

In Setback for Corporate Lobbyists, Whistleblowers Can Take Tips First to Government Investigators

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Top securities regulators on Wednesday said financial whistleblowers can bypass internal corporate procedures and report suspected fraud first to government investigators, a setback for big U.S. companies that lobbied hard for the agency to take the opposite approach.

The **Securities and Exchange Commission** decision was hailed as a “major victory” for whistleblowers and investors by one advocacy group.

The agency’s two Democratic commissioners and Chairman Mary Schapiro, an independent, voted to approve final [rules](#) on how the agency will operate the generous whistleblower bounty program created by the last year’s Dodd-Frank corporate reform act. The SEC’s two Republican commissioners voted against the rules.

Under **Dodd-Frank**, whistleblowers can claim big cash rewards if they provide the SEC with “original information” that leads to financial sanctions totaling \$1 million or more. They are eligible to receive between 10 percent and 30 percent of the money collected by the **SEC** in criminal or civil cases against corporate wrongdoers.

Led by the U.S. Chamber of Commerce, dozens of big companies such as Google Inc. and JPMorgan Chase & Co. argued that the SEC should require bounty-seeking whistleblowers to report fraud first to their employers, rather than the government.

Schapiro [said](#) giving whistleblowers the option of coming directly to the SEC “makes sense . . . because it is the whistleblower who is in the best position to know which route is best to pursue.”

“While the SEC has a history of receiving a high volume of tips and complaints, the quality of the tips we have received has been better since Section 922 [of the Dodd-Frank act] became law. And we expect this trend to continue,” Schapiro said.

Republicans criticize final rules

Republican commissioners Troy Paredes and Kathleen Casey said they believed the rules would harm companies’ effort to police themselves by allowing whistleblowers to bypass their employers’

internal compliance systems.

Casey said the final rules package “favors a pound of cure over an ounce of prevention.” In addition to harming internal compliance efforts, she said, the rules overestimate the SEC’s ability to “triage and manage” the large volume of whistleblower tips that will be encouraged by the “very large checks” that whistleblowers might snag by reporting fraud.

The SEC’s enforcement director, Robert Khuzami, told the commissioners that it didn’t make sense to put in place a rule that would require whistleblowers in some cases to report fraud to the very corporate insiders they suspect are violating the law. Khuzami said letting whistleblowers come first to the SEC will allow the agency to build stronger cases and move quickly to head off problems, “preventing small frauds from growing into even bigger frauds.”

Stephen Kohn, executive director of the National Whistleblowers Center, said “the SEC refused to buckle under tremendous pressure from Wall Street lobbyists” who “worked overtime” in an effort to undermine the protections contained in the Dodd-Frank Act.

The Chamber of Commerce [countered](#) that “the SEC has chosen to put trial lawyer profits ahead of effective compliance and corporate governance. This rule will make it harder and slower to detect and stop corporate fraud.”

Schapiro and SEC staff said the final rules differed from the agency's earlier proposed rules in several respects.

The final version narrows provisions that generally exclude accountants and internal compliance employees from qualifying for whistleblower awards. They may qualify for a bounty, for example, if they believe the company is impeding the investigation, or if at least 120 days have gone by since they reported possible fraud to higher ups.

Another change from the agency's earlier proposal encourages whistleblowers to work through their employers’ internal compliance systems. While whistleblowers are not required to first report their concerns internally, the new rules provide incentives for them to do so.

For example, in determining the size of a whistleblower’s award, the SEC will consider how much the tipster participated in the company’s in-house compliance process. In addition, whistleblowers who report violations directly to their companies may still qualify for a share of the SEC’s monetary recovery, even if they never go to SEC, under the final rules.

Tougher than Sarbanes-Oxley law

The rulemaking process was an important battleground in the campaign to encourage whistleblowers to report corporate crime.

Almost a decade ago, after the Enron debacle and other multi-billion-dollar corporate scandals, Congress passed what one scholar “the most important whistleblower protection law in the world.” But as *iWatch News* has [reported](#), the whistleblower protections included in 2002’s **Sarbanes-Oxley** corporate reform act largely failed to protect workers or prevent the corrupt practices that helped cause the financial meltdown of 2008.

The Dodd-Frank Act, passed last year by Congress and signed by President Barack Obama, seeks

to improve on previous whistleblower laws and use financial incentives to encourage workers to report fraud.

A Senate Banking Committee report said generous rewards are needed to encourage whistleblowers to come forward, because they “often face the difficult choice between telling the truth and the risk of committing ‘career suicide.’ ” Sen. Charles Grassley, an Iowa Republican who helped craft the Dodd-Frank whistleblower bounty provision, has [noted](#) that he’s personally known many whistleblowers who were blacklisted by government agencies, hospitals, drug companies and other businesses.

After passage of Dodd-Frank, the SEC took up the task of writing the rule that would implement the law’s provisions.

The proposed rules that the SEC released last November drew criticism from a variety of sources. The proposed rules drew 240 written comments and more than 1,300 form letters.

Business lobbyists complained that the rules would hurt companies’ efforts to police themselves. “Instead of allowing companies to identify and fix problems, we are just creating a lottery,” David Hirschmann, president of the Chamber’s Center for Capital Markets Competitiveness, [said](#) in November. “This bounty program creates incentive for employees to become amateur sleuths in search of a big payday.”

Whistleblower advocates, meanwhile, complained that the SEC’s proposed rules would spawn red tape and discourage workers from stepping forward with information about fraud.

Grassley [wrote](#) earlier this month that he was concerned that the agency would show too much deference to companies’ own self-investigations.

In [proposing](#) preliminary whistleblower rules last year, the SEC noted that in many cases it would simply contact the company, “describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back. . . . This has been the approach of the Enforcement staff in the past, and the Commission expects that it will continue in the future.”

Even if workers aren’t required to report problems first to their employers, Grassley said, this approach would expose whistleblowers and put them at risk without the benefit of a serious SEC investigation. He said “the SEC seems to think the business as usual approach will help it catch criminals and cheats while admitting that they will essentially sell whistleblowers out to the company in question at the first opportunity.”

The need for the SEC to finalize the whistleblower rules has become more urgent. Earlier this month, a federal district court in New York [issued](#) the first decision related to the Dodd-Frank law’s whistleblower mandate. The judge ruled that a whistleblower usually must first provide information to the SEC to pursue a claim, unless the information falls into four narrow categories. Congress “intended to encourage whistleblowers” to report securities violations to the SEC,” the judge said in the case Patrick Egan v. TradingScreen Inc.

To fund payments to whistleblowers, the SEC already has already [set aside nearly \\$452 million](#) from past civil settlements in enforcement cases and invested the money in Treasury bills until it is needed.

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