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BY EMAIL

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Re: Model Whistleblower Award and Protection Act

Dear Chairs Egan and Anderson:

We welcome the opportunity to submit our comments regarding the Model Whistleblower Award and Protection Act (the "Model Act"). We are attorneys at Constantine Cannon LLP and Katz Marshall & Banks LLP who represent whistleblowers in retaliation cases and whistleblower-reward matters. Collectively, our firms' attorneys have represented hundreds of whistleblowers, including under the reward and anti-retaliation provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, on which the Model Act is based. Our comments are based on our deep understanding of what motivates whistleblowers and the significant risks and burdens they undertake in reporting wrongdoing.

We commend your efforts to standardize and expand the protections and awards available to whistleblowers who expose securities laws violations. As the hugely successful SEC whistleblower program demonstrates, when properly incentivized and protected, whistleblowers play an indispensable role in exposing fraud, abuse, and other misconduct in the securities industry. The Model Act has adopted many of the best practices from the SEC program, including an anti-retaliation cause of action, a prohibition on impeding reporting to government regulators, and a sensible award process.

However, the Model Act diverges from the SEC program in several ways that will undermine its goal of "incentivize[ng] individuals who have knowledge of potential securities law violations to make reports to state regulators in the interest of investor protection."[1]

On the incentive side, first, and perhaps unintentionally, the Model Act makes rewards discretionary, stripping away the certainty that has been fundamental to the SEC program's success. Second, the Model Act excludes restitution and certain criminal recoveries from the definition of Monetary Sanctions, limiting whistleblower awards and injecting further uncertainty from the perspective of prospective whistleblowers. Finally, the Model Act does not allow for anonymous reporting, which is often the critical protection that persuades vulnerable whistleblowers to come forward.

Despite providing some critical protections, the Model Act also could be greatly improved with a few changes to its retaliation provisions. First, it should include protections for internal whistleblowing, not just for those who go immediately to government regulators. Second, it should expand remedies to include non-economic damages and include a non-waivable right to a jury trial. Third, it should eliminate the unnecessary exclusions from retaliation coverage.

As we explain in detail below, we strongly believe that if NASAA addresses these deficiencies, the Model Act will prove much more successful upon adoption.

I. SUGGESTED IMPROVEMENTS TO THE AWARD PROVISIONS

A. To Incentivize Whistleblowers, Rewards Must be Mandatory

In establishing the highly successful SEC whistleblower program under Dodd-Frank, Congress recognized that only a mandatory rewards program would sufficiently incentivize whistleblowers to come forward:

> Recognizing that whistleblowers often face the difficult choice between telling the truth and the risk of committing "career suicide", the program provides for amply rewarding whistleblower(s), with between 10% and 30% of any monetary sanctions that are collected based on the "original information" offered by the whistleblower. . . . **The Committee feels the critical component of the Whistleblower Program is the minimum payout that any individual could look towards in determining**

[1] NASAA Notice of Request for Public Comments on Proposed Model Whistleblower Award and Protection Act 2 (May 26, 2020) [hereinafter Request for Public Comments].

> **whether to take the enormous risk of blowing the whistle in calling attention to fraud**.[2]

In announcing the Model Act, the NASAA Whistleblower Protections/Awards working group echoed this Congressional finding: "The members of the working group opted to follow the language of the Dodd-Frank Act with respect to the amount of whistleblower awards, including the 10% floor, to ensure that potential whistleblowers are appropriately incentivized to file whistleblower reports."[3] We assume, therefore, that the working group intended to follow the Dodd-Frank model, which makes awards mandatory when the eligibility criteria are met.

But the text of the Model Act creates confusion on this critical issue. Although Section 4 establishes a 10% floor for any rewards made under the Model Act, Section 3 appears to provide the Securities Administrator with discretion over whether to provide a reward at all: "Subject to the provisions of this act, the [Securities Administrator] ***may*** award an amount . . . ."[4] Likewise, the introductory clause to Section 4 states: "***If*** the [Securities Administrator] ***determines to*** make one or more awards under Section 3 . . . ."[5] If these provisions are interpreted as providing a Securities Administrator with unfettered discretion over whether to provide a reward, then the 10% "floor" in Section 4 is no floor at all—a whistleblower could get nothing if the Securities Administrator so chooses.

If the working committee did intend to make awards fully discretionary, this diversion from Dodd-Frank will undermine the Model Act's principal goal of incentivizing more people to speak up. Although some whistleblowers come forward purely because of their integrity, with only secondary concern for their careers or well-being, the Model Act is designed to encourage those for whom the impediments to whistleblowing are presently too high. It will only succeed if it shifts the cost/benefit analysis for would-be whistleblowers. But history has shown that discretionary awards do not accomplish that goal.

For example, in enacting Dodd-Frank, Congress found that the SEC's then-existing discretionary reward regime was a failure, having issued just seven awards in two decades.[6] Similarly, Congress acknowledged that the IRS's whistleblower program was "largely

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[2] S. Rep. No. 111-176, at 111 (2010); *see also id.* at 112 (noting that a "predictable level of payout will go a long way to motivate potential whistleblowers to come forward and help the Government identify and prosecute fraudsters").

[3] Request for Public Comments at 3.

[4] NASAA Model Whistleblower Award and Protection Act Proposed for Public Comment § 3 (May 26, 2020) (emphasis added) [hereinafter Model Act].

[5] *Id.* § 4 (emphasis added).

[6] S. Rep. No. 111-176, at 111.

ineffective" until Congress mandated minimum rewards.[7] And at the state level, the Indiana and Utah discretionary award programs—upon which the Model Act is partially based—have seen little success, collectively producing only "a small number" of tips and just two awards over the past decade.[8]

Congress correctly diagnosed why these programs have failed: many individuals are unwilling to risk "career suicide" without assurance that they will receive some reward for doing so.[9] No question, laws protecting whistleblowers from retaliation, like the provisions included in the Model Act, help deter and punish retaliation against whistleblowers. But retaliation—whether through termination, marginalization, harassment, or blacklisting—remains very real. We know this firsthand from our clients, and studies continually underscore the point.[10] This retaliation has a substantial chilling effect on those who are inclined to "do the right thing" but justifiably fear losing their livelihood if they do so. While robust protections are critical, Congress also recognized that only the guarantee of a reward is sufficient to persuade these potential whistleblowers to come forward.

In addition, financial incentives allow whistleblowers to more easily partner with qualified counsel to represent them through the legal process. In the vast majority of cases, blowing the whistle means more than just submitting a tip. The whistleblower may also attend interviews with government agents, respond to requests for documents, provide ongoing consultation as the government investigates, and even testify in depositions or trials. Most whistleblowers cannot afford hourly legal representation for this process and instead rely on counsel being willing to represent them on a contingency basis. Without a mandatory reward, qualified counsel are very unlikely to offer such contingency arrangements. In addition, from the government's perspective, the involvement of counsel helps conserve scarce resources by weeding out frivolous complaints and by packaging those that are worthy with legal arguments and evidence that streamline the government's evaluation of the potential claim.

For these reasons, we strongly urge you to make clear that rewards under the Model Act are mandatory for all whistleblowers who meet the eligibility criteria set out in Section 3.

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[7] *Id.*

[8] Request for Public Comments at 2.

[9] S. Rep. No. 111-176, at 111.

[10] For example, a survey published by the nonprofit Ethics Resource Center in 2014 reports that "[m]ore than one in five workers (21 percent) who reported misconduct said they suffered from retribution as a result." Press Release, Ethics Resource Center, Survey: Workplace Misconduct at Historic Low (Feb. 4, 2014), https://www.businesswire.com/news/home/20140204006180/en/Survey-Workplace-Misconduct-Historic.

B. Whistleblowers Should Be Rewarded, Not Penalized, When Their Information Leads to Restitution for Victims

The Model Act also diverges from Dodd-Frank in excluding "restitution" from the calculation of a whistleblower award. That divergence could lead to lack of clarity, excessive litigation, and an undermining of the incentives for whistleblowers to come forward.

Section 2(2) of the Model Act defines "Monetary Sanction" to include "disgorgement" but exclude "restitution." As an initial matter, that formulation is confusing. Disgorgement is often considered one type of restitution. For example, in a recent case involving the SEC's disgorgement authority, the Supreme Court noted that "disgorgement is a form of '[r]estitution measured by the defendant's wrongful gain.'"[11]

Aside from unclear drafting, there are other problems. Assuming that the Model Act intends to preclude awards based on restitution (i.e., amounts ordered returned to investors), such a divergence from Dodd-Frank is unwise.

The Model Act does not pay whistleblower awards out of the money that would otherwise go to victims, but instead directs that awards "shall be paid from a fund established elsewhere under state law."[12] This structure is modeled after Dodd-Frank's creation of the Investor Protection Fund used to pay awards under federal law.[13] The decision to set up a separate fund is prudent. Awards paid to whistleblowers from the proceeds of a successful securities action would create competition between whistleblowers and victims, which would undermine support for the Model Act. Instead, Congress established the Investor Protection Fund so that whistleblowers would be rewarded for helping return money to investors without taking money from the victims' pockets:

> Whenever a whistleblower or whistleblowers tip leads the SEC to collect sanctions and penalties that are determined to be distributed to the victims of the fraud, the intent of the Committee is to reward the whistleblower prior or at the same time as paying such victims, recognizing that were it not for the whistleblower's actions, there would have been no discovery of the harm to the investors and no collection of any sanctions for their benefit.[14]

But excluding restitution under this structure erodes the certainty of the award regime and could lead to arbitrary outcomes. To illustrate, assume a whistleblower-initiated action results in

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[11] *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1640 (2017) (quoting Restatement (Third) of Restitution and Unjust Enrichment § 51, cmt. a (2010)).

[12] Model Act § 6.

[13] 15 U.S.C. § 78u-6(g).

[14] S. Rep. No. 111-176, 111-12.

the recovery of $500,000 in disgorgement and a $500,000 fine. The whistleblower would be entitled to a reward of $100,000-$300,000. But if the securities regulator returned the $500,000 in disgorged funds to victims, arguably a better outcome, then the whistleblower would only receive $50,000-$150,000 for the same tip. That disparity is unjustified.

Indeed, it would appear not only arbitrary but unjust that a whistleblower whose information allows victims to be made whole should receive **less** than an identical whistleblower whose case does not.

For all these reasons Dodd-Frank does not create such distinctions, but awards whistleblowers 10-30% of monetary sanctions imposed in any "related action," whether criminal or civil.[15] The same is true of the similar whistleblower award regime applied to IRS whistleblowers.[16] Victims are fully compensated, and whistleblowers are fairly rewarded.

Whistleblower rewards are most effective when they are predictable and perceived to be fair. Eliminating the distinction between related actions involving disgorgement and restitution would enhance both predictability and fairness and encourage more whistleblowers to step forward. The Model Act should follow the lead of Dodd-Frank and the IRS whistleblower regime and determine any rewards based on all funds recovered from wrongdoers.

C. Whistleblowers Should be Able to Report Anonymously

As a further incentive for those whistleblowers who might have the most to lose by coming forward, the Model Act should offer provisions for anonymous whistleblowing. Allowing anonymous reporting of the type permitted by the SEC program decreases the chances of retaliation and lowers the barrier to coming forward, without negatively impacting the functioning of the program.

As described above, the Model Act will only function successfully if it shifts the cost/benefit analysis for would-be whistleblowers. Often, those with the most critical information, which would be of the most use to regulators and law enforcement, are also the most vulnerable to overt retaliation and more subtle assaults on their future careers. Permitting them to proceed anonymously gives them the comfort to do the right thing. In our collective experience, most whistleblowers are willing to work openly with the government, but some are willing to come forward only if they receive more assurances that their identities will be

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[15] 15 U.S.C. § 78u-6(a)(5), (b)(1).

[16] 26 U.S.C. § 7623(b), (c)(2). Indeed, there was some confusion about whether the original IRS reward statute included criminal penalties, and in 2018, Congress amended the law to expressly include them. *See* Bipartisan Budget Act of 2018, Pub. L. 115-123, § 41108, 132 Stat. 158.

concealed. While the government is typically very protective of whistleblower identities, certain circumstances require their disclosure.[17] And of course, mistakes happen.

Typically, a whistleblower's hesitation to risk disclosure is grounded in a real fear of retaliation, often because they are in a uniquely vulnerable position professionally or personally. In some cases, they are reluctant to come forward because the nature of the wrongdoers they seek to expose causes them to legitimately fear for their own safety. Some, over time, will reveal their identity, particularly if the government has demonstrated an interest in pursuing their information. But having the ability to proceed anonymously at the outset has convinced many key whistleblowers to bring their information to light.

The Model Act can permit anonymous reporting without sacrificing any of its goals. Indeed, the SEC program's provisions on anonymous reporting strike the right balance, and we encourage NASAA to incorporate them.[18] SEC whistleblowers have the right to proceed anonymously if they comply with certain requirements.[19] Primarily, they must be represented by an attorney. That attorney takes on some of the verification function typically conducted by the regulator: they must certify to the Commission that they have reviewed the information in the tip and that it is true and correct. Additionally, the whistleblower must sign the tip under penalty of perjury; that copy is preserved by the attorney and must be provided to the Commission if it has concerns that the submission contains false information. Finally, should the whistleblower ultimately be eligible for an award, they must disclose their identity to the Commission and have it verified before they can receive any payment.

This structure encourages additional whistleblowers to come forward without sacrificing the integrity of the program. By requiring an attorney, the Dodd-Frank program sensibly preserves the gatekeeping function that might otherwise be lost with anonymous reporting. The attorney for an anonymous whistleblower puts their own reputation on the line, so they have a strong incentive to assure the tip is credible. Moreover, most attorneys who represent whistleblowers do so on a contingency basis, so their economic incentive to avoid squandering time on low-quality information promotes further vetting.

Most importantly, the regulator can still interact directly with the whistleblower. Under Dodd-Frank, with the attorney as a go-between, the SEC regularly interviews anonymous whistleblowers, testing their credibility and developing their information just as they would with an identified source. Although the logistics are minorly more complex, the results are just as

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[17] *See, e.g.*, 17 C.F.R. § 240.21F-7(a).

[18] The Dodd-Frank Act's only reference to anonymous reporting is to require representation by an attorney. *See* 15 U.S.C. § 78u–6(d)(2)(A). The provision is given specific life in the implementing regulations at 17 C.F.R. §§ 240.21F-7(b), F-9(c).

[19] *See* 17 C.F.R. §§ 240.21F-7(b), F-9(c).

strong as without anonymity. Those small hurdles are a small price to pay for encouraging the most vulnerable whistleblowers still to come forward.

II. SUGGESTED IMPROVEMENTS TO THE RETALIATION PROVISIONS

While allowing anonymity provides some measure of protection for employee whistleblowers, that step alone is insufficient to protect employees fully and incentivize them to come forward. To further shift the cost-benefit calculus in favor of whistleblowing, strong anti-retaliation measures must also be provided. The two seminal laws enacted in the 21st Century to reform corporate responsibility – the Sarbanes-Oxley Act and the Dodd-Frank Act – work together to do just that. While neither law is perfect, working in tandem, they have provided an umbrella of protection for corporate whistleblowers.

The Model Act wisely mirrors the anti-retaliation protections in Dodd-Frank Act, but because it does not incorporate critical components of the Sarbanes-Oxley Act, it does not adequately protect corporate whistleblowers from retaliation. Three suggested improvements will make for a significantly stronger Act.

A. Internal Whistleblowing Should Be Protected

Most employees who encounter potential securities violations at work first report the misconduct internally. They do so for a variety of reasons, but most often because they hope the company will take immediate corrective action or because they have no choice unless they allow themselves to be implicated in the unlawful conduct otherwise. The Model Act should encourage such internal whistleblowing because it can be one of the most effective ways to quickly stop ongoing misconduct and in doing so protect investors from further harm. Internal reporting also frequently leads companies to self-report to regulators, which has the dual benefit of quickly stopping the misconduct that harms investors and alerting the regulators to the misconduct.

As the Model Act is currently drafted, there is no protection from retaliation for whistleblowers who report internally if the retaliation happens before they report to the state securities regulator. Like the Dodd-Frank Act, it only protects employees who externally report. On the federal level, however, the Dodd-Frank Act's limited retaliation protection is complemented by the Sarbanes-Oxley Act's protections for internal reporting.

The Model Act should mirror not just the Dodd-Frank Act, but the fuller body of federal corporate whistleblowing law, by protecting both internal and external whistleblowing. To do so, it needs to replace the term "whistleblower" in Section 9 with the term "individual," or at the

least "employee." It also needs to add language similar to the Sarbanes-Oxley Act that protects individuals who report potential securities violations internally.[20]

B. Broader Rights and Remedies Should Be Provided

In addition to this expanded coverage, to be in full alignment with federal corporate whistleblowing law, the Model Act should expand its protection of the rights and remedies of whistleblowers.

First, the available relief should be expanded to include emotional distress and reputational harm damages, which are remedies typically available in whistleblower statutes.[21] Providing these non-economic damages is critical in retaliation cases because some frequent, actionable forms of retaliation have no economic damages, such as industry blackballing, "outing" a whistleblower, and workplace harassment. Additionally, facing unlawful retaliation causes substantial emotional distress and reputational harm, which should be compensable. The Model Act should provide relief for the full scope of damages that a whistleblower suffers.

The Model Act also should expressly provide for a jury trial and prohibit waiver of that right in pre-dispute agreements. Including such a provision would ensure that all plaintiffs have the ability to try their case to a jury, regardless of whether under a specific state's law the relief available under the Act would qualify as a legal remedy, which would constitutionally require a jury trial, or an equitable one, which would not. Such a right is also in keeping with the whistleblower protections available in the Sarbanes-Oxley Act.[22]

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[20] *See* 18 U.S.C. § 1514A(a)(1)(C) (protecting disclosures related to violations of federal fraud statutes and SEC rules and regulations when made to "a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)").

[21] *See* Sarbanes-Oxley Act, 18 U.S.C. § 1514A(c)(2)(C)(defining compensatory damages to include "compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees"); *Jones v. Southpeak Interactive Corp. of Delaware*, 777 F.3d 658, 672 (4th Cir. 2015) (holding that the Sarbanes-Oxley Act's special damages provision includes compensation for emotional and reputational harm); False Claims Act, 31 U.S.C. §3730(h)(2) (providing for reinstatement, two times the amount of back pay, interest on the back pay, and "compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees"); *Brandon v. Anesthesia & Pain Mgmt. Assoc., Ltd*., 277 F.3d 936, 944 (7th Cir. 2002) (emotional distress damages are available under the statutory provision for "special damages"); *Hammond v. Northland Counseling Center, Inc.*, 218 F.3d 886, 892–93 (8th Cir. 2000) (same); *Neal v. Honeywell, Inc.*, 191 F.3d 827, 831–32 (7th Cir. 1999) (same).

[22] *See* 18 U.S.C. § 1514A(b)(2)(E).

It is also critical that the Model Act incorporate similar language to the Dodd-Frank Act that protects the other rights and causes of action available to whistleblowers. The Dodd-Frank Act states: "Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any whistleblower under any federal or state law, or under any collective bargaining agreement."[23] Without such language, the Model Act could inadvertently limit the protections available to employees, such as a claim for wrongful termination in violation of public policy or other statutory whistleblower claims.

C. No Exceptions from Retaliation Protections Should Be Included

Finally, the provision of the Model Act that creates "Exceptions from protection against retaliation" should be deleted.[24] Federal corporate whistleblower laws contain no similar exclusions from retaliation protections, and they are not necessary.

At most, the Sarbanes-Oxley Act requires that employees report conduct that they "reasonably believe[] constitutes a violation" to qualify for protection.[25] This "reasonable belief" standard is well-established throughout discrimination and retaliation law. The Dodd-Frank Act is even more liberal in that it does not contain any such restriction. It appears that the Model Act's language is modeled on the Dodd-Frank Act's "Provision of false information" provision that makes a whistleblower ineligible for an award if they make knowing or willfully false, fictitious, or fraudulent statements or representation or if they use any false writing or documents knowing the writing or documents contain any false, fictitious, or fraudulent statement or entry.[26] Critically, this provision does not relate or apply to the Dodd-Frank Act's retaliation protections.

Importing this standard to the retaliation protection would only serve to dissuade whistleblowers with potentially helpful information from coming forward, particularly since many whistleblowers are already intimidated by the process and would likely be fearful that they might say or do something that could result in the loss of their retaliation protections. It will also needlessly increase litigation by introducing a novel legal standard when the "reasonable belief" standard is well-established and understood by courts and employment attorneys.

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The authors of the Model Act should be commended for the work done to produce this draft legislation. With the improvements we suggest above, the Model Act can serve as a guide

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[23] 15 U.S.C. § 78u-6(h)(3).

[24] Model Act § 9(a)

[25] 18 U.S.C. § 1514A(a)(1).

[26] 15 U.S.C. § 78u-6(i).

for state legislatures who wish to enact a compelling whistleblower program to bolster their securities enforcement. When the SEC and IRS enacted whistleblower regimes incorporating these provisions, they received an enormous boost to enforcement efforts. States that adopt similar measures should achieve similar results. We thank you for your time and consideration.

Sincerely,

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