



# SECURITIES REGULATION & LAW



## REPORT

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### *SEC Enforcement*

#### **Whistleblowers Must Protect Interests In Impending New SEC Regime, Lawyer Says**

**A**s the Securities and Exchange Commission stands poised to gain new authority to establish a whistleblower bounty program under pending financial regulatory reform legislation, Washington attorney Daniel Hurson warned that whistleblowers must adequately protect themselves, and the SEC must implement certain measures, for the program to succeed.

Hurson is senior partner in Hurson Law Firm LLP, which has represented whistleblowers in government investigations and proceedings. In a June 7 interview with BNA, Hurson—a former federal prosecutor and SEC enforcement trial attorney—said the whistleblower bounty provisions in the new bill being hammered out by the conference committee are “a revolutionary upgrade in the way that whistleblowers are handled.”

**Proposed Whistleblower Provisions.** Although the House and Senate reform bills (both numbered H.R. 4173) differ slightly in their whistleblower provisions, both would authorize the SEC to reward whistleblowers up to 30 percent of monetary penalties in cases where the penalties reach over \$1 million. Both bills also would require the Treasury Department to establish an SEC Investor Protection Fund out of which the awards would be paid. The bills further contain strong language against employer retaliation, and allow employees and contractors who allege they have been retaliated against to sue their employers within 6 years of the retaliation, or within 3 years of discovering the retaliation, but no later than 10 years after the retaliation occurs.

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Hurson noted that among other advantages, the proposed SEC whistleblower bounty procedures are a lot easier to use, and more streamlined, than those established by the qui tam amendments to the False Claims Act, which allow whistleblowers to bring lawsuits against those who file fraudulent claims for federal funds.

In addition, the proposed anti-retaliation provisions are “far superior” to those in the 2002 Sarbanes-Oxley Act, Hurson said. SOX’s whistleblower provisions require employees who experience retaliation after reporting on a company’s internal fraud to approach the Labor Department’s Occupational Safety and Health Administration within 90 days of the evidence of retaliation. Hurson pointed out that the proposed SEC whistleblower protections also provide that employees or contractors who prevail in retaliation claims are entitled to reinstatement, two times the amount of back pay, and attorneys’ fees and litigation expenses.

**Painful Experience.** However, Hurson warned, experience has shown that being a whistleblower can be “extremely difficult, painful, and frequently frustrating.” He cited a May 13 New England Journal of Medicine article—“Whistleblowers’ Experiences in Fraud Litigation Against Pharmaceutical Companies”—on a study that tracked the experiences of 42 individuals who had blown the whistle on health care fraud. The study found that most of the whistleblowers experienced immense



stress connected to litigation and retaliation, and suffered financial distress, familial strife, and employment disruptions that were not fully compensated by the rewards.

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Hurson also cited the experience of Bradley Birkenfeld, the UBS AG banker who in August 2009 was sentenced to 40 months in prison despite blowing the whistle on one of the biggest U.S. tax fraud cases in history.

In order to protect themselves under a new SEC whistleblower regime, Hurson said individuals who witness wrongdoing within their companies should first document everything they find. Documentation is “critically important” to establish that the whistleblower was the first to provide the information, Hurson said. “I would not go to the general counsel; I would not go to the compliance officer,” he added. Although the attorney acknowledged that “this sounds like heresy,” he said that talking to fellow employees, and reporting incidents up the line opens the door to retaliation.

Moreover, approaching the legal or compliance departments could result in the loss of control over the information, Hurson said. “Although the information may ultimately be traced back to you and you can get the reward, the far safer thing to do is to document everything privately, and collect whatever e-mails or other documents that you think are supportive of your findings,” he said.

**Hire an Attorney.** Second, whistleblowers should retain an attorney to protect their interests, Hurson said, in part because an attorney can allow the whistleblower to remain anonymous.

Both the House and Senate bills would allow the information provided by whistleblowers to remain confidential and privileged, although only the House bill would bar disclosure of any information that could reasonably reveal the whistleblower’s identity. Watchdog groups also have suggested that the House bill provides stronger protections for whistleblowers in the event that regulators do not follow up on their tips (42 SRLR 954, 5/17/10).

Hurson added that an attorney also can work with the whistleblower to determine whether he or she has a valid claim, and whether the information is already in the public domain. Once the attorney determines the claim is valid, the attorney then can approach the SEC, present the information, and ask staff if it has an ongoing investigation into the matter or any other information related to it. If the agency confirms that there is no ongoing investigation or that there are no specific allegations that touch on the whistleblower’s information, the attorney “can document that and nail down the idea

that his client was the first one in the door,” Hurson said.

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Without an attorney, a whistleblower who reports his or her information directly to the SEC will find the tip going into “the black hole of the SEC’s complaint bureau, which handles thousands” of complaints and referrals, Hurson said. He noted that a recent SEC Inspector General report on the agency’s current whistleblower program for insider trading found that staff performed poorly in updating whistleblowers on their bounty applications, and often did not track and review the applications to ensure they were timely and adequately reviewed (42 SRLR 671, 4/12/10).

**Litigation, Enforcement Exposure.** Importantly, the attorney can determine whether the whistleblower client is open to any litigation or enforcement exposure, Hurson continued. Among other litigation risks, whistleblowers conceivably could be sued by their employers for breach of contract for taking documents outside the company’s premises. Realistically, however, employers are unlikely to bring a lawsuit because that could be construed as retaliation, Hurson said. On the issue of enforcement, the attorney noted that if the whistleblower does not come with clean hands, his or her attorney might have to negotiate a cooperation agreement—part of the SEC’s new cooperation initiatives—on his client’s behalf with the SEC.

Hurson said that under the reform proposals, whistleblowers who are a party to cooperation agreements or civil settlements with the SEC can still receive their bounties. However, both bills would bar awards in certain circumstances, including conviction of a criminal violation related to the matter for which the information is provided. Given that scenario, the attorney would have to ensure his whistleblower client is protected from criminal prosecution, which could entail asking the SEC to work out an immunity deal with the Department of Justice. Hurson acknowledged that such deals could be extremely difficult to reach. On that point, SEC and DOJ officials have been careful to stress that although both agencies work closely together, cooperation with the SEC does not necessarily ensure that the DOJ will not mount a prosecution.

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If the SEC whistleblower bounty program envisioned by the reform legislation becomes law, it has the potential to yield millions of dollars in rewards, and could be “very, very effective,” especially in areas such as enforcement of the Foreign Corrupt Practices Act, Hurson said. The attorney noted that foreign whistleblowers

also are eligible to receive rewards under the proposed legislation. “The SEC and DOJ’s jurisdiction under the FCPA spans the globe, and this new whistleblower bounty program could open the floodgates to that.”

**SEC Measures.** However, Hurson said that he was “shocked” to see that the SEC’s current bounty program—limited to tips in the insider trading arena—has resulted over its 20-year existence in total rewards of only \$160,000 to five whistleblowers. To ensure the new program succeeds, the SEC has to take its responsibilities seriously, and try to make the process more user friendly, the attorney said. “The effectiveness of the program is really going to depend on the good faith and seriousness with which the agency implements it,” he said. “If whistleblowers are treated better, then this program could be much more effective than what we’ve seen in the past.”

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Hurson suggested that once reform legislation passes, the agency should speedily implement the recommendations of the OIG—issued March 29—for the SEC’s insider trading whistleblower program. The OIG, among other recommendations, urged the SEC to develop specific criteria for recommending awards, and review ways in which it could increase communications with whistleblowers. “One of the frequent complaints of whistleblowers is that they don’t get any feedback,” Hurson said. “They don’t know what’s going on, what is the status of the case, because the government won’t talk to them.”

SEC Enforcement Director Robert Khuzami has agreed with all the OIG’s recommendations, saying he would fully address them when the agency gains new authority to reward whistleblowers.

Hurson said the SEC also should follow in the footsteps of the Internal Revenue Service by establishing a dedicated whistleblower office. Moreover, the SEC should designate that office as the advocate for whistleblowers who approach the commission.

**Treatment by Government.** Hurson said that as a former prosecutor, he understands that government lawyers receive thousands of tips—many of them “off the wall”—and as such do not necessarily treat whistleblowers with much respect. Hurson added that when he worked as a prosecutor, “half of the people who came in were carrying bags full of documents, they hadn’t shaved, they didn’t look good . . . and you get this mentality after a while, even with white-collar people, that they’re half crazy.”

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“I bet you that most of the government lawyers who are going to be involved in the SEC’s bounty program will be trying to figure out a way in which not to give that money out,” Hurson added. “[T]here might be an impetus to file charges against them just to cut them out of the reward.”

On the treatment of whistleblowers, the SEC has come under fire from Sen. Charles Grassley (R-Iowa)—a longtime champion of whistleblowers—for the way it handles whistleblowers from within its own ranks. Most recently, Grassley May 27 issued a statement asking the SEC to “hold someone accountable” for the way the agency treated Gary Aguirre, a former enforcement attorney who said he was fired because of his vigorous investigation of Pequot Capital Management Inc. (42 SRLR 1042, 5/31/10).

Grassley, one of the authors of the 1986 amendments to the False Claims Act that allowed whistleblowers to file qui tam lawsuits, in 2008 also queried an internal SEC staff memorandum entitled “Loose Lips Sink Ships” that warned employees not to disclose nonpublic information without prior authorization (41 SRLR 860, 5/11/09). In response to Grassley’s concerns that the memo could chill employees from coming forward to report wrongdoing within the agency, the SEC added new language stating that the memo did not affect employee whistleblower rights.

**Publicity.** Finally, Hurson said, the SEC should widely publicize the rewards to encourage other whistleblowers to come forward. “Once three or four of these things get worked through the system and people actually collect money, the SEC ought to parade them in front of the camera,” he said. “They ought to make a big deal of these things, put successful whistleblowers on the front page and have the attorney general have a press conference with them if it is a significant amount of money.”

Hurson warned that whistleblowers should think carefully about their options “before starting down this long road.” He also warned that the new SEC program could become bogged down in bureaucracy, as has occurred for qui tam cases. The attorney cited to figures released by Grassley in October 2009 showing that over 1,000 qui tam cases remain unresolved because of federal government inaction. “Just moving these things through the bureaucracy is brutal on the whistleblower,” Hurson said.

Meanwhile, Hurson suggested that corporations can also protect themselves in the new SEC whistleblower regime. Most companies should seriously consider establishing their own whistleblower programs to encourage employees to come forward instead of approaching the authorities, he said.

“Particularly if companies are doing business overseas, they should have a whistleblower program that provides financial incentives to compete with the government,” the attorney said. “Anybody that brings in credible information that benefits the company by

avoiding prosecution under the FCPA or any other law should get the reward.”

BY YIN WILCZEK