New York
Menlo Park
Washington DC
London
Paris
Madrid
Tokyo
Beijing
Hong Kong

Davis Polk

Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, NY 10017

212 450 4000 tel
212 701 5800 fax

December 17, 2010

Re: Comments on Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

File Number S7-33-10

VIA E-MAIL: rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Ms. Murphy:

We are submitting this letter in response to the solicitation by the Commission of comments on the proposed rules set forth in Release No. 34-63237 implementing the whistleblower provisions of Section 21F of the Exchange Act.

We appreciate the opportunity to comment on the release. We recognize the Commission's efforts to craft a release that balances the goal of maximizing the submission of high-quality tips with an acknowledgement that the proposed rules should not (1) reward persons who are themselves culpable in wrongdoing or responsible for preventing and reporting misconduct or (2) undermine internal corporate processes already in place to prevent and resolve misconduct. The Proposed Rules, however, have not fully addressed the intrinsic conflicts that exist as a result of the significant financial and other incentives inherent within the whistleblower provisions. In order to implement the whistleblower provisions in a way that is effective, fair and balanced, we believe the rules should:

- Define "whistleblower" and the resulting eligibility for award and protection from retaliation under the statute to include only those who, in good faith, provide specific and substantiated information about the material misconduct of others without having a prior obligation or responsibility to do so. Those persons who are (1) themselves culpable or complicit in the misconduct or (2) responsible for maintaining an entity's ethical conduct and/or reporting and addressing misconduct, such as those with governance, legal, audit

or compliance duties, should not be included within the threshold definition of "whistleblower" and should not be eligible for an award or protection from retaliation. This should include all members of an entity's senior management since all officers and directors are tasked with compliance responsibilities.

- Require and promote the use of internal compliance systems as the first and foremost method of addressing misconduct. The Commission will be more successful and efficient in ferreting out wrongdoing if it can utilize the information obtained through effective internal compliance programs to eliminate frivolous claims and assist it in investigations. Undermining or hindering these systems will increase the Commission's burden and distract it from proactively assessing and pursuing other instances of wrongdoing, which will ultimately be detrimental to both whistleblowers and shareholders. In order to protect and promote internal corporate compliance systems, the rules should:

    - exclude from the definition of "whistleblower" a person who has had access to an internal compliance system and who has failed to exhaust appropriate procedures under that system before reporting his or her complaint to the Commission;

    - require the Commission to contact a company upon receipt of a report of misconduct and provide the company with an opportunity to investigate the misconduct and report back, absent exceptional circumstances; and

    - allow corporations sufficient time to perform internal investigations without imposing a 90-day or other arbitrary deadline for the whistleblower to report an internally reported complaint to the Commission.

We further discuss these key principles below.

1. "Whistleblower" Should be Defined to Exclude Those Who are Culpable or Complicit in Wrongdoing. Only Those Who, in Good Faith, Provide Specific and Substantiated Information about the Material Misconduct of Others Should be Eligible for Awards and Protection from Retaliation.

Persons who are themselves culpable or complicit in potential wrongdoing should not be entitled to an award or protection from retaliation under the whistleblower provisions in any circumstance.

The whistleblower provisions provide that no award shall be made to any whistleblower convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award. The proposed rules also provide that for purposes of making any award, the Commission will not take into account any monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on the conduct that the whistleblower directed, planned or initiated. Similarly, if the Commission determines that a whistleblower is eligible for an award, any amounts that the whistleblower or such an entity pay in sanctions as a result of the action or related actions will not be included within the calculation of the amounts collected for purposes of making payments.

Although these provisions recognize the key principle that culpable parties should not benefit from their misconduct, the proposed rules do not sufficiently address this principle, particularly

with respect to the protection against retaliation. First, the proposed rules only exclude from award eligibility any sanctions that a whistleblower is ordered to pay or an entity is ordered to pay for liability that is "based substantially on conduct that the whistleblower directed, planned or initiated." While not entirely clear, this could allow an employee to collect an award for reporting misconduct that he or she participated in to a lesser degree, of which he or she is aware of but does nothing about, or conduct by others that is related to misconduct by the employee. This incentivizes an employee who is a minor participant in misconduct or who learns of others' misconduct not to prevent or report the misconduct internally, so that he or she can collect an award from the Commission. It could also prevent the company's discipline of the employee even if he or she fails to report the misconduct internally. Most corporate codes of conduct and internal compliance programs require employees to follow the code and report instances of suspected misconduct. An employee's failure to comply with these responsibilities should not be rewarded or protected under the rules.

In addition, the proposed rules provide that the retaliation protections apply irrespective of whether a whistleblower satisfies the procedures and conditions to qualify for an award. This suggests that a person who had engaged in but reported substantial misconduct, and is therefore ultimately disqualified from receiving an award, could be protected from retaliation by the company in connection with the misconduct. The rules should not discourage a company from disciplining and possibly terminating employees due to their misconduct. Culpable parties already have incentives to report their own misconduct in return for leniency. Accordingly, the rules should be modified to exclude from the definition of "whistleblower" culpable parties and those who are aware of misconduct yet fail to report it internally. This would prevent culpable and complicit persons from being eligible for an award or protected under the retaliation provisions.

Persons with governance, legal, compliance or audit responsibilities for an entity and those who obtain information through these channels should not be considered "whistleblowers" or entitled to awards or protection under the whistleblower provisions.

The proposed rules provide that certain information will not be deemed to result from independent knowledge or analysis, and therefore will not be eligible for a whistleblower award, if obtained by persons responsible for an entity's legal, compliance, audit or governance or through these channels. These persons will be eligible for an award under the whistleblower provisions, however, if the entity does not disclose the information to the Commission within a reasonable time or proceeds in bad faith. What constitutes a "reasonable time" is not defined in the proposed rules, and the release indicates that this will be a flexible concept that will depend upon the facts and circumstances of a particular case. The release also notes that in some cases a "reasonable time" for disclosing violations to the Commission could "be almost immediate," although the determination will be made after the fact.

Persons with legal, compliance, audit, supervisory or governance responsibilities or those who obtain information through these channels should not be eligible for awards under any circumstance. The rules should exclude these individuals from the definition of "whistleblower" to make this clear. The rules should also make it clear that this category includes those persons responsible, directly or indirectly, for the certification and internal control reporting requirements of the Sarbanes-Oxley Act. A significant and sometimes sole purpose of these positions and procedures is to ensure an entity's compliance with rules and regulations. Persons in these roles are therefore obligated to promote a culture of compliance and to utilize internal procedures and

systems to address and report instances of noncompliance. This duty to promote corporate compliance from within exists irrespective of the time involved or the existence of bad faith by others. Unless persons with these responsibilities are excluded from the definition of whistleblower absolutely, they will have a financial incentive to ignore or be apathetic about potential instances of noncompliance so that they can ultimately report them to the Commission.

Only persons who, in good faith, provide specific and substantiated information about the material misconduct of others should qualify as "whistleblowers." Those who provide frivolous or unsubstantiated information that is not based on first-hand knowledge should not be entitled to protection from retaliation.

The proposed rules set forth several conditions that must be met in order for a person to be eligible for an award under the whistleblower provisions, many of which relate to the quality of information provided by the whistleblower. Yet the proposed rules set forth few conditions that must be met in order for the retaliation protection to apply. Placing little to no conditions on protection under the retaliation provisions is overly protective and invites a flood of frivolous complaints from employees who have nothing to lose. An employee who is concerned about impending disciplinary actions or termination by his or her employer may be incentivized to report any claim, no matter how small, irrelevant or unsubstantiated, to the Commission in order to gain protection from retaliation under the statute. Such an employee may also be incentivized to seek out and report to the Commission information about ongoing internal investigations that the company is not yet in a position to report. Other employees may report information based entirely on rumors or hearsay without any first-hand knowledge of the misconduct and/or without making any effort to confirm the validity of the allegations. Not only should this type of conduct not be protected, it will place a substantial burden on the Commission to respond to a multitude of potentially frivolous complaints. In order to prevent abuse of the protections offered by the statute and ensure that the Commission receives high quality tips, only persons who, in good faith, submit specific and substantiated information about material misconduct should meet the definition of "whistleblower" and be entitled to retaliation protection. Those who provide frivolous or unsubstantiated information that is not based on first-hand knowledge should not be entitled to protection from retaliation.

2. The Definition of Whistleblower Should Exclude a Person Who Has Had Access to an Internal Compliance System and Who Has Failed to Exhaust Appropriate Procedures under that System before Reporting His or Her Complaint to the Commission.

Both whistleblowers and shareholders benefit from effective corporate compliance programs. These programs, when operating effectively, provide an opportunity for whistleblowers to report wrongdoing in an environment best suited for a quick and comprehensive investigation. They also ensure that a corporation has the means to investigate and remedy potentially unlawful behavior. Internal whistleblower complaints are typically taken very seriously and subject to internal investigations that are both thorough and immediate, often with the assistance of outside counsel. Due to their inside knowledge of the corporation and immediate access to employees and reports, compliance officers are in a unique position to understand and investigate any potential complaints quickly and accurately.

Even with the best intentions, the Commission will not be able to act on a whistleblower's report of misconduct as quickly or as easily as a corporation can internally or with the assistance of outside counsel. Upon receipt of a complaint, the Commission must first assess the validity of

the complaint and more often than not it will need to contact the corporation for access to information and develop an understanding of the conduct involved. To date, the Commission has reportedly received at least one whistleblower complaint per day and the volume of complaints is expected to rise given the significant financial incentives involved. The Commission staff, even if expanded considerably, is unlikely to be able to keep up with this volume of complaints on a timely basis without substantial cooperation from internal corporate resources. Initial internal investigation of complaints will be an effective method for determining the validity of claims of wrongdoing and pushing valid claims forward. Alternatively, if corporate compliance programs are marginalized and wither unused, whistleblower complaints will likely sit in a long queue at the Commission and it will be forced to spend significant resources on the initial investigation of each complaint, even those that ultimately turn out to be without merit. This will provide less time for the staff to focus on those complaints that are substantial and deserve considerable attention and will also prevent the Commission from anticipating and pursuing other enforcement agenda items, which will ultimately harm both whistleblowers and shareholders.

The Sarbanes-Oxley Act requires audit committees of listed companies to establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal auditing controls or auditing matters and for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters. It also protects whistleblowers from retaliation, discrimination and other adverse employment actions in connection with their submission of an internal whistleblower complaint. In light of these requirements, companies have spent considerable time and expense to develop procedures that ensure that whistleblowers have a safe and effective internal mechanism for submitting complaints. These statutorily required systems are rendered superfluous if not used, yet given the substantial awards available under the whistleblower provisions for reporting directly to the Commission, there is little incentive for whistleblowers to first report under these internal mechanisms even when they are uncertain of the validity of their claims. In order to prevent whistleblowers from disregarding these statutorily required systems, the final rules must exclude from the definition of "whistleblower" a person who has had access to an internal compliance system and who has failed to exhaust appropriate procedures under that system before reporting his or her complaint to the Commission. This would preserve the utility of internal compliance systems and reduce the number of frivolous claims ultimately submitted to the Commission. Such a requirement would not significantly disadvantage valid whistleblowers because of (1) safeguards against retaliation for internal reporting contained in the Sarbanes-Oxley Act and the whistleblower provisions and (2) the provisions in the proposed rules that permit whistleblowers who first report through their internal compliance systems to preserve their status as the original source of information (and therefore their eligibility for an award) and ultimately report their claims to the Commission.

3. The Commission Should First Contact the Company Upon Receipt of a Report of Wrongdoing and Allow the Company to Investigate and Report Back.

Absent exceptional circumstances and in accordance with the confidentiality restrictions in the whistleblower provisions, companies should be given notice that the Commission has received a complaint and allowed to investigate the complaint and report back to the Commission. As discussed above, in most cases companies will be better suited than the Commission to conduct an internal investigation of alleged wrongdoing quickly and accurately. Allowing companies to conduct a thorough investigation of potential wrongdoing will enable the company to report actual violations to the Commission with a full record of the conduct, while preventing a flood of

meritless claims from overwhelming the Commission. In addition to reducing the Commission's burden with respect to potentially frivolous claims, early notification to the company will allow it to address the potential problem before it reaches a more serious stage, thereby reducing the potentially disruptive pressure a more formal Commission inquiry can have on a company.

4. The Rules Should Not Impose an Arbitrary Deadline for a Whistleblower's Reporting to the Commission After Internally Reporting the Complaint.

The proposed rules allow whistleblowers who provide information about potential violations through internal compliance procedures to preserve their status as the original source of information (and therefore their eligibility for an award) as of the date the information is provided internally so long as they submit the necessary forms to the Commission within 90 days. In order to maximize the utility of this provision, the rules should not require that the complaint be provided to the Commission within 90 days. Such a deadline is unnecessary given the whistleblower's significant financial incentive to ultimately report the misconduct to the Commission and would put undue pressure on the company to quickly verify or discredit the complaint rather than undertake a comprehensive internal investigation. We can also envision a situation in which an unscrupulous employee could use this deadline as a bargaining chip in his or her efforts to negotiate some sort of employment settlement with the corporation without giving it a chance to fully vet the potential whistleblower's accusations. The date of the internal complaint will need to be adequately documented, whether or not a specific deadline exists, and this internal document can be used to assess the whistleblower's eligibility for an award.

* * *

The Commission has recognized in the proposed rules that certain persons are not entitled to the benefits and protections afforded by the whistleblower provisions and that effective implementation of the whistleblower provisions will depend upon and must coexist with the successful operation of internal corporate compliance programs. The proposed rules, however, do not go far enough in supporting and promoting these important principles. The rules should define "whistleblower" to include only those persons who, in good faith, provide specific and substantiated information to the Commission about the material misconduct of others. Persons who are themselves culpable or complicit in the misconduct or are responsible for preventing or reporting misconduct should not qualify as whistleblowers under the rules or be eligible for awards or protection from retaliation. In addition, in order to prevent the Commission from being overwhelmed by a flood of meritless claims and preserve the integrity and utility of corporate compliance programs, the rules must (1) exclude from the definition of "whistleblower" a person who has had access to an internal compliance system and who has failed to exhaust appropriate procedures under that system before reporting his or her complaint to the Commission; (2) require the Commission to contact companies upon receipt of a complaint and (3) allow companies sufficient time to perform internal investigations, absent exceptional circumstances. The incorporation of these important principles into the rules will result in faster and better investigation and resolution of misconduct, which will ultimately benefit valid whistleblowers and shareholders.

We would be pleased to discuss our comments or any questions the Commission may have with respect to this letter. Any questions about this letter may be directed to William Kelly at 650-752-2000, Richard Sandler at 212-450-4000 or Linda Chatman Thomsen at 202-962-7000.

Very truly yours,

DAVIS POLK & WARDWELL LLP