June 29, 2020

Via Email

Lynne Egan, Chair, State Legislation Committee
Faith Anderson, Chair, Whistleblower Protections/Awards Working Group

North American Securities Administrators Association
750 First Street NE, Suite 1140
Washington, DC 20002

RE: Proposed Model Whistleblower Award and Protection Act

Dear Chairs Egan and Anderson:

We are scholars of securities regulation and appreciate the opportunity to comment on the North American Securities Administrators Association ("NASAA")'s Model Whistleblower Award and Protection Act (as drafted, the "Proposed Act," and as to be adopted, the "Final Act"). Although we identify our affiliations below, we write solely in our personal capacities; the views we express are ours alone.

I. Introduction

We recognize the potential for the Final Act to become an important new tool in detecting securities violations and promoting integrity in the capital markets. The Final Act could expand on Congress's prior efforts in the Sarbanes-Oxley and Dodd-Frank Acts to incent whistleblowing and to protect those who risk their careers to do the right thing. Often times, securities misconduct simply will not come to light unless whistleblowers decide to step forward, and the Final Act stands to advance state efforts to combat that misconduct.

In this comment letter, however, we do highlight two concerns that we believe could limit the efficacy of the Final Act. First, the Proposed Act's Section 9 excludes internal whistleblowing from its anti-retaliation provisions, while at the same time it unnecessarily privileges whistleblowing to federal agencies or related to federal law or regulations. Second, the Proposed Act does not immediately contemplate the practice of whistleblowers who provide information anonymously via counsel.

II. States Have an Opportunity to Close Gaps in the Dodd-Frank's Anti-Retaliation Provision

Although financial awards can motivate whistleblowing, many insiders simply want to do the right thing. Often, the greatest barrier to their doing so is fear over impacts to current and future employment. Given this barrier, the Final Act's anti-retaliation provision is likely to be its most important feature. Below, however, we identify concerns

related to the protection of internal whistleblowers, as well as privileges the Proposed Act gives disclosures related to *federal* (but not *state*) law, regulations, and agencies.

A. Avoiding the *Digital Realty* Problem in Defining "Whistleblower"

NASAA's Notice of Request for Public Comments notes that the Proposed Act draws from the Dodd-Frank Act's securities anti-retaliation provision (the "Dodd-Frank Provision"), as well as the Indiana and Utah securities-whistleblower statutes. Indeed, the Proposed Act borrows the Dodd-Frank Provision's definition of "whistleblower," as well as its substantive terms for the types of whistleblowing conduct that will receive retaliation protection. Given the post-enactment history of the Dodd-Frank Provision, however, there should be caution around how closely the Final Act tracks it.

The Dodd-Frank Provision restricts "whistleblower" to being someone who provides "information relating to a violation of the securities laws *to the Commission*."[1]

Substantively, the Dodd-Frank Provision sets conduct that extends retaliation protections to "whistleblowers." The provision does so in part by incorporating conduct protected under the Sarbanes-Oxley Act's whistleblower provision (the "SoX Provision").[2] Looking just to the incorporation of the SoX Provision's protected conduct suggests that there is broad protection under the Dodd-Frank Provision. Examples include protecting those who report suspected securities violations to federal regulators or law enforcement, members or committees of Congress, or 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)."[3] The Dodd-Frank Provision also incorporates 18 U.S.C. § 1513(e)'s prohibition on workplace retaliation against law-enforcement informants, which is not specific to securities violations.[4]

Our concern around the Proposed Act's "whistleblower" definition is as follows:

After Congress enacted the Dodd-Frank Provision, the SEC interpreted the provision to require direct reporting to the SEC for award eligibility, while reporting through certain non-SEC channels, including internally, would suffice for retaliation protection.[5] This interpretation offered pragmatic appeal. Employees who spot potential securities violations might first speak to supervisors or others up the chain. Calling a prominent federal regulatory agency to report wrongdoing, however, is a more intimidating and daunting prospect than raising concerns internally. And whistleblowers who are willing to report to the government might not know to whom they should go or how, and thus they might go to the Federal Bureau of Investigation or another agency.

---

[1] 15 U.S.C. § 78u–6(a)(6) (defining "whistleblower") (emphasis added).
[2] 15 U.S.C. § 78u–6(h)(1)(A)(iii) (incorporating "disclosures that are required or protected under the Sarbanes-Oxley Act of 2002" into the Dodd-Frank Provision's retaliation protections).
[3] *See* 18 U.S.C. § 1514A(a)(1). The SoX Provision, however, creates liability only for retaliatory acts by Exchange Act reporting companies. *See id.*
[4] 15 U.S.C. § 78u–6(h)(1)(A)(iii) (incorporating 18 U.S.C. § 1513(e)).
[5] *See* 17 C.F.R. § 240.21F-2(a)(1), (b)(1) (eff. Aug. 12, 2011).

(Or, in the state context, they might call the state's securities regulator, its attorney general, a local police department, or another agency.)

Yet, the Dodd-Frank Provision's definition of "whistleblower" as someone who provides information "to the Commission" raises the question whether someone who reports internally, or to an agency other than the SEC, receives retaliation protection. In *Digital Realty*, the Supreme Court addressed this question directly. It held that given the Dodd-Frank Provision's "whistleblower" definition, its retaliation protections cover only those who provide information directly *to the Commission*.[6] That restriction applies even though the conduct protected under the Dodd-Frank Provision—assuming "whistleblower" had been defined generically—would have protected those who made disclosures to a wider array of actors, including Congress, internal company personnel, and non-SEC federal regulators and law enforcement.[7]

Section 2(3) of the Proposed Act tracks the Dodd-Frank Provision in defining a whistleblower as someone who "*provides the [Securities Division] with information . . .* .". Its Section 9 lists protected reporting conduct that also tracks the Dodd-Frank Provision. Thus, if a state court followed *Digital Realty*'s reasoning, it would hold that whistleblowers must report to the state's securities regulator before receiving retaliation protection. We believe, however, that including this restriction in the Final Act would represent an unfortunate narrowing of whistleblower protection, particularly as it relates to internal reporting. Instead, a Final Act that serves to incent internal reporting would advance a number of law-enforcement purposes, including:

a. Encouraging whistleblowers to speak up even if they are intimidated by, or otherwise wish to avoid speaking to, the state securities regulator, or they are unaware of the option to speak to the state securities regulator;
b. Prompting firms to conduct internal investigations sparked by internal reports, which in turn would allocate some investigative burden to firms and thereby preserve securities regulators' enforcement resources;
c. Causing the creation of documents and other evidence that might support public enforcement actions, particularly if they show failures by management to investigate, take action, or self-report; or
d. Incenting whistleblowers who do not desire financial awards (but rather who just want to be protected from retaliation) to report, thereby preserving whistleblower funds for other matters.

This problem can be avoided by removing the provide-to-regulator restriction in the Proposed Act's definition of "whistleblower" and adding the SoX Provision's internal-whistleblowing term. Doing so will not cause the legislation to become overly broad in its coverage because Sections 3 through 8 substantively limit who may receive whistleblower

[6] Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 778 (2018) (Ginsburg, J.) (8-0 in the judgment).
[7] *Cf. id.* at 778 (noting that a brief submitted by the United States as amicus curiae urged a construction of "whistleblower" consistent with that word's "ordinary" meaning).

awards and Section 9 substantively restricts the conduct that qualifies for retaliation protection.

B. Avoiding Overly Strict Requirements to Obtain Retaliation Protection

We also identify a potential ambiguity in the Proposed Act's Section 9(1)(a) in which "in accordance with the act" could be construed as requiring whistleblowers to report under Section 3, implying that they must comply with specific reporting requirements established by securities administrators. It is worth considering the types of whistleblowers the states might see. Many will be scared, legally unsophisticated, unrepresented, or all of these things, and so requiring technical reporting compliance to receive retaliation protection is inconsistent with a purpose of protecting those who risk their livelihoods to speak up. We instead view the Proposed Act as intending to provide retaliation protection to a broader class of whistleblowers than those who might receive a financial award (who must satisfy securities administrators' reporting requirements). Modest clarification of Section 9 would avoid any ambiguity over that aim.

In keeping with these observations, we respectfully recommend the following amendments to Sections 2 and 9 of the Proposed Act for your consideration:

Section 2

(3) "Whistleblower" means an individual who, alone or jointly with others, provides ~~**the [Securities Division] with**~~ information pursuant to the ***provisions*~~**procedures**~~** set forth in this act, and the information relates to a possible violation of state or federal securities laws, including any rules or regulations thereunder, that has occurred, is ongoing, or is about to occur.

Section 9

(1) Prohibition against retaliation. No employer may terminate, discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner retaliate against, a whistleblower because of any lawful act done by the whistleblower:

a. in providing information to the [Securities Division] in accordance with this Act***, provided that such information need not be provided in accordance with Section 3***;

b. in initiating, testifying in, or assisting in any investigation or administrative or judicial action of the [Securities Administrator] or [Securities Division] based upon or related to such information; ~~**or**~~

c. in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.); the Securities Act of 1933 (15 U.S.C. 77a et seq.); the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.); 18

U.S.C. 1513(e); any other law, rule, or regulation subject to the jurisdiction of the Securities and Exchange Commission; or [the Securities Act of this State] or a rule adopted thereunder~~.~~***; or***

d. in making disclosures 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) regarding matters subject to the jurisdiction of the [Securities Administrator], [Securities Division], or Securities and Exchange Commission.[8]

C. Incorporating Federal Interests into State Legislation

We draw attention to the federal statutes that the Proposed Act's Section 9(1)(c) incorporates by reference.[9] These incorporated statutes privilege federal securities statutes and regulations and federal law-enforcement and regulatory agencies. We believe that after *Digital Realty* that this coverage is important for providing federal whistleblowers state-law claims against retaliation. In drawing attention to this subsection, however, we encourage amendments to Section 9(1)(c) that would extend equal status to state law, regulations, and agencies.

III. Allowing Anonymous Reporting Via Counsel Will Encourage More Reporting and More Useful Disclosures

The SEC whistleblower program established by the Dodd-Frank Act routinely involves anonymous, attorney-mediated tips up until the point that the SEC is ready to make an award. This allowance encourages whistleblowing by mitigating potential reporters' understandable anxieties around preserving anonymity. Whistleblower counsel are also able to professionally vet tips and prepare submissions that articulate legal issues and marshal evidence in ways that save considerable time for a regulator's attorneys and investigators.

To extend this benefit to the states, we respectfully recommend the following amendments to the Proposed Act for your consideration:[10]

Section 6

Section 6: Source of payment of whistleblower award ***and whistleblower identity***

[8] This proposed language tracks the SoX Provision, 18 U.S.C § 1514A(a)(1)(c).
[9] *See* notes 2–3 and accompanying text.
[10] This proposed amendment tracks 15 U.S.C. § 78u–6(d)(2) in the Dodd-Frank Act's securities whistleblower-awards provision.

> ***(1)*** Any whistleblower awards paid under this act shall be paid from the fund established in [state code citation].
>
> ***(2) Any whistleblower who makes a claim for an award under Section 3 shall be represented by counsel if the whistleblower anonymously submits the information upon which the claim is based. Prior to the payment of an award, a whistleblower shall disclose the identity of the whistleblower and provide such other information as the [Securities Administrator] may require, directly or through counsel for the whistleblower.***

IV. Conclusion

We applaud NASAA's introduction of the Proposed Act and believe that the Final Act could prove an important tool within this country's federalist securities-enforcement system. We believe that the anti-retaliation provision will prove the most important feature of the Final Act, and so we encourage NASAA to consider ways to avoid the restrictive interpretation of "whistleblowing" that the *Digital Realty* Court applied to the Dodd-Frank Provision. We further encourage NASAA to consider adopting statutory language that recognizes the value of pre-award anonymous whistleblowing.

Respectfully submitted,[11]

Andrew C. Baker
Academic Fellow, Rock Center for Corporate Governance
Stanford University

Benjamin P. Edwards
Associate Professor of Law
University of Nevada, Las Vegas

Andrew K. Jennings
Fellow, Corporate Governance & Practice and Lecturer in Law
Stanford University

Samantha J. Prince
Associate Professor of Lawyering Skills and Entrepreneurship
Penn State Dickinson Law

[11] Institutional affiliations and titles for identification purposes only.