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# Whistle While You Work

**by Thomas Brom**

At the close of 2010 Julian Assange was THE State Department's ghost of Christmas past, pointing his bony finger at embarrassing diplomatic cables released by WikiLeaks. To American corporations, whistleblowers may be the ghost of Christmases to come as well—at least if you believe the comment letters many of them sent last year to the Securities and Exchange Commission.

In November, the SEC proposed rules implementing section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203), which added section 21F to the Securities Exchange Act of 1934. A brief comment period followed, during which hundreds of businesses scorched the Internet with lists of horrible outcomes should the rules become permanent.

Under the new section, the SEC could provide an award for tips related to any administrative or judicial action resulting in sanctions of more than $1 million; whistleblowers could receive anywhere from 10 to 30 percent of the amount recovered. They are not required to report allegations first through a corporate compliance program, and—if they are represented by counsel—they can make disclosures anonymously. Finally, whistleblowers would be protected from retaliation by employers.

"What's unusual here is that the government is providing money to people who have suffered no injury to aid it in regulating the private sector," says Sean Farhang, an assistant professor at UC Berkeley's Goldman School of Public Policy. "Normally, people who are injured get to sue. This is regulation by bounty for bystanders."

Farhang says the SEC's approach is rare, but not unique. He traces the lineage of the proposed rules to the False Claims Act (31 U.S.C. §§ 3729 – 3733), a post–Civil War statute that permits private parties to sue government contractors for alleged fraud. That statute, revised in 1986, promoted the growth of a thriving qui tam plaintiffs bar. Farhang, author of *The Litigation State: Public Regulation and Private Lawsuits in the U.S.* (Princeton University Press, 2010), calls the resulting regulatory regime typically American: a hybrid that combines private enforcement with public administration.

"Clearly, the False Claims Act has deterred fraud against the government," says Mark Labaton, managing partner in the Los Angeles office of Motley Rice who represents whistleblowers. "It is a significant deterrent, it saves the taxpayers money, and it [protects] consumers from unsafe products sold under government contract."

But U.S. corporations have called the SEC's proposed rules an open invitation to greedy lawyers and gold-digging whistleblowers. In December, the Washington, D.C.based Association of Corporate Counsel (ACC) sent the SEC a letter signed by 270 chief legal officers of U.S. corporations, demanding that the commission require whistleblowers to use existing internal compliance and reporting systems before they report any suspected wrongdoing.

Two days later, ACC general counsel Susan Hackett followed up with a technical letter outlining ten major areas of disagreement with the proposed rules. Among her main points, Hackett asked the SEC to require that prospective whistleblowers disclose any conflicts of interest they may have and comply with their employer's corporate policy in obtaining or disclosing submitted information, and to bar rewards to individuals who engaged in the underlying misconduct or sold company stock short in the reporting period. Finally, Hackett requested that the SEC consider prohibiting whistleblowers from signing contingency fee agreements with outside counsel.

"Moving toward a bounty-hunting system will lead to the evisceration of internal reporting," Hackett warned in an interview. "The proposed SEC rules only offer incentives for people to go outside of corporate compliance programs."

Proponents of the new rules, however, contend that internal reporting programs are ineffective. In its comment letter last year to the SEC, the National Whistleblowers Center wrote that, based on its review of False Claims Act cases filed between 2007 and 2010, 89.7 percent of the employees who eventually filed complaints had initially

reported their concerns internally—proving that an offer of rewards doesn't discourage employees from using compliance programs.

But reporting through channels does expose employees to retaliation. The letter stated, "Since 1984, when counsel for the NWC first became involved with this issue, we are not aware of any corporation in the United States that has ever urged any federal court to protect employees who chose to file their whistleblower claims internally."

Labaton, a former assistant U.S. Attorney, contends there is no conflict between the SEC's proposed new rules and corporate compliance programs. "Dealing with insiders is nothing new for the SEC," he says. "Even before it released the proposed rules, the commission was discussing how to be more receptive to tips. The reality is that often, the best information about fraud comes from people working for the company."

Labaton also sees the human cost of whistleblowing. "There's lots of pressure *not* to come forward," he says. "It's generally tough and you could lose your job, and you're often blackballed. The motivations of people are often complex. Of course making money can be a factor. But remember—no whistleblower under this program is going to benefit unless the SEC can successfully build a case using their information."

Labaton predicts that the SEC will proceed cautiously. "There's a tremendous amount of fear out there," he says. "But the SEC has never wanted to bring actions that weren't justified, and it realizes public companies have competent defense lawyers and all sorts of due-process rights. It usually will weed out spurious claims very quickly."

Final rules implementing section 922 are scheduled to be released in April. Now if only the SEC can weather WikiLeaks's threatened release of a trove of bank documents revealing just how incompetent the commission can be *without* the assistance of whistleblowers.