M E M O R A N D U M

To: File No. S7-33-10

From: Stephen L. Cohen
Associate Director, Division of Enforcement

Date: March 31, 2011

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

On March 15, 2011, Chairman Mary Schapiro, Chairman's Counsel Matthew Strada, Sean McKessey, Chief of the Whistleblower Office and I met with the following individuals: Mark Cohen, Executive Director, Government Accountability Project, Tom Devine, Legal Director, Government Accountability Project, Reuben Guttman, Co-Founder, Voices for Corporate Responsibility and director at Grant & Eisenhofer, Michael Smallberg, Investigator, Project on Government Oversight, Jason Zuckerman, Government Accountability Project Advisory Committee and Principal, The Employment Law Group .

The participants discussed the Commission's proposed rules implementing the whistleblower provisions of Section 21F of the Securities Exchange Act of 1934. Specifically, most of the following proposed topics were discussed:

1. Industry proposal to require internal whistleblowing.
2. Coordinating inter-agency investigations of related actions.
3. Impact of barring awards to whistleblowers who disclose violations to other agencies.
4. Sharing information with whistlelowers and updating whistleblowers on the status of an investigation.
5. Excluding organizations from the definition of "whistleblower."
6. Proposed definitions of "original information" and "independent knowledge."
7. Requirement to prove that disclosure led to a successful enforcement action.
8. Proposed definition for the term "action."
9. Proving that information led to a successful enforcement action.
10. Proposed procedures to make a claim for an award.
11. Confidentiality of submissions.
12. Prohibiting use of confidentiality agreements to bar whistleblowing to the SEC.

All of the areas of discussion are covered by the comments already posted to the public comment file by Voices for Corporate Responsibility and POGO or in documents presented at the meeting and posted to the File with this memorandum.

FOR CORPORATE RESPONSIBILITY
VOICES

December 17, 2010

<u>Electronically and Via UPS</u>

Elizabeth M. Murphy
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: File Number S7-33-10- Comments of Voices for Corporate Responsibility, the Government Accountability Project, Change to Win, and the National Employment Lawyers Association on the Securities and Exchange Commission's Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

Dear Ms. Murphy:

This document encompasses the comments of Voices for Corporate Responsibility, the Government Accountability Project, Change to Win, and the National Employment Lawyers Association on the Securities and Exchange Commission's ("SEC" or "Commission") Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 ("the Exchange Act") .

I. <u>Overview</u>

The Dodd Frank Wall Street Reform and Consumer Protection Act, PL 111-203, 2010 HR 4173 (The "Dodd-Frank Act" or "Act") was passed to protect consumers and investors by preventing the type of financial fraud that has recently destroyed the retirement savings of millions of U.S. citizens. The Act provides a myriad of mechanisms to increase the accountability and oversight of Wall Street and key players in America's financial sector. Some of the most powerful provisions of the Act are those accorded by Section 21F "Securities Whistleblower Incentives and Protection."[1] If the SEC is able to heed the information brought forth by whistleblowers, the Commission will be in a position to take action before wrongful conduct causes injury to investors.

Our comments raise serious concerns that the Proposed Regulations indicate that the SEC does not have or does not plan to implement a process to work closely with meritorious whistleblowers and utilize their information and testimony. Curiously, the Proposed Rules set forth a process, to occur after a successful SEC enforcement action, requiring the whistleblowers to petition the SEC to advise the Commission of his or her status as a whistleblower with an entitlement to an award. If the Commission was working closely with the whistleblower, such a petition would not be necessary as the Commission would be cognizant of the whistleblower's contribution.

The text of the Proposed Rules similarly reveals an attempt to balance a tension between SEC compliance enforcement and self regulation through internal compliance mechanisms. The Proposed Rules provide too much deference, however, to internal compliance procedures. In its rulemaking efforts, the Commission must be reminded

[1] The legislative history behind the enactment of the Act reveals a clear Congressional mandate to encourage whistleblowers to come forward. In an impassioned speech on the importance of the Act, Congressman Charlie Melancon of Louisiana pledged his support, stating: "One thing we have learned through this tragedy is that the greed of criminals . . . is matched only by the danger of deregulation. The Securities and Exchange Commission, which was designed to prevent this very situation, is deeply flawed. The bill we are now considering reforms the agency and strengthens its authority to effectively and forcefully protect investors and our securities markets . . .. the bill creates incentives for whistleblowers to expose crooks. . .. Through a new whistleblower bounty program, we will reward individuals who provide tips that lead to the prosecution of fraud." Encouraging whistleblowers to come forward was an important consideration for Congress in passing the Act and the proposed SEC regulations must effectuate that intent.

that deference is not warranted where, by definition, securities fraud occurs with the knowledge and consent of the highest levels of corporate governance. Against this backdrop, internal compliance programs will almost certainly fail to effect change.[2]

These comments address these and other concerns.

II. Background on Those Filing Comments

Voices for Corporate Responsibility, www.voicsforcorporateresponsibility.com, is a project of the law firms of Grant & Eisenhofer PA, Mehri & Skalet PLLC, and the Employment Law Group, which was formed with an advisory board[3] to accomplish the following goals:

- To help corporate employees, including professionals, to stand up against officer and director decision-making that is motivated by their own personal greed and short-term interests;
- To encourage corporate employees, including professionals, to participate in regulatory and legislative reform that protects their right to address conduct that adversely impacts the corporation, shareholders, and consumers;
- To prompt corporate employees, including professionals, to recognize wrongdoing in their own place of employment, and to take action;
- To enable corporate employees, including professionals, who have lost their jobs or have been injured as a result of wrongful conduct, to network with one another in order to make themselves whole.

The Government Accountability Project (GAP) is a non-partisan, non-profit organization specializing in legal and other advocacy on behalf of whistleblowers. GAP has a 30-year history of working on behalf of government and corporate employees who

[2] Accordingly, to the extent the Commission has required a comment on whether whistleblower should be required to utilize employer-sponsored complaint and reporting procedures, the answer is there should be no such requirement. (See request for comment no. 18).

[3] Information about "Voices" is contained at www.voicesforcorporateresponsibility.com.

expose illegality, gross waste and mismanagement, abuse of authority, substantial or specific dangers to public health and safety, or other institutional misconduct undermining the public interest. GAP played a lead role in the passage of the whistleblower provisions of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), 18 U.S.C. §1514A, and is cited in its legislative history. *See* 148 CONG. REC. 6439-6440, 107th Congress, 2d Session (2002). Additionally, GAP was instrumental in implementing the anti-retaliation provisions and Sarbanes-Oxley revisions in the Dodd-Frank Act.

Change to Win is a labor federation of four national and international labor unions - the International Brotherhood of Teamsters, Service Employees International Union, United Farm Workers of America, and United Food and Commercial Workers International Union - which collectively represent approximately 5.5 million working men and women throughout the United States. As set forth in Change to Win's constitution, among the objects and purposes of the organization are to protect the rights of working people and to gain for them "affordable, quality health care" and "a retirement with dignity." To these ends, the Change to Win Investment Group works to encourage long-term shareholder returns necessary to enable funds established by its affiliates and workers themselves to invest safely and without fear of fraud or mismanagement. For their own part and on behalf of the Unions and workers they represent, Change to Win and the Change to Win Investment Group therefore have a strong interest in insuring the effective implementation of Section 12F and in promoting the adherence to the law and corporate responsibility that was the primary purpose for its enactment.

The National Employment Lawyers Association (NELA) advances employee rights and serves lawyers who advocate for equality and justice in the American workplace. Founded in 1985, NELA is the country's largest professional organization comprised exclusively of lawyers who represent individual employees in cases involving labor, employment, and civil rights disputes such those challenging retaliation against whistleblowers. NELA provides assistance and support to lawyers in protecting the rights of employees against the greater resources of their employers and the defense bar. NELA and its 68 state and local affiliates have more than 3,000 members nationwide committed to working for those who have been illegally treated in the workplace. A great many of NELA's members specialize in representing whistleblowers who face retaliation for having uncovered fraudulent or other unlawful conduct in their workplaces.

The constituencies of Voices for Corporate Responsibility, the Government Accountability Project, Change to Win, and the National Employment Lawyers Association share a particular interest in the implementation of Section 21F of the Securities Exchange Act as introduced by Section 922 of the "Dodd-Frank Act." This provision is critically important to providing early warning information to the SEC before wrongful conduct causes massive injury to shareholders as was the case with those that invested in Enron, Madoff, and Tyco. Because of the damage that securities fraud can cause to individual investors, retirees and institutional investors, efficient implementation of this legislation is critical. And efficient implementation requires strong protections for employees who blow the whistle.

III. The Dodd-Frank Enabling Legislation

The Dodd-Frank Act establishes a whistleblower program requiring the Commission to pay an award, subject to certain limitations and conditions, to whistleblowers who voluntarily provide original information to the Commission about violations of the federal securities laws leading to the successful enforcement of the covered judicial or administrative action, or related action.

These comments address: (1) matters not addressed by the Proposed Rules, (2) specific Proposed Rules, and (3) specific requests by the SEC for comments on the Proposed Rules. The following areas are covered:

- No requirement to utilize employer-sponsored complaint and reporting procedures (page 3 footnote 2);
- Matters not covered by the Proposed Rules, including the coordination of inter-government agency investigations (page 6);
- The proposed definition of a whistleblower, limited to the "individual" (page 8);
- The payment of awards and related actions (page 9);
- The proposed definition of "original information" (page 14);
- The requirements for information that leads to successful enforcement (page 17);
- The proposed definition for the term "action" (page 18)
- The proposed procedures to make a claim for an award (page 19);
- Confidentiality of submissions (page 20); and
- Staff communication with the whistleblower (page 21)

IV. Comments

A. Matters Not Covered by the Proposed Rule

1. Coordination of Inter-Government Agency Investigation

The Proposed Rules do not address the coordination of investigations by overlapping Federal agencies. While the Proposed Rules acknowledge the likelihood of related actions by other agencies (*see, e.g.,* Proposed § 240.21F-3(b)), the Rules omit any method of coordinating investigations so as not do duplicate efforts or interfere with respective inter-agency investigations while allowing the SEC to tap the expertise of agencies as to predicate conduct within their jurisdiction.

The need for coordination is particularly critical where the SEC has limited resources and must respond to claims originating from a universe of approximately 6,700 publicly traded companies and related advisors and entities. The SEC must develop a transparent process for coordination of filing and that process must begin with a disclosure on the intake form of (1) other venues where the whistleblower has made claims and (2) the identity of the agency personnel overseeing those claims.

This process is of paramount importance where the whistleblower has filed a False Claims Act, 31 U.S.C.S. 3729, *et seq.,* complaint in court and the Department of Justice (the "DOJ") and the Federal Bureau of Investigation (the "FBI") are investigating predicate conduct that may also implicate securities law violations.[4] Not only must there

[4] See head note B(2) "Payment of Awards and Related Actions" below for additional discussion.

be coordination to ensure the efficiency of the investigation, but coordination must occur to ensure that investigation of the False Claims Act allegations is not disrupted.

The False Claims Act is but one example of where there may be overlapping investigations of predicate conduct and thus the SEC must plan for coordination with multiple agencies.[5]

B. Matters Covered by the Proposed Rule

1. Definition of a Whistleblower

The proposed definition, under subsection (a), states "[y]ou are a whistleblower if, alone or jointly with others, you provide the Commission with information relating to a potential violation of the securities laws. A whistleblower must be an individual. **A company or other entity is not eligible to be a whistleblower**." (Proposed § 240.21F-2, emphasis added).

Although the word "individual" is used in the enabling statute, use of this word in similar whistleblower legislation, i.e., the False Claims Act, 31 U.S.C. § 3730 (d), has been construed to allow non-governmental organizations (NGOs) and/or worker representatives, including labor unions, to bring claims. *See In U.S. ex rel. Koch v. Koch Industries, Inc.*, 1995 WL 812134, at *12 (N.D.Okl. Oct 6, 1995) (the Court held "the whistle-blowing insider is not the only type of person that can qualify as a *qui tam* plaintiff . . . A *qui tam* plaintiff may qualify as an original source where the 'core'

[5] See section 2, "Payment of Awards and Related Actions," 7-13 for additional comments.

information on which Plaintiffs' (complaint) is based was obtained through their own investigation."); *U.S. ex rel. Plumbers and Steamfitters Local Union No. 38 v. C.W. Roen Const. Co.*, 183 F.3d 1088 (9th Cir. 1999) (no question that a union had standing to bring a *qui tam* action alleging a contractor and its president and office manager violated the False Claims Act.); *U.S. ex rel. Local 342 Plumbers and Steamfitters v. Dan Caputo Co.*, 321 F.3d 926 (9th Cir. 2003) (local unions sued contractors under the False Claims Act for failure to pay prevailing wage rates. While the claim was not successful, it was not because the unions lacked standing).

The SEC faces a daunting task in weeding through claims made by whistleblowers. Accordingly, the rules should encourage claims made by those individuals and entities who are in the best position to document and analyze the wrongdoing. Labor unions and NGOs have the institutional capacity to digest and analyze relevant information in order to bring well documented claims. Labor unions and NGOs, by their very nature, understand the complexities of the administrative compliance process and potentially have the experience to manage claims. Therefore, discouraging these institutions from acting as whistleblowers and bringing claims to the SEC, defeats the overall intent of the Act. If these regulations are meant to serve the public interest, they must encourage whistleblowers with the capacity to bring the most meritorious claims to come forward.

2. Payment of Awards and Related Actions

a. General Comments

The SEC has acknowledged that there may be "related actions" brought by the Attorney General of the United States, an appropriate regulatory agency, a self-regulatory organization, or a state attorney general. *See* 240.21F-3(b)(1)-(4). While the SEC has Proposed Rules on the entitlement of a whistleblower to a bounty from a successful related action, the rules, as articulated earlier in these comments, provide no guidance on: (1) coordination of related investigations, and (2) cross-filing of related information.

There are, for example, numerous instances where False Claims Act (FCA), 31 U.S.C. § 3729, *et. seq.,* violations, or conduct giving rise to an FCA case, serve as the predicate for a securities law violation. For example, a pharmaceutical company which reports revenue that is the product of marketing activities proscribed by the Food Drug and Cosmetics Act of 1938, 21 U.S.C. §301 *et seq*. (2002) (the "FDCA") may similarly violate securities laws where the unlawful conduct is concealed from the market and the unlawful revenue is reported as a legal and reliable revenue stream. *See In re Pfizer Inc. Shareholder Derivative Litigation*, 2010 WL 2747447 (S.D.N.Y. July 13, 2010). The cases listed in Table 1 below illustrate some of the largest settlements resulting from federal and state government intervention in a number of cases filed by private whistleblowers.

Table 1. FCA Drug Settlements Following Government Intervention

Company	**Allegations**	**Settlement Date**	**Total Settlement Amount**	**Criminal Fine + Disgorgement of Profits**	**Civil Settlement**

Pfizer	Off-label marketing of Geodon, Bextra, Zyvox and Lyrica; kickbacks to doctors	September 2009	$2.3 billion	$1.3 billion	$1 billion
Eli Lilly	Off-label marketing of antipsychotic drug Zyprexa	January 2009	$1.4 billion	$615 million	$800 million
Cephalon	Off-label marketing of Gabitril, Actiq and Provigil between 2001 and 2006	September 2008	$425 million	$50 million	$375 million
Bristol-Myers Squibb	Illegal kickbacks to doctors, pharmacies and wholesale customers; price inflation on drugs including Serzone; off-label marketing of Abilify between 2002 and 2005	September 2007	$515 million	$25 million	$490 million
Serono	Off-label marketing and kickbacks for AIDS drug Serostim	October 2005	$704 million	$136.9 million	$567 million
Warner-Lambert	Off-label marketing of Neurontin between 1994 and 2002	May 2004	$430 million	$240 million	$190 million

Table 2 reported here below shows instances where courts evaluated FCA violations as securities law violations and denied defendants' motion to dismiss.

Table 2. Securities Class Action Cases Arising from Off-label Marketing of Drugs – Defendants' Motion to Dismiss Denied

#	*Case*	*Plaintiff's Name*	*Claims*	*Disposition / result*
1	*Minneapolis Firefighters' Relief Association v. Medtronic, Inc. et al*, No.08-cv-06324-PAM-AJB(D. Minn.,	Medtronic Institutional Investor Group, consisting of the: 1) Teachers Retirement	Misrepresented the true facts concerning the off-label use of the medical device maker's InFuse spinal graft.	On February 3, 2010, Judge Paul Magnuson ruled the case is allowed to proceed, but ruled that some of the company's allegedly misleading

	filed December 10, 2008)	System of Oklahoma, 2) Oklahoma Firefighters Pension Fund, 3) Union Asset Management Holding AG, and 4) Danske Invest Management A/S.		statements aren't actionable. The judge ruled that plaintiffs had successfully alleged materiality and scienter with respect to statements by Medtronic and its officers that InFuse was experiencing growth in sales primarily because of increased on-label use, and that it would likely to continue to experience sales growth for this reason.

Securities Class Action Cases Arising from Off-label Marketing of Drugs, continued...

#	*Case*	*Plaintiff's Name*	*Claims*	*Disposition / result*
2	*In re Amgen Sec. Litig.,* No. 07-cv-02536 (C.D. Calf. filed April 17, 2007)	Connecticut Retirement Plans and Trust Funds	Amgen makes and sells Epogen and Aranesp, erythropoiesis-stimulating agents, a type of drug which encourages the creation of oxygen carrying red blood cells. Defendants marketed Aranesp and Epogen to doctors for off-label uses. As a result, Amgen sold several hundred million dollars worth of drugs each year for these off-label uses. In October 2006, researchers halted a clinical cancer study because more deaths occurred in patients taking Aranesp than in those taking a placebo. Defendants did not disclose these results to investors. On February 16, 2007, *The Cancer Letter* published the results of the study and on March 9, 2007, the FDA mandated a Black Box warning regarding the off-label use of Aranesp and Epogen. These revelations caused Amgen's stock price to decline.	On February 1, 2008, the judge denied Amgen's motion to dismiss. Judge Philip Gutierrez granted Amgen's motion to toss charges against five of the nine individual Amgen officers and directors named in the suit. On August 12, 2009, the judge granted plaintiff's motion for class certification. On December 11, 2009, defendants filed a Rule 23(f) appeal with the Ninth Circuit, and asked for a stay of the case. On January 4, 2010, the judge granted plaintiff's leave to file Second Consolidated Amended Complaint.

Securities Class Action Cases Arising from Off-label Marketing of Drugs, continued...

#	*Case*	*Plaintiff's Name*	*Claims*	*Disposition / result*
3	*Yanek v. Staar Surgical Co.*, 388 F. Supp. 2d1110 (C.D. Cal. 2005) (No. 04-cv-8007, 04-cv-8263, 04-cv-8613 SJO(CWX)).	Eugene N. Yanek	Investors sued manufacturer and its president seeking to offer implantable contact lenses used by ophthalmologists and other eye care professionals to improve or correct vision in patients with cataracts, refractive conditions and glaucoma, asserting claims for securities fraud and control person liability. Company failed to notify market that they had received FDA form noting objectionable conditions at their manufacturing facilities, plaintiffs alleged.	On September 19, 2005, the court denied defendant's motion to dismiss, finding that investors sufficiently identified statements alleged to be false or misleading. On March 22, 2006, the parties announced a $3.7 million settlement, and on May 26, 2006, the judge approved the settlement.

Similarly, and by way of further example, for-profit education companies have been the target of FCA compliance actions, which served as the predicate to securities actions. *See In re Apollo Group, Inc. Securities Litigation*, 251 F.R.D. 12 (D.D.C. 2008).

Section (c) of Proposed Rule 240.21F-3 sets forth the requirements for awards in connection with related actions. In determining whether the information meets the criteria used to evaluate awards for the Commission actions, the Commission may seek confirmation of the relevant facts regarding the whistleblower's assistance. This provision highlights the need for coordination. If there were a mechanism to coordinate inter-agency investigations, the SEC would presumably understand the contribution of the whistleblower in terms of his/her value with regard to: (1) the provision of documents that may be used in an enforcement action, (2) analysis underlying a claim, or (3) testimony in a proceeding.

Ignoring the need to know the whistleblower (assuming he or she has meritorious claims) and coordinate investigations with related agency actions, the Proposed Rule establishes that the award may be denied if "the Commission is unable to obtain sufficient and reliable information about the related action to make a conclusive determination" about whether the original information met the criteria used to evaluate awards for Commission actions.

In sum, the proposed text not only fails to find any support in the Dodd-Frank Act; it underscores the need to coordinate investigations and work with whistleblowers so that there will be no doubt about the whistleblower's contribution.

b. Request For Comment No. 3

The Commission's request for comment no. 3 seeks to establish whether the Proposed Rule should exclude from the definition of "voluntarily" situations where the information was received from a whistleblower after he/she received a request, inquiry or demand from a foreign regulatory authority, law enforcement organization or self-regulatory organization.

The Dodd-Frank Act does not support such an exclusion. Any request for information received from a foreign authority would not compel the whistleblower to provide information to the Commission. To the extent the whistleblower does provide information, it should qualify as a "voluntary" submission.

3. Original Information

a. General Comments

Proposed Rule 21F-4(b)(2) defines "independent knowledge" as factual information in possession of the whistleblower that is not derived from "publicly" available sources. The Proposed Rule further clarifies that the whistleblower may gain independent knowledge from his or her experiences, communications and observations from his or her business or social interactions.

b. Specific Requests for Comments

1. Request for Comment No. 7

Request for comment no. 7 asks whether it is appropriate to include knowledge that is learned from others as "independent knowledge" subject only to an exclusion for knowledge learned from publicly-available sources. The use of the word "publicly" provides an exclusion not found in the statute, and eviscerates the intent of 21F-4(b)(4), which mirrors the False Claims Act's limited definition of "publicly."[6] The sentence stating that "you may gain independent knowledge from your experience, communications and observations in your business and social interactions" is reasonable guidance and should serve as the definition of independent knowledge.

[6] 31 U.S.C. §§ 3730(e)(4)(A)-(B). This section of the FCA states, "[f]or purposes of this paragraph, "original source" means 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. False Claims Act 31 U.S.C. § 3730(e)(4)(B).

2. Request for Comment No. 14

Request for comment no. 14 elicits comments about whether the proposed exclusion for information obtained by a violation of federal or state criminal law should be extended to information obtained in violation of the criminal laws of foreign countries. This provision should not be included. If a foreign country prohibits conduct that is not a violation of U.S. federal or state criminal laws, that violation would have no relevance for the Commission's purposes and should not deter whistleblowers from coming forward or limit their right to an award. Subjecting a whistleblower to this limitation, which is not included in the Dodd-Frank Act, may undermine the whistleblower program and, in turn, prevent the Commission from uncovering violations of federal securities laws occurring in the United States.

3. Request for Comment No. 15

Request for comment no. 15 seeks comments, *inter alia*, on whether an award should be granted to a whistleblower providing information in violation of protective orders in private litigation. Protective orders are many times negotiated with the ultimate purpose of protecting non-public, highly sensitive confidential information and may be issued in compliance with the parties' obligations to respect confidentiality agreements or other agreements.

While parties have the right to protect confidential sensitive information involving business or private information, the purpose of the protective order is not to conceal violations of law by shielding essential documents from regulatory agencies.

Whistleblowers who provide information in violation of such orders should not be excluded from receiving an award.

c. Definition of Independent Analysis

Proposed section 21F-4(b)(3) defines "independent analysis" as "your own analysis, whether done alone or in combination with others. Analysis means your examination and evaluation of information that may be generally available, but reveals information that is not generally known or available to the public."

The proposed definition of independent analysis should be clarified to state that while the analysis cannot be one that is known to the Commission or published in any of the sources identified in subsections 21F-4(b)(4)(i) through (vii), "analysis" can be one which relies on facts that are derived from public sources including those identified in those subsections. To construe this section otherwise would eliminate whistleblowers such as Harry Markopolis, whose analysis, although unknown to the Commission, may rely on public information.

4. Information that Leads to Successful Enforcement

The requirements introduced by this Proposed Rule were not intended by Congress and do not otherwise find a basis in the enabling legislation. In particular, the Proposed Rule provides that the Commission will consider that the whistleblower provided original information that led to the successful enforcement of a judicial or administrative action in the following circumstances:

> "(1) If you gave the Commission original information that caused the 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 your information **significantly contributed** to the success of the action; or (2) if you gave the Commission original information about conduct that was already under examination or investigation by the Commission, Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Oversight Board (except in cases where you were an original source of this information as defined in paragraph (b)(4) of this section), and your information **would not otherwise have been obtained and was essential to the success of the action.**" (Proposed Rule 21F-4(c), emphasis added).

The requirements introduced by this rule are excessively burdensome and not sufficiently defined. In the first instance, the rule requires the whistleblower to prove that the information "significantly contributed" to the success of the action. This language cannot be found in the Dodd-Frank Act and imposes an excessive burden on the whistleblower. We agree with the Commission's position that the information needs to be reliable, but we do not believe that the language of the rule successfully conveys that requirement.

Similarly, we disagree with the language of paragraph two, which imposes the unnecessary requirement that the information "would not otherwise have been obtained and was essential" to the success of the action. These requirements are also vague and do not serve the purpose of the rule. The whistleblower should not be disqualified because the staff could have obtained the information "in the normal course of the investigation." This approach would bar a whistleblower from a bounty where it is theoretically possible that the SEC could have obtained the information. The SEC is responsible for the oversight of over 6700 publicly traded companies. While it is possible to allocate resources to secure specific information, it is not possible for the SEC to be all places at all times. This provision should be reconsidered especially in light of the difficulty of establishing a whistleblower office, as required by the Dodd-Frank Act, for lack of funding. Any assistance provided by the whistleblower to the Commission's staff with original information leading to a successful enforcement action, or related action, should be rewarded, as provided by the Dodd-Frank Act.

5. Definition of Action

Under Proposed Rule 21F-(4)(d), the Commission defines the term "action" as "a single captioned judicial or administrative proceeding." This proposed approach, as explained by the Commission, would cause the Commission "not to aggregate sanctions that are imposed in separate judicial or administrative actions for purposes of determining whether the $1,000,000 threshold is satisfied, even if the actions arise out of a single investigation."

The Proposed Rule will reach results that were not intended by Congress. The Dodd-Frank Act defines covered judicial or administrative action as "any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000." The statute does not contemplate any further limitations on the right of the whistleblower to receive an award. If the original information generates a successful action, or if a single investigation generates two related actions based on the same original information, the sanctions obtained by the Commission should be combined for the purposes of assessing whether the threshold amount has been met. A variety of reasons may cause the Commission to bring multiple actions against multiple parties although the actions were generated by the whistleblower's single submission of "original information." Accordingly, the whistleblower should not be penalized by the Commission's legal strategy.

6. Confidentiality of Submissions

We strongly agree that, as provided in Proposed Rule 21F-7, submissions should be kept confidential or anonymous. Whistleblowers are often discouraged from revealing information clearly leading to violations of laws, for fear of retaliation or any other form of discrimination. The submissions should be kept confidential to the extent permitted by law, and further steps to protect the identity of the whistleblower should be established for anonymous submissions.

7. Procedures to Make a Claim for an Award

Proposed section 21F-10 outlines the steps a whistleblower must follow to make a claim for an award. Proposed Rule 21F-10(a) places a burden on a whistleblower to check the Commission's website for Notice that an action brought by the Commission resulted in monetary sanctions exceeding $1,000,000. If the whistleblower sees the Notice, the whistleblower must file a claim (discussed below) for an award within sixty days of the publication of the Notice. Nothing in the Proposed Rule indicates that the Commission will notify the whistleblower individually or that they will be informed when Notice is published on the website. The Proposed Rule establishes that "[a] claimant's failure to timely file a request for a whistleblower award would bar that individual later seeking recovery." The proposed text has no support in the Dodd-Frank Act and places an undue burden on the whistleblower who provided original information leading to the successful enforcement of an action by the Commission. If the Commission were committed to maintaining contact with the whistleblower, its witness, the whistleblower, would not have to periodically check the Commission's website to see if his or her claim was successful. The Commission should be committed to keeping the whistleblower informed and the burden should not be on the whistleblower to seek out information on the outcome of the action.

Proposed section 21-F-10(b) requires a whistleblower to submit a claim for an award on proposed Form WB-APP. The purpose of Proposed Form WB-APP is "to provide an opportunity for the whistleblower to 'make his case' for why he is entitled to an award by describing the information and assistance he has provided and its significance to the Commission's successful action." The requirement that the whistleblower must "make his case" in order to receive his award underscores a concern that once the whistleblower provides the Commission with the information necessary to successfully pursue an action, the Commission will do nothing to maintain contact with the whistleblower. If, after the whistleblower came forward with original information, the Commission kept a file on the whistleblower and remained committed to maintaining a transparent and open dialogue with the whistleblower, there would be no need for this section or Proposed Form WB-APP. Maintenance of contact is of critical importance if the SEC pursues an enforcement action and must secure testimony from the whistleblower.

8. <u>Staff Communications with Whistleblower</u>

We strongly support provision 21F-16, providing that no person may take any action to prevent a whistleblower from communicating directly with Commission staff about a potential securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement with respect to such communications. We agree that any effort to prevent whistleblower's direct communications with Commission staff about a potential securities law violation would conflict with the purpose of the statute, which aims at encouraging whistleblowers to report violations of securities laws.

***

We appreciate the opportunity to provide our comments.

Respectfully,

Voices For Corporate Responsibility

Reuben Guttman
Lydia Ferrarese
Reena Liebling

Voices For Corporate Responsibility

Jason Zuckerman

Change to Win

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Exposing Corruption Exploring Solutions
Project On Government Oversight

December 17, 2010

Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Via email: rule-comments@sec.gov

Dear Ms. Murphy:

The Project On Government Oversight (POGO) provides the following public comment on the Securities and Exchange Commission's (SEC) "Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934" (Release No. 34-63237, File No. S7-33-10).

As an independent watchdog that champions good government reforms, POGO has a keen interest in establishing safe and open channels for whistleblower disclosures, and we welcome the opportunity to comment on the SEC's proposed rule.

POGO believes the SEC's mission to protect investors and regulate financial markets will be greatly advanced by incentivizing whistleblowers to come forward with tips, and by protecting those whistleblowers from retaliation. However, we are concerned that the SEC's proposed rules might be overly deferential to internal corporate compliance programs. As a result, the rules contain provisions that could jeopardize the ability of whistleblowers to make anonymous disclosures to the government without fear of retaliation, and include many traps that would disqualify credible whistleblowers and limit the flow of potentially valuable information to the SEC.

POGO would like to respond to several specific questions posed by the SEC in its proposed rules, and to offer other suggestions for strengthening the whistleblower award program.

BACKGROUND

Whistleblowers play an essential role in exposing corporate misconduct. A recent survey conducted by the Association of Certified Fraud Examiners found that nearly half of occupational fraud cases were uncovered by a tip or complaint from an employee, customer, vendor, or other source. In the case of detecting fraud perpetrated by owners and executives, tips played an even more important role.[1] Another recent study found that whistleblowers played a bigger role than external auditors, government regulators, self-regulatory organizations, or the media in detecting fraud.[2]

Indeed, whistleblowers have featured prominently in numerous high-profile SEC enforcement cases. In late 2008, for instance, Glen and Karen Kaiser provided the SEC with information and documents that enabled the agency to reopen its investigation into insider trading at Pequot Capital Management, formerly the nation's largest hedge fund, leading to a $28 million settlement.[3] And the public is now well aware of the attempts by Harry Markopolos to provide the SEC with detailed evidence of Bernie Madoff's Ponzi scheme.

Whistleblowers often take tremendous personal and professional risks in order to expose corporate misconduct. Yet, the SEC often fails to make use of tips and to encourage more whistleblowers to come forward with relevant information. The SEC Office of Inspector General (OIG) has criticized the agency for failing to act on tips provided by Markopolos and other whistleblowers seeking to expose the Madoff and Stanford Ponzi schemes.[4] A separate OIG audit exposed some serious shortcomings in the SEC's previous whistleblower award program, which was limited to tips on insider trading. For instance, the audit revealed that only five people had received an award payment during the program's 20-year history. The OIG put forth a number of sensible recommendations for increasing awareness of the program and improving the agency's communication with whistleblowers.[5]

In some cases, the SEC's actions may have actively discouraged whistleblowers from coming forward with tips. For instance, POGO has written about an OIG investigation which found that an SEC enforcement attorney disclosed non-public information about a whistleblower from JPMorgan, and even encouraged JPMorgan's counsel to use the information against the whistleblower in a retaliation proceeding.[6]

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[1] Association of Certified Fraud Examiners, *2008 Report to the Nation on Occupational Fraud & Abuse*, http://www.acfe.com/documents/2008-rttn.pdf (Downloaded December 17, 2010); Alexander Dyck, Adair Morse, and Luigi Zingales, "Who Blows the Whistle on Corporate Fraud?" http://www.afajof.org/afa/forthcoming/4820p.pdf (Downloaded December 17, 2010)
[2] Alexander Dyck, Adair Morse, and Luigi Zingales, "Who Blows the Whistle on Corporate Fraud?" http://www.afajof.org/afa/forthcoming/4820p.pdf (Downloaded December 17, 2010)
[3] Securities and Exchange Commission, "SEC Awards $1 Million for Information Provided in Insider Trading Case," July 23, 2010. http://www.sec.gov/litigation/litreleases/2010/lr21601.htm (Downloaded December 17, 2010)
[4] Securities and Exchange Commission, Office of Inspector General, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme* (Report No. OIG-509), August 31, 2009. http://www.sec.gov/news/studies/2009/oig-509.pdf; and Securities and Exchange Commission, Office of Inspector General, *Investigation of the SEC's Response to Concerns Regarding Robert Allen Stanford's Alleged Ponzi Scheme* (Case No. OIG-526), March 31, 2010. http://www.sec.gov/news/studies/2010/oig-526.pdf (Downloaded December 17, 2010)
[5] Securities and Exchange Commission, Office of Inspector General, *Assessment of the SEC's Bounty Program* (Report No. 474), March 29, 2010. http://www.sec-oig.gov/Reports/AuditsInspections/2010/474.pdf (Downloaded December 17, 2010)
[6] Michael Smallberg and Adam Zagorin, "Long Island Congressional Candidate Cited or Giving Up JPMorgan Whistleblower," *Politics Daily*, January 28, 2010.

Dodd-Frank reforms

Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 21F to the Securities Exchange Act of 1934 and called for a major overhaul of the SEC's whistleblower award program. Section 21F provides several new tools to strengthen the program:

- Under the previous program, the SEC could only provide awards for tips related to insider trading; the SEC can now provide an award related to any administrative or judicial action that results in sanctions of more than $1 million
- Under the previous program, whistleblowers could only receive up to 10 percent of the amount recovered; under the new program, if an award is provided, it can be anywhere between 10 and 30 percent of the amount recovered
- Whistleblowers can make disclosures anonymously, as long as they're represented by counsel
- Whistleblowers can appeal the SEC's decision to not provide an award
- Whistleblowers cannot be retaliated against for providing a tip to the SEC, and can file for relief in U.S. District Court including reinstatement and back-pay if they are retaliated against
- The SEC must take steps to protect the confidentiality of whistleblowers, but can release information related to the substance of the whistleblower tips in response to public records requests[7]

A Senate report accompanying the Dodd-Frank bill elaborates on Congress's reasons for including Section 922:

> The Committee, having heard from several parties involved in whistleblower related cases, has determined that enforceability and relatively predictable level of payout will go a long way to motivate potential whistleblowers to come forward and help the government identify and prosecute fraudsters.
>
> The Committee intends for this program to be used actively with ample rewards to promote the integrity of the financial markets.[8]

The SEC should implement Section 21F in keeping with Congress's intent that the award program be strengthened and expanded in order to assist the government with its prosecution of corporate fraud.

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http://www.politicsdaily.com/2010/01/28/long-island-congressional-candidate-cited-for-giving-up-jpmorgan (Downloaded December 17, 2010)

[7] 111th Congress, "Dodd-Frank Wall Street Reform and Consumer Protection Act" (Public Law 111-203), July 21, 2010, Section 922. http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf (Downloaded December 17, 2010)

[8] Senate Committee on Banking, Housing, and Urban Affairs, *The Restoring American Financial Stability Act of 2010* (Report No. 111-176), April 30, 2010, p. 112. http://www.gpo.gov/fdsys/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf (Downloaded December 17, 2010)

POGO offers the following comments on the SEC's proposal for Regulation 21F to implement Section 21F of the Exchange Act.

REGULATION 21F

Internal compliance programs

POGO's concern is that the SEC's proposed rules might be overly deferential to the internal compliance programs that were established at many firms in the aftermath of Enron and after the passage of the Sarbanes-Oxley Act.

Despite the fact that Section 21F makes no mention of internal compliance programs, a public comment recently submitted by the Chamber of Commerce and other groups proposed that whistleblowers be required to report problems internally before going to the SEC.[9]

POGO urges the SEC to reject this reporting requirement, which is plainly contrary to the meaning and intent of Section 21F. In many cases, forcing a whistleblower to report a problem internally will undermine the SEC's ability to learn about corporate fraud. This is especially true in cases where senior managers and executives are implicated in the alleged fraud. For instance, the Association of Certified Fraud Examiners found that "internal controls were not as effective at detecting frauds committed by top-level perpetrators, as these individuals are often uniquely positioned to override even the best-designed controls."[10]

A recent survey conducted by KPMG revealed that many employees lack confidence in their firms' internal reporting systems. Nearly 75 percent of employees reported that they have personally observed or have firsthand knowledge of wrongdoing within their organizations during the previous 12 months (roughly 50 percent of the employees reported that the wrongdoing they observed could cause a "significant loss of public trust if discovered.") However, only 50 percent of the employees believed they would be protected from retaliation if they reported the wrongdoing to management, and even fewer believed they would be satisfied with the outcome of the internal investigation.[11]

An internal reporting requirement could do great harm to whistleblowers. Eric Havian, a prominent attorney with decades of experience working on False Claims Act cases, stated

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[9] Letter from Americans for Limited Government, Ryder Systems, Inc., *et al.*, to Securities and Exchange Commission regarding "Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934," December 7, 2010. http://sec.gov/comments/s7-33-10/s73310-110.pdf (Downloaded December 17, 2010)

[10] Association of Certified Fraud Examiners, *2008 Report to the Nation on Occupational Fraud & Abuse,* p. 19. http://www.acfe.com/documents/2008-rttn.pdf (Downloaded December 17, 2010)

[11] KPMG Forensic, *Integrity Survey 2008-2009*. http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Documents/KPMG%20Integrity%20Survey%202008.pdf (Downloaded December 17, 2010)

that an internal reporting requirement would "eviscerate the SEC program" from the outset and put whistleblowers in harm's way:

> If formal internal reporting is a requirement, the instant the SEC begins its investigation and serves its first subpoena, the corporation will have a short list of possible whistleblowers—i.e. those persons who formally reported the fraud to internal compliance. It will not be difficult for corporate attorneys to hone in on the likely turncoats. Nothing will create a greater chilling effect on the SEC whistleblower program than this proposed internal reporting requirement.[12]

Havian also challenged the claim made repeatedly by industry groups over the past few months that the award program will result in a deluge of whistleblowers circumventing their employers and going directly to the SEC in search of a big payout. Similar concerns were raised about the False Claims Act and the Internal Revenue Service's (IRS) whistleblower program, yet Havian notes that in his firm's "20-plus years of filing whistleblower cases, in almost every instance, whistleblowers seek to report their concerns internally, only coming to us as a last resort."[13]

Furthermore, if internal compliance programs were as effective as industry groups claim, we wonder why they failed to detect and avert the widespread financial fraud that precipitated the current economic crisis. In fact, there's a good chance that a strong SEC whistleblower award program will pressure companies to make substantial improvements to their own compliance programs in order to fix the problems before the employees have to go to the SEC.[14] POGO strongly recommends that the SEC resist any calls from industry to make internal reporting a requirement.

POGO is also deeply concerned by a statement in the commentary attached to the proposed rules suggesting that the SEC will occasionally send disclosures directly to the firms cited for misconduct and let them investigate the problems internally:

> We expect that in appropriate cases, consistent with the public interest and our obligation to preserve the confidentiality of a whistleblower, our staff will, upon receiving a whistleblower complaint, contact a company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back.[15]

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[12] Some of this inflammatory rhetoric has also been repeated by senior DOJ officials such as Preet Bharara, U.S. Attorney for the Southern District of New York, who recently made statements to industry representatives about "whistleblowers run amok." Dena Aubin, "Prosecutor warns of 'whistleblowers run amok,'" *Reuters*, November 12, 2010. http://www.reuters.com/article/idUSTRE6AB4U720101112 (Downloaded December 17, 2010)

[13] Eric Havian, "Solution: Don't Let Wall Street Get Away With It! Protect and Reward SEC Whistleblowers," *Truthout*, December 15, 2010. http://www.truth-out.org/solution-dont-let-wall-street-get-away-with-it-protect-and-reward-sec-whistleblowers65971 (Downloaded December 17, 2010)

[14] David Childers, "Protect Against the Perils of the Dodd-Frank Whistleblower Guidelines," *Corporate Compliance Insights*, December 2, 2010. http://www.corporatecomplianceinsights.com/2010/protect-against-the-perils-of-the-dodd-frank-whistleblower-guidelines (Downloaded December 17, 2010)

[15] Securities and Exchange Commission, "Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934" (17 CFR Parts 240 and 249, Release No. 34-63237,

Furthermore, according to sources, SEC Enforcement Director Robert Khuzami recently stated at a securities industry conference[16]:

> I am sure that it will be not uncommon, in the appropriate case, to contact the company and indicate that we have received this and have them undertake at least the same kind of initial review that they would currently do or hopefully that they would have done even if it had never come to our attention and it had stayed within the company.

POGO has serious concerns about the SEC sending whistleblower disclosures back to the firms accused of wrongdoing and letting them conduct their own investigations. In many cases, sending a tip back to the same firm cited for misconduct jeopardizes the confidentiality of the whistleblower who disclosed the wrongdoing. As such, this proposal contradicts Congress's clear intent to provide for safe and anonymous whistleblowing.[17] Furthermore, POGO is generally skeptical of government programs that rely on companies to investigate themselves.

POGO strongly recommends that the SEC reconsider its position about referring tips back to the companies accused of fraud, and explicitly clarify in the final rules that such referrals will not occur.

Original information

Proposed Rule 21F-4(b)(3) defines "independent analysis" as "your own analysis, whether done alone or in combination with others," and defines "analysis" as "your own examination and evaluation of information that may be generally available, but which reveals information that is not generally known or available to the public."

POGO urges the SEC to clarify that the analysis itself cannot have been previously published in one of the sources listed in Proposed Rule 21F-4(b)(1)(iii) ("a governmental report, hearing, audit, or investigation, or from the news media"), but that a new analysis could draw on facts published in these sources. This clarification would allow the SEC to receive tips from whistleblowers, such as Harry Markopolos, who often perform original analysis based on publicly available sources.

File No. S7-33-10), November 3, 2010, p. 34. http://sec.gov/rules/proposed/2010/34-63237.pdf (Downloaded December 17, 2010) (hereinafter "SEC Proposed Rules")

[16] Practising Law Institute, Securities Law Practice Center, "Securities Regulation Institute: Enforcement Agenda," November 12, 2010. http://seclawcenter.pli.edu/2010/11/12/securities-regulation-institute-enforcement-agenda/ (Downloaded December 17, 2010)

[17] The Dodd-Frank law created a similar whistleblower award program at the Commodity Futures Trading Commission (CFTC). It's worth noting that the CFTC's proposed rules make no mention of the agency sending tips back to the firms accused of misconduct. Commodity Futures Trading Commission, "Implementing the Whistleblower Provisions of Section 23 of the Commodity Exchange Act" (17 CFR Part 165), *Federal Register*, Vol. 75, No. 233, December 6, 2010. http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29022a.pdf (Downloaded December 17, 2010) (hereinafter "CFTC Proposed Rules")

Proposed Rule 21F-4(b)(iv) states that the SEC will not consider information to be derived from "independent knowledge" or "independent analysis" if it is obtained:

> Because you were a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity, and the information was communicated to you with the reasonable expectation that you 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.

Along similar lines, Proposed Rule 21F-4(b)(v) would exclude information that is otherwise obtained "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."

The SEC has asked if "the carve-out for situations where the entity does not disclose the information within a reasonable time promote effective self- policing functions and compliance with the law without undermining the operation of Section 21F."

Again, POGO is concerned that this rule demonstrates unnecessary deference to internal compliance programs. The SEC's commentary suggests a high barrier for demonstrating that a company acted in bad faith: "for example, an effort by company officials to destroy documents or to interfere with witnesses would constitute bad faith conduct."[18] Given the likelihood that the SEC will be receiving many tips from employees who first provided information to internal compliance programs, we urge the SEC to come up with a broader definition of "bad faith." For instance, a broader definition could include the failure to document investigations or to increase ethics awareness within the company.

The SEC is also declining to provide a specific definition of "reasonable time." POGO urges the SEC to consider adopting the Commodity Futures Trading Commission's proposal to define "reasonable time" as 60 days,[19] in order to ensure that internal compliance investigations are conducted in a timely fashion.

Proposed Rule 21F-4(b)(iv) would exclude information obtained "by a means or in a manner that violates applicable federal or state criminal law." The SEC is seeking comment on whether the exclusion should "extend to violations of the criminal laws of foreign countries."

POGO urges the SEC not to extend the exclusion to violations of foreign criminal laws. There may be situations in which a violation of a foreign criminal law is not a violation of a U.S. federal or state law, in which case the whistleblower should be entitled to disclose the information to the SEC.

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[18] SEC Proposed Rules, p. 26.
[19] CFTC Proposed Rules, p. 75730.

The SEC is also seeking comment on “information provided...in violation of judicial or administrative orders such as protective orders in private litigation.” POGO believes that protective orders should never be used to conceal violations of federal securities laws from the SEC.

Anti-retaliation measures

Proposed Rule 21F-2 would define a whistleblower as an individual who, alone or jointly with others, provides the Commission with “information relating to a *potential* violation of the securities laws” (emphasis added). In commentary attached to the proposed rules, the SEC explained that using the term “potential violation” makes clear that the anti-retaliation measures set forth in Section 21F do not depend on an ultimate determination that the misconduct disclosed by the whistleblower meets the criteria for a violation of federal securities laws. In addition, Paragraph (b) of Proposed Rule 21F-2 makes clear that the anti-retaliation measures will still apply even if the whistleblower does not satisfy all the conditions to qualify for an award.

The SEC is seeking comment on whether the anti-retaliation measures in Section 21F should be “applied broadly to any person who provides information to the Commission concerning a potential violation of the securities laws.”

Given the serious threat of retaliation facing corporate whistleblowers, POGO supports the SEC’s Proposed Rule 21F-2, which broadly applies the anti-retaliation measures in Section 21F. Whistleblowers should not be subject to retaliation just because they don’t qualify for the terms of the SEC’s award program.

Staff communications with whistleblowers

Proposed Rule 21F-16(a) states that “no person may take any action to impede a whistleblower from communicating directly with the Commission staff about a potential securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement...with respect to such communications.”

The SEC is seeking comment on whether these provisions would “encourage whistleblowers to provide information to the Commission regarding potential securities law violations.”

POGO supports the SEC’s proposal to ensure open communications between the agency and whistleblowers. The SEC should be primarily concerned with ensuring the free flow of information between the agency and any whistleblowers seeking to disclose corporate fraud. This proposal is especially important given that many firms require their employees to sign confidentiality agreements.

OIG RECOMMENDATIONS

POGO urges the SEC to consider adding other rules to incorporate recommendations made by the OIG in its audit of the previous whistleblower award program:

- Establish policies on when to follow-up with whistleblowers who submit applications to clarify information in the bounty applications and obtain readily available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.
- Examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing non-public or confidential information during the course of an investigation or examination.
- Develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of Enforcement's tips, complaints, and referrals processes and systems for other tips and complaints.
- Incorporate best practices obtained from DOJ and the IRS into the SEC bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.[20]

If the SEC establishes better policies for communicating with whistleblowers throughout the application process, it could lessen the burden imposed on whistleblowers to explain the importance of their disclosures.

We would just add one note of caution: the SEC may wish to review some criticisms that have been made regarding the IRS whistleblower program. For instance, a 2009 audit by the Treasury Inspector General for Tax Administration found that the IRS's program does not have a good system in place to manage and track cases, and that no awards had actually been paid out under the new program, in part because the claims can take over a decade to process.[21] Recent reports indicate that the IRS has still not made any payments under the program.[22]

BUDGETARY ISSUES

Finally, we want to acknowledge that the SEC is under tremendous pressure to implement dozens of Dodd-Frank provisions in a narrow timeframe, and we appreciate the agency's efforts to strike a number of delicate balances in its implementation of the

[20] Securities and Exchange Commission, Office of Inspector General, *Assessment of the SEC's Bounty Program* (Report No. 474), March 29, 2010. http://www.sec-oig.gov/Reports/AuditsInspections/2010/474.pdf (Downloaded December 17, 2010)

[21] Treasury Inspector General for Tax Administration, *Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*, August 20, 2009. http://www.treas.gov/tigta/auditreports/2009reports/200930114fr.pdf (Downloaded December 17, 2010)

[22] Ryan J. Donmoyer, "IRS Paid No Rewards in U.S. Whistleblower Program," *Bloomberg*, December 15, 2010. http://www.bloomberg.com/news/2010-12-15/irs-paid-no-rewards-to-informants-in-u-s-whistleblower-program.html (Downloaded December 17, 2010)

whistleblower award program. We also want to acknowledge that the agency is facing enormous staffing and budgetary challenges, which may create additional difficulties in the implementation of the program. For instance, the SEC recently announced it will be delaying the creation and staffing of the Whistleblower Office due to "budget uncertainty."[23]

However, we would caution the SEC not to scale back its implementation of the whistleblower award program due to exaggerated concerns that the agency will be overwhelmed with a deluge of tips. In fact, the SEC's lack of resources is all the more reason to encourage whistleblowers to help the agency uncover corporate fraud. SEC Chairman Mary Schapiro made this point in testimony before Congress last year:

> You can give us all the money and all the people in the world. And we're still going to need to rely on citizens and the private-sector accounting firms and others, to be able to do our job effectively.[24]

POGO urges the SEC to take every step necessary to facilitate the free flow of information from whistleblowers who can help the agency do its job, and to protect those whistleblowers from retaliation.

Thank you for your consideration of this comment. If you have any questions, please contact Angela Canterbury or Michael Smallberg at (202) 347-1122.

Sincerely,

Danielle Brian

Danielle Brian
Executive Director

[23] Securities and Exchange Commission, "Implementing the Dodd-Frank Wall Street Reform and Consumer Act – Dates to be Determined," December 2, 2010. http://www.sec.gov/spotlight/dodd-frank/dates_to_be_determined.shtml (Downloaded December 17, 2010)
[24] Testimony of Mary Schapiro, "SEC Actions Relating to the Financial Crisis," Hearing before the House Appropriations Subcommittee on Financial Services and General Government Appropriations, March 11, 2009, p. 22. http://appropriations.house.gov/images/stories/pdf/fsdc/Hearing_Volumes/FinServ-FY10-Pt5.pdf#page=7 (Downloaded December 17, 2010)

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February 18, 2011

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

Re: Supplemental comments on File S7-33-10, Proposed Rule for Whistleblower Provisions in Section 21F of the Securities Exchange Act

Dear Ms. Murphy:

These supplemental comments are submitted at the request of Securities and Exchange Commission (SEC) staff from a January 27, 2011 stakeholders meeting. The comments provide further research and support for points asserted at the meeting, when the Government Accountability Project (GAP) and other participants voiced a basic conclusion throughout the whistleblower community: It would turn the recent congressional reform into a counterproductive caricature if mandatory internal reporting were a prerequisite for rights or rewards under the Section 21F whistleblower program.

At the meeting GAP emphasized three primary themes: 1) Mandatory internal disclosures are unnecessary, if corporations have an effective safe whistleblower policy and channel, employees overwhelmingly will make that choice voluntarily. Corporations should voluntarily create those policies and channels, because whistleblowers are their most valuable resource against internal fraud. 2) Mandatory prior internal reporting prior to government disclosures could create insurmountable obstacles to civil and criminal prosecutions. 3) There cannot be any exception in the whistleblower program for those carrying out job duties connected with the disclosure.

1) <u>Mandatory prior internal reporting is unnecessary</u>.

As discussed, in addition to fear of retaliation there are tremendous social and cultural barriers to an employee "going outside the family" to blow the whistle. They include accumulated trust in the institution, corresponding loyalty, a history of successful internal problem solving, personal identity developed throughout a career, and effects on colleagues. A 2010 Ethics Resource Center report supplementing its 2009 National Business Ethics Survey, found that only 4% of whistleblowers make their disclosures outside the corporate system, and only 3% even to hotlines. 46% went to their supervisor.[i] In short, it takes extreme concern over institutional bad faith before an employee will blow the whistle to a third party, or even outside the normal chain of command.

It is in corporations' self-interest to recruit open communications from whistleblowers. The 2010 Ethics Resource Center report also found that while some 50% of employees witness misconduct on the job, roughly 40% do not act on their knowledge.[ii] Silence from those 40% undermines corporate efforts to prevent or recoup losses. A 2007 PricewaterhouseCoopers global crime survey of over 5,400 companies in 40 countries found that 43 percent had been victimized by one or more serious economic crimes, and that 80 percent of that group reported damage or significant damage to their institutions.[iii] The average loss from fraud per company was more than $3.2 million in 2007.[iv] Furthermore, PricewaterhouseCoopers reported that whistleblower hotlines as well as internal and external sources were the initial means of detection in 43 percent of the cases, more than the combined results from corporate security, internal audits, fraud risk management, rotation of personnel, and law enforcement.[v] Similarly, a 2008 report of the Association of Certified Fraud Examiners, reviewing 959 cases of fraud, credited exposure of 46.2% of that fraud to tipsters, compared to only 3.2% detected by law enforcement. 57.7% of the tips came from employees. The Association advised that employees "should be encouraged to report illegal or suspicious behavior, and they should be reassured that reports may be made confidentially and that the organization prohibits retaliation against whistleblowers."[vi] It pays to listen to the messenger.

Industry lobbyists demanding mandatory prior internal disclosures seek to impose an unprecedented prior restraint on communications with the government about illegality. None of the 47 corporate whistleblower statutes require mandatory company disclosures as a prerequisite for rights. This includes the Sarbanes Oxley and Dodd Frank provisions in section 1057 of the law, both which will overlap with many Section 21F disclosures.

The lesson from this research is clear. The demand for unprecedented mandatory prior disclosures is misplaced. Being a whistleblower's first option comes from trust, not prior restraint, and earning that trust is good business.

2) <u>Mandatory prior internal disclosures could create insurmountable obstacles to criminal and civil law enforcement actions</u>.

As discussed above, unless there is overwhelming evidence of institutional bad faith, i.e., intentional illegality and criminal liability, employees trust and voluntarily operate through normal company channels. When that trust has been breached, it would be foolhardy to provide advance knowledge of the employee's evidence to a potential civil or criminal defendant. Whether a bad faith institution is the potential defendant in an SEC enforcement action or a Justice Department prosecution, it can be a decisive advantage to know all the evidence that threatens liability. The opportunity for a customized cover up before the government learns of misconduct can sabotage the prospects for civil or criminal law enforcement.

This basic fact of life for law enforcement long has been recognized. In the 1980's the Department of Justice testified at congressional hearings about the counterproductive impact of a Nuclear Regulatory Commission (NRC) program that rechanneled whistleblowers' allegations and evidence back to the industry for response, instead of independently investigating the disclosures. Justice stated that this made effective criminal prosecutions impossible, because the defendants had advance warning of the evidence, advance opportunity to cover up intentional misconduct and advance opportunity to perfect defenses.[vii]

The success of America's most effective anti-corruption statute, the False Claims Act, would not have occurred if industry had succeeded in an analogous campaign for Congress to impose deference to internal corporate programs. Sparked by the Act's early success, in 1993 a coalition of 22 contractors, nicknamed the "fraud lobby," launched a campaign to gut the law. Since 1990, nearly all of the contractors had pled guilty or paid fines totaling hundreds of millions of dollars for fraud, 17 of them on multiple incidents. During their legislative efforts, the lobby's members faced 28 active, unsealed *qui tam* suits. As Senator Grassley summarized, "They hate the Act because it is very effective at exposing their fraud."[viii]

The showdown was over proposed industry legislation to ban citizen suits once a company announced related internal investigations through a voluntary disclosure program. In the end, there was so little credibility for the idea that lobbyists could not find as single sponsor for the legislation. Relevant for the current proposal is a 1996 GAO report that concluded government and corporate disclosure channels complement each other, that *qui tam* suits help to keep voluntary disclosure programs more honest.[ix]

On balance, the track record demonstrates that voluntary disclosure programs are not an effective substitute for independent law enforcement, and too often serve as a shield for liability. Summarized below are lessons learned about corporate hotlines and voluntary disclosure programs from a review of whistleblower cases since 1979. Programs have been:

* incomplete in scope, because institutions set the boundaries for investigations, which at times have been limited to exploring the "tip" of the misconduct and ignoring the rest of the "iceberg";

* incomplete in their findings of fact, because companies elect not to disclose the most significant misconduct;

* inadequate even for government oversight, because firms can and do rely on claims of "commercial or proprietary" information and the attorney-client privilege to withhold key records in corporate investigative files from government auditors;

* a rationale for delaying formal proceedings while a company's self-investigation proceeds – taking 2.8 years on average and over ten years in some of the cases surveyed by a 1996 Government Accountability Office study;[x]

* a form of advance discovery for future litigation, which at worst creates opportunities to intimidate or influence witness testimony and at best provides early knowledge of – and a corresponding opportunity to rebut – significant, threatening testimony; and

* openly advocated in industry speeches as a way to avoid independent government scrutiny and harsher government enforcement action, despite official disclaimers that the programs' purpose is good corporate citizenship.

These type vulnerabilities are most likely, when the institution has lost a whistleblower's trust and mandatory prior disclosure to the company would give the defendant the hard start to defeat law enforcement. In short, the only firms who will not get first crack at the evidence are the last who should benefit from that preview.

3) There cannot be any exception in the whistleblower program for those carrying out job duties connected with the disclosure.

The proposal to exempt those with associated job duties is a direct attack on the law's objectives. The purpose of the Section 21F program is to obtain the highest volume, highest quality evidence when there are intentional violations of SEC rules. No witnesses are more knowledgeable or credible to provide that evidence than employees responsible to carry out the corporation's internal checks and balances for compliance. To illustrate, they can navigate the difference between good faith errors, and confirmed violations followed by bad faith or nonexistent corrective action.

Whistleblower protection laws long have covered those carrying out job duties, because they are the most direct witnesses to evidence of violations.[xi] None of the 47 whistleblower statutes excludes protection for job duties, and section 1057 of the Dodd Frank law explicitly includes that context as protected activity.

On balance, the industry proposals to weaken Section 21F are not new. They reflect challenges to whistleblower laws for decades. None of them has been accepted in any of the corporate whistleblower statutes. The SEC should not set public policy precedents rejected by Congress so many times for so long.

Respectfully submitted,

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[i] Ethics Resource Center, *Reporting: Who's Telling You What You Need to Know, Who Isn't, and What You Can Do About It*, at 15 (2010)
[ii] *Id.* at 1.
[iii] PricewaterhouseCoopers and Martin Luther University Economy and Crime Research Center, *Economic Crime, People, Culture and Controls: The 4th Biennial Global Economic Crime Survey* (2007), http://www.pwc.com/extweb/home.nsf/docid/29CAE5B1F1D40EE38525736A007123FD.
[iv] *Id.* at 8.
[v] *Id.* at 10.
[vi] *2008 Report to the Nation on Occupational Fraud and Abuse* (Society of Certified Fraud Examiners 2008) , at 4, 30.
[vii] *See, e.g., Sacramento Bee,* "Nuclear Inspections Criticized, Testimony Alleges" (April 10, 1987); *Fresno Bee,* "NRC Probes Hurt by its Staff, Panel Told" (April 10, 1987).
[viii] K.R. Sawyer, "The Test Called Whistleblowing," paper delivered to the National Conference of Whistleblowers Australia (September 11, 2005).
[ix] *Id.*
[x] Voices of Scientists at FDA: Protecting Public Health Depends on Independent Science, Union of Concerned Scientists (2006) at 2, http://www.ucsusa.org/assets/documents/scientific_integrity/FDA-Survey-Brochure.pdf.
[xi] *Mackowiak v. University Nuclear Systems*, 735 F. 2d 1159 (Ninth Cir. 1984).