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U.S. Chamber of Commerce

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February 4, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st St. NW
Washington, D.C. 20581

Re: Proposed Rules for Implementing the Whistleblower Provisions of Section 23 of the Commodity Exchange Act, RIN Number 3038-AD04

Dear Mr. Stawick:

We are submitting these comments on behalf of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing the interests of more than three million companies of every size, sector, and region. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, fairer and faster for all participants.

Businesses have a strong self-interest in detecting and eliminating illegal conduct within their organizations, including conduct that violates the Commodity Exchange Act ("CEA").[1] Such unlawful activity is, of course, wrong, and businesses strive to comply with the law and their ethical obligations. Unlawful misconduct is also bad for the corporate bottom line: it hurts investors by driving down a company's value, damages a company's reputation, drives away business partners and customers, and otherwise harms the company in the marketplace.

[1] 7 U.S.C. § 1 *et seq.*

For these reasons, large numbers of companies that engage in conduct regulated by the Commodity Futures Trading Commission ("CFTC" or the "Commission") have implemented strong internal reporting and compliance programs to obtain information about potential wrongdoing. Recent regulatory developments, including the adoption of Section 301 of the Sarbanes-Oxley Act of 2002 ("SOX") and revisions to the federal Sentencing Guidelines, have accelerated this trend over the past decade. Businesses invest substantial resources in their internal compliance programs, and the evidence indicates that such programs are effective in identifying and remediating wrongdoing. Moreover, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") imposes new compliance requirements on a number of entities regulated by the CFTC.[2] The Commission is still considering how to implement the details of these requirements; but it stands to reason that the entities subject to the new requirements will adopt many of the compliance "best practices" employed successfully by companies governed by Section 301, the federal Sentencing Guidelines, and other regulatory regimes.

In Section 748 of the Dodd-Frank Act, Congress directed the Commission to establish an award program for whistleblowers who voluntarily provide the Commission with original information about a violation of the CEA that leads to a successful CFTC (or related) enforcement action resulting in monetary sanctions exceeding $1,000,000.[3] We have no objection to the Commission's establishment of a whistleblower program that financially rewards individuals who bring actionable information to the Commission's attention *when the company itself is unwilling or unable to engage in effective self-policing*. But we are concerned that the proposed rule would create perverse incentives if promulgated as drafted. Our most significant concern is that the rule does not do enough to preserve the important role served by corporate compliance programs.

Put simply, the proposed rule creates a set of incentives that are skewed overwhelmingly in favor of direct reporting to the CFTC—even when companies are willing to, and fully capable of, addressing reports themselves. The preamble itself correctly acknowledges the importance of the rule "support[ing], not undermin[ing],

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[2] Pub. L. No. 111-203 (2010).
[3] 75 Fed. Reg. 75728, 75728 (2010).

the effective functioning of company compliance and related systems."[4] The preamble also acknowledges a related concern: "the potential harm to companies and individuals that may be caused by false or spurious allegations of wrongdoing."[5]

But the proposed rule does almost nothing to address these risks. Rather, it affords those with knowledge of CEA violations no meaningful reason to look first to their companies' own internal reporting processes, or to hold back from reporting to the Commission information that is trivial or frivolous. Therefore, if implemented as proposed, the rule would have a number of harmful consequences, including eviscerating corporate compliance and reporting programs; giving rise to unjustified negative publicity about, and unnecessary CFTC investigations of, innocent companies; and overwhelming the Commission with an avalanche of poor-quality information. These results are directly contrary to the well-documented fact that companies and employees benefit, and scarce government enforcement dollars are preserved, when companies have the first chance to address financial wrongdoing. They also fly in the face of the legislative purpose reflected in Section 301 of SOX and the Dodd-Frank Act, both of which *require* many entities regulated by the CFTC to develop sophisticated internal reporting programs.

Changes to the proposed rule are needed to address these concerns, and Congress in enacting Section 748 has granted the Commission ample discretion to make them.[6] The interests of investors, employees, and taxpayers would be served better by an approach that recognizes and preserves legitimate internal compliance mechanisms as the first line of defense against CEA violations, with the CFTC whistleblower program serving in an important supporting role. In particular, as discussed below, we urge the Commission to put in place regulatory safeguards that limit the ability of whistleblowers to unnecessarily bypass companies' compliance programs, as well as other measures to ensure that only high-quality information regarding actual wrongdoing is provided to the Commission. An incentive program structured in this way would ensure that legitimate evidence of wrongdoing is

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[4] *Id.* at 75733.
[5] *Id.* at 75735.
[6] *See* 7 U.S.C. § 26(a)(7) (requiring whistleblowers to submit their allegations "in a manner established by rule or regulation by the Commission"); *id.* § 26(i) ("The Commission shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section.").

addressed promptly and effectively, preserving corporate compliance programs as a critical supplement to government enforcement efforts—rather than simply overriding those programs, as the current proposal would do.

I. Analysis of the Proposed Rule

1. Internal reporting of potential wrongdoing benefits investors and society at large

The experience of the many companies with robust internal reporting programs, as well as the empirical evidence, demonstrate that all stakeholders benefit when those with knowledge of potential wrongdoing report internally, thus enabling management to promptly investigate and take remedial action. With timely access to information about potential problems, companies can address and punish wrongdoing, avoid lawsuits, improve efficiency, and reduce costs. Without voluntary reporting up the corporate hierarchy, however, it is unlikely that corporate decision-makers will be able to obtain the facts they need to take the necessary corrective action. Indeed, the preamble to the proposed rule itself acknowledges that "[c]ompliance with the CEA is promoted when companies implement effective legal, audit, compliance, and similar functions" and "have effective programs for identifying, correcting, and self-reporting unlawful conduct by company officers or employees."[7] And as one of the leading researchers in the field has explained, internal reporting

> facilitat[es] the prompt investigation and correction of wrongful conduct and minimiz[es] the organizational costs of whistleblowing by permitting employers to rectify misconduct confidentially, with little disruption to the employer-employee relationship. Internal whistleblowing also enables the correction of misunderstanding, which reduces the likelihood that the organization and its employees will unfairly suffer harm.[8]

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[7] 75 Fed. Reg. at 75730, 75733.

[8] Terry Dworkin, *SOX and Whistleblowing*, 105 Mich. L. Rev. 1757, 1760 (2007).

More generally, internal reporting improves corporate governance by affording employees an opportunity to participate in the compliance process, thus improving morale and efficiency and fostering a culture of cooperation, trust, and respect for the law.[9] Internal reporting also complements the activities of the CFTC and other government agencies by providing them with high-quality information obtained through internal investigations,[10] and by freeing them to focus their resources and energies on those companies that are unwilling or unable to take remedial action on their own.

Moreover, internal reporting works. As a group of the leading researchers on this question recently reported, "empirical studies have shown few substantial differences in antecedents or outcomes of whistle-blowing as a function of type of channel [*i.e.*, external or internal] used."[11] And internal reporting can precipitate more timely corrective action than external reporting, while imposing fewer costs on companies and the overall economy. In commenting on the SEC's very similar whistleblower award program, SEC Commissioner Paredes correctly observed that companies "may be able to respond in a more timely manner—thus acting more quickly to remedy any misbehavior—than the Commission could given the SEC's many other responsibilities."[12] Given the CFTC's myriad enforcement responsibilities and limited resources, this observation applies equally here.

Most companies do, in fact, vigorously investigate the tips that they receive through their internal compliance systems. For example, a recent survey of approximately 117,000 whistleblower reports received by the hotline operator the Network in 2009 found that companies investigated 73 percent of whistleblower reports, and declined to investigate only 23 percent of reports (companies referred 2

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[9] *See, e.g.*, Corporate Compliance Comm., ABA Section of Bus. Law, *Corporate Compliance Survey*, 60 Bus. Law 1759, 1759 (2005) (noting that in order to "achieve compliance with applicable legal regulations and internal ethical standards," compliance programs aim both to "create an ethical corporate culture that educates and motivate the organization's employees" and also "deter and detect violations through risk assessment, monitoring, auditing, and appropriate discipline").

[10] *See* Lucinda Low et al., *The Uncertain Calculus of FCPA Voluntary Disclosures*, Paper for the March 2007 American Conference Institute FCPA Conference (March 2007), available at http://tinyurl.com/5sqwdck (describing increase in voluntary disclosures made to both the SEC and the Department of Justice and providing examples of federal agencies receiving information as a result of internal investigations).

[11] Marcia P. Miceli *et al.*, *Whistleblowing in Organizations* 7 (2008).

[12] *See* Troy A. Paredes, Commissioner, SEC, *Statement at Open Meeting to Propose Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934* (Nov. 3, 2010) ("Paredes Statement").

percent, and resolved the resolved the remaining 2 percent in other ways).[13] This is a sharp improvement from as recently as 2005, when companies investigated a still respectable 64 percent of reports and declined to investigate 26 percent.[14] In interpreting these results, it should be kept in mind that approximately half of whistleblower reports relate to personnel issues.[15] Accordingly, the 73 percent investigation rate in 2009 suggests that companies are highly responsive to information they receive internally regarding ***actionable*** wrongdoing—and are becoming more so over time.

Companies also take appropriate corrective action once the internal investigation is complete. In the Network study, for example, 40 percent of investigations led to action by the company.[16] This response rate compares quite favorably with the rates in analogous contexts. For example, the Government Accountability Office ("GAO") reported in 2005 that the Department of Justice decided to pursue only 26 percent of qui tam cases filed by relators under the False Claims Act.[17] The reality is that many internal reports—like many qui tam filings—lack merit. Indeed, the relative ease of filing an internal report compared to filing a complaint in federal court places the statistics on corrective action by companies in an even better light. The reality is that many investigations in response to internal reporting will reveal that no wrongdoing took place, or that there is insufficient evidence of wrongdoing to support action by the company. Accordingly, a 40 percent response rate supports the conclusion that corporate compliance systems are, in general, responsive and effective.

Significantly, one prominent study that the SEC relied on heavily in crafting its own proposed whistleblower rule,[18] a working paper titled "Who Blows the Whistle on Corporate Fraud?," acknowledged that "[m]onitoring by the board of directors

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[13] *See* The Network, Corporate Governance and Compliance Hotline Benchmarking Report 70 (2010) ("Network Report"), *available at* http://www.tnwinc.com/downloads/2010BenchmarkingReport.pdf.
[14] *See id.*
[15] *See* Deloitte, *Whistleblowing and the New Race to Report* 3 (Dec. 2010), *available at* http://tinyurl.com/36bu7nu.
[16] Network Report at 22.
[17] 31 U.S.C. § 3729. *See* GAO, Briefing for Congressional Requesters, *Information on False Claims Act Litigation* 29 (Dec. 15, 2005), *available at* http://www.gao.gov/new.items/d06320r.pdf.
[18] *See* 75 Fed. Reg. at 70514 n.105.

might be very effective in deterring fraud and in stopping fraud early on."[19] The report attributed 34 percent of fraud detections to internal governance, but also stated that "this is undoubtedly a vast under-estimate of how many frauds are prevented and corrected by internal corporate governance."[20]

Furthermore, the costs imposed by external reporting on companies and the economy appear to be significant, and much higher than the costs imposed by internal reporting. Target companies and their shareholders can suffer substantial harm from negative publicity and disruptive government investigations, even if no actual wrongdoing has taken place. A survey of external financial whistle-blowing events from 1989 to 2004 reports that whistleblowing allegations have an immediate negative economic effect on target firms, with an average market-adjusted return of almost -3 percent in the five days around the day the allegation becomes public.[21] Thus, even ill-founded allegations can impose a significant deadweight loss on shareholders. Moreover, the survey indicates that employees who report externally are disproportionately likely to target those companies that are growing, successful, and highly regarded.[22] The reasons are not entirely clear, but the survey's authors suggest that one explanation may be that well-respected companies—by virtue of their prominence and newsworthiness—are more likely to attract the ire of employees who are dissatisfied or desire publicity.[23]

Of course, when internal reporting systems are nonexistent or illusory, it is appropriate and beneficial for employees to report information of wrongdoing directly to the CFTC. However, the available empirical evidence, as well as the experience of the business community, demonstrate that external reporting works best when it functions as a backstop to internal controls.

The critical challenge faced by the Commission in this rulemaking is to design a whistleblower program that reinforces the important role played by internal reporting

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[19] Alexander Dyck, Adair Morse, Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?*, at 9 (September 2009), *available at* http://faculty.chicagobooth.edu/luigi.zingales/research/papers/whistle.pdf.

[20] *Id.*

[21] *See* Robert M. Bowen *et al.*, "Whistle-Blowing: Target Firm Characteristics and Economic Consequences," at 29 (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=890750.

[22] *Id.*

[23] *See id.* at 9.

systems—and does not instead drain these programs of all vitality by incentivizing employees to ignore them and report only to the Commission in order to obtain a large financial award. Section 748, while mandating the creation of financial incentives for whistleblowers who report to the CFTC, left many aspects of the structure of the program to the Commission. As discussed below, we are extremely concerned that the approach set forth in the proposed rule, if adopted, would severely undercut companies' internal fraud detection efforts.

2. *Companies' internal compliance systems have improved significantly in recent years*

Over the past decade, changes in federal law and an emerging understanding of the importance of internal reporting have driven significant improvements in the sophistication and effectiveness of many companies' internal compliance systems. The CFTC's whistleblower program should encourage, not short-circuit, these promising developments.

The enactment of Section 301 of SOX in 2002 was a watershed event in the history of corporate compliance.[24] That provision requires publicly traded companies to establish internal compliance systems that meet stringent criteria. Under Section 301, the audit committees of covered companies must establish channels for employees to report organizational misconduct relating to auditing or accounting.[25] Covered companies also must allow employees to submit reports confidentially and anonymously. The requirements are backed by a strong enforcement mechanism: the national securities exchanges and associations must by law delist companies that fail to comply.[26]

Since the enactment of Section 301, most public companies have responded to this mandate—and their own real world experience—by developing well-publicized, effective, and secure internal reporting programs, and by integrating those programs into their corporate cultures. Many of these programs are highly sophisticated, consisting of comprehensive training and education of employees and management,

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[24] Pub. L. No. 107-204.
[25] *See* 15 U.S.C. § 78j-1(m)(4)(B).
[26] *See id.* § 78j-1(m)(4)(A); 17 C.F.R. § 240.10A-3(a)(1), (2).

hotlines, designated compliance officers, and ombudsmen specifically designated to receive complaints. Audit committees now routinely review, investigate, and seek to address anonymous complaints.

Studies show that organizations with effective internal compliance systems have an increased amount of internal reporting.[27] Indeed, "two of the most prominent social science researchers of whistleblowing behavior contend that the best approach for encouraging whistleblowing is to 'set up internal complaint procedures where concerned employees could report, and make sure that those procedures provide for speedy and impartial review.'"[28] Systems with the features mandated by Section 301 are particularly likely to result in more internal reporting because they ensure high-level attention to complaints, and allow employees to report anonymously and confidentially. These characteristics of an internal-reporting system minimize the ability of wrongdoers to retaliate against whistle-blowing employees or to obstruct investigations. They also bolster the confidence of prospective whistleblowers that companies will take their reports seriously, ensure their safety, and respond with prompt and decisive action when warranted. As the SEC observed in issuing regulations to implement Section 301, "[t]he establishment of formal procedures for receiving and handling complaints should serve to facilitate disclosures, encourage proper individual conduct and alert the audit committee to potential problems before they have serious consequences."[29]

The federal Sentencing Guidelines also afford a strong incentive to all companies—not just publicly traded ones—to maintain effective internal reporting programs.[30] The Guidelines provide for a business organization to reduce potential penalties for wrongdoing (and perhaps avoid prosecution altogether) if it can demonstrate that it had in place an "effective compliance and ethics program" that is well-publicized and monitored by the company's board, and that protects whistleblowers from retaliation.[31] Recent amendments to the guidelines create further

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[27] *See* Richard E. Moberly, *Sarbanes-Oxley's Structural Model To Encourage Corporate Whistleblowers*, 2006 B.Y.U. L. Rev. 1107, 1142-43, 1147.
[28] *Id.* at 1147 (quoting Marcia P. Miceli & Janet P. Near, *Blowing the Whistle: The Organizational and Legal Implications for Companies and Employees* 249 (1992)).
[29] 68 Fed. Reg. 18788, 18798 (2003).
[30] U.S. Sentencing Commission, Guidelines Manual § 8B2.1 ("Effective Compliance and Ethics Program") (Nov. 2010).
[31] *See id.*

incentives for companies to provide for direct reporting from the Chief Compliance Officer ("CCO") to the Board of Directors, and for the Board to promptly report any criminal conduct to the government.[32] Because of the substantial benefits that can result from meeting the guideline standards, companies are likely to modify their reporting programs as necessary to come into compliance.

These changes in federal law have had a significant effect, with employees becoming increasingly comfortable in recent years with the idea of reporting fraud through internal compliance programs. In the Network study discussed earlier, the share of internal reports that concerned fraud increased from 10.9% in 2006 to 20.2% in the first quarter of 2010.[33] And according to the Ethics Research Center, the percentage of employees who reported misconduct when they saw it increased from 58 percent to 63 percent between 2007 and 2009, with almost all of that reporting directed internally.[34] These developments suggest a high and steadily increasing level of employee confidence that company compliance systems will protect their confidentiality and safety, and lead to effective corrective action.

Significantly, the Dodd-Frank Act imposes new compliance requirements on a large number of entities regulated by the CFTC, including futures commissions, futures commission merchants, derivatives clearing organizations, swap data repositories, swap dealers, major swap participants, swap execution facilities, and registered clearing agencies.[35] Under the Act, all these entities must designate an individual to serve as a CCO, and that CCO must report directly to the board or to the senior officer of the entity, and must meet with the board or the senior officer at least once a year regarding the entity's compliance program. The CCO also is responsible under the Act for ensuring the entity's compliance with the CEA, and for reporting annually to the Commission regarding the state of compliance and the entity's compliance-related policies and procedures.

The Commission has not yet promulgated final regulations elaborating the details of these compliance requirements, and it remains to be seen how covered

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[32] *See* 75 Fed. Reg. 27388, 27394 (2010).
[33] Network Report at 12.
[34] *See* Ethics Resource Center, *2009 National Business Ethics Survey* at 35-36.
[35] *See* Pub. L. 111-203, §§ 725, 728, 731, 732, 733, 763; *see also* 75 Fed. Reg. 70881 (2010);75 Fed. Reg. 77576 (2010); 76 Fed. Reg. 1214 (2011). .

entities will structure their compliance programs in response to the mandates that the Commission does establish. Regardless, it seems safe to assume that entities covered by the new requirements will follow many of the best-practices adopted by companies under other regulatory regimes—and will be equally effective at policing wrongdoing.

3. The proposed rule does not provide adequate incentives for employees to report internally and to self-censor trivial or frivolous complaints

In light of these trends, the Commission should design the whistleblower program to support and promote internal reporting. There can be little doubt, however, that the proposed rule—if implemented as drafted—would encourage a large number of employees with knowledge of wrongdoing to go directly to the Commission rather than making use of internal reporting channels. The minimum bounty under the program, $100,000 (10 percent of $1 million), is about twice the median household income in the United States—an enormous enticement for almost any employee. Moreover, penalties in Commission cases routinely amount to tens of millions of dollars, meaning that qualifying whistleblowers will have the potential to attain millionaire status, possibly many times over.[36]

The empirical evidence also shows, consistent with common sense, that employees are more likely to make external allegations of wrongdoing when the potential benefits to doing so increase.[37] In the face of these incentives, it is difficult to imagine that many employees would forego the opportunity for a life-changing award by reporting their concerns internally.[38]

An additional important consideration is that a meaningful number of reports do not consist of actionable information. Many tips are trivial or frivolous, whether because an employee misunderstood something he saw, desires to neutralize a rival, or

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[36] *See, e.g.*, CFTC, *FY 2009 Performance and Accountability Report* 63-64 (Nov. 2009), available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2009par.pdf.
[37] *See* Bowen *et al.*, supra note 21.
[38] *See* T.M. Dworkin & E.S. Callahan, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society*, 29 Am. Bus. L. J. 267, 273 (1991) (noting that "substantial financial rewards" under False Claims Act provide "a great incentive to report the wrongdoing externally . . . rather than report the wrongdoing internally and have it corrected or reported by the organization").

wishes to obtain protected status in order to protect himself against a pending or impending discharge or disciplinary proceeding grounded in wholly legitimate reasons.[39] Significantly, Section 165.2(p) (and Section 165.6(b)) of the proposed rule would extend the anti-retaliatory protections of Section 23(h) of the CEA, as amended by the Dodd-Frank Act,[40] to anyone who provides the CFTC with information relating to a "potential" violation of the CEA, even if that person does not follow the specified procedures and conditions for obtaining an award.[41] This broad application of the CEA's anti-retaliatory protections will increase the incentive for misuse and overuse of the Commission reporting option.

To be sure, the rule (at proposed Section 165.3) requires whistleblowers to submit a sworn declaration attesting to the veracity of the information provided, and whistleblowers who "knowingly and willfully" make false representations to the Commission (or another authority in connection with a related action) are ineligible for an award and may be subject to prosecution.[42] On the margins, this may help, as intended, to "deter the submission of false and misleading tips and the resulting inefficient use of the Commission's resources," and to "mitigate the potential harm to companies and individuals that may be caused by false or spurious allegations of wrongdoing."[43] But the proposed rule appears to extend the statutory anti-retaliation protection to even those employees who submit a false report to the Commission.[44] And while criminal prosecution for such false statements will be a theoretical possibility, criminal liability will be extremely difficult to prove, and the Department has limited resources and a myriad of other enforcement responsibilities. In addition, a sizeable proportion of the reports that do involve some type of inappropriate behavior likely will not concern conduct that violates the CEA. Obviously, the company is better positioned than the Commission to handle such matters.

Finally, by undermining the incentives to use internal reporting programs, the proposed rule risks undermining trust between employees and management and

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[39] *See* Miceli, supra note 11, at 195 (noting that "some whistle-blowers can be mistaken, or may find objectionable certain types of behavior that are not widely defined as wrongdoing").
[40] 7 U.S.C. § 26(h).
[41] *See* 75 Fed. Reg. at 75735.
[42] *See* Proposed 17 C.F.R. § 165.6(5); *see also* 75 Fed. Reg. at 75735.
[43] 75 Fed. Reg. at 75735.
[44] *See* Proposed 17 C.F.R. § 165.6(b) (whistleblower remains eligible for anti-retaliation protections "[n]otwithstanding [the] whistleblowers ineligibility for an award for any reason set forth in paragraph (a) of this section").

fostering an adversarial culture within many companies. Employees who become aware of evidence of potential CEA violations will have a tremendous financial incentive to take their concerns to the Commission rather than to the company's directors. Such divergence between the incentives of employees and management is detrimental to companies, employees, and the long-term enforcement of the CEA.

We appreciate that the Commission has exhibited some awareness of the danger to internal compliance in drafting the proposed rule, and that it has included three provisions intended to preserve the effectiveness of internal reporting programs. First, the rule establishes that an award generally cannot be made to those with "legal, compliance, audit, supervisory, or governance responsibilities for an entity" who report information that a third party communicated to them with the reasonable expectation that the entity would take remedial action.[45] Second, the rule provides that an award generally cannot be based on information otherwise obtained "from or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential non-compliance with law."[46] These exclusions would not apply, however, if the entity does not disclose the information to the Commission within 60 days, or acts in "bad faith"—a term that the rule does not define.[47] Third, the proposed rule would allow individuals who report information through internal compliance channels to still qualify for an award if, within 90 days, they also submit the necessary forms to the Commission.[48]

Unfortunately, while reflecting some understanding of the problem, these provisions would do little, if anything, in their operation to counteract the baseline incentive under the proposed rule for whistleblowers to bypass internal reporting options. In the absence of an affirmative restriction on external reporting when effective internal reporting channels are available, or the provision of a positive and extremely powerful incentive for using those internal channels, prospective whistleblowers will face an irresistible temptation to go to the Commission with their report. The 90-day grace period eliminates one possible disincentive to internal reporting that the rule might otherwise create. But it does not itself establish an affirmative reason for employees to report internally, and it is not at all clear why an

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[45] Proposed 17 C.F.R. § 165.2(g)(4).
[46] *Id.* § 165.2(g)(5).
[47] *Id.* § 165.2(g)(4), (5).
[48] *Id.* § 165.2(l)(2).

employee with actionable information would take advantage of the 90-day window in the absence of some positive incentive to do so.

The likely consequences of this programmatic structure are clear. Enticed by the skewed incentives that the proposed rule would create, many employees with weak or dubious claims will adopt a lottery mentality, filing their reports with the Commission in the hopes of beating the odds and garnering a substantial windfall. Other employees will seek to hedge their bets by lodging complaints with both the Commission and the company at the same time. While "[s]ection 23 of the CEA evinces a strong Congressional policy to facilitate the disclosure of information to the Commission relating to potential CEA violations and to preserve the confidentiality of those who do so,"[49] Congress cannot have intended the CFTC whistleblower program to encourage or condone harmful strategic behavior of this type. And while it is true that whistleblowers often have multiple motivations and many if not most sincerely wish to promote change within their organization,[50] even such principled employees likely will find it difficult to resist the temptation of a large whistleblower award. By affording no countervailing reason for these employees to report internally, the proposed rule thus could have the unfortunate additional consequence of forcing the most loyal employees to choose between the company's health and their own financial benefit. If, consistent with Congress's true intent, the Commission wishes to avoid these results, it must build additional robust safeguards into the rule.

We are particularly disappointed that the CFTC's proposed rule contains even *fewer* incentives for internal reporting than does the SEC's whistleblower proposal. In particular, the preamble to the SEC rule expressly states that the Commission, in determining the amount of an award, may (but need not) consider "whether, and the extent to which, a whistleblower reported the potential violation through effective internal whistleblower, legal or compliance procedures before reporting the violation to the Commission."[51] No comparable statement appears in the preamble to the CFTC's rule, or in the rule itself. Instead, the rule provides merely that in determining the amount of an award, the CFTC "shall take into consideration" three specified factors that concern the success of the Commission's enforcement action and the

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[49] *Id.* at 75741.
[50] *See, e.g., id.* at 70514 n.103.
[51] *Id.* at 70488, 70500.

whistleblower's contribution to that success and, as a fourth factor, "[w]hether the award otherwise enhances the Commission's ability to enforce the CEA, protect customers, and encourage the submission of high quality information from whistleblowers."[52] According to the preamble, these "four criteria afford the Commission broad discretion to weigh a multitude of considerations in determining the amount of any particular award."[53] But it is not entirely clear that these categories are sufficiently broad to permit the Commission to consider the whistleblower's use of effective internal compliance mechanisms in calculating the size of an award. Significantly, the preamble does not include the use (or not) of internal reporting mechanisms among a rather long list of "permissible considerations" in determining award size.[54] And even if the Commission does have this discretion, the preamble does not indicate—let alone assure—that the Commission will exercise it.

Thus, at best, the proposed rule gives no reason for confidence that the Commission will take into account a whistleblower's initial resort to internal reporting channels in determining the size of an award. Worse, by identifying numerous permissible factors that the Commission may consider, and not including the use of internal channels among them, the rule appears to affirmatively disfavor the relevance of that factor, and could even be read to forbid the Commission from considering it.

To be clear, our concerns regarding the proposed rule's likely effects on internal reporting do not turn on the relatively minor question of whether the Commission may take the whistleblower's use of an available internal reporting option into account in calculating the size of an award. Nor do we mean to suggest that the CFTC should look to the SEC approach to this question as a model for how to address the serious adverse consequences of the proposed rule in this regard. As we observed in our comments to the SEC on its own program, the mere possibility that, at the SEC's discretion, a whistleblower who reports internally first will receive a larger award is unlikely to afford an incentive that is sufficiently concrete and

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[52] Proposed 17 C.F.R. § 165.9.
[53] 75 Fed. Reg. at 75738.
[54] *Id.* at 75738-75739. The two identified "permissible considerations" that are most on point are "[t]he degree to which the whistleblower took steps to prevent the violations from occurring or continuing" and "[t]he efforts undertaken by the whistleblower to remediate the harm caused by the violations including assisting the authorities in the recovery of the fruits and instrumentalities of the violations." *Id.* at 75739. Both considerations are perhaps broad enough to include the whistleblower's use or not of internal reporting mechanisms, but they are far from clear on that score.

substantial to meaningfully affect reporting behavior.[55] But it is troubling that the Commission has failed to at least match the SEC's approach by extending this modicum of protection.

In sum, on the critical issue of internal reporting, the proposed rule presents serious concerns for the business community—and indeed is even more problematic than the SEC's own inadequate proposal. In attempting to discern a way forward, we think it significant that the Commission's cost-benefit analysis of the proposed rule, while discussing the potential costs of the rule for prospective whistleblowers, does not appear to have taken into account at all the costs the rule would impose on the entities and individuals that will be the targets of whistleblower complaints—a meaningful proportion of which, experience suggests, will not be well-founded.[56] There is no doubt that the Commission had the authority to consider such costs,[57] but we can only infer that it was not sufficiently aware of their significance. We hope that this letter will prompt a reevaluation of that approach, and an openness to consideration of the modest proposed modifications discussed below. Adoption of these modifications would go a long way towards allaying our concerns that the CFTC's award program would have the wholly unnecessary consequence of seriously undermining the effectiveness of internal corporate compliance programs.

II. Recommended Modifications to the Proposed Rule

To address the concerns identified above, as well as several related issues, we recommend the following modifications to the proposed rule.

1. Condition whistleblower awards on a requirement that whistleblowers first make use of effective internal reporting options

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[55] Letter from David Hirschman, President and Chief Executive Officer, Center of Capital Markets Competitiveness, U.S. Chamber of Commerce & Lisa A. Rickard, President, U.S. Chamber Institute for Legal Reform, *Re: Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*, File Number S7-33-10, at 11-12 (Dec. 17, 2010) ("Chamber SEC Letter").
[56] *See* 75 Fed. Reg. at 75741-75742.
[57] *See id.* at 75741 (noting that CEA specifies that costs and benefits of a rule "shall be evaluated in light of, among other areas, the "efficiency, competitiveness, and financial integrity of futures markets" and "other public interest considerations").

"The Commission requests comment on the ineligibility criteria set forth in Proposed Rule 165.6(a)," and asks whether there are "other statuses or activities that should render an individual ineligible for a whistleblower award."[58] We strongly believe that Section 165.6 should be modified to provide that a whistleblower is ineligible for an award if the whistleblower has not first reported the relevant information through the entity's internal reporting program, and afforded the entity a reasonable opportunity—a specified period of at least 180 days—to address the alleged violation.

The rule could establish an exception to this requirement where the whistleblower can demonstrate to the Commission that (i) the entity's internal reporting program fails to comply with an applicable federal standard, such as Section 301 of SOX, or (ii) with respect to entities to which no federal standard applies, the internal reporting program is objectively inadequate. The rule might permit the whistleblower to establish "inadequacy" for purposes of the latter prong of the exception through a showing that the program (i) does not afford a practical way for employees to report violations, (ii) fails to provide for thorough investigation of reports, or (iii) does not adequately protect against retaliatory action. A number of states—including Ohio, Florida, New York, Maine, Indiana, New Jersey, and New Hampshire—have statutory whistleblower regimes that function in essentially this manner.[59] Section 10A of the Securities and Exchange Act similarly requires auditors who believe that they have discovered an illegal act at a company to first report it to company management and the audit committee.

The Commission does not appear to have considered such an eligibility requirement. In rejecting an analogous approach, the SEC expressed the "concerns . . . that, while many employers have compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances of confidentiality, others lack such established procedures and protections."[60] Our proposal addresses concerns of this nature by dispensing with the requirement of internal reporting if the whistleblower can demonstrate to the Commission that the

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[58] *Id.* at 75737.

[59] *See, e.g.*, Ohio Rev. Code Ann. § 4113.52(A)(1)(a); Fla. Stat. Ann. § 448.102(1); N.Y. Lab. Law § 740(2)(a), (3); Me. Rev. Stat. Ann. tit. 26, § 833(2); Ind. Code § 22-5-3-3(a); N.J. Stat. Ann. § 34:19-4(II); N.H. Rev. Stat. Ann. § 275-E:2.
[60] 75 Fed. Reg. at 70496.

internal program fails to comply with applicable standards or, in the case of entities to which no such standards apply, fails to facilitate thorough investigation of complaints or to protect against retaliation. We note, moreover, that our proposal—by limiting only the circumstances in which a whistleblower is entitled to an award—would not affect the scope of the statutory retaliation protections afforded whistleblowers under the proposed rule.[61]

As discussed above, the past decade has been a time of tremendous improvement in the area of corporate compliance. Many companies now have reporting systems that provide for the procedures and protections—for example, high-level attention to complaints, anonymity and confidentiality for whistleblowers, and speedy and impartial review of reports—that are widely recognized as constituting the critical components of an effective internal reporting program. The structure of the CFTC whistleblower program should not be driven by the small minority of companies that are failing to establish systems that meet these standards, but rather should address the few compliance laggards through targeted exceptions.

Finally, the rule currently affords those who report to a company's legal, compliance, or audit personnel a 90-day grace period in which to make their report to the Commission, and the preamble asks whether the 90-day deadline "is the appropriate time frame" for a company to complete an internal investigation.[62] We do not believe that it is, and recommend that the proposed internal reporting requirement instead afford companies at least 180 days to conclude their internal investigations.[63]

Any period shorter than 180 days does not take adequate account of the realities of the investigative process, and would not allow sufficient time for a company to complete the type of "full and fair" investigation necessary to ensure justice for both the whistleblower and any individuals accused of wrongdoing.[64]

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[61] *See* Proposed 17 C.F.R. § 165.6(b).
[62] 75 Fed. Reg. at 75733.
[63] A "reasonable time" standard, such as the one that the SEC adopted in the corresponding provision of its own whistleblower rule, *see* Proposed 17 C.F.R. § 240.2 IF-4(b)(4)(iv), (v), presents the different—but equally serious—problem of uncertainty regarding what the agency will determine *ex post* to have constituted an "unreasonable" amount of time. *See* Chamber SEC Letter, supra note 55, at 14. We therefore do not recommend that the CFTC follow this approach.
[64] Micelli, supra note 11, at 193.

Conducting such a full and fair investigation requires a thorough review—often time-consuming and resource-intensive—of the alleged conduct's scope, origins, and consequences. The fact-gathering stage generally involves interviews of relevant individuals and the collection and review of relevant documents. In more complicated cases, companies may have to engage forensic or accounting experts to determine the import of the collected facts. And, after the facts have been established, the company must analyze those facts and their legal implications—a process that often requires the involvement of internal or external counsel, or both. Finally, depending upon the nature of the alleged wrongdoing and the strength of the evidence that the investigation uncovers, senior management or members of the board may have to make a decision about the appropriate course of action for the company to take.

The amount of time required to perform an investigation naturally will vary depending on the nature of the allegations. But 90 days is simply not enough time to complete all these tasks in the context of an investigation of even moderate complexity. Indeed, by way of comparison, the proposed rule would afford a whistleblower who makes a submission before the effective date of the final rules (but after the enactment of the Dodd-Frank Act) a full 120 days after the rules have become effective to perfect his status by submitting the proper forms.[65] Thus, the proposed rule would give a whistleblower who has ***already made a report to the Commission*** more time to simply fill out and mail the forms necessary to perfect his claim (120 days) than it would give a company that receives a report internally to investigate the allegations and reach well-found conclusions about their merit (90 days).

A deadline of 90 days thus would place companies under tremendous pressure to rush their investigations and to disclose their findings to the Commission, potentially before they have had adequate time to collect, process, and analyze all the relevant evidence, and to properly deliberate the appropriate course of action. Ultimately, then, the effect of establishing such an attenuated deadline would be to effectively compel companies to report *unsubstantiated* allegations to the Commission, thus completely undermining the very rationale for requiring internal reporting in the first place. A deadline of 180 days, by contrast, should afford sufficient time for a fair

[65] *See* 17 C.F.R. § 165.3(d).

and thorough investigation in the vast majority of cases. (Likewise, we recommend modifying Section 165.2(o) to provide that an employee who provides information within the scope of a "request, inquiry, or demand" received by his employer is ineligible for an award unless the employer fails to disclose the information to the requesting authority within ***180 days*** after the employee provides the information to the employer.[66])

2. Establish CFTC policy on information sharing with corporations

The proposed rule does not address the circumstances in which the Commission will give notice to a company that it has been the subject of a whistleblower's report. It is our view that the Commission should be required, before taking further action on a report, to promptly inform the company implicated, and to furnish the company such details concerning the report as are necessary to enable it to conduct its own investigation. This process should, of course, be designed in a way that ensures that the whistleblower's anonymity is preserved throughout. The rule could establish an exception to this requirement if the Commission has an objective and articulable basis for concluding that the company will not investigate the report in good faith. As outlined above, such a basis could include a finding that the company's program does not meet applicable federal requirements, or is otherwise inadequate. ("Inadequacy" could again be defined to mean that the program (i) does not afford a practical way for employees to report violations, (ii) fails to provide for thorough investigation of reports, or (iii) does not adequately protect against retaliatory action.)

This formulation of a requirement and an available exception would ensure that companies with effective compliance programs have an opportunity to internally investigate allegations of wrongdoing before the Commission initiates its own investigation, while also preserving the Commission's discretion to dispense with such notification where circumstances so warrant. And it properly places on the Commission the burden of showing that a company will not be capable of conducting

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[66] There is at present an inconsistency between the text of proposed section 165.2(o) and the preamble on how long the employer has to report. *Compare* Proposed Section 165.2(o) (employer must provide information in a "timely manner"), *with* 75 Fed. Reg. at 75734 (employer has 60 days).

a full, fair, and thorough investigation that preserves the whistleblower's anonymity and security.

3. Tighten exclusions for reporting of compliance-related information

The Commission "requests comment on the proposed exclusions for information obtained by a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity under an expectation that the person would cause the entity to take steps to remedy the violation, and for information otherwise obtained from or through an entity's legal, compliance, audit, or similar functions."[67] In particular, the Commission asks whether "the carve-out for situations where the entity fails to disclose the information within sixty (60) days [will] promote effective self-policing functions and compliance with the law without undermining the operation of Section 23," and whether "sixty (60) days [is] a 'reasonable time' for the entity to disclose the information and, if not, what period should be specified."[68]

The Chamber supports the current exclusions from the definition of "independent knowledge" of information communicated to legal, compliance, and similar personnel and information obtained from or through compliance, audit, and similar functions.[69] If personnel charged with responding to internal reports of wrongdoing could benefit financially from disclosing such information to the CFTC, or if employees more generally had an incentive to redirect information submitted to corporate compliance mechanisms to the Commission, those mechanisms would cease to function effectively. We have concerns, however, about two aspects of these exclusions.

First, we believe that the existing forms do not provide enough information for the Commission to determine whether the exclusions apply. Accordingly, we recommend that the Commission amend Section D of Form WB-DEC to request the information necessary to make that determination.

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[67] 75 Fed. Reg. at 75730.
[68] *Id.* at 75730-75731.
[69] *See* Proposed 17 C.F.R. § 165.2(l)(4), (5).

Second, we believe that the Commission should eliminate the exception to these exclusions where an entity does not report the compliance-related information to the Commission within 60 days. Although the Commission posits that 60 days constitutes "a reasonable period of time for entities to report potential violations,"[70] in fact, as we have already explained, even a period of ***90 days*** does not afford sufficient time for a company to complete an investigation of even moderate complexity. 60 days is wholly inadequate to that task, and will result in an investigative process that is even more rushed and incomplete.

A deadline that is so truncated risks further undesirable consequences by creating an incentive for compliance personal to delay the internal investigation so that, once the 60-day period has passed, they can report directly to the Commission. The proposed rule expressly provides that "independent knowledge from your experiences, communications and observations in your personal business or social interactions" may constitute "independent knowledge" that qualifies for an award,[71] thus strongly implying that compliance personnel may themselves obtain an award if they report to the Commission after the 60-day period has run. Realizing this possibility, an employee who is considering reporting internally may be impelled to take his complaint directly to the CFTC instead. It is true that, even if a member of the compliance department reports to the Commission before the employee does, the rule still might permit the employee to establish his status as an "original source" if he can show that the compliance member obtained the information from the employee.[72] But the preamble is clear that the whistleblower who makes the second report "bears the burden of establishing that he is the original source of information,"[73] and many employees will be reluctant to take the chance of being unable to satisfy this burden.

To address these concerns, we recommend modifying the carve-out to the compliance-related exclusions established by proposed Section 165.2(g)(4) and (5) so that the carve-out is not triggered merely by the passage of 60 days (or any other period of time), but rather requires in all circumstances a showing of "bad faith" on the part of the company. This change is essential to making the internal and external

[70] 75 Fed. Reg. at 75730.
[71] 17 C.F.R. § 165.2(g).
[72] *See* 17 C.F.R. § 165. 2(l)(1)
[73] 75 Fed. Reg. at 75733

reporting systems work together effectively.[74] We also recommend that the CFTC follow the SEC in elaborating what type of conduct will be deemed to constitute bad faith.[75]

4. Exclude from award eligibility information reported after employer has initiated an investigation

Companies should not be penalized for initiating an internal investigation into suspected wrongdoing. Yet the rule does precisely that at present by permitting a person who submits a report to the Commission to qualify for an award even if the person submits the information ***after*** receiving a request about possible violations from employer personnel conducting an internal investigation, compliance review, audit, or similar function. By contrast, proposed Section 165.2(o) establishes an exclusion for information submitted after a "request, inquiry, or demand" to the prospective whistleblower "from the Commission, Congress, any other federal or state authority, the Department of Justice, a registered entity, a registered futures association, or a self-regulatory organization."

We urge extension of this exclusion to bar recovery when a prospective whistleblower has received a request for information from his employer in the course of a bona fide internal investigation. The CFTC does not appear to have considered such an exclusion, but in considering and rejecting an analogous provision, the SEC reasoned that the purposes of its whistleblower program would be undermined if such a bar were in place and an employer did not disclose the results of its internal investigation to the Commission.[76] The SEC's concern is overstated, and should not dissuade the CFTC from adopting this proposed modification. The vast majority of employers that have initiated an investigation have little incentive to bury its results

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[74] We also note as a technical matter that the preamble and the rule incorrectly identify section 165.2(g)(3) and (4) as establishing the exclusions for personnel involved in compliance or similar functions, *see* 75 Fed. Reg. at 75733; Proposed 17 C.F.R. § 165.2(l)(2), whereas those exclusions are in fact contained in section 165.2(g)(4) and (5).

[75] *See* 75 Fed. Reg. at 70494 ("In determining whether an entity acted in bad faith, the Commission will, among other things, consider whether the entity or any personnel who were responsible for responding to allegations of misconduct took affirmative steps to hinder the preservation of evidence or a timely and appropriate investigation. For example, an effort by company officials to destroy documents or to interfere with witnesses would constitute bad faith conduct. Similarly, if a company engaged in a sham investigation of allegations, then the company's response would constitute bad faith.").

[76] *See id.* at 70490 n.11.

without taking corrective action and, if appropriate, reporting the results to the relevant regulatory agencies. To address the concern regarding employer stonewalling, the CFTC could include a "bad faith" exception in the rule—akin to the one applicable to the exclusion for compliance-related information—that would permit the whistleblower to qualify for an award if the whistleblower can show that the employer proceeded in bad faith in conducting the relevant investigation.

5. Categorically exclude reports of information subject to the attorney-client privilege, or information obtained by an attorney as a result of legal representation of a client, from award eligibility

The preamble correctly notes the important function served by the attorney-client privilege in promoting compliance with the CEA, as well as the threat that an overly expansive whistleblower award program could pose to that function:

> [c]ompliance with the CEA is promoted when individuals, corporate officers, Commission registrants and others consult with counsel about potential violations, and the attorney-client privilege furthers such consultation. This important benefit could be undermined if the whistleblower award program vitiated the public's perception of the scope of the attorney-client privilege or created monetary incentives for counsel to disclose information about potential CEA violations that they learned of through privileged communications.[77]

In an effort to ameliorate this threat, proposed Section 165.2(2) and (3) generally bar award eligibility for reports based on information derived from communications subject to the attorney-client privilege, or obtained by an attorney as a result of his legal representation of a client. But both these provisions contain an exception for disclosures "otherwise permitted by the applicable federal or state attorney conduct rules."

The preamble asks whether it is "appropriate to exclude from the definition of 'independent knowledge' information that is obtained through a communication that is protected by the attorney-client privilege."[78] We strongly believe that it is. We also

[77] *Id.* at 75730.
[78] *Id.*

are of the view, however, that the exceptions for "permitted" disclosures are dangerous and unwise.

In-house counsel occupy positions of significant trust and responsibility within most companies, and outside counsel are similarly essential to the efforts of many companies to comply with applicable law, including the CEA. Moreover, companies usually afford inside and outside counsel access to the most sensitive information regarding corporate operations—a precondition to the provision of sound legal advice. If adopted, the proposed exceptions would undermine the effectiveness of these attorney-client relationships by rendering even more difficult the fine distinctions that attorneys already must make under federal and state attorney conduct rules between permissible and impermissible disclosures. The whistleblower program should not place attorneys in the difficult position of making decisions about whether to disclose client confidences in the shadow of a potential financial windfall. And clients who know that their attorneys may face such a difficult choice between client loyalty and a possibly huge payout likely will be less willing to share information freely with them.

To avoid these undesirable consequences, the Commission should establish a blanket exclusion for information that attorneys obtain from their clients by eliminating the exceptions for permitted disclosures.

6. Provide further protection for information covered by companies' attorney-client privilege

Proposed Section 165.18 would authorize Commission staff to communicate directly with whistleblowers who are directors, officers, members, agents, or employees of an entity that has counsel, and who have initiated communication with the Commission relating to a potential CEA violation, without first seeking the consent of the entity's counsel. According to the preamble, such direct contacts are consistent with ABA Model Rule 4.2 (which every jurisdiction has adopted in some form) because they are "authorized by law"—namely, the amended Section 23 of the CEA.[79]

[79] *Id.* at 75741.

We are concerned that this provision, by excluding corporate counsel from the process whereby the CFTC contacts prospective whistleblowers, threatens to seriously erode the protections afforded companies by the attorney-client privilege. We do not believe that the Commission intends to use this purported exception to the normal application of ABA Model Rule 4.2 to obtain otherwise privileged information about an entity, although the preamble makes no assurances on this front.[80] Nonetheless, in light of the significant dangers presented by the abrogation of ABA Model Rule 4.2, our faith in the Commission's forbearance does not constitute adequate assurance. In particular, if the rule is to permit the CFTC to bypass company counsel in communicating with whistleblowers, we think that it also should establish clear and comprehensive safeguards that are binding on the Commission. These safeguards must be adequate to protect each company's right to assert the attorney-client privilege with respect to privileged information, including any conversations that company counsel may have had with the whistleblower.

Accordingly, at minimum, the rule should provide that whistleblowers who contact the CFTC directly must immediately be read a cautionary statement informing them of the company's right to protect privileged information and asking whether the whistleblower's report includes information received in the context of communications with corporate counsel, or any otherwise privileged information. If the answer is yes, the Commission should be obliged to contact the company and provide it with a reasonable amount of time to assert any relevant privilege.

7. Exclude wrongdoers from award eligibility

The preamble recognizes that "some whistleblowers who provide original information that significantly aids in detecting and prosecuting sophisticated manipulation or fraud schemes may themselves be participants in the scheme who would be subject to Commission enforcement actions."[81] And Section 23(c)(2)(B) of the CEA renders whistleblowers statutorily ineligible for an award if they are convicted of a criminal violation related to the judicial or administrative action precipitated by their report.[82] Surprisingly, however, the proposed rule does not extend this categorical exclusion from award eligibility to "whistleblowers with

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[80] *Id.* at 70510 n.89.
[81] *Id.* at 75740.
[82] *See* 7 U.S.C. § 26(c)(2)(B).

potential civil liability or criminal liability for CEA violations."[83]

Instead, the rule addresses the status of such wrongdoers in two main ways. First, it clarifies that the anti-retaliation protections afforded by Section 23(h) of the CEA (and the proposed rule) "do not provide individuals who provide information to the Commission with immunity from prosecution."[84] And second, it provides that the Commission must calculate the whistleblower's eligibility for, and the amount of, an award without taking into consideration any monetary sanctions (i) that the whistleblower is ordered to pay or (ii) that are ordered against an entity with liability "based primarily on conduct that the whistleblower principally directed, planned, or initiated."[85]

The preamble states that "[t]he rationale for th[e] limitation" on considering sanctions imposed on a whistleblower in calculating his award "is to prevent wrongdoers from financially benefiting from their own misconduct, and [to] ensure[] equitable treatment of culpable and non-culpable whistleblowers."[86] But the limitation fails to accomplish this goal. In particular, under the proposed rule, a whistleblower can recover for reporting on his own misconduct so long as either (i) others joined him in his wrongful actions and were subject to sanctions in a Commission or related proceeding of over a million dollars, or (ii) his report concerns an entity with a total liability that is not based "substantially" on the whistleblower's actions. For example, to take a slightly modified version of the scenario discussed in the preamble, a whistleblower who "was the leader or organizer of a fraudulent scheme involving multiple defendants that resulted in total monetary sanctions of $1,250,000 would exceed the $1,000,000 minimum threshold required for making an award"—and thus would be eligible for an award—even if he personally was ordered to pay $250,000 of those monetary sanctions.[87]

This bizarre result—with the government paying a ringleader for successfully encouraging others to join in his fraudulent scheme—is highly unjust and inequitable. It also is unnecessary to incentivize those involved in misconduct to report the

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[83] 75 Fed. Reg. at 75740.
[84] Proposed 17 C.F.R. § 165.16.
[85] *Id.* § 165.17.
[86] 75 Fed. Reg. at 75741.
[87] *Id.*

existence of their own wrongdoing, or the related wrongdoing of others, to the Commission. As the preamble notes, the Commission in carrying out its enforcement function may "credit cooperation by whistleblowers who have participated in misconduct," and the options available to it in so doing include "taking no enforcement action" at all.[88] And wrongdoers who come forward may also receive favorable treatment from the Department of Justice in making its prosecutorial decision and, if convicted, from the courts in determining the appropriate sentence.[89] The chance of avoiding a Commission enforcement action and possible criminal prosecution altogether, and of a more lenient sentence if convicted, should afford those involved in wrongdoing ample incentive to report. There is no good reason to offer them the added enticement of a chance at a government payout.

Finally, the proposed rule also could create pernicious incentives for employees or others to participate in misconduct in a strategic effort to lay the groundwork for a possible future report to the Commission, thus potentially furthering the scheme and doing immediate harm to the company and its shareholders. Even if the employee ultimately does report to the Commission, and the Commission takes remedial action, these losses may be irrecoverable.

To address these concerns, the rule should provide categorically that any person who reports to the Commission, and who has participated in or facilitated the violation of the CEA that is the subject of the report, is ineligible to receive an award. Even if wrongdoers do sometimes have the most significant and relevant information about wrongdoing, the dangers of rewarding those who have engaged in misconduct with a monetary award simply are too great to justify such an approach.

8. Modify scope of anti-retaliation protections

a. Exclude frivolous claims from scope of anti-retaliation protections

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[88] *Id.* at 75740.

[89] *See, e.g.*, U.S. Dep't of Justice, U.S. Attorneys' Manual § 9-27.230 (consideration of cooperation in initiating and declining charges); U.S. Sentencing Guidelines manual § 5K2.16 (2010) (consideration of voluntary disclosure of offense in sentencing calculation).

The Commission asks "whether the anti-retaliation protections set forth in Section 23(h)(1) of the CEA should be applied broadly to any person who provides information to the Commission concerning a potential violation of the CEA, or [instead] should . . . be limited by the various procedural or substantive prerequisites to consideration for a whistleblower award."[90] We strongly recommend that the anti-retaliation protections not cover those who make frivolous or bad faith reports to the CFTC. Nothing in the statute requires such broad protection; indeed, section 23(h)(1) specifies that it applies to only those whistleblowers who lawfully submit information "***in accordance with subsection (b)***," or who assist "in any investigation or judicial or administrative action of the Commission ***based upon or related to such information***." (emphasis added). And given the significant costs that false reports can impose on companies, shareholders, and employees, the rules should not hamstring the ability of companies to take appropriate action against those who have no bona fide evidence of CEA violations, but rather simply seek to use the reporting process to inflict harm for inappropriate reasons or to garner attention. We believe that the following modification of Section 165.6(b) would address this concern, while retaining an appropriately broad protection for those whistleblowers who report legitimate information regarding violations: "[n]otwithstanding a whistleblowers ineligibility for an award for any reason set forth in paragraph (a) of this section, the whistleblower will remain eligible for the anti-retaliation protections set forth in Section 23(h) of the Commodity Exchange Act. Those protections will not apply, however, if the employer can demonstrate that the whistleblower did not have a good faith belief that the information reported concerned a violation of the CEA."

b. Clarify that anti-retaliation protections do not apply to employment actions based on factors other than those specified in section 23(h)(1) of the CEA

We also note that the proposed rule does not expressly address a company's ability to take legitimate employment action against a whistleblowing employee who has engaged in misconduct. Nothing in the Dodd-Frank Act is properly read to prevent employers from taking adverse action ***for legitimate, non-retaliatory reasons*** against an employee who happens to have made a protected report to the CFTC. Thus, as a matter of law, employers should be able to sanction whistleblowing

[90] 75 Fed. Reg. at 75735.

employees who have engaged in misconduct, such as a violation of law or legitimate company policy. As a practical matter, however, in the absence of further clarification, the broad anti-retaliation provisions of the section 23(h)(1) likely will result in a wave of meritless litigation based on such legally permissible employer action, imposing substantial unnecessary litigation costs on defendants.

For purposes of avoiding the burdens of such frivolous suits, we urge the Commission to clarify in the rules that section 23(h)(1) does not apply to employment actions based on any factor other than the employee's "lawful act done . . . (i) in providing information to the Commission in accordance with subsection (b)" and "(ii) [i]n assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information." While already implicit in the statutory text and Appendix A to 17 C.F.R. part 165, this modification would make crystal clear the actual contours of the anti-retaliation protections, and thus perform an important public service.

This modification also would be consistent with the longstanding policies of federal enforcement agencies, which repeatedly have underscored that a key element of an effective corporate compliance program is the company's demonstrated practice of imposing discipline and corrective actions to address compliance violations.[91] And we seriously doubt that Congress intended the anti-retaliation protections to have the effect of deterring companies from taking legitimate action against employees who engage in wrongdoing for fear of the *in terrorem* effect of meritless lawsuits.

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The Chamber is committed to providing the views of the business community to the CFTC and other government agencies. Businesses have a strong interest in detecting and eliminating illegal activity within their organizations—and they have acted on that interest by establishing effective internal reporting and remediation systems. The Commission should not adopt a rule that will have the effect of rendering those systems a nullity.

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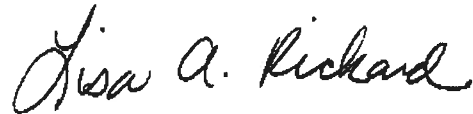
[91] *See, e.g.*, U.S. Sentencing Guidelines Manual § 8B2.1(b)(6); DOJ, U.S. Attorneys' Manual § 9.28-800; U.S. Sec. & Exch. Comm'n, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement, Exchange Act Release No. 44969 (Oct. 23, 2001).

We thank you for your consideration of these comments and would be happy to discuss these issues further with you and your staff.

Sincerely,



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CC: The Honorable Gary Gensler, Chairman
The Honorable Michael Dunn, Commissioner
The Honorable Jill Sommers, Commissioner
The Honorable Bart Chilton, Commissioner
The Honorable Scott O'Malia, Commissioner