if there are truly compelling and extraordinary reasons why internal reporting is not appropriate. Given the widespread availability of anonymous reporting mechanisms in many companies, such circumstances should be rare. If an internal investigation did not reach a conclusion within a reasonable time (90 days in the proposed rules), the whistleblower would be free to report the matter to the Commission and still be eligible for a bounty. As a practical matter, in many cases, companies would likely determine to make their own report to the Commission, at which time the company could also disclose to the Commission the whistleblower's report and ask the Commission to await the completion of the internal review before commencing an investigation.

Indeed, the Commission clearly intends to continue its own practice of relying on companies to conduct internal investigations. As explained in the Release, in many instances, the Commission intends to refer whistleblower complaints to the employer for review and a report back to the Commission of findings:

> We expect that in appropriate cases, consistent with the public interest and our obligation to preserve the confidentiality of a whistleblower, our staff will, upon receiving a whistleblower complaint, contact a company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back.

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[3] As noted below, the whistleblower rules technically extend to conduct that could occur within the confines of a private (*i.e.*, non-public) company.

This is a sound and prudent approach to handling many whistleblower claims, and one that the Commission should employ whenever possible. Employers who respond to such inquiries by conducting a thorough and balanced investigation will be in the best position to resolve any issues identified. Moreover, the Commission staff should be instructed to extend substantial deference to ongoing internal investigations irrespective whether the company has self-reported or is conducting an investigation in response to an inquiry from the Commission.

Deferring to effective ECPs is consistent with the Commission's acknowledgement in the Release that "many employers have compliance processes that are well-documented, thorough and robust, and offer whistleblowers appropriate assurances of confidentiality. . . ." Proposed Rule 21F-4(a)(2) recognizes the important role of corporate legal and compliance functions in providing that a whistleblower is not eligible for a bounty payment if the whistleblower report occurs after the employer received a request for information on the same subject matter from the Commission or other investigative or regulatory authorities. That rule provides an exception only when the employer has failed to provide the whistleblower's documents or information to the investigative body in response to the prior request "in a timely manner."

Requiring internal reports to precede submission of a whistleblower report to the Commission would permit companies with strong ethics and compliance cultures to investigate and identify instances of wrongdoing, stop any improper activities and take other appropriate remedial actions. This approach allows the continued effective functioning of ECPs in which companies have invested tremendous resources; give such companies appropriate "credit"[4] with the Commission for their efforts, including self-reporting and also allow whistleblowers to claim a bounty, with their "original information" status dating back to the time of their internal report. Requiring internal reporting also would better align the whistleblower rules with policies under the Sarbanes-Oxley Act, the Guidelines and the Department of Justice Principles of Federal Prosecution of Business Organizations, all of which encourage companies to maintain robust ECPs.

For these reasons, whistleblower awards should be available only to those who report potential violations in accordance with the company's internal ECP prior to reporting that violation to the Commission.

The Ninety (90) Day Relation-Back-Period Should Be Lengthened and the Whistleblower Given Some Incentive to Utilize the Internal Reporting Mechanism Prior to Reporting to the Commission (Request for Comment No.* 17*)

In order to be eligible for a Dodd-Frank Section 922 bounty payment, a whistleblower must provide "original information" to the Commission, defined as information that the Commission has not previously obtained from another source. This

[4] This is consistent with the purpose of ECPs under the Guidelines under which companies receive "credit" toward sentencing if they have effective ECPs.

requirement obviously creates a substantial financial incentive for whistleblowers to go directly to the Commission, rather than voicing their concerns internally, so as not to jeopardize their eligibility for a bounty by running the risk that another employee – or even the corporate employer itself – might report the matter to the SEC first. The Commission is to be commended on its attempts to address this issue through Proposed Rule 21F-4(b)(7), which provides that a whistleblower's report to the SEC will relate back to the date of the whistleblower's internal report to a corporate legal, compliance, audit or similar function, provided that the whistleblower contacts the SEC within 90 days of having reported internally.

There are two problems with the Commission's approach. First, the 90-day period contemplated by the proposed rules is unrealistically short for all but the simplest internal inquiries. A 180-day period would be more reasonable, although even that amount of time will often be insufficient for a thorough and balanced investigation to be completed.

Second, the currently proposed 90-day provision only removes – for a short time – the incentive for a whistleblower to race in to the Commission. It stops short of providing any incentive for the whistleblower to use internal corporate reporting mechanisms. Although the Release indicates that the Commission will consider increasing the bounty payments for whistleblowers who initially report their concerns through the applicable corporate compliance program, that is a speculative and weak incentive, if it is an incentive at all. A more productive message would be sent by (1) requiring employees first to use internal compliance mechanisms, absent extraordinary circumstances, as indicated above; and (2) allowing a more reasonable time for the internal process to proceed before the employee becomes eligible for whistleblower status with the SEC. Finally, the Commission should consider revising the proposed rules to establish a presumption that a whistleblower who makes full disclosure internally and waits for the waiting period (currently 90 days) to expire while the internal investigation proceeds will receive a bounty at the high end of the statutory 10% to 30% range.

How the Commission Can Encourage Companies to Implement Robust Ethics and Compliance Policies (Request for Comment No.* 18*)

There are many incentives for companies to adopt robust ECPs:

- They can prevent loss of business (*e.g.*, suspension, debarment)
- They can avoid/mitigate the effects of a federal criminal prosecution (the "Holder/Thompson/McNulty memos")
- They may negate "knowledge" under the False Claims Act
- They can shield directors from personal liability (*Caremark; Stone v. Ritter*)

Often overlooked, however, is the *basic* reason to adopt robust ECPs – they can be useful in detecting and preventing criminal and other improper activity. There is no single "best" ECP, given the diversity among and within industries. Every effective ECP, however, must begin with a formal commitment by the company's governing body to include all of the applicable elements listed below, which are set forth in Guidelines:

(1) The organization must establish standards and procedures to prevent and detect criminal conduct.

(2) (A) The organization's governing authority must be knowledgeable about the content and operation of the ECP and must exercise reasonable oversight with respect to the implementation and effectiveness of the ECP.

(B) High-level personnel of the organization must ensure that the organization has an effective ECP, as described in the Guidelines. Specific individual(s) within high-level personnel must be assigned overall responsibility for the ECP.

(C) Specific individual(s) within the organization must be delegated day-to-day operational responsibility for the ECP. Individual(s) with operational responsibility must report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the ECP. To carry out this operational responsibility, those individual(s) must be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

(3) The organization must use reasonable efforts not to include within the "substantial authority personnel" (those persons with substantial discretionary authority) of the organization any individual who the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective ECP.

(4) (A) The organization must take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the ECP, to the individuals referred to in (4)(B) below by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities.

(B) The individuals referred to in (4)(A) above are the members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents.

(5) The organization must take reasonable steps—

(A) to ensure that the organization's ECP is followed, including monitoring and auditing to detect criminal conduct;

(B) to evaluate periodically the effectiveness of the organization's ECP; and

(C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

(6) The organization's ECP must be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the ECP; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

(7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's ECP.

I believe that the following steps could be taken by the Commission in order to encourage companies to implement robust ECPs that, in turn, allow companies the benefits suggested above in the handling of whistleblower reports under the Commission's rules:

(1) Make the ECPs an integral part of the Commission's whistleblower initiatives. Corporations are supposed to be self-regulating and self-regulation should be embraced and given an opportunity to have an effect before the government intercedes.

(2) Formally adopt the seven elements from the Guidelines as the Commission's "template" for an effective ECP. This has been done by other agencies, such as the Department of Health and Human Services[5]. Adoption of the elements of an ECP would not be a new matter under the federal securities laws. Indeed, Section 406 of the Sarbanes-Oxley Act required the Commission to promulgate rules requiring companies to disclose whether they had adopted codes of ethics for senior financial officers and if not, why not. Sarbanes-Oxley Section 406(c) went on to define what such a code of ethics consisted of.

(3) Require, similar to the disclosure already required in Item 406 of Regulation S-K, disclosure[6] whether the company has adopted an ECP that addresses the seven elements of the Guidelines and if not, why not.

(4) Require, similar to the disclosure required in Item 407(d)(5) of Regulation S-K[7], whether the company has an Ethics and Compliance Officer who reports directly to the

[5] 68 Federal Register 23,731 (May 5, 2003); 65 Federal Register 59,434 (Oct. 5, 2000).
[6] Technically, the Commission may only require such disclosure as well as that in number (4) below by companies that are subject to the federal securities laws. The whistleblower rules, however, extend to conduct that could occur within the confines of a private (*i.e.*, non-public) company. In these situations, the Commission could allow for voluntary disclosure by such companies in some public format, such as on a website.

governing body (or an appropriate committee thereof) and if not, why not. The 2010 amendments to the Guidelines, while not technically adding this requirement to the elements of an ECP, did add this as an element to be considered in mitigating the sentence of an organization under the Guidelines. It would also be similar to the requirements of companies to disclose why their governance structure (*i.e.*, whether the Chairman and CEO are the same or different persons) is appropriate.

I appreciate this opportunity to comment on these important issues and ask the Commission to consider these comments. I also would be pleased to respond to any questions that the Commission or its Staff might have.

Very truly yours,

Gary M. Brown

[7] That disclosure requirement implements the requirements of Section 407 of the Sarbanes-Oxley Act to disclose whether a company has an "audit committee financial expert" and, if not, why not.