THE AGUIRRE LAW FIRM

BY FACSIMILE, EMAIL AND FIRST CLASS MAIL

December 17, 2010

Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F St. N.E.
Washington, D.C. 20549

Dear Chairman Schapiro:

I am submitting this letter to express my deep concern that the Securities and Exchange Commission's proposed practices and rules, as articulated in its November 3, 2010, release (titled "Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934") will neutralize the most valuable tool Congress created for the Commission to protect the nation's capital markets. I refer to whistleblower provisions (Sections 922 through 924) of the Dodd-Frank Act.

Introduction

Not surprisingly, attorneys for regulated entities and public companies have aggressively lobbied the Commission to adopt practices and regulations which would defeat the spirit, letter and objectives of the whistleblower provisions (Sections 922 through 924) of the Dodd-Frank Act. These provisions are designed to encourage whistleblowers to *voluntarily* provide the Commission with *original information of major violations* of the federal securities laws, while protecting them from reprisal.

The ferocity and tone of Wall Street's attack on the whistleblower provisions belies the obvious. For decades, Wall Street—its big banks and large hedge funds—have had free reign to abuse the nation's financial markets through insider trading and market manipulation. More recently, Wall Street brought the nation to the edge of a global financial meltdown by gaming the markets with tens of trillions of dollars in arcane derivatives, more akin to the bets placed in VIP rooms along the Las Vegas strip than the movement of capital through stable financial channels that fuel the nation's economy.

In the past, the Commissioner has frequently complained to Congress that it has been unable to uncover the hard evidence necessary to prove the violations of the securities laws that undermine the integrity of the nation's financial markets, such as proof of institutionalized insider trading by large hedge funds. Likewise, with rare exception, the Commission has failed to file cases against those individuals and institutions whose fraudulent activity caused the nation's worst financial crisis in almost eight decades. Indeed, the SEC lost the *only* case it filed for using

THEAGUIRRELAWFIRM.COM
501 W. BROADWAY, SUITE 800
SAN DIEGO, CA 92101-3546
PHONE: 619-269-9778

GARY@AGUIRRELAWFIRM.COM
445 S. FIGUEROA STREET, SUITE, 2700
LOS ANGELES, CA 90071
FAX: 619-501-7072

material and confidential information in trading credit default swaps. The use of insider information by hedge funds in trading credit default swaps with the nation's largest banks may in part explain how those banks were consistently on the wrong side of those trades, a key dynamic in causing the financial crisis. To its credit, the FBI has recently used wiretaps in the Galleon insider trading investigation to obtain the necessary evidence.

Congress's answer to the financial crisis was the Dodd-Frank Act. As part of that Act, it empowered the Commission with a new tool, the whistleblower provisions, to obtain exactly the type of evidence the Commission needs to civilly prosecute the major Wall Street players who gave us the last crisis, before they can give us a new one. Now the Commission can obtain critical evidence of securities violations *before* those violations cause harm to investors, such as the Madoff Ponzi scheme, or cripple the nation's markets, as the big banks did with ABS-MBS-CDS frauds.

As enacted, those provisions reduce to two elements: (1) financial incentives for the whistleblowers to step forward and (2) protections from reprisal for doing so. Wall Street's proposals attack both elements. In the past, there has been little incentive for these individuals to step forward and considerable disincentive to do so, since whistleblowing is often a career ending experience. It is an excellent application of the old adage: "No good deed goes unpunished."

In general, I would adopt the arguments urged by the National Whistleblowers Center (NWC) as stated in its letters of November 1, 2010 and November 22, 2010, as well as those urged in the Project on Government Oversight's December 17, 2010, submittal. In the interest of brevity, I will not repeat those arguments here.

I do wish to emphasize one argument urged in POGO's submittal. In particular, I have concern regarding the Commission's decision to provide information from the whistleblower's complaint to the companies which are the subject of the whistleblower's complaint (Subject Companies) before the Commission conducts its own investigation. Further, I understand the Commission may not conduct any investigation if the subject company conducts an internal investigation clearing the company. It is hard to conceive how the Commission could engage in this practice without violating express provisions of the Dodd-Frank Act requiring it and its employees to maintain the confidentiality of the whistleblower. It is disturbing that the Commission would emasculate the most powerful weapon Congress granted the Commission to contain Wall Street abuses. It of course raises the obvious question: Who is the Commission protecting investors or Wall Street?

The Dodd-Frank Act Protects Whistleblowers

With narrow exceptions, Section 922(h)(2) states the general rule: "The Commission and any officer or employee of the Commission shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower …" This was Congress's clear and unequivocal message statement to the Commission: *You must protect whistleblowers!*

The Commission's Proposed Practice Would Violate Section 922(h)(2)

In reviewing the commentary to the regulations, I came across the following statement:

> We emphasize, however, that our proposal not to require a whistleblower to utilize internal compliance processes does not mean that our receipt of a whistleblower complaint will lead to internal processes being bypassed. 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.

Curiously, the Commission's preliminary regulations did not describe under what circumstances it would provide the information obtained from the whistleblower to a Subject Company, what statements would be provided to the company, or how it would protect the identity of the whistleblower. The failure of the Commission to articulate in any rule how it would furnish information from a whistleblower to a Subject Company, without disclosing the identity of the whistleblower, strongly suggests it has no practical plan how this could be done. I can think of no way this could be done.

Also, the lack of regulations permits anonymous staff to employ whatever subjective criteria they feel are appropriate in releasing this information. This is particularly troublesome in view of the historical hostility senior Commission staff have demonstrated through their comments and acts *towards external and internal whistleblowers*, as described in reports by its own inspector general. Moreover, since industry professionals cycle in and out of the Commission, senior Commission officials may have concerns regarding possible complaints from whistleblowers *about them*, whether from their last position in the financial industry or when they revolve back out into the industry. For many if not most senior SEC officials, their time at the Commission is merely a sabbatical between multi-million dollar jobs defending the financial industry.

In this context, I bring to your attention the statement of Enforcement Director Robert Khuzami at the Practicing Law Institute Securities conference in New York on November 12, 2010. Mr. Khuzami offered his view how the Commission would process whistleblower complaints under the Dodd-Frank Act as follows:

> I am sure that it will be not uncommon, in the appropriate case, to contact the company and indicate that we have received this [the details of the whistleblower's complaint] and have them undertake at least the same kind of initial review that they would currently do or hopefully that they would have done even if it had never come to our attention and it had stayed within the company. And then, we'll analyze and evaluate that effort based on the traditional criteria and if we feel that it's been thorough and complete and honest and candid, the likelihood of us independently conducting that review is lessened, if we have reason to think otherwise, then we may conduct our own review.

It is hard to imagine how the disclosure of such information to a Subject Company would not reveal the whistleblower's identity. By way of example, in May 2010, the Commission filed an insider trading case against Pequot Capital Management and his Chief Executive Officer, Arthur Samberg, for trading in Microsoft securities during April 2001. Had this information been provided to the Commission from a staff member within Pequot, and had the Commission given that same information back to Pequot, it would have taken little time for Pequot management to ferret out the whistleblower, eventually fire him on some pretext, and then blackball him within the industry.

Please note that the Commission claims in its administrative proceeding against Mr. Zilkha that Mr. Samberg paid hush money to Mr. Zilkha so he would remain silent. Given that fact, can there be any question to what extremes Pequot and Mr. Samberg would have gone to find the internal whistleblower who gave information to the Commission?

Further, Samberg's and Pequot's attorneys, Fried Frank, demonstrated that they were willing to do virtually anything to derail the Commission's investigation. According to Fried Frank's lead partner, Pequot paid its attorneys $31 million to fight the Commission's investigation. And you can expect that millions of dollars will be spent by any regulated entity to disapprove the claim of a whistleblower. That kind of money buys excellent internal studies that inevitably find the Subject Company did no wrong. Are you not aware of this? Is Mr. Khuzami unaware of this practice?

Mr. Khuzami's statement that the Commission will send the whistleblower's allegations to the Subject Company without an investigation assumes the company has committed no violations. If the Commission sends a whistleblower's complaint back to a Pequot-style hedge fund, it will likely destroy his or her future. In essence, the Commission's and Mr. Khuzami's proposed practice assumes as a practical matter that the whistleblower's complaint is groundless. This is exactly the assumptions the Commission made when it repeatedly rejected the complaints of Harry Markopolos that Bernard Madoff was bilking billions from his investors. It would seem that the Commission should have learned its lesson after that colossal failure.

The Revolving Door

Some have expressed concern how the Commission will protect the identity of whistleblowers as high level Commission officials rotate back to the financial industry and potentially to companies where whistleblowers who provided information to the Commission are employed. I also share this concern, but I have an additional concern. It appears that Mr. Khuzami as the head of the Division of Enforcement and Adam Storch, who has supervisory responsibility for the Office of Market Intelligence, will jointly have considerable responsibility for the new whistleblower program. Both come directly from large banks which were deeply involved in the ABS-MBS-CDS fraud that delivered the financial crisis. In Mr. Khuzami's case, he supervised the attorneys who were involved in this process. Does it make sense to place the responsibility of the whistleblower program in the hands of those who have such close connections to the institutions which were responsible for the financial crisis?

Commission's Liability for Effectuating Practices that Violate the Dodd-Frank Act.

The Commission proposed practices as stated in the commentary quoted above and amplified by Mr. Khuzami's presentation on November 12, 2010, violate Section 922(h) of the Dodd-Frank Act. Further, I believe this unlawful practice would warrant both injunctive relief and, if effectuated, a private action for damages by any whistleblower harmed by the Commission's unlawful conduct.

Injunctive relief

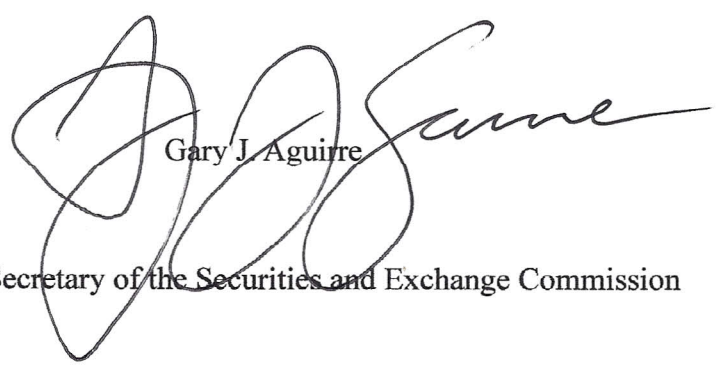
It is a well-developed equitable principle that a party who may be harmed by a threatened unlawful practice may seek injunctive relief. *Thomas v. Washington County School Bd.*, 915 F.2d 922, 925 (4th Cir. Va. 1990). I would expect firms representing whistleblowers to initiate such litigation against the Commission if it does not renounce its proposed practice.

Claims for Damages

The Dodd-Frank Act prohibits the Commission from releasing "any information, including information provided by the whistleblower to the Commission, which could be reasonably be expected to reveal the identity of the whistleblower." As the Supreme Court held in *Berkovitz v. United States*, 486 U.S. 531, 536 (U.S. 1988), "[T]he discretionary function exception [to the Federal Claims Statute] will not apply when a federal statute, regulation, or policy specifically prescribes a course of action for an employee to follow. In this event, the employee has no rightful option but to adhere to the directive." Accordingly, the disclosure of information by the Commission which may harm a whistleblower, e.g., cause his discharge, would not be barred by Federal Tort Claims Act. Further, the Commission would also be responsible should the harm end the whistleblower's career. Given the fact that some whistleblowers may be in high paying positions within the financial industry, the damages could easily run into the millions of dollars. Madoff victims are now suing the Commission for tens of billions of dollars. Is the Commission unable to learn anything from its prior blunders?

For the reasons stated above, I request the Commission to publically renounce its proposed practice of sending information provided by whistleblowers to the Subject Companies, as stated in its November 3, 2010, release, and articulated by Mr. Khuzami during his November 12, 2010, presentation to securities lawyers. I also urge the Commission to issue regulations informing all Commission employees that a staff member will be disciplined if he or she provides information to a Subject Company "which could reasonably be expected to reveal the identity of a whistleblower ..." I also join in the NTC's and POGO's requests that the Commission protect whistleblowers in other ways specified in their submittals.

Sincerely,



Gary J. Aguirre

CC: Elizabeth M. Murphy, Secretary of the Securities and Exchange Commission