

December 17, 2010

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

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

Dear Ms. Murphy:

The Association of Corporate Counsel (“ACC”)<sup>1</sup> appreciates the opportunity to further present our views to the Commission regarding its above-referenced proposed rules. On December 15, 2010, ACC and in-house counsel in charge of their companies’ compliance and legal functions submitted a letter generally addressing our shared, larger concerns about the deleterious impact the proposed rules will have on internal compliance and reporting systems. In this comment letter, ACC appreciates the opportunity to delve further into some of the technical issues addressing non-compliance related aspects of the proposed rules.

For the reasons we identified in our prior comment letter, it remains vitally important that the Commission require prospective whistleblowers to first make use of internal reporting and investigative systems before submitting their reports to the Commission if they wish to be considered for a related reward. Beyond this issue, however, the proposed rules introduces other dynamics that could incent inappropriate conduct or operate to the detriment of compliant corporate conduct. In order to avoid that result, ACC requests that the Commission integrate the following into their proposed rules:

- Bar all individuals who engaged in the underlying misconduct from eligibility as a whistleblower who can receive awards for their reports.
- Require disclosure of any conflict of interest and, in particular, bar short-sellers from obtaining an award pursuant to the program.

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<sup>1</sup> ACC is the bar association for attorneys employed in the legal departments of corporations and private-sector organizations worldwide. ACC has more than 26,000 members in over 75 countries, employed by over 10,000 organizations. In addition, our membership brings to these important issues the unique views of in-house counsel who are at the very intersection of the compliance and reporting functions. As such, our membership speaks not only for in-house counsel, but also for the interests of their client organizations and the stakeholders who will be affected by the proposed rules.

- Require prospective whistleblowers to comply with corporate policy in obtaining or disclosing any submitted information.
- Ensure that prospective whistleblowers timely report their suspicion of wrongdoing, rather than holding concerns until problems further fester.
- Comply with state ethics rules in communicating with represented clients.
- Conduct the regulatory flexibility analysis required pursuant to the Small Business Regulatory Enforcement Fairness Act of 1996. In addition, the Commission should reassess the impact of its proposed rules on efficiency, competition and capital formation.
- Issue rules of practice for attorneys who wish to represent prospective whistleblowers.
- Clarify the scope of the anti-retaliation provision through notice-and-comment rulemaking.
- Engage in a formal review of the bounty program eighteen months after issuing the implementing rules.
- Establish a compliance programs working group with other enforcement agencies, the United States Sentencing Commission and other interested parties.

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**The Commission should expressly bar wrongdoers from recovering a bounty under the program.** Wrongdoers retain the benefit of leniency pursuant to the Commission's cooperation initiative; rewarding them with a financial windfall is not only unseemly, but introduces an unwelcome dynamic.

We applaud the Commission's decision to deny individuals from obtaining a bounty based on conduct for which they are culpable. However, we believe that the Commission unnecessarily narrowed the definition of "culpable conduct" to conduct which the individuals themselves "directed, planned or initiated." We believe that individuals who participate in the underlying misconduct should be barred from eligibility as a whistleblower pursuant to the incentive program. While the effort of any conspirator to redeem past misconduct should be applauded, the individual should not be rewarded by the prospect of a bounty. Not only do we believe that the Commission's current approach requires difficult line drawing that will likely rely on the prospective whistleblower's self-serving denial of significant participation, but we also suggest that culpable individuals who seek to extricate themselves should instead be awarded leniency

regarding any penalty—if appropriate, given the circumstances—pursuant to the Commission’s well-established Cooperation Policy.<sup>2</sup>

**The Commission should bar short sellers from obtaining a second bite at the apple through the whistleblower process.** The Commission should require individuals seeking recovery as a whistleblower to disclose any conflict of interest at the time of submitting the tip or during the pendency of the investigation. If the individual retains a stock position, particularly a short position, that individual should be ineligible to be a whistleblower.

In defining the term “whistleblower,” the proposed rules do not exclude individuals who possess a financial conflict of interest from being eligible to recover an award. For instance, an individual, or group of individuals, who retained a short position in the company’s stock, could nevertheless be entitled to a bounty for submitting information. This could lead to the anomalous situation, in which a short seller anonymously submits a tip to the Commission and then leaks that submission to the public. The potential to profit from such an arrangement is not speculative and should be precluded by program rules. In order to ferret out individuals who possess this, or a similar, type of conflict of interest (or an interest in leveraging inside information), the Commission should require disclosure of any conflict at the time of the submission of the tip and then bar any individuals who possess a conflict of interest from collecting an award.

**The Commission should ensure that prospective whistleblowers timely report their suspicion of wrongdoing.** Otherwise, these whistleblowers will be incented to wait until the problem increases in magnitude.

In assessing eligibility to whistleblower status,<sup>3</sup> the Commission should determine whether the prospective whistleblower submitted the tip in a timely manner. Failure to do so will invite individuals to time their submission with an eye to the amount of any resulting bounty. Certainly, if the overall intention of the Dodd-Frank reforms is to prevent and redress significant frauds before they hurt innocent investors or impact the market, then the proposed rules should dis-incent any reports that “profit” from an unseemly intent to increase the award at the expense of prevented fraud. Indeed, prompt reporting of suspected violations is crucial to prompt corrective action, which could have the practical impact of reducing the amount of any eventual penalty and award. In order to make a determination of timeliness, the Commission should ask when the prospective whistleblower learned of the submitted information.

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<sup>2</sup> Policy Statement Concerning Cooperation by Individuals in [SEC] Investigations and Related Enforcement Actions. 17 C.F.R. § 202.12.

<sup>3</sup> The expedience with which the whistleblower provides necessary information after first becoming aware of the same could also be a factor in determining any reward.

**The Commission should require prospective whistleblowers to comply with corporate policy in obtaining the submitted information.** Otherwise, individuals may be incited to engage in bounty-hunting investigations beyond their responsibilities or potentially their understanding, possibly jeopardizing firewalls companies are required (and entitled) to maintain.

As the rules are currently drafted, individuals who obtain information in violation of federal or state criminal law may not recover as a whistleblower. We suggest expanding that exclusion to violations of corporate policy as well. Corporate employees are required to safeguard a variety of information that could be susceptible to a fishing expedition undertaken to obtain a bounty. For instance, companies are required by law to prevent disclosures of classified information or employee's personal information. If individuals could violate corporate policy in an effort to obtain information that could support the issuance of an award, important firewalls could be breached. These breaches could lead to a host of unwelcome results for companies and their stakeholders, such as the undermining of internal controls or violations of protected individual privacy.

**The Commission should not authorize its lawyers to violate state ethics rules, thereby undermining the Congressional purpose animating the McDade Amendment, which requires federal lawyers to abide by those rules.** Doing otherwise invites the significant potential for abuse.

As the Commission acknowledged in the commentary appended to its proposed rules, state ethics rules bar communications between attorneys and individuals or entities represented by counsel.<sup>4</sup> Nevertheless, the Commission seeks to avoid this requirement by rationalizing that its contacts with whistleblowers would be "authorized by law" and would thereby comply with state ethics rules.<sup>5</sup> We strongly disagree. What is, in fact, "authorized by law" is the intake of tips and the opening of an investigation based on such tips. Nothing in the law authorizes any different process for the conduct of a Commission investigation in a whistleblower-initiated case as opposed to one generated in a different manner.

Speaking directly with represented employees invites a host of difficulties and creates inappropriate exceptions to well-established ethical precepts of professional responsibility. For instance, the temptation to deputize employees to uncover further information will be significantly heightened. In addition, Commission attorneys will find it difficult to assess claims of privilege—necessary to determine if the information can

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<sup>4</sup> The Commission failed to cite in its commentary the McDade Amendment, which Congress enacted when the Department of Justice attempted to avoid state ethics rules in a similar manner. Nothing in the Dodd-Frank legislation suggests that Congress meant to undermine its prior insistence that attorneys comply with applicable state ethics rules.

<sup>5</sup> The Commission's effort to insulate its staff attorneys is not likely to be treated with deference in a state ethics investigation, in any event.

qualify as original information—without consulting with the company’s lawyers.<sup>6</sup> Relying solely on the prospective whistleblower’s characterization of how the information was obtained—as the applicable forms currently do—might lead to those individuals covering their tracks as to how the information was obtained.

The rules applying to attorney conduct were carefully constructed to create the proper balance between parties, so as to assure the fair and impartial administration of justice. No lawyer may exempt themselves from the rules if the system is to operate with the appropriate balance.

**The Commission should conduct the regulatory flexibility analysis that is required when there is a significant impact on small businesses.** The proposed rules, by not requiring individuals to report internally, will significantly increase the costs of small businesses, which will suffer significant business interruptions and need to retain (potentially expensive) assistance necessary to deal with a Commission investigation for what may be low quality or irrelevant tips.

**The Commission should assess the proposed rules’ impact on efficiency, competition and capital formation, paying particular attention to the impact of the proposed rules on companies.** The Commission’s current analysis fails to address the costs imposed on a company by not requiring an internal report.

In declining to conduct a regulatory flexibility analysis, the Commission contends that its proposed rules do not regulate small businesses, but rather only prospective whistleblowers. This conclusion is wholly incorrect. The very laws being enforced pursuant to the whistleblower tips apply to any listed company, including small businesses. While the literal terms of the whistleblower provision do not refer to companies, except insofar as they are barred from being whistleblowers, the program “directly affects” the companies’ ability to order their affairs. *See Aeronautical Repair Station Association v. Federal Aviation Administration*, 494 F.3d 161 (D.C. Cir. 2007) (finding that entities “directly affected” by regulation were “regulated” for purposes of the Small Business Regulatory Enforcement Fairness Act). The Commission’s decision to permit prospective whistleblowers to first go to the Commission without being required to report internally will impose significant costs and create significant disruptions for small businesses. That decision should therefore be subject to a regulatory flexibility analysis.

The Commission’s required inquiry into the proposed rules’ effect on efficiency, competition and capital formation likewise suffers from a focus on the effects of the rules

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<sup>6</sup> For instance, one element of the requisite attorney-client privilege inquiry is the purpose of the communications. It is not clear how the Commission will make that determination. As another example, one element of the attorney work product analysis is whether the document was created in anticipation of litigation. Again, we wonder how the Commission would make such a determination without the input of company lawyers.

on the prospective whistleblower and on the Commission without a careful analysis of the effects on the companies. For instance, the Commission's efficiency analysis at no point compares the costs imposed on companies by permitting an initial external report with requiring a report internally. The Commission's failure to consider the costs imposed by alternatives elides an important source of burdens that will be imposed by the program.

**The Commission should issues rules of practice for lawyers representing prospective whistleblowers.** In doing so, the Commission may wish to consider a rule barring or limiting contingency fee arrangements.

The Commission has requested comment as to whether it should adopt rules of practice governing conduct by attorneys representing whistleblowers. In light of the significant role of plaintiffs' attorneys in the practical operation of the envisioned program, the Commission should implement specific practice rules for attorneys who represent prospective whistleblowers before the Commission. We believe that many submissions will be anonymous and will therefore require attorney representation, pursuant to the proposed rules. Because the Commission, in the course of its investigation will rely on the attorney's certification as to the bona fides of the anonymous whistleblower, the Commission should provide rules designed for this unusual set of circumstances. In developing those rules of practice, the Commission should consider barring attorneys who have maintained an underlying position in the subject company's stock from representing prospective whistleblowers. In order to ensure this requirement is being met, attorneys should be required to disclose any conflict of interest and, in particular, any financial position in the company. In addition, the Commission may wish to bar contingency fee arrangements as they introduce an unwelcome dynamic into government enforcement of the securities laws. *Cf.* Exec. Order No. 13,433, 72 Fed. Reg. 28441 (May 18, 2007).

**The Commission should clarify the scope of the anti-retaliation provision applicable to whistleblowers who submit tips to, or otherwise cooperate with, the Commission.** The Commission should make clear that (1) policies commonly available in employee handbooks creating an employee responsibility to report misconduct or participate in corporate internal investigations are not barred by the anti-retaliation provision; and that (2) prospective whistleblowers cannot rely on the anti-retaliation provision when they are terminated, or otherwise disciplined, for conduct unrelated to being a whistleblower.

In the commentary appended to the proposed rules, the Commission asked whether it should promulgate rules regarding the interpretation or implementation of the anti-retaliation provisions of the Act. We believe that it should, as doing so will provide guidance to both prospective whistleblowers and defendants as to the proper scope of the anti-retaliation provision without having to wait for years of, perhaps ambiguous, judicial precedent. In promulgating that rulemaking, the Commission should ensure that the scope of the anti-retaliation provision is consonant with its purpose.

First, the anti-retaliation provision should not apply to corporate policies that encourage internal reporting and investigation of misconduct. Both are vital to the robust and effective operation of internal compliance and reporting systems and to corporate compliance with the securities laws. Permitting an employee to litigate discipline based on a violation of such a policy would undermine those systems' ability to function and preclude companies from engaging in self-policing and compliance activities that are often required by federal and state regulation, as well as factored into cooperation and evaluative standards such as the US Sentencing Guidelines.

Second, prospective whistleblowers who were terminated for reasons unrelated to any tips provided to the Commission should be clearly barred from relying on the anti-retaliation provision. Unambiguous guidance on this front will ensure that whistleblowers do not file litigation that, while dismissed at a later stage, serves only to protect them from otherwise legitimate performance evaluations and impose unnecessary costs on companies that are engaging in appropriate and lawful conduct.<sup>7</sup>

**The Commission should establish a working group with other enforcement agencies and the United States Sentencing Commission to reconcile the varying approaches regarding compliance programs.** In doing so, this working group should request the views of interested parties.

For the past three decades, companies have developed effective compliance, investigative and reporting systems, often at the behest of the government enforcement agencies, including the SEC. Indeed, the United States Sentencing Commission, in issuing its organizational sentencing guidelines, made clear that operating a robust compliance regime was necessary to obtain a reduction in penalty at sentencing. We worry, however, that the Commission has produced these rules on its own without consulting with other agencies and departments with an interest in compliance programs or whistleblower initiatives. We therefore encourage the Commission to launch a working group with those other entities and with interested companies and individuals who are otherwise left to struggle with inconsistent rules and difficult reconciliations of competing requirements imposed by different agencies of government. In this vein, the Commission may wish to consider helping to form a Federal Advisory Committee devoted to issues surrounding compliance programs and their interrelationship with whistleblower-initiated enforcement.

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<sup>7</sup> While the Commission was not specifically delegated authority to conduct a rulemaking pursuant to the anti-retaliation provision, courts will extend deference to the Commission based on its clear authority to enforce the underlying set of statutes and regulations.

**The Commission should announce that it intends to engage in a formal review of the bounty program eighteen months after issuing the final rule.** The Commission should reconvene after a short period, to analyze how the program has unfolded. Actual data should then drive a redesign of the program, if necessary.

When it finalizes its rules implementing the whistleblower bounty program, the Commission should announce a formal review process to begin eighteen months after promulgation. Because we are so concerned about the practical implications of the Commission's rules (regardless of the legitimate intentions of the legislation), we believe there will be a pressing need for the Commission to review the hard data that will be generated by its decisions. We suggest that the Commission calendar a formal review eighteen months after promulgation of its rules, at which point it should take comment from affected individuals and companies about their experiences over that period.

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One final point: throughout the proposed rules and the accompanying commentary, the Commission seeks to retain discretion for itself at the expense of clarity for the companies it regulates.<sup>8</sup> This is understandable: discretion lies at the heart of enforcement. However, for the regulated community, such discretion undermines the certainty necessary to order business affairs and to execute policies and practices that are responsible and protect the company from liability or criticism. We strongly encourage the Commission, as it weighs the various options, to opt in favor of an approach that provides clear and unambiguous guidance, so that companies and prospective whistleblowers will not be left guessing as to how the Commission will approach relevant issues.

Thank you again for the opportunity to comment on the proposed rules. Please let us know whether you need further information.

Submitted on behalf of the Association of Corporate Counsel:



Susan Hackett

Senior Vice President and General Counsel, Association of Corporate Counsel

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<sup>8</sup> As but one example, the Commission indicates that it will take into account whether the prospective whistleblower first reported internally when determining the amount of any award. However, it declines to incorporate that factor explicitly in the rule. Instead, that factor is mentioned only in the commentary.