



July 24, 2018

Hon. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

**Re: File No. S7-16-18, Amendments to the
SEC's Whistleblower Program Rules**

Dear Mr. Chairman:

We are writing in regard to the proposed Amendments to the Commission's Whistleblower Program Rules, Release No. 34-83557; File No. S7-16-18, RIN 3235—AM11, 83 *Federal Register* 34702 (July 20, 2018) (hereinafter, "Proposed Rules"). Please file this letter on the public record as a formal comment submitted by the law firm [Kohn, Kohn & Colapinto, LLP](#).

Our firm has represented whistleblowers in securities cases since 1999.¹ At that time there were no effective protections for Wall Street whistleblowers and the U.S. Securities and Exchange Commission ("SEC") had no effective whistleblower program. In 2001, during the ENRON scandal, the problems caused by the lack of protections for corporate whistleblowers became readily apparent to the general public. Based on our extensive experience representing employees in publicly traded companies, we recommended to staff of the U.S. Senate Committee on the Judiciary a corporate whistleblower bill. Thereafter, we worked with staff from that Committee and offered guidance on the legislative language that was needed in order to provide meaningful and effective whistleblower protection to corporate employees. Our assistance resulted in the enactment of the whistleblower protection provision of the Sarbanes-Oxley Act ("SOX").² Unfortunately, for a number of different reasons, SOX did little to ameliorate engrained corporate hostility toward whistleblowers.³

¹ Nash, Jeff. *Linda's Lawyers Tripp To Wall Street: Whistleblower Firm Has a Broker in Fold Already*, Nov. 1, 1999. <http://www.investmentnews.com/article/19991101/SUB/911010731/lindas-lawyers-tripp-to-wall-street-whistleblower-firm-has-a-broker>.

² See 18 U.S.C §1514A.

³ The Senate Report on the SOX whistleblower law described this culture as follows: "These examples further expose a culture, supported by law, that discourage employees from reporting fraudulent behavior not only to the proper authorities, such as the FBI and the SEC, but even internally. This "corporate code of silence" not only hampers investigations, but also creates a climate where ongoing wrongdoing can occur with virtual impunity. The consequences of this corporate code of silence for investors in publicly traded companies, in particular, and for the stock market, in general, are serious and adverse, and they must be remedied."

SOX was ineffective and six years later the stock market crashed. A movement to enact meaningful Wall Street reforms emerged from the 2007-2008 financial crisis, which resulted in the passage of the Dodd-Frank Act (“DFA”). Among the key reforms was the creation of a whistleblower program within the SEC modeled on the highly effective False Claims Act (“FCA”) (a/k/a “Lincoln’s Law”) and the equally effective Internal Revenue Service whistleblower award law. These laws incentivized company insiders to report fraud by offering substantial monetary awards based on the FCA’s *qui tam* model of paying whistleblower awards between 10-30% based on the amount of fines and damages recovered by the government due to the whistleblower’s disclosure of wrongdoing. In the wake of the 2007-2008 financial crisis and subsequent market crash that led to the “Great Recession,” the Senate sponsors of the DFA recognized that the SEC needed to pay “ample rewards to promote the integrity of the financial markets.”⁴ Staff from the Senate Banking Committee contacted us to provide input into the new securities whistleblower protection provisions that were under consideration by Congress. Based on our experience representing whistleblowers since 1984 we strongly supported enacting a provision within that law to protect internal whistleblowers.

After the enactment of the DFA, SEC Chair Mary Schapiro’s staff reached out to the non-profit organization we founded, the National Whistleblower Center (“NWC”). We met with her staff on August 23rd, 2010 and provided suggestions for the whistleblower rules the Commission was starting to develop.⁵ After the Commission published its proposed whistleblower rules, we had the opportunity to meet one-on-one with each of the five Commissioners, as well as with the Commission staff that was drafting the whistleblower rules.⁶ On behalf of the National

[https://www.kkc.com/assets/site_18/files/senate%20report%20107-146%20\(2002\)%20_%20legislative%20history%20of%20sox%20whistleblower%20provisions.pdf](https://www.kkc.com/assets/site_18/files/senate%20report%20107-146%20(2002)%20_%20legislative%20history%20of%20sox%20whistleblower%20provisions.pdf)
Stephen M. Kohn, *The New Whistleblower’s Handbook: A Step-by-Step Guide to Doing What’s Right and Protecting Yourself*, 3rd ed. (Guildford, CT: Lyons Press, 2017), 34, 35, 38, 182, 282, 293, 306.

⁴ Dodd-Frank Act Senate Report. https://www.kkc.com/assets/site_18/files/dodd-frank-act-111-176.pdf;
Reuben, Ernesto and Stephenson, Matt. Nobody likes a rat: On the willingness to report lies and the consequences thereof, 2012. https://www.kkc.com/assets/site_18/files/resources/ernesto%20reuben-nobody%20lies%20a%20rate-%20on%20the%20willingness%20to%20report%20lies%20and%20the%20consequences%20thereof.pdf.

⁵ See <https://www.sec.gov/comments/df-title-ix/whistleblower/whistleblower-9.pdf>.

⁶ January 25, 2011 meeting with Division of Enforcement. <https://www.whistleblowers.org/storage/documents/DoddFrank/1.25.2011enforcementmeetingmemo.pdf>.
February 10, 2011 meeting with Commissioner Aguilar. <https://www.whistleblowers.org/storage/documents/DoddFrank/2.10.2011aguilarmeetingmemo.pdf>.
February 11, 2011 Meeting with Commissioner Paredes. <https://www.whistleblowers.org/storage/documents/DoddFrank/2.11.2011paredesmeetingmemo.pdf>.
February 15, 2011 Meeting with Commissioner Walter. <https://www.whistleblowers.org/storage/documents/DoddFrank/2.15.2011waltermeetingmemo.pdf>.
March 11, 2011 Meeting with Commissioner Casey. <https://www.whistleblowers.org/storage/documents/DoddFrank/3.11.2011caseymeetingmemo.pdf>.
March 28, 2011 Meeting with Chairman Schapiro. <https://www.whistleblowers.org/storage/documents/DoddFrank/3.28.2011schapiromeetingmemo.pdf>.

Whistleblower Center, we drafted numerous letters, reports and rulemaking proposals,⁷ many of which were incorporated into the final whistleblower rules.⁸

Currently, we represent a number of whistleblowers who have filed TCR complaints and WB-APP applications with the SEC's Office of the Whistleblower. We also represented the NWC in its *amicus* brief filed with the U.S. Supreme Court strongly supporting the SEC's position in the case of *Digital Reality*.⁹ We have advocated on behalf of the rights of internal whistleblowers and corporate compliance officers for over 33 years, and in 1985, one of our partners was a primary contributor to an *amicus* brief on that issue.¹⁰ We are also responsible for the litigation that resulted in the SEC's landmark holding that prohibits companies from stifling whistleblowers through the use of restrictive confidentiality agreements.¹¹

We have had the opportunity to work with the staff of the Office of the Whistleblower, as well as various SEC investigators and staff attorneys assigned to cases for which we have filed. We have found your whistleblower staff and enforcement investigators to be extremely competent, highly professional, and a credit to the Commission. They have been responsive to our client's concerns, and the investigators and staff attorneys have fully protected the identity of our confidential whistleblowers.

Based on our experience we offer the following comments on the main features of the Proposed Rules:

⁷ Letter to SEC opposing corporate lobby position, including comments from Baker Donelson and Arent Fox.

<https://www.whistleblowers.org/storage/documents/nwclettersecwbrulemaking.pdf>;

Letter to Chairman Schapiro explaining that Proposed Rules violate Congressional intent,

<https://www.whistleblowers.org/storage/documents/DoddFrank/11.22.2010lettertoschapiro.pdf>;

Formal rulemaking letter with report entitled "Impact of Qui Tam Rules on Internal Compliance,"

<https://www.whistleblowers.org/storage/documents/DoddFrank/12.18.2010secformalcommentupdated.pdf>;

Letter to Commissioners explaining the proposed rules' impact on the ability of U.S. to enforce the Foreign Corrupt Practices Act,

<https://www.whistleblowers.org/storage/documents/DoddFrank/2.10.2011lettertocommissionersfcpa.pdf>;

Letter to Chairman Schapiro responding to Chamber of Commerce's incorrect attacks of the NWC's December 17, 2010 report,

<https://www.whistleblowers.org/storage/documents/DoddFrank/3.7.2011lettertoschapiroreplychamber.pdf>;

Letter to SEC with provision-by-provision analysis of proposed rules with suggested revisions and justifications for revisions,

<https://www.whistleblowers.org/storage/documents/DoddFrank/3.17.2011lettertosecrulerecommendations.pdf>;

Letter to Chairman Schapiro and Gensler regarding the impact of the first reported decision under the Dodd-Frank Act on the rulemaking process,

<https://www.whistleblowers.org/storage/documents/DoddFrank/5.16.2011lettertoschapiroandgensler.pdf>.

⁸ NWC was cited over 40 times in the SEC *Federal Register* notice approving the final rules. See Whistleblower Incentives and Protections, https://www.kkc.com/assets/site_18/files/sec-final-rules-for-dodd-frank.pdf.

⁹ See NWC *Amicus* Brief filed in *Digital Realty Trust v. Somers*,

https://www.kkc.com/assets/site_18/files/nwcsomersamicus.pdf.

¹⁰ Stephen M. Kohn. *Digital Reality V. Somers May Kill Corporate Compliance*. 2017

<https://www.kkc.com/news/?id=637> ; Kohn. *Clarifying Anti-Retaliation Protections Under Dodd-Frank*. 2017

<https://www.kkc.com/news/?id=636>. *Kansas Gas & Electric v. Brock*, 780 F.2d 1505 (10th Cir. 1985,

https://www.kkc.com/assets/site_18/files/kansas-gas-electric-v.-brock-780-f2d-1505.pdf.

¹¹ See https://www.sec.gov/news/pressrelease/2015-54.html#.VRwcovnF_To ;

<https://www.whistleblowersblog.org/2015/04/articles/corporate-whistleblowers/sec-sanctions-kbr-for-illegal-non-disclosure-agreement/>.

10% Rate Cap

The SEC's proposed rate-cap is a drastic step in the wrong direction. Whistleblower laws that have capped rewards have universally failed and there is not a single whistleblower award program that has a cap on awards that is successful. For example, the Financial Institution Reform, Recovery, and Enforcement Act (FIRREA) capped rewards at over \$1 million.¹² That law has been virtually ignored by potential whistleblowers since it was enacted years ago, resulting in the prior administration's Attorney General calling for an end to these caps.¹³ Other whistleblower award laws that lack mandatory awards and/or cap awards have universally failed, as there is no incentive for whistleblowers to risk their careers to file complaints with the government under these ineffective programs.¹⁴

The SEC's proposed 10% cap on large whistleblower rewards will be the greatest rulemaking setback for whistleblowers under *qui tam* or other reward programs since the FCA's *qui tam* amendments were enacted in 1986. It will have a devastating impact on the deterrent effect of the DFA, a law designed to discourage corruption on Wall Street by incentivizing informants to disclose criminal activity. It will discourage potential whistleblowers in many of the largest or most important financial fraud cases.¹⁵ The cap would send the wrong message to both fraudsters and employees contemplating taking the risk of blowing the whistle on major corporate and financial fraud.¹⁶

Our firm has significant experience working with reluctant employees who must decide whether or not to risk their careers (and even their freedom, if they reside in certain countries) to expose corporate crimes and major financial fraud. For example, our firm represented Swiss bank whistleblower Mr. Bradley Birkenfeld, whose historic case achieved unprecedented reforms concerning illegal offshore banking, money laundering, and tax evasion.¹⁷ In 2012, Mr. Birkenfeld obtained the largest monetary award provided to an individual whistleblower, \$104 million. Unquestionably, the payment of this large award has been the primary motivating factor that caused several whistleblowers we represent who reside in dangerous countries and/or who hold high-level corporate positions, to blow the whistle. Although Mr. Birkenfeld's case had a direct impact on the willingness of highly placed employees to become whistleblowers in the tax cases, it impacted the willingness of whistleblowers to step forward in other areas, such as the Foreign Corrupt Practices Act ("FCPA") and other serious securities law violations by high-level executives and corporations. Based on our experience, the size of Birkenfeld's award is the primary reason many employees agree to take risks involved with whistleblowing, regardless of the level of position they hold or the country in which they reside. Indeed, there are several other potential

¹² 12 U.S.C. §§ 4201-10.

¹³ <https://www.politico.com/story/2014/09/eric-holder-wall-street-whistleblower-reward-111056> ("Risky behavior is creeping back into the financial industry six years after the 2008 crisis and Congress could do more to help prosecutors combat emerging crimes, including increasing the amount of reward money paid to whistleblowers, U.S. Attorney General Eric Holder said in a speech on Wednesday.").

¹⁴ See, e.g., 10 U.S.C. § 1031(g).

¹⁵ Stephen M. Kohn. *The Problem with SEC's Plan To Cap Whistleblower Awards*. 2018 <https://www.kkc.com/news/?id=651>.

¹⁶ *CFTC Announces Its Largest Ever Whistleblower Award of Approximately \$30 million*. July 12, 2018. <https://www.cftc.gov/PressRoom/PressReleases/7753-18>.

¹⁷ *Meet the Whistleblower: Bradley Birkenfeld* <https://www.kkc.com/whistleblowers/?id=41>.

whistleblowers we have spoken with who have forgone blowing the whistle even with the current financial incentives that exist because they view the risk-to-reward-ratio too steep a hill to climb.

Significantly, the size of the Birkenfeld award achieved two purposes. First and foremost, it sent a message that the United States was serious about paying awards. Many employees are skeptical about ever receiving a payment. Adding to this skepticism is the popular culture surrounding whistleblowing, which contradicts any expectation that the government will treat them properly: most news articles about whistleblowing concern retaliation and the destruction of a whistleblower's career. Furthermore, because of the high-profile nature of some of the leak-related stories, many whistleblowers fear government prosecution, knowing that whistleblowers have been criminally prosecuted and imprisoned, even if the whistleblower subjectively believes he or she is serving the public interest.¹⁸ These factors weigh heavily against an employee ever taking the enormous risk that nearly all whistleblowers confront.

The payment of the large reward in the Birkenfeld case has enabled our firm to counter these messages. We can explain to potential whistleblowers that if whistleblowing is done lawfully, and information is provided to agencies such as the IRS or SEC, the U.S. government will be their friend and supporter. We can further explain that stereotypes of employees who raise concerns, as well as the government's so-called "War on Whistleblowers," are not applicable to the SEC program. Nothing permits us to make these arguments better than pointing to the Birkenfeld whistleblower award. It is our #1 argument that convinces skeptical employees to trust working with U.S. law enforcement.

The Proposed Rule sends the opposite message. It tells whistleblowers that agencies like the SEC are interested in reducing awards or using their administrative powers to find technical reasons for denying rewards. It creates an appearance of bias against whistleblowers, especially in light of the fact that there are no caps on executive compensation or other profit-based motives that proliferate the culture within the financial services industry. The proposed rule sends a message that agencies will use legal tactics to reduce awards, even outside the 10%-rate cap. The message the rule sends is that whistleblowers, who suffer so much serving the public interest, are unworthy of large awards, while others on Wall Street, who commit crimes or whose actions are purely selfish or greed-driven, have no caps on their salaries, and are often paid massive salaries and bonuses.

The risks facing Wall Street whistleblowers are enormous. An employee marked as a whistleblower risks losing his or her place in these highly-compensated labor markets. Even if the whistleblower is not currently a high-earning executive or money manager, the whistleblower usually forfeits the opportunity to ever obtain those levels of compensation or status within the financial services or corporate job markets.

¹⁸ We appreciate the fact that a publicly identified whistleblower has never served as an SEC Commissioner, nor to our knowledge held a high-level management position in the SEC. But regardless of this lack of subjective experience, the Commission's Office of the Whistleblower has demonstrated sensitivity to the issues faced by whistleblowers. Prior to the publication of the Proposed Rules, the Office of the Whistleblower proudly publicized its handful of large rewards. That practice sent the right message. Large rewards do motivate whistleblowers, some of whom will report massive criminal activity, often condoned (and supported) by top corporate officials. .

Additionally, the Proposed Rule indicates that the SEC is changing its enforcement priorities and is previous strong commitment toward whistleblowers. By establishing a 10% rate cap rule in cases over \$30 million, the SEC is sending a message that it is not willing to fully compensate whistleblowers who might know about the largest and most significant frauds. Many whistleblowers have already reported big corporate and securities fraud schemes that exceed \$100 million and many of those whistleblowers took huge risks in deciding whether to even report that fraud. The Commission clearly does not want to convert its program into one that emphasizes the reporting of smaller frauds, while it disincentives well placed informants risking their careers to report the largest frauds. The policy the Commission must advance is simple: The larger the suspected fraud, the larger the inducement to blow the whistle.

The Commission's proposed 10% rate cap rule has already sent a harmful message to potential whistleblowers and should be immediately withdrawn and repudiated. Whistleblowers are well aware of the substantial delay in recovering a reward and are equally aware of the small percentage of claims that ultimately result in a reward. Given these headwinds, capping a reward at this juncture will have a devastating impact on the number of whistleblower willing to come forward.

In analyzing the impact of the Birkenfeld case, it becomes very clear how the public benefits from large whistleblower rewards. Mr. Birkenfeld's case demonstrated, beyond any doubt, that large rewards can have a remarkable impact on protecting the public interest and forcing corporations to implement reforms. The Commission must look beyond its preconceived notions about paying large awards to whistleblower, and the clear prejudices corporate executives have against paying large rewards, and objectively consider what is necessary, in practice, to make whistleblower rewards work in practice. Whistleblower laws need to be effective tools for detecting, deterring, and eradicating corruption.

The positive impact of Mr. Birkenfeld's whistleblowing is clear. The IRS, in evaluating his eligibility for an award under the U.S. tax laws, explained why they were approving the largest-ever individual whistleblower reward:

Birkenfeld provided information on taxpayer behavior that the IRS had been unable to detect, provided exceptional cooperation, identified connections between parties to transactions (and the methods used by UBS AG), and the information led to substantial changes in UBS AG business practices and commitment to future compliance. The actions against UBS AG and the attendant publicity also contributed to other compliance programs. Each of these factors could support an increase in the award percentage above the statutory minimum. The comprehensive information provided by the whistleblower was exceptional in both its breadth and depth. While the IRS was aware of tax compliance issues related to secret bank accounts in Switzerland and elsewhere, the information provided by the whistleblower formed the basis for unprecedented actions against UBS AG, with collateral impact on other enforcement activities and a continuing impact on future compliance by UBS AG.¹⁹

¹⁹ IRS Summary Reward Report. https://www.kkc.com/assets/site_18/files/whistleblowers/birkenfeld-award.pdf (emphasis added).

In 2009, capitalizing on the fear of detection triggered by Mr. Birkenfeld's disclosures, the IRS launched an *Offshore Voluntary Disclosure Program*, allowing taxpayers with undisclosed offshore accounts to self-report their crimes, reduce their penalties, and possibly avoid criminal prosecution. As of 2018, more than 56,000 delinquent taxpayers had come forward and the IRS had collected \$11.1 billion in back taxes.²⁰

Numerous other Swiss bankers were also motivated by Birkenfeld's historic whistleblower payment and started to blow the whistle on their banks. As of 2014 nearly every Swiss bank had executed a settlement or plead guilty to tax crimes, often on the basis of whistleblower disclosures.²¹ In addition to the \$11.1 billion collected from individual tax cheats, the United States collected an additional \$5.09 billion from numerous Swiss banks.²² Thus, triggered by one whistleblower, the largest fraud prosecutions in U.S. history were successfully completed, and the U.S. taxpayers have, to date, recovered \$16.19 billion.²³

The Swiss banking industry quickly realized the impact of paying a whistleblower a \$104 million award would have on other employees working in that industry. Days after the Birkenfeld award was announced, bankers and their consultants held a major industry meeting in Geneva, Switzerland. At this meeting, the attendees "seethed" at Birkenfeld and attacked his "total lack of morality" for blowing the whistle on them. According to a reporter from *Agence France-Presse* who attended the meeting, Birkenfeld had "driven the nail into the heart of the once seemingly invincible Swiss bank secrecy" system. A respected banking consultant was reported declaring that their U.S. client offshore banking program was "over."²⁴

The day after the Birkenfeld award was announced, the publication *SwissInfo*²⁵ reported on the reaction to the award in the Swiss newspapers and published the following summarizes of these Swiss press stories:

The Blick tabloid newspaper said...it proves how ruthlessly US officials are pursuing tax evaders and how determined they are to dry up tax havens.

²⁰ *IRS to end offshore voluntary disclosure program; Taxpayers with undisclosed foreign assets urged to come forward now*, March 13, 2018. <https://www.irs.gov/newsroom/irs-to-end-offshore-voluntary-disclosure-program-taxpayers-with-undisclosed-foreign-assets-urged-to-come-forward-now>.

²¹ Department of Justice, *Swiss Bank Program*. <https://www.justice.gov/tax/swiss-bank-program>.

²² Stephen M. Kohn. *13.769 Billion Reasons to Thank Whistleblowers on Tax Day*, April 18, 2016.

<https://www.whistleblowersblog.org/2016/04/articles/tax-whistleblowers/13-769-billion-reasons-to-thank-whistleblowers-on-tax-day/>.

IRS Offshore Voluntary Disclosure Efforts Produce \$6.5 Billion; 45,000 Taxpayers Participate.

<https://www.irs.gov/newsroom/irs-offshore-voluntary-disclosure-efforts-produce-65-billion-45000-taxpayers-participate>.

²³ The impact of Mr. Birkenfeld's whistleblowing, and the IRS's payment of the \$104 million award, continues to reverberate in Switzerland. On July 19, 2018 the Swiss publication *SwissInfo* reported on another Swiss bank reaching a settlement with the Department of Justice, and agreeing to pay a \$5 million sanction.

https://www.swissinfo.ch/eng/business/-5-million-fine_swiss-bank-settles-us-tax-evasion-probe/44267588.

²⁴ [Stephen M. Kohn](#), *The New Whistleblower's Handbook: A Step-by-Step Guide to Doing What's Right and Protecting Yourself*, 3rd ed. (Guildford, CT: Lyons Press, 2017). Pg. 89.

²⁵ Bradley, Simon. "Birkenfeld reward may tempt other bankers." *SwissInfo*, Sep. 12, 2012.

https://www.swissinfo.ch/eng/whistleblower-payoff_birkenfeld-reward-may-tempt-other-bankers/33500198.

Zurich's Tages-Anzeiger went further describing it as a "seductive offer for bankers." "This enormous reward show how the US are raising the stakes in their tax fight with Switzerland...in promising such high compensation the IRS are hoping that more incriminating material is handed over."

The French-speaking daily Le Temps agreed that Birkenfeld's huge reward could encourage other bank employees to follow his example.

It was clear to these industry leaders that Swiss bankers could make far more money turning in their U.S. clients, rather than servicing them. Eventually, all known illegal U.S. accounts in Switzerland were closed, and *billions upon billions* of dollars in monies formally held in illegal offshore accounts were repatriated to the U.S. economy. These monies will be taxed forever and become part of the lawful U.S. economy.

In a 2014 article in the *Villanova Law Review*, University of California-Davis professor of law and Chairman of the IRS Advisory Council Dr. Dennis J. Ventry described the "collateral impact" Birkenfeld's case had on Swiss bank secrecy: "'Collateral impact' hardly does justice to the effect of Birkenfeld's whistleblowing." He not only triggered the "UBS debacle," but also "everything that followed," including "more than 120 criminal indictments of U.S. taxpayers," "additional indictments against foreign bankers, advisor, and lawyers," "closure of prominent Swiss banks—including the oldest private bank," other persons "ratting out banks," and "banks themselves disclosing the names and accounts of [US] clients."²⁶

Professor Ventry also discussed the deterrent effect of whistleblowing, citing to specific studies:

*Whistleblowers can do more than just uncover and report knowing violations of the law. They can also prevent noncompliance from happening in the first place. An effective whistleblower program (run either through a state's FCA or as a standalone statute) would add significant risk to noncompliance by increasing the probability of detection and the likelihood of potential penalties, the two most important variables in traditional tax deterrence models. In turn, **increased aversion to noncompliance—due to increased fear of detection** and palpable penalties as well as additional variables such as moral, ethical and reputational inputs—would result in increased revenue collection...*

Professor Ventry (emphasis added).²⁷

The Birkenfeld case was the trigger that ultimately resulted in the entire Swiss banking industry changing its practices concerning illegal and undeclared private banking. As reported in the July 19, 2018 edition of *SwissInfo*: "The tax evasion battle between the Swiss financial sector and the DOJ began a decade ago when whistleblower Bradley Birkenfeld provided evidence that his former employer, UBS, was helping wealthy Americans evade taxes The tax evasion spat as a whole forced Switzerland to end its tradition of providing strict banking secrecy, a practice

²⁶ Ventry Jr., Dennis. *Not Just Whistling Dixie: The Case For Tax Whistleblowers In The States*. 59 Villanova Law Review 425 (2014).

²⁷ *Id.*

that had shielded foreign tax evaders from the scrutiny of their home tax authorities.” *SwissInfo*, “Swiss Bank Settles US Tax Evasion Probe.”²⁸

This is the power of anti-fraud whistleblowing. These are the kind of fraud-deterrence and compliance results Congress wanted to achieve when it passed the DFA. The absolutely essential cornerstone to the Birkenfeld case was the incredibly insightful decision of the IRS to pay Mr. Birkenfeld a 26% award based on *all* of the back taxes and penalties paid by UBS. The IRS Office of the Whistleblower fully understood the positive impact a widely publicized award would have on its program, and its ability to ensure that the voluntary disclosure program was effective and that other whistleblowers would step forward. Significantly, IRS officials strongly encouraged Mr. Birkenfeld’s counsel to call widespread attention to the award.

Prior to the Birkenfeld case and the effective implementation of an international reward program, all attempts to crack Swiss bank secrecy had failed, or were inconsequential in comparison. It was the fear of detection that triggered the unprecedented repatriation of offshore monies to the United States.

This is precisely why Attorney General Eric Holder called for eliminating the caps on the FIRREA. Based on the history of the non-capped reward programs, the former Attorney General supported “modifying the FIRREA whistleblower provision,” to mirror the False Claims Act in order “to increase its incentives for individual cooperation.” He pointed out that lifting the caps on FIRREA “could significantly improve the Justice Department’s ability to gather evidence of wrongdoing while complex financial crimes are still in progress – making it easier to complete investigations and to stop misconduct before it becomes so widespread that it foments the next crisis.”²⁹

Since the passage of the FCA, no whistleblower law has been amended to impose a cap on rewards. Likewise, no regulatory agency ever imposed a rate-cap by rule or regulation. The movement has been in the precise opposite direction, as evidenced by the support within the Department of Justice to eliminate caps in FIRREA.

In regard to the integrity of the Investor Protection Fund (the special fund established to compensate whistleblowers), Congress ensured that monies would be available to compensate whistleblowers directly from the monies obtained in cases for which the whistleblower was responsible, regardless of the amount of money in the Fund. *See* 15 U.S.C. § 78u-6(g)((3)B). Furthermore, Congress explicitly prohibited the Commission from taking into consideration the amount of money in the Fund when deciding an appropriate award. 15 U.S.C. § 78u-6(c)(1)((B)(ii)) (“In determining the amount of an award . . . the Commission . . . shall not take into consideration the balance of the Fund.”).

Finally, in its justification for the 10% cap, the Commission pointed to old non-binding instructions from the Department of Justice permitting the department to take the size of a potential reward

²⁸ https://www.swissinfo.ch/eng/business/-5-million-fine_swiss-bank-settles-us-tax-evasion-probe/44267588.

²⁹ Attorney General Holder Remarks on Financial Fraud Prosecutions at NYU School of Law https://www.kkc.com/assets/site_18/files/firrea_ag-holders-speech-sep-17-2014.pdf. Although the cap on FIRREA awards is low, the financial limitations that triggered the former Attorney General’s concerns are equally applicable to the impact on whistleblower-perceptions caused by any caps.

into consideration in setting the percentage of reward given to the whistleblower. This non-binding memorandum is *not* a formal rule and lacks the force and effect of law. It is also completely inapplicable in the context of the DFA. Under the FCA, a whistleblower who does not agree with the percentage of his or her award can challenge that percentage in Court. In fact, the whistleblower has standing to oppose any settlement between the United States and the fraudster on the basis that the settlement was not “fair, adequate, and reasonable.”³⁰ These challenges are not ancillary to an FCA case. A whistleblower has standing to challenge the entire settlement between the United States and a fraudster on the basis that his or her reward is not large enough. Thus, whistleblowers have strong due process rights in FCA cases, and have the right to argue before a judge that their awards should be paid at the highest rate. These due process protections have resulted in the settlement of most issues related to the size of a whistleblower’s award, and there are very few public disputes over the “relator share” in FCA cases.

The DFA is completely different. The percentage award granted by the Commission is not subject to appeal, as long as the whistleblower is awarded 10% of the collected proceeds. Still, it is not uncommon for multiple whistleblowers to emerge to find that this 10% share must be divided between multiple whistleblowers. Under the FCA, there is a “first to file” rule, which essentially guarantees that the first whistleblower who comes forward will recover not less than 15%.

In the DFA Congress prohibited whistleblowers from challenging the percentage of an SEC award in Court. Thus, in practice, the SEC’s decision to reduce rewards will be difficult, if not impossible, to challenge. However, imposing an arbitrary cap will likely increase judicial appeals, as whistleblowers can challenge the legality of the rule. If judicial challenges to the rate-cap rule are not successful, rewards will be arbitrarily reduced regardless of the hardships whistleblowers suffer. Thus, regardless of the impact of retaliation on their income, years of delay in obtaining compensation, the nature of their contributions to the public interests and/or the emotional distress triggered by the experience of becoming a whistleblower, the Commission staff will rely on the rule to cut rewards.

The arbitrary nature of the cap is reinforced by the scientific literature that demonstrates the severe stress suffered by whistleblowers, even those who obtain large *qui tam* awards.³¹ Once the rate-cap is imposed, the Commission will not be able to effectively waive the cap in cases of documented hardship. First, it is difficult to prove emotional distress damages like those documented in the *New England Journal of Medicine*. Would the SEC require whistleblowers to produce medical or psychiatric records? Would the Claims Review Staff hold hearings on the damages suffered by claimants that would support waiving the rule? Second, any work-around the rule would trigger more delays in deciding cases and waste Commission staff time. It would impose additional burdens on claimants, and potentially force them to produce embarrassing or private information. By following the clear intent of Congress the Commission should continue its policy of paying rewards under the current rules, and using these rewards to stimulate additional strong disclosures and deter misconduct.

³⁰ See 30 U.S.C. § 3730(c)(2)(B).

³¹ Kesselheim, Aaron S., Studdert, David, and Mello, Michelle. *Whistle-Blowers’ Experiences in Fraud Litigation against Pharmaceutical Companies*, 2010. The New England Journal of Medicine. <https://www.nejm.org/doi/full/10.1056/NEJMSr0912039>

Digital Realty and Internal Disclosures

The SEC justified issuing the Proposed Rules due in part to the Supreme Court’s decision in *Digital Realty Trust, Inc. v. Somers*.³² As stated in the rulemaking proposal: “The amendments that we are proposing to this rule are in response to the Supreme Court’s recent decision in *Digital Realty Trust, Inc. v. Somers*.” In that decision, the Court held that Section 21F(a)(6) of the Exchange Act required that individuals report securities law violations to the SEC to be considered a “whistleblower” under the DFA. The Proposed Rule conforms the anti-retaliation provisions of the SEC’s rules to the Supreme Court’s decision. It requires that whistleblowers provide information to the Commission, and disqualifies employees who only report their concerns to internal compliance programs from protection under the DFA. However, the Commission ignored the impact of that decision on other rules related to internal reporting requirements. The Commission rules that encourage internal reporting under the DFA, or force various classes of employees to report internally in order to be classified as a “whistleblower” under the DFA, are now, at best, inconsistent with *Digital*. Given the unanimous ruling of the Supreme Court, these rules violate the DFA, and could now be successfully challenged in Court. The Commission must review all of its DFA rules regarding internal reporting, and amend these rules to be consistent with the ruling in *Digital*.

When the Commission issued its final DFA rules in 2012, it had been heavily lobbied by the Chamber of Commerce, corporate lawyers, trade organizations and publicly traded companies to ensure that the DFA not undermine corporate compliance. The Commission responded to this intense lobbying effort by enacting specific rules covering internal whistleblowing. On the one hand, they issued a rule to strongly protect employees who work in or report to compliance programs from retaliation. On the other hand, they issued a number of rules to promote internal reporting, going so far as to restrict the right of some employees to report directly to the Commission. All of the rules promoting internal reporting and restricting the rights of employees to directly report concerns to the Commission were predicated on the Commission’s understanding that as part of its rulemaking authority, it had the power to override the Congressional mandate that all individuals should be encouraged to report directly to the Commission.

The U.S. Supreme Court unanimously struck down this interpretation of the DFA. The Court held that the Commission lacked authority to protect internal whistleblowers. If the Commission lacked the authority under the DFA to protect internal whistleblowers, it follows that the Commission likewise lacked the authority to encourage or require internal reporting. It is a clear abuse of discretion for the SEC to encourage activity which would leave employees unprotected under the DFA’s anti-retaliation law. As confirmed by the Supreme Court, the DFA is perfectly clear. It was designed to encourage reporting directly to the SEC. The Commission must now conform all of its DFA whistleblower rules regarding internal whistleblowing to that mandate.

In this rulemaking proceeding the Commission *must* eliminate all provisions of the rules that promote internal reporting, at the expense of directly reporting concerns to the Commission. Furthermore, the Commission *must* rescind all restrictions on various classes of employees who, unquestionably, have a right to report their concerns directly to the Commission, even if they work

³² 138 S. Ct. 767 (2018).

as auditors or directors. The Supreme Court clarified that the “core purpose” of the DFA was to encourage direct reporting to the Commission, not to promote internal compliance programs.³³

In *Digital* the Supreme Court explained its reasoning:

Dodd-Frank’s purpose and design corroborate our comprehension of §78u–6(h)’s reporting requirement. The “core objective” of Dodd-Frank’s robust whistleblower program . . . is “to motivate people who know of securities law violations to *tell the SEC*,” S. Rep. No. 111–176, at 38 (emphasis added). By enlisting whistleblowers to “assist the Government [in] identify[ing] and prosecut[ing] persons who have violated securities laws,” Congress undertook to improve SEC enforcement and facilitate the Commission’s “recover[y] [of] money for victims of financial fraud.” *Id.*, at 110. To that end, §78u–6 provides substantial monetary rewards to whistleblowers who furnish actionable information to the SEC. *See* §78u–6(b).

* * *

[The SEC before the Supreme Court] express concern that our reading would jettison protection for auditors, attorneys, and other employees subject to internal-reporting requirements. *See* Brief for Respondent 35; Brief for United States as *Amicus Curiae* 21. Sarbanes-Oxley, for example, requires auditors and attorneys to report certain information within the company before making disclosures externally. *See* 15 U. S. C. §§78j–1(b), 7245; 17 CFR §205.3. If the whistleblower definition applies, Somers and the Solicitor General fear, these professionals will be “[le]ft] . . . vulnerable to discharge or other retaliatory action for complying with” their internal-reporting obligations. Brief for United States as *Amicus Curiae* 22 (internal quotation marks omitted).

Our reading shields employees in these circumstances, however, *as soon as they also provide relevant information to the Commission*. True, such employees will remain ineligible for Dodd-Frank’s protection until they tell the SEC, but this result is consistent with Congress’ aim to encourage SEC disclosures. . . .

³³ We note that the Commission’s attempt to balance the Chamber of Commerce’s former policy of promoting internal compliance with the clear mandates of the DFA to encourage direct reporting to the SEC were noble and well-reasoned. As the Commission is aware, our firm represented the NWC in its brief before the Supreme Court in defending the Commission’s rule filed in the *Digital* case. However, the Chamber of Commerce and other industry leaders took an opposite view. Despite the arguments raised by the Commission, the NWC and counsel for Mr. Somers, the Supreme Court issued a clear and unequivocal ruling that now must be fully implemented. The Proposed Rule takes a haphazard approach, and only amends the rules that explicitly helped whistleblowers, but keeps in place rules that help potential retaliators, placing whistleblowers at risk and undermining the intent behind the DFA. The Supreme Court’s decision in *Digital* cannot be selectively implemented. In its brief before the Supreme Court the Chamber of Commerce identified itself as “the world’s largest business federation” representing “300,000 direct members” and “indirectly” “the interests of more than three million companies and professional organizations of every size, in every industry sector, from every region of the country.” Not one member of the Chamber protested the position taken by its representative. Not one member filed a brief before the Supreme Court explaining the importance of protecting internal whistleblowers in order to ensure the integrity of corporate compliance programs. *See Amicus* Brief of the U.S. Chamber of Commerce, https://www.kkc.com/assets/site_18/files/blog/chamberamicussomers.pdf.

Overlooked in this protest is **Dodd-Frank’s core objective: to prompt reporting to the SEC.** *Supra*, at 3–4, 11. In view of that precise aim, it is understandable that the statute’s retaliation protections, like its financial rewards, would be reserved for employees who have done what Dodd-Frank seeks to achieve, *i.e.*, they have placed information about unlawful activity before the Commission to aid its enforcement efforts.

Digital, 138 S.Ct. 767 (2018) (emphasis added).

Thus, the “core objective” of the DFA is to encourage employees to report directly to the SEC. Rules enacted by the SEC that conflict with this “core objective” are contrary to law and unenforceable.

The Chamber of Commerce and the regulated community petitioned the courts to strip internal whistleblowers of protection under the DFA. Having prevailed, the Chamber of Commerce and the regulated community must be held accountable to the full ramifications the loss of internal whistleblower protections triggered. The Director of the Office of the Whistleblower publicly warned the regulated community that they should be “careful about what they wish for” when urging the Supreme Court to strip internal whistleblowers of the rights under the DFA.³⁴ The Commission *must* conform *all* of its DFA whistleblower rules to the mandates of the Supreme Court, not just the anti-retaliation provisions.

These changes should be as follows:

First, existing rule 240.21F-6(a)(4) must be removed. This rule was intended to encourage employees to report concerns first to their internal compliance programs. However, as the Supreme Court has made perfectly clear, the core purpose of the DFA is to encourage employees to report directly to the SEC, and as such the Court held that the Commission was without legal authority to provide any protection to employees who report internally. The current rule not only has no support in law, but badly misleads employees. It encourages employees to file internally with companies, without warning them that if they do, they can lose *all* of the employment rights under the DFA. The rule flouts the explicit holding of the Supreme Court and undermines the Congressional intent behind the DFA, as explained by the Court. The rules on calculating the amount of an award must conform to the *Digital* mandate interpreting the “core purpose” of the DFA, and there is simply no place in this calculation for promoting internal reporting.

Second, Rule 240.21F-4(b)(4)(iii) must be deleted. This rule places restrictions on the right of certain employees, otherwise fully qualified as “whistleblowers” under Congress’ definition of that term, to qualify for a reward. Under this rule, company directors, officers, auditors, and compliance officials could not report their concerns directly to the SEC, but instead would have to wait at least 120 days to file such a report.

Under the *Digital* decision these restrictions are clearly illegal. The DFA provided an explicit definition of “whistleblower” and set forth an explicit definition of those classes of persons

³⁴ Jane Norberg, quoted in *Think Advisor* (June 29, 2017), <https://www.thinkadvisor.com/2017/06/29/sec-whistleblower-chief-be-careful-what-you-wish-f/?slreturn=20180617222357>

excluded from the reward provisions. Directors, officers, auditors and compliance officials were not excluded from coverage under the DFA, and all are included within the definition of “whistleblower.” These classes of employees often have the most significant evidence of corporate crimes and must be actively encouraged to blow the whistle.

The regulated community strongly argued that potential whistleblowers employed as directors, officers, auditors or compliance officials were not protected under the DFA if they simply reported their concerns internally. The Chamber of Commerce and the regulated community cannot now be heard to protest the impact of their own arguments, successfully raised in numerous courts.

The Commission must amend *all* of its DFA whistleblower rules to conform with the *Digital* decision.

Clarification of the Definition of “Compliance”

The *Digital* decision also opens up the question as to what precisely a corporate compliance program is. The current rules use the term “compliance” thirteen times. The Commission’s publication of the Proposed Rules referenced internal compliance programs on pages 19, 41, 71, 73 and 134, and again used the term “compliance” without defining precisely what constitutes a corporate compliance program. Although it is well recognized that a company has wide discretion in creating a compliance program, a company’s branding of a department with the title “compliance program” does not create a compliance department. For example, a company cannot transform its law department into a compliance department simply by calling one of the law department’s sub-offices a “compliance” department.

It is absolutely essential that the Commission define the meaning of a corporate compliance program as understood in the DFA whistleblower rules and prohibit the practice of confusing a company’s legal department with a company’s corporate compliance program.

Circuit Judge Brett Kavanaugh made it perfectly clear in his decision in *In re Kellogg Brown & Root, Inc.*³⁵ that law departments within corporations have a duty to protect and defend their client (i.e. the corporation). These law departments serve a radically different purpose than an independent compliance program. Unlike an independent compliance program, law departments have the ability to keep information confidential from the United States government, even when that information may contain direct evidence of criminal activity.³⁶ This is so, even if the law department operates under the misleading title of “compliance.”³⁷ As the Supreme Court

³⁵ See *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. Jun. 27, 2014).

https://www.kkc.com/assets/site_18/files/resources/in-re-kellogg-brown-root-no.-14-5055-jun-27-2014.pdf.

³⁶ The problems with the KBR decision were spelled out in a White Paper published by the Rand Corporation: Greenberg, Michael D., *Transforming Compliance: Emerging Paradigms for Boards, Management, Compliance Officers, and the Government*. Pgs. 61-65 https://www.kkc.com/assets/site_18/files/resources/rand-compliance-white-paper-2014.pdf.

³⁷ The Commission should review the entire record of the KBR case, in which the district court judge, *in camera*, reviewed documents that KBR maintained were attorney client privileged. See *U.S. ex rel Barko v. Halliburton Co.*, No. 1:05-cv-2276 (U.S. District Court for the District of Columbia). The district court discussed the contents of these documents in two decisions, and the materials being secreted by the law department clearly contained factual evidence of criminal activity and contracting fraud. The documents in question were created by non-lawyer

recognized in *Upjohn*, the legal department of a corporation has a duty to protect its client, even at the expense of the whistleblower.

As demonstrated by the underlying fact in *KBR*, compliance programs that are managed by attorneys have broad powers to suppress information and their conduct is not tied to any purported compliance functions performed by a corporation. The U.S. Court of Appeals for the District of Columbia Circuit permitted KBR to keep its compliance records secret despite the following uncontested findings by the district court:

The investigators prepared the documents to comply with government contractor regulations, specifically the Department of Defense regulation requiring contractors to discover and report improper conduct regarding Government contracts. Nothing suggests the reports were prepared to obtain legal advice. Instead, the reports were prepared to try to comply with KBR's obligation to report improper conduct to the Department of Defense.

None of the documents give legal advice. Investigators, not attorneys, conducted the interviews and wrote the reports. The investigators wrote the reports when no litigation had been filed. KBR investigators wrote the reports and conducted the interviews to comply with federal defense contracting regulations, not to secure legal advice.

U.S. ex rel. Barko v. Halliburton Co., 4 Supp.3d 162 (D.C.D.C. 2014), reversed 756 F.3d 754 (D.C. Cir. 2014).

investigators for KBR's compliance program pursuant to the company's Code of Business Ethics. The D.C. Circuit overruled the district court's decision that the documents be produced in discovery based on its finding that the Iraq-based compliance program was ultimately managed KBR's Office of General Counsel in Houston. The compliance documents suppressed by the appeals court included evidence that subcontractors paid for by taxpayer money were given "preferential treatment," employees accepted payoffs to illegally steer business to an unqualified subcontractor, contracts were approved by KBR that were more expensive than those submitted by honest applicants, and where a preferred subcontractor had regularly tried to "double bill" the government. The suppressed documents included evidence that contracts were given that were twice as expensive as contracts offered by more qualified companies. See *U.S. ex rel. Barko v. Halliburton Co.*, 37 F.Supp.3d 1 and 4 Supp.3d 162 (D.C.D.C. 2014), reversed 756 F.3d 754 (D.C. Cir. 2014). Despite this direct evidence of fraud, and despite the fact that employees provided this evidence to a department with the title of "compliance," Judge Kavanaugh ruled that the materials could not be produced in discovery, as they were, as a matter of law, the property of KBR's law department.

To make matters worse, the KBR compliance investigators utilized a non-disclosure agreement (NDA) that improperly restricted the right of the employees to blow the whistle. The Commission found that the NDA used in the KBR case also created a chilling effect on potential whistleblowing. KBR's nondisclosure agreements were eventually found void by the SEC (and KBR agreed to pay a fine based on the NDA the company used in the *Barko* case. *In re KBR*, SEC Ad. Action No. 3-16466 (4-1-15), [https://www.kkc.com/assets/site_18/files/resources/in%20the%20matter%20of%20kbr.%20inc.,%20securities%20and%20exchange%20commission%20file%20no.%203-16466%20\(april%201,%202015\).pdf](https://www.kkc.com/assets/site_18/files/resources/in%20the%20matter%20of%20kbr.%20inc.,%20securities%20and%20exchange%20commission%20file%20no.%203-16466%20(april%201,%202015).pdf)). However, Judge Kavanaugh permitted KBR to rely on this illegal NDA to meet its notice requirements under the *Upjohn* precedent. In other words, KBR was permitted to use an illegal NDA to silence employees, and still rely on that NDA as proof that the investigatory interviews should be covered under KBR's attorney-client and work product privileges.

Furthermore, a so-called compliance program managed by company attorneys can suppress critical facts demonstrating fraud. In the *KBR* case the district court judge explained why KBR wanted to keep its compliance documents secret:

KBR's embarrassment that its internal investigation raised major suggestions of bribery, raised major questions whether KBR employees were steering contracts to favored contractors, raised major questions whether KBR improperly approved change orders that sometimes doubled the cost of agreed contracts, and raised major questions why additional contracts were given to contractors who had miserably failed to complete earlier work.

U.S. ex rel. Barko v. Halliburton Co., 4 Supp.3d 162, reversed 756 F.3d 754 (D.C. Cir. 2014).

Despite this evidence, the D.C. Circuit suppressed the release of these documents simply because the compliance investigators ultimately reported to the company's law department.

The DFA rules must make it clear that the term "compliance," when used to discuss a compliance program or a compliance officer, means an independent compliance program not subject to a corporate attorney-client or work product privilege. Whenever a compliance program is managed by the law office, the company can invoke its attorney-client privilege and, as KBR did in the *In re KBR* case, invoke that privilege and block the release of compliance documentation, including information provided by whistleblowers that may demonstrate fraud. Thus, the lawyer run compliance program is, as a matter of law, simply an arm of the law department, and should be classified under the rules for what it is. Under *In re KBR* there is simply no question that a legal department program entitled "compliance" has the discretion to conceal information and utilize its "compliance" program to collect information for the purpose of defending the company from an SEC regulatory investigation and to unmask the identity of internal whistleblowers. Corporate law departments can serve a legitimate purpose, but that purpose cannot be confused with a compliance program that is blessed by the Commission.

There is no public interest in the SEC encouraging employees to report information to the company's law department if that department has the full authority to hide the information it collects pursuant to the attorney-client and work product privileges.³⁸ Moreover, the Commission

³⁸ Inherent conflicts of interest exist whenever a compliance program is managed by attorneys. As explained by Jeffrey Eglash, Senior Counsel for General Electric, Gordon A. Greenberg, attorney with McDermott Will & Emery, and Professor Laurie L. Levenson, Chair of Ethical Advocacy Loyola Law School: "*Because of [the] risk to individual employees who cooperate in internal investigations, corporate counsel and outside counsel retained to conduct internal investigations must warn their interviewees that statements they make are subject to disclosure if the corporation decides to waive the privilege as to the statements. . . . At a minimum, a proper Upjohn warning informs the interviewee that: (1) the attorney is there to conduct a privileged and confidential interview of the employee; (2) the attorney represents the company, not the individual; (3) the company, not the individual, enjoys an attorney-client privilege with the attorney; and (4) the company may, as it sees fit, disclose the employee's information and statements to third parties, including the government.*" See ABA Section of Litigation Corporate Counsel CLE Seminar, February 11-14, 2010, "I am Not Your Lawyer: Best Practices Concerning Upjohn Warnings in Corporate Internal Investigations," https://www.kkc.com/assets/site_18/files/resources/avoiding-the-pitfalls-of-internal-corporate-investigations-proper-use-of-upjohn-warnings.pdf. SEC rules must carefully explain that attorney-managed "compliance" programs do not meet the definition of a compliance program, and furthermore

actually creates serious ethical and conflict of interest issues by promoting employee disclosures to company lawyers. As explained by U.S. Senator Charles Grassley: “It doesn’t take a pig farmer from Iowa to smell the stench of conflict in that arrangement.”³⁹

This distinction is very important, as most corporations do not provide their employees with the notice required/recommended by the applicable bar associations. Specifically, the New York Bar fully understood that a lawyer-managed compliance program was in fact an arm of the company’s law office, and non-lawyer intake officials were required to notify employees of this status. In New York Bar Ethics Opinion 650, the bar considered what type of warnings corporate compliance employees whose report to a company attorney must give to employees filing a concern with the lawyer-managed compliance program. They approved the following warning: “*If the caller is unrepresented by counsel*” the compliance intake officer should “*make the following statement:*”

I want to caution you that I am an attorney for the Company and not for you or other employees. Therefore, while I can record your complaint, I cannot and will not give you legal advice, and you should not understand our conversation to consist of such advice. I do advise you to seek your own counsel, however, as your interests and the Company’s may differ. Having said this, I would be happy to listen to your complaint.

This requirement is consistent with the rules of other state bar associations.⁴⁰ Moreover, the New York Bar guidance also instructed companies that have lawyer-managed compliance programs to decline accepting information from employees who are represented by counsel. Instead, these programs were advised to inform employees so represented to contact their own lawyers and have their lawyers communicate to the company’s compliance program.

The current SEC rules have not been changed in light of either the *In re KBR* or the strong ethics guidance issued by the New York Bar. The New York Bar’s ethics guidance became extremely relevant to the functioning of attorney-run compliance programs after the KBR decision. The SEC rules unintentionally mislead employees into cooperating with corporate law departments, without fully understanding that the program can be, in fact, simply a tool of the company lawyers. Furthermore, the SEC rules do not require lawyer-managed compliance programs to adhere to the controlling bar rules. Such lawyer-managed programs not only can keep critical information secret under the attorney client and work product privilege, but they can also use any information the obtain from or about the whistleblower to discredit the whistleblower or even make the whistleblower a scapegoat for the wrongdoing he or she reveals. It is absolutely imperative that the SEC clarify its rules as to the actual meaning of a compliance program, as distinct from a company law department.

must explicitly instruct all regulated entities to ensure that employees are not confused by companies that fail to provide warnings to employees consistent with those set forth above, and the New York State bar recommendations.

³⁹ Kohn, *The New Whistleblower’s Handbook*, p. 222.

⁴⁰ Jeffrey Eglash, *et al.*, “Avoiding the Perils and Pitfalls of Internal Compliance Investigations: Proper Use of Upjohn Warnings,” ABA Section of Litigation Corporate Counsel; D.C. Bar Ethics Op. 269; ABA Model Rules of Professional Conduct 4.2 and 4.3; Donna Boehme, “DOJ Tells HSBC and Corporate America: Reform Your Compliance Departments,” *Corporate Counsel* (Dec. 20, 2012); Jacelyn Jaeger, “The Importance of Splitting Legal and Compliance,” *Compliance Week* (December 2011).

Related Action

The Proposed Rule requires whistleblowers to directly provide their “original information” to agencies for which he or she may later seek a “related action” reward. Proposed Rule, p. 38.⁴¹ Currently, there is no such requirement.

This Proposed Rule is highly problematic and should not be approved. First, the rule must conform to the actual language of the DFA. The DFA does not require whistleblowers to directly file information with agencies that could ultimately issue sanctions that qualify as a related action. Because no such requirement exists in the statute, it would be an abuse of discretion to create new criteria restricting whistleblower rights.

In this manner, the Proposed Rule on “related action” is in conflict with the U.S. Supreme Court’s recent decision in *Digital Realty v. Somers*. In interpreting the DFA, the Supreme Court concluded that when the DFA “includes an explicit definition, we must follow that definition, even if it varies from a term’s ordinary meaning.” Congress provided an explicit definition of “related action:”

The term “related action”, when used with respect to any judicial or administrative action brought by the Commission under the securities laws, means any judicial or administrative action brought by an entity described in subclauses (I) through (IV) of subsection (h)(2)(D)(i) that is based upon the original information provided by a whistleblower pursuant to subsection (a) that led to the successful enforcement of the Commission action.

15 U.S.C. § 76u-6(a)(5).

The current rules directly incorporate this definition:

A *related action* is a judicial or administrative action that is brought by: (i) The Attorney General of the United States; (ii) An appropriate regulatory authority; (iii) A self-regulatory organization; or (iv) A state attorney general in a criminal case, and is based on the same original information that the whistleblower voluntarily provided to the Commission, and that led the Commission to obtain monetary sanctions totaling more than \$1,000,000.

§ 240.21F-3(b)(1).

⁴¹ The Commission rules also permit a whistleblower to qualify for a “related action” award if the SEC provides the sister-agency with the whistleblowers information. However, the whistleblower has no control over the Commission’s decision to make such a referral, and also has no control over what information provided by the whistleblower is provided to the sister-agency. The whistleblower may never even be informed of this referral. Thus, as explained above, should this rule be implemented whistleblowers would be forced to provide information directly to all potential agencies that could conceivably issue a sanction qualifying as a related action in nearly every case, even if the SEC has already made the referral. Unfortunately, unlike the Commission’s referral, if the whistleblower directly provides the information to the sister-agency, that disclosure will not be covered under the strict confidentiality rules of the DFA.

These definitions only require that the original information be directly provided by the whistleblower to the Commission, not to other federal or state agencies.

Under the DFA's explicit definition, when a "related" agency issues an order that relied on the original information provided by the whistleblower, regardless of whether or not the whistleblower directly provided that information to the agency, the whistleblower meets the definition necessary to qualify for a related action reward.

The DFA defines "original information" as "information that (A) is derived from the independent knowledge or analysis of a whistleblower; (B) is not known to the Commission from any other source . . . (C) is not exclusively derived from an allegation made in a judicial or administrative hearing [unless the source of that information is the whistleblower]." 15 U.S.C. § 76u-6(a)(3). The whistleblower is only required to provide the original information directly to the SEC. He or she is not required to submit his or her information, shotgun-style, to every federal or state agency that may also issue a sanction based on his or her information. The key to this rule is not who hands the whistleblower's information over to the sister-agency, but whether or not the sister-agency relied upon the whistleblower's original information. This is a factual analysis, not subject to the prophylactic rule proposed by the Commission.

Second, the Proposed Rule focuses on whether or not a whistleblower provided information directly to the agency that issued the related action sanction. However, this iron-clad rule is at war with Congress' clear instruction that the identity of the whistleblower must be protected. When an agency does not have a Whistleblower Office designed to protect the identity of a whistleblower, or specific binding regulations permitting the agency to accept confidential or anonymous whistleblower disclosures, the SEC simply cannot require whistleblowers to submit their information to those agencies, or risk losing their entitlement to a related action award.

Numerous federal and state agencies that could potentially issue sanctions covered under the "related action" provision do not have whistleblower offices, mandatory rules protecting confidential informants, and/or anonymity requirements consistent with the DFA. It would violate a central premise of the DFA to force a whistleblower to file his or her information with an agency that fails to provide confidentiality protections consistent with those in the DFA in order to qualify for a "related action" award.

Third, the Proposed Rule creates a prophylactic rule that will not fit every case. For example, there will be cases for which it is beyond dispute that a whistleblower's original information triggered the related action sanction, such as where the whistleblower's original information is provided to a sister-agency by agencies such as the Department of Justice (that protects the identity of confidential informants and often works together with the SEC on investigations, including those under the DFA). Additionally, whistleblowers may make disclosures to entities such as Congress, or provide testimony in a Grand Jury or in a shareholder lawsuit, that could result in a "related action" sanction by a regulatory agency. Thus, in cases for which there is a direct causal nexus between the "original information" provided to the Commission and the sanction issued by a sister-agency, a related action award must be given, even if the whistleblower did not personally provide the sister-agency with the information.

Finally, employees who work for publicly traded companies outside the United States can be essential sources of information. Based on numerous precedents concerning the extraterritorial jurisdiction of employment laws, most of these employees are not covered under the anti-retaliation protections afforded under the DFA or the Sarbanes-Oxley Act. *See Asadi v. G.E. Energy*, 2012 U.S. Dist. LEXIS 89746 (S.D. Tex. 2012). These employees would be at great risk if they were forced to file claims with state or federal agencies that had no whistleblower program, and no rules guaranteeing confidentiality. Worse still, in many countries providing information to U.S. law enforcement agencies may be illegal. These employees would risk not just termination, but imprisonment.

Consistent with the DFA, the SEC also cannot require whistleblowers to directly provide any information to any federal or state agency that does not have explicit (and enforceable) rules protecting whistleblowers' confidentiality. Even if the DFA did not explicitly define "related action," it would still be an abuse of discretion for the SEC to require any individual to provide information to a sister-law enforcement agency that fails to provide the same level of protection for whistleblowers as provided by DFA and SOX. This would include the strict confidentiality requirements and the right to file claims anonymously, as permitted under the DFA.

For these reasons, the Proposed Rule mandating that whistleblowers directly provide agencies outside the SEC with their whistleblower disclosures in order to qualify for a "related action" award must be withdrawn.

Delay and the Summary Decision Procedures

The most significant problem with the SEC's current whistleblower program is not the rare instance where a whistleblower obtains a large reward, but rather the prolonged delay in processing reward applications. These delays can drag on for years and based on our direct experience, can be as long as four (4) years and running. It is simply unacceptable that the Commission can take the duration of an entire Presidential term to decide on an award in a whistleblower case, *after* the Commission has completed its investigation into the underlying misconduct and collected the sanctions from the wrongdoer. Moreover, because the Commission staff would have directly worked with the whistleblower and/or used the whistleblower's "original information" to sanction the wrongdoer, the Commission should be in a position to expeditiously approve rewards.

When the SEC staff completes its investigation, and the Commission approves a sanction against a corporation the staff and its investigators know what individuals provided "original information" that contributed to the sanction. Obviously, the SEC employees directly involved in the case would clearly know who the real whistleblowers were, and would be in a position to immediately make recommendations to the Office of the Whistleblower as to who was qualified for a reward. In order to prevent undue delay the rules need to be amended to reflect this reality, and ensure that the reward process commence without undue delay.

The experience in FCA cases is analogous. As in the DFA, the FCA permits a reward for whistleblowers whose original information results in the United States obtaining a monetary judgment against a wrongdoer. Also, as in the DFA, the United States officials who investigated and/or prosecuted the FCA case would have very specific information as to who the whistleblower

was, and their contribution to the case. In both the FCA and DFA, the officials who participated in the investigation would be in a position to make recommendations as to the amount of payment a whistleblower should receive even before the final settlement is reached between the United States and the corporate wrongdoer.

But here is where the similarities end. Under the FCA, the whistleblower's reward is usually decided *before* the sanction against the corrupt government contractor is presented to a court for approval. This has been the practice in the FCA for 30-years, and there have been few problems with this practice, even in cases for which there are multiple whistleblowers and more than one FCA complaint filed. Whistleblowers are usually paid within days of the United States collecting the sanction from the wrongdoer.

Instead of following the FCA practice, the Commission's current rules permit any person to file an application (known as a WB APP) for a reward within 90 days of the posting that the Commission obtained a sanction against a wrongdoer. The WB APP merely commences a prolonged process of determining a whistleblower's award. Whereas in FCA cases the decision-making process regarding the payment of a reward is usually concluded *before* the sanction is obtained from the wrongdoer, in SEC cases, the collection of a sanction merely commences an internal and complex multi-layer adjudication that can take years to complete.

The Commission has now apparently realized that this free-for-all application process encourages frivolous filings, wastes Commission resources, and delays the processing of valid award applications. The Commission's proposed solution is to expedite the decision-making process for frivolous filings. This is understandable, but the Proposed Rules contain no reforms that address the root cause of these delays and does not directly address the long delays experienced in meritorious whistleblower cases. It is the delay in reaching a final decision in meritorious cases that should be of primary concern to the Commission.

The rules must be amended in order to ensure that undue delays are avoided, decisions are expeditiously rendered, and the Congressional intent behind the DFA is fulfilled. The solution offered by the Commission in the Proposed Rules is woefully inadequate to ensure that whistleblower reward decisions are not unduly delayed.

As a threshold matter, the Commission's current program violates the Administrative Procedure Act's requirement that administrative decisions in DFA cases not be "unreasonably delayed." 5 U.S.C. § 706(1). Likewise, section 922(d)(1)(C) of the DFA establishes a public policy that requires the SEC to act "promptly" when deciding applications for whistleblower awards. It requires that the SEC Inspector General review the Commission's actions as to "whether the Commission is prompt in . . . responding to . . . applications for rewards filed by whistleblowers."

In order to ensure that the Commission pays rewards in a timely manner consistent with the requirements of the Administrative Procedure Act and the Congressional intent reflected in section 922(d)(1)(C) of the DFA, Congress set aside \$450 million to permit the Commission to immediately start paying awards. Congress sent a clear message that they wanted rewards to be paid in a timely manner as "the Committee...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 Restoring American Stability Act of 2010, S Rep. No. 111-176, 112 (2010). Nearly eight years after the passage of the DFA, the Commission still has not spent the initial funds allocated by Congress to pay awards.

Significantly, between FY 2012-17, the Commission has paid less in rewards than either the Department of Justice under the False Claims Act or the IRS under the tax whistleblower law. Based on the number of TCR and APP applications filed in Commission proceedings, there is no justification for the SEC to be lagging behind these other agencies, especially given the very liberal related action rules that expand the basis for the amount of potential rewards.

As stated above, the delays in issuing rewards is in violation of the requirements of the Administrative Procedure Act, Pub. L. 79-404, 60 Stat. 237 (1946) (codified at 5 U.S.C. § 551, *et seq.*). The APA makes it unequivocally clear that agency actions are to be conducted on a timely basis.” Although the APA is over 70-years old, its legislative history is still instructive when deciding the meaning of “unreasonable delay” in section 706. During hearings held before the House Committee on the Judiciary, the following policy statements were issued on the record:

“...[I]t is the declared policy of Congress that administrative adjudications shall be made speedily, and matters not susceptible of prompt informal disposition shall be set for formal hearing forthwith, and promptly heard, argued, and decided.”⁴²

“That no such person or party shall in any manner be made to suffer, through the subsequent exercise of administrative powers or otherwise, the consequences of any **unwarranted or avoidable administrative delay in determining any such matter.**”⁴³

While discussing another previous version of the bill during a May 3, 1946 meeting, the House Committee on the Judiciary elaborated on the meaning and purpose of a phrase inserted into the statute to ensure swift administrative action:

“The requirement that agencies proceed ‘with reasonable dispatch to conclude any matter presented’ means that no agency shall in effect deny relief or fail to conclude a case by mere inaction, or proceed in dilatory fashion **to the injury of the persons concerned. No agency should permit any person to suffer injurious consequences of unwarranted official delay.**”⁴⁴

In the spring of 1946, the Senate held proceedings on the bill that would become the APA. Senator Edwin C. Johnson of Colorado placed onto the record an address discussing the bill by Allen Moore, a member of the Colorado bar. Mr. Moore’s address reads, in relevant parts:

⁴² *Administrative Procedure: Hearing on H.R. 184, H.R. 339, H.R. 1117, H.R. 1203, H.R. 1206, and H.R. 2602 Before the H. Comm. on the Judiciary, 79th Cong.* 170 (1946).

⁴³ *Id.* at 178-79.

⁴⁴ H.R. Rep. No. 79-1980, at 264 (1946) (emphasis added).

“A **second provision** [of the part of the bill that discusses ancillary matters] **is designed to do what is possible to remedy delays in the administrative process,** since ‘**expedition in the disposition of cases is commonly a major objective of the administrative process.**’ It relieves the private parties from consequences of unwarranted or unavoidable administrative delay [and] provides that cases shall be promptly set and determined...”⁴⁵

Remarks by Senator Adolph J. Sabath provide further evidence that Congress thought preventing administrative delay was of paramount importance when drafting the bill. Sabath remarked:

“The object of the bill is, as I have stated, to improve the administration of rules and regulations made by the agencies under grants of power from Congress, and to establish uniformity of practice **so that any citizen may have his day in court with a minimum of delay and expense.**”⁴⁶

The concerns and policies reflected in this legislative history were unquestionably addressed in the final version of the Administrative Procedure Act, which granted persons (such as whistleblowers awaiting award determinations by the Commission) the right to challenge delays in federal court. Thus, the APA permits individuals to bring an action in federal court to “compel agency action unlawfully withheld or unreasonably delayed[.]” 5 U.S.C. § 706(1). Congress created this private right of action for parties appearing before administrative agencies to provide a remedy for administrative delay. The statute’s legislative history confirms that its drafters sought to ensure that any party involved in an action before an administrative agency would not be burdened by crushing delays.

Forcing whistleblowers to wait years in order to obtain a reward has and will cause financial and emotional harm to whistleblowers.

In order to prevent undue delay, the current rules should be amended in a manner consistent with current practice under the FCA. As required under *Digital Reality* in order to qualify for a reward whistleblowers must provide their information directly to the SEC. Thus, the Commission’s staff knows, well before issuing a sanction, the identity of every whistleblower who provided information to the SEC, and for which the SEC relied upon when issuing the sanction. The Commission is in a position to make their reward recommendations simultaneous with the Commission’s approval of any sanction. The Commission should consider requiring the staff to make these recommendations immediately after the issuance of a sanction, and providing these recommendations to the whistleblowers for comment.

Like in FCA cases, the Commission staff and the whistleblower should also be encouraged to informally discuss the appropriate reward immediately after the Commission approves the sanction, and attempt to reach a stipulation on this issue. That stipulation, along with the SEC staff justification, can be immediately forwarded to the Claims Review Staff or the Commission for immediate approval.

⁴⁵ S. Doc. No. 293, 79th Cong., at 333 (1946) (emphasis added).

⁴⁶ *Id.* at 345-46 (emphasis added).

Moreover, just as whistleblowers must adhere to strict timing requirements for filing TCR and APP applications, the SEC staff should similarly be bound by strict time requirements for approving reward applications. We strongly suggest that the Commission be required to approve all reward applications within 90 days of the issuance of the sanction for which the Commission action was based, and that other policies and procedures be amended to accommodate this 90 day requirement.

Finally, the Commission should adopt a rule requiring that all whistleblower rewards be paid in the fiscal year for which the collected proceeds/sanctions are obtained. This will help ensure that the Investor Protection Fund can directly use the sanctions obtained from the whistleblower cases to pay rewards, and not require the Commission to obtain these funds from other sources as would be required under 15 U.S.C. § 78u-6(g)(3)(B).

Adjudication of “Related Action” and “Commission Action” Proceedings

When adjudicating reward applications, the Commission should not combine its decision-making process concerning a “related action” with its decision-making process related to “Commission actions.” Combining these two proceedings can result in prolonged delays, as the decision-making process in a related action proceeding can be distinct from a Commission action proceeding.

Reward determinations based on final orders issued by the SEC (i.e. a “Commission Action”) are far easier to decide than those based on sanctions obtained by a separate state or federal agency (i.e. a “related action”). Because the Commission is fully aware of who filed a TCR complaint and knows how that information was used during the investigation the Commission has the ability (and responsibility) to issue an immediate preliminary determination. Given the fact that the Commission knows who the valuable whistleblowers were, the Commission must render Commission action awards within the 90 day time period outlined above. The same may not be true for a “related action” award.

First, in order for a related action to be paid, the whistleblower must qualify for a reward under the “Commission action” rules. Related action awards can only be paid if the SEC obtains a sanction of \$1 million or more in an SEC proceeding, regardless of the amount of penalty obtained by a sister-agency. Thus, the SEC must always initially render a decision on the Commission action before turning to the related action. There is simply no reason to delay issuing the determination on the Commission action award, as that decision is a condition precedent for a related action claim.

Second, a related action claim may become ripe well after the Commission action claim. For example, the DOJ could issue a related action sanction months or years after the Commission issued its sanction. There should be no delay in immediately processing the Commission action decision, even if the related action sanctions were approved shortly after the Commission action ruling.

Third, a related action adjudication will almost always take more time than a Commission action. In regard to Commission actions, the staff of the SEC will have all of the information normally necessary to decide a Commission action case. Whereas, in order to decide a related action claim,

the staff of the SEC may have to reach out to another federal or state agency for information, a matter that would cause delay.

Fourth, if the Commission action is denied, there is simply no reason to spend any time deciding the related action claim, as a related action is subordinate to the Commission action and can only be granted if the whistleblower has a valid Commission action.

Fifth, because the related action concerns actions taken outside of the SEC's direct knowledge, deciding level of contribution or reward will almost always be more difficult than in a Commission action.

Sixth, the related action award need not be paid at the same percentage as a Commission action award. Thus, a related action award may need to undergo a separate decision-making process to determine the rate of payment, which would almost always cause delay in issuing a Commission action award.

The existing regulations already call for two separate proceedings when deciding Commission and related action, and there are no provisions permitting the two proceedings to be consolidated. 17 C.F.R. § 240.21F-10 (Commission action adjudications); 17 C.F.R. § 240.21F-11 (related action adjudications). Currently, there are separate application and appeal procedures set forth for these rewards. Also, the percentage paid to a whistleblower for a Commission Action and a related action proceeding are not tied-together.⁴⁷ Finally, the Commission's current regulations specifically mention that "[a]dditional procedures apply to the payment of awards in related actions."⁴⁸

Because the issues on appeal concerning a related action and a Commission action may be separate and distinct, combining these two proceedings has resulted in unnecessary delays. Delay in the adjudication of a whistleblower claim is inconsistent with the Congressional purposes behind the whistleblower provisions. This is made clear in Section 922(d)(1)(C) of the DFA, in which Congress required the SEC Inspector General to review and report on whether or not the Commission is "prompt" in "responding to applications for awards." Furthermore, the Administrative Procedure Act requires expeditious determinations of administrative cases and permits a party to file an appeal in cases of undue delay. 5 U.S.C. § 706(1).

The Commission, through this rulemaking, should clarify that the normal practice should be to decide Commission claims on the most expeditious basis possible. If deciding a related action claim simultaneous with a Commission action claim would result in any delay, the Commission action claim should be decided first. Thereafter, a separate decision should be rendered on the related action claim.

Interpretive Guidance on "Independent Analysis"

The Commission has proposed issuing "interpretive guidance" on the meaning of "independent analysis." This guidance could materially impact the rights of "analysts" as defined in the

⁴⁷ *Id.* § 240.21F-5(b).

⁴⁸ *Id.* § 240.21F-3(b)(2)(ii).

definition of a “whistleblower.” We are concerned that the proposal sketched out in the Proposed Rule would materially restrict the rights of analysts under the DFA. The Commission should publish a draft of this guidance, and permit comment on the draft. Regardless, the Commission cannot deviate from Congress’ definition of “independent analysis” and must ensure that the purposes behind the DFA are strictly implemented.

Impact on Current Cases

The current rulemaking proceeding initiated by the Commission should not be used to justify a delay in the decision-making process of pending cases.

First, the current delays are already intolerable and contrary to the Congressional intent behind the DFA. They also violate the Administrative Procedure Act and are harmful to whistleblowers.

Second, changing rules to negatively impact a whistleblower or reducing or limiting an award through a cap after a whistleblower has filed his or her TCR and/or APP application could be highly prejudicial. Whistleblowers took the risk of suffering retaliation when they filed their initial TCRs and worked with the SEC on enforcement investigations. When they took these risks, they relied upon the rules that are currently in place. Thus, Proposed Rules that create new barriers or limits on whistleblower awards should not be applied to pending cases.⁴⁹

Third, whistleblowers in pending cases, especially those who wish to remain completely anonymous, will not be in a position to respond to each and every comment filed in the rulemaking proceeding that could impact the Commission’s final decision. This raises major due process issues, especially in light of the adjudicatory nature of the Commission’s decision-making process in reviewing recommendations issued by the Whistleblower Office or the Claims Review Staff (“CRS”).

Fourth, the Commission can use its adjudicatory authority to issue decisions on a case-by-case basis until the final rules are approved, even if some of the issues in these pending cases are addressed in the Proposed Rules.

Finally, in regard to the Commission’s proposed “interpretive guidance” concerning the meaning of “independent analysis,” inasmuch as the Commission’s guidance strictly conforms to the statutory definition.

⁴⁹ To the extent there are Proposed Rule changes that simply provide clarification to increase or expand whistleblower rights it would be appropriate to apply those to pending cases. We reserve the right to address this issue separately before the public comment period is over.

Conclusion

For the reasons set forth above, the Proposed Rules should be changed, and the current rules amended, as set forth in this letter.

Thank you for your attention to these matters. Please feel free to contact us at your convenience by email at contact@kkc.com or by phone at 202-342-6980.

Respectfully submitted,

/s/

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