MEMORANDUM

TO: File on S7-33-10, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

FROM: Christian L. Broadbent
Counsel to Commissioner Elisse B. Walter

DATE: March 16, 2011

RE: Meeting with Taxpayers Against Fraud ("TAF")

On January 13, 2011, Commissioner Walter and Christian Broadbent of Commissioner Walter's office met with members and representatives of TAF. Parties indicated to be in attendance included the following:

- Eric R. Havian of Phillips & Cohen LLP
- Erika A. Kelton of Phillips & Cohen LLP
- Cleveland Lawrence III of TAF and TAF Education Fund
- Paul D. Scott of the Law Offices of Paul D. Scott, P.C.
- Michael A. Sullivan of Finch McCranie LLP

The proposed agenda and comment letter provided are attached to this Memorandum.

Agenda for SEC Commissioner Elisse Walter's
Meeting with Taxpayers Against Fraud to Discuss
Dodd-Frank Act Section 922 Whistleblower Provisions
January 13, 2011

1. Introductions

2. Discussion of SEC's proposed rules for implementation of its whistleblower program

TAF
TAXPAYERS AGAINST FRAUD

THE FALSE CLAIMS ACT LEGAL CENTER

December 17, 2010

Elizabeth M. Murphy, Secretary
Securities & Exchange Commission
100 F Street, NE
Washington DC 20549

Re: Dodd-Frank Wall Street Reform and Consumer Protection Act's
Securities Whistleblower Incentives and Protection Program

Dear Ms. Murphy:

Taxpayers Against Fraud ("TAF") submits these comments in response to the SEC's (or "Commission") proposed rulemaking governing the whistleblower program established by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010) (hereinafter "Dodd-Frank"). TAF is a national non-profit, public interest organization dedicated to combating fraud through the promotion and use of federal and state whistleblower laws. TAF's membership includes nearly 400 attorneys who represent whistleblowers and assist federal and state governments to recover funds lost through fraudulent and corrupt business practices.

TAF submits these comments to convey deep concern that the Commission's proposed rules will seriously undermine the enormous promise of the Dodd-Frank whistleblower program. As discussed below, we urge the Commission to reconsider and revise the proposed rules to ensure (1) they are aligned with the statutory provisions of Section 21F of the Securities Exchange Act of 1934 as amended; and (2) they provide a structure that fosters – rather than deters – the active use of the SEC's whistleblower program, as Congress intended. S. Rep. No. 111-176 ("Senate Report") at 112.

1220 19th Street, NW Suite 501 Washington, DC 20036 phone (202) 296-4826 fax (202) 296-4838
internet: http://www.taf.org or taf-info@taf.org

I. INTRODUCTION

Before Dodd-Frank was enacted, the SEC had a whistleblower program for insider trading violations for more than two decades. That program was a failure. It failed to attract significant whistleblowers, or to generate significant enforcement actions, or to create meaningful deterrent effects. Without a doubt, the reason for the predecessor program's failure is (1) the lack of a mandatory award; (2) the SEC's complete discretion in making any award; (3) the absence of structures to encourage collaboration or prompt action by the SEC; and (4) the lack of any judicial oversight. The structural weaknesses in the SEC's previous whistleblower program created unacceptable uncertainty for individuals with the best information and the most to lose professionally by stepping forward – uncertainty as to whether the SEC would act on the information; whether the SEC would pay an award if action was taken; and whether the award amount would be fair.

Despite the SEC's poor track record, the Commission now proposes rules that resurrect many of the same structural flaws that caused the agency's previous whistleblower program to fail. As detailed below, the proposed rules: (1) expand agency discretion well beyond what the statute contemplates; (2) dilute the mandatory awards that are the very heart of Dodd-Frank's amendments to Section 21F of the Securities and Exchange Act of 1934; and (3) create enormous uncertainty that would discourage individuals who would consider stepping forward with significant information of securities frauds from doing so. These weaknesses, if unchanged, will render the program ineffective.

II. THE FALSE CLAIMS ACT'S WHISTLEBLOWER PROGRAM IS A TEMPLATE FOR SUCCESS AND SHOULD GUIDE THE SEC'S RULEMAKING

TAF is uniquely situated to comment on the factors necessary to build a successful whistleblower program. Since 1986, TAF's members have represented whistleblowers in federal False Claims Act ("FCA") matters that have generated tens of billions of civil and criminal recoveries, and set records for Department of Justice success. The FCA's whistleblower provisions are recognized to be the Justice Department's chief civil fraud enforcement tool,[1] and

[1] See H.R. Rep. No. 99-660, p. 18 (1986) ("[T]he False Claims Act is used as ... the primary vehicle by the Government for recouping losses suffered through fraud").

are a model for the states[2] and the Internal Revenue Service[3] which have adopted similar whistleblower statutes.

The impact and importance of FCA whistleblower matters goes well beyond the large dollar amounts recovered for US taxpayers, however. False Claims Act matters – big and small – protect patients, safeguard our military, and provide transparency and integrity in government contracting that touches everything from advance weapons systems to public employee retirement funds. Importantly, FCA whistleblower enforcement has also yielded serious efforts to improve internal compliance within the business community and is estimated to have saved tens of billions of dollars through deterrent effects.

The same potential exists for the SEC's whistleblower program. A well-crafted SEC program will generate high quality information, realize large recoveries, improve deterrence, safeguard investors, bring greater transparency to the markets, and reinvigorate and stimulate meaningful internal compliance programs. These results are entirely consistent with the SEC's overall mission and should be embraced and celebrated by all stakeholder communities – be they business, financial services, government prosecutors, employees or investors.

There are at least five key factors to the FCA's success. First, the statute provides a guaranteed, non-discretionary award if the whistleblower's information leads to the government's recovery or judgment. Second, the statute provides federal court oversight over the whistleblower award determination. Third, the statute creates a structure for whistleblower collaboration in investigation and prosecution, bringing needed private resources to bear. Fourth, there are limited and discrete bases for denying an award under the statute, and it does not create broad disqualifications based on an individual's status. Fifth, the statute does not require that an individual exhaust internal procedures before filing a whistleblower action.

Whistleblowers, therefore, have confidence that if they provide information that leads to an FCA judgment or settlement, then they will almost certainly receive a guaranteed award.

---

[2] At least twenty eight states have enacted false claims statutes that include whistleblower provisions modeled on the federal False Claims Act.

[3] See Internal Revenue Code Sections 7623(a) and (b).

They are assured that the award can be reviewed by a court, if the Justice Department does not adequately value their contribution. This certainty has encouraged more than 7,000 whistleblowers to report fraud to the Department of Justice through the False Claims Act. The payoff to taxpayers has been huge. Altogether, the US Treasury and state governments have recovered nearly $30 billion in civil settlements and criminal fines as a result of whistleblower cases since Congress strengthened the whistleblower provisions of the FCA in 1986. Nearly half of that amount has been recovered in just the past five years, as the public has become more familiar with the False Claims Act and the qui tam provisions.

At the same time, the amounts recovered from individual cases continue to set records: $2.3 billion from a civil and criminal settlement in 2009 with Pfizer Inc., which is the largest US recovery in history; $325 million from a civil and criminal settlement in 2009 with Northrop-Grumman, which was the largest defense contractor settlement in a whistleblower case; and $302 million in 2009 from a civil and criminal settlement with Quest Diagnostics, which was the largest settlement ever paid by a medical lab company for a faulty product.

III. THE SEC'S PROPOSED RULES ARE AT ODDS WITH THE LAW

Congress' intent in expanding and reinvigorating the SEC's limited whistleblower program is straightforward:

> The Whistleblower program aims to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated securities laws and recover money for victims of financial fraud. Senate Report at 110.

The statute also advises that the program's rules and regulations should be "clearly defined and user-friendly." Dodd-Frank § 922(d)(1). The legislative history further directs that the SEC's whistleblower program is "to be used actively, with ample awards to protect the integrity of the financial markets." Id. at 112.

These clear statements should be the touchstone for the SEC's rulemaking. Yet, the proposed rules are anything but "clear" or "motivating." They are labyrinthine, often vague, and send a general message of discouragement to potential whistleblowers. Overall, the rules articulate numerous non-statutory bases for denying an award; dilute appellate rights; thwart individuals with the most valuable information; and propose a baffling award process that creates

undue burden for individuals. Taken together, the SEC's proposed rules ignore two decades of success under the FCA's whistleblower program and two decades of failure under the SEC's predecessor whistleblower program.

The SEC's proposed rules go off-track in two ways: First, the proposed rules achieve, in effect, the kind of discretionary program that Congress rejected through Dodd-Frank. Second, the proposed rules ignore Congress' clear instruction to create a program that motivates knowledgeable insiders to assist securities law enforcement. Instead, the proposed rules are predicated on the incorrect assumption that whistleblowers' assistance in achieving SEC goals would compete with company internal reporting procedures. This is a faulty construct for rulemaking – it is not supported by the statute and it fails to recognize the practical reality that robust statutory whistleblower programs strengthen, rather than dilute, internal compliance efforts.

Dodd-Frank sets forth only three general requirements for a whistleblower to be entitled to an award, provided that a threshold $1 million is recovered: the whistleblower must (1) submit "original information" that is based on the individual's "independent knowledge" or "independent analysis"; (2) the submission must be made "voluntarily"; and (3) the submission must lead to a successful enforcement action. We believe that for the SEC's whistleblower program to realize its enormous promise, the rules as proposed must undergo meaningful revision to align them with Dodd-Frank's provisions, as discussed below.

1. Proposed Rule 21F-4(b)'s Definition of "Original Information" Impermissibly Creates Numerous Non-Statutory Bases to Deny Whistleblower Awards

Congress intentionally limited the occasions on which an award could be denied for a very basic reason – imposing impediments to awards chills the submission of valuable information by whistleblowers. With this in mind, Dodd-Frank created only four, narrowly drawn bases for disqualifying a whistleblower. Dodd-Frank § 922(b)(2). These include disqualification where: (1) a whistleblower, at the time the information was acquired, was an employee, member or officer of "an appropriate regulatory agency," the Department of Justice, a self-regulatory organization, the Public Accounting Oversight Board, or a law enforcement organization; (2) a whistleblower is convicted of a criminal violation related to the action for which he might receive an award; (3) a whistleblower gains the information through an audit

required by the securities laws and for whom a submission would be contrary to requirements of Section 10A of the 1934 Act; and (4) a whistleblower fails to submit information to the SEC in the required form. Section 21F (b)(2). The statute goes no further than this.

It is important to note that each of these statutory bases for denying an award is either known, or ascertainable to a high degree of certainty, at the time a whistleblower makes a submission. Such clarity is vital to the success of a whistleblower program because it assures those considering making a submission that if they fulfill established, clear requirements (and the enforcement action recovers more than $1 million), they will be entitled to an award of between 10 and 30 percent of amounts recovered. This certainty is paramount in motivating whistleblowers to take the personal and professional risks in stepping forward. The success of the False Claims Act stands as proof. Uncertainty – such as that inherent in the SEC's predecessor discretionary program – causes even well-intended whistleblower programs to fail.

In this instance, the SEC's proposed rules stray from Dodd-Frank's restrained approach by greatly expanding the bases for denying a whistleblower award and creating ill-defined terms that inject even greater uncertainty into the process. In particular, Proposed Rule 21F-4(b)(4)'s definition of "original information" creates sweeping, and often vague, status exclusions that would disqualify broad categories of whistleblowers far beyond what Congress envisioned or the statute articulates. In many instances, those most likely to be disqualified are also those likely to have the best and most significant information of securities frauds.

In addition, many of the SEC's additional bases for disqualification are contingent upon the agency's exercise of discretion and can be neither known nor ascertained at the time a submission is made. Such contingency and uncertainty as to the entitlement to an award undercuts the mandatory nature of the statutory awards and will no doubt discourage whistleblower submissions. In particular, Proposed Rule 21F-4(b)(4) states that the "Commission will not consider information to be derived from your independent knowledge or independent analysis if you obtained the knowledge or the information upon which your analysis is based" through seven prohibited sources. As mentioned above, none of the seven exclusions created in the proposed rules appears in Dodd-Frank.

TAF provides comments and recommendations as to each of these non-statutory disqualifications below.

(a) Proposed Rule 21F-4(b)(4)(i) denies a whistleblower an award if he received "independent knowledge" "[t]hrough a communication that was subject to the attorney-client privilege, unless disclosure of that information is otherwise permitted by § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise." This definition of "independent knowledge" has no basis in the statute and should be viewed skeptically. The handling and use of privileged information is appropriately addressed through rules governing the use of privileged information as evidence, and not through developing new sanctions on those who provide that evidence. Indeed, judicial decisions and state ethics rules already provide ample guidance on the circumstances under which attorney-client communications can properly be used by the Government as evidence. To create a separate basis for disqualification goes beyond what the SEC should or needs to do.

Rather than creating a non-statutory basis for disqualification, the SEC should take a more effective approach by proposing a rule that governs the submission and handling of putatively privileged information, and excludes validly privileged information as evidence. This recommended approach is consistent with the Justice Department and IRS whistleblower programs, which also exclude the use of attorney-client privileged information in almost every circumstance. Neither program, however, makes it an independent basis for denying an award, and neither does Dodd-Frank. Indeed, under a rule that addresses privilege issues by excluding validly asserted attorney-client privileged information, whistleblowers who exclusively rely on privileged information would not be entitled to an award because they have no non-privileged information to submit. Thus, an approach that excludes validly asserted privileged information as evidence is both consistent with Dodd-Frank and results in no award being paid in situations where the privilege has been abused.

The approach recommended by TAF would fairly distinguish between individuals who exclusively rely on privileged information and those who have independent knowledge of violations in addition to privileged information. A rule that excludes privileged evidence would sufficiently discourage persons with no information other than the privileged materials, while not

penalizing those who have sufficient non-privileged information but who may also inadvertently submit privileged information.

(b) Similarly, Rule 21F-4(b)(4)(ii) proposes that an award be denied if the whistleblower obtained knowledge "[a]s a result of the legal representation of a client on whose behalf [the whistleblower's] services, or the services of [the whistleblower's] employer or firm, have been retained, and [the whistleblower] seek[s] to use the information to make a whistleblower submission for [his] own benefit, unless disclosure is authorized by § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise."

As was true with respect to Proposed Rule 21F-4(b)(4)(i), this provision is without basis in the language of Dodd-Frank and would place the SEC in the position of deciding ethical issues governing attorneys that are already (and better) addressed under state law by judicial decisions and rules of ethics. Again, the better approach is that followed by the Justice Department and the IRS – i.e., exclude validly privileged information from consideration, and leave sanctions against attorneys to those professional and judicial tribunals charged with enforcing the relevant conduct rules. As mentioned above, under the approach suggested by TAF, submissions that are derived solely from validly privileged information would fail by virtue of the exclusion of that evidence.

(c) Proposed Rule 21F-4(b)(4)(iv) disqualifies any whistleblower "with legal, compliance, audit, supervisory, or governance responsibilities for an entity, and the information was communicated to [the whistleblower] with the reasonable expectation that [the whistleblower] would take steps to cause the entity to respond appropriately to the violation, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith."

This rule and the one following in subsection (v) are among the most problematic proposed by the Commission and would bar a wide range of potential whistleblowers, among whom are those most likely to possess significant information of wrongdoing. The "supervisory" responsibilities relevant to disqualification under this subsection are undefined, and could be broadly cast to include a vast number of employees in any organization. Such vagueness would no doubt chill many from stepping forward. Although the provision contains an exception for circumstances where the subject entity "did not disclose the information to the

Commission within a reasonable time or proceeded in bad faith," the exception itself places unreasonable burdens on the potential whistleblower.

Indeed, the proposed rule raises the larger question of why a requirement mandating that concerns be reported internally first is bad policy. As discussed below, any "one-size fits all" requirement to report concerns internally first is unworkable in any robust whistleblower program. In TAF's experience, the most significant frauds are directed from the top, rather than by mid- or low-level employees. Requiring that a whistleblower first advance his allegations internally to officials who may be the architects of the scheme places that individual's livelihood in peril. Practical experience shows that reporting high-level wrongdoing to those very wrongdoers is more often than not a fast track to termination, as described below.

The exception to the proposed rule – i.e., when the company fails to disclose the whistleblower's information to the SEC – inherently shows why internal reporting in this instance is not a necessary requirement. The rule proposes a structure where either way the SEC will get the whistleblower's information – it is just a matter of who delivers it first and when. There is no strong policy reason that the wrongdoer should be the one to submit information raised by the whistleblower, and there are very good reasons why the whistleblower should have the option of going first to the SEC, including fear of workplace reprisals.

Congress could have mandated that whistleblowers report claims internally before submitting information to the SEC, but it did not. Congress understands – and the SEC should realize – that hurdles mandating internal reporting will not serve the SEC whistleblower program or, ultimately, the investors.

(d) Proposed Rule 21F-4(b)(4)(v) includes similar exclusions to those found at Proposed Rule 21F-4(b)(4)(iv). It disqualifies individuals who obtain information "from or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential non-compliance with law, unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith."

This disqualification suffers from perhaps even greater overbreadth and vagueness than that proposed by Rule 4(b)(4)(iv). The exclusion bars a broad category of claims by anyone exposed to relevant information through legal, compliance, audit or other undefined "similar

functions," "unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith." Thus, any employee who happens to learn relevant information through exposure to one of the foregoing enumerated functions – even if he may have other sources of knowledge – risks not being able to proceed unless he reports the issue internally. As with subsection (iv), potential whistleblowers in this category would place their careers at risk, potentially for no reward, to try to satisfy the exception to this exclusion, making it highly unlikely that they would provide the SEC with information.

Notably, the phrase "reasonable time" used in Proposed Rules 21F-4(b)(4)(iv) and (v) is also not defined. The SEC's explanatory summary suggests that the question of reasonable time should be left to the Commission's discretion, stating:

> The determination of what is a "reasonable time" in this context will necessarily be a flexible concept that will depend on all of the facts and circumstances of the particular case. In some cases – for example, an ongoing fraud that poses substantial risk of harm to investors – a "reasonable time" for disclosing violations to the Commission may be almost immediate. Nonetheless, given the competing concerns just described, the Commission preliminarily believes that the proposed rule should not define one fixed period that would represent a "reasonable time" in all cases. We anticipate that in evaluating any whistleblower submissions by personnel covered by these exclusions, we will review all of the circumstances of the case after the fact in order to determine whether the company disclosed the misconduct to the Commission within a reasonable time or proceeded in bad faith. SEC Release No. 34-63237 at 26-27.

TAF believes that such sweeping discretion is counter-productive and does not serve the Dodd-Frank program's interests. As discussed above, the question of who delivers the information to the SEC and when is not a reasonable basis upon which to disqualify a whistleblower who either gave the information directly to the SEC, or prompted the company to disclose it later. To bar broad categories of knowledgeable individuals listed in subsections (iv) and (v) simply because they may have submitted information, for example, in Week 1 rather than Week 2 – as determined unilaterally by the SEC – is profoundly unreasonable. The risks and uncertainties subsections (iv) and (v) create would be certain to discourage the vast majority of quality whistleblowers from even bothering to make their allegations known, for the negatives associated with stepping forward would simply not be counterbalanced by a sufficient incentive to make the risk worth taking.

Knowledgeable persons should be permitted alternative means of reporting their concerns, either internally or directly to the SEC, because it increases the probability that violations will be reported, and thus increases the likelihood of compliance in the first instance. Indeed, we know of no other law enforcement paradigm that requires that potential wrongdoers be alerted first, before prosecuting officials learn of the potential wrongdoing. Although constraints on an entity's legal and compliance officials may be appropriate, we believe that finalizing the sweeping and vague categories of affected individuals included in Proposed Rules 21F-4(b)(4)(iv) and (v) would be profoundly poor public policy, and would seriously thwart the use of whistleblower information in achieving enforcement and deterrence goals.

Dodd-Frank is better served if, at minimum, the Proposed Rules were revised to (1) limit the category of affected individuals to designated legal and compliance officers, and (2) narrow and specifically define the "reasonable time" for reporting by the entity as no more than "30 days."

(e) Proposed Rule 21F-4(b)(4)(vi) disqualifies whistleblowers who obtain information "[b]y a means or in a manner that violates applicable federal or state criminal law." This proposed disqualification is directly at odds with Dodd-Frank, which provides only that no award shall be made to "any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower could otherwise receive an award..." Dodd-Frank § 922 (b)(2)(B) (emphasis added); see also Senate Report at 112 ("[a]lso not eligible are whistleblowers who are convicted of a criminal violation related to the case at hand") (emphasis added).

Thus, the statute is clear that only persons convicted of a crime relating to the securities violation are excluded. Yet the proposed exclusion goes much further. Rule 21F-4(b)(4)(vi)'s use of the term "violates" eliminates the statute's requirement of a conviction by an appropriate tribunal, and replaces it with the SEC's judgment as to whether a violation occurred.

It could also preclude whistleblowers from states that criminalize a broad range of conduct that can include, under certain circumstances, the taking of documents obtained in the course of employment. Such prospective whistleblowers could be denied a reward if the SEC adopts a broad reading of certain criminal statutes such as "trespass," "conversion," and other

such laws – readings that no doubt will deter many whistleblowers. Historically, the only issue of concern for the Government in such cases has been whether it may lawfully make use of the documents, and there are many instances where it may do so, as long as it did not direct the whistleblower to take those documents. There is no sound policy reason for a threshold rule barring a whistleblower with probative documents from proceeding, if the Government would be permitted to use those documents by operation of law to prosecute securities violations in any event.

We ask that the Commission revise Proposed Rule 21F-4(b)(4)(vi), by conforming it to the statutory language and excluding only those whistleblowers who are "convicted of a criminal violation related to the judicial or administrative action."

With respect to the independent issue of the copying of documentary evidence of wrongdoing, we also propose that that Commission adopt language similar to the HIPAA[4] regulations governing the taking of documents for the purpose of a fraud investigation. See 45 CFR sec. 164.502(j)(1).

> (j) Standard: Disclosures by whistleblowers and workforce member crime victims.
>
> > (1) Disclosures by whistleblowers. A covered entity is not considered to have violated the requirements of this subpart if a member of its workforce or a business associate discloses protected health information, provided that:
> >
> > > (i) The workforce member or business associate believes in good faith that the covered entity has engaged in conduct that is unlawful or otherwise violates professional or clinical standards, or that the care, services, or conditions provided by the covered entity potentially endangers one or more patients, workers, or the public; and
> > >
> > > (ii) The disclosure is to:
> > >
> > > > (A) A health oversight agency or public health authority authorized by law to investigate or otherwise oversee the relevant conduct or conditions of the covered entity or to an appropriate health care accreditation organization for the purpose of reporting the allegation of failure to meet professional standards or misconduct by the covered entity; or

[4] Health Insurance Portability and Privacy Act, Public Law 104-191, 104th Congress.

> (B) An attorney retained by or on behalf of the workforce member or business associate for the purpose of determining the legal options of the workforce member or business associate with regard to the conduct described in paragraph (j)(1)(i) of this section.

A similar rule would protect the SEC's interest in receiving probative evidence of wrongdoing, and better effectuate the policies underlying the Dodd-Frank whistleblower provision by setting clear standards as to when documents obtained in employment may be copied and submitted to enforcement officials.

(f) Proposed Rule 21F-4(b)(4)(iii) disqualifies a whistleblower if information is obtained "[t]hrough the performance of an engagement required under the securities laws by an independent public accountant, if that information relates to a violation by the engagement client or the client's directors, officers or other employees." The companion provision under Dodd-Frank § 922(c)(2)(C) limits such a bar to "any person who obtained the information provided to the Commission through an audit of a company's financial statements, and making a whistleblower submission would be contrary to the requirements of Section 10A of the Exchange Act."

Section 10A requires independent public accountants to report certain wrongdoing to the SEC. TAF recognizes that a whistleblower award to a public accounting firm may not be appropriate where there is a pre-existing legal obligation on the part of a public accounting firm to report wrongdoing to the SEC. However, where that legal duty is not honored, and the audit firm fails to comply with its obligations under Section 10A, a whistleblower's submission of the information to the SEC is consistent with both Section 10A and the Commission's overall enforcement mission. In such circumstance, the policies underlying both Section 10A and Dodd-Frank weigh in favor of rewarding the whistleblower who reports wrongdoing when the audit firm has failed to.

TAF believes that Proposed Rule 21F-4(b)(4)(iii) should be revised to create an exception for instances when the information is not reported to the SEC by the client or the public accounting firm within the time periods required under Section 10A..

2. Proposed Rule 21F-4(a)'s Definition of "Voluntary Submission of Information" Is Overbroad And Vague

Proposed Rule 21F-4(a) provides that a submission is "made voluntarily within the meaning of § 240.21F of this chapter if [the whistleblower] provide[s] the Commission with the information before [the whistleblower] or anyone representing [the whistleblower] (such as an attorney) receives any request, inquiry, or demand from the Commission, the 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." The proposed definition also provides that a whistleblower "will be considered to have received a request, inquiry or demand if documents or information from [the whistleblower] are within the scope of a request, inquiry, or demand that [the whistleblower's] employer receives unless, after receiving the documents or information from [the whistleblower, the] employer fails to provide [the whistleblower's] documents." Id. at (a)(2).

This definition is overbroad and vague, and could potentially bar cases where a general or informal request for information is made, yet the whistleblower's information is arguably "relevant" to the request. This would result in cases being barred, even when the requesting authority was not focused on the "relevant" issue and had not specifically intended to ask for documents relevant to that issue. For example, a request by a municipal bond issuer for completed transaction documents from a guaranteed investment contract ("GIC") provider could preclude a "voluntary" submission of whistleblower allegations that the GIC provider engaged in large-scale bid-rigging, even if those allegations were not publicly known. In this instance the information requested is "relevant" to the whistleblower's allegations, even if the requesting agency is completely unaware of those allegations.

Rather than create an exclusion based on whether the information is "relevant" to a request, Rule 21F-4(a) should be revised so that it bars individuals whose allegations are the subject of investigation by the public entities enumerated in the Rule. This is far more consistent with the policy goals underlying the proposed rule – i.e., to preclude parasitic and opportunistic whistleblowers. The suggested revision targets those who submit allegations that are already

under investigation, while not sweeping in whistleblowers whose information may be relevant to a request, but whose allegations are as yet unknown.[5]

3. Proposed Rule 21F-4(b)(5)'s Definition Of "Original Source" Is Problematic

Dodd-Frank has two "source" provisions. If the whistleblower's information is exclusively derived from allegations that are "publicly disclosed," Dodd-Frank requires the whistleblower to be "a source" of the information. Dodd-Frank § 922(a)(3)(C). This is similar to the public disclosure provisions of the False Claims Act[6], although the FCA provisions refer to an "original source." 31 USC § 3730(e)(4)(A). In any event, Dodd-Frank's use of the term "a

---

[5] The distinction between information and allegations is also found in the FCA, which in some instances may bar a whistleblower action where "substantially the same allegations or transactions as alleged in the action or claim were publicly disclosed." 31 USC § 3730(e)(4). The False Claims Act's focus on "allegations" that are in the public domain is a targeted, and we think appropriate, approach to precluding opportunistic – but not valid – whistleblowers.

[6] As acknowledged by the SEC, some of the key terms in the proposed rules have "antecedents in the False Claims Act" due to the fact that "the qui tam provisions of the False Claims Act have played a significant role in the development of whistleblower law generally." SEC Release No. 34-63237 at 13, n. 14. To understand these terms in the context of Dodd-Frank, it is important to understand the original purposes and meanings of these terms as first used in the FCA, 31 U.S.C. § 3729 et seq. The concepts of "original information," "independent knowledge," "voluntarily" providing information, and being an "original source" of information, which are referenced in the proposed rules, come primarily from the "public disclosure" and "original source" provisions of the FCA.

The public disclosure provision of the FCA bars a narrow band of claims "if substantially the same allegations or transactions as alleged in the action or claim were publicly disclosed" in certain enumerated fora (e.g., a civil or criminal hearing, government audit, or the news media), unless the person bringing the action "is the original source of the information." 31 USC § 3730(e)(4)(A). The term "original source" is then defined under the FCA to mean "an individual who either: (i) prior to a public disclosure under subsection (e)(4)(a) has voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based, or (2) who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing an action under this section." 31 U.S.C. § 3730(e)(4)(B).

source" makes clear that there can be more than one "source" for purposes of the public disclosure provisions.

In a different context, however, Dodd-Frank uses the phrase "original source." If the Commission knows of the information from a source other than the whistleblower, the whistleblower may still collect if he or she is "the original source" of the information. Dodd-Frank § 922(a)(3)(B). The use of the definite article suggests that there can be only one "original source" in a particular case.

The SEC's rules indicate that a whistleblower will be deemed the original source if the Commission initially received the information from a governmental organization and the whistleblower had voluntarily provided it to that organization. Rule 21F-4(b)(5). But the "original source" requirement in Dodd-Frank is not limited to situations where the SEC learns of the fraud through government agencies; it also includes sources that are private parties, including other whistleblowers. See e.g., Rule 21F-4(b)(1). In that context, the SEC's proposed rule is troublesome. For example, assume Whistleblower A learns of the fraud from his supervisor, but the supervisor does nothing to stop it, so Whistleblower A files a submission with the SEC. If the supervisor learns about the submission and files his own later submission, he ought to be barred because the SEC already knows about the fraud. But under the SEC's rule, the parasitic supervisor could qualify for a reward because he was the "original source" of Whistleblower A's information.

Proposed Rule 21F-4(b)(5) should be revised to preclude such opportunistic submissions.

4. Proposed Rule 21F-4(b)(2)'s and (b)(3)'s Definitions of "Independent Knowledge" And "Independent Analysis" Go Well Beyond What Congress Intended

Dodd-Frank provides that "original information" that may qualify for a whistleblower award means information that is, inter alia, "derived from the independent knowledge or analysis of a whistleblower." Dodd-Frank § 922(a)(3). Proposed Rule 21F-4(b)(2) defines "independent knowledge" to mean "factual information in your possession that is not derived from publicly available sources." The proposed definition of "independent knowledge" has the effect of narrowing the statutory definition of "original information." Although the statute precludes

claims based on information "already known to the Commission," Dodd-Frank § 922(a)(3)(B), it contains no language prohibiting claims based on "publicly available information."

Likewise, the statute also precludes original information that is "exclusively derived from an allegation made" in six specifically enumerated fora. Dodd-Frank § 922(a)(3)(C). To the extent information is publicly available, this statutory provision would only preclude an award if the information were disclosed in at least one of the enumerated fora and the whistleblower's information was "exclusively derived" from it. This provision of Dodd-Frank parallels the "public disclosure" provision under the FCA. 31 USC § 3730(e)(4).

By defining "independent knowledge" to bar information derived from any public sources, and not just the six identified in the statute, the SEC would bar a broad category of claims that Dodd-Frank would otherwise permit under Sections 922(a)(3)(B) and (C).

While Proposed Rule 21F-4(b)(3) permits a whistleblower to proceed based on "independent analysis" of publicly available information under certain specified circumstances, the Proposed Rule requires that the "independent analysis" "reveal[] information that is not generally known or available to the public." Id. Accordingly, if a whistleblower were to cause the SEC to focus on publicly available information, of which it was not otherwise aware, that would not form the basis for a claim. If it were not for the fact that "independent knowledge" was defined in the first instance to exclude claims based on publicly available information, this exception for "independent analysis" would not even be necessary.

5. Proposed Rule 21F-4(c) Imposes Additional, Non-Statutory Hurdles To The Meaning Of "Led To The Successful Enforcement"

To qualify for an award, Dodd-Frank requires that the whistleblower's information must have, inter alia, "led to the successful enforcement of the covered judicial or administrative enforcement action." Dodd-Frank § 922(b)(1). Proposed Rule 21-F4(c)(1) defines the phrase: "information that led to the successful enforcement" to mean information that causes the SEC staff "to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning new or different conduct as part of a current examination or investigation, and [the whistleblower's] information significantly contributed to the success of the action" (emphasis added).

As proposed, the Rule is overbroad and deviates significantly from the statutory language. The Commission thus greatly broadens the agency's discretion to deny awards beyond what Dodd-Frank contemplates. TAF agrees that commencing, opening, or reopening an examination or investigation are all appropriate definitions for what "leads to a successful enforcement action." Each term connotes a causal connection between the submission of the information and the ultimate enforcement action. That is what Congress intended.

However, the additional requirement that information "significantly contribute" to the success of the action goes far beyond the law and introduces unacceptable vagueness and contingency – thereby diluting the structure of mandatory awards enacted by Congress. Judgment of what constitutes a "significant contribution" is subjective and leaves the decision as to whether to make an award to the Commission's sole discretion.

Indeed, Dodd-Frank rejected a structure that left the question of whether to make an award to the SEC's discretion. That discretionary structure proved to be a failure under the SEC's predecessor whistleblower program. The statute makes clear that the significance of the contribution is not a threshold consideration as to whether an award should be made. See § 922(b)(1).[7] The significance of the whistleblower's contribution is only a factor in determining how much an award should be – i.e., where on the range of 10 to 30 percent it should be. See § 922(c)(1)(B)(i)(I).[8] Yet the proposed rules would make contribution not only a factor in determining how much to award, but whether to make an award at all. By importing considerations for determining the amount of an award into the definitions of whether to award, the SEC has rendered Congress' mandatory awards a matter of agency discretion. Such uncertainty will only discourage whistleblowers from coming forward, thereby undermining Congressional intent and the purposes of the whistleblower program.

---

[7] "[T]he Commission shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or enforcement action. . . ."

[8] "In determining the amount of an award. . . the Commission (i) shall take into consideration – (I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action" (emphasis added).

The proposed rule exceeds the bounds of Dodd-Frank, and it should be revised to conform to the structure and language of the statute.[9] The phrase "and your information significantly contributed to the success of the action" should be deleted.

6. Proposed Rule 21F-12 Turns The Statutory Right Of Appeal On Its Head

As mentioned above, judicial review of the whistleblower award determination is one of the essential components of any meaningful whistleblower program. This fact was recognized by Congress in enacting Dodd-Frank. As noted by the Senate Report: "The Committee feels that this [appellate] review process will significantly contribute to make the program reliable for persons who are contemplating whether or not to blow the whistle on fraud. It will add to the notion of enforceable payout." Senate Report at 112.

Accordingly, the statute balances the Commission's discretion to determine the award amount with the whistleblower's entitlement to appeal an award or denial of an award on abuse of discretion grounds. The statute states:

> Any such [award] determination, except the determination of the amount of the award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States . . . ." Dodd-Frank § 922(f).

Subsection (b), which is incorporated by reference in subsection (f), in turn, provides:

> In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to:
>
> > (A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and
> >
> > (B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions.

---

[9] The False Claims Act is similarly structured and distinguishes between threshold entitlement, and factors for determining the size of the award. 31 USC § 3730(d).

And Subsection (c), which is incorporated by reference in subsection (b), provides the criteria for determining the amount of the award, including, inter alia, (1) the significance of the whistleblower's information; and (2) the degree of assistance by the whistleblower and counsel.

Although this creates an intricate statutory structure, because subsection (b) incorporates subsection (c), those subsections are in turn both incorporated into subsection (f)'s delineation of a whistleblower's right of appeal. As a result, a whistleblower may appeal both whether the award falls within the 10 to 30 percent mandated under subsection (b), and also whether the criteria for determining an award have been appropriately applied under subsection (c).

The legislative history explains that this is the intended result: "The SEC has discretion in determining the amount and whether or not a whistleblower is eligible to be awarded. In cases when whistleblowers feel that the SEC had abused its discretion in determining the amount of the award, they have the right to appeal, within 30 days of the decision, to a court of appeals." Senate Report at 112.

Yet, Proposed Rule 21F-12 unduly constricts the whistleblower's right to appeal by eliminating any judicial scrutiny of the Commission's determination of the amount of the award and whether the Commission has abused its discretion in applying the statutory criteria set forth in Dodd-Frank §922(f). The proposed rule provides that a whistleblower may only appeal a "determination of whether or to whom to make an award," and states that the "determination regarding the amount of an award . . . is not appealable." Rule 21F-12(a).

This proposed rule is at odds with Dodd-Frank and should be revised to conform with Congress' intent that whistleblowers who believe that the SEC abused its discretion have the right to appeal the amount of an award, as well as the denial of an award.

From a practical perspective, any concerns the Commission may have that the full appeal rights provided by Dodd-Frank would lead to a flood of award litigation should be allayed by the experience with award challenges under the False Claims Act. Notwithstanding the fact that the FCA provides district court jurisdiction over the determination of awards to whistleblowers, 31 USC §3730, after nearly 25 years of experience and thousands of matters filed, the number of award determinations litigated in court is extremely low. We know of only a handful.

7. Proposed Rule 21F-10 Creates A Burdensome And Backwards Claims Process

Proposed Rule 21F-10 unduly burdens whistleblowers by requiring that they notify the SEC of their claim for reward upon the successful completion of an enforcement action. The rule states that when an SEC action results in monetary sanctions greater than $1 million, "the Whistleblower office will cause to be published on the commission's website a "Notice of Covered Action," and that a whistleblower "will have sixty days from the date of the Notice of a Covered Action to file a claim for an award based on that action, or that claim will be barred" (emphasis added).

This procedure is backwards and creates unnecessary hurdles for whistleblowers who – by law – are entitled to receive a mandatory award. Clearly, the SEC is best-positioned to notify potential claimants that the right to an award, if any, has ripened. It will handle enforcement actions in all instances and knows which individuals have made submissions. If finalized, the rule would almost certainly result in denying qualified whistleblowers their rightful awards in many cases.

But not only is the proposed rule impractical and unfair, it is also contrary to the law. The statute is clear: The Commission "shall pay an award" where a whistleblower (1) voluntarily provided, (2) original information, (3) that led to the successful enforcement action. The statute is mandatory. There is no additional language providing for forfeiture of an award for failure to advise the SEC of facts that are already known to it. Proposed Rule 21F-10 should be revised so that the SEC shall advise whistleblowers when the right to a potential award has ripened by virtue of the recovery of more than $1 million in monetary sanctions.

IV. The SEC Rules Should Not Include A Broad Requirement to Report Internally

The Commission has requested comment on the question of whether whistleblowers should be required to report to their companies' internal compliance programs before filing a submission. Dodd-Frank does not impose an internal reporting requirement for good reason. Mandating that all allegations of wrongdoing first be reported to the suspected wrongdoer before being communicated to law enforcement authorities is both unprecedented and bad public policy and would profoundly discourage individuals from stepping forward. TAF has no doubt that such a requirement would render the SEC's whistleblower program ineffective from the start.

Imposing a blanket internal reporting requirement is a solution to a problem that does not exist. Nearly twenty-five years of experience under the FCA shows that financial incentives do not systematically motivate individuals to opportunistically avoid reporting their concerns internally. Proponents of the mandatory reporting requirement offer no evidence of a widespread diminution in the use of internal reporting mechanisms. Indeed, to the contrary, it is our membership's experience that the vast majority of whistleblowers do, in fact, report their concerns first to either their superiors or compliance officers, and only avail themselves of statutory whistleblower programs when their concerns have been dismissed or unaddressed, or when they suffer retaliation.

Numerous cases show the serious consequences whistleblowers often suffer when they report internally. The following examples stand as reasons enough why a mandatory internal reporting requirement should not be imposed.

1. Cheryl Eckard was terminated from her job after raising concerns that Glaxo SmithKline ("GSK") was manufacturing prescription drugs containing serious contaminants. In October 2010, GSK paid $750 million in civil damages and criminal fines to resolve the allegations in October 2010. Eckard, who was a company quality control manager, repeatedly alerted a string of GSK executives to a catalogue of breaches. After she was fired in 2003, she phoned JP Garnier, then-CEO of GSK. Garnier declined to take the call to speak to her about her findings and the company's lack of response.

2. Martin Woods, a former employee of Wachovia's anti-money laundering unit, was told to keep quiet lest he be fired over his concerns of massive wrongdoing. He disclosed what he knew to authorities privately, but then Wachovia blamed him for the wrongdoing and subjected him to disciplinary proceedings. Wachovia paid $160 million earlier this year to settle related federal charges.

3. Robert McCaslin's FCA allegations of Medicare billing fraud resulted in Harris County Hospital District paying $15.5 million in 2007. Prior to initiating an FCA action, however, McCaslin reported the billing fraud to his supervisors only to

find out that they were already aware of it. In one meeting, a manager told him "that's just the way we do it here."

4. Matthew Lee, a former senior vice president of finance at Lehman Brothers, was fired after informing senior managers about $50 billion moved off its balance sheet. These assets were primarily risky investments in mortgage-backed securities, and the accounting chicanery helped the company conceal the heavy risks it was taking.

5. Bruce Boise was terminated and blackballed after complaining about his former employer Cephalon's illegal marketing practices concerning prescription drugs. Cephalon paid $425 million to the Justice Department to resolve the allegations.

6. Christopher Gobble raised concerns to his former employer – Forest Laboratories – about illegal drug marketing practices and was terminated within three months of doing so. He subsequently filed an FCA action in which the Justice Department recently recovered over $300 million in civil and criminal penalties.

It is important to note that in these cases – as in most cases of significant wrongdoing – the fraudulent schemes are initiated or directed at the top levels of an organization. Critics of whistleblowers suggest that internal reporting is best at addressing and stopping fraud. But not only is this view simplistic, it also ignores the observed fact that the architects of most egregious frauds sit at or near the top of an organization. Requiring formal internal reporting as a threshold qualification for the SEC whistleblower program would not deter corporate wrongdoing. But it would succeed in discouraging potential whistleblowers from alerting the SEC to serious wrongdoing.

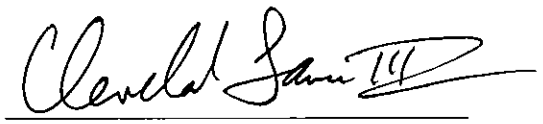
TAF believes that the right approach is found in the comments to Rule 21F-6 and Rule 21F-4(b)(7) which encourage internal reporting without penalizing those who do not report. The Commission's comments to Proposed Rule 21F-6 provide that an individual's reporting internally will be considered a "plus" factor in an award determination and justify a higher reward. At the same time, this approach does not make internal reporting a prerequisite to

getting a reward within the guaranteed 10 to 30 percent range. In addition, if a whistleblower reports internally and then goes to the SEC, the rules provide that the SEC submission will be deemed made as of the date of the internal reporting. Rule 21F-4(b)(7) allows whistleblowers to effectively backdate their submissions to the time they reported fraud internally. We agree with this rule conceptually, but believe that it should be modified to extend the period from 90 days to 180 days. Whistleblowers often report fraud with every expectation that the report will be acted upon. The realization that the company intends to ignore the whistleblower's efforts often takes a great deal of time to develop – far longer than three months. The rule should accommodate this practical reality by extending the "backdating" period to six months. The incentives in comments to Rule 21F-6 and Rule 21F-4(b)(7) strike the right balance.

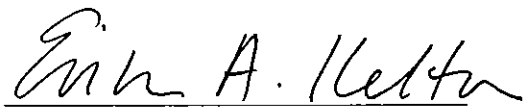
TAF urges the SEC not to create a mandatory internal reporting requirement.

Should you have any questions or need additional information, please do not hesitate to contact Cleveland Lawrence III at (202) 296-4826, ext. 27 or Erika Kelton at (202) 296-7572.

Sincerely,



Cleveland Lawrence, III
Acting Executive Director
Taxpayers Against Fraud



Erika A. Kelton
Phillips & Cohen LLP
Washington, DC
Chair, SEC Whistleblower Committee
Taxpayers Against Fraud