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October 21, 2019

URGENT MATTER

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Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
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Re: **FIFTH SUPPLEMENTAL COMMENT: PROPOSED RULES**
File Number S7-16-18

Update: **Comments Related to Proposed Rules 21F-6(d) and 21F-9(e)**
"Good Cause" Exception for 21F-9(e)

Dear Chairman Clayton and Secretary Countryman:

On behalf of the National Whistleblower Center, Sherron Watkins, and our law firm, we thank the Commissioners and members of the Commission staff who took the time to meet with us and discuss the proposed changes to the whistleblower rules. As a result of these discussions, we wanted to share additional information that may help guide your decision and ensure that the final approved rules will improve the highly successful whistleblower program and "motivate people who know of securities law violations to *tell the SEC*." *Digital Reality Trust, Inc. v. Somers,* 138 S. Ct. 767, 777 (quoting S. Rep. No. 111–176, at 38) (emphasis in original).[1]

We have carefully reviewed the decisions of the SEC regarding compliance with the "form" submission requirements that are at the heart of Proposed Rule 21F-9(e). The Commission has waived, or not applied, the "form" filing requirements (including the TCR requirement and the written submission requirement) on a number of occasions, and granted rewards to whistleblowers

[1] *Digital Reality Trust, Inc., v. Somers,* 138 S.Ct. 767 (2018) available at https://www.kkc.com/assets/Site_18/files/SEC/Digital%20realty%20v%20somers.pdf; and Senate Report, S. Rep. No. 111–176, available at https://www.kkc.com/assets/Site_18/files/resources/Rule%208/Senate%20Report%20No.%20111-176.pdf.

when they met all of the other requirements for obtaining an award, but had contacted the Commission prior to filing the required "form."[2]

Similarly, we have reviewed the cases in which the failure to properly file a TCR (or otherwise fail to file original information in the "form" required under the rules[3]) was referenced in the denial of a reward. In these cases, it is clear that the main reason for denying the reward was that the applicants were unquestionably not qualified to obtain a reward because they failed to provide original information that was used to sanction a wrongdoer. The failure to comply with the TCR requirement was mentioned in these cases, but the actual decisions appear to be premised on the fact that the applicant was not otherwise eligible for a reward.[4]

In these denial cases, the Commission fully documented that the applicant's information was not "original" and not relied upon by the enforcement division when sanctioning the company. In fact, the Commission often considered other communications with the Commission or SEC staff, even in cases where the filing of TCR was discussed as a component of a denial.[5]

Although many of the Commission's published award decisions are extremely vague, they appear to confirm that prior to the publication of the Proposed Rules, the SEC had never denied an otherwise qualified whistleblower from obtaining an award based *solely* on failure to follow the technical filing "form" requirements.

This distinction is extremely significant. No one could reasonably question the legitimacy of denying an otherwise *unqualified* whistleblower, in part, on a failure to file a TCR. The failure to file the TCR simply compounded other problems. But if the whistleblower was fully qualified for a reward, but for the failure to timely file a TCR, that is an entirely separate matter. As far as the public record demonstrates, *every time* the Commission confronted that issue the Commission

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[2] *See, e.g.*, *In the Matter of Claim for Award*, Rel. No. 85412, 4 (Mar. 26, 2019); *In the Matter of Claims for Award*, Rel. No. 82181, n.5 (Nov. 30, 2017); *In the Matter of the Claim for Award*, Rel. No. 81227, n.4 (July 27, 2017); *In the Matter of Claim for Award*, Rel. No. 79747, n.3 (Jan. 6, 2017).

[3] For a period of time some whistleblowers were excused from filing a formal TCR but were required to file "written" submissions.

[4] *See, e.g.*, *In the Matter of Claim for Award,* Rel. No. 80596, 5 (May 4, 2017) ("With respect to the Claimant's letter to the Commission's Chair and the Form TCR that the Claimant provided in [redacted] (and supplemented in [redacted]) we find that the administrative record demonstrates that these submissions were not used in any way by the Enforcement staff and, thus, these submissions did not lead to the success of the Covered Actions."); *In the Matter of Claim for Award,* Rel. No. 79604, 2 (Dec. 19, 2016) ("The CRS preliminarily found that Claimant 1's information did not cause the Commission to open its investigation (or inquire into different conduct as part of a current Commission investigation)."); *In the Matter of Claim for Award,* Rel. No. 77037, 2 (Feb. 2, 2016) ("We also find that Claimant is not a 'whistleblower' with respect to the Covered Action, something which Claimant does not dispute in the reconsideration request. According to Claimant's award applications, Claimant submitted information to other federal agencies, but does not identify any information that [redacted] provided to the Commission."). One case exclusively mentioned the failure to file a TCR as a basis for denial, but it was a one-page summary affirmance of a preliminary determination by the Claims Review Staff that did not provide any facts related to the underlying claims. *In the Matter of Claim for Award,* No Release Number, CRS decision of Nov. 21, 2017/Commission Order dated Jan. 29, 2018.

[5] *See In the Matter of Claim for Award,* Release No. 80596 (May 4, 2017); *In the Matter of Claim for Award,* Release No. 77037, 2-3 (February 2, 2016); *In the Matter of Claim for Award*, Release No. 85412, 4 (March 26, 2019); *In the Matter of Claim for Award,* Release No. 80596 (May 4, 2017).

approved the award.[6] Our firm and the National Whistleblower Center seek to modify Proposed Rule 21F-9(e) by codifying this practice in the new rules and harmonizing this practice with the parallel procedures under the False Claims Act and the IRS whistleblower law.

The current proposed rule would achieve the opposite effect. It would automatically exclude all otherwise fully-qualified whistleblowers from the Dodd-Frank Act's mandatory reward program. Although the proposed rules have a very limited right to appeal in order to obtain a fully discretionary award (that is not bound by the 10-30% mandate), fully-qualified whistleblowers who do not file a TCR application within 30 days of their "first" contact with the SEC would be *permanently barred* from ever collecting a reward. Thus, under the proposed rule, a whistleblower could initiate a major investigation into a billion dollar fraud, risk their safety when collecting evidence for the government, and play a key role in the collection of $75 million in sanctions, yet still be prohibited from obtaining one penny as a reward, even if they were unemployed and living in poverty. This result is not supported under the Commission's current case law, the legislative history, or the purposes behind the reward law. This result was explicitly rejected in a case decided by the Tax Court under a similar reward law.

In *Anonymous Whistleblower 21276-13W,* Tax Court Case No. 144 T.C. 15, the whistleblowers failed to timely file the required Form 211 (a form that is substantially identical to the Form TCR), yet were otherwise fully qualified for a reward.[7] The whistleblowers triggered a major investigation into a billion dollar tax fraud, and provided critical information resulting in a successful criminal prosecution and the collection of over $75 million in sanctions. Under these facts, the Tax Court ruled that the whistleblowers were fully eligible. Similarly, under the 1943 version of the False Claims Act, whistleblowers who provided the government with information prior to filing their formal *qui tam* lawsuit were barred from collecting an award.

Although the Commission has not articulated a clear rule based on facts similar to those the Tax Court faced in *Anonymous Whistleblower 21276-13W*, as described above, the Commission's decisions in prior cases demonstrate that it understands the wisdom of that decision.

I. The Commission Could Adopt a "Good Cause" Exception to Proposed Rule 21F-9(e) that Would Prevent Hardships and Unjust Results Based on the Timing of the Filing of the TCR

Our law firm and the National Whistleblower Center have presented specific language modifying Proposed Rule 21F-9(e) to remedy the problem presented by the proposed rule.[8] Although we maintain that this proposal should be approved, there is an alternative approach that could ensure that qualified whistleblowers are not excluded from the program: a "good cause" exception to the

[6] Significantly, the vast majority of cases for which the Commission granted an award do not discuss the timing of the TCR filing. If such a timely filing was a mandatory prerequisite for obtaining a reward one would assume that requirement would have been analyzed in each case and discussed.

[7] *See* Letter from Kohn, Kohn, Colapinto (October 8, 2019), for our in-depth analysis and recommendations to the Commission (available at https://www.kkc.com/wp-content/uploads/2019/10/Oct-8-Kohn-SEC.pdf).

[8] Letter from Kohn, Kohn, and Colapinto, p. 20 (October 8, 2019)(available at, https://www.kkc.com/wp-content/uploads/2019/10/Oct-8-Kohn-SEC.pdf), *see also* Letter from Kohn, Kohn, and Colapinto, Exhibit 4 (October 16, 2019)(available at https://www.sec.gov/comments/s7-16-18/s71618-6297913-193414.pdf).

proposed rule. Under this exception, if a whistleblower met the terms of the exception, they would qualify for a mandatory reward under the Dodd-Frank Act. The Commission could narrowly write the exception to cover only those whistleblowers who can demonstrate that they would otherwise be fully qualified for a reward. The exception could also require confirmation by the Commission's investigatory staff, who would have first-hand knowledge that the whistleblower seeking the exception was fully qualified.

The SEC has adopted a "good cause" rule to waive requirements in other contexts. For example, "bad actors" otherwise disqualified from various securities-related activities can obtain a "waiver" for "good cause" shown. *See* 17 C.F.R. § 230.506(d)(2)(ii) (waiver of disqualification for "good cause"). Thus, there is precedent for waiving requirements for "good cause," even where individuals acted in a manner inconsistent with the purposes of the Securities and Exchange Act (i.e. were sanctioned as a "bad actor"). The Commission could incorporate a similar provision into Proposed Rule 21F-9(e), not aimed at "bad actors," but tailored specifically to ensure that "good actors" who contributed to the enforcement and oversight goals of the Commission, to ensure that valuable whistleblowers were not prejudiced by Rule 21F-9(e).

As explained above, approving a reasonable "good cause" exception is consistent with prior decisions of the Commission, and consistent with the practices under the IRS whistleblower law and the False Claims Act. The Commission has, in practice, waived the "form" filing requirements in cases where a whistleblower was otherwise fully qualified for an award, but has also enforced the "form" requirements in cases where an applicant would have been ineligible for a reward even if they had filed a timely TCR.[9]

The grounds for a "good cause" exemption should be predicated on evidence that the whistleblower was otherwise fully qualified for an award, and in fact engaged in the conduct explicitly promoted by Congress in 15 U.S.C. §§ 78u-6(b) and (c). A "good cause" exemption should include the following:

> (1) the individual provided original information to the Commission;
>
> (2) the original information caused the Commission to commence an examination, open or reopen an investigation, or inquire into different conduct as part of a current Commission examination or investigation under Rule21F-4(c)(1) of the Exchange Act;
>
> (3) the original information significantly contributed to the success of a Commission judicial or administrative enforcement action under Rule 21F-4(c)(2) of the Exchange Act

[9] Even after the publication of the Proposed Rules, the Commission approved a $13 million award to a whistleblower who had not strictly followed TCR rules. *In the Matter of Claim for Award*, Rel. No. 85412. In that case, the attorneys for the whistleblower met prior to the submission of the TCR and provided the Commission's enforcement staff with information about the frauds. Based on this conversation, and prior to the submission of the formal TCR the Commission opened a case. The Commission did not discuss the impact of this pre-TCR disclosure in its opinion, and the whistleblower, who provided his information "first" to the Commission (without a TCR), obtained a large reward. The Commission's decision in this matter illustrates that whistleblowers often reach out to the Commission outside the TCR process, and that early notification of frauds serves the public interest. *See also supra* n. 2, 3.

or that the information was otherwise relied upon by the Commission as required under 15 U.S.C. §§ 78u-6(b) and (c);

(4) the individual's information materially contributed to a sanction of over $1 million;

(5) once the "good cause" standard is met, the whistleblower would thereafter be permitted to obtain his or her award of no less then 10% or more then 30% as mandated by the Dodd-Frank Act, applying the standards set forth in 15 U.S.C. § 78u-6(c) and 17 C.F.R. § 240.21F-6.

(6) whistleblowers should be able to apply for this exception at the time they file their WB APP application. Thereafter, the Commission staff will be able to review the WB APP and determine whether or not the individual seeking the exemption was in fact a "whistleblower" as defined under law and whether the "good cause" exception should apply. The enforcement staff knows precisely who provided the critical information and what assistance the applicant made toward the final enforcement action.

In this way, only fully-qualified whistleblowers will meet the "good cause" standard. The evidence required to meet this standard would include the testimony of the enforcement officials who have direct knowledge of the whistleblower's contribution. Adopting such a "good cause" exception for fully-qualified whistleblowers will also vindicate the core mission of the Dodd-Frank Act's whistleblower law, i.e. to "assist the Commission 'in identifying securities law violations,'" *Digital Reality,* 138 S. Ct. at 773 (quoting S. Rep. No. 111–176, at 38), and ensure that the basic whistleblower notification policies of the SEC are consistent with those of the IRS and the DOJ.[10]

II. The Commission Should Ensure That Its Reporting Requirements Do Not Conflict with Those of the IRS and DOJ

As discussed in the SEC Inspector General Report on the SEC rewards program and the legislative history of the whistleblower program, it was the intent of Congress for the IRS, DOJ, and SEC programs to be similarly administered. It would be incongruous (and against public policy) if the DOJ and IRS permitted whistleblowers to provide their agencies with information prior to filing the formal whistleblower applications, but for the SEC to have a different rule.

[10] The "good cause" exception recommended here is completely distinct from the provision in the proposed rule permitting a limited correction of the TCR filing issue. The proposed rule has a mandatory, 30-day statute of limitations to file a TCR to even be considered for a completely discretionary remedy. The 30-day time limit is not only unrealistically short, it fails to take into consideration the actual basis for a "good cause" exception, i.e. the public policy for awarding fully-qualified whistleblowers an award if they meet every substantive criteria of the Dodd-Frank Act. Moreover, the exception in the proposed rule is purely discretionary. Neither the Tax Court decision nor the False Claims Act excludes whistleblowers from the mandatory reward program based on communications with the government prior to submitting a formal reward application. Making the "good cause" exception strictly discretionary continues to undermine the Congressional intent behind creating a mandatory reward program, as required under law. Significantly, the record of discretionary reward laws demonstrates that *all* discretionary reward programs have failed, including the pre-2006 IRS reward law, the pre-2010 SEC reward law, the 1943 FCA, and the current reward laws under the Lacey Act and Endangered Species Act.

Moreover, many whistleblower cases concern violations that fall within the jurisdiction of both the SEC and another government agency, such as the IRS or DOJ. It would not serve the interests of justice if a whistleblower understood that he or she could immediately contact the DOJ or IRS with information about frauds, but then learned (when it is to late) that the SEC has a completely different procedure.

III. Comments on the Position Taken by the Chamber of Commerce on Reducing Award Percentages in Large Cases

The Chamber of Commerce submitted comments to the proposed rule on September 18, 2018, at the end of the published rulemaking comment deadline. As such, no one has submitted an on-the-record rebuttal to the Chamber's arguments. Thus, we think it is constructive to briefly address their comments related to Proposed Rule 21F-6(d).

First, the Chamber claimed that the rule permitting the Commission to reduce the size of awards in larger cases would apply to "bounties of at least $100 million." Chamber Letter at 6. This is not accurate. The proposed rule would apply to awards of $30 million, not $100 million. However, there are strong economic grounds to significantly increase the award threshold set forth in the proposed rule, taking into consideration the adverse tax consequences faced by whistleblower,[11] the emotional distress they suffer, and the long periods of unemployment or underemployment they often face. The fact that whistleblowers suffer is well understood, and the fear of these consequences keeps most potential whistleblowers silent.[12]

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[11] Whistleblower rewards are fully taxable as income, and awards at the higher rates would be subject to an overall tax in the range of 50%. For example, the tax on a whistleblower award of $30 million would be approximately $15.7 million if the whistleblower were a resident of the State of California. *See* https://www.irscalculators.com/tax-calculator. According to the most recent annual report of the Office of the Whistleblower, California had the largest number of whistleblowers filing claims. These whistleblowers will either be forced to pay the 50%+ tax rate or be forced to move out of their homes in order to reduce the tax liability (which would be significant).

[12] Persons who are contemplating blowing the whistle fear that they will suffer retaliation. Whether or not they are ever fired, and whether or not a large reward is ever issued, the prospect of a large reward mitigates against this fear of retaliation and economic ruin. This fear is well placed. First, a study published in the *New England Journal of Medicine,* referenced in the 2011 rulemaking (76 Fed. Reg. 34,361, n. 459), explains the non-economic hardships that whistleblowers who obtain large rewards often suffer. Aaron S. Kesselheim, et al*., Whistle-Blowers' Experiences in Fraud Litigation Against Pharmaceutical Companies*, THE NEW ENGLAND JOURNAL OF MEDICINE (May 13, 2010), *https://www.nejm.org/doi/pdf/10.1056/NEJMsr0912039.*

Second, the fear that a wrongfully-discharged whistleblower will face adverse economic circumstances over a prolonged period of time is also well supported. For example, in employment cases, "front pay" awards are intended to compensate wrongfully-discharged employees for their lost future income. *See Williams v. Pharmacia, Inc.,* 137 F.3d 944, 952 (7th Cir. 1998). Although there is no rule for the number of years a "front pay" award should cover, numerous cases authorize front pay to cover over ten years of compensation, given the strong likelihood of long-term hardships. *See Hukkanen v. Int'l Union of Operating Eng'rs, Hoisting & Portable Local No. 101*, 3 F.3d 281, 286 (8th Cir. 1993) (10-year front pay period); *Stephens v. Global NAPs*, 70 Mass. App. 676, 685 (2007) (33.5 years of front pay); *Handrahan v. Red Roof Inns, Inc.,* 48 Mass. App. 901, 902 (1999) (30 years of front pay); *Padilla v. Metro-North Commuter R.R.*, 92 F.3d 117, 125-26 (2nd Cir. 1996) (20-year award of front pay); *Cummings v. Standard Register Co.*, 265 F.3d 56, 66-67 (1st Cir. 2001) (14 years).

Second, the Chamber asserted that the Commission has "wide, subjective discretion" in setting reward amounts and that this discretion "undermines public confidence in the agency." *Id.* This is also not accurate. Congress set forth specific and clear criteria for setting awards. *See* 15 U.S.C. § 78u-6(b)(1)(B). These criteria serves the public interest and is consistent with the legislative intent. As such, applying these criteria in determining the amount of an award is mandatory for the Commission, and limits any "wide, subjective discretion" to set the amount of an award. 15 U.S.C. § 78u-6(j). As explained above, the general rulemaking authority of the Commission is also limited, and *must* be "consistent with the purposes" of that the whistleblower law.

Third, without any empirical support (and ignoring the public statements of the Commission that demonstrate the opposite), the Chamber argued that "the payment of life-altering bounties has had a material adverse impact on the efficacy of internal compliance systems." Not only is this statement not true, it runs counter to the position the Chamber of Commerce aggressively argued before the U.S. Supreme Court.

In *Digital Reality*, the Chamber argued that whistleblowers who provide information to internal compliance were not covered at all under the Dodd-Frank Act ("DFA"), and could be fired, even though the DFA had an anti-retaliation provision. The Supreme Court *agreed* with the Chamber. We note that our law firm and the National Whistleblower Center filed a detailed *amicus* brief supporting the position taken by the SEC, arguing that internal whistleblowers are protected under the law. It is odd that the Chamber would argue before the Supreme Court that internal whistleblowers lacked any anti-retaliation protections under the DFA, but here complain that internal whistleblower programs are somehow harmed by paying large bounties. It would seem obvious that retaliation would have a far more detrimental impact on internal compliance then paying awards to employees, including rewarding employees who use internal compliance programs as encouraged under the current rules.

The Chamber also ignored evidence that the DFA award program is *enhancing* internal compliance. For example, in her remarks at the Securities Enforcement Forum, former SEC Chair Mary Jo White explained how the reward program was enhancing internal compliance:

> Just last week, one whistleblower was paid more than $14 million – the largest amount to date – for providing our investigators with this kind of very specific, timely and credible tip that we expect the whistleblower program to incentivize. The tip led directly to the opening of an investigation, and allowed us to bring, in just a few short months, a case that resulted in the return of tens of millions of dollars to investors.
>
> That is the benefit of significant whistleblower incentives.
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> They persuade people to step forward.
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> They put fraudulent conduct on our radar that we may not have found ourselves, or as quickly.

> And they deter wrongdoing by making would-be violators ask themselves – who else is watching me?
>
> **The program also incentivizes companies to report misconduct before a whistleblower comes to us first.**
>
> **When our whistleblower program was being set up, many in the securities bar – perhaps some here today – worried that the program would undermine internal compliance efforts. It seems, however, that the program may be having the *opposite effect.***
>
> **Today, we hear that companies are beefing up their internal compliance function and making it clear to their own employees that internal reporting will be treated seriously and fairly. And most in-house whistleblowers that come to us went the internal route first.**
>
> We believe this program is already a success. And, **as more awards are made, we expect more people to come forward**, which will dramatically broaden our presence.

Chair Mary Jo White, *Remarks at the Securities Enforcement Forum*, U.S. SEC. & EXCH. COMM'N (Oct. 9, 2013), https://www.sec.gov/news/speech/spch100913mjw. (emphasis added).

Former Chair White further elaborated as to how the reward program was enhancing internal compliance programs:

> **There have always been mixed feelings about whistleblowers and many companies tolerate, at best, their existence because the law requires it.** I would urge that, especially in the post-financial crisis era when regulators and right-minded companies are searching for new, more aggressive ways to improve corporate culture and compliance, it is past time to stop wringing our hands about whistleblowers. They provide an invaluable public service, and they should be supported. And, we at the SEC increasingly see ourselves as the whistleblower's advocate. It has been nearly four years since the SEC implemented its whistleblower program. While still evolving and improving, we have enough experience now to take a hard look at how the program is working and what we have learned. **Overall, I am here to say that the program is a success** – and we will work hard at the SEC to build on that success.
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> * * *
>
> Let me say a bit more about company compliance programs. When the Commission was considering its whistleblower rules, concerns were raised about undermining companies' internal compliance programs. Some commenters urged that internal reporting be made a pre-condition to a whistleblower award. That was not done, but the final whistleblower rules established a framework to incentivize

> employees to report internally first . . . **All indications are that internal compliance functions are as strong as ever – if not stronger – and that insiders continue to report possible violations internally first . . . over 80% [of those who have obtained rewards] first raised their concerns internally to their supervisors or compliance personnel before reporting to the Commission. Many in-house lawyers, compliance professionals, and law firms representing companies have told us that since the implementation of our program, companies have taken fresh looks at their internal compliance functions and made enhancements to further encourage their employees to view internal reporting as an effective means to address potential wrongdoing without fear of reprisal or retaliation.**

Chair Mary Jo White*, The SEC as the Whistleblower's Advocate,* RAY GARRETT, JR. CORPORATE AND SECURITIES LAW INSTITUTE-NORTHWESTERN UNIVERSITY SCHOOL OF LAW (April 30, 2015), https://www.kkc.com/wp-content/uploads/2019/10/The-SEC-as-the-Whistleblowers-Advocate.pdf (emphasis added).

Our comments are offered in light of our shared commitment to the success of the whistleblower program and continuing the success that former Chair White celebrated in her remarks. We are confident that the Commission can strike a balance between the programmatic priorities underlying the proposed rules and the core purpose of the Dodd-Frank Act and are happy to be of assistance however we can to advance this purpose.

Thank you for your careful attention to these matters.

Respectfully submitted,

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