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Via e-mail to: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

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

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee" or "we") of the Section of Business Law (the "Section") of the American Bar Association (the "ABA"), in response to the request for comments by the U.S. Securities and Exchange Commission (the "Commission") in the proposing release referenced above (the "Proposing Release"). In the Proposing Release, the Commission has proposed rules implementing the whistleblower provisions of new Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act"). This letter also reflects significant input from the Committee on Corporate Laws of the Section) (the Committees are referred to in this letter as the "Committees").

The comments expressed in this letter (the "Comment Letter") represent the views of the Committees only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section.

Overview

The implementation of the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[1] involves the balancing of a number of important, and sometimes competing, public policy goals. We believe that the rules the Commission adopts pursuant to new Section 21F of the Exchange Act should operate in tandem with, and support and strengthen, the existing matrix of laws, regulations and policies designed to encourage the reporting of serious violations of law, require the investigation of allegations of wrongdoing, and provide meaningful and effective responses to such allegations. These include the establishment of effective controls and procedures by companies to ensure legal compliance.[2] In addition, the Commission's rules should recognize the fiduciary duties imposed on directors and officers under state law.[3] A coherent, integrated and well-crafted legal

[1] The whistleblower provisions of the Dodd-Frank Act appear in Sections 922 through 924 of the Act. Pursuant to Section 922, a new Section 21F was added to the Exchange Act.

[2] The Sarbanes-Oxley Act of 2002 (the "Sarbanes Oxley Act") required the Commission to adopt rules mandating that companies have in place systems to receive and respond to whistleblower complaints, and also increased substantially the responsibilities of senior executives to identify and respond to violations of law that affected companies' disclosure and internal control systems. For example, pursuant to Section 301 of the Sarbanes-Oxley Act, the Commission has adopted Rule 10A-3 under the Exchange Act to require the audit committees of listed companies to establish "procedures for (i) the receipt, retention and treatment of complaints received by the listed issuer regarding accounting, internal accounting controls or auditing matters, and (ii) the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters." In addition, Section 404 of the Sarbanes-Oxley Act requires companies to design, implement and assess internal controls over financial reporting and their principal executive and principal financial officers to certify quarterly that, among other things, they have disclosed to the company's outside auditors and audit committee any fraud, whether or not material, that involves management or other employees who have a significant role over financial reporting. (See Sections 302, 404 and 906 of the Sarbanes-Oxley Act and the Commission's rules implementing such provisions). Moreover, the Commission has adopted rules pursuant to Section 307 of the Sarbanes-Oxley Act to require attorneys appearing and practicing before the Commission on behalf of a client to report within the company evidence of a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law. See 17 U.S.C. Part 205, at http://law.justia.com/us/cfr/title17/17-2.0.1.1.6.html (the "Attorney Conduct Rules").

[3] Directors and officers owe fiduciary duties to the corporation for which they serve, which may require that they cause the corporation to take affirmative actions in response to claims of serious wrongdoing. These duties arise both from state corporate statutes and from case law. The Model Business Corporation Act (the "Model Act") sets forth director and officer duties. Under Section 8.30(a) of the Model Act, a director is required to "act (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation." Pursuant to Section

compliance system would afford significant benefits to companies, shareholders and the investing public generally.

In considering its final rules, the Commission should also be mindful of the potential for harm that an unbalanced whistleblower program may present. The risks include rewarding and even encouraging wrongdoers, creating incentives (by reason of over-broad anti-retaliation provisions and substantial monetary awards) to bypass or upend effective company programs for the investigation of and response to wrongdoing, and eroding significant attorney-client protections. An unbalanced program could lead to a flood of frivolous and ill-informed whistleblower claims that would require the devotion, at considerable expense, of significant investigative resources by the Commission and the companies implicated. None of these undesirable results would benefit companies, their shareholders or the investing public generally.

The Committees understand that the Commission has been sensitive to many of these considerations in its Proposing Release, and we support the principal concepts reflected in proposed Regulation 21F with respect to persons eligible for whistleblower rewards, the procedural aspects of the program and the anti-retaliation provisions. We believe, however, that by refining certain of the proposed provisions and by adopting additional provisions to further enhance the integrity of Regulation 21F, the Commission can satisfy its statutory mandates and policy objectives, while at the same time minimizing the risks referred to above. It appears to us

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8.42(a) of the Model Act, an officer is required to act "(1) in good faith; (2) with the care that a person in a like position would reasonably exercise under similar circumstances; and (3) in a manner the officer reasonably believes to be in the best interests of the corporation." In *Caremark International Inc*., 698 A.2d 959 (Del. Ch. 1996), the Delaware Court of Chancery reviewed claims that directors had breached their duty of attention or care in connection with their monitoring of the on-going operation of the corporation's business. Chancellor Allen held that "In order to show that the Caremark directors breached their duty of care by failing adequately to control Caremark's employees, plaintiffs would have to show either (1) that the directors knew or (2) should have known that violations of law were occurring and, in either event, (3) that the directors took no steps in a good faith effort to prevent or remedy that situation, and (4) that such failure proximately resulted in the losses complained of…" In *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), the Delaware Supreme Court held that "Caremark articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith." Based upon these duties, once a director is put on notice regarding a claim of serious wrongdoing, fiduciary concepts require that the director cause the corporation to undertake a reasonable effort to discover the relevant information relating to the claim.

that the Commission has been granted considerable discretion in Section 21F to craft these provisions, and we encourage the Commission to use its authority in the interest of investors and the public companies in which they invest, and in the broader public interest of fostering legal compliance.[4]

Principal Policy Recommendations

As more fully discussed below, we believe the Commission should:

1. Set minimum standards for whistleblower status, to encourage whistleblowers to provide the Commission high-quality information and to minimize false, spurious or frivolous claims;
2. Refine the definitions of "voluntary", "original information", "independent knowledge" and "independent analysis" to help assure that only persons who should be entitled to awards receive them;
3. Provide that persons who have engaged in culpable conduct would not be eligible for anti-retaliation protection or whistleblower awards; and
4. Require, as a condition for receiving an award, absent extraordinary circumstances, that company employees pursue internal company whistleblower programs prior to submitting information to the Commission.

Discussion

1. The Commission Should Impose Additional Requirements on Persons Entitled to "Whistleblower" Status and, Therefore, Anti-Retaliation Protection

The term "whistleblower" is defined broadly in Proposed Rule 21F-2(a) to include a person, who, alone or jointly with others, provides the Commission with information relating to a potential violation of the securities laws.[5] Proposed Rule 21F-2(b) provides that Section

[4] The Commission's specific rulemaking authority under Section 21F is set forth in the following sections of Section 21F: 21F(a)(6) (authority to determine the manner in which a whistleblower may provide information to the Commission); 21F(b)(1) (authority with respect to the payment of awards); and 21F(d)(2)(B) (authority to require a whistleblower to provide information to the Commission prior to the payment of an award). In addition, Section 36 of the Exchange Act grants the Commission general exemptive authority, and provides that "the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."

[5] Although we note that the proposed definition of "whistleblower" generally tracks Section 21F(a)(6) of the Exchange Act, we believe it would be appropriate for the Commission, either in the definition of the term, or in the provisions of paragraph (b) of Rule 21F-2 relating to retaliation, to limit the definition as provided in this letter. Specifically, as discussed below, we

21F(h)(1) of the Exchange Act (which prevents an employer from discharging, demoting, suspending, threatening, harassing, directly or indirectly, or in any manner discriminating against, a whistleblower because of lawful acts done by the whistleblower in certain specified activities) applies irrespective of whether a whistleblower satisfies the procedures and conditions to qualify for an award. It further provides that for purposes of the anti-retaliation provision of paragraph (h)(1)(A)(i) of Section 21(F) of the Exchange Act the requirement that a whistleblower provide "information to the Commission in accordance with" Section 21F is satisfied "if an individual provides information to the Commission that relates to a potential violation of the securities laws".

The Commission's proposed definition of "whistleblower" would clearly prevent retaliation against an employee who has provided information to the Commission relating to a potential violation of the securities laws. We are concerned, however, about the potential for abuse by employees who may make frivolous whistleblower claims solely to avail themselves of the anti-retaliation provisions of Regulation 21F or to seek a chance to receive a potentially large award. This potential for abuse could hinder the ability of companies to conduct their own internal investigations and to appropriately discipline employees who have engaged in wrongdoing, subject companies to substantial costs by increasing investigations based on unsubstantiated allegations, and also impose significant investigative burdens on the staff of the Commission. For example, the definition would bring within its scope information provided by:

(a) Persons who provide information to the Commission relating solely to their own wrongdoing;

(b) Persons who provide information that, although "relating to a potential violation of the securities laws", may be frivolous, without any factual foundation and based on mere speculation, or clearly immaterial;

(c) Persons who provide information following the public dissemination of such information (such as through news reports), or the commencement of internal investigations or civil or criminal proceedings in which the information has already been made known to the company or the Commission; and

(d) Persons who provide information in violation of a professional obligation to maintain such information in confidence.

Although we realize that the Commission needs to strike a balance to provide appropriate protections to employees who make whistleblower claims in good faith, even if the claims are ultimately determined not to be valid, we believe strongly that employees who make frivolous claims to the Commission should not be provided with a shield that could prevent companies from terminating or otherwise changing the employment status of the employee.

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suggest that the Commission refer to a "claimed" violation of the federal securities laws (or some other term), rather than a "potential" violation.

In making this observation, we understand that the anti-retaliation provisions apply only to terminations or other sanctions "because" the employee provided information to the Commission or engaged in the other activities referred to in Section 21F(h)(1)(A) of the Exchange Act. As proposed, Regulation 21F would not prevent a company from terminating, demoting or suspending an employee for reasons independent of the employee's having provided information to the Commission. We remain concerned, however, that unless the ability of employees to rely upon the anti-retaliation provisions is more narrowly defined, in practice many employees will claim that the termination or other sanctions resulted from the protected activities.

Some employees (including employees who may fear potential termination or demotion) may believe that it is in their interest to provide information solely for the purpose of obtaining a possible defense against a subsequent termination or demotion. Such information may be unreliable, immaterial or non-original, but regardless of these infirmities, proposed Rule 21F-2 would still provide such employees with a basis for a claim of retaliation. Were the employee thereafter to be terminated, demoted or suspended, he or she would be entitled to assert claims that the employer's action was in retaliation for providing the Commission with information, and, if it could be so proven, would be entitled not only to reinstatement, but to double the amount of back pay (with interest), as well as litigation costs, expert witness fees and reasonable attorneys' fees.

These burdens may affect the decision of an employer with respect to their termination or demotion of an employee, including an employee whom the employer believes it has substantial independent grounds to terminate or demote. Also, because an employer would not necessarily be placed on notice that a specific employee had provided information to the Commission,[6] an employee's claim that a termination, demotion or suspension was retaliatory may come as a complete surprise to the employer.[7]

In view of the significant incentives provided by proposed Rule 21F-2 for employees with ulterior motives to cast themselves as whistleblowers, and the costs and burdens that would

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[6] We note that although the Proposing Release states that the Commission expects that in appropriate cases, consistent with the public interest and its obligation to preserve the confidentiality of a whistleblower, the 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, nothing in Regulation 21F would require this communication.

[7] If an employee claims (on information and belief) that an employer's conduct was based on the employer's knowledge that the employee had provided information to the Commission, we do not believe that the burden of proof should shift to the employer to prove either that it did not have such knowledge, or if it did, that the employment action was not based on the employee's having provided information to the Commission. We request the Commission to make clear in its final rulemaking that the burden of proof remains with the employee.

be imposed on employers in order to defend against a claim of retaliation, we are concerned that Rule 21F-2, if adopted in its proposed form, would significantly affect the ability of employers to exercise their legitimate rights, and therefore recommend that the protection of the anti-retaliation provisions should apply only to a person who provides information:

(a) about claimed violations of the securities laws "by another person or entity". It would be inappropriate for the Commission to confer whistleblower status under Regulation 21F, and therefore anti-retaliation protection, on a person who provides the Commission information relating solely to his or her own wrongdoing, or wrongdoing by an entity whose conduct the person directed, planned or initiated.[8] The Commission may want to consider including in its final rule or rule release a description of how individuals who wish to provide information to the Commission regarding their own conduct may proceed under the Commission's Policy Statement Concerning Cooperation by Individuals in Its Investigations and Related Enforcement Actions (17 C.F.R. § 202.12) ("Cooperation Initiative").

(b) that is material to the claimed violation of the securities laws. By "material" we refer both to the relationship between the information provided and the potential violation and the salience or importance of the information provided. Materiality will, of course, depend on facts and circumstances, but it is clear to us that an employee who communicates a fact which, even with the benefit of doubt, is immaterial to a claimed securities law violation, should not be accorded anti-retaliation protection. Materiality is an objective standard that a whistleblower should reasonably be expected to recognize.

(c) that has a basis in fact or knowledge (which must be articulated) rather than speculation. In view of the significant incentives provided by Regulation 21F to employees to come forward with information, we believe the whistleblower program could be significantly abused if employees would be entitled to anti-retaliation protection on the basis of providing information that is speculative and not founded on fact or knowledge. An allegation that "I think there's something inappropriate going on in the accounting department" should not, without some basis, entitle an employee to anti-retaliation protection.[9]

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[8] We note that under Proposed Rule 21F-14, a whistleblower would receive no amnesty from the Commission with respect to enforcement actions relating to his or her own conduct. We therefore question why a person who provides information to the Commission solely with respect to his or her own deeds (or conduct of an entity that he or she controlled) should be afforded any protections pursuant to Regulation 21F.

[9] We note that the Commission's Attorney Conduct Rules provide for a response by an attorney only when the attorney has "evidence of a material violation." Rule 205.2(e) states that "*Evidence of a material violation* means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that

(d) that is not based on information that is either publicly disseminated or which the employee should reasonably know is already known to the company's board of directors or chief compliance officer, a court or the Commission or another governmental entity. As drafted, it is possible for an employee to obtain the benefit of anti-retaliation protection by merely reporting to the Commission information that has previously been reported to the employee by others (including publicly available information and information the employee has been advised has previously been disclosed to the Commission by another person).[10]

(e) the provision of which does not result in the violation of a professional obligation, including the obligation to maintain such information in confidence. In this regard, we note that Rule 1.6(a) of the ABA Model Rules of Professional Conduct provides that "a lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b) [of Model Rule 1.6]".[11] In the absence of disclosure permitted by Rule 1.6(b), the Commission would seriously undermine professional and ethical standards by providing that an attorney who has breached his or her duties of confidentiality to an employer-client is protected against retaliation by the employer arising from such breach. Presumably, based on the Proposed Rule, even if the attorney is disbarred as a result of his or her providing information to the Commission in violation of the professional conduct rules, the employer would not be able to terminate or demote such employee. We believe this to be an

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it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." (emphasis added). This definition contrasts strongly with the complete absence of any factors relating to credible evidence or materiality in the Commission's proposed standards under Regulation 21F.

[10] The ability of a whistleblower to provide information based on public or other known sources contrasts with the Commission's proposal to limit eligibility for awards to original information. See Proposed Rule 21F-4(b).

[11] See ABA Model Rule of Professional Conduct 1.6, available at http://www.abanet.org/cpr/mrpc/rule_1_6.html. Other professionals also have ethical obligations to maintain the confidentiality of client information. See, *e.g.*, Section 301 of the AICPA Code of Professional Conduct ("Confidential Client Information") (providing that certified public accountants in public practice "shall not disclose any confidential client information without the specific consent of the client."). We note that although under the Attorney Conduct Rules and certain of the ABA Model Rules attorneys are permitted to "report out" in certain circumstances, we are concerned that any effort to reward attorneys or other professionals for reporting out creates inherent conflicts and could intrude on the attorney-client relationship.

irrational result. In our view, the Commission's rules should not provide a benefit to professionals who violate their professional obligations.[12]

The definition of "whistleblower" proposed by the Commission in Rule 21F-2(a) is self-executing, and does not require any action by the Commission; the only condition is that a person has provided information to the Commission "relating to a potential violation of the securities laws". The definition we are proposing would require the Commission to determine whether the information provided by an employee meets certain minimum criteria. Although the proper application of the minimum criteria may not always be clear, we believe that this process would be significantly superior to the overly broad system the Commission has proposed. Among other things, adoption of our proposed changes would diminish the incentive for providing low-quality information to the Commission solely to establish a predicate for a potential retaliation claim. We believe that the Rule, as revised, should state that the Commission will deliver to an employee who has met the requisite criteria to establish his or her status as a "whistleblower" a letter or other statement indicating that the person has been accorded such status pursuant to Regulation 21F by reason of the information the employee has provided to the Commission with respect to matters referred to in the letter. The Commission could issue such a letter on the basis of the quality of the information provided, even if the staff of the Commission determines not to pursue a particular matter. In the situation involving an anonymous disclosure, the Commission could deliver the letter to the attorney who submitted Form WB-DEC on behalf of an anonymous whistleblower pursuant to Rule 21F-9.[13] Absent

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[12] We note that the Commission's Attorney Conduct Rules governing attorneys appearing and practicing before the Commission do not provide for the attorney "reporting out" unless the attorney reasonably believes that such reporting is necessary (i) to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; (ii) to prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or (iii) to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used. In Proposed Rule 21F-4, the Commission makes clear that information based on "independent knowledge" or "independent analysis" does not include information obtained through a communication subject to an attorney-client privilege, or as a result of the legal representation of a client on whose behalf the services of the whistleblower, or the services of the whistleblower's employer or firm, have been retained, unless in either such case, such disclosure is permitted by Commission's Attorney Conduct Rules, applicable state attorney conduct rules, or otherwise. In our view, these same disqualifications should apply to whistleblower status for the purposes of the anti-retaliation provisions.

[13] Although the letter would not be dispositive as to the identity of the whistleblower, it would provide some confirmation that the Commission had received a whistleblower complaint with respect to a specific company and a specific matter. The Commission may want to consider whether to include in Rule 21F-7 a statement that a claim made by a whistleblower against an

such a letter, there exists the possibility that a terminated employee could claim to be protected pursuant to Regulation 21F, and an employer would have no reasonable means to determine whether the employee did, in fact, speak with the Commission and whether the claim is valid, unless the employer were to compel the disclosure in a legal action.[14] This process would impose an undue burden both on companies and on the Commission.

2. The Commission Should Change the Term "Potential Violation of the Securities Laws" to "Claimed Violation of the Federal Securities Laws"

Proposed Rule 21F-2 refers to a person who, alone or jointly with others, provides the Commission with information regarding a "potential violation" of the securities laws. The term "potential violation", however, is not separately defined. The Commission makes clear in the Proposing Release that it uses the term because of the importance of being able to determine whether a person is a "whistleblower" at the time he or she submits information to the Commission. If the term "whistleblower" only encompassed individuals who provide the Commission with information about actual, proven securities violations, it would be impossible to determine whistleblower status at the time a person provides information to the Commission.

We agree that it would be unrealistic for a determination to be made as to whether a violation had, in fact, occurred at the time information was submitted. However, we believe the Commission's use of the term "potential violation" creates a significant ambiguity, because it could be read to refer to future acts or omissions, such as whether a company might engage in conduct that would constitute a violation of the securities laws after the time a whistleblower submission was made. This ambiguity may lead purported whistleblowers and their counsel to claim a good-faith reliance on the common meaning of the term, and increase the likelihood of false or spurious claims.[15] In Section 21F, Congress refers to a "violation of the securities laws" and there is nothing in Section 21F that indicates that Congress intended the whistleblower provisions to apply to conduct in which a company might engage in the future. Instead, we believe it is reasonable to conclude that Section 21F was intended to apply to actions that had

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employer based upon an alleged violation of Rule 21F-2 would be deemed to constitute a waiver by the employee of any claim of confidentiality pursuant to Regulation 21F.

[14] Although the Commission has stated in its proposal that "in appropriate cases… 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", the Commission would likely not be permitted by Section 21F and Rule 21F-7 to reveal the identity of a whistleblower.

[15] The word "potential" is defined in the Merriam-Webster Collegiate Dictionary as "existing in possibility: capable of development into actuality." Therefore, the phrase "potential violation" may be interpreted to include securities law violations that have not even occurred or suspicions of violations that are speculative or have little or no factual support.

been taken (or actions that should have been taken, but which were not taken) prior to a whistleblower submission.

Although Item D.1 of proposed Form TCR appears to reflect that the matter has already occurred (see, for example, Item D.1 requiring the "occurrence date" to be set forth), the lack of clarity as to the term "potential violation" creates the possibility that whistleblowers will approach the Commission with claims based on possible future violations. We encourage the Commission to clarify that this was not intended, and suggest that the Commission consider using another phrase (such as "claimed violation") and adding a definition of the term to further minimize the ambiguity.

We also believe the Commission should state clearly in Regulation 21F that a "violation of the securities laws" in the Regulation relates only to the federal securities laws and not to violations of state or foreign securities laws that do not also constitute violations of the federal securities laws.[16] Although Rule 21F-1 refers specifically to "whistleblowers who provide the Commission with original information about violations of the federal securities laws" (emphasis added), and Form TCR contains a similar reference, the reference is missing in Proposed Rule 21F-2.[17] In order to avoid any ambiguity that the reference to "federal" was intentionally omitted from Proposed Rule 21F-2 in order to expand its scope, we believe the Commission should clarify that information provided pursuant to Regulation 21-F relates to potential violations of the federal securities laws.

Also, as with the definition of "whistleblower", we believe there would be merit in limiting the definition of the term "potential violation" (or "claimed violation" or such other term as the Commission may adopt) so as not to include matters that are clearly stale (*e.g.*, flawed disclosure in a ten-year old proxy statement), or immaterial (*e.g.*, erring by a year in setting forth the age of a director in a proxy statement).[18] Although these matters may also be dealt with in

[16] We note that Section 21F is not limited to violations of the securities laws by public companies, and that whistleblower protections and awards could, therefore, be applicable to such matters as antifraud claims involving private companies and to claims relating to violations of the private offering exemptions. We suggest that the Commission give special consideration to the implications of extending the Regulation 21F protections to claims against private companies that are not themselves involved in the securities industry. We also note that in the Instructions to Form TCR (Section C, Question 1 "For Entity"), there are listed many categories of entities to which a complaint relates, including the Commission and FINRA, and private/closely held companies, but that there is no reference to public companies.

[17] Although Section 3(a)(47) of the Exchange Act makes clear that "securities laws" refers only to specified federal statutes, in the interest of maintaining the "plain English" language of Regulation 21F, the term "federal" could be added to Rule 21-F.

[18] Although we would not expect whistleblowers to necessarily know applicable statutes of limitations, there may be a benefit to providing in Regulation 21F that the acts or omissions

the definition of "whistleblower", we believe it important that the Commission apply standards to the types of matters that would fall within the scope of "potential violation" so as to not invite information that would not result in Commission enforcement action, even if the information provided were substantiated and correct.

3. Persons Who Have Engaged in Culpable Conduct Should Not Be Eligible for Awards

The Commission's proposed Rules provide only a limited restriction on a person's eligibility for whistleblower awards to persons based on culpable conduct. Section (c)(3) of Proposed Rule 21F-8 would disallow an award to a person based on culpable conduct only if that person is convicted of a criminal violation that is related to the Commission action or a related action for which the whistleblower could otherwise receive an award. Unless a person has been convicted, the Commission does not propose to disallow the person from eligibility to receive an award, although proposed Rule 21F-15 would exclude from the calculation of whether the $1,000,000 threshold has been satisfied for purposes of making an award any monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planned or initiated. Similarly, the Commission would disallow amounts that the whistleblower or such an entity pays in sanctions as a result of the action or related actions from the calculation of the amounts collected for purposed of making the payment.

In our view, the Commission's proposed rules do not go far enough to deprive wrongdoers of the ability to reap rewards as a result of their wrongdoing. Simply stated, a person should not profit from his or her own misconduct, and persons who have engaged in culpable conduct should not be entitled to whistleblower awards. We believe, therefore, that Section (c)(3) of Rule 21F-8 should be revised to state that persons with any degree of direct or indirect responsibility for violations of law, regulations or codes of conduct relating to matters within the scope of the whistleblower complaint should be excluded from eligibility for receiving a whistleblower award. Our recommendation is based, among other things, on our concern that persons convicted of criminal violations represent only a small percentage of persons culpable for unlawful conduct. As the Commission is no doubt aware, establishing a criminal conviction as the only conduct-based bar to eligibility for an award creates an extremely high standard for disqualification, and may lead to the unseemly spectacle of persons subject to civil bars and civil penalties as a result of their active involvement in the reported unlawful activity receiving significant monetary awards.

We believe the absence of a more stringent standard may, in fact, create an incentive for persons to promote or engage in unlawful acts solely for the purpose of seeking awards and protections. Persons who have "crossed the line" and engaged in violations (or possible violations) of the securities laws may in fact have an incentive under the proposed whistleblower

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complained of should have occurred not less than a specified period of time (*e.g.*, 5 years) prior to the date of the whistleblower submission.

rules to maximize the seriousness of the violation in order to increase the potential amount of their awards. Rather than advising company compliance personnel or approaching the Commission at an early stage of a violation, they may determine to wait until the likely monetary sanctions exceed $1 million before coming forward with information. Although this might also be the case for non-culpable persons, those who may have contributed to the violation raise the specter of rewarding people with unclean hands, under circumstances where the violation may not have occurred, or risen to its magnitude, without the participation or assistance of a person who then seeks an award based on the violation.

For these reasons, we suggest that Subsection (c) of Proposed Rule 21F-8 provide that a person will not be eligible for an award if he or she (or an entity whose liability is based substantially on conduct that the whistleblower directed, planned or initiated) has been convicted of a criminal violation (including entering into a plea agreement or entering a plea of *nolo contendere*), or is found liable in, settles (including settlements without admitting or denying the allegations), or enters into a cooperation, deferred prosecution, or non-prosecution agreement in connection with, a proceeding brought by the Commission, a self-regulatory organization, or other securities regulator or government entity, which proceeding is related to a Commission action or a related action for which the whistleblower could otherwise receive an award.[19]

In this regard, we are of the view that eliminating the eligibility for whistleblower awards of persons who engage in culpable conduct under Regulation 21F should not eliminate the incentive of such persons to step forward with information regarding violations of law. We note, among other things, that a person with some culpability who brings information regarding potential violations of securities laws to the attention of the Commission or the Department of Justice may still be entitled to be considered for leniency pursuant to cooperation, deferred or non-prosecution agreements under Justice Department guidelines and pursuant to the Cooperation Initiative. In our view, these provisions, and not Proposed Regulation 21F, set forth the appropriate standards for the government's treatment of persons culpable for securities law violations.

Were our recommendation to expand the disqualification for culpability in Subsection (c) of Proposed Rule 21F-8 to be adopted by the Commission, Proposed Rule 21F-15 should be eliminated, because there would be no basis for providing a whistleblower award to persons who engage in culpable conduct.[20]

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[19] In our view, the Commission has authority, under Section 21F(h)(1) of the Exchange Act, to prohibit a culpable employee from claiming that he or she was subject to retaliation for having provided information to the Commission or having engaged in other authorized acts.

[20] If the Commission does not accept in full our recommendation of changes to Rule 21F-8(c), we nonetheless believe that a broad definition of culpable conduct should be adopted to ensure that a whistleblower who was an active and ongoing participant in the illegal wrongdoing is ineligible for an award.

4. The Commission Should Further Refine the Definition of "Voluntary"

Proposed Regulation 21F provides that whistleblowers would only be eligible for awards when they provide original information "voluntarily". Proposed Rule 21F-4(a)(1) would define a submission as voluntary if a whistleblower provides the Commission with information before the company receives any formal or informal request, inquiry, or demand from the Commission, Congress, any other federal, state or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information in the whistleblower's submission is relevant. In our view, the proposed definition of "voluntary" should be expanded to encompass all situations where the whistleblower may have reason to believe that certain other persons or entities charged with regulatory or oversight responsibilities are aware of the possible violations of law. Accordingly, in addition to the proposed definition, we believe that the proposed Rule should exclude from the definition of "voluntary" any information the whistleblower provides (i) after a request, inquiry, or demand from a foreign securities regulator (including a foreign securities exchange) or law enforcement organization is received, (ii) after a civil action is commenced in connection with any matter to which the information in the whistleblower's submission is relevant, and (iii) after the commencement of any inquiry or investigation by a company's in-house counsel, outside counsel, compliance staff, internal or external auditors or other persons with supervisory and governance responsibilities which is known to the whistleblower.

We discuss these suggested additional categories below.

(a) Foreign requests

With increased enforcement of securities law violations by foreign authorities and more extensive cooperation between the Division of Enforcement and foreign securities regulators, persons should not be entitled to claim an award pursuant to Section 21F with respect to matters that have previously been the subject of a formal or informal request, inquiry or demand by a foreign entity. We believe that there is a reasonable basis in policy for the Commission to consider inquiries from foreign securities regulators (including foreign securities exchanges) or law enforcement organizations to be equivalent to inquiries from domestic regulators, self-regulatory organizations or law enforcement organizations. Similarly, the whistleblower must not have been under a pre-existing legal duty to report the information to a foreign securities regulator (including a foreign securities exchange) or law enforcement organization.

Adding this exclusion would promote international comity because it would prevent the unseemly result of a person who has received an inquiry regarding a securities fraud matter from a foreign regulator being rewarded under Section 21F because that person happened to bring the matter to the attention of the Commission before U.S. regulators have acted.

(b) Civil actions

We believe that the commencement of a civil action in connection with any matter to which the information in the whistleblower's submission is relevant should render the

whistleblower ineligible for an award. Among other things, the commencement of such an action indicates that persons other than the whistleblower are aware of the alleged improprieties and may alert regulatory and law enforcement authorities to the alleged improprieties. The commencement of a civil action would involve, in many respects, the same attributes as a regulatory inquiry: it would alert the whistleblower to the matter, and would deprive the whistleblower of the ability to claim that his or her communication to the Commission is completely voluntary.

(c) Internal Investigations

In order to support more strongly a company's internal investigations, we believe that the commencement of inquiries or investigations, known to the whistleblower, by a company's in-house counsel, outside counsel, compliance staff, internal or external auditors or other persons with supervisory and governance responsibilities, based on information not provided solely by the whistleblower, should be viewed as a trigger of outside interest that would prevent a whistleblower from being eligible for an award. Our view is consistent with the views expressed above in connection with civil actions: the fact that an inquiry has commenced should negate any possibility that a whistleblower's disclosure to the Commission should be deemed to be voluntary. Good policy suggests that the internal investigation process be conducted in an orderly and intelligent manner. If the company is unable to conduct such an investigation because participants have chosen to speak with the Commission and are unwilling to lend efforts to support the internal investigation, the likely result is to hamper a company's legitimate inquiries.

5. The Commission's Rule Should More Strongly Support a Company's Internal Legal, Compliance, and Audit Procedures

(a) Employees Should be Required to Exhaust Internal Compliance Procedures in Order To Be Eligible For Whistleblower Awards

The Committees appreciate that in proposing Regulation 21F, the Commission is not seeking to undermine the efforts of companies to investigate potential securities laws violations on their own. Such internal compliance efforts permit directors and officers to appropriately discharge their fiduciary duties to a company, and are often critical to the company's effort to identify and remediate problems with the least harm to shareholders. It is critical that the Rule 21F process work in tandem with, and not in opposition to, a company's internal processes.

To the extent that a company's internal ethics or compliance guidelines contemplate or require a company employee to advise management immediately upon learning any facts regarding a potential illegality, the company's internal processes would be rendered meaningless if the employee could, without consequence from the company, gather up (and even retain) information privately and disclose it to the Commission without first disclosing it to the company and providing the company an opportunity to respond. Similarly, listed company audit committees are required to establish procedures for (a) the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing

matters, and (b) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters". These systems may be severely hampered if whistleblowers are provided an incentive to report possible violations to the Commission instead of, or even before, making any report to the company. The Committees believe that in order for whistleblowers to be eligible for an award, whistleblowers should be required, absent extraordinary circumstances, to exercise reasonable efforts to exhaust all reasonably available internal processes a company has established for reporting compliance concerns.[21] We believe that whistleblowers who are company employees should be required to demonstrate that they have made a good faith attempt to use the range of internal reporting mechanisms a company has put into place to enable the reporting of such complaints, up to and including reporting to the company's audit committee. Without such a requirement, internal processes that companies have expended substantial resources to develop, which the Commission has long sought to foster, and which have proven effective in ensuring compliance with law and established codes of conduct, will be undermined and will no longer serve the purposes for which they were specifically designed.

With approximately 10,000 public companies in the United States, we believe that effective internal compliance programs are a critical component in the mitigation of fraud, and a necessary counterpart to the enforcement efforts of the Commission. Simply stated, if the whistleblower rules undermine the effectiveness of internal compliance programs, the consequence may be to weaken, rather than strengthen, the existing corporate infrastructure dealing with the investigation and response to illegal conduct.

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[21] The Commission has stated that its proposal not to require a whistleblower to utilize internal compliance processes will not lead to the circumvention of internal processes because, "in appropriate cases… 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." Were the Commission not to accept our recommendation to require the exhaustion of internal compliance procedures, we believe the Commission's final rule should reflect an obligation on the part of the staff to notify a company with respect to all whistleblower complaints (including complaints that do not come from company employees). Instead of limiting this practice solely to "appropriate cases," the staff of the Commission should, absent extraordinary circumstances, be required to inform appropriate company personnel of any allegations made and allow the company a reasonable period of time to investigate and report back to the Commission. Extraordinary circumstances might include a reasonable and substantiated determination by the Commission staff that providing the company with an opportunity to investigate and report back would be futile, or would result in a continued material violation of the securities law, or the existence of a criminal enterprise. In such situations, the Commission could make a discretionary determination not to communicate with the company regarding a whistleblower complaint. In this regard, the Commission should set forth in the provisions of Regulation 21F the guidelines it will use for determining whether or not to advise a company of whistleblower allegations. By providing for prompt disclosure to a company of the whistleblower reports it receives, Regulation 21F would deter a whistleblower from bypassing a company's established internal compliance processes.

Were the Commission to require an employee to "exhaust" internal reporting systems before reporting to the Commission in order to be eligible for whistleblower awards, companies would have both fair notice of potential issues and an adequate opportunity to investigate and respond to such issues prior to the time that the whistleblower approaches the Commission. An internal reporting requirement may also reduce the reporting of false, spurious or frivolous claims to the Commission and increase the quality of the information the Commission eventually receives, as such tips may indicate the existence of more serious or systemic issues at the companies in question.

The effectiveness of a company's internal reporting and compliance systems depends in large part on the willingness of persons within the company to come forward with information regarding alleged improprieties. Such information permits a company to review not only the information provided by the original source, but to consider efficient means to determine the truthfulness of the allegations and the scope and materiality of the potential issues involved. In the context of this review, a company can develop an investigation plan as well as a review of the systems implicated in the allegations. Although the allegations regarding improprieties may relate to violations of the securities laws, they may also involve state laws and other federal laws; the fiduciary duties of officers and directors; employee policies; commercial, competitive and strategic matters; and reputational considerations.

The company's shareholders would in most cases be best served by an investigation and response that addresses each of the matters implicated by the complaint. If a problem is identified, companies will need to know why it occurred, whether it is likely to happen again, what system failures may have enabled the problem, what system strengths may have mitigated its effects, and what response is appropriate. We submit that a whistleblower program that does not require the exhaustion of internal compliance procedures may both cut off the information that is necessary in order for the system to operate effectively, and also delay (and in some cases completely prevent) the company's ability to investigate and address the range of issues that may be implicated by the allegations. The Commission's concern, of course, relates to violations of the securities laws. A company's concern extends to everything that affects its compliance with all applicable laws, the quality of its management, and the conduct of its operations. In our view, it is critically important to a company and its shareholders that its internal compliance mechanisms are permitted to function efficiently and effectively. Such programs encourage vigilant oversight by companies of their conduct and promote compliance with laws. Accordingly, we believe that company employees should be encouraged by the whistleblower rules to report through internal compliance programs, and that internal investigations of alleged wrongdoing be allowed to run their course, without any unnecessary interference.[22]

[22] Proposed Regulation 21F recognizes that legal, compliance, and audit personnel should not be eligible for a whistleblower award because the prospect of an award could compromise the critical duties these individuals are entrusted to perform. Similarly, we believe that companies as a whole should be allowed to perform these same duties in a thorough and diligent way.

We are concerned that, as drafted, Regulation 21F may encourage whistleblowers to withhold information from internal investigations and instead to "front-run" any self-disclosure by a company.[23] Absent an internal reporting requirement, employees would be incentivized to speak with the Commission staff as early as possible in order to provide voluntary disclosure of original information, which may lead to the disclosure of ill-informed, incomplete or unsubstantiated information. Not only would the investigation of matters brought to the attention of the Commission staff based on low-quality information burden the staff, it may also burden company personnel, to the extent any communication by the Commission to the company regarding an allegation may impel the company to undertake a potentially costly investigation. Although a company that receives a report of possible impropriety from an employee based on unsupported information may, for good reason, determine not to commence an internal investigation in the absence of some form of substantiation, a company may be less likely to defer the investigation if the allegation is communicated by the Enforcement Division.[24]

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[23] We note that, in addressing its need to balance the whistleblower provisions, the Commission stated in the Proposing Release that it sought not to create "incentives for company personnel to seek a personal financial benefit by "front running" internal investigations and similar processes that are important components of effective company compliance programs."

[24] We note that, in addition to the statutory and fiduciary duties referred to above, there are other significant reasons why a company may determine that it needs to implement an effective internal compliance program. Under the 2010 Federal Sentencing Guidelines Manual (which became effective on November 1, 2010), companies are credited with having in place an effective compliance and ethics program and with self-reporting violations of law. As the introductory commentary to Chapter 8 (Sentencing of Organizations") (available at http://www.ussc.gov/Guidelines/2010_guidelines/Manual_PDF/Chapter_8.pdf) provides "The two factors that mitigate the ultimate punishment of an organization are: (i) the existence of an effective compliance and ethics program; and (ii) self-reporting, cooperation, or acceptance of responsibility." Section 8B2.1 (Effective Compliance and Ethics Program) provides that "to have an effective compliance and ethics program…an organization shall (1) exercise due diligence to prevent and detect criminal conduct; and (2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with law. Such compliance and ethics programs shall be reasonably designed, implemented and enforced so that the program is generally effective in preventing and detecting criminal conduct." The guidelines specify in some detail additional characteristics of an effective compliance and ethics program. Section 8C2.5(g)(1) provides that "if the organization (A) prior to an imminent threat of disclosure or government investigation; and (B) within a reasonably prompt time after becoming aware of the offense, reported the offense to appropriate governmental authorities, fully cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract 5 points..."
Were the Commission's whistleblower rules to interfere in any material respect with the operation of company's internal compliance program or undermine its ability to self-report violations of law, the consequence may be to deprive the company (and, indirectly, its security holders) of significant benefits afforded under the sentencing guidelines.

For the reasons set forth above, we suggest that the Commission provide that, in order to receive a whistleblower award, a whistleblower who is an employee of the company that is the subject of the claimed violation, absent extraordinary circumstances, would first need to exhaust the internal reporting procedures the company has made available, and would only be entitled to an award if the company either did not follow up with an investigation or if it otherwise proceeded in bad faith. In the event the Commission determines not to mandate internal reporting, we suggest that the Commission considering adding compliance with internal reporting programs to the list of factors that the Commission will consider in its criteria for determining the amount of an award pursuant to Proposed Rule 21F-6.

(b) The Commission Should Not Require the Submission of Forms TCR and WB-DEC Within 90 Days in Order for a Whistleblower To Be Eligible for an Award

Proposed Rule 21F-4(b)(7) provides that if a whistleblower provides information to specified governmental, regulatory or compliance personnel, he or she must submit Forms TCR and WB-DEC to the Commission within 90 days in order for the information to be deemed to have been provided as of the date of the original disclosure, report or submission. This rule will strongly encourage whistleblowers to submit these forms to the Commission within the 90-day period in order to protect their "place in line" if they perceive that other whistleblowers, or the company itself, might also provide the same information directly to the Commission.

The Committees believe this 90-day deadline should be eliminated. Imposing a deadline on reports to the Commission regarding alleged misconduct already reported internally would put all internal investigations—no matter how complex—on a clock, with an inquiry from the Commission likely to follow shortly thereafter if the company has not, prior to that time, self-reported. Many companies may prefer to self-report, and would want to have the benefit of having concluded a full investigation prior to the reporting. It would be unrealistic to suggest that a full investigation be completed within 90 days. Imposing a 90-day deadline may make it more likely that the companies would find themselves reporting the status of investigations, rather than the conclusions, which may not be in the best interests of the company and its shareholders.

As an alternative, the rule could provide for a whistleblower to document the date of his or her internal report of alleged misconduct, which would serve to confirm the information provided and the date it was provided, and thereby protect the whistleblower's "place in line" with respect to an award. We also suggest that, if the Commission determines to keep a deadline, it provide for a more realistic period, such as 180 days, for the submission of the Forms. This extended deadline would afford companies a more reasonable period of time to conclude an investigation.

6. The Commission Should Further Refine the Definitions of "Original Information", "Independent Knowledge" and "Independent Analysis"

(a) Original Information

The Commission proposes to limit eligibility for an award to persons who provide "original information". We concur with this concept, but believe the enumerated exclusions from the definition are not sufficiently broad to achieve the intended originality. For example, the definition would not clearly exclude information a whistleblower receives as a result of an investigation by a securities exchange or other self-regulatory organization, a foreign regulator, or information received in connection with internal investigations or civil or criminal proceedings in which the information has already been made known to the company.

To the extent that the Commission intends to provide whistleblower awards only to persons who provide the Commission with information that is original and not derived from other sources, we see no basis for not excluding from the definition all information deriving from an allegation made in any investigative or enforcement activity or proceeding, rather than limiting the scope only to allegations not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit or investigation or from the news media.[25] In addition, the Commission's proposed language refers to "allegations" made in such proceedings. Because allegations may constitute only a small part of the information forming part of such proceedings, and allegations are generally only made after an initial fact-finding effort is completed, we believe the scope of the exclusion should extend to all information elicited during, or deriving from, any such proceeding or other matter.

(b) Independent Knowledge

Paragraph (b)(2) of Proposed Rule 21F-4 defines "independent knowledge" as "factual information in [the whistleblower's] possession that is not obtained from publicly available sources". The Proposing Release states that "Publicly available sources may include both sources that are widely disseminated (such as corporate press releases and filings, media reports, and information on the internet), and sources that, though not widely disseminated, are generally available to the public (such as court filings and documents obtained through Freedom of Information Act requests). Importantly, the proposed definition of "independent knowledge" does not require that a whistleblower have direct, first-hand knowledge of potential violations. Instead, knowledge may be obtained from any of the whistleblower's experiences, observations, or communications (subject to the exclusion for knowledge obtained from public sources)".

We believe the Commission should restrict the definition of "independent knowledge" to first-hand knowledge. As a policy matter, this restriction would be based on the same rationale underlying the hearsay rule, which is premised on the unreliability of oral information obtained from third parties. The source of the original information may be insincere, or subject to flaws in memory or perception. Among other things, by encouraging persons without first-hand

[25] Paragraph (b)(3) of Proposed Rule 21F-4 refers to information "not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless you are a source of the information.

knowledge to come forward, the Commission will be incentivizing reports based on unsubstantiated rumors or ill-informed sources.

We believe significant harm may be done to companies by a program that encourages reporting of information without foundation or basis. Especially because the program would reward those first in the door, the program would in fact encourage reporting at the most preliminary stage, without any effort being made by the reporting person to confirm sources or to consider legitimate bases for the conduct involved. Also, and importantly, we believe that the absence of a firsthand knowledge requirement would encourage collaboration to circumvent the intent of the statute. For example, a person who would be ineligible for an award directly by reason of culpable conduct might provide the information to a third person who would be the whistleblower. The two could agree to share any award eventually paid. Not only could the possibility of an award in this instance induce persons to undertake efforts to maximize the harm, and therefore the amount of the award, but also the potential large amount of any recovery may in fact encourage unethical conduct.

(c) Independent Analysis

Similarly, we believe that the term "independent analysis" in paragraph (b)(2) of Proposed Rule 21F-4 should be restricted to an analysis of the whistleblower's own "independent knowledge" along with other purely objective facts, such as share price or trading volume.

(d) Exclusions from "Independent Knowledge" and "Independent Analysis"

Proposed Rule 21F-4(b)(4) sets forth the limitations on the information that may be used as the source of a claim that a communication to the Commission derives from independent knowledge or independent analysis. With respect to the limitations set forth in Proposed Rule 21F-4(b)(4):

(i) The Committees believe that the exclusion in Proposed Rule 21F-4(b)(4)(i) for information obtained through a communication that was subject to the attorney-client privilege (subject to the stated exceptions) is appropriate; we suggest, though, that the Commission consider expanding this provision to also refer to information derived from materials that are subject to the protections of the attorney work-product doctrine;

(ii) The Committees believe that Proposed Rule 21F-4(b)(4)(iii) with respect to information obtained through the performance of an engagement required under the securities laws by an independent public accountant should also include information obtained by internal company personnel in connection with their role supporting an independent public accountant conducting an audit required under the securities laws (including both a financial statement audit and an audit of internal controls). In other words, when an internal employee is consulted by independent public accountant in connection with a required audit, any information learned by the

internal employee should be excluded from the definition of "independent knowledge" and "independent analysis" in the same manner that such information obtained by outside auditors would be excluded from the definition.

The independent audit is a vital function for companies, their investors, as well as the markets, and therefore should not be impeded from running its course under Section 10A of the Exchange Act. We note that existing requirements under Section 10A of the Exchange Act provide a process for information coming to the attention of auditors regarding illegal acts by a company to be disclosed within the company and to the Commission.[26] Keeping this regime intact not only allows for an opportunity for errors and misconduct to be corrected through existing corporate compliance mechanisms, but also would prevent potential whistleblowers who may learn of possible illegal acts by reason of their work in connection with an audit from inundating the Commission with bad faith or frivolous claims with the hope of receiving a windfall.

(iii) The Committees believe that the exclusion in Proposed Rule 21F-4(b)(4)(iv) for a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity who received information with a reasonable expectation that the recipient would act on the information should be expanded to include persons who perform such functions for subsidiaries or other units of an entity; in many instances, "reporting up" involves reporting to supervisory personnel or another responsible person at the entity where a person is employed. In addition, the recipient is responsible for ascertaining the "reasonable expectation" of the person who provided such information. We believe it would be preferable for the rule to provide that the recipient "reasonably understood that the information was communicated to you with the expectation that you would take steps…"

(iv) The exclusions in Proposed Rules 21F-4(b)(4)(iv) (discussed above) and 21F-4(b)(4)(v) (relating to information obtained from or through an

[26] Under Section 10A of the Exchange Act, auditors who believe they have discovered that an illegal act has or may have occurred at a company are required to first report it to company management and to assure that the information is also known to the audit committee. If the illegal act has a material effect on the financial statements, the senior management has not taken appropriate remedial action, and the failure to take such action would either warrant departure from the standard auditor's report or resignation of the auditor, the auditor is then required to report the illegal act to the Board, which is required to advise the Commission by notice. If the auditor has not received a copy of the notice in the prescribed time, it must either resign from the engagement or furnish the Commission with a copy of its report.

entity's legal, compliance, audit, or other similar functions or processes for identifying, reporting, and addressing potential non-compliance with the law) would not apply, and such persons would be eligible for awards, if the entity does not disclose the information to the Commission within a reasonable time or proceeds in bad faith.

The Committees believe that such persons should be eligible for awards if the entity proceeds in bad faith but that the Commission should not require that disclosure be made within a reasonable time. What may constitute a "reasonable time" before a whistleblower is able to approach the Commission would likely be difficult to determine. In fact, persons within the investigatory process may have difficulty determining this, and anyone outside the investigatory process may simply be unable to make this determination without complete information about the company's response to an allegation, the nature of which is typically highly confidential. In our view, bright line rules of what constitutes a reasonable period of time would be inappropriate in view of the varying complexities of internal investigations. To the extent that the goal of excluding certain categories of employees from award eligibility is to enable companies to operate effective internal compliance programs and conduct thorough internal investigations, such an amorphous standard would risk interfering with, rather than promoting, internal compliance efforts. Objective acts of bad faith, on the other hand, are likely to be more easily observable and are more indicative of an entity's intentions with respect to particular allegations than the amount of time an internal investigation takes.

Further, because the term "information" is not defined in Proposed Rule 21F-4(b)(4)(iv) or (v), a company may believe that, in order to protect the exclusion of the information, it will need to report to the Commission every whistleblower complaint that it receives, even conduct that may not clearly involve a securities law violation. Presumably in this context, a person who has disclosed to a company the information referred to in Proposed Rule 21F-4(b)(4)(iv) or (v) would need to determine whether the company provided such information to the Commission.[27] If the company did not provide such information to the Commission, the person may have no way of knowing whether the company had a valid basis for determining not to notify the Commission, and the person might then disclose to the Commission the information that might otherwise have been deemed not to have been derived from independent knowledge or independent analysis.

[27] It is unclear to us from the proposed Rule how a whistleblower would be in a position to determine whether the company disclosed the information to the Commission. Unless the whistleblower is a member of senior management, he or she may be unaware of the company's communications with the Commission.

The process as proposed has a number of flaws, including the fact that nothing in the exclusion may deter a person from providing to the Commission, even before notification to the company, the information that would have been excluded.

(v) The Committees believe that information obtained by internal personnel in connection with their responsibilities under Sections 302 and 404 of Sarbanes-Oxley should also be excluded from the definition of "independent knowledge" and "independent analysis" because the very purpose of these sections is to identify and elevate to senior management issues of concern, including potential violations of the federal securities laws.

(vi) The Committees believe that information obtained by company personnel, or personnel of any consulting or advisory firm engaged by the company, in connection with audits or reviews required under the securities laws (including SAS 100 reviews), reviews undertaken by companies in the context of the internal audit function, and investigations by the Board or any committee of the Board, should be excluded from the definition of "independent knowledge" and "independent analysis" in the same manner that such information obtained by the outside auditors is excluded from the definition. These audits and reviews play a critical role in a company's governance and reporting structures, and companies should, therefore, be entitled to undertake these matters without having a concern that the persons involved in these matters have a different agenda from that of the company.

(vii) Also, the Committees believe that information that is obtained by internal personnel in connection with their responsibilities relating to the preparation of Sarbanes-Oxley certifications under Sections 302, 404 and 906[28] should be excluded from the definition of "independent knowledge" and "independent analysis" because the purpose of those certification processes is to identify and elevate to senior management issues of concern, including potential violations of the federal securities laws. We propose that the exclusion also cover information provided in whatever sub-certifications management may request relating to a 302 or 906 certification.

[28] The certifications pursuant to Section 302 of the Sarbanes-Oxley Act are set forth in Rule 13a-14(a) (17 CFR 240.13a-14(a)) and Rule 15d-14(a) (17 CFR 240.15d-14(a)) under the Exchange Act. The certification pursuant to Section 906 of the Sarbanes-Oxley Act is set forth in Rule 13a-14(b) (17 CFR 240.13a-14(b)) and Rule 15d-14(b) (17 CFR 240.15d-14(b)) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350) .

(viii) Finally, information that is obtained through communications protected by other confidentiality obligations under federal or state law (such as communications between patients and healthcare providers) should be excluded from the definition of "independent knowledge" or "independent analysis". This follows from the same rationale underlying the present exclusion of information that is obtained as a result of communication protected by the attorney-client privilege. With this broader set of exclusions, the rules would avoid chilling important confidential communications while reducing any perverse incentives individuals might have to disclose the content of such communications.

7. Even If the Commission Determines Not To Disqualify Persons with Culpability for Securities Law Violations from Award Eligibility, It Should Take Such Conduct into Consideration in Determining the Amount of any Reward

If the Commission determines not to exclude persons with civil, but not criminal, responsibility for violations of the securities laws from eligibility for whistleblower awards, we believe that any award such a whistleblower receives under Regulation 21F should be appropriately limited by including a provision that the Commission should take the person's role and culpability into consideration in determining the amount of any reward pursuant to Proposed Rule 21F-6. Although under Proposed Rule 21F-15 the monetary sanction paid by a culpable whistleblower would not be considered in determining whether the $1 million threshold has been satisfied or for the purpose of calculating the whistleblower's award, there may be instances in which such provisions would not adequately address the person's culpability. For example, a whistleblower who was an active participant in a fraud that resulted in monetary sanctions of $5 million against a company may have been personally sanctioned a significantly lesser amount.

Providing the whistleblower with a substantial award may send a message to others that "crime pays". Although we recognize that the Commission's payment of whistleblower awards may be necessary to incentivize the reporting of violations of law, we believe that the rules should afford the staff and the Commission a reasonable basis for evaluating a person's culpable conduct and for reducing the amount of an award based on that assessment and public policy considerations.[29]

[29] In conducting its analysis, the Commission and its staff should be entitled to review all judicial, administrative and other findings relating to the conduct of the whistleblower. In the case of internal company investigations, the Commission could consider any findings and supporting information a company may provide to the Commission indicating that the employee has engaged in unlawful or unethical behavior, or has materially breached the company's code of conduct in connection with the matters giving rise to the whistleblower claim.

8. Rule 21F-6 Should Expressly Permit the Commission To Deny an Award in Situations Where It Determines That an Award Would Be Against Public Policy

As we state in Paragraph 3 above, we urge the Commission to expand the definition of culpable conduct and to deny awards to persons who engage in culpable conduct. However, because not every act that may reflect some degree of responsibility for securities law violations will necessarily be within the definition of culpable conduct (even under the definition we propose), we suggest that Rule 21F-6 should expressly permit the Commission to deny an award when it determines that the payment of an award would be against public policy. Such a provision would provide flexibility in the event that circumstances arise in the future in which a person otherwise entitled to an award should not receive one due to public policy considerations not specifically addressed by the rules limiting eligibility for awards.

9. The Commission Should Reconsider the Appropriateness of Proposed Rule 21F-16(b) and, If It Determines To Adopt the Rule, Provide Detail Regarding Its Procedures for Contacting Whistleblowers Without Consent of Company Counsel

Proposed Rule 21F-16(b) provides that if a whistleblower who is a director, officer, member, agent or employee of an entity that has counsel initiates communication with the Commission relating to a potential securities law violation, Commission staff is authorized to communicate directly with such person regarding that information without seeking the consent of the entity's counsel. Although the Commission states in the Proposing Release that the objective of Proposed Rule 21F-16(b) is to implement several important policies inherent in Section 21F in a manner consistent with state bar ethics rules governing the professional responsibilities of lawyers, including Model Rule 4.2 of the ABA Model Rules of Professional Conduct,[30] we strongly disagree with the Commission's view that Section 21F authorized the Commission to bypass state bar ethics rules. In our view, Proposed Rule 21F-16(b) may have profound implications with respect to the preservation of a company's attorney-client privilege and information protected by the work-product doctrine.

As the Commission notes in the Proposing Release, the primary purpose of Model Rule 4.2 is to protect the attorney-client relationship and to protect represented persons, in the absence of their lawyers, from being taken advantage of by lawyers who are not representing their interests. Proposed Rule 21F-16(b) may result in the very harm that Model Rule 4.2 was

[30] In the Proposing Release, the Commission refers to ABA Model Rule 4.2 which prohibits lawyers from communicating about the subject of a representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order. The Commission indicates that Congressional policy would be significantly impaired were the Commission required to seek the consent of an entity's counsel before speaking with a whistleblower who has initiated the contact and who is a director, officer, member, agent or employee of the entity. The Commission would justify this position by viewing the discussions with such a person as having been "authorized by law."

intended to address. For example, information the Commission staff may seek from an employee, and which an employee may disclose pursuant thereto, may have derived from privileged communications the employee or others within the organization may have had with company counsel.

The right to waive the privilege in such circumstances would belong to the company, and not to any single employee, and the ability of Commission staff to communicate with an employee without first seeking the consent of the company's counsel may affect the company's ability to claim privilege with respect to such matters. We are concerned that the Commission's communications with an employee could, therefore, have the intent and effect of undermining the privileges a company would ordinary expect to preserve.

The Commission indicates in the Proposing Release that it may be unable to fulfill its statutory role without the rights set forth in Proposed Rule 21F-16(b). We disagree. First, we note that employees would always have the ability to provide information to the Commission, and if they meet applicable standards would be entitled to anti-retaliation protection and to eligibility for awards. Such communications could be made either on a disclosed basis or anonymously. Proposed Rule 21F-16(b) deals not with the initial communication by the employee, but instead with responsive communications by the staff. Having had the benefit of a whistleblower's initial communication, we see no reasonable basis not to require the staff to communicate with company counsel prior to any further communications.[31]

We believe that, in many cases, communication by the staff with company counsel prior to further discussions with a whistleblower could assist the staff's investigative efforts. Such communications would permit company counsel to advise the staff of the information the company may have developed in connection with a matter, and assist in coordinating an appropriate investigative process. The communications would also permit company counsel to consider issues of privilege in the context of the investigations. Because of the importance to a company of preserving its attorney-client privilege and information protected by the work-product doctrine, we believe the Commission should not adopt Proposed Rule 21F-16(b) as part of Regulation 21F.

If the Commission determines to adopt Proposed Rule 21F-16(b), we suggest that in its final rule or the final rule release the Commission consider detailing procedures relating to communications by Commission staff to ensure that the attorney work-product doctrine and the attorney-client privilege are not jeopardized. There are many circumstances in which an employee may become aware of information which, if disclosed, could jeopardize the privilege protections. In order to address these considerations, the Rule could, for example, require the Commission staff to inquire, prior to any substantive discussion with an employee, as to the

[31] The Commission suggests that it in fact intends regularly to communicate in this way: "in appropriate cases… 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." (emphasis added)

source of the information the employee may be providing, and to advise the employee that any information which the employee believes may derive directly or indirectly from communications with company counsel should not be communicated at that time. The Commission's delineation of such policies and procedures would also be consistent with current enforcement policy, which seeks to avoid situations in which staff members obtain privileged information. In light of these and other provisions, a more detailed set of guidelines on how Commission staff would seek to preserve such privileges would help to further ensure that Regulation 21F would be consistent with the Commission's prior policy statement.[32]

10. Specific Comments on the Cost-Benefit Analysis and the Need To Improve System Integrity

In our view, the cost-benefit analysis in the Proposing Release fails to take into account all of the likely costs of the proposed rules. Because the anti-retaliation protection provided by the whistleblower provisions is very broad and excludes only a very limited class of claimants, employees who fear termination by their employer because of a poor performance review or for some other legitimate reason have a very strong incentive to make whistleblower claims that are false or spurious in order to obtain that protection and deter their employers from taking otherwise justified adverse action against them. Although it is not possible to quantify the level of false or spurious claims that are likely to be filed, we believe the percentage could be very high. And if that is the case, we also believe that innocent companies may be required to expend considerable amounts due to investigations triggered by false or spurious claims and the high volume of documentation that these innocent companies would need to review and produce, often with the assistance of legal counsel and accounting firms. The Commission itself would also incur significant costs to review and evaluate all of these false or spurious claims and would need to divert its limited resources from higher priorities and legitimate claims. Such false or spurious claims can also lead to the wrongful public disparagement of innocent companies with damaging results to such innocent companies.

To help avoid this result, potential whistleblowers need to understand that the whistleblower provisions will not present an opportunity to reap a large monetary award with no downside risk associated with claims that are false, spurious or frivolous. As a result, stronger safeguards should be adopted to prevent improper use of the whistleblower provisions. We have the following suggestions for your consideration to achieve this result.

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[32] In addition to the substantive comments set forth in this letter, we note that Proposed Rule 21F-14 ("No Amnesty") refers to the Cooperation Initiative. Because the Cooperation Initiative is a policy statement that may be changed from time to time, the Commission may want to either refer to the Cooperation Initiative "or such other policy or policies that the Commission may from time to time have in place with respect to cooperation by individuals in investigations and related enforcement actions", or alternatively move the reference to the adopting release. Were the Commission to revise the Cooperation Initiative, it would be cumbersome for the Commission to also need to amend Rule 21F-14 (with notice and a rulemaking period) to make a corresponding change.

First, if documents are delivered directly to the Commission, Form TCR should be subject to penalty of perjury, similar to Form WB-DEC. If a whistleblower utilizes an attorney, then the Form TCR with such sworn declaration should be retained by the attorney.

In the cost-benefit analysis in the Proposing Release, the Commission argues that making Form WB-DEC alone subject to penalty of perjury is sufficient to "mitigate the potential harm to companies and individuals that may be caused by false or spurious allegations of wrongdoing". We respectfully disagree. Because Form WB-DEC can be submitted up to 30 days after Form TCR, claimants could cause significant resources to be expended by filing a Form TCR with a false or spurious claim if the Commission thought that the allegations warranted immediate investigation. Claimants could also fail to file a Form WB-DEC or change their stories before filing such form. Claimants might not read Form WB-DEC before filing Form TCR and might not realize that they later have to swear to its accuracy under penalty of perjury. Therefore, Form TCR should also be subject to penalty of perjury so that whistleblowers are definitely aware from the beginning that dishonest claims carry significant risks.

In addition, attorneys who assist clients in submitting anonymous claims should have special responsibilities. The ethics rules in most jurisdictions already prevent attorneys from filing false or spurious claims, but those rules should be explicitly restated with respect to whistleblower claims. Attorneys handling anonymous claims should be required to review the client's information and certify to the Commission that the client can show *particularized* facts suggesting a *reasonable probability* that a securities violation has actually occurred or is occurring. The existing Counsel Certification and other applicable forms should also be modified to reflect these requirements. This will ensure that whistleblowers who engage legal counsel do not submit claims based on mere speculation or hunches. Additionally, while lay individuals may not have the necessary level of knowledge and sophistication to know whether their information truly evidences a securities violation, attorneys are capable of making that determination and, therefore, should be required to help screen unsubstantiated claims and avoid the incurrence of unnecessary costs and labor to innocent companies.

Finally, the Commission should consider additional ways to safeguard against abuse of the whistleblower provisions and ensure the utmost integrity in the process for whistleblowers to submit tips. The goal should be to ensure that precautions are taken at each step to screen out claims that are false, spurious or frivolous.

Summary of Specific Recommendations

Our principal recommendations, as more fully discussed in this letter, are summarized below:

1. Proposed Rule 21F-2 ("Definition of a Whistleblower")

    (a) The Commission should impose additional requirements on persons entitled to "whistleblower" status and, therefore, anti-retaliation protection. We believe that

these provisions should refer to a person who provides information to the Commission:

(i) about a claimed violation of the securities laws by another person or entity;

(ii) that is material to the claimed violation;

(iii) that has a basis in fact or knowledge (which must be articulated);

(iv) that is not based on information that is either publicly disseminated or which the employee should reasonably know is already known to the company's board of directors or chief compliance officer, a court or the Commission or another governmental entity; and

(v) the provision of which does not result in the violation of a professional obligation, including the obligation to maintain such information in confidence.

(b) The Commission should change the term "potential violation of the securities laws" to "claimed violation of the federal securities laws" to avoid confusion, and should define the term to add clarity.

2. Proposed Rule 21F-4 ("Other Definitions")

(a) The Commission should further refine the definition of "voluntary".

(b) The Commission should further refine the definition of "original information".

Among other things, the Commission should not require a whistleblower who provides information to specified compliance personnel to submit Forms TCR and WB-DEC within 90 days in order for the whistleblower to be eligible for an award. If the Commission does not eliminate the time period, it should extend the period to 180 days.

(c) The Commission should further refine the definition of "independent knowledge" and "independent analysis".

3. Proposed Rule 21F-6 ("Criteria For Determining Amount of an Award")

Although we suggest in this letter that persons who have engaged in culpable conduct should not be eligible to receive a whistleblower award, should the Commission determine not to provide for a complete disqualification, the Commission should include the role and culpability of the whistleblower as express criteria that the Commission will consider in determining the amount of any award a whistleblower might receive. Culpability in this context would include not only matters determined in judicial

proceedings, but also in administrative and other proceedings. We also suggest that this Rule should contain an express provision to permit the Commission to deny an award in situations where it determines that the payment of an award would be against public policy.

4. Proposed Rule 21F-8 ("Eligibility")

   (a) The scope of culpable conduct that would disqualify a person from receiving a monetary award should be expanded. Persons who have engaged in culpable conduct should not be eligible for awards.

   (b) Employees should be required to exhaust internal compliance procedures in order to be eligible for whistleblower awards.

5. Proposed Rule 21F-15 ("Awards to Whistleblowers Who Engage in Culpable Conduct")

   If the Commission agrees with our position that a person who engages in culpable conduct should not be eligible for awards, Rule 21F-15 would no longer be necessary.

6. Proposed Rule 21F-16 ("Staff Communications with Whistleblowers")

   The Commission should reconsider the appropriateness of Proposed Rule 21F-16(b) and, if it determines to adopt the Rule, provide detail regarding its procedures for contacting whistleblowers without the consent of company counsel.

Conclusion

The Commission's whistleblower rules, if carefully crafted, should inure to the benefit of shareholders and the investing public. We encourage the Commission to make every effort in its final rules to be sensitive to the concerns we have expressed in this letter, and to eliminate incentives for frivolous or irresponsible reporting, to avoid rewarding culpable persons, and to consider the effects the rules may have on companies' internal compliance programs and legal privileges. A whistleblower program that will elicit high-quality information will contribute significantly to the effectiveness of the Commission's enforcement efforts, while providing needed protections to companies and minimizing the burdens both companies and the Commission staff will incur in responding to meritless claims.

The Committees appreciate the opportunity to comment on the Proposing Release and respectfully requests that the Commission consider the comments and recommendations set forth above. Members of the Committees are available to discuss these comments should the Commission or the staff so desire.

Very truly yours,

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