Blowing the Whistle on Fake It Til You Make It- Inspired by Theranos

October 27, 2021

6:30 – 8 pm

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Blowing the Whistle on “Fake It Til You Make It” – Inspired by Theranos
New York American Inn of Court White Collar Crime Program
October 27, 2021 – 6:30 - 8 pm

Timed Agenda

Introduction **2 min.**
Steven Tugander

Scene 1: The Hype **3 min.**
CEO makes bold claims about her company’s technology.
(Diana Haladey, Brian Steinwascher)

Scene 2: Red Flags **2 min.**
Employees detect problems with the technology and wrongdoing at the company.
(Mary Diaz, Eugene Frenkel, Eugene Meyers, Jared Rosen)

Scene 3: Comparing Notes **2 min.**
Employees discuss what they’ve seen and what to do.
(Mary Diaz, Eugene Frenkel)

Scene 4: Blowing the Whistle **4 min.**
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(Evan Brustein, Eugene Frenkel, Diana Haladey)

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(Eugene Frenkel, Milosz Gudzowski)
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Panel/Q&A **35 min.**
Laurie Brecher, Glenn Colton, Debra Katz, Linda Severin

The SEC Whistleblower Practice Guide

Navigating the SEC Whistleblower Program and the Rules and Procedures that Can Lead to Financial Rewards for Reporting Securities Violations

Lisa J. Banks and Michael A Filoromo

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INTRODUCTION

Congress directed the U.S. Securities and Exchange Commission ("SEC" or the "Commission") to establish a whistleblower program as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[1] Under the rules of the SEC whistleblower program ("Whistleblower Program"), individuals who provide the SEC with original information leading to an enforcement action that results in over $1 million in monetary sanctions are entitled to receive an award ranging from 10% to 30% of the moneys collected.[2]

The Whistleblower Program is now in its tenth year, and since its inception, it has steadily gained momentum and influence. Between its first award in 2012 and January 31, 2021, the SEC Office of the Whistleblower has issued approximately $738 million in awards to 134 individuals whose information led to successful enforcement actions for violations of securities laws.[3] Fiscal Year 2020, which ended on September 30, 2020, saw a record-setting total of $175 million awarded to thirty-nine individuals.[4] That record has already been broken in Fiscal Year 2021, as the SEC has awarded approximately $190 million to 33 individuals between October 1, 2020 and February 28, 2021.[5]

Since 2012, the SEC has issued at least 56 awards that exceeded $1 million, at least fifteen of which were in the tens of millions.[6] The highest award to date was over $114 million issued to a single whistleblower, which consisted of approximately $52 million in connection with an SEC action and approximately $62 million arising from related actions by another enforcement agency.[7]

The true measure of the success of the Whistleblower Program is the powerful role that it has played in incentivizing whistleblowers to report information regarding securities violations that the SEC otherwise might never have discovered. As of September 30, 2020, whistleblower tips had led to enforcement actions resulting in orders totaling more than $2.5 billion in monetary sanctions. Of this amount, more than $1.4 billion was disgorgement of ill-gotten gains with interest.[8]

In addition to providing monetary incentives to individuals who submit helpful information to the SEC, the Dodd-Frank Act established whistleblower protections designed to ensure that individuals who experience retaliation for providing information to the SEC have legal remedies. Additionally, as detailed in this guide, the SEC has taken direct action against several employers for retaliating against whistleblowers.

The Commission also has sought to prevent companies from using employer-imposed agreements to impede their employees from providing information to the SEC. To date, the Commission has brought and settled twelve enforcement actions[9] against employers for using a variety of such agreements to bind employees and former employees, including provisions that: (1) prohibit communication with the SEC, (2) require notification to the employer's legal department prior to speaking with the SEC, or (3) require an employee to waive the right to receive a whistleblower award from the SEC. The Commission's leadership on this front has prompted other federal agencies to institute similar policies prohibiting the use of agreements to silence employees on matters within their regulatory reach.

Taken together, the Commission's actions and initiatives to support whistleblowers have had a profound impact on the ability and willingness of employees to raise concerns about perceived securities violations, both to their employers and to the SEC. As a result, employees and former employees can participate confidently in the SEC Whistleblower Program and earn monetary awards, and can do so even after their employers have forced them to sign agreements intended to deter them from speaking to the SEC.

> "[I]t seems that nearly every day has provided us with an opportunity to appreciate the contributions of whistleblowers."
>
> – Allison Herren Lee, Acting SEC Chair

As it grows, the SEC Whistleblower Program is also evolving. On September 23, 2020, the SEC adopted final rules ("Final Rules"), the first revisions to the rules since the inception of the Whistleblower Program. The Final Rules became effective on December 7, 2020.[10] They include amendments to how the SEC calculates a whistleblower's award, most significantly creating a presumption—subject to some exceptions—that an individual is entitled to the 30% statutory maximum award if the award will be $5 million or less.[11] The Final Rules alter or provide additional guidance on the definitions of several terms, including who qualifies as a "whistleblower," what qualifies as an "action" that a whistleblower may recover an award from, and when the SEC may add to a whistleblower's award based on recovery in a "related action."[12] The amendments also have changed the manner in which a whistleblower must provide "original information" to the SEC when submitting a tip.[13]

It is clear that the SEC's leadership and staff have grown to rely on the help of whistleblowers during the years that the SEC Whistleblower Program has been in existence. The program has repeatedly allowed the SEC to detect well-hidden frauds early on, and to take quick and effective action to protect the investing public while conserving limited agency resources. This has greatly benefited investors in the U.S. capital markets, who

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include tens of millions of working families with their savings and retirement funds invested in a wide range of stocks, bonds and mutual funds. While sometimes cast as incentivizing disloyalty and greed among employees, the Whistleblower Program has in fact benefited corporations and financial firms by encouraging them to strengthen their internal compliance programs, giving management the opportunity to address potential misconduct before it becomes a larger problem—or one that merits a government enforcement action. The Whistleblower Program is in a strong position to continue growing, aiding the SEC's enforcement efforts and generating more and even larger awards.

The goal of this Practice Guide is to explain the rules and procedures of the SEC Whistleblower Program in a way that will aid whistleblowers and their counsel in submitting high-quality tips to the SEC, in assisting the SEC and related agencies in any investigations that follow, and in claiming the financial awards they have earned for their role in helping the SEC to enforce the nation's securities laws. The Practice Guide contains an up-to-date explanation of the expanding protections for employees who seek to blow the whistle on securities violations, and for those who experience retaliation for their courage in speaking up to protect investors. This 2021 edition also features a useful Appendix A, "SEC Whistleblower Awards Through January 31, 2021" which provides the dates, amounts and summaries of other available information for every award the SEC has issued since the inception of the program.

BACKGROUND

The Dodd-Frank Act is one of a series of significant financial reforms that began with passage of the Sarbanes-Oxley Act ("SOX") in 2002.[14] Popular outrage over the greed exhibited and corruption engaged in at Enron, MCI and other companies prompted Congress's near-unanimous passage of SOX, which provided a comprehensive set of rules and regulations designed to prevent accounting fraud by publicly traded companies. SOX also contained a whistleblower provision to protect employees from retaliation by their employers for reporting fraud or violations of securities laws.[15]

In late 2008, six years after the enactment of SOX, the housing and financial markets collapsed, revealing rampant, dangerous financial risk-taking and misconduct, particularly with respect to securities backed by subprime mortgages. That financial crisis was still unfolding when Bernard Madoff's "Ponzi" scandal hit the news and educated large numbers of Americans about shortcomings in the government's ability to detect and prevent large-scale fraud on investors. The market collapse prompted a massive infusion of government "bailout" funds, with legislation that included protections for whistleblowers who reported fraud, gross mismanagement, or waste of those funds. In 2009, Congress also amended the U.S. False Claims Act, making it easier for whistleblowers to assist the U.S. government in recovering money lost to fraud.[16]

Perhaps the most significant, comprehensive response to the 2008 crisis was the Dodd-Frank Act, enacted in 2010. The Dodd-Frank Act initiated a massive financial regulatory overhaul that lawmakers hoped would help restore confidence—some would say sanity—in U.S. financial markets through a wide range of oversight and enforcement measures. Among other sweeping changes, the Dodd-Frank Act directed the SEC to create the Whistleblower Program to incentivize individuals to come forward with information about securities violations. This would give the SEC a powerful enforcement tool to help it prevent future Enrons, MCIs and Madoffs from harming the investing public and the broader economy. The Dodd-Frank Act also established a similar whistleblower program for commodities trading that is administered by the Commodity Futures Trading Commission ("CFTC").[17]

> The past ten years have demonstrated that the Commission has designed and implemented an effective program that both rewards and protects whistleblowers.

At its inception, the SEC Whistleblower Program received an enthusiastic welcome from employee-rights advocates and "good-government" groups but generated a great deal of concern among large corporations and their law firms. After asking for public comment on its proposed rules for the program in November 2010, the SEC received some 240 comment letters and 1,300 form letters from a broad array of stakeholders.[18] Consumer advocates and the whistleblower community argued that the program was necessary to prevent the sort of fraud that had damaged the economy in the prior decade, largely at the expense of the nation's working people. The whistleblower community noted that employees were in the best position to identify corporate misconduct, but that many were afraid to come forward because the very real risk of derailing their careers far outweighed the benefits of speaking up, which would be few in the absence of the significant financial incentives mandated by the Dodd-Frank Act.

The corporate defense bar and their clients, on the other hand, claimed that the SEC Whistleblower Program, which many of them derisively called a "bounty-hunter program," would serve

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only to create a perverse incentive for employees to hunt for potential corporate fraud or illegalities, disclose nothing to the employer, and then report their information to the government only when the violations had grown to a size that would warrant payment of a large enough "bounty" to justify the risk to their careers. Corporations noted that they had gone to great lengths to create internal reporting mechanisms, as SOX required public companies to do, only to find themselves facing a radical new program that would give the would-be whistleblowers little or no reason to use internal channels that could help management correct minor problem before they became major liabilities.

The final rules that the SEC Commissioners adopted by a 3-2 vote on May 25, 2011, reflected the Commission's effort to address these competing concerns, as it explained in an adopting release accompanying the rules ("2011 Adopting Release").[19] The business lobby and defense bar remained dissatisfied, as was evident in a number of statements issued by the U.S. Chamber of Commerce and others in response to issuance of the program. As the subsequent decade has demonstrated, however, the Commission and its staff designed, and have since implemented, what is proving to be a workable and very effective program—both in rewarding and protecting whistleblowers and in giving corporations strong incentives to strengthen their compliance programs and improve their corporate governance standards.

THE SEC WHISTLEBLOWER PROGRAM RULES

The Dodd-Frank Act added a new provision to the Securities Exchange Act of 1934, Section 21F, that created the Whistleblower Program. Under the Whistleblower Program rules, the SEC is required to pay awards to eligible whistleblowers who voluntarily provide the Commission with original information that leads to a successful enforcement action in which the SEC recovers monetary sanctions in an amount over $1,000,000. Sanctions can include disgorgement, penalties, fines and interest. A whistleblower who meets these and certain other criteria is entitled to an award of 10% to 30% of the amount recovered by the SEC or by other authorities in "related actions." Whistleblower awards can be substantial, as SEC sanctions against companies have run into the tens and even hundreds of millions of dollars in recent years, with at least one judgment for the SEC topping $1 billion in disgorgement and penalties against a real estate company and its owner for running a Ponzi scheme.[20]

A. Whistleblower Status

The Whistleblower Program rules define a "whistleblower" as an individual who, "alone or jointly with others" provides the SEC with "information in writing that relates to a possible violation of the federal securities laws (including any law, rule, or regulation subject to the jurisdiction of the Commission) that has occurred, is ongoing, or is about to occur." Rule 21F-2(a).

The program rules make clear that a corporation or other such entity is not eligible for whistleblower status. Rule 21F-2(a)(2). In an award determination in November 2017, the SEC cited this corporate ineligibility rule as one reason justifying the denial of awards to two experts whose incorporated entity had provided information to the SEC in the form of an expert report.[21]

> The SEC Whistleblower Program has accepted tips from individuals throughout the United States and in at least 130 foreign countries.

The SEC Whistleblower Program has accepted tips from individuals throughout the United States and in at least 130 foreign countries.[22] The SEC will make awards to foreign nationals where otherwise appropriate, even when the whistleblower resides overseas and submits the tip from overseas, and when the misconduct complained of occurs entirely overseas.

In issuing one such award in 2014,[23] the SEC acknowledged well-established limits on the extraterritorial application of U.S. law, as set forth by the Supreme Court in *Morrison v. Nat'l Aust. Bank Ltd.*, 561 U.S. 247, 266 (2010). The SEC noted, however, that the Court in Morrison pointed out that the application of U.S. law in cases having certain foreign aspects could nonetheless be a domestic rather than an extraterritorial application in circumstances where the application targeted conduct or situations that were a "focus of congressional concern" and also had a "sufficient U.S territorial nexus." Based on this analysis, the SEC ruled, whistleblower awards are appropriate where a whistleblower's information leads to a successful enforcement action, brought in the United States, by a U.S. regulatory agency, which is enforcing U.S. securities laws. In short, international whistleblowers are eligible for awards for providing information that leads to a successful SEC enforcement action.[24]

The Dodd-Frank Act and Rule 21F-8(c) specifically exclude from participation in the SEC Whistleblower Program employees of the SEC, the U.S. Department of Justice, certain regulatory agencies and self-regulatory organizations, any law enforcement organization, and foreign governments. In an award determination issued in July 2017, however, the SEC made clear that not all government employees are excluded, even where their agencies may have certain law-enforcement functions, when it awarded nearly $2.5 million to an employee of an unnamed "domestic government agency" who worked in a section of the agency unrelated to law enforcement.[25]

1. "Voluntarily Provide"

In order to qualify for an award under Section 21F(b)(1) of the Securities Exchange Act,[26] a whistleblower must "voluntarily provide" the SEC with information concerning a securities violation. The SEC will view such information as provided voluntarily only if the whistleblower provides it to the Commission before he or she has received a request, inquiry or demand for the same: 1) from the SEC; 2) in connection with an investigation, inspection or examination by the Public Company Accounting Oversight Board or a self-regulatory organization; or 3) related to an investigation by Congress, another federal agency or authority, or a state attorney general or securities regulator. Rule 21F-4(a)(1), (2).

The program rules address a concern among whistleblower advocates that a whistleblower might lose eligibility because the SEC or another of the agencies listed above has directed an inquiry or request to his employer but not to him individually. Given that such requests or demands are often drafted such that they arguably apply to a large number of employees (and to broad categories of information), this reading of "voluntary" would have barred many corporate employees from participation in the program. The rules as adopted make clear that a whistleblower will be deemed to have submitted information "voluntarily" as long as an official inquiry is not directed to him as an individual. *Id.*

If the whistleblower is obligated to report information to the SEC as a result of a pre-existing duty to the Commission or to one of the other entities described above, whether by contract or by court or administrative order, the information will not be considered voluntary and he or she will not be entitled to an award. *See* Rule 21F-4(a)(3). This disqualification is not triggered by an employee's contractual obligation to his employer or another third party or by the employee's receipt of a request for the same or related information from his employer as part of an internal investigation.[27] This means that an employer cannot remove the incentives that are key to the whistleblower program's effectiveness by requiring all employees to sign agreements that they will report any perceived securities violations to the SEC.

Notwithstanding the rule that whistleblowers provide information to the SEC "voluntarily" only if they do so before receiving requests for the same from the SEC or certain other agencies, the SEC surprised many observers when it demonstrated that it would waive this restriction under certain circumstances.

On July 31, 2014, the SEC awarded $400,000 to a whistleblower who had not come forward "voluntarily" as required by the rules because a self-regulatory organization had earlier requested the same information directly from the whistleblower.[28] As the SEC's order granting the award pointed out, the whistleblower had gone out of his way first to raise the issues internally and had made every effort to have the company address them before turning to the SEC after the company refused. The SEC further found that the whistleblower initially believed that a third party had relayed all of the whistleblower's information to the self-regulatory organization. Under these "materially significant extenuating circumstances," the SEC found waiver of the "voluntary" requirement of Rule 21F-4(a) to be "in the public interest and consistent with the protection of investors."[29] The SEC made a similar decision to waive the voluntariness requirement in issuing a $3,000,000 award in June 2019 upon determining that doing so was "appropriate in the public interest and consistent with the protection of investors."[30]

The SEC's decision to waive the "voluntary" requirement in these cases is particularly noteworthy because it reflects the Commission's willingness to use its full authority under the Exchange Act to reward individuals who show courage and determination in helping the Enforcement Division undertake a more prompt and effective investigation of serious securities violations than would otherwise have been possible. As authority for its decision to waive the "voluntary" requirement, the SEC relied on Section 36(a) of the Exchange Act, 15 U.S.C. § 77mm, which allows the Commission to "conditionally or unconditionally exempt any person … or transaction" from a provision, rule or regulation of the securities laws "to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."[31] The SEC's application of the same exemptive authority to the issuance of whistleblower awards that it has applied in the regulation of issuers and financial advisors has strengthened the whistleblower program. It reassures would-be whistleblowers that the SEC and its staff are willing, where appropriate, to reach as far as the law allows to reward individuals who assist in enforcing the nation's securities laws.

2. "Original Information"

In order to qualify as "original information" that will support a claim for an award, the whistleblower's tip must consist of information that is: 1) derived from the individual's "independent knowledge" or "independent analysis"; 2) not already known to the SEC from any other source (unless the whistleblower is the "original source" of the information, such as where he or she had first reported the information to the Department of Justice or Department of Labor, which then passed the information on to the SEC); and 3) not "exclusively derived" from allegations made in certain judicial or administrative hearings, government reports, audits or investigations, or derived from the media, unless the whistleblower is "a source of the information." Rule 21F-4(b)(1).

Independent Knowledge and Independent Analysis

Rule 21F-4(b)(2) defines "independent knowledge" simply as "factual information … this is not derived from publicly available sources." The whistleblower may have observed the facts first-hand but may also acquire the knowledge through her "experiences" or communications. This means that the whistleblower can have "independent knowledge" of facts despite having learned those from someone else such as a supervisor, co- worker or customer, as long as that third person is not a company attorney, compliance officer or other representative who would usually be ineligible for a reward under Rule 21F-4(b)(4) as discussed below.

In declining to heed the warning of business-side commentators that allowing tips based on third-party information would encourage frivolous claims, the SEC noted when issuing the final rules that excluding such information could deprive the Commission of highly probative information that could aid significantly in an enforcement action.[32] The SEC pointed out that Congress had recently amended the False Claims Act to remove a similar requirement that a qui tam relator possess "direct" (or first-hand) knowledge of the facts.[33]

> Employees in certain roles can participate in the SEC's whistleblower reward program only under certain circumstances.

"Independent analysis" refers to a whistleblower's "examination and evaluation," conducted by herself or with others, of information that might be publicly available where the whistleblower's analysis reveals additional information that is not This might include, for example, an expert analysis of data that could significantly advance an investigation.[34]

In conjunction with the SEC's 2020 Final Rules and Adopting Release, the Commission published interpretive guidance offering a restrictive reading of what constitutes viable "independent analysis."[35] Under this guidance, a whistleblower's conclusion must derive "from multiple sources, including sources that, although publicly available, are not readily identified and accessed by a member of the public without specialized knowledge, unusual effort, or substantial cost," and those sources must "collectively raise a strong inference of a potential securities law violation that is not reasonably inferable by the Commission from any of the sources individually."[36] There is no bright-line test for when an individual tip raises to the level of "independent analysis" under the statute—the SEC retains discretion to decide each case based on its facts.[37] While the guidance states that "technical expertise is not a requirement" for a whistleblower to submit "independent analysis," the analysis must be "highly-probative" and should "bridge the gap between the publicly available information itself and the possibility of securities violations," something that will be most feasible for experts to do.[38] The guidance also emphasized that for both "independent knowledge" and "independent analysis," the SEC must not know about the information from any other source, and the tip must lead to a successful enforcement action before the whistleblower is entitled to an award.[39] The knowledge or analysis cannot derive exclusively from "the news media," which has been interpreted broadly to include publicly available websites.[40]

In justifying this restrictive interpretation, the Commission contended that both Congress and the SEC had expressed a desire to "substantially restrict any role for publicly available information in potential whistleblower awards."[41] The SEC asserted that Congress did not intend for the SEC to pay for publicly available-available information, but rather to reward "detailed and sophisticated" work such as that done by the whistleblower who exposed the Madoff fraud.[42] In sum, the SEC's interpretive guidance strongly suggests that the Commission will not reward whistleblowers who loosely invoke the "independent analysis" prong of original information in seeking an award, and will closely scrutinize applications seeking such awards for consistency with the criteria described above.

Until recently, awards for tips based on independent analysis alone were rare, with only one such award issued through the end of August 2020. On January 15, 2016, the SEC issued a whistleblower award to a "company outsider" whose information was derived not from independent knowledge of the facts but rather from his or her "independent analysis."[43] According to subsequent media reports,[44] the tip originated from the whistleblower's review of publicly available information regarding practices of the New York Stock Exchange that favored high-frequency traders over other market participants, and which resulted in a $5 million fine against the exchange.

However, awards based on independent analyses have become more common recently. On September 1, 2020, the SEC issued a joint award to two whistleblowers who were unaffiliated with the company and whose tip was based largely on independent analysis of the company's public filings.[45] Already in Fiscal Year 2021, the SEC has awarded five individuals based on independent analyses.[46]

Exclusions from Independent Knowledge and Analysis – Attorneys, Compliance Personnel, Auditors and Officers

Consistent with its goal of promoting enforcement of securities laws while also encouraging corporate efforts to maintain effective corporate-governance and internal-compliance programs, the SEC has designated information in the possession of certain categories of individuals as not being derived from independent knowledge or analysis, making these individuals presumptively ineligible for participation in the whistleblower reward program. Two of these exclusions apply specifically to attorneys, both in-house and retained, and to non-attorneys who possess attorney-client-privileged information. The rules exclude:

- Information obtained through a communication subject to attorney-client privilege, unless disclosure would be permitted under either SEC rules governing the conduct of attorneys practicing before the Commission, or state ethics rules governing attorneys, Rule 21F-4(b)(4)(i); and
- Information obtained in connection with the whistleblower's (or her firm's) legal representation of a client, unless disclosure would be permitted by the rules described above. Rule 21F-4(b)(4)(ii).

The SEC rules that govern the professional conduct of attorneys practicing before the SEC on behalf of an issuer of publicly traded securities are found at 17 CFR Part 205 ("SEC Part 205").[47] Section 205.3(d)(2) permits attorneys practicing before the Commission to disclose client confidences when reporting suspected securities violations to the SEC under certain circumstances, including where necessary to prevent a material violation that would significantly harm investors, or to prevent the issuer from committing perjury or a fraud on the SEC during an investigation. Lawyers who are considering providing the SEC with information about securities violations need to be particularly careful, however, as they may run afoul of state rules of professional responsibility even when SEC Part 205 would allow disclosure and thus allow participation in the SEC Whistleblower Program. State bar rules vary widely in their restrictions on attorney disclosures of client confidences, with some following the American Bar Association's Model Rule of Professional Conduct 1.6 and other states imposing either more or less restrictive rules. For this reason, attorneys thinking of participating in the whistleblower program should make sure to carefully review and adhere to the rules of professional conduct that apply to them and their actions.

At least one state bar association and one court have gone as far as to bar attorneys altogether from participating in whistleblower reward programs on the grounds that attorneys who disclose client confidences for financial gain are in fundamental conflict with the interests of their clients. The Professional Ethics Committee of the New York County Lawyers Association issued a bar opinion stating that New York's rules of professional conduct prohibit attorneys from collecting SEC awards, and presumably other "bounties," based on the confidential information of a client.[48] In another case, one branch of the New York Supreme Court ruled that an attorney could not maintain a qui tam lawsuit against his former employer for state tax avoidance, as the action would potentially result in the attorney's earning a whistleblower reward for his disclosure of client confidences that he obtained as in-house counsel.[49]

In addition to lawyers, the SEC Whistleblower Program rules make certain other individuals presumptively ineligible to receive awards because of their roles, formal or otherwise, in the internal compliance functions that the SEC believes are critical to the overall goal of increased adherence to securities laws. The SEC deems a person to lack "independent knowledge or analysis" where the person obtains the information through his or her role as:

- An officer, director, trustee or partner to whom another employee reports the information, or who learns the information, in connection with the entity's processes for identifying and addressing unlawful conduct, Rule 21F-4(b)(4)(iii)(A);
- An employee or contractor whose principal duties are in compliance or internal audit, Rule 21F-4(b)(4)(iii)(B);
- An employee of a firm retained to investigate possible violations of the law, Rule 21F-4(b)(4)(iii)(C); or
- An employee of a public accounting firm performing an engagement required by federal securities laws, who, through the engagement, obtains information about a violation by the engagement client, Rule 21F-4(b)(4)(iii) (D).

Persons who learn information second-hand from these categories of persons will also not be considered to be providing "original information" if they report the information to the SEC. Rule 21F-4(b)(4)(vi).[50]

The four non-attorney exclusions described above – those for upper-level management, compliance personnel and auditors serving in the roles set forth in Rule 21F-4(b)(4)(iii) – do not apply in all circumstances. The wording of the rules suggests that these persons might have "independent knowledge" as long as they obtain their information outside their roles in compliance, investigation or audit. In addition, these exclusions do not apply, and the person submitting the information can be eligible for an award, where at least one of the following conditions is present:

- The would-be whistleblower "reasonably believes" that disclosure to the SEC is needed to prevent "substantial injury" to the entity or investors, Rule 21F-4(b)(4)(v)(A);
- The would-be whistleblower "reasonably believes" that the entity is acting in a way that would impede an investigation of the violations, Rule 21F-4(b)(4)(v)(B); or
- At least 120 days have passed since the whistleblower reported her information internally to the audit committee, chief legal officer or other appropriate official of the entity, or since he or she obtained the information under circumstance indicating that those officials were already aware of the information, Rule 21F-4(b)(4)(v)(C).

The SEC first applied this 120-day exception on August 29, 2014, when it issued a whistleblower award of more than

$300,000, or approximately 20% of the more than $1,500,000 it recovered from the wrongdoers, to an employee who performed audit and compliance functions.[51] In that case, the whistleblower reported the securities violations internally, gave the company at least 120 days to take action, and then reported the same information to the SEC when the company did not act to address the violations. This entitled the whistleblower to claim an award under the 120-day exception set forth in Rule 21F-4(b)(4)(v)(C).

On March 2, 2015, the SEC again applied the 120-day exception, this time issuing an award to a former corporate officer who received the information about a violation of U.S. securities laws from another employee who had reported the misconduct through the company's corporate compliance channels. The officer first reported the misconduct through internal compliance channels, and then reported to the SEC when 120 days passed and the company failed to take action. The SEC issued an award between $475,000 and $575,000 for the information the officer provided.[52] The SEC applied the exception a third time on March 30, 2020, awarding $450,000 to a whistleblower with internal compliance responsibilities who reported to the SEC at least 120 days after reporting violations internally to a supervisor.[53]

The SEC Whistleblower Program rules strike a reasonable balance between the public's need for strict enforcement and the need for strong corporate compliance programs.

The SEC applied the "substantial injury" exception for the first time in April 2015 when it awarded a compliance professional between $1.4 and $1.6 million.[54] Although the whistleblower's compliance role would have presumptively excluded him from eligibility for an award, the SEC determined that he reported the information to the SEC because he reasonably believed that disclosure was necessary to prevent a substantial injury to the company or its investors, and he was therefore eligible for an award. As then-SEC Director of Enforcement Ceresney explained, "[t]his compliance officer reported misconduct after responsible management at the entity became aware of potentially impending harm to investors and failed to take steps to prevent it."[55]

Whistleblowers and their counsel should keep in mind that a whistleblower's belief that "substantial injury" is imminent could be misplaced. For this reason, they should strongly consider waiting 120 days to submit their tips to the SEC in such situations, at least unless they can also qualify for the third exception – i.e., that the whistleblower has reason to believe that that the entity is acting in a way that would impede an investigation of the violations.

The SEC issued its first award under this third exception in December of 2020.[56] The SEC noted that the whistleblower "aggressively attempted to remedy the misconduct and suffered a unique hardship," and had reason to believe that the company would impede the SEC investigation.[57]

The SEC's payment of awards to employees who submit information gained through their respective roles in a company's compliance functions shows that the door is open for the submission of tips from categories of employees who hold trusted roles in corporations, but who are often the best-positioned to learn about their employers' securities violations. All three of the award recipients mentioned above did exactly what Congress intended the program to encourage: two of them reported the violations internally, acted responsibly by giving their companies four months to address them, and then turned to the SEC when the companies failed to act. The third learned that an entity's management was refusing to prevent impending harm to investors, and reported the information to the SEC because he reasonably believed it necessary in order to prevent the harm. By paying these individuals awards for their tips, the SEC ensured that more employees and officers who have roles in compliance and audit functions would come forward if they believe they fit into one of the three exceptions to the rule that would otherwise exclude them from the program.

These cases also demonstrate how the program rules strike a reasonable balance between the public's need for strict enforcement and the interests of corporations (and their shareholders) in maintaining effective legal, compliance and audit functions, which can serve to protect investors and avoid the need for SEC enforcement action. While generally excluding information from employees who staff compliance and audit functions will mean that the SEC will never hear from some would-be whistleblowers who have credible knowledge of securities violations, the rules ensure that even these individuals can report their information to the SEC and become eligible for an award in certain exceptional situations. Where the wrongful conduct is seriously endangering investors, where the entity is destroying evidence, or where upper management has known about the problem for four months or more, the SEC will accept the non-attorney whistleblower's original information despite her role as a professional with compliance-related responsibilities.

Corporations thus face the risk that even those employees whom they have entrusted with knowledge of the most serious securities violations can earn awards under the SEC whistleblower program. The only way a corporation can mitigate that risk is to make sure it maintains effective and efficient mechanisms for responding promptly to suspected securities violations.

In deciding where to draw the line between those who can earn an award for blowing the whistle on securities violations and those who cannot, the SEC rejected proposals at the inception of the program that would have excluded many more, perhaps even most, of those individuals who would most likely be able to provide the Commission with high-quality tips. As originally proposed, the rules excluded from "independent knowledge" and "independent analysis" any information obtained not just by officers, directors, trustees and partners, but also by anyone with "supervisory" or "governance" responsibilities who was given the information with the expectation that they would do something about it.[58] The proposed rules also required such persons to wait a "reasonable time" (as opposed to 120 days) before reporting to the SEC.

These proposals drew intense criticism from whistleblower advocates, who pointed out correctly that excluding all "supervisory" personnel would effectively undermine the program. The whistleblower bar also criticized the rule as being so vague as to ensure that few supervisors would risk their positions to report to the SEC. At the same time, SEC's proposed exclusion of some employees with governance responsibilities emboldened big-business interests to call for extending the ban to all variety of positions in operations, finance, technology, credit, risk, product management, and on and on. In the end, the SEC struck a fair balance, adopting narrow exclusions for core, compliance-related personnel and processes while rejecting pressure to deny eligibility to far more employees than Congress could possibly have intended or anticipated.[59] The balance between these exclusions and the exceptions to them is now leading to successful enforcement actions without harm to legitimate corporate interests.

Information "Not Already Known" and the "Original Source" Exception

For purposes of determining an individual's entitlement to a wFor purposes of determining an individual's entitlement to a whistleblower award, information that is already known to the SEC cannot qualify as "original information" unless the whistleblower is the "original source" of the information.

The "original source" exception applies to information the whistleblower may have already reported to DOJ or certain other agencies, perhaps because the whistleblower was simply trying to alert law enforcement authorities to unlawful practices and reported them to the FBI or DOJ, but was unaware of the SEC Whistleblower Program.

This "original source" exception is particularly important for the many employees who file SOX complaints with the Department of Labor after facing retaliation for reporting securities violations to their employers, but who have not filed tips with the SEC. Under an arrangement between the SEC and DOL, DOL's Occupational Safety and Health Administration (OSHA) cross-files with the SEC every charge of unlawful retaliation it receives under Section 806 of SOX.[60] These SOX charges often contain detailed information about securities violations that the employee reported to the employer, and that information will become "known" to the SEC upon the SEC's receipt of the charge from DOL. Without the "original source" exception, the employee's information thus could not qualify as "original information" for purposes of a whistleblower award under Rule 21F-4(b)(1) if the employee later submitted the information to the to the SEC. This could undermine a whistleblower's right to an award because SEC staff from time to time initiate investigations based on the SOX charges they receive from OSHA. By allowing the whistleblower to submit a Tip, Complaint or Referral form ("TCR") containing information "already known" to the SEC and still have his information qualify as "original information," the "original source" doctrine allows SOX complainants to participate in the SEC Whistleblower Program.

Whistleblowers cannot earn awards for information provided to other agencies where the SEC never learns of or uses the information in taking enforcement action.

The authors' law firm, which represents employees not only before the SEC Whistleblower Program but also in cases of retaliation for blowing the whistle internally on corporate wrongdoing, has seen a significant increase in the number of SEC investigations stemming from the SEC's review of SOX retaliation charges filed with OSHA. If a SOX complainant is contacted by the SEC for follow-up on the information contained in a charge filed with OSHA, he or she should perfect the SEC tip by then submitting a TCR form with SEC reiterating the relevant facts from the charge supplementing them with any additional information in his or her possession regarding the underlying securities violations. The whistleblower must do so within 120 days of filing the SOX charge with OSHA in order for the SEC to deem the tip to have been filed at the time the whistleblower submitted the SOX charge to OSHA. Rule 21F-4(b)(7).[61]

On April 5, 2018, the SEC made its first whistleblower award pursuant to this 120-day "safe harbor" provision, awarding over $2.2 million to a former company insider who had first reported the violations to another government agency.[62] In that case, the Commission determined that the whistleblower had voluntarily reported the wrongdoing to an agency covered by Rule 21F-4(b)(7). That agency then referred the information to the SEC, which opened an investigation into the matter. The whistleblower also submitted a TCR to the SEC's Office of the Whistleblower within the 120-day safe harbor period, including in that tip the same information the whistleblower had provided to the Rule 21F-4(b)(7) agency, and thereby satisfying the requirements of the safe harbor provision. In announcing the award, Jane Norberg, Chief of the SEC's Office of the Whistleblower, explained, "Whistleblowers, especially non-lawyers, may not always know where to report, or may report to multiple agencies. This award shows that whistleblowers can still receive an award if they first report to another agency, as long as they also report their information to the SEC within the 120-day safe harbor period and their information otherwise meets the eligibility criteria for an award."[63] The SEC not only considers such a whistleblower eligible for an award, but also accepts the date of his reporting to the other agency as the date of his reporting to the SEC, placing him ahead in time of any other whistleblower who may have submitted a TCR during the 120-day period.

The whistleblower cannot earn an award, however, for information provided to other agencies where the SEC never learns of or uses the information in taking enforcement action. In denying the award application of one individual who had provided information to other federal agencies, the Commission found that those other agencies "did not share, directly or indirectly, any information provided by Claimant with Commission staff" and thus that "any information provided by Claimant to those federal agencies could not have had any impact on the Covered Actions."[64]

B. Rules Designed to Incentivize Internal Reporting

The SEC rules repeatedly make clear that the main purpose of the whistleblower program is to encourage individuals to provide high-quality tips to the Commission. The SEC notes in the 2011 Adopting Release:

> …the broad objective of the whistleblower program is to enhance the Commission's law enforcement operations by increasing the financial incentives for reporting and lowering the costs and barriers to potential whistleblowers, so that they are more inclined to provide the Commission with timely, useful information that the Commission might not otherwise have received.[65]

With this purpose in mind, the SEC when developing the program rules rejected the business lobby's near-unanimous insistence that it require all whistleblowers submit their complaints internally before filing them with the SEC and earning an award.[66] "[W]hile internal compliance programs are valuable," the Commission observed, "they are not substitutes for strong law enforcement."[67] The Adopting Release recognizes that whistleblowers might reasonably fear retaliation for raising their concerns, and also notes that law enforcement interests are sometimes better served when the Commission can launch an investigation before the alleged wrongdoers learn about it and are able to destroy evidence or tamper with potential witnesses.[68] For these and related reasons, the SEC leaves it to each whistleblower to decide whether to report first internally or to the SEC.[69]

At the same time, the Commission included several provisions in the rules that are expressly designed to incentivize whistleblowers to utilize internal compliance programs.

These include:

- Affording whistleblower status to the individual as of the date he or she reports the information internally, as long as the whistleblower provides the same information to the SEC within 120 days. This allows an employee to report internally while preserving his "place in line" for an award from the SEC for 120 days, even if another whistleblower provides the same or related information to the Commission in the interim. *See* Rule 21F-4(c)(3); Rule 21F-4(b)(7).[70]
- Giving a whistleblower full credit for information provided by his employer to the SEC where the employee reports the information internally and the employer then investigates and "self-reports" that information (and even additional information that the whistleblower may not have had to the SEC, and where the information supplied by the employer "leads" to a successful enforcement action. *See* Rule 21F-4(c)(3). In order to benefit from this provision of the program rules, the whistleblower must also report his information to the SEC within 120 days of reporting it internally, using the procedures set forth in Rule 21F-9. In May 2019, the SEC issued its first award pursuant to this rule to a whistleblower who reported wrongdoing to the company compliance department, prompting the company to notify the SEC of the results of an internal investigation it initiated based on the whistleblower's internal report.
- Treating a whistleblower's participation in an internal compliance and reporting system as a positive factor in determining the amount of an award within the range of 10% to 30%. *See* Rule 21 F-6(a)(4). Conversely, a whistleblower's interference with internal compliance and reporting systems, including an internal investigation, may decrease the amount of the award. *See* Rule 21 F-6(b)(3).

These rules provide flexibility to the whistleblower, who the SEC believes is the best position to determine the effectiveness or ineffectiveness of the particular internal-compliance system that he or she can decide whether to use, in choosing how to report

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violations. The rules enhance the SEC's law enforcement operations by encouraging people who may otherwise be deterred to report violations. This group includes those who will be persuaded to use the internal compliance programs by the new financial incentives the come with such reporting, as well as those who will report directly to the SEC and who may not have reported any violations at all if required to go to the company first.[71]

The SEC also points out that the rules' incentives to employees to report internally are likely to encourage companies to create and maintain effective internal compliance programs, as whistleblowers are more likely to participate in such a program.[72]

Maintaining an effective program is in the best interests of a company because the SEC, upon receiving reports of a violation, will often notify the company and give it an opportunity to investigate the issue. In deciding whether to give a company that opportunity, the SEC will consider the company's "existing culture related to corporate governance," and, in particular, the effectiveness of the company's internal compliance programs.[73]

In the view of the authors, who have specialized in the representation of corporate whistleblowers for many years, the business community's fears of a rush to report improprieties to regulators have proven to be unfounded. In fact, the authors and other whistleblower-side lawyers have observed that very few employees, current or former, report their concerns to the SEC without having first reported them internally. This observation is consistent with data collected from whistleblowers by the SEC Office of the Whistleblower, which has reported that approximately 85% of award recipients who were current or former employees of the subject entity had first reported their concerns internally.[74]

C. Information that Leads to a Successful Enforcement Action

The program rules establish the standard for determining when a whistleblower's information has led to a successful investigation, entitling her to an award if the action results in monetary sanctions exceeding $1,000,000. When information concerns conduct not already under investigation or examination by the SEC, it will be considered to have led to successful enforcement if:

- It is "sufficiently specific, credible, and timely" to cause the staff to commence an examination, to open an investigation, to reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation; and
- The Commission brings a successful judicial or administrative action based in whole or in part on the conduct identified in the original information. *See* Rule 21F-4(c)(1).

The standard is somewhat higher for information that focuses on conduct already under investigation or examination, although some 33% of whistleblowers who have earned awards from the SEC did so in the basis of such information.[75] The information will be deemed to have led to successful enforcement if it "significantly contributes" to the success of the action. *See* Rule F-4(c)(2). In determining whether information "significantly contributed" to the success of an investigation and resulting enforcement action, the Commission will consider whether the information allowed the SEC to bring a successful action in significantly less time or with significantly fewer resources, bring additional successful claims, or take action against additional parties.[76] The SEC has denied a number of claims for awards on the grounds that the tip neither led to nor contributed to a successful enforcement action.[77]

The SEC has provided additional guidance as to what actions might constitute a "significant contribution" to an ongoing investigation within the meaning of Rule 21F-4(c)(2). On May 13, 2016, the SEC announced that it was awarding more than $3.5 million to a whistleblower even though the whistleblower's reports to the SEC had not prompted the SEC to start an investigation.[78] An SEC investigation was already underway as a result of media coverage of potential securities violations when the whistleblower submitted the tip to the SEC and later assisted SEC staff in their investigation.

> The size of an SEC award is based on how much the SEC ultimately collects from the company.

On these facts, the SEC's Claims Review Staff preliminarily decided that the whistleblower was not entitled to an award because his or her information had not caused the SEC to open an investigation or to expand the investigation to focus on additional conduct. The whistleblower contested the preliminary determination, arguing that his or her information had in fact "significantly contributed" to the covered action's success within the meaning of Rule 21F-4(c)(2), and SEC enforcement staff supported the whistleblower's position. The Commission ultimately agreed, finding that the whistleblower's information had "significantly contributed" by focusing the staff's attention on certain evidence and "meaningfully increasing Enforcement staff's leverage during the settlement negotiations." In determining the percentage to award the whistleblower, the SEC noted that it had also considered the "unique hardship" the whistleblower had suffered in the form of being unable to find a job since reporting the misconduct.

On May 24, 2019, the SEC made its first whistleblower award under Rule 21F-4(c)(3), which allows whistleblowers who internally report to receive credit for a company's whistleblower also externally reported to the SEC within 120 days. The Commission awarded the whistleblower $4.5 million because their internal reporting subsequently led to a successful enforcement action and a related action by another agency.

The whistleblower sent an anonymous tip to the company and submitted the same information to the SEC within 120 days. The company self-disclosed the tip as well as the results of an internal investigation it initiated in response to the tip. The Commission found that the whistleblower's original information led to the successful enforcement under the standards set forth in Rule 21F-4(c)(3), although the whistleblower never communicated with the Commission's staff.

In the SEC's 2020 guidance interpreting what qualifies as "independent analysis," the Commission adopted a new standard that it will only consider a whistleblower's analysis to have led to a successful enforcement action if the "analysis—as distinct from the publicly available information on which the analysis was based—either (1) was a principal motivating factor in the staff's decision to open its investigation, or (2) made a substantial and important contribution to the success of an existing investigation.[79] According to the SEC, this determination hinges on whether the analysis "is of such high quality that it either causes the staff to open an investigation, or significantly contributes to the successful enforcement action."[80] In addition, the Commission has cautioned that in instances where the SEC's staff "looks to other information as well in determining to open an investigation, the Commission will find that the independent analysis 'led to' the success of the enforcement action only if the Commission determines that the whistleblower's analysis was a 'principal motivating factor' in the staff's decision to open the investigation."[81] For this reason, "even an otherwise compelling analysis may not satisfy the 'leads to' requirement depending on the nature of other information already in the staff's possession."[82]

It should go without saying that for a whistleblower's information to have "led to" a successful enforcement action, the SEC staff had to have been aware of the information when they investigated and took enforcement action. The SEC has repeatedly denied claims for awards after determining that SEC staff were not aware of the whistleblower's information and thus the information could not have led to the success of the covered action. In one determination in April 2016, for example, the SEC found that its Office of Market Intelligence, which screens tips as they come into the SEC, had designated one claimant's tips for "no further action" and had never forwarded them to Enforcement staff, and that Enforcement staff had not had any contact with the claimant until after settlement of the enforcement action.[83]

The SEC cannot use information protected by attorney-client privilege in an investigation or enforcement action.

In a March 2018 order awarding three whistleblowers a combined $83 million, the SEC denied the claims of four additional whistleblowers on the grounds that the information they provided had not "led to" the Commission's successful enforcement action as required under the program rules.[84] Whistleblowers and their counsel seeking an understanding of the "led to" requirement can benefit from reviewing this award determination, as it describes in detail some of the ways in which information that appears potentially relevant can fall short of "leading to" a successful enforcement action. In the case of these four unsuccessful claimants, the SEC found that their information was variously submitted too late in the investigation, duplicative of information submitted by others, too vague or too general in content, focused on misconduct different from the conduct that was the focus of investigation, or not used or even received by the SEC, whose investigation resulted in the enforcement action.[85]

In March 2019, the SEC denied an award to a claimant who had provided potentially relevant information to an SEC regional office some time before two other whistleblowers contacted other SEC with information that led them to commence an investigation leading to a successful enforcement action.[86] The two later whistleblowers received large awards as a result, but the SEC found that the first whistleblower's information had not "led to" the enforcement action because the regional office forwarded the first whistleblower's information to the investigating SEC staff only after they had commenced an investigation, and the investigating staff stated that the first whistleblower's information had not "advanced the investigation in any way." The SEC rejected the first whistleblower's argument that the regional staff "should have" forwarded his or her information earlier.

Whistleblowers often have difficulty knowing whether their information "led to" the successful enforcement action for which they are applying for an award, but they and their counsel need to be aware that the SEC will not grant them an award unless the record demonstrates that their information either caused the Commission to initiate an investigation or "significantly contributed" to the action as required by Rule 21F-4(c).

The SEC has repeatedly and successfully enforced the rule disallowing awards for information provided to the Commission

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prior to July 21, 2010, the date of enactment of the Dodd-Frank Act, even if an enforcement action followed. In *Stryker v. SEC*, the U.S. Court of Appeals for the Second Circuit affirmed the SECs denial of an application for such an award.[87] Even though the SEC collected sanctions of more than $20 million in the action after the whistleblower program went into effect, the claimant had submitted the information prior to enactment of the Act and received no award.

D. Monetary Sanctions Totaling More than $1 Million

In determining whether the recovery in an enforcement action exceeds the $1,000,000 threshold, the word "action" generally means a single judicial or administrative proceeding. *See* Rule 21 F-4(d). However, in certain circumstances actions can be aggregated. The SEC adopted this broad interpretation of the term "action" in accordance with congressional intent to increase the incentives for individuals to report securities violations. Actions may include cases from two or more administrative or judicial proceedings that arise out of a common nucleus of operative facts, and any follow-on proceedings arising out of the same nucleus of operative facts may be aggregated as well. *See* Rule 21 F-4(d)(1). Factors that may be taken into account when determining whether two or more proceedings arise from the same nucleus of operative facts include parties, factual allegations, alleged violations of federal securities laws, or transactions and occurrences.[88]

The 2020 Final Rules and Adopting Release expanded upon the definition of "action" to also include non-prosecution and deferred prosecution agreements by the U.S. Department of Justice, and any similar agreements entered into by the SEC to address securities law violations.[89] The Commission noted that these agreements are key tools of enforcement for both the DOJ and the SEC, and that they include "monetary sanctions" as defined by Rule 21F-4(e).[90] The SEC further noted that "Congress did not intend for meritorious whistleblowers to be denied awards simply because of the procedural vehicle that the Commission (or the other authority) has selected to pursue an enforcement matter."[91]

Rule 21F-3(b) provides that, where the SEC has brought a successful enforcement action resulting in sanctions exceeding $1 million, the SEC will also issue awards based on amounts collected by other entities in "related actions." Those are judicial or administrative actions which yield monetary sanctions, are based on the same original information the whistleblower voluntarily provided to the SEC, and are brought by the U.S. Attorney General, a state Attorney General in a criminal case, an "appropriate regulatory authority," or a self-regulatory organization. *See* Rule 21F-3(b)(1). The SEC has demonstrated that it will interpret this list liberally to include a potentially broader group of "other governmental authorities" than those described in the rule,[92] and has issued at least one award based in part on the proceeds collected from a related criminal action.[93] The largest single award issued by the SEC to date consisted of $52 million in relation to an SEC action and $62 million in connection with related actions.[94]

In determining whether to add to the whistleblower's award based on the monetary sanctions collected by another entity, the SEC will consider a number of factors to avoid double recovery for the whistleblower.[95] First, if the second entity has a separate monetary award program, the SEC must decide whether its own whistleblower program or the other entity's program has a "more direct and relevant connection to the action."[96] The action by the other entity will only be deemed a "related action" for purposes of the SEC's award if the SEC program has the more direct connection to the action. The SEC will then make an award for the related action only if the whistleblower has not already received an award from the other entity and waives her right to receive such an additional award.[97]

It is also crucial to note that the SEC considers the amount of money it has collected or will collect from a company, not the amount of the sanctions ordered in the case, when determining both eligibility for a whistleblower award and the amount of the award. This can have a significant impact on the process of claiming an award because the SEC does not always collect the sanctions it levies and sometimes collects more than expected. For example, in the three-year period ending in September 2013, the SEC collected just 42% of the amount defendants were ordered to pay as a result of enforcement actions.[98] Consequently, whistleblowers and their attorneys cannot rely solely on the amount of sanctions ordered by the SEC in determining the size of an award, but rather must look to how much the SEC ultimately collects from the company. The very first whistleblower to receive an award under the new program in 2012 received an additional $150,000 nearly 20 months after receiving the initial $200,000 reward after the SEC was able to collect additional sanctions levied in the case.[99] The SEC has determined claimants to be eligible for awards based on proceeds yet to be collected in a number of award determinations.[100]

E. SEC Procedures for Submitting a Tip

The TCR Form

The program rules describe a straightforward set of procedures for submitting original information about possible securities violations to the SEC Office of the Whistleblower. An individual must file a Form Tip, Complaint or Referral ("TCR") that the SEC makes available on its website, and can file either online or by mailing or faxing it to the SEC. *See* Rule 21F-9(a).[101] The rules require the individual to declare under penalty of perjury that the information provided in the Form TCR is true and correct to the best of his or her knowledge and belief. *See* Rule 21F-9(b).[102]

The 2020 Final Rules and Adopting Release stressed that a whistleblower must submit a tip in writing and through the Form TCR. First, it added the words "in writing" to the definition of "whistleblower," meaning that an individual who gives information to the SEC only orally is not protected from retaliation and cannot receive a whistleblower award. Rule 21F-2(a).[103] Second, the Final Rules clarified that while the whistleblower can initially submit information to the SEC in any form, in order to be eligible for an award he or she must submit the information through the online portal or the Form TCR via fax or mail within 30 days of making initial contact. Rule 21F-9(e).[104] The SEC will waive this requirement only if the whistleblower complies with the specified procedures within 30 days of receiving actual or constructive notice about the requirements, and the SEC can "readily" and "unambiguously" determine that the whistleblower would otherwise be eligible for an award.[105]

When preparing tips for submission to the SEC, whistleblowers and their counsel should make sure that the Form TCR and accompanying exhibits present the most comprehensive and compelling evidence and argument for the SEC taking enforcement action that his information and appropriate inferences can support. With the SEC receiving a steadily increasing number of tips per year – more than 23,650 TCRs in FY 2020 alone[106] – it is important that a first read of a whistleblower tip provide SEC staff with a sound understanding of the alleged violations and, to the extent possible, how to investigate and prove them.

Whistleblowers should describe in detail the particular practices and transactions that they believe to have violated U.S. securities laws, identify the individuals and entities that participated in or directed the violations, and provide a well-organized presentation of whatever supporting evidence the whistleblower possesses.

The Commission encourages individuals to submit information to the SEC via the online portal, which the SEC modified in January 2018 to better process and handle the submission of much larger attachments to a whistleblower's electronic TCR form.[107]

Under no circumstances should whistleblowers give the SEC information that is protected by attorney-client privilege, as the SEC cannot use privileged information in an investigation or enforcement action, and the SEC's mere receipt of such information can interfere with and significantly delay the staff's ability to proceed. Potentially privileged information generally includes documents authored by, received by, or prepared at the request of counsel for the entities or individuals that may be the subjects of an SEC investigation. It also can include conversations with counsel, the contents of which the whistleblower might disclose in a written submission or in discussions with SEC staff. Determinations about the application of attorney-client information to specific information can be complicated. For whistleblowers submitting information to the SEC without counsel, the best practice is to avoid the submission of any information about which the whistleblower has any doubt as to whether the information to be submitted might be governed by attorney-client privilege.

Submitting an Anonymous Tip

Given the very real risks of retaliation from employers and the risk of associated reputational harm that would interfere with future job prospects, many employee-whistleblowers are understandably concerned that their employers will learn their identities if they submit tips to the SEC. The program rules address this concern by allowing whistleblowers to file their submissions anonymously provided that they do so through counsel. Rule 21F-9(c). The attorney submits the TCR form without the whistleblower's signature and other identifying information, while keeping a copy of the same completed form containing the whistleblower's identifying information and signature in his files. On the anonymous TCR form that the attorney submits to the SEC, the attorney affixes his or her own signature and certifies that he or she has verified the whistleblower's identity, has reviewed a version of the TCR form signed by the whistleblower and that the information therein is true and correct, and has obtained the whistleblower's non-waivable consent for the attorney to provide that document to the SEC if Commission staff have reason to believe the whistleblower has willfully provided false information. The SEC Form TCR and instructions, available on the Commission's website, explain these requirements clearly.[108]

The SEC protects against the disclosure of whistleblowers' identities "to the fullest extent possible" regardless of whether they submit their information anonymously, but the Commission acknowledges that there are limits to its ability to shield a whistleblower's identity under certain circumstances. For example, the SEC explains on its website that "in an administrative or court proceeding, we may be required to produce documents or other information which would reveal your identity."[109]

While the SEC cannot provide a 100% guarantee that no one will uncover a whistleblower's identity during the course of investigation and enforcement action, the risk of public disclosure remains very small. A few whistleblowers to date have self-identified to the media. Others may choose to disclose to their employers that they have blown the whistle to the SEC to secure maximum protection against retaliation, or to discourage further retaliation if it has already occurred. Whistleblower's submissions, and occasionally their identities may become known through other legal proceedings, including criminal proceedings in which a whistleblower is called testify. In one case, a court ordered the SEC to hand over an anonymously filed TCR form—without disclosing the whistleblower's name—to counsel defending a corporation in an SEC enforcement action.[110]

In the numerous cases in which the authors and their firm have represented whistleblowers before the Commission, SEC staff have demonstrated that they will go to great lengths to protect a whistleblower's identity at every stage of the process, from receiving the tip and investigating it to announcing whistleblower awards. Indeed, the SEC has instituted policies that prevent agency staff from sharing any identifying information even with other law enforcement agencies without permission. In the improbable event that the SEC is forced to disclose a whistleblower's identity in the course of a legal proceeding, whistleblowers can expect the SEC (and the court) to take steps to prevent the disclosure from becoming public.

F. Determining the Amount of an Award

The amount of a successful whistleblower's award is within the sole discretion of the Commission as long as the award falls within the 10% to 30% range that Congress established in the Dodd-Frank Act. *See* Rule 21F-5. The total award cannot exceed 30% of the sanctions ordered even where the Commission distributes the award to more than one whistleblower.[111] The program rules set forth a number of factors that the SEC may consider when calculating the final award within the 10% to 30% range. Factors that might increase an award include the whistleblower's reporting the perceived violations through an entity's internal-compliance program, the significance of information provided by the whistleblower, the degree of assistance provided by the whistleblower to SEC investigators, and the SEC's programmatic or enforcement interest in the particular securities violations at issue. *See* Rule 21F-6(a)(1)-(4). Factors that might decrease an award include the level of culpability of the whistleblower in the wrongdoing, unreasonable delay on the part of the whistleblower in reporting the violations to the SEC, or the whistleblower's interference with internal compliance and reporting systems. *See* Rule 21F-6(b)(1)-(3). These factors are discussed in various places throughout this Practice Guide.

The 2020 Final Rules and Adopting Release created a new presumption that the whistleblower is entitled to the maximum "30 percent of the monetary sanctions collected in any covered and related action(s)" if that award will be $5 million or less. *See* Rule 21F-6(c).[112] The presumption is designed to encourage whistleblowing by increasing transparency and efficiency in the award process and ensuring the highest award for smaller cases.[113] A whistleblower will not receive the maximum award if they trigger any of the negative factors listed in Rules 21F-6(b)(1) (culpability), 21F-16 (highly culpable conduct), or 21F-6(b)(3) (interference with internal compliance and reporting systems).[114] The SEC has discretion to award the maximum if the whistleblower unreasonably delayed reporting under Rule 21F-6(b)(2), but only if awarding the maximum amount is "consistent with the public interest, the promotion of investor protection, and the objectives of the whistleblower program."[115] The SEC also retains discretion to grant an award below the 30% maximum if the claimant's assistance was limited as assessed under Rule 21F-6(a) or if awarding the maximum "would be inconsistent with the public interest, investor protection or the objectives of the whistleblower program."[116] The SEC has already found that a claimant's limited assistance overcame the presumption in at least one case.[117] Where there are multiple whistleblowers and one alone would be eligible for the presumptive maximum, the SEC must award 30% to the group as a whole, but has discretion as to how to divide it between the individuals.[118]

In the 2020 Final Rules and Adopting Release, the SEC voted not to pass one of the more controversial proposed amendments, which would have allowed the SEC to reduce an award based on the total dollar amount if that amount was more than reasonably necessary to incentivize a similar whistleblower—but never reducing an award to less than 10% of the total sanctions or less than $30 million on that basis.[119] The proposal received numerous comments in opposition that argued the rule would discourage whistleblowers from coming forward and that it would arbitrarily penalize whistleblowers.[120] Rather than adopt the proposed rule, the SEC modified the introductory language of Rule 21F-6 to make explicit that the SEC can consider the total dollar amount of an award, as well as the percent of monetary sanctions collected.[121] The Commission justified the change as simply a clarification of the discretion that it already had to consider the dollar amount of an award, although it had stated explicitly in its 2018 proposal that it did not have such discretion.[122]

While some whistleblower advocates fear that this new language will lower awards and deter whistleblowers from making reports at all,[123] that may not be the result. The presumption that the SEC will award the maximum 30% will apply in many more cases than the potential for reducing an award based on the dollar amount being too large. As of July 2020, 74% of all whistleblower awards had been under $5 million (although it is not clear how many of those could have exceeded $5 million if the statutory maximum were granted) while only 7% were at least $30 million.[124] Due to the highly redacted nature of award announcements, and the brevity with which the Commission explains its determinations, it will be difficult to calculate the impact of this amendment. However, the frequency and size of awards has been steadily increasing, particularly in the past few years,[125] and likely will continue to do so.

SEC Enforcement Interests

The SEC's publicly available descriptions of its law-enforcement interests provide important guidance to practitioners who are assessing the Commission's likely response to a potential whistleblower tip. Key to the SEC's response will be, inter alia, whether the conduct at issue involves an industry-wide practice, *see* Rule 21F-6(a)(3)(iii); the type, severity, duration and isolated or ongoing nature of the violations, *id.*; the danger to investors "and others," *see* Rule 21F-6(a)(3)(iv); and the number of entities and individuals who have suffered harm. *Id.*

Individuals who are thinking about submitting tips regarding suspected securities violations can learn a great deal about the SEC's regulatory enforcement priorities, which change from time to time, by perusing the Commission's website. This well-organized resource not only reports on all SEC enforcement actions,[126] the work of SEC divisions, offices and specialized units,[127] and congressional testimony and speeches of SEC Commissioners and high-level staff,[128] but also provides periodic recaps of recent enforcement actions and enforcement perspectives for the future.[129] The site also gives users access to the Commission's system of company filings, known as EDGAR, and a search engine that can locate all information available from the SEC across various databases.[130]

Unreasonable Delay in Reporting

The SEC places significant emphasis on a whistleblower's timely reporting of suspected securities violations, and an "unreasonable reporting delay" is a negative factor that the SEC considers in determining whistleblower award amounts. *See* Rule 21F-6(b)(2). In determining whether a delay was "unreasonable" and should reduce an award, the SEC may consider factors such as whether the whistleblower took reasonable steps to report or prevent the violations, whether the whistleblower only reported the violations after learning about a related investigation or action, and whether the whistleblower had a legitimate reason to delay reporting. *Id.*

Delayed reporting has likely cost more than one whistleblower millions of dollars in award money. On September 22, 2014, the SEC announced what was then its largest award to date—$30 million to an overseas whistleblower whose information allowed the SEC to stop an ongoing fraud that would otherwise have gone undetected.[131] In its order determining the award, the SEC explained that it had adjusted the whistleblower's award downward because the whistleblower delayed reporting a serious fraud for a period long enough to allow additional investors to be harmed. The whistleblower's explanation for the delay was that the whistleblower was unsure whether the SEC would take action on the information provided. The SEC found this to constitute unreasonable delay and reduced the award percentage significantly. Noting that no previous award had involved such an unreasonable delay, the SEC stated in its order that it would have reduced the award even further had it not been for the fact that some of the delay had occurred before the inception of the SEC Whistleblower Program. This suggests that the SEC awarded the whistleblower somewhat more than the statutory minimum of 10% of collected proceeds, but well below the 30% maximum.

In another case in November 2015, the SEC awarded a whistleblower $325,000 but explained that the reward would have been greater had the whistleblower not waited until he left his job to report to the Commission.[132] The SEC noted in its order that the delay in this case occurred entirely after the SEC Whistleblower Program went into effect and was thus "unreasonable in light of the incentives and protections now afforded to whistleblowers under the Commission's whistleblower program."[133] In an April 2018 award determination, the SEC decreased a whistleblower's award because the individual had delayed unreasonably in reporting the information for a period of ten months.[134]

Even where the SEC finds that a whistleblower delayed reporting unreasonably, the Commission also considers mitigating circumstances surrounding the delay in lessening the blow to the whistleblower's award. In a December 2017 award determination, for instance, the SEC awarded a whistleblower more than $4.1 million, but also noted that the award might have been larger if the whistleblower had not delayed his or her reporting to the SEC.[135] However, the SEC did not weigh the delay as severely as might have done due to two mitigating factors: (1) much of the reporting delay occurred before the SEC's whistleblower program was established in 2010; and (2) the whistleblower was a foreign national working outside the United States, and therefore might have been protected by U.S. anti-retaliation prohibitions, giving the whistleblower greater reason to fear retaliation for reporting the matter than a domestic whistleblower might have.

Even more surprising, the SEC awarded over $27 million to a whistleblower on April 16, 2020, and did not reduce the award at all despite finding that the individual had unreasonably delayed reporting.[136] The Commission determined that the positive factors—including that whistleblower uncovered hidden conduct occurring overseas, provided substantial assistance to the SEC, furthered a significant law enforcement interest, and repeatedly raised concerns internally—outweighed the delay in reporting.

Culpability of the Whistleblower

The program rules balance policy concerns about rewarding persons who are culpable for wrongdoing with the understanding that, at times, those who have participated in the wrongdoing at some level are often the individuals with the best access to information that the Commission needs in order to investigate and take action. In order to incentivize these whistleblowers to come forward with information about securities violations, the rules do not exclude culpable whistleblowers from awards altogether, but the rules prevent such award claimants from recovering from their own misconduct. This means that in determining whether the whistleblower has met the $1,000,000 threshold and in calculating an award, the SEC will exclude any monetary sanctions that the whistleblower is ordered to pay individually or that an entity is ordered to pay based substantially on the conduct of the whistleblower. *See* Rule 21F-16. The SEC also considers the whistleblower's culpability as a negative factor in setting the amount of any award earned. Rule 21F-6(b)(1)-(3). The program rules thus allow culpable whistleblowers, who may be uniquely situated to provide information regarding securities violations, to come forward and earn awards while not creating incentives that would encourage them to engage in securities violations.

The SEC has issued awards to whistleblowers who took part in the offending misconduct, but has also offset or reduced such awards by penalizing whistleblowers for their culpability when setting the amount of awards. On April 5, 2016, for example, the SEC announced an award of $275,000 to a claimant for submitting information that had led to a successful enforcement action and also to a related criminal action, but noted that the SEC would offset the whistleblower's award by the (undisclosed) portion of a final judgment entered earlier against the whistleblower that remained unpaid.[137]

Several months later the SEC issued a very sizable award—totaling more than $22.4 million—even though the whistleblower had apparently played some role in the fraud at issue.[138] The SEC announced the award on August 30, 2016, and indicated in its redacted order that the whistleblower was culpable for the misconduct to a certain degree. In justifying this sizable award to this culpable whistleblower, the SEC explained in an accompanying footnote that "[s]everal other factors mitigating the Claimant's culpability were considered" in determining the award percentage. The SEC noted in particular that the whistleblower had not benefitted financially from the misconduct. The anonymous whistleblower's counsel later announced that the $22.4 million award represented 28% of the total $80 million settlement between the SEC and Monsanto Company stemming from Monsanto's failure to publicly disclose millions of dollars in rebates to Roundup weed-killer retailers.[139]

In a February 2017 determination, the SEC limited a whistleblower award to 20% of the amount collected so far and to be collected in the future. Although the SEC did not disclose the amount of the award, it noted in the determination order that it had "reduced the award from what it might otherwise have been because of both the Claimant's culpability in connection with the securities law violations at issue in the Covered Action and the Claimant's unreasonable delay in reporting the wrongdoing to the Commission."[140]

In a September 14, 2018, determination generating an award of $1.5 million, the SEC "severely reduced" the award after considering various award criteria.[141] Specifically, the SEC alleged that the claimant had unreasonably delayed by waiting longer than one year to report to the Commission, and then did so only after learning about an ongoing SEC investigation. The SEC also noted that investors were being harmed during the delay and that the size of the total monetary sanctions had increased accordingly. In addition, the SEC took into account the whistleblower's culpability in the wrongful conduct, and warned that "[w]histleblowers with similar conduct should expect to receive a severely reduced award – indeed, even one as low as the minimum statutory threshold – in future cases." This SEC award determination makes clear that the Commission has little patience for dilatory whistleblowers, and even less for those who are culpable and delay reporting for potentially opportunistic reasons while investors suffer further harm.

G. Whistleblower Awards to Date.

As of January 31, 2021, the SEC Office of the Whistleblower has issued awards totaling $738 million in monetary rewards to 134 individuals. Awards have ranged from less than $50,000 to $114 million.[142] Appendix A to this SEC Whistleblower Practice Guide lists all SEC whistleblower awards under the whistleblower program in the nearly ten years of its existence. The awards table, organized chronologically, highlights important information about particular award determinations, including a number of "firsts" in the SEC's handling of award applications.

The SEC has issued awards totaling $738 million to 134 individuals.

As the SEC orders listed in Appendix A show, the SEC discloses limited information when issuing awards in order to protect the identity of whistleblowers, whether or not they filed their tip anonymously. The SEC's guarded approach to disclosing such information is warranted because it minimizes the chances that a whistleblower's identity will become public, and that is a critical concern of would-be whistleblowers on whom the success of the program depends. However, unlike court and agency decisions that normally allow the public to fully understand the bases for government action, the SEC's orders determining claims for whistleblower awards do not cite the underlying enforcement action, do not disclose the name of the respondent, and disclose little about the nature of the entity or the details of the misconduct involved. For this reason, practitioners will need to read the SEC orders carefully in order to use them effectively as guides to participation in the whistleblower program and as legal precedent for use in preparing tips, assisting the SEC in any ensuing investigations, and claiming awards.

The awards listed in Appendix A reflect a very active, successful first decade of the SEC Whistleblower Program. Even in heavily redacted orders, the Commission has made clear that the program is honoring its commitment to reward individuals who come forward with helpful information about securities violations, sometimes at great risk to their careers. Awards to date demonstrate that the SEC is willing to:

- set award amounts relatively high within the allowable range, at an average that is likely greater than 25% of

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sanctions imposed;
- pay awards both to whistleblowers whose information causes the SEC to commence investigations leading to enforcement actions, and to whistleblowers whose information "significantly contributes" to investigations already underway;
- pay whistleblowers in installments and increase the awards paid as the government collects additional sanctions and penalties from respondents;
- use the Commission's authority to waive program requirements where needed to serve the interests of investors and to act fairly towards whistleblowers;
- apply appropriate exceptions to the presumptive exemptions that prohibit compliance and audit personnel, as well as corporate officers who receive information as part of a company's internal-reporting mechanism, from participating in the whistleblower program;
- protect whistleblowers' identities from public disclosure by ensuring that orders determining whistleblower award claims and related press releases disclose little information about the underlying enforcement actions;
- allow whistleblowers to challenge the amounts of their awards, give fair consideration to the arguments the whistleblowers raise, and reverse or revise preliminary determinations in whistleblowers' favor when appropriate;
- pay awards to individuals who report only internally when the company ultimately self-discloses the information; and
- reward individuals who voluntarily come forward with information containing "independent analysis" as well as "independent knowledge."

Based on these results of the SEC Whistleblower Program to date, whistleblowers and their counsel can be sure that many more awards, including very large ones, are forthcoming. It is a fair assumption that in coming years a growing number of the Commission's successful enforcement actions of all varieties and sizes will have begun with a tip from a whistleblower.

H. Claiming a Whistleblower Award

The SEC posts a "Notice of Covered Action" on its website for each Commission enforcement action in which a final judgment or order, by itself or together with prior judgments or orders in the same action results in monetary sanctions exceeding $1 million.[143] The posting of a notice on the SEC website means only that an order was entered with monetary sanctions exceeding $1 million. The notice does not necessarily mean that a whistleblower tip led to the investigation or enforcement action, or that the SEC will pay an award to a whistleblower in connection with the case.

Once a Notice of Covered Action is posted, anyone claiming entitlement to a whistleblower award in connection with the action has 90 days to apply for an award. Each Notice of Covered Action names the defendants or respondents in the SEC enforcement action, provides links to relevant documents such as administrative or court complaints and settlement orders, and clearly lists the date of the notice and the 90-day deadline for the submission of claims for awards. This deadline is critical. For Whistleblowers seeking to earn awards based on deferred prosecution, non-prosecution, or similar agreements under the newly expanded definition of "action," the SEC will not post a Notice of Covered Action. Rather, the 90-day window will begin on the day the first press release or similar public notice of the action is posted, or if no public notice is granted, the date of the last signature necessary for the agreement. *See* Rule 21F-11(b)(1)(ii). If that date is before December 7, 2020 when the Final Rules became effective, the 90-day period began on December 7. *See* Rule 21F-11(b)(1)(i).

A whistleblower must apply for an award by submitting a completed Form WB-APP to the Office of the Whistleblower by midnight on the claim due date. Whistleblowers and their counsel need to be vigilant in monitoring the list of Cover Actions, which the SEC updates monthly at the end of each calendar month, and in submitting timely claims for award using the WB_APP form that is available on the SEC website.[144] The SEC has consistently denied claims where the claimant has failed to meet the 90-day deadline for submitting a WB- APP form. On July 23, 2014, for example, the SEC denied a whistleblower's claims for awards in connection to two covered actions that the whistleblower had submitted more than three months after the 90-day claims window.[145] The SEC found the claimant's explanation that the claimant was unaware of the Notices of Covered Actions on the SEC's website fell short of the "extraordinary circumstances" needed under Rule 21F-8(a) to justify the SEC's waiver of the filing deadline.

> "We hope these awards continue to encourage individuals with information…to report to the Commission."
>
> – Office of the Whistleblower Chief, Jane Norberg

In another case in 2017, the claimant went even further in arguing for waiver of the deadline, insisting that the SEC not only should have posted the Notice of Covered Action on its website, but also should have notified him or her personally with specific instructions about how to apply for an award.[146] Not surprisingly, the SEC rejected this argument, noting the even-handedness and reasonableness of the notice mechanism provided under the rules. The SEC's repeated denial of award applications submitted after the 90-day deadline has not deterred untimely filers in challenging the Commission's denial of their claims, but the SEC has so far refused arguments put forth by claimants to justify missing the deadline.[147]

Although whistleblowers must meet a strict deadline for filing their claims for awards, there is no such deadline by which the Commission must process those claims. Concerns about a growing backlog in the SEC's processing of award application began to be raised within the first several years of the program, and the backlog has continued to increase. The Wall Street Journal reported in April 2018 that the one-year backlog that had slowed the process in its early years had grown to more than two years by the end of 2017.[148] Although this has understandably been a source of frustration for whistleblowers, the Office of the Whistleblower has consistently acknowledged the problem, explained the factors contributing to it over the years, and, in the view of the authors, done its best to expedite processing of a fast-growing number of award applications without a commensurate increase in staffing.[149] Some of the 2020 amendments were designed to expedite award processes, including the presumption that whistleblowers with potential awards under $5 million will receive the maximum, clarification on the SEC's ability to bar whistleblowers who have submitted false information in the past, and a new Rule 21F-18 creating summary disposition procedure for common types of denials like untimely award applications.[150]

Thus far, no whistleblower has been successful in overturning a denial of their award application by the SEC Office of the Whistleblower. A group of whistleblowers recently brought their challenge to the SEC's denial of their award applications before the U.S. Court of Appeals for the Second Circuit.[151] The Second Circuit affirmed the SEC's decision. The court found for one whistleblower that although he may have provided useful information to the SEC, it did not lead to an award because the SEC did not use the information.[152] For two more whistleblowers, the court affirmed the SEC's denial of an award upon finding that the SEC already had the information they provided by the time they submitted a Form TCR.[153]

PROTECTIONS FOR WHISTLEBLOWERS AGAINST RETALIATION

Firings, demotions and other acts of retaliation against employees who blow the whistle on employer misconduct are all too common. A 2013 survey of more than 6,400 employees working in the for-profit sector found that 21% of responding employees who had reported misconduct said that they had suffered some form of retribution as a result of their actions.[154] Individuals who contact lawyers in search of legal representation before the SEC Whistleblower Program fall into this category at least as often as not, and in many cases are still reeling from a recent and sudden firing when they first meet with a lawyer. Some contact a lawyer for the purpose of challenging their wrongful termination, and learn only during the initial consultation that the conduct that they reported to their company, leading to their termination, could form the basis for an important, timely and potentially lucrative tip to the SEC.

Certain protections for whistleblowers against retaliation are built in to the rules governing the SEC Whistleblower Program. The most impactful protection may be the ability of whistleblowers to submit their tips anonymously and the SEC's commitment to shielding the whistleblower's identity from disclosure throughout the investigation, enforcement action and awards process, as discussed above.

The Dodd-Frank Act and the SEC Whistleblower Program have significantly expanded whistleblower protections for employees in other ways as well. The Dodd-Frank Act amends the employee-protection provisions of the Sarbanes-Oxley Act (SOX) to make them more favorable to employees; creates a new cause of action that a whistleblowing employee can bring in federal court; and, as implemented by the SEC's rules for the whistleblower program, allows the Commission to use its enforcement powers to hold employers accountable for retaliation against whistleblowers.[155] The SEC has brought successful enforcement actions against companies that retaliated against employees who reported securities violations to the Commission.[156]

Attorneys who represent employee-whistleblowers before the SEC will want to familiarize themselves with applicable anti-retaliation laws and the SEC's enforcement actions enforcing those laws, discussed below, as their clients may have suffered or might yet suffer retaliation, including loss of their jobs, especially where they have reported their employers' securities violations internally with the company. Practitioners should remember that, for a whistleblower who has suffered career-derailing retaliation by an employer, the goal of correcting that injustice and obtaining prompt and just compensation can be just as important as, if not more important than, submitting a tip to the SEC in hopes of earning an award that may not come for years if at all. And whistleblowers often have the ability to remedy the retaliation with little downside. Because of the stakes involved for companies defending against lawsuits by such whistleblowers, plaintiff-side attorneys may find that they can negotiate a favorable resolution of their clients' claims, in many cases without having to take legal action, and in a manner that allows their clients to rebuild their careers without the reputational harm that typically flows from suing their current or previous employers.

In addition to focusing on the enforcement of employee protections afforded by these laws, the SEC has taken aim in recent years at employer-imposed agreements that might impede the flow of information from employees to the Commission. The agreements at issue, often signed by the employee as a condition of employment itself or as a condition of receiving severance payments, might require employees to certify that they have not shared confidential information with any third party, to alert the employer to any inquiries from government agencies, or to waive their right to the monetary awards that Dodd-Frank directed the SEC to provide to whistleblowers. The SEC has shown that it will penalize employers for using such agreements to impede whistleblowers from participating in the whistleblower program.

"Strong enforcement of the anti-retaliation protections is critical to the success of the SEC's whistleblower program."

– Mary Jo White, former SEC Chair

A. Employee Protections Under SOX

Section 806 of SOX, 18 U.S.C. § 1514A(a)(1), provides a cause of action to employees of publicly traded companies and certain of their subsidiaries and contractors whose employers retaliated against them because they provided information about, or participated in an investigation relating to, what they:

> reasonably believe[d] constitute[d] a violation of section 1341 [mail fraud], 1343 [wire fraud], 1344 [bank fraud], or 1348 [securities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.[157]

The information must have been provided to, or the investigation must be conducted by: (1) a federal regulatory or law enforcement agency; (2) a member of Congress or any committee of Congress; (3) a person with supervisory authority over the employee; or (4) a person working for the employer who has the authority to investigate, discover, or terminate the misconduct.[158]

The law also protects those who file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed, or about to be filed, relating to an alleged violation of federal securities and fraud laws.[159] In order to prevail in a claim of retaliation brought under SOX, the complainant must show that his protected activity was a contributing factor in the adverse personnel action. Available remedies include reinstatement, back pay, compensatory damages, and attorneys' fees and costs sustained as a result of the discharge or other retaliation.

The Dodd-Frank Act amendments to SOX Section 806 are in Section 21F(c) of the Act.[160] These provisions strengthen the hand of employees bringing claims of retaliation under SOX by increasing the SOX statute of limitations from 90 days to 180 days, providing for jury trials in SOX cases brought in federal court, and invalidating mandatory, pre-dispute arbitration agreements, which typically favor employers, to the extent those agreements purport to apply to SOX retaliation claims.

Dodd-Frank and a 2014 Supreme Court decision have also widened the range of employers whose employees are protected by SOX. Section 929A of the Dodd-Frank Act expanded SOX 806's coverage to include subsidiary entities whose financial information is included in a publicly traded parent's consolidated financial statements.[161] In a 2014 decision that will gradually expand the ranks of employees bringing SOX whistleblower claims, the Supreme Court further expanded the statute's coverage, holding that SOX Section 806 protects the employees of contractors and of subcontractors of publicly- traded companies.[162] An employee seeking relief from retaliation under SOX must file the claim with OSHA, which investigates the claim and issues a determination. SOX claims are further adjudicated by administrative law judges, or, if the DOL has not issued a final decision within 180 days, in federal district court if the claimant decides to pull the matter from the DOL and refile it there.[163]

B. Employee Protections Under Dodd-Frank

The new cause of action created by the Dodd-Frank Act is set forth in Section 21F(h)(1)(A), which allows "whistleblowers" to sue in federal court if their employers retaliate against them because they:

- provide information about their employer to the SEC in accordance with the above-described whistleblower bounty program;
- initiate, testify or assist in any investigation related to the program; or
- make disclosures "required or protected" under the Sarbanes-Oxley Act, the Securities Exchange Act of 1934, or any other law, rule, or regulation under the jurisdiction of the SEC.

A Dodd-Frank retaliation claim may be filed directly in federal court within three years "after the date when facts material to the right of action are known or reasonably should have been known to the employee" (but subject to a maximum of six years).[164] A whistleblower's remedies include reinstatement, double back pay with interest, attorneys' fees, and reimbursement of other related litigation expenses.[165] Punitive damages are not recoverable under the statute.[166]

The SEC initially interpreted Dodd-Frank to cover employees who report violations internally to their employers as well as those who report to the SEC.[167] On February 21, 2018, however, the Supreme Court ruled unanimously that the statutory definition of the word "whistleblower" limited the anti-retaliation protections of Section 922 to those who have reported to the SEC.[168] The SEC codified that decision in its 2020 Final Rules and Adopting Release by adding a provision explicitly stating that Dodd-Frank's retaliation protection only applies to employer conduct which occurred after the employee qualified as a "whistleblower" under the rules.[169] Where the whistleblower first reports a violation internally and then to the SEC, Dodd-Frank only prohibits retaliation after the employee files the written report with the SEC.[170]

In July 2019, the U.S. House of Representatives passed H.R. 2515, known as the Whistleblower Protection Reform Act of 2019, which would, among other things, effectively reverse Digital Realty and protect whistleblowers who only reported their concerns internally. As of this writing, the Senate has not brought the bill to the floor for a vote.[171]

While widely viewed as a victory for the management bar, this change will likely frustrate one of the primary policy goals that corporate interests had pursued during the development of the SEC whistleblower program. While the SEC was initially crafting rules to implement the program in 2010, several corporations weighed in requesting that the Commission put in place rules designed to encourage or even require whistleblowers to first utilize internal whistleblower programs before reporting to the SEC.[172] Because the Supreme Court's decision and the 2020 rule change limit the generous remedies available under the Dodd-Frank anti-retaliation provision to those employees who report to the SEC, employees will now be incentivized to report to the Commission before they report internally and face the prospect of retaliation. These incentives to report externally could lessen the effectiveness of internal compliance programs, and thus degrade their ability to help management identify and address securities violations without facing full-blown SEC investigations and potential sanctions. The SEC addressed this concern by stating that whistleblowers will still be incentivized to comply with internal reporting procedures by the fact that the SEC can adjust a whistleblower's award up or down depending on their compliance with employer procedures.[173] Whether this is a strong enough incentive remains to be seen.

> Dodd-Frank provides protection against retaliation only for employees who have reported to the SEC.

C. Extraterritorial Application of Whistleblower Protections.

It is not uncommon for whistleblowers to discover securities violations while working overseas for their corporate employers–i.e., in places falling outside of the U.S. government's territorial jurisdiction.[174] Whether and to what extent an overseas whistleblower can successfully prosecute extraterritorial claims of retaliation is an evolving issue. In 2017, the U.S. Department of Labor's Administrative Review Board (ARB) held that SOX 806 extended to whistleblowers who worked overseas so long as the misconduct of the employer affected the United States "in some significant way."[175] Just over two years later, however, an ARB containing several new appointees effectively reversed that decision and held that SOX does not apply extraterritorially.[176] The ARB did, however, appear to leave the door open to claims brought by employees based in the United States who experienced retaliation during a temporary post overseas.

Similar to SOX, the Dodd-Frank Act is unlikely to provide anti-retaliation protections for employees working overseas. Although non-U.S. employees working for non-U.S. companies can be eligible for rewards under the SEC's Whistleblower Program, such employees do not enjoy the same anti-retaliation protections as U.S.-based employees. In Liu Meng-Lin v. Siemens AG, the Second Circuit held that Dodd-Frank's anti-retaliation provisions do not apply to non-U.S. employees working for non-U.S. companies, even when those companies are listed on a U.S. stock exchange.[177] In that case, a non-U.S. employee of a Chinese company was subjected to retaliation for reporting violations of the Foreign Corrupt Practices Act to both the company's compliance department and the SEC. The Court of Appeals held that the anti-retaliation provisions of the Dodd-Frank Act do not apply to non-U.S. employees of non-U.S. companies where all events related to the employee's disclosures occurred outside the U.S.[178]

The SEC has made clear that the considerations underlying the Second Circuit's holding in Liu do not prevent the Commission from issuing whistleblower awards to individuals working and living outside the U.S. "[T]he whistleblower award provisions have a different Congressional focus than the anti-retaliation provisions," the SEC explained in its first order paying an award to a foreign whistleblower, "which are generally focused on preventing retaliatory employment actions and protecting the employment relationship."[179] As described in more detail below, the SEC has also taken action against a company for impeding a foreign-based employee from communicating with the SEC, if not directly for retaliating against him. This action impacting on the employer-employee relationship in another country, while not strictly an action challenging an act of retaliation, could point the way towards a more expansive view on the part of the SEC of its ability to protect whistleblowing employees against retaliation overseas.

D. Enforcement of Anti-Retaliation Provisions by the SEC

Both SOX and the Dodd-Frank Act allow individuals who have suffered unlawful retaliation to prosecute their own legal actions against employers, but the SEC Whistleblower Program rules allow the SEC also to sanction employers for violations of the Dodd-Frank anti-retaliation provisions through the Commission's own enforcement actions. *See* Rule 21F-2(b)(2). The SEC invoked this authority on June 15, 2014, when it announced its first enforcement action against a company based in part on the company's retaliation against a whistleblower.

In that case, the SEC charged a hedge fund advisory firm with engaging in principal transactions that created an undisclosed conflict of interest, and also charged the firm with retaliating against an employee who had reported the matter to the SEC and suffered retaliation as a result. The company agreed to settle the SEC enforcement action for $2.2 million, although the SEC's order implementing the settlement left unclear what portion of the settlement was based on the retaliation allegations.[180] The whistleblower later received an award of $600,000 for the information he provided to the SEC.[181]

On September 29, 2016, the SEC issued its only penalty so far against a company for retaliating against a whistleblower in a "stand-alone" case of retaliation in which the Commission did not also impose a penalty for substantive securities violations. In that case, a casino-gaming company known as International Game Technology (IGT) agreed to pay $500,000 "for firing an employee with several years of positive performance reviews because he reported to senior management and the SEC that the company's financial statements might be distorted."[182] The SEC found that the employee had been "removed from significant work assignments within weeks of raising concerns about the company's cost accounting model" and was terminated just three months later.

On January 19, 2017, the SEC announced the settlement of charges that a financial service company, HomeStreet, Inc., had engaged in misconduct by impeding whistleblowers who reported to the SEC.[183] The Commission found that in response to an SEC inquiry, HomeStreet management officials had attempted to investigate and uncover the identity of the whistleblower, including by interrogating employees as to whether they or their colleagues were the "whistleblower."

These SEC actions have sent a strong signal to employers that the SEC will take action when they retaliate against whistleblowers. Employers that engage in unlawful retaliation risk having to defend themselves not only against lawsuits and administrative charges filed by the employees, but also against costly SEC investigations and enforcement actions that can lead to significant penalties over and above any amounts employees win in court. As the IGT case further shows, the rules protect whistleblowing employees who have a "reasonable belief" that the information they are reporting reveals possible securities law violations, which means that an employee is protected even if he or she ends up being wrong in her belief or if the SEC decides not to take action targeting those violations. *See* Rule 21F-2(b). The terms "reasonable belief" and "possible violation" were included in Rule 21F-2(b) as an attempt to deter frivolous claims while still protecting those with information regarding a plausible violation.[184] The same rule makes clear that the anti-retaliation protections apply regardless of whether a whistleblower qualifies for an award.

The SEC's enforcement actions against retaliating employers also send a strong signal to would-be whistleblowers: the SEC Whistleblower Program welcomes their participation in two ways – not only by providing financial rewards where appropriate, but also by penalizing (and hopefully deterring) retaliation against whistleblowing employees to the extent that the Commission is allowed to do so by law. This gives meaning to former SEC Chair White's comment to a gathering of securities lawyers in April 2015, when she explained that "we at the SEC increasingly see ourselves as the whistleblower's advocate."[185] Chair White further stated, "Strong enforcement of the anti-retaliation protections is critical to the success of the SEC's whistleblower program and bringing retaliation cases will continue to be a high priority for us."

E. Employer-Imposed Agreements That Impede Whistleblowers

Another very important protection for employees who blow the whistle on securities violations is found in Rule 21F-17(a), which states:

> No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications.

This ground-breaking rule applies to all confidentiality and non-disclosure agreements that employers require of current employees. It also applies to separation, severance or settlement agreements that employers require employees to sign when exiting a company, as these almost invariably include confidentiality provisions and non-disparagement provisions. The rule has no parallel in the Internal Revenue Service's whistleblower program or under the False Claims Act, although courts have refused to enforce confidentiality agreements in the context of the False Claims Act.[186] The CFTC adopted rules amendments similar to the SEC's prohibition of impediments to whistleblowers on May 22, 2017.[187]

During the first few years of the SEC Whistleblower Program, lawyers representing whistleblowers observed a troubling trend among employers seeking to circumvent Rule 21F-17(a). Employees increasingly found themselves presented with agreements that required them to certify that they had not shared and would not share confidential information with any third party except "as required by law," to waive their right to an SEC award, to assign any award received to the government, and/or to keep the employer informed of any contact with or inquiries from government agencies. While not expressly prohibiting contact with the SEC, such terms have the purpose directly with the Commission.

> Employees can participate in the SEC Whistleblower Program without regard to restrictive agreements that employers have forced them to sign.

Attorneys representing whistleblowers before the SEC started bringing employers' widespread use of restrictive agreements to the SEC's attention as early as mid-2013.[188] The SEC began addressing these concerns in late 2013 or early 2014, and since that time has taken a series of enforcement actions that have prompted companies nationwide to rewrite their employee agreements to bring them into compliance with Rule 21F-17(a).

In early 2015 the SEC sent letters to a number of companies requesting years of nondisclosure agreements in an effort to determine whether the companies had restricted their employees' ability to share information with law enforcement agencies. These investigations culminated in an enforcement action against KBR, Inc. On April 1, 2015, the SEC announced that it had entered into a settlement with KBR related to the company's confidentiality agreements. The provision at issue appeared in an agreement that KBR required employees to sign when participating in the company's internal investigations:

> I understand that in order to protect the integrity of this review I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.[189]

Without admitting to any rule violation, KBR agreed to pay a $130,000 fine and change its confidentiality agreement language going forward. The new language would read:

> Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.[190]

Following the KBR action, the SEC stepped up its efforts to combat agreements that similarly impeded whistleblowers, and broadened its targets to include additional types of provisions that could dissuade employees from approaching the SEC with concerns about securities violations. In her April 2015 speech on "The SEC as the Whistleblower's Advocate," SEC Chair White noted that "a number of other concerns have come to our attention, including that some companies may be trying to require their employees to sign agreements mandating that they forego any whistleblower award or represent, as a precondition to obtaining a severance payment, that they have not made a prior report of misconduct to the SEC. You can imagine our Enforcement Division's view of those and similar provisions under our rules."[191] The SEC has since taken nearly a dozen additional enforcement actions specifically targeting such employer-imposed restrictions in employment and severance agreements.[192]

Seeing the SEC take aggressive and rapid-fire aim at company agreements that required an employee to waive her right to receive an SEC was a welcome development for whistleblowers. As a letter from Katz, Marshall & Banks to the SEC told the Commissioners in 2013, the attempt to require employees to waive their right to an SEC award was among the most common and insidious impediments that employers had contrived to discourage employees from communicating with the Commission.[193] In the SEC whistleblower program, it is the government, and not the employer that pays an award to the employee. The whistleblower's right to an award is a statutory right that has nothing to do with the legal dispute the employee settled with the employer. Therefore, the only benefit an employer receives from such an agreement is to dis-incentivize employee whistleblowing to the SEC—a goal with no legitimate justification. Courts would likely find such agreements void as against public policy, but the agreement could still prevent individuals from reporting to the SEC if they believe they will receive no award and will face a breach-of-contract lawsuit and accompanying career harm.

The SEC's enforcement actions against employers who have erected barriers to whistleblowers advances the ability of the Commission (and investors) to draw on the knowledge of whistleblowers to protect investors against securities fraud.

These SEC actions have not only forced employers nationwide to scramble to reform their agreements with employees, but they have no doubt rendered the outlawed provisions and ones like them effectively unenforceable in court. The removal of such onerous restrictions is especially welcome for employees who are abruptly fired or otherwise retaliated against for reporting their concerns internally, as it leaves them free to challenge the retaliation, obtain just compensation by settling the dispute prior to or during litigation, and then still participate in the SEC Whistleblower Program, if they so choose, without fear that an employer will be able to sue them and claw back whatever severance or settlement amount it may have paid them.[194]

THINGS TO THINK ABOUT BEFORE YOU TIP

Whistleblowers who prepare strong submissions focusing on violations that fit within the SEC's law-enforcement priorities can expect an opportunity to meet with SEC staff early on in the process. From there, the whistleblower's responsibility is to assist the SEC as needed in the ensuing investigation, and to be prepared to claim an award if the Commission takes enforcement action resulting in a qualifying sanction.

The following is a partial list of practical advice for practitioners who seek to assist their clients in making a compelling case for enforcement action by the SEC. These considerations, which should also be helpful to whistleblowers who participate in the program without counsel, are based on the program discussed above, the SEC's handling of whistleblower tips to date, and the authors' first-hand experience representing numerous clients before the SEC Whistleblower Program, leading to successful enforcement actions:

- Determine whether the client has original information about violations of securities laws or the Foreign Corrupt Practices Act.
- Assess the seriousness of the alleged violations by reviewing past SEC regulatory and enforcement actions, which are available on the SEC's website and searchable by topic, violation, company and other parameters.
- Where needed, assess the potential tip with the help of an expert in the appropriate specialty, such as securities trading or public accounting. Do the work necessary to find experts in whatever subspecialty is needed, such as broker-dealer compliance, revenue recognition, loan loss reserves, alternative trading platforms, or the intricacies of accounting standards applicable to the particular industry or sector whose activities are in question.
- Determine whether and to what extent your client's information might advance the SEC's current enforcement agenda, which is not a constant. The SEC's website contains a great deal of information about Commission priorities, including enforcement actions, press releases and task-force reports. Speeches by SEC commissioners and leading officials can also shed light on the types of information that may be of greatest interest to the SEC.
- Make sure that your client will be providing information "voluntarily," prior to receiving a request for the same from the SEC or another agency or self-regulatory organization ("SRO"). If such a request has already been made, consider whether your client might still be eligible for an award given the circumstances of the SEC's waiver of the "voluntary" requirement in one case in 2014 as discussed above.
- Prepare the client's submission to the SEC with an emphasis on facts about which the client has "independent knowledge" as defined in the final rules above. Review the client's position, job duties, and how he came into possession of his information to determine whether he falls within one of the groups of individuals who are presumptively excluded from the program for lack of "independent knowledge." This would include attorneys, compliance and audit personnel, and officers or directors who received the information in connection with corporate-governance responsibilities.
- If the client falls into one of the excluded categories, see if the client may be exempt from the exclusion because he reported his concerns internally and has waited 120 days as in the case of the compliance employee discussed above, or because he has reason to believe investors may suffer imminent harm or the company is taking action that is likely to impede an investigation.
- Give careful consideration to whether to advise the client to report internally, keeping in mind that doing so might subject the client to retaliation but might also entitle the client to a larger award, both because he can benefit from additional, related information the company "self-reports" to the SEC and because SEC staff will consider his internal reporting as a factor in determining the size of an award. And as discussed above, your client may have legal protections against retaliation for internal reporting under SOX even if not directly under the anti-retaliation provisions of the Dodd-Frank Act.

- Remember that your client, through you, may file his tip anonymously as long as you follow the procedures set forth in the rules for anonymous submissions. This can certainly help prevent retaliation against your client, especially if he is determined not to report internally for fear of retaliation. Anonymous reporting can also provide your client with greater confidence that his identity will not become known to future employers and thus pose future risk to his career.
- Use the SEC-supplied forms and carefully follow the rules that apply to them, as a whistleblower is eligible for a reward only if he follows the prescribed procedures.[195] The importance of following the rules cannot be overemphasized.
- Remember that the SEC receives thousands of tips per year, and that it is important to make sure your client's TCR is as compelling as possible. If the lawyers and accountants who review tips in the Office of the Whistleblower and the Office of Market Intelligence cannot understand your client's submission on a first read, it will not likely end up at the top of the stack. Present your facts and analysis clearly and include with the TCR form any relevant documents your client can provide.
- Although it is possible to supplement your submission later, you do not want to lose the opportunity for the SEC staff to see the basis for a winnable enforcement action to remedy a pressing need in the first thirty minutes of reviewing your tip, and you get only one chance to make that happen.
- Include any useful analysis that you, your client, or an expert you retain can apply to other facts, even publicly available ones, in a way that will assist SEC lawyers in an investigation. Keep in mind that your submission cannot be "exclusively derived" from certain public sources, but that SEC investigators will accept and appreciate your analysis of publicly available information if the analysis helps lead the SEC to information that is not publicly available or provides insights that are not generally known. One successful tip discussed above appears to have consisted entirely of independent analysis and no independent knowledge.
- Do not include attorney-client privileged communications in your client's submission to the SEC. The Commission will not consider the information, and its receipt of such communications will in itself delay or even discourage the SEC's consideration of the submission as a whole. If unsure about potentially privileged materials, speak with the Office of the Whistleblower and/or Enforcement staff assigned to the investigation about the possibility of having an SEC "filter" team screen certain documents to prevent staff involved in the investigation from viewing privilege materials, possibly resulting in their disqualification from the investigation.
- Make sure to study the website of the SEC Office of the Whistleblower thoroughly,[196] as it contains a wealth of useful information about how to submit a tip and claim an award. That office's staff also answers telephone inquiries about the program and how it works. In addition, the SEC website provides comprehensive, searchable information about securities laws, company filings, comment letters to issuers of securities, and past and ongoing Commission enforcement actions that can be very helpful in preparing your tip and claiming an award. The Office of the Whistleblower's annual reports also contain valuable information about the whistleblower program.
- If you are an individual thinking about submitting a tip to the SEC, you may want to consult with attorneys who specialize in representing whistleblowers before the SEC, and who have first-hand experience with the SEC's handling of tips under the new program. Attorneys practicing before the SEC will have useful advice about how best to prepare your tip, how to direct the information to appropriate SEC staff, how best to aid the staff in a successful investigation of your information, and how to claim an award successfully.
- Do not needlessly delay in submitting your tip. The statute of limitations for securities violations is generally five years, but beyond the risk of submitting a tip that the SEC is time-barred from pursuing, an unreasonable delay in submitting a tip can negatively affect the size of the whistleblower's reward. Promptly submitting a tip also reduces the chances of a competing whistleblower submitting the same information first.
- Provide the SEC with as much documentation of your allegations as possible. While being mindful of any privilege issues, including documentation that supports the allegations made in the tip allows the SEC to judge the reliability of the information in the tip, and helps the agency build a case against the company. Whistleblowers can further assist the SEC by providing a "roadmap" for the agency to follow in seeking additional information from the respondent to the investigation and related individuals and entities.

… And After You Tip.

- Check your email! Do not make the mistake that one claimant made when he or she failed to respond to an email from SEC staff seeking to follow up on the claimant's tip. The SEC's follow up email was directed to the email address the claimant had provided on the TCR form. The whistleblower's failure to check his or her inbox led SEC staff to close the tip with no further action and was in part responsible for the SEC's later denial of an award to the claimant, whose tip had not "led to" a successful enforcement action. In so ruling, the SEC rejected the claimant's argument that he or she "would have" provided critical information had the SEC tried harder to make contact.[197]

- Throughout the process, think twice – no, at least ten times – before accusing the SEC and its staff of corruption, dishonesty or other malfeasance in their handling of your whistleblower tip or in making a preliminary determination regarding your application for an award. The SEC staff are extremely hard-working, dedicated, honest and fair-minded in their dealings with whistleblowers. Their advocacy for the whistleblower, moreover, is critical to the whistleblower's ability to earn an award, and you should assume that the Commission will reject wild allegations of malfeasance as lacking credibility.[198]
- Related to the prior practice point, remember that the primary purpose of the SEC Whistleblower Program is to assist the Commission in enforcing the nation's securities laws, and that the financial incentives the program provides are designed to further that purpose. The whistleblower's role is to submit information he or she believes will be helpful to the SEC in bringing a successful enforcement action, hopefully one that qualifies as a covered action and entitles the whistleblower to an award. The role of the SEC and its staff is to investigate the information if warranted, to take action if appropriate, and to impose sanctions in an amount that the facts, the law, and the SEC's enforcement priorities warrant. The whistleblower, for good reason, has no right to decide what action, if any, the SEC should take based on his or her tip.
- This does not mean you cannot argue for investigation, suggest theories of recovery, etc., in working with the SEC as a whistleblower. It does mean that you need to be careful to remember your role, manage your expectations, and show respect for the SEC staff's decisions as to strategy and tactics over the course of what can be a long process.
- Keep detailed records of all contact with the SEC and with related agencies that are investigating alongside the SEC. If the SEC takes enforcement action resulting in more than $1 million in sanctions, you will be glad that you can support your claim with your saved emails, phone records, recollections informed by contemporaneous notes, etc. that demonstrate the extent to which you and your information assisted the SEC in achieving a favorable outcome.
- Monitor the monthly postings of notice of covered actions carefully. The SEC has made clear that "[a] potential claimant's responsibility includes the obligation to regularly monitor the Commission's web page for NoCA postings and to properly calculate the deadline for filing an award claim."[199] Whistleblowers should also monitor media reports about potential deferred prosecution, non-prosecution, and settlement agreements in light of the Rule 21F-11(b)(1) making it a whistleblower's responsibility to monitor SEC press releases and media reports to determine whether a qualifying agreement has been announced publicly (thereby triggering the 90-day period of time to file an application for an award).

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Lisa J. Banks and Michael A. Filoromo are partners with Katz, Marshall & Banks, LLP, a whistleblower and employment law firm based in Washington, D.C. They specialize in the representation of whistleblowers in tips submitted to the Securities and Exchange Commission's Office of the Whistleblower, in qui tam lawsuits filed under the False Claims Act, in tips filed with the Commodity Futures Trading Commission, and in tips submitted to the Internal Revenue Service's whistleblower program. They also represent employees in whistleblower-retaliation cases filed under the Sarbanes-Oxley Act, the Dodd-Frank Act and other federal and state laws.

Katz, Marshall & Banks, LLP's website at www.kmblegal.com features detailed information about how employees who have blown the whistle on unlawful conduct can fight back against unlawful retaliation and also earn financial rewards where available. Articles in the website's Whistleblower Law section explain both the law and practicalities of whistleblowing as they play out in a wide range of industries and professions. Whistleblower topics include the SEC Whistleblower Program, Corporate and Accounting Fraud, Qui Tam Lawsuits under the False Claims Act, IRS Whistleblowers, Compliance Officer Whistleblowers, Consumer Finance Whistleblowing, the Pharmaceutical Industry, Food Safety, the Nuclear Industry, and Consumer Product Safety Whistleblowers, to name just a few. *See* http://www.kmblegal.com/practice-areas/whistleblower-law/ and http://www.kmblegal.com/practice-areas/sec-whistleblower-law.

The Katz, Marshall & Banks website also hosts an informative SEC Whistleblower Law Blog and also a more general Whistleblower Law Blog that can help keep whistleblowers and other conscientious employees up to date on new developments in whistleblower law and related news separate with broader whistleblower news and developments. *See* http://www.kmblegal.com/blogs.

ENDNOTES

[1] 15 U.S.C. § 78u-6(j).

[2] This Guide follows SEC numbering practice by referring to the Rules as "Rule 21F-1" etc. The rules are codified at 17 C.F.R. §240.21F-1 et seq. The most recent version of the rules, as amended in December 2020, can be found on the SEC's website at https://www.sec.gov/files/amended-rules-whistleblower-december2020.pdf. The rule establishing the range of awards is Rule 21F-3(a).

[3] SEC Press Release No. 2021-7, SEC Awards Nearly $600,000 to Whistleblower (Jan. 14, 2021), https://www.sec.gov/news/press-release/2020-333. This Practice Guide contains updated information about whistleblower awards issued through January 31, 2021.

[4] SEC Division of Enforcement 2020 Annual Report, 20-21 (Nov. 22, 2020), available at https://www.sec.gov/files/enforcement-annual-report-2020.pdf (hereinafter "2020 Annual Report"); SEC Press Release No. 2020-240, SEC Whistleblower Program Ends Record-Setting Fiscal Year With Four Additional Awards (Sept. 30, 2020), https://www.sec.gov/news/press-release/2020-240.

[5] SEC Press Release No. 2021-34, SEC Issues Whistleblower Awards Totaling Over $1.7 Million (Feb. 25, 2021), https://www.sec.gov/news/press-release/2021-34. See Appendix A: SEC Whistleblower Awards Through February 28, 2021, infra, for a list of awards and amounts.

[6] See Appendix A: SEC Whistleblower Awards Through January 31, 2021, infra.

[7] SEC Press Release No. 2020-266, SEC Issues Record $114 Million Whistleblower Award (Oct. 22, 2020), https://www.sec.gov/news/press-release/2020-266.

[8] 2020 Annual Report, supra note 4, at 20.

[9] SEC, Enforcement Actions Based on Actions Taken to Impede Reporting, https://www.sec.gov/whistleblower/retaliation#enforcement-actions (last visited Feb. 1, 2021).

[10] See SEC Release No. 34-89963, Whistleblower Program Final Rules (Sept. 23, 2020), https://www.sec.gov/rules/final/2020/34-89963.pdf (referred to hereinafter as "2020 Final Rules and Adopting Release"); SEC Press Release No. 2020-219, SEC Adds Clarity, Efficiency and Transparency to Its Successful Whistleblower Award Program (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-219.

[11] 2020 Final Rules and Adopting Release, supra note 10, at 49-52; Rule 21F-6(c).

[12] For the definition of "whistleblower," see Rule 21F-2(a), and 2020 Final Rules and Adopting Release, supra note 10, at 63-64 (discussing changes to the rule). For the definition of "action," see Rule 21F-4(d), and 2020 Final Rules and Adopting Release supra note 10, at 15-20 (discussing changes). For the definition of "related action," see Rule 21F-3(b), and 2020 Final Rules and Adopting Release, supra note 10, at 35-43 (discussing changes).

[13] 2020 Final Rules and Adopting Release, supra note 10, at 94-102; Rule 21F-9(e).

[14] 12 U.S.C. 7201 et seq.

[15] 18 U.S.C. § 1514A.

[16] Fraud Enforcement and Recovery Act of 2009, Pub. L. 111-21, 123 Stat. 1617 (2009); see also False Claims Act, 31 U.S.C. § 3729 et seq.

[17] For a comprehensive guide to the CFTC Whistleblower Program, see Lisa J. Banks' CFTC Whistleblower Practice Guide, a sister publication to this SEC Whistleblower Practice Guide that is also published annually by Katz, Marshall & Banks, LLP. The 2021 edition is available online at http://www.kmblegal.com/resources/guide-navigating-cftc-whistleblower-program. The range of trading activity that can form the basis for tips to the CFTC includes trades not only in cotton and pork bellies but also in oil and gas, treasury futures, commodities such as currencies, cryptocurrencies and alternative investment products such as derivatives and swaps. Although the CFTC program has attracted far fewer whistleblower tips than the SEC program, it has seen increased activity in the past few years, perhaps due in part to the CFTC's announcement in April 2018 of its largest award of approximately $30 million. See id. at 3; CFTC Release No. 7753-18, CFTC Announces Its Largest Ever Whistleblower Award of Approximately $30 Million (July 12, 2018), https://www.cftc.gov/PressRoom/PressReleases/7753-18.

[18] SEC Release No. 34-64545, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 4 (Aug. 12, 2011), https://www.sec.gov/rules/final/2011/34-64545.pdf (hereinafter "2011 Final Rules and Adopting Release").

[19] The 2011 Final Rules and Adopting Release, supra note 18, a combined 305 pages, provides a very useful summary of the policy discussion surrounding the formation of the SEC Whistleblower Program, and remains an invaluable resource for whistleblowers and their lawyers in preparing tips and applying for awards. Corporate counsel whose clients may be the subject of whistleblower tips can also benefit from a review of the Adopting Release. The text of the rules themselves begins on page 241.

[20] SEC Press Release No. 2019-3, Court Orders $1 Billion Judgment Against Operators of Woodbridge Ponzi Scheme Targeting Retail Investors (Jan. 28, 2019), https://www.sec.gov/news/press-release/2019-3.

[21] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 82181, at 8 n.13 (Nov. 30, 2017), https://www.sec.gov/rules/other/2017/34-82181.pdf.

[22] SEC Press Release No. 2020-288, SEC Awards Whistleblower Over $900,000 (Nov. 19, 2020), https://www.sec.gov/news/press-release/2020-288.

[23] See, e.g., Order Determining Whistleblower Award Claim, Exchange Act Release No. 73174, at 2 n.2 (Sept. 22, 2014), https://www.sec.gov/rules/other/2014/34-73174.pdf.

[24] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 84270 (Sept. 24, 2018), https://www.sec.gov/rules/other/2018/34-84270.pdf (awarding nearly $4 million to an "individual residing in a foreign country").

[25] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 81200 (July 25, 2017), https://www.sec.gov/rules/other/2017/34-81200.pdf.

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[26] Section 922 of the Dodd-Frank Act amends the Securities Exchange Act of 1934 (commonly referred to as the "Exchange Act") to add a Section 21F, which directs the SEC to establish the SEC Whistleblower Program. 15 U.S.C. § 78u-6.

[27] See 2011 Final Rules and Adopting Release, supra note 18, at 35-37.

[28] SEC Press Release No. 2014-154, SEC Announces Award for Whistleblower Who Reported Fraud to SEC After Company Failed to Address Issue Internally, and linked Order Determining Whistleblower Award Claim (July 31, 2014), https://www.sec.gov/ news/press-release/2014-154.

[29] Id.

[30] SEC Press Release No. 2019-81, SEC Awards $3 Million to Joint Whistleblowers, and linked Order Determining Whistleblower Award Claim 2-3 (June 3, 2019), https://www.sec.gov/news/press-release/2019-81.

[31] See also Rule 21F-8(a), which expressly allows the SEC, "upon a showing of extraordinary circumstances," to waive any of the procedures for submitting tips and claiming an award that are set forth in Rules 21F-9 through 21F-11.

[32] 2011 Final Rules and Adopting Release, supra note 18, at 47.

[33] Id. at 47 n. 104.

[34] See id. at 51.

[35] 2020 Final Rules and Adopting Release, supra note 10, at 110-24.

[36] Id. at 118-19.

[37] Id. at 120. The SEC gave examples in its proposed rule of analysis that would be insufficient, such as where the whistleblower "points to common hallmarks of fraud on the face of public materials (e.g., impossibly high, guaranteed investment returns or extravagant claims in press releases) or to public discourse (e.g., discussions on a public message board) in which investors or others are alleging a fraudulent scheme." Id. at 113; SEC Whistleblower Program Rules, Proposed Rule, Release No. 34-83557, at 106-08 (June 28, 2018), available online at https://www.sec.gov/rules/proposed/2018/34-83557.pdf (hereinafter "2018 Proposed Rules).

[38] Id. at 119-20.

[39] Id. at 123.

[40] Id. at 124.

[41] Id. at 112.

[42] Id. at 120.

[43] Id. at 107–08. See also SEC Press Release No. 2016-10, and the linked Order Determining Whistleblower Award Claim, (Jan. 15, 2016), https://www.sec.gov/news/pressrelease/2016-10.html

[44] See, e.g., Francine McKenna, Whistleblower Award for NYSE Fine Goes to HFT Critic, MarketWatch (Mar. 1, 2016), http://www.marketwatch.com/story/whistleblower-award-for-nyse-fine-goes-to-hft-critic-2016-03-01.

[45] SEC Press Release No. 2020-201, SEC Awards Over $2.5 Million to Two Whistleblowers for Detailed Analysis That Led to Multiple Successful Actions (Sept. 1, 2020), https://www.sec.gov/news/press-release/2020-201.

[46] SEC Press Release 2021-2, SEC Issues Over $1.1 Million to Multiple Whistleblowers (Jan. 7, 2021), https://www.sec.gov/news/press-release/2021-2.

[47] Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R. Part 205, available at https://www.law.cornell.edu/cfr/text/17/part-205.

[48] See New York County Lawyers Association, Ethics Opinion 746, "Ethical Conflicts Caused by Lawyers as Whistleblowers under the Dodd-Frank Act of 2010" (Oct. 7, 2013), available online at https://www.nycla.org/siteFiles/Publications/Publications1647_0.pdf.

[49] See New York ex rel. Danon v. Vanguard Group, Inc., No. 100711/13, 2015 WL 7594570 (N.Y. Sup. Ct. Nov. 13, 2015).

[50] Individuals who obtain information for a tip using methods that a court finds to have violated criminal laws are excluded as well, without exception. Rule 21F-4(b)(4)(iv).

[51] See SEC Press Release No. 2014-180, SEC Announces $300,000 Whistleblower Award to Audit and Compliance Professional Who Reported Company's Wrongdoing, and linked Order Determining Whistleblower Award Claim (Aug. 29, 2014), https://www.sec.gov/news/press-release/2014-180.

[52] See SEC Press Release No. 2015-45, Former Company Officer Earns Half-Million Dollar Whistleblower Award for Reporting Fraud Case to SEC, and linked Order Determining Whistleblower Award Claim (March 2, 2015), https://www.sec.gov/news/pressrelease/2015-45.html.

[53] SEC Press Release No. 2020-75, SEC Awards $450,000 to Whistleblower, and linked Order Determining Whistleblower Award Claim (March 30, 2020), https://www.sec.gov/news/press-release/2020-75.

[54] SEC Press Release No. 2015-73, SEC Announces Million-Dollar Award to Compliance Officer, and linked Order Determining Whistleblower Award Claim (Apr. 22, 2015), https://www.sec.gov/news/pressrelease/2015-73.html.

[55] Id.

[56] See Sec Press Release No. 2020-316, SEC Awards More than $300,000 to Whistleblower with Audit Responsibilities, and linked Order Determining Whistleblower Award Claim (Dec. 14, 2020), https://www.sec.gov/news/press-release/2020-316.

[57] Order Determining Whistleblower Award Claim, Exchange Act Release No. 90656, at 2 (Dec. 14, 2020), https://www.sec.gov/rules/other/2020/34-90656.pdf.

[58] See 2011 Final Rules and Adopting Release, supra note 18, at 64.

[59] See 2011 Final Rules and Adopting Release, supra note 18, at 90–92 for the SEC's most comprehensive explanation of these competing interests and how the Commission weighed them in developing the final rules.

[60] 29 C.F.R. § 1980.104(a).

[61] As reflected in a November 2017 SEC award determination, the Commission takes the "original source" requirement seriously and is hostile to applications from persons whom a whistleblower retained to assist that whistleblower in communicating information to the SEC. Order Determining Whistleblower Award Claim, Exchange Act Release No. 82181, at 10-12 (Nov. 30, 2017), https://www.sec.gov/rules/other/2017/34-82181.pdf. In that case, two claimants had been hired by a whistleblower to prepare an expert report on behalf of that whistleblower, which the whistleblower then provided to the Commission. The SEC eventually gave an award of $8 million to the whistleblower, but it refused awards to the two experts who also applied for a share of the award in the same covered action, reasoning that the experts were not the original source of the information but rather were working on behalf of the whistleblower.

[62] See SEC Press Release No. 2018-58, SEC Awards More than $2.2 Million to Whistleblower Who First Reported Information to Another Federal Agency Before SEC, and linked Order determining Whistleblower Award Claim (April 5, 2018), https://www.sec.gov/news/press-release/2018-58.

[63] Id.

[64] See Order Determining Whistleblower Award Claims, Exchange Act Release No. 80596, at 6 (May 4, 2017), https://www.sec.gov/rules/other/2017/34-80596.pdf.

[65] 2011 Final Rules and Adopting Release, supra note 18, at 105.

[66] Id. at 103.

[67] Id. at 104.

[68] Id.

[69] Id. at 91-92.

[70] See SEC Press Release No. 2019-76, SEC Awards $4.5 Million to Whistleblower Whose Internal Reporting Led to Successful SEC Case and Related Action (May 24, 2019), https://www.sec.gov/news/press-release/2019-76. As discussed above, a similar 120-day rule applies to cases in which a whistleblower seeks an award based on information passed to the SEC by another federal agency. In such cases, the SEC will treat the whistleblower as "first in line" as of the time he or she submitted the information to the other federal agency only if the whistleblower submits the same information with 120 days of providing the information to the other federal agency. See Order Determining Whistleblower Award Claims, Exchange Act Release No. 80596, at 6, n.9 (May 4, 2017), https://www.sec.gov/rules/other/2017/34-80596.pdf.

[71] See 2011 Final Rules and Adopting Release, supra note 18, at 91-92.

[72] Id. at 104.

[73] Id. at 92 n.197.

[74] See 2019 Annual Report to Congress on the Dodd-Frank Whistleblower Program 18 (Nov. 15, 2019), https://www.sec.gov/files/sec-2019-annual-report-whistleblower-program.pdf.

[75] See id.

[76] 2011 Final Rules and Adopting Release, supra note 18, at 100.

[77] See, e.g., Order Determining Whistleblower Award Claim, Exchange Act Release No. 82897, at 7-9 (Mar. 19, 2018), https://www.sec.gov/rules/other/2018/34-82897.pdf (emphasizing the importance of the "leads to" requirement and underscoring the SEC's strong reluctance ever to waive that requirement). The SEC website provides a complete list of orders approving and denying awards, many of which turn on the "leads to" requirement, at http://www.sec.gov/about/offices/owb/owb-final-orders.shtml.

[78] See SEC Press Release No. 2016-88, Whistleblower Earns $3.5 Million Award for Bolstering Ongoing Investigation, and linked Order in Whistleblower Award Proceeding (May 13, 2016), https://www.sec.gov/news/pressrelease/2016-88.html.

[79] 2020 Final Rules and Adopting Release, supra note 10, at 113-14 & n.301 (largely incorporating 2018 Proposed Rules).

[80] 2018 Proposed Rules at 108.

[81] Id. at 108–09.

[82] Id. at 109.

[83] See Order Determining Whistleblower Award Claim, Exchange Act Release No.77530, at 2 (Apr. 5, 2016), available online at https://www.sec.gov/rules/other/2016/34-77530.pdf (discussion of "Claimant 2").

[84] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 82897 (March 19, 2018), https://www.sec.gov/rules/other/2018/34-82897.pdf.

[85] Id. at 6–12.

[86] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 85412 (March 26, 2019), https://www.sec.gov/rules/other/2019/34-85412.pdf.

[87] Stryker v. SEC, 780 F.3d 163 (2d Cir. Mar. 11, 2015), discussed in 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program, 15 (Nov. 16, 2015), available at https://www.sec.gov/files/owb-annual-report-2015.pdf. See also, Order Determining Whistleblower Award Claim, Exchange Act Release No. 79294, at 4-8 (Nov. 14, 2016), http://www.lexissecuritiesmosaic.com/gateway/sec/press-release/2016_34-79294.pdf (two claimants denied awards because information submitted prior to July 21, 2010 did not constitute "original information" under the rules, citing Second Circuit's decision in Stryker).

[88] See 2011 Final Rules and Adopting Release, supra note 18, at 110.

[89] Rule 21F-4(d); 2020 Final Rules and Adopting Release, supra note 10, at 15-20.

[90] 2020 Final Rules and Adopting Release, supra note 10, at 16-20.

[91] Id. at 12.

[92] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 80521, at 2 n.1 (Apr. 25, 2017), https://www.sec.gov/rules/other/2017/34-80521.pdf.

[93] See, e.g., Order Determining Whistleblower Award Claim, Exchange Act Release No. 77530 (Apr. 5, 2016), https://www.sec.gov/rules/other/2016/34-77530.pdf.

[94] See Order Determining Whistleblower Award Claims, Exchange Act Release No. 90245, at 1, 5 (Oct. 22, 2020), https://www.sec.gov/rules/other/2020/34-90247.pdf.

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[95] Rule 21F-3(b)(3); 2020 Final Rules and Adopting Release, supra note 10, at 38-43.

[96] Rule 21F-3(b)(3)(i). Factors for determining which award program has a more direct or relevant connection to the action include "(A) The relative extent to which the misconduct charged in the potential related action implicates the public policy interests underlying the Federal securities laws (such as investor protection) rather than other law-enforcement or regulatory interests (such as tax collection or fraud against the Federal Government); (b) The degree to which the monetary sanctions imposed in the potential related action are attributable to conduct that also underlies the Federal securities law violations that were the subject of the Commission's enforcement action; and (C) Whether the potential related action involves state-law claims and the extent to which the state may have a whistleblower award program that potentially applies to that type of law-enforcement action." Rule 21F-3(b)(3)(ii).

[97] Rule 21F-3(b)(iii).

[98] Michael Rothfeld and Brad Reagan, Prosecutors are Still Chasing Billions in Uncollected Debts, Wall St. J. (Sept. 17, 2014) http://www.wsj.com/articles/prosecutors-are-still-chasing-97-billion-in-uncollected-debts-1410984264.

[99] See SEC Press Release No. 2014-68, SEC Announces Additional $150,000 Payment to Recipient of First Whistleblower Award (April 4, 2014), https://www.sec.gov/news/press-release/2014-68.

[100] See Appendix A, infra.

[101] The Form TCR can be found online at https://www.sec.gov/files/formtcr.pdf. The 2020 Final Rules and Adopting Release allowed the SEC to update the Form TCR as frequently as it chooses, so attorneys and whistleblowers should monitor the website for form changes. See 2020 Final Rules and Adopting Release, supra note 10, at 84.

[102] In an October 2017 award determination granting more than $1 million, the Commission exercised its discretionary power to waive the requirement that a whistleblower have submitted a declaration to the SEC under penalty of perjury. See Order Determining Whistleblower Award Claim, Exchange Act Release No. 81857, at 2 n.1 (Oct. 12, 2017), https://www.sec.gov/rules/other/2017/34-81857.pdf (noting that this failure was the result of the SEC's online portal and that the claimant promptly submitted a declaration once the issue was flagged for him by the SEC).

[103] See also 2020 Final Rules and Adopting Release, supra note 10, at 72-76.

[104] Id. at 94-95. The only exception to this rule is for information submitted between July 21, 2010, when Dodd-Frank was enacted, and August 11, 2011, when the SEC Whistleblower Program Rules took effect. E.g. SEC Press Release No. 2017-1, SEC Awards $5.5 Million to Whistleblower, and linked Order Determining Whistleblower Award Claim, at 1 & nn.2, 3 (Jan. 6, 2017) https://www.sec.gov/news/pressrelease/2017-1.html (waiving "in writing" requirement where whistleblower provided information before Dodd-Frank and in the format the SEC requested). The Commission also waived the requirement in April 2020 under "highly unusual facts and circumstances" where the SEC had requested that the Claimant provide information over the phone. Order Determining Whistleblower Award Claim, Exchange Act Release No. 88687, at 1-3 (Apr. 20, 2020), https://www.sec.gov/rules/other/2020/34-88687.pdf.

[105] The SEC waived the Form TCR requirement twice in December 2020 for unique circumstances, but may be stricter for tips submitted after December 7, 2020 when the Final Rules went into effect. In the first case, the whistleblower had provided the information in writing, unambiguously indicated that it was a tip pursuant to the whistleblower program, their attorney misunderstood SEC communications about the procedural requirements, and they would otherwise have been eligible for an award. Order Determining Whistleblower Award Claims, Exchange Act Release No. 90580, at 1-2 (Dec. 7, 2020), https://www.sec.gov/rules/other/2020/34-90580.pdf. In the second, the whistleblower provided information to their attorney, who submitted a Form TCR with the attorney as the whistleblower, without the client's informed consent. The client provided follow-up information to the SEC and believed that the information was submitted on the client's behalf. Order Determining Whistleblower Award Claim, Exchange Act Release No. 90721, at 1-2 (Dec. 18, 2020), https://www.sec.gov/rules/other/2020/34-90721.pdf.

[106] See 2020 Annual Report, supra note 4, at 19. This was up from approximately 16,850 TCRs in Fiscal Year 2019, which the SEC attributed at least in part to the COVID-19 pandemic. Id.

[107] See SEC OWB Frequently Asked Questions No. 9 at https://www.sec.gov/whistleblower/frequently-asked-questions#P19_5641.

[108] SEC Form TCR – Tip, Complaint or Referral – and related instructions are available online at https://www.sec.gov/files/formtcr.pdf.

[109] See SEC OWB Frequently Asked Questions No. 11 at https://www.sec.gov/whistleblower/frequently-asked-questions#P19_5641.

[110] See SEC v. Yorkville Advisors, LLC, 300 F.R.D. 152 (S.D.N.Y. May 27, 2014) (granting in part and denying in part motion to compel production of documents).

[111] Id.; see also SEC Order Determining Whistleblower Award Claim, Exchange Act Release No. 85412, at 2 n.3 (Mar. 16, 2019), https://www.sec.gov/rules/other/2019/34-85412.pdf.

[112] 2020 Final Rules and Adopting Release, supra note 10, at 49-50.

[113] Id. at 50.

[114] Id. at 50-51.

[115] Id. at 51.

[116] Id. at 52.

[117] Order Determining Whistleblower Award Claim, Exchange Act Release No. 90867, at 2 (Jan. 7, 2021).

[118] 2020 Final Rules and Adopting Release, supra note 10, at 53.

[119] 2020 Final Rules and Adopting Release, supra note 10, at 54-55.

[120] Id. at 55-59.

[121] Id. at 59-60.

[122] Id. at 43-44.

[123] Lydia DePhillips, *The SEC Undermined a Powerful Weapon Against White-Collar Crime*, ProPublica (Jan. 13, 2021), https://www.propublica.org/article/the-sec-undermined-a-powerful-weapon-against-white-collar-crime

[124] 2020 Final Rules and Adopting Release, supra note 10, at 135-36.

[125] 2020 Annual Report, supra note 4, at 20.

[126] See the landing page on the SEC's website for the Division of Enforcement at https://www.sec.gov/page/enforcement-section-landing, with links to SEC litigation releases (https://www.sec.gov/litigation/litreleases.shtml), notices and orders in SEC administrative proceedings (https://www.sec.gov/litigation/admin.shtml), and other information regarding enforcement actions.

[127] For example, the SEC Office of Investor Education and Advocacy, which maintains its own separate website at https://www.investor.gov/, issues Investor Alerts that notify mainly retail investors to be aware of risky or unsound investments and of those who offer them. See https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins.

Recent alerts have focused on issues ranging from trading suspensions to variable annuities to a wide range of investment scams. Similarly, the SEC Office of Compliance and Examinations publishes at least annually an explanation of the issues that the SEC is focusing on in its review of the work of investment advisors, broker-dealers and other financial institutions. See, e.g., SEC Office of Compliance Inspections and Examinations, 2019 Examination Priorities (2019) https://www.sec.gov/files/OCIE%202019%20Priorities.pdf, and accompanying SEC Press Release 2018-299, SEC Office of Compliance Inspections and Examinations Announces 2019 Examination Priorities (Dec. 20, 2018), https://www.sec.gov/news/press-release/2018-299.

[128] Congressional testimony and speeches by SEC commissioners and staff are available in searchable databases online at https://www.sec.gov/news/testimony and https://www.sec.gov/news/speeches. See, e.g., Jay Clayton, Chairman, Director, SEC, Testimony on "Oversight of the U.S. Securities and Exchange Commission" (Dec. 11, 2018), available at https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0; Speech by Chairman Jay Clayton, SEC Rulemaking Over the Past Year, The Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 6, 2018), available at https://www.sec.gov/news/speech/speech-clayton-120618; Speech by Steven Peikin, Co-Director, SEC Division of Enforcement, The Salutary Effects of International Cooperation on SEC Enforcement: Remarks at the IOSCO/PIFS-Harvard Law School Global Certificate Program for Regulators of Securities Markets (Dec. 3, 2018), available online at https://www.sec.gov/news/speech/speech-peikin-120318.

[129] See, e.g., 2020 Annual Report, supra note 4, at ; SEC Press Release 2018-250, SEC Division of Enforcement Publishes Annual report for Fiscal Year 2020 (Nov. 2, 2020), https://www.sec.gov/news/press-release/2020-274.

[130] See Search Company Filings, SEC https://www.sec.gov/search/search.htm.

[131] See SEC Press Release No. 2014-206, SEC Announces Largest-Ever Whistleblower Award, and linked Order Determining Whistleblower Award (Sept. 22, 2014), https://www.sec.gov/news/press-release/2014-206.

[132] See SEC Press Release No. 2015-252, SEC Announces Whistleblower Award of More Than $325,000, and linked Order Determining Whistleblower Claim (Nov. 4, 2015), http://www.sec.gov/news/pressrelease/2015-252.html.

[133] Id.

[134] See SEC Order Determining Whistleblower Award Claim, Exchange Act Release No. 83037 (Apr. 12, 2018), https://www.sec.gov/rules/other/2018/34-83037.pdf.

[135] See SEC Order Determining Whistleblower Award Claim, Exchange Act Release No. 82214 (Dec. 5, 2017), https://www.sec.gov/rules/other/2017/34-82214.pdf.

[136] Order Determining Whistleblower Award Claim, Exchange Act Release No. 88658 (Apr. 16, 2020), https://www.sec.gov/rules/other/2020/34-88658.pdf.

[137] See SEC Order Determining Whistleblower Award Claim, Exchange Act Release No. 77530 (Apr. 5, 2016), https://www.sec.gov/rules/other/2016/34-77530.pdf.

[138] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 78719 (Aug. 30, 2016), https://www.sec.gov/rules/other/2016/34-78719.pdf.

[139] See Suzanne Barlyn, SEC Awards $22 Million to Ex-Monsanto Executive Through Whistleblower Program, Reuters (Aug. 30, 3016), http://www.reuters.com/article/us-sec-monsanto-whistleblower-idUSKCN1152KG.

[140] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 80115 (Feb. 28, 2017), https://www.sec.gov/rules/other/2017/34-80115.pdf.

[141] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 84125, at 2 (Sept. 14, 2018), https://www.sec.gov/rules/other/2018/34-84125.pdf.

[142] See SEC Press Release No. 2020-266, SEC Issues Record $114 Million Whistleblower Award (Oct. 22, 2020), https://www.sec.gov/news/press-release/2020-266.

[143] The list of Covered Actions can be accessed by clicking on the "Claim an Award" tab on the SEC Office of the Whistleblower website, at https://www.sec.gov/whistleblower/claim-award. The SEC has published on its website an easy-to-read flow chart describing the program, with attention to the steps in the award application and determination process. https://www.sec.gov/page/whistleblower-100million.

[144] The WB-APP form and instructions for completing and submitting it are available at https://www.sec.gov/files/formwb-app.pdf. Note that the SEC released a new version of the WB-APP along with the 2020 Rule Amendments.

[145] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 72659 (July 23, 2014), http://www.sec.gov/rules/other/2014/34-72659.pdf.

[146] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 79464 (Dec. 5, 2016), https://www.sec.gov/rules/other/2016/34-79464.pdf.

[147] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 85412, at 12-14 (Mar. 26, 2019), https://www.sec.gov/rules/other/2019/34-85412.pdf, in which the SEC denied an award to a claimant who failed to file an application until 15 months past the deadline because he or she had not seen the Notice of Covered Action and was "under the impression that the Commission would contact claimants about filing an award application." In denying the claimant an award, the Commission explained that it would waive the 90-day deadline only under "extraordinary circumstances" that caused a failure to file on time for reasons "beyond the claimant's control."

[148] See Dave Michaels, SEC Whistleblower Payouts Slow Amid Deluge of Reward Seekers, Wall St. J. (Apr. 5, 2018), https://www.wsj.com/articles/sec-whistleblower-payouts-slow-amid-deluge-of-reward-seekers-1533474001.

[149] The 2019 Annual Report contains a concise summary of the claims-review and awards process, along with an explanation of some of the factors that bear on the length of time it takes the SEC to issue a final determination of an award claim. 2019 Annual Report to Congress on the Dodd-Frank Whistleblower Program 12-16 (Nov. 15, 2019), https://www.sec.gov/files/sec-2019-annual-report-whistleblower-program.pdf

[150] See 2020 Final Rules and Adopting Release, supra note 10, at 8-10.

[151] Kilgour v. Sec. & Exch. Comm'n, 942 F.3d 113 (2d Cir. 2019).

[152] Id. at 121-23.

[153] Id. at 124-25.

[154] Ethics Resource Center, National Business Ethics Survey of the U.S. Workforce 2013, at 12 (2014), available at https://magazine.ethisphere.com/wp-content/uploads/2013NBESExecSummary.pdf.

[155] 15 U.S.C. § 78u-6.

[156] See e.g., SEC Press Release No. 2016-204, SEC: Casino-Gaming Company Retaliated Against Whistleblower (Sept. 29, 2016), https://www.sec.gov/news/pressrelease/2016-204.html, (announcing second whistleblower retaliation case under Dodd-Frank); SEC Press Release No. 2016-270, Company Settles Charges in Whistleblower Retaliation Case (Dec. 20, 2016), https://www.sec.gov/news/pressrelease/2016-270.html (announcing first settlement for retaliation against internal whistleblower).

[157] 18 U.S.C. § 1514A(a)(1).

[158] Id.

[159] 18 U.S.C. § 1514A(a)(2).

[160] 15 U.S.C. § 78u-6.

[161] 18 U.S.C. § 1514A(a).

[162] Lawson v. FMR LLC, 571 U.S. 429 (2014).

[163] OSHA handles the initial investigation and remediation stages for complaints of retaliation not only under SOX, but also under more than 20 other federal statues, most of which are particular to certain industries. OSHA publishes desk aids for some of the statutes it administers, including SOX. See OSHA, Investigator's Desk Aid to the Sarbanes-Oxley Act (SOX) Whistleblower Protection Provision (Sept. 27, 2018), available at https://www.osha.gov/sites/default/files/SOXDeskAid.pdf.

[164] 15 U.S.C. § 76u-6(h)(1)(B)(iii)(I).

[165] Id. § 78u-6(h)(1)(C).

[166] See Rosenblum v. Thomson Reuters (Markets) LLC, 13 CIV. 2219 SAS, 2013 WL 5780775, at *5 (S.D.N.Y. Oct. 25, 2013).

[167] See Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300–01 (June 13, 2011); Interpretation of the SEC's Whistleblower Rules Under Section 21F of the Securities Exchange Act of 1934, SEC Release No. 34-75592 (Aug. 4, 2015), available at http://www.sec.gov/rules/interp/2015/34-75592.pdf.

[168] Digital Realty Tr., Inc. v. Somers, 138 S. Ct. 767 (2018).

[169] See Rule 21F-2(d)(1)(i).

[170] Id. at 76.

[171] H.R.2515 – Whistleblower Protection Reform Act of 2019, https://www.congress.gov/bill/116th-congress/house-bill/2515/text#:~:text=Referred%20in%20Senate%20(07%2F10%2F2019)&text=To%20amend%20the%20Securities%20and,whistleblowers%2C%20and%20for%20other%20purposes (last accessed Dec. 31, 2020).

[172] See, e.g., Gen. Elec. Co., et al., Comments on Proposed Rules for Implementing Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 1 (Dec. 17, 2010), https://www.sec.gov/comments/s7-33-10/s73310-179.pdf; Alcoa et al., Comments on Proposed Rules for Implementing Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 11 (Dec. 17, 2010), https://www.sec.gov/comments/s7-33-10/s73310-182.pdf.

[173] 2020 Final Rules and Adopting Release, supra note 10, at 80; Rule 21F-6(a)(4), (b)(3).

[174] See SEC Press Release No. 2020-288, SEC Awards Whistleblower Over $900,000 (Nov. 19, 2020), https://www.sec.gov/news/press-release/2020-288 ("The agency has received whistleblower tips from individuals in 130 countries. Overseas whistleblowers are in a unique position to help identify wrongdoing occurring abroad that may otherwise be hard to detect.").

[175] Blanchard v. Exelis Sys. Corp., ARB No. 15-031, ALJ No. 2014-SOX-20, 2017 WL 3953474 (Dep't of Labor Aug. 29, 2017).

[176] Hu v. PTC, Inc., ARB No. 2017-0068, ALJ No. 2017-SOX-00019, 2019 WL 5089597 (Dep't of Labor Sept. 18, 2019).

[177] Liu Meng-Lin v. Siemens AG, 763 F.3d 175, 180-83 (2d Cir. 2014).

[178] Id.

[179] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 73174, at 2 n.2 (Sept. 22, 2014), https://www.sec.gov/rules/other/2014/34-73174.pdf.

[180] See SEC Press Release No. 2014-118, SEC Charges Hedge Fund Adviser With Conducting Conflicted Transactions and Retaliating Against Whistleblower, and linked Order Instituting Cease and Desist Proceedings (June 16, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542096307#.VAndkPldXxp.

[181] See SEC Press Release No. 2015-75, SEC Announces Award to Whistleblower In First Retaliation Case, and linked Order Determining Whistleblower Award Claim (Apr. 28, 2015), https://www.sec.gov/news/pressrelease/2015-75.html.

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[182] See SEC Press Release No. 2016-204, SEC: Casino-Gaming Company Retaliated Against Whistleblower (Sept. 29, 2016), available online at https://www.sec.gov/news/pressrelease/2016-204.html. For more analysis of the enforcement action, see Alexis Ronickher, SEC Brings its First Stand-Alone Whistleblower Retaliation Action, FCPA Blog (Oct. 6, 2016), http://www.fcpablog.com/blog/2016/10/6/sec-brings-its-first-stand-alone-whistleblower-retaliation-a.html. Ms. Ronickher and Lisa Banks, both partners with whistleblower law firm Katz, Marshall & Banks, represented the IGT whistleblower in the case.

[183] See SEC Press Release No. 2017-24, Financial Company Charged With Improper Accounting and Impeding Whistleblowers, and linked Order Determining Whistleblower Award Claim (Jan. 19, 2017), https://www.sec.gov/news/pressrelease/2017-24.html.

[184] See 2011 Final Rules and Adopting Release, supra note 18, at 12-13.

[185] Chair White's speech, The SEC as the Whistleblower's Advocate, presented at the Ray Garrett, Jr. Corporate and Securities Law Institute at Northwestern University School of Law in April 2015, is available online at http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html.

[186] See, e.g., Head v. Kane Co., 668 F. Supp. 2d 146, 152 (D.D.C. 2009).

[187] On May 22, 2017, the CFTC adopted a series of amendments to the rules governing the CFTC Whistleblower Program. Among other changes, the amendments allow the agency, like the SEC, to take action to enforce the anti-retaliation provisions of the Dodd-Frank Act that apply to CFTC whistleblowers. The amendments also prohibit entities from impeding whistleblowers from reporting commodities-trading violations to the CFTC, including through the use of confidentiality and pre-dispute arbitration agreements. See CFTC Office of Public Affairs, Strengthening Anti-Retaliation Protections for Whistleblowers and Enhancing the Award Claims Review Process, (May 22, 2017), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/wbruleamend_factsheet052217.pdf.

[188] See David Marshall & Debra Katz, SEC Whistleblowers' Rights Being Restricted in Severance Agreements, Katz, Marshall & Banks, LLP (May 15, 2013), http://www.kmblegal.com/sec-whistleblower-blog/sec-whistleblowers-rights-being-restricted-severance-agreements; David Marshall & Debra Katz, Letter to SEC Commissioners re: The Use of Severance Agreements to Impede Individuals from Participating in the SEC Whistleblower Program: A Growing Problem and a Recommendation (May 8, 2013), available at http://www.kmblegal.com/wp-content/uploads/2015/04/130508-Letter-to-SEC-Commissioners.pdf.

[189] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Exchange Act Release No. 74619, at 2 (Apr. 1, 2015), http://www.sec.gov/litigation/admin/2015/34-74619.pdf.

[190] Id. at 3.

[191] See Mary Jo White, The SEC as the Whistleblower's Advocate (Apr. 30, 2015), http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html.

[192] For an up-to-date list of all enforcement actions the SEC has taken based on employer actions to impede reporting, see SEC, Enforcement Actions Based on Actions Taken to Impede Reporting, https://www.sec.gov/whistleblower/retaliation#enforcement-actions (last visited Feb. 1, 2021).

[193] See David Marshall & Debra Katz, Letter to SEC Commissioners re: The Use of Severance Agreements to Impede Individuals from Participating in the SEC Whistleblower Program: A Growing Problem and a Recommendation, at 6-7 (May 8, 2013), available at http://www.kmblegal.com/wp-content/uploads/2015/04/130508-Letter-to-SEC-Commissioners.pdf.

[194] Other agencies have also given greater scrutiny to confidentiality agreements. The National Labor Relations Board, Equal Employment Opportunity Commission, and Financial Industry Regulatory Authority, to name a few, have taken action against employer-employee confidentiality agreements in recent years. In addition, a March 2015 report by the State Department's Office of Inspector General examined confidentiality agreements that the 30 largest State Department contractors have required their employees to sign. U.S. Dep't of State Office of Inspector General, Review of the Use of Confidentiality Agreements by Department of State Contractors, Report ESP-15-03 (March 2015), https://www.stateoig.gov/system/files/esp-15-03.pdf.

[195] This Practice Guide does not discuss all of the forms and procedures in detail, but they are spelled out clearly in the program, including Rules 21F-1, 21F-2 and 21F-10, and in the sample forms and directions for Form TCR ("Tip, Complaint or Referral") and Form WB-APP ("Application for Award of Original Information") that are appended to the rules at 278–305.

[196] SEC Office of the Whistleblower, Welcome, (last modified Dec. 7, 2020), http://www.sec.gov/whistleblower.

[197] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 79294, at 6-7 (Nov. 14, 2016), http://www.lexissecuritiesmosaic.com/gateway/sec/press-release/2016_34-79294.pdf.

[198] See id. at 4–8.

[199] See Order Determining Whistleblower Award Claim, Exchange Act Release No. 79464, at 3 n.6 (Dec. 5, 2016), available online at https://www.sec.gov/rules/other/2016/34-79464.pdf.

APPENDIX A

SEC Whistleblower Awards Through March 31, 2021

Each award is issued through an "Order Determining Whistleblower Award Claim." The SEC also issues press releases announcing most but not all awards. The first number in the second column in the table below refers to the Exchange Release number that appears on all Orders. The second, hyphenated number refers to the Press Release number that appears at the top left of each press release.

Readers can find all SEC press releases listed by date and number on at https://www.sec.gov/news/pressreleases. Most press releases announcing whistleblower awardshave links to the accompanying order at the upper right of the page. The orders granting and denying award applications are also listed, by date only, on the SEC Office of the Whistleblower website at https://www.sec.gov/about/offices/owb/owb-final-orders.shtml.

The SEC heavily redacts its Orders Determining Whistleblower Award Claims to eliminate any information that would potentially disclose a whistleblower's identity. This practice has evolved to the point where the redacted orders on the website lack not only the names of the whistleblower and the sanctioned entity, but also the percentage of proceeds awarded and occasionally the total amounts of the award. The reasoning behind these redactions is that disclosing these numbers could make it possible to link an award to a Covered Action, which would in turn show which actions rested on whistleblower tips and possibly encourage employers, the media, or others to search for the identity of the whistleblower.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Mar. 29, 2021	91427; No press release.	Less than $5 million	20% and 10%	Two-thirds to one claimant; one-third to another.	The SEC cited the revised Rule 21F-6(c), which created a presumption for a maximum (30%) award where the award would be less than $5 million, the claimant has no negative factors, and is not a culpable whistleblower. Notably, both claimants were harmed investors, not insiders. The claimant receiving the larger award (20% of the proceeds) submitted information earlier in time, significantly expanding an ongoing investigation. Both claimants provided substantial assistance that helped the SEC stop an ongoing fraudulent scheme.
Mar. 29, 2021	91426; 2021-54	Over $500,000	?	All to single claimant.	The SEC granted this award through the "safe harbor" provision under Rule 21F-4(b)(7), which provides that if whistleblower submits information to another federal agency and submits same to SEC within 120 days, SEC will treat information as though submitted at same time it was submitted to the other agency.
Mar. 16, 2021	91332; No press release.	Less than $5 million	30%	All to single claimant.	The SEC for the first time cited the presumption under revised Rule 21F-6(c) for a maximum (30%) award where the award would be less than $5 million. The claimant provided significant ongoing assistance, answering the investigative staff's questions and providing numerous documents.
Mar. 9, 2021	91280; 2021-44	$1.5 million	?	All to single claimant.	Whistleblower raised flags about previously unknown misconduct, identified potential witnesses, and talked with SEC on multiple occasions.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Mar. 1, 2021	91225; 2021-37	$500,000	?	Two claimants split the award	Both whistleblowers provided substantial, ongoing assistance that conserved the agencies' time and resources.
Feb. 25, 2021	91207; 2021-34	Over $800,000	?	All to single claimant.	Commission waived noncompliance with requirement to file TCR within 30 days of providing information because Claimant complied once the Claimant learned of those requirements. Claimant participated in an interview and provided documents that showed false and misleading statements made to investors.
Feb. 25, 2021	91206; 2021-34	Over $900,000	?	All to single claimant.	Commission waived noncompliance with requirement to file TCR within 30 days of providing information because Claimant complied once the Claimant learned of those requirements. Claimant's substantial information and "critical declaration" helped stop a scheme to defraud retail investors.
Feb. 23, 2021	91183; 2021-31	Over $9.2 million	?	All to single claimant.	This marks the first time an award had been granted on the basis of the Dec. 7, 2020 amendments which included deferred and non-prosecution agreements as "related actions" eligible for an award.
Feb. 19, 2021	91164; 2021-30	Nearly $700,000	?	All to single claimant.	Claimant prompted the SEC investigation, provided significant information, and reported internally.
Feb. 19, 2021	91163; 2021-30	Over $2.2 million	?	All to single claimant.	Information in Claimant's submission was "of such high quality that staff was able to draft document requests . . . without speaking to Claimant."
Jan. 14, 2021	90922; 2021-7	Nearly $600,000	?	All to single claimant.	Claimant provided substantial assistance and met with investigators multiple times.
Jan. 7, 2021	90866; 2021-2	Nearly $600,000	?	All to single claimant.	Claimant prompted the SEC investigation, provided significant information, and reported internally many times.
Jan. 7, 2021	90867; 2021-2	Over $100,000	?	All to single claimant.	Claimant credited for independent analysis of public documents. The Rule 21F-6(c) presumption of the 30% maximum award applied, but was overcome because Claimant provided limited assistance.
Jan. 7, 2021	90864; 2021-2	Nearly $500,000	?	$240,000 to Claimant 1, $240,000 to Claimant 2, $10,000 to Claimant 3.	Claimant 1, an outsider, prompted the SEC investigation. The others provided significant additional information leading to two SEC actions.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Dec. 22, 2020	90767; 2020-333	Over $1.6 million	?	All to single claimant.	Claimant provided ongoing assistance to SEC despite fears for personal safety.
Dec. 18, 2020	90721; 2020-325	Over $500,000	?	All to single claimant.	The SEC waived the Form TCR requirement due to attorney misconduct, but award was reduced due to unreasonable delay in reporting.
Dec. 18, 2020	90718; 2020-325	Over $1.8 million	?	All to single claimant.	Claimant took immediate steps to mitigate harm to investors and provided significant assistance to the SEC, leading to millions of dollars returned to investors.
Dec. 18, 2020	90720; 2020-325	Over $1.2 million	?	All to single claimant.	SEC determined that claimant did not initiate the misconduct, but did actively participate in it, financially benefit from it, and unreasonably delay reporting. Award was therefore reduced.
Dec. 14, 2020	90656; 2020-316	$300,000	?	All to single claimant.	Claimant had audit responsibilities, but met exception where wrongdoer is engaging in conduct that impedes internal investigation.
Dec. 7, 2020	90582; 2020-307	Nearly $400,000	?	Half to each of two claimants.	Claimants' independent analysis prompted the SEC to open an investigation and provided ongoing support.
Dec. 7, 2020	90580; 2020-307	$750,000	?	$500,000 to one and $250,000 to another.	Claimant 1 submitted the first tip and provided more information than Claimant 2, whose information led to additional allegations in the charges brought. Claimant 1 refused to participate in the wrongdoing and Claimant 2 reported internally.
Dec. 7, 2020	90578; 2020-307	Nearly $1.8 million	?	All to single claimant.	Claimant reported internally and to the SEC, provided detailed information into wrongdoing the SEC would not otherwise have uncovered.
Dec. 1, 2020	90537; 2020-297	Over $6 million	?	Half to each of two claimants.	Claimants' joint tip and ongoing assistance led to successful actions by multiple agencies, uncovering tens of millions of dollars in ill-gotten gains.
Nov. 24, 2020	90506; No press release.	?	30%	All to single claimant.	Claimant's tip was a factor in the SEC opening an investigation, which uncovered additional misconduct. Minimal sanctions were collected.
Nov. 20, 2020	90468; No press release.	?	30%	All to single claimant.	Claimant helped uncover Ponzi scheme preying on retail investors. No collections were anticipated in the matter.
Nov. 19, 2020	90460; 2020-288	Over $900,000	?	All to single claimant.	Claimant provided timely and ongoing assistance, including information about misconduct overseas.
Nov. 13, 2020	90412; 2020-283	Over $1.1 million	?	All to single claimant.	Claimant's independent analysis refocused ongoing SEC investigation, saved significant time and resources, and allowed the SEC to freeze wrongdoer assets.
Nov. 5, 2020	90351; 2020-278	$750,000	?	All to single claimant.	Claimant provided significant information, SEC likely would not have uncovered the fraud without it.

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Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Nov. 5, 2020	90350; 2020-278	Over $3.6 million	?	All to single claimant.	Claimant successfully contested award amount and SEC increased percentage. Claimant provided significant information including misconduct abroad, and traveled internationally at own expense for investigation.
Nov. 3, 2020	90317; 2020-275	Over $28 million	?	All to single claimant.	Claimant's reports prompted internal and SEC investigations. Claimant identified a key witness and provided information closely related to some of the charges brought.
Oct. 29, 2020	90284; 2020-270	Over $10 million	?	All to single claimant. Two others denied.	Claimant's information caused the SEC to open its investigation and led to almost every finding and charge. Claimant also raised concerns internally several times. Other claimants submitted information later and did not add significant new information.
Oct. 22, 2020	90247; 2020-266	Over $114 million	?	All to single claimant. Three others denied.	Award consisted of $52 million in connection with the SEC case and $62 million from related actions. Other claimants did not significantly contribute to the enforcement actions. Highest award as of publication.
Oct. 15, 2020	90189; 2020-255	More than $800,000	?	All to single claimant.	Claimant offered detailed independent analysis, but no continuing assistance.
Sept. 30, 2020	90054; No press release.	Nearly $400,000	?	Half to each of two claimants.	Claimants provided detailed and ongoing information, reported internally, and faced retaliation.
Sept. 30, 2020	90059; No press release.	Nearly $2.9 million	?	All to single claimant. Two others denied.	Claimant's tip prompted the SEC to open investigation. Claimant did not recover for "related action" because it was not based on the same original information. Claimants 2 and 3 submitted tips after Claimant 1 and did not provide significant additional information.
Sept. 30, 2020	90049; 2020-239	Nearly $30 million	?	$22 million to one; $7 million to another.	Claimant 1 reported to the SEC first, provided substantial ongoing assistance, and internally reported. Claimant 2 provided more limited and duplicative information.
Sept. 30, 2020	90057; No press release.	Over $1.7 million	?	All to single claimant.	Award reduced for unreasonable delay of three years, but mitigated because Claimant's attempted to alert investors in the interim and feared retaliation by the company.
Sept. 28, 2020	90021; 2020-231	Over $1.8 million	?	All to single claimant.	Claimant was unaffiliated with the wrongdoer and provided prompt information which was closely connected to the charges brought.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Sept. 25, 2020	89996; 2020-225	Over $1.8 million	?	All to single claimant.	Claimant provided key information to internal investigation, which aided the SEC's investigation, and uncovered overseas misconduct. Company had been sanctioned previously for similar misconduct.
Sept. 25, 2020	89995; 2020-225	$750,000	?	All to single claimant.	Claimant's information prompted the SEC investigation and uncovered foreign misconduct, but the case was largely built on information from other sources.
Sept. 21, 2020	89929; 2020-215	$2.4 million	?	All to single claimant.	Claimant's information prompted the investigation and contributed to all charges.
Sept. 17, 2020	89912; 2020-214	Nearly $250,000	?	Half to each of two claimants.	Claimants promptly provided the information that initiated the investigation, but the case was largely built by SEC investigators.
Sept. 14, 2020	89850; 2020-209	Over $10 million	?	All to single claimant.	Claimant exposed abuses and provided extensive and ongoing assistance during the investigation, including identifying witnesses and assisting SEC in understanding complex issues. Claimant suffered hardships after persistently trying to remedy the issues.
Sept. 8, 2020	89780; No press release.	Nearly $30,000	?	All to single claimant.	Claimant alerted SEC to violations and provided exemplary assistance to programmatically significant enforcement action, but collections were limited.
Sept. 1, 2020	89721; 2020-201	Over $2.5 million	?	Half to each of two claimants.	Claimants, both unaffiliated with the company, provided highly probative independent analysis of company's filings which caused SEC to open investigation and saved significant resources.
Aug. 31, 2020	89712; 2020-199	Over $1.25 million	?	All to single claimant.	Claimant's information led to investigation which promptly returned millions of dollars to investors.
July 21, 2020	89355; No press release.	?	30%	All to single claimant.	Claimant promptly provided unknown information and continued to provide helpful information.
July 21, 2020	89354; No press release.	?	20%	All to single claimant.	Claimant provided detailed and previously unknown information to ongoing investigation, but was not able to provide ongoing information.
July 14, 2020	89311; 2020-155	$3.8 million	?	All to single claimant.	Award was lowered because Claimant provided discrete information and had no first-hand knowledge of the fraud.
June 23, 2020	89124; 2020-141	$125,000	?	All to single claimant.	Award based on monetary sanctions obtained by the SEC and another agency in a related action, where Claimant's information led to both investigations.
June 19, 2020	89102; 2020-138	Nearly $700,000	?	All to single claimant.	Claimant's information prompted the SEC to open the investigation, which led to significant returns to investors. Claimant reported internally and suffered retaliation.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
June 4, 2020	89002; 2020-126	Nearly $50 million	?	All to single claimant. Second claimant denied.	First claimant provided significant unknown information which led to significant recovery for investors. Second claimant did not provide information to the SEC relating to the covered action or file a timely WB-APP.
May 4, 2020	88803; 2020-100	Nearly $2 million	?	All to single claimant.	Claimant's information allowed the SEC to obtain a temporary restraining order and asset freeze against wrongdoer, and investors recovered much of their investments.
April 28, 2020	88759; 2020-98	Over $18 million	?	All to single claimant.	Claimant's information prompted the SEC to start an investigation which led to millions of dollars being returned to retail investors, but a large portion stemmed from violations not reported by Claimant.
April 20, 2020	88687; No press release.	?	?	All to single claimant.	SEC waived the "in writing" requirement due to unusual circumstances, where Claimant provided information to an officer who reported it to the SEC, and Claimant provided additional information over the phone as requested by the SEC.
April 20, 2020	88689; 2020-91	$5 million	?	All to single claimant.	Claimant promptly provided information which led to the SEC's investigation, provided a critical document, and suffered unique hardship after raising concerns internally.
April 16, 2020	88658; 2020-89	Over $27 million	?	All to single claimant.	Claimant provided critical information uncovering misconduct partly overseas and saving the SEC significant time. The award was not reduced despite an unreasonable delay in reporting.
April 3, 2020	88547; 2020-80	$2 million	?	All to single claimant.	Claimant provided vital information that would have been difficult to obtain otherwise, and despite receiving implicit threats from the wrongdoers.
March 30, 2020	88507; 2020-75	$450,000	?	All to single claimant.	Claimant's information did not originate, but refocused the SEC investigation. Claimant complied with internal reporting procedures and suffered unique hardships as a result. Claimant had internal compliance responsibilities, but met the 120-day waiting period for reporting to the SEC.
March 24, 2020	88462; 2020-71	Over $570,000	?	$478,000 to one claimant; $94,000 to another.	One claimant received a substantially higher amount because they more information, which led to more enforcement actions, and provided it much earlier than the other claimant did.
March 23, 2020	88449; 2020-69	Over $1.6 million	?	All to single claimant.	Claimant's information caused the SEC to open its investigation and supported some charges and the allegations would have been hard to detect, but the Claimant unreasonably delayed reporting.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Feb. 28, 2020	88299; 2020-46	Over $7 million	?	All to single claimant.	Claimant provided extensive and sustained assistance to the SEC's investigation and enforcement action against serious financial abuses.
Jan. 22, 2020	88015; 2020-15	$277,000	?	All to single claimant.	This award included proceeds recovered from a related action. The SEC noted that Claimant's information helped shut down an ongoing scheme preying on retail investors.
Jan. 22, 2020	88014; 2020-15	$45,000	?	All to single claimant.	Claimant was an investor who lost money in the fraudulent scheme and was able to provide the SEC "new, critical, time-sensitive information that allowed staff to recover assets that were later returned to harmed investors."
Nov. 15, 2019	87544; 2019-238	$260,000	?	$260,000 jointly to three claimants.	Claimants were not insiders, but rather were themselves harmed investors who alerted the agency "to a well-concealed fraud targeting retail investors." The SEC noted that it would have been unlikely for Commission staff to have learned of the misconduct absent the Claimants' initial tip.
Sept. 20, 2019	87039; no press release	$38,000	?	All to single claimant.	Claimant prompted SEC to open investigation that resulted in two successful enforcement actions involving harm to retail investors.
Aug. 29, 2019	86803; 2019-165	Over $1.8 million	?	All to single claimant.	Claimant informed SEC of misconduct, which occurred overseas, and provided extensive and ongoing cooperation during the course of the investigation. Claimant also internally reported the conduct on multiple occasions.
July 23, 2019	86431; 2019-138	$500,000	?	All to single claimant.	The award was to "an overseas whistleblower" and involved misconduct occurring abroad. The SEC noted that the claimant's tip was the first information that the Commission received on the charged misconduct.
June 3, 2019	86010; 2019-81	$3 million	?	$3 million jointly to two claimants.	The SEC noted that it "positively assessed" the "significant and timely steps" the claimants undertook to have the company remediate the harm caused by the alleged violations, including advocating for full disclosure of the violation and for compensation of harmed investors.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
May 24, 2019	85936; 2019-76	$4.5 million	?	All to single claimant.	The award was to claimant whose tip triggered the company to review the allegations as part of an internal investigation and subsequently report the whistleblower's allegations to the SEC and another agency. This was the first time a claimant was awarded under Rule 21F-4(c)(3), which incentivizes internal reporting by whistleblowers who also report the same information to the Commission within 120 days.
Mar. 26, 2019	85412; 2019-42	$50 million	?	$37 million to one claimant; $13 million to another; five claimants denied awards.	$37 million to Claimant 2 who "swiftly" provided "smoking gun" evidence; award reduced by amount claimant received through another agency's reward program so as to avoid double payment for same information. $13 million to Claimant 1 who "unreasonably delayed" reporting while investors were harmed and claimant "passively financially benefitted" as basis for award amount grew.
Sept. 24, 2018	84270; 2018-209	Nearly $4 million	?	All to single claimant.	The award was to "overseas whistleblower" where covered action had "opened as a direct result of Claimant's tip to the Commission."
Sept. 14, 2018	84125; 2018-194	Over $1.5 million	?	All to single claimant.	The SEC noted it had "severely reduced" award because Claimant had "unreasonably delayed in reporting the information to the Commission and was culpable."
Sept. 6, 2018	84046; 2018-179	Over $54 million	?	One claimant received $39 million; another received $15 million. A third claimant was denied an award.	SEC noted that although Claimants 1 and 2 both provided helpful information, Claimant 1 came forward 18 months before Claimant 2, and his or her information was "critical to advancing the investigation" and "saved the Commission considerable time and resources." SEC also noted that "several facts mitigate the unreasonableness of Claimant 1's reporting delay." In its order, SEC also stated that Claimant 2, who had a pending action with "Agency 2" which had its own whistleblower award mechanism, would not be eligible for SEC award for information that led to enforcement action by Agency 2.
Apr. 12, 2018	83037; 2018-64	Over $2.1 million	?	All to single claimant.	Claimant was a former company insider whose information strongly supported the findings and provided SEC with ongoing helpful assistance to staff during the investigation. Reduced award because Claimant unreasonably delayed in reporting the matter to the SEC.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Apr. 5, 2018	82996; 2018-58	Over $2.2 million	?	All to single claimant.	This marked SEC's first "safe harbor" award under Rule 21F-4(b)(7), which provides that if whistleblower submits information to another federal agency and submits same to SEC within 120 days, SEC will treat information as though submitted at same time it was submitted to the other agency.
Mar. 19, 2018	82897; 2018-44	About $88 million	?	Nearly $50 million jointly to two claimants; over $33 million to one claimant; three other claimants denied.	The $50 million award had been reduced slightly due to the whistleblowers' unreasonable delay.
Dec. 5, 2017	82214; 2017-222	Over $4.1 million	?	All to single claimant.	Although SEC reduced award because of Claimant's unreasonable delay in reporting misconduct, this award reduction was also mitigated by, inter alia, fact that Claimant was foreign national working outside U.S. and therefore potentially not protected against retaliation.
Nov. 30, 2017	82181; 2017-216	Over $16 million	?	$8 million each to two claimants; five other claimants denied.	Claimant 1 informed SEC of misconduct that was focus of the staff's investigation and cornerstone of the agency's subsequent enforcement action. Claimant 2 provided additional significant information" that saved substantial amount of time and agency resources.
Oct. 12, 2017	81857; 2017-195	Over $1 million	?	All to single claimant.	Award granted to "company outsider" who provided SEC with information regarding securities violations by entity that impacted retail customers. SEC found "extraordinary circumstances" that warranted waiver of requirement that claimants submit declaration signed under penalty of perjury at the time the tip was filed.
July 27, 2017	81227; 2017-134	Over $1.7 million	?	All to single claimant.	Company insider provided SEC with information to help stop a fraud that would have otherwise been difficult to detect. SEC waived noncompliance with rule requiring information be submitted "in writing" if submitted between signing of Dodd-Frank Act and effective date of SEC rules based on quality of whistleblower's cooperation with SEC.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
July 25, 2017	81200; 2017-130	Nearly $2.5 million	30% [i]	All to single claimant.	Claimant was a public sector employee who assisted SEC in stopping a mutual fund company's illegal practice of manipulating the prices of mutual fund shares to the detriment of shareholders.
May 2, 2017	80571; 2017-90	$500,000	?	All to single claimant.	"Claimant, a company insider, provided information to the Commission that instigated the Commission's investigation into well-hidden and hard-to-detect violations of the securities laws."
Apr. 25, 2017	80521; 2017-84	$4 million	?	All to single claimant.	Whistleblower provided "detailed and specific information about serious misconduct and provided additional assistance during the ensuing investigation, including industry-specific knowledge and expertise." Award based in part on moneys paid to a government agency not among those enumerated as prosecutors of "related actions" under Rule 21F-3(b)(1).
Feb. 28, 2017	80115; no press release	?	20% of	All to single claimant.	Amount of award not disclosed. SEC "reduced the award from what it might otherwise have been because of both the Claimant's culpability in connection with the securities law violations at issue in the Covered Action and the Claimant's unreasonable delay in reporting the wrongdoing to the Commission."
Jan. 23, 2017	79853; 2017-27	$7 million	?	One claimant received $4 million; two others shared $3 million.	Information submitted by claimant awarded $4 million provided impetus for investigation of "investment scheme that defrauded hundreds of investors, many . . . unsophisticated." Two claimants awarded $3 million jointly submitted new information while investigation underway, significantly contributing to successful enforcement action. All claimants to receive additional award moneys based on additional sanctions recovered after date of order.
Jan. 6, 2017	79747; 2017-1	$5.5 million	?	All to single claimant.	Whistleblower "helped prevent further harm to a vulnerable investor community by boldly stepping forward while still employed at the company." SEC applies first waiver of Rule 21F-9(d) "in writing" requirement for pre-TCR period between enactment of Dodd-Frank and issuance of program rules.

[i] Although the SEC Order Determining Whistleblower Award Claim and the agency press release did not specify the percentage of the whistleblower's award, the whistleblower was a client of the authors' law firm, Katz, Marshall & Banks, LLP, and authorized the firm to disclose the percentage information publicly. Read more about the award and our representation here: https://www.kmblegal.com/news/katz-marshall-banks-client-awarded-24-million-sec-whistleblower-office-role-stopping.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Dec. 9, 2016	79517; 2016-260	Over $900,000	?	All to single claimant.	Whistleblower's tip led to "multiple actions against wrongdoers." Actions were consolidated for purpose of award determination; claimant received award based on sanctions collected in both, including proceeds collected after date of order.
Dec. 5, 2016	79464; 2016-255	$5 million	?	All to single claimant; two other claimants denied awards.	SEC rejected an unsuccessful claimant's arguments that 1) the claimant's information "should have caused an investigation," and 2) the SEC's failure to provide the claimant with "actual notice" of the Covered Action, rather than simply post it on the OWB website list of covered actions, caused the claimant to submit application for an award after 90-day deadline elapsed.
Nov. 14, 2016	70294; 2016-237	$20 million	?	All to single claimant.	Sizable award upwardly adjusted after claimant contested preliminary amount. Award will include amounts collected in future. Award went to a whistleblower whose information "enabled the Commission to move quickly to shut down the [illegal scheme] and to obtain a near total recovery of investors' funds . . . before the Defendants could squander those monies." Two additional claimants denied awards for information submitted prior to July 21, 2010.
Sept. 20, 2016	78881; 2016-17	$4 million	?	All to single claimant.	Claimant did not contest award.
Aug. 30, 2016	78719; 2016-173	$22.437 million	28%	All to single claimant.	The SEC did not disclose the percentage, but the whistleblower's counsel informed the media that his client had received 28% of sanctions against Monsanto. The SEC's press release announced that this award pushed the program total to date above $100 million mark. The SEC referenced the claimant's culpability in the misconduct in explaining SEC's decision to make this sizable award.
June 9, 2016	78025; 2016-13	$17 million	?	All to single claimant.	Claimant's information, provided in one or more TCRs and in subsequent communications, directed SEC staff to new information that conserved SEC's time and resources, helped staff collect evidence, "substantially advanced" investigation, and thus "led to" successful enforcement action" for securities violations already under investigation. SEC denied applications of four other claimants.
May 20, 2016	77873; 2016-11	Over $450,000	?	Awarded jointly to two claimants.	SEC paid each claimant half of the amount awarded.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
May 17, 2016	77843; 2016-10	$5 to $6 million	?	All to single claimant.	Whistleblower's "detailed tip led the agency to uncover securities violations that would have been nearly impossible for it to detect[.]"
May 13, 2016	77833; 2016-88	Over $3.5 million	?	All to single claimant.	Whistleblower's award did not cause SEC to initiate investigation but rather bolstered an ongoing investigation, strengthened SEC's settlement position, and thus "significantly contributed" to success of covered action. May be first award issued in connection with a whistleblower's disclosures of FCPA violations.
Apr. 5, 2016	77530; no press release	$275,000 or more, offset by sanctions against claimant	?	All to single claimant. Second claimant denied.	The $275,000 award, issued in part for sanctions in a related criminal action, "shall be subject to offset for any monetary obligations" remaining unpaid as part of an earlier final judgment against claimant, probably in a related action. SEC denied award to second claimant upon determining that he/she had not provided any information which led to successful enforcement of the covered action.
Mar. 8, 2016	77322; 2016-41	$1.93 million	?	$1.8 million to Claimant 1 and $65,000 to each of Claimants 2 & 3. Claimant 4 denied.	Claimant receiving bulk of award submitted tip causing SEC to open investigation, met with SEC staff several times and gave useful information, all before the other two filed their tips 1.5 years later. SEC denied award altogether to a fourth claimant who had "knowingly and willfully made false, fictitious, or fraudulent statements" to SEC over several years.
Jan. 15, 2016	76921; 2016-10	Over $700,000	?	All to single claimant	First award for "independent analysis" by an "industry expert," whose information significantly contributed to successful enforcement action.
Nov. 4, 2015	76338; 2015-252	Over $325,000	?	All to single claimant.	Percentage not disclosed but reduced by "unreasonable delay" that allowed wrongdoers to obtain additional ill-gotten gains.
Sept. 29, 2015	76025; no press release	?	28%	All to single claimant.	Amount of award not disclosed by SEC.
Sept. 28, 2015	76000; no press release	?	20%	11% and 9% to two claimants.	Amount of award not disclosed by SEC.
July 17, 2015	75477; 2015-150	Over $3 million	?	All to single claimant.	Information allowed SEC to "crack a complex fraud." Award increased because of successful "related actions" and reduced due to unreasonable delay, not "as severely" as could have been because some of delay occurred before establishment of SEC Whistleblower Program.
Apr. 28, 2015	74826; 2015-75	Over $600,000	30%	All to single claimant.	First award issued in part in connection with retaliation case. Percentage set at 30% in light of "unique hardships" claimant experienced for reporting to SEC.

Date	Release Nos.	Award Total	%	Allocation Among Claimants	Notes from SEC Press Releases and Orders Determining Awards
Apr. 22, 2015	74781; 2015-73	$1.4 to $1.6 million	?	All to single claimant.	Second award to an employee working in compliance function and first application of “substantial injury” exception to exclusion of such employees from program.
March 2, 2015	74404; 2015-45	Between $475,000 & $575,000	?	All to single claimant.	First award to company officer receiving information in compliance role; waited 120 days after reporting internally. Percentage not disclosed.
Sept. 22, 2014	73174;2014-206	$30 million	?	All to single claimant.	Substantial award issued to a foreign resident working outside U.S. Percentage not disclosed but award decreased by “unreasonable delay” in reporting to SEC.
Aug. 29, 2014	72947; 2014-180	$300,000	20%	All to single claimant.	First award to employee working in compliance and audit function; also first application of “120-day” exception to exclusion of such employees from program.
July 31, 2014	72727; 2014-154	$400,000	25% [ii]	All to single claimant.	SEC waived “voluntary” requirement where employee tried diligently to have company address violations.
July 22, 2014	72652	?	30%	15%, 10%, and 5% to three claimants.	Amount of award not disclosed by SEC.
June 3, 2014	72301; 2014-113	$875,000	30%	15% of collected sanctions to each of two claimants.	Information allowed SEC to “bring a successful enforcement action in a complex area of the securities market.”
Oct. 30, 2013	70775; 2013-231	$150,000	30%	All to single claimant.	SEC investigated fraud scheme and “obtain[ed] emergency relief before additional investors were harmed.”
Sept. 30, 2013	70544; 2013-209	$14 million	30%	All to single claimant.	Information allowed recovery of “substantial investor funds . . . more quickly than otherwise would have been possible.”
June 12, 2013	69749; no press release [iii]	$125,000	15%	5% of collected proceeds to each of three claimants.	In two award announcements concerning a June 12 Order, the SEC announced payment to three whistleblowers a total of 15% of amounts that SEC collected, and also of amounts DOJ collected in related action, against sham hedge fund.
Aug. 30, 2013	70293; 2013-169				
Aug. 21, 2012	67698; 2012-162	$50,000	30%	All to single claimant.	Whistleblower helped prevent “multi-million dollar fraud” from “ensnaring additional victims”; SEC later paid an additional $150,000 after further collections, for a total of $200,000.

[ii] The SEC did not report the percentage in its press release or accompanying order. However, the whistleblower later sat for a newspaper interview and reported that he had received 25% of a $1.6 million penalty. See J. Nocera, The Man Who Blew the Whistle, N.Y. Times (Aug. 18, 2014), https://www.nytimes.com/2014/08/19/opinion/joe-nocera-the-man-who-blew-the-whistle.html. At around this time the SEC began redacting the percentage from most orders prior to public release.

[iii] The SEC released only a press announcement and not a formal press release. See SEC Announces Whistleblower Action (June 12, 2013), available online at https://www.sec.gov/news/press/2013/2013-06-announcement.htm.

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Whistleblower Cases – Key Factors for Success

April 26, 2019

Author: Linda C. Severin

Whistleblower attorneys and government attorneys look at certain key factors in deciding whether a matter has the potential to become a successful whistleblower case. We first consider liability — whether the allegations amount to illegal conduct. We then evaluate the strength of the evidence of fraud. This involves analyzing what the whistleblower knows of the wrongdoing and identifying supporting documents and witnesses. Another important factor is the size of any potential recovery to the government.

Here's a checklist of factors to consider when deciding whether to come forward as a whistleblower.

Does the fraud involve a government-funded or government-regulated program?

Government-funded programs include, among other things: health care programs (*e.g,*, Medicare, Medicaid); national security and defense; mortgage and banking; transportation and public construction projects; education; and, research sponsored or funded by the government.

Examples of government-regulated programs include securities laws, tax laws, commodities and futures trading laws, banking and mortgage industry laws, and customs duties and tariffs.

Note: The states of Illinois and California have whistleblower laws addressing fraud committed against private health care insurers. If the fraud occurred in those states, you may have a claim under these laws.

Do you have personal, non-public information about the fraud?

Whether a whistleblower has personal and "non-public" information about the fraud is a complex legal and factual issue. At the simplest level, it means that you did not discover the fraud by reading about it in the newspaper or other public source but rather from your own personal observation or experience, such as your employment.

Do you have any documentation of the fraud or know of others who could corroborate your allegations?

Successful whistleblower cases require strong evidence. Some of the best evidence often comes from a company's own documents. In general, the law allows a whistleblower employee to take company documents showing the fraud to give to the authorities. You should limit such evidence, however, only to those documents you have access to in the ordinary course of your employment. Documentation is important but not absolutely required in all cases. Similarly, it is helpful if you know of others, such as former employees, who can back up your allegations. You should consult with an attorney before taking any action with respect to documents or witnesses.

Does the fraud involve a substantial amount of money?

While not a prerequisite to a claim, most successful whistleblower cases involve significant sums of money. The amount of potential damages will be a factor in assessing (i) whether it makes sense to pursue a claim and (ii)whether the government will be interested in devoting resources to investigating your case. Sometimes other factors, such as public safety or potential harm to individuals, can offset a relatively "small dollar" case.

Does the fraud negatively impact public safety or patient care?

Again, while not a prerequisite to a claim (and the majority of cases do not involve this), safety and protection from harm are important considerations for the government prosecutors who will be reviewing your case. This factor can arise in many different forms. For example, patients could face harm in receiving healthcare services, service members could be endangered by defective equipment, or the broader public could be at risk from a defective road or bridge.

In the healthcare context, fraud can impact patient safety and care in myriad ways. Some examples are: providing inadequate or worthless services, ordering unnecessary testing or procedures, promoting prescription drugs for uses that have not received FDA approval and have not been shown to be safe or effective, or neglecting nursing home patients.

Is the fraud intentional or the result of negligence?

Gross negligence, reckless disregard, or deliberate ignorance can serve as the basis of a claim, but intentional fraud and misconduct make the most compelling cases. Simple negligence is likely insufficient for a successful whistleblower case.

Did you initiate or participate in the fraud?

Under the False Claims Act a court can reduce an award if the person bringing the whistleblower case planned and initiated the fraud. If you were the mastermind behind a fraud scheme, you could become the target of a government investigation. A whistleblower who is convicted of a crime for the fraud cannot receive any share of the government's recovery.

"Initiation" of the fraud (i.e., planning and devising it), however, is quite different from "participation" in the fraud. Companies sometimes expect or require employees to participate in fraud as part of their employment. Sometimes, companies subtly pressure employees to break the law in order to succeed. Potential whistleblowers may not know at first that they are doing something improper. Participating in a fraud that others masterminded generally would not disqualify a whistleblower from receiving an award.

Does the defendant have sufficient assets and ability to pay?

While fraud is often a profitable business and most defendants do have sufficient assets, if the fraud is small in scale or the defendant is in poor financial condition, it may not be worthwhile to pursue a claim as a whistleblower.

Do you have any reason to believe there is already a government investigation underway?

A government investigation may signal that another whistleblower has already reported the fraud or that the allegations are in the public domain. While none of these would necessarily bar your claim, it is important to consider this factor.

Why are you coming forward?

Whistleblowers come to us for a variety of reasons. Most have learned of or even been involved in illegal conduct in their jobs and want to do the right thing. By coming forward, they can expose wrongdoing, set the record straight, and obtain legal advice if they have knowledge of the fraud and fear they could face exposure themselves.

The possibility of a financial award motivates many whistleblowers. There is nothing wrong with that, so long as the information provided is truthful and can be corroborated. Whistleblower laws exist to encourage and reward private citizens who expose fraud. The possibility of receiving an award has motivated many successful whistleblower cases.

Many whistleblowers come to us after they have been fired or otherwise suffered adverse employment consequences from speaking out. These can be compelling cases so long as the employee has clear evidence of fraud.

Whatever their reason for coming forward, whistleblowers must be prepared for a long and uncertain process. There are risks in becoming a whistleblower and no guarantees of success.

If you believe you may have a case, please contact us for a free, confidential consultation.

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A Guide To The Federal False Claims Act

The Federal False Claims Act is the U.S. Government's primary weapon for combatting fraud. It allows whistleblowers to sue persons or entities that are defrauding the government and recover damages and penalties on the government's behalf. The statute provides whistleblowers financial rewards as well as job protection against retaliation.

The federal False Claims Act (FCA), 31 U.S.C. §§ 3729, *et seq*, is sometimes known as "Lincoln's Law," because it was enacted during the Civil War to counter widespread fraud by contractors supplying the military. More recently, it has been amended to enhance the Government's ability to recover money for losses caused to it by fraud.

A key feature of the law is the *qui tam* (or whistleblower) provision under which an individual or entity (known as a "relator") with knowledge of fraud against the Government may file a lawsuit under seal on behalf of the United States. If the case is successful, the relator can share in the Government's monetary recovery and recover attorney's fees and costs from the defendant. Congress hoped that creating these monetary incentives, along with provisions protecting whistleblowers from reprisal or retaliation would encourage whistleblowers to come forward and incentivize private lawyers to commit legal resources to representing whistleblowers in prosecuting fraud on the Government's behalf.

The FCA has been highly successful as a public-private partnership: as of the end of 2018, Government recoveries have exceeded $59 billion following 1986 amendments that strengthened the False Claims Act, with rewards to whistleblowers totaling billions of dollars.

Liability Under the False Claims Act

The FCA is written broadly, with the aim of reaching all types of fraud that might result in financial loss to the United States. It identifies seven violations, any of which is a violation of the False Claims Act.

1. **False Claims** – Presenting, or causing the presentment, of a false claim for payment or approval. 31 U.S.C. § 3729(a)(1)(A)

2. **False Records or Statements** – Making, using, or causing others to make or use, a false record or statement that is material to a false or fraudulent claim. 31 U.S.C. §3729(a)(1)(B)

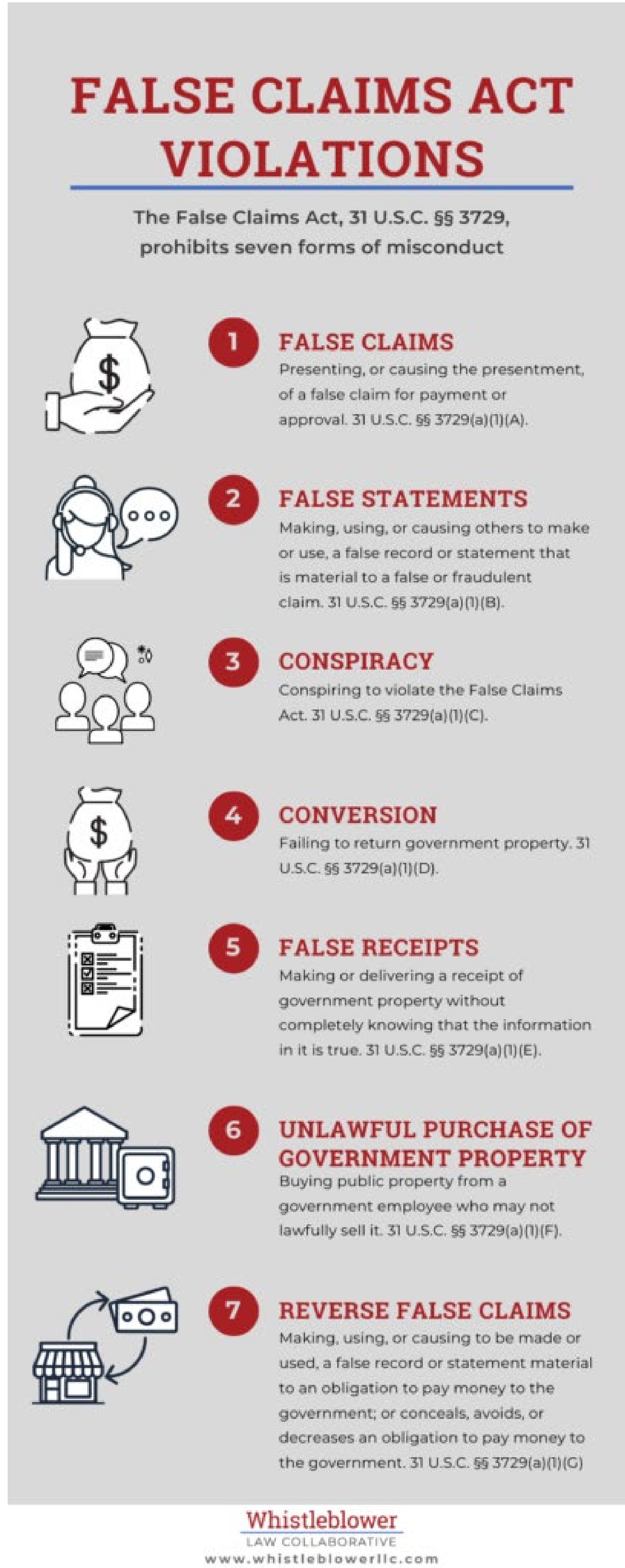
3. **Conspiracy** – Conspiring to violate the False Claims Act. 31 U.S.C. § 3729(a)(1)(C)

4. **Conversion** – Failing to return government property. 31 U.S.C. § 3729(a)(1)(D)

5. **False Receipts** – Making or delivering a receipt of government property without completely knowing that the information in it is true. 31 U.S.C. § 3729(a)(1)(E)

6. **Unlawful purchase of Government Property** – Buying public property from a government employee who may not lawfully sell it. 31 U.S.C. § 3729(a)(1)(F)

7. **Reverse False Claims** – Making, using, or causing to be made or used, a false record or statement material to an obligation to pay money to the government; or concealing, improperly avoiding, or decreasing an obligation to pay money to thegovernment. 31 U.S.C. § 3729(a)(1)(G)



False Claims Act Damages and Penalties

The United States may recover up to three times the damages caused to the Government by the fraud plus a sizeable civil penalty for each violation. While the False Claims Act references a penalty of between $5,000 and $10,000, it is indexed to inflation; by June 2020, False Claims Act penalties ranged from $11,665 to $23,331 perviolation.

False Claims Act Penalties Ranges

False Claims Act penalty ranges adjust for inflation periodically. Both the date of violation (when the conduct occurred) and the date of assessment (when the court awards penalties) matter.

Violation After	1986	September 30, 1999	November 2, 2015 →				
Assessed After	-	-	November 2, 2015	August 1, 2016	February 3, 2017	January 29, 2018	June 19, 2020
Minimum Penalty	$5,000	$5,500	$5,500	$10,781	$10,957	$11,181	$11,665
Maximum Penalty	$10,000	$11,000	$11,000	$21,563	$21,916	$22,363	$23,331

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False Claims Act Materiality

A requirement of all fraud law (and contracts and torts for that matter), is that the subject of the fraud be material. The purpose of the materiality requirement is to ensure that the "thing" that someone was defrauded about is important enough to justify legal action. It is the same with the False Claims Act. The materiality requirement ensures that the False Claims Act applies only when the false or fraudulent conduct, was important enough that it would have influenced a government decision.

Since 2009, the False Claims Act has defined the term material as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property." 31 U.S.C. § 3729(b)(4). In *Universal Health Servs., Inc. v. United States ex rel. Escobar*, the Supreme Court held that that definition applied to all actions under the False Claims Act.

The Supreme Court went on to identify factors that were relevant but not dispositive to materiality:

- The Government's decision to expressly identify a regulatory provision as a condition of payment;
- Evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement;
- If the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material;
- Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.

136 S. Ct. 1989, 2002.

In the aftermath of *Escobar*, defendants have tried to argue that courts should dismiss False Claims Act cases on materiality grounds. For the most part, they argue that lack of evidence that the government refused to pay when it learned of identical fraud is a requirement for whistleblowers and the government. *Escobar* said no such thing and for the most part, courts have rejected these claims in favor of a holistic approach to determining whether fraud is material.

Establishing Knowledge

While the False Claims Act is an anti-fraud law that requires a "knowing" violation, it does not require proof that thefraudster had a specific intent to defraud the Government. Rather, the False Claims Act provides that the terms 'knowing' and 'knowingly' simply mean that a person:

- had actual knowledge that a statement or claim was false
- acted in deliberate ignorance of whether information was true or false, or
- acted in reckless disregard of truth or falsity

False or Fraudulent Claims

At the heart of several provisions of the False Claims Act is whether there is a false or fraudulent claim to the Government for payment. The law defines "claim" broadly as "any request or demand, whether under a contract or otherwise, for money or property and whether or not the United States has title to the money or property, that— (i) is presented to an officer, employee, or agent of the United States; or (ii) is made to a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government's behalf or to advance a Government program or interest, and if the United States Government— (I) provides or has provided any portion of the money or property requested or demanded; or (II) will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded." 31 U.S.C. § 3729(b)(2).

Reverse False Claims/Obligations to Repay

There is also what is known as the "reverse false claim" provision, which is where a person underpays or fails to pay back what they are obligated to pay the Government. The term "obligation" is defined generally in the False Claims Act as "an established duty, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment." 31 U.S.C. § 3729(b)(3). In the health care context, the term "obligation" includes overpayments that have been retained for more than 60 days after they were identified as overpayments.

Statutory Limitations That Bar Qui Tam Cases

A whistleblower may be barred from bringing or maintaining a *qui tam* complaint under certain circumstances. The two most important restrictions are known as the "first to file rule" and the "public disclosure bar."

- The "first to file rule" generally prevents a second relator from filing suit or recovering a reward if someone else hasalready filed the same allegations or claim with the court.
- The "public disclosure bar" generally prevents a relator from filing or maintaining a *qui tam* case where substantially the same allegations or transactions have already been disclosed in the news media, in a federal court or administrative proceeding to which the United States is a party, or in a Congressional or other Government report, hearing, audit, or investigation.
- The "Tax bar" prevents use of the False Claims Act to recover for tax fraud. Due to the Tax Bar, the False Claims Actdoes not apply to money owed to the IRS. While the IRS whistleblower program does apply to tax fraud, it lacks features that make the False Claims Act so valuable.

Whistleblower Reward ("Relator's Share")

The whistleblower's share of the Government's monetary recovery depends on several factors. The most important is whether the Government intervened in and "took over" the relator's FCA case or whether the Government declined to intervene and the relator chose to proceed on his or her own to prosecute the case. The general guidelines are as follows.

- **Intervention**: the FCA provides for a relator share of 15%-25% of the proceeds collected by the United States "depending upon the extent to which the person substantially contributed to the prosecution of the action."
- **Declination**: the FCA provides for a relator share of 25%-30% of the proceeds collected by the United States based on what the court finds "reasonable" for collecting the damages and penalties.
- **Exceptions**: The share may be reduced or eliminated where the relator was a planner and initiator of the fraud, or was criminally convicted, or based their *qui tam* action on information learned from a Government investigation.

Attorneys' Fees and Costs

A losing defendant is required to pay the relator's reasonable attorneys' fees and costs. If a relator proceeds with a case after the United States has declined to intervene, and loses, the court may award attorneys' fees and costs to the defendant if the court finds that the relator's claim was "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."

Anti-Retaliation Provisions

The False Claims Act protects employees, contractors, or agents who are discharged, demoted, suspended, threatened, harassed, or discriminated against in any other way because of lawful acts taken to stop violations of the FCA. Liability for retaliation is not limited to one's employer, but may extend to others. Wronged whistleblowers may recover reinstatement with the same seniority status they would have had but for the discrimination, two times the amount of back pay plus interest, and compensation for any special damages sustained such as emotional distress and attorney's fees and costs. A retaliation case may be brought together with or separately from a FCA *qui tam* complaint.

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Thorny Issues in Whistleblower Law: The Rights and Duties of Attorneys, Compliance Officers, and Accountants, and the Effect of Confidentiality Agreements On Their Ability to Assert Claims in Various Legal Forums

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Introduction

Whistleblower reward and anti-retaliation laws have proliferated in recent decades. The trend reflects a recognition by federal, state, and local lawmakers that company insiders are often in the best position to detect fraud and corporate misconduct that can have devastating consequences for investors, and in some cases, for the national and global economies. Certain insiders, such as attorneys, compliance officers, and accountants, are most likely to learn of illegal and unethical business practices. Whether and under what circumstances these so-called gatekeepers can—or should—have access to the same anti-retaliation protections or rewards as their non-gatekeeper colleagues is a rapidly evolving, often contentious, area of whistleblower law.

By virtue of their advisory roles, in-house attorneys and their external legal partners have insight into many aspects of a company's business – including legal violations. As such, they are also often best positioned to address wrongdoing internally or, if they are unable to do so, to bring illegal conduct to the attention of government regulators. Unlike most other employees, however, attorneys are bound by ethical and legal constraints on what they can disclose in the face of wrongdoing. These constraints may even limit an in-house attorney's ability to seek remedies if they face retaliation from their employer (and client) for their efforts to prevent or correct the unlawful conduct. In some cases, the Whistleblower Program administered by the Securities and Exchange Commission ("SEC" or "Commission") provides financial rewards to whistleblowers who report violations of the federal securities laws to the SEC, but this incentive presents an additional ethical dilemma for an attorney considering disclosure. As a result, difficult questions arise as to the circumstances in which an attorney may disclose wrongdoing to the SEC, including whether an attorney who "blows the whistle" remains eligible for a reward under the SEC Whistleblower Program and whether such an attorney can assert and pursue claims against his employer for alleged retaliation consistent with the attorney's ethical duties. Congress and the

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courts have worked to strike a balance recognizing the obligations of attorneys to their client, while also providing protections and incentives, under limited circumstances, for attorneys who report unlawful conduct.

In many companies, accountants and compliance officers are also in a unique position to possess information concerning legal violations. While accountants and compliance officers face fewer restrictions on disclosing confidential information than lawyers, these professionals, based on the nature of their position, often face heightened requirements for demonstrating that they were retaliated against for engaging in statutorily protected whistleblowing activity. Employers—and courts—often view whistleblowing by these employees not as protected activity, but rather as simply the performance of their job duties. Similarly, whistleblower incentive programs often require that accountants and compliance officers first report apparent illegal conduct internally and give their employer an opportunity to correct or self-report the problem. As with attorneys, Congress and the courts have attempted to strike a balance between the fiduciary and professional duties of accountants and compliance officers and the public policy in favor of encouraging and supporting whistleblowing to prevent and correct corporate misconduct.

Moreover, until recently, many employees—whether gatekeepers or not—faced barriers to their ability to participate in whistleblowing activities by virtue of employer-imposed agreements, such as nondisclosure agreements. These agreements generally fell short of prohibiting reporting to the SEC but restricted former employees from reporting except "as required by law." Regardless of the enforceability of a contract with such language, the inclusion of these sorts of terms had a substantial chilling effect on the willingness of potential whistleblower to come forward and assist the SEC in rectifying instances of securities fraud.

This paper addresses the many ethical and legal considerations that arise for attorneys, accountants, and compliance officers who blow the whistle, specifically in the context of the SEC Whistleblower Program and the anti-retaliation provisions of the Sarbanes-Oxley Act ("SOX") and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). It also addresses how the SEC has combatted employer-imposed agreements which limit a whistleblower's ability to subsequently participate in government investigations.

The paper first outlines the general ethical and legal obligations that these gatekeeper whistleblowers have to their clients and/or employers. The paper then analyzes the circumstances under which gatekeeper whistleblowers can disclose information to the SEC and whether they are eligible to receive an award from the SEC Whistleblower Program for the information they provide. Next, the paper discusses important issues relevant to the litigation of SOX and Dodd-Frank retaliation claims by attorneys, accountants, and compliance officers. Finally, the paper explores the use of employer-imposed agreements designed to erect barriers to reporting to the SEC and how the SEC has taken enforcement actions against these sorts of agreements.

I. Blowing the Whistle with Privileged and Confidential Communications and Materials

A. Ethical Obligations of Gatekeepers

1. Attorneys

Attorneys are subject to the ethical rules of the jurisdiction(s) in which they are barred and those of any jurisdiction in which their conduct occurs. The professional ethical rules adopted by state bar associations often vary significantly, but they are generally uniform regarding the obligations of an attorney to protect client information and communications.[2] Attorneys are often charged to protect client confidences even in the face of wrongdoing, and courts have long recognized and enforced the fiduciary duties attorneys have to their clients. The Supreme Court has also recognized that the confidentiality of communications between attorneys and their clients is a bedrock legal principle that is crucial to the rule of law and the integrity of the legal profession.[3] For these reasons, the general obligation of attorneys to keep client confidences appears antithetical to the very idea of "blowing the whistle."

While an attorney's obligation to protect client confidentiality is universally recognized, the obligation has never been absolute. The specific exceptions vary from state to state, but most jurisdictions have adopted some exceptions to the duty of confidentiality, permitting disclosure of confidential client information in certain limited circumstances. For example, most jurisdictions permit an attorney to disclose information related to an ongoing crime or fraud that involves the use of the lawyer's services; in some jurisdictions disclosure is required in such cases.[4] In addition, some jurisdictions permit disclosures for past or intended crime or fraud, or disclosures required to meet the attorney's obligation of candor to a tribunal.[5] Even with these exceptions to the duty

[2] *See, e.g.*, Cal. R. Prof. Conduct 1.6, cmt. 1 ("Preserving the confidentiality of client information contributes to the trust that is the hallmark of the lawyer-client relationship."); N.Y. R. Prof. Conduct 1.6, cmt. 1 ("A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, or except as permitted or required by these Rules, the lawyer must not knowingly reveal information gained during and related to the representation, whatever its source."); Tex. R. Prof. Conduct 1.05, cmt. 1 ("Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidential information of one who has employed or sought to employ the lawyer. Free discussion should prevail between lawyer and client in order for the lawyer to be fully informed and for the client to obtain the full benefit of the legal system. The ethical obligation of the lawyer to protect the confidential information of the client not only facilitates the proper representation of the client but also encourages potential clients to seek early legal assistance.").

[3] *See Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

[4] *See, e.g.*, Pa. R. Prof. Conduct 4.1(b) (requiring disclosure if necessary to avoid assisting in a client's crime or fraud, unless prohibited by duty of confidentiality under Rule 1.6).

[5] *See, e.g.*, Fla. R. Prof. Conduct 4-3.3(a)(2) (requiring disclosure of a material fact to the tribunal where necessary to avoid assisting in criminal or fraudulent act of client); Va. R. Prof. Conduct 1.6(c)(1) (requiring disclosure of the client's stated intent to commit a crime that is reasonably certain to result in death, substantial bodily harm or financial injury to another, after the attorney has attempted to dissuade the client and given notice of the intent to disclose).

of confidentiality, the legal profession as a whole generally favors non-disclosure. Courts and state bar associations maintain in their case law and professional rules that disclosures should be strictly limited to those required to fulfill an attorney's ethical duties and/or rights as a litigant (in certain instances).

2. Accountants

Accountants and compliance officers may not share as high a level of obligation to protect confidential information, as compared to attorneys, but they must still comport with a duty of confidentiality that is inherent to their roles as fiduciary agents and a professional ethos that favors non-disclosure of confidential communications and information obtained in the course of performing their duties.[6] Accountants working for publicly traded companies must also comply with the rules and regulations set forth by the Public Company Accounting Oversight Board ("PCAOB") established under SOX. Under the PCAOB rules, accountants have a responsibility not to knowingly or recklessly contribute to legal violations. In addition, the American Institute of Certified Public Accountants ("AICPA") provides the professional and ethical standards for the accounting profession. Under Rule 1.7 of the AICPA Code of Professional Conduct, accountants are prohibited from disclosing confidential information about clients.[7] However, one of the AICPA's comments interpreting Rule 1.7 provides that accountants should consider the AICPA's guidance in the case of ethical conflicts.[8] AICPA's guidance states that an ethical conflict arises when a member encounters (a) obstacles to following an appropriate course of action due to internal or external pressures or (b) conflicts in applying relevant professional standards or legal standards.[9] As an example, the AICPA offers a case where "a members suspects a fraud may have occurred, but reporting the suspected fraud would violate the member's responsibility to maintain client confidentiality." In that case, the AICPA states that members "may be required to take steps to best achieve compliance with the rules and law," and suggests that the member weigh alternative courses of action while considering the specific facts and circumstances, the ethical issues involved, and the established internal procedures.

3. Compliance Officers

[6] Although there are technically many different types of accountants, for purposes of this paper, "accountant" will generally refer to Certified Public Accountants ("CPAs") associated with public accounting firms. Internal auditors may appropriately be considered members of an issuer's compliance personnel.

[7] AICPA Code R. 1.700.001 ("A member in public practice shall not disclose any confidential client information without the specific consent of the client.").

[8] AICPA Code R. 1.700.001 cmt. 3 ("A member should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the member encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both.").

[9] AICPA Code R. 1.000.020.

In the case of compliance officers, there is no self-regulating professional organization that compares to the self-governing bodies of the legal and accounting professions. Nevertheless, the primary function of compliance personnel is to investigate and otherwise assist with a company's adherence to laws, regulations, and policies that applicable to the company's operations. Accordingly, a duty of confidentiality is implied with respect to the performance of these job duties. Additionally, although there is no widely-accepted self-regulating body for compliance officers, there is an emerging organization called the Society of Corporate Compliance and Ethics ("SCCE") that supports the compliance and ethics profession with educational opportunities, certification and additional resources. The SCCE has adopted a Code of Professional Ethics to provide guidance for compliance personnel. According to Rule 2.6 of that Code, compliance officers should "carefully guard against disclosure of confidential information obtained through the performance of their job duties, except under certain circumstances, such as "when necessary to comply with a subpoena or other legal process."[10]

B. SEC Whistleblower Program: Disclosures and Eligibility for Awards

The Sarbanes-Oxley Act of 2002 ("SOX") and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") were both passed in response to highly public financial crises. These statutes reorganized the financial regulatory system to better protect investors and to minimize market instability by, among other things, mandating corporate disclosures and protecting whistleblowers in the financial industry. The Securities and Exchange Commission administers the SEC Whistleblower Program, which was established pursuant to Dodd-Frank in 2010.[11] The program provides financial rewards to certain individuals who submit tips related to violations of federal securities laws. The incentive program provides that individuals are eligible to receive an award who (1) voluntarily provide the Commission, (2) with "original information," (3) that leads to a successful enforcement action by the Commission in a federal court or by administrative action, and (4) in which the SEC obtains monetary sanctions exceeding $1 million.[12] A whistleblower can obtain an award ranging from 10% to 30% of the total monetary sanctions collected in actions brought by the SEC (or related actions brought by other regulatory and law enforcement authorities), depending on the value of the information the whistleblower provides.[13] For example, the SEC awarded $33 million, one of its largest awards to date, to a

[10] SCCE Code R. 2.6. ("[compliance officers] shall carefully guard against disclosure of confidential information obtained in the course of their professional activities, recognizing that under certain circumstances confidentiality must yield to other values or concerns, *e.g.*, to stop an act which creates appreciable risk to health and safety, or to reveal a confidence when necessary to comply with a subpoena or other legal process.").

[11] Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010); 12 U.S.C. § 5301 note.

[12] 17 C.F.R. § 240.21F-3(a).

[13] In 2020, the SEC implemented a new rule creating a statutory presumption that whistleblowers are entitled to a 30% award if the award would be $5 million or less. *See* SEC Release No. 34-89963, Whistleblower Program Final Rules (Sept. 23, 2020),https://www.sec.gov/rules/final/2020/34-89963.pdf; SEC Press Release No. 2020-219, SEC Adds Clarity, Efficiency and Transparency to Its Successful Whistleblower Award Program (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-219.

whistleblower who provided information to the SEC that would not likely have been detected without the disclosure.[14] SOX and Dodd-Frank attempt to perform a balancing act between encouraging publicly traded companies ("issuers") to take proactive steps to detect and prevent certain wrongful conduct internally and incentivizing employees to make disclosures to regulators when internal procedures have failed to correct unlawful conduct. This balancing act is most apparent in the provisions concerning gatekeeper whistleblowers.

1. Attorneys

Under SOX, the SEC has promulgated rules for attorney disclosures that address the "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of an issuer," known collectively as Part 205.[15] These rules are intended to supplement and supersede ethical rules applicable in any jurisdiction, as "where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with [Part 205], [Part 205] shall govern."[16] Notably, these rules apply to attorneys who "appear" and "practice" before the Commission, which is broadly defined to include communication with the Commission in any form, as well as providing advice concerning securities laws and/or the SEC's rules and regulations.[17] Under SOX, attorneys are required to internally report evidence of a "material violation"[18] to an issuer's Chief Legal Officer ("CLO"), who must then investigate the evidence and provide the attorney with the status of the investigation.[19] If the attorney believes that the CLO has failed to take an "appropriate response in a reasonable amount of time," the attorney must then report the material violation to members of the board of directors or its committees. If the attorney believes that reporting to the CLO would be futile, the attorney may instead make an initial report directly to members of the company's board of directors.[20] In the alternative, an attorney may also satisfy their reporting obligation by reporting the material violation to the company's qualified legal compliance committee.[21] After

[14] "SEC Announces Largest-Ever Whistleblower Awards," SEC Press Release (March 19, 2018), available at https://www.sec.gov/news/press-release/2018-44 (last visited Jan. 15, 2019).

[15] 17 C.F.R. pt. 205

[16] 17 C.F.R. § 205.1.

[17] 17 C.F.R. § 205.2(a).

[18] A "material violation" is defined as "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law." 17 C.F.R. § 205.2(i).

[19] 17 C.F.R. § 205.3(b)(1)-(2).

[20] 17 C.F.R. § 205.3(b)(4).

[21] The definition of a "qualified legal compliance committee" is provided in Part 205. 17 C.F.R. § 205.2.

an attorney makes a report to the committee, they have no further obligation to determine whether any response made is proper.[22]

Although the SEC's mandatory reporting rules do not require an attorney to "report out" material violations to the SEC, the rules do provide that an attorney may disclose confidential information to the Commission without the consent of the company in connection with an investigation into the attorney's compliance with his reporting obligations to:

> (1) Prevent the issuer from committing a material violation that will cause "substantial injury to the financial interests or property of the issuer or investors;"
>
> (2) Prevent the issuer from engaging in perjury or fraud on the Commission; or
>
> (3) Rectify a material violation that caused substantial injury to the financial interests of the issuer or investors, in which the attorney's services were used.[23]

These permissive exceptions to an attorney's obligation to protect client confidences conflict with the ethical rules of many jurisdictions. Although Part 205 claims that it supersedes other jurisdictions, some jurisdictions have explicitly forbid attorneys from disclosing information under the circumstance's set out by the regulations.[24] In fact, some jurisdictions have raised challenges to the SEC's authority to permit "reporting out" in preemption of local rules. For instance, in 2013 the Professional Ethics Committee of the New York County Lawyers Association issued a bar opinion stating that New York's rules of professional conduct prohibit attorneys from collecting SEC awards, and presumably other "bounties," based on the confidential information of a client.[25] Thus, it remains unsettled whether the SEC rules provide an effective safe harbor to attorneys whose jurisdiction prohibits certain disclosures permitted by the SEC. Taking into account the historical power of the states to regulate the legal profession as well as the fact that disclosure to the Commission is merely permissive, state bar associations likely retain some authority to discipline attorneys who disclose protected client information, even though the SEC claims that its rules are controlling. In addition, because the SEC rules only set minimum standards for attorney conduct, state ethical rules may still apply. In other words, attorneys may also be subject to additional reporting requirements particular to a given jurisdiction.

The SEC Whistleblower incentive program may create an apparent conflict of interest for gatekeeper whistleblowers, who are generally obligated to act on behalf of the best interests of

[22] 17 C.F.R. § 205.3(c)(1).

[23] 17 C.F.R. § 205.3(d)(2).

[24] *See, e.g.*, D.C. R. Prof. Conduct 1.6(d) (permitting attorneys to disclose confidential information to prevent or rectify crime or fraud that has or is reasonably certain to result in "substantial injury to the financial interests or property of another," but only in instances where the attorney's services were used).

[25] *See* New York County Lawyers Association, Ethics Opinion 746, "Ethical Conflicts Caused by Lawyers as Whistleblowers under the Dodd-Frank Act of 2010" (Oct. 7, 2013).

their employer/client. Because a whistleblower has the potential to receive millions of dollars as a result of an SEC enforcement action, it is reasonable to question whether the potential to receive such large sums of money makes them less likely to exercise proper professional judgment or appropriately advise their clients. For attorneys, there may be a tension between potentially lucrative incentives to blow the whistle and their obligation to be zealous advocates and confidential advisors to their client.

The SEC has expressed its awareness of this potential conflict of interest but maintains that its "exclusions send a clear, important signal to attorneys, clients, and others that there will be no prospect of financial benefit for submitting information in violation of an attorney's ethical obligations."[26] Accordingly, the SEC does not generally award attorneys who breach their ethical obligations to clients. The SEC restricts the ability of an attorney to receive such an award through the definition of "original information" as well as the state professional rules. To receive an award, "original information" must be, *inter alia*, derived from the whistleblower's "independent knowledge or independent analysis." In the case of attorneys, the SEC excludes (1) information obtained through a communication subject to the attorney-client privilege, unless disclosure of that information falls under Part 205's permissible exceptions or by state ethical rules; and (2) information obtained in connection with the legal representation of a client that the attorney seeks to use to make a whistleblower submission for his or her own benefit, unless disclosure is otherwise permitted by a Part 205 exception or a state's ethical rules.[27]

It is important to note that attorneys who do not "practice" or "appear" before the Commission, *e.g.*, communicate with the SEC or advise on securities law or SEC rules and regulations), are subject to the restrictions of applicable state rules and cannot benefit from any overriding permission of Part 205. While most states require disclosures in the case of ongoing crime or fraud in certain circumstances, some jurisdictions prohibit disclosure of client information in all but the most extreme circumstances. For instance, California prohibits attorneys from revealing client information concerning crime or fraud unless it is necessary to prevent a criminal act the attorney "reasonably believes is likely to result in death of, or substantial bodily harm to, an individual."[28] A number of states permit an attorney to disclose confidential information to third parties when an organization they represent may suffer substantial harm as a result of unlawful conduct by its leadership. New Jersey, for example, permits disclosure of otherwise protected information when "(1) the highest authority in the organization has acted to further the personal or financial interests of members of that authority which are in conflict with the interests of the organization; and (2) revealing the information is necessary in the best interest of the organization."[29] In short, either a state's ethical rules or Part 205's permissible exceptions may provide a basis for "original information" and qualify an attorney for an award under the incentive

[26] *See* 76 Fed. Reg. 34,300, 34,315 (June 13, 2011).

[27] *See* 17 C.F.R. § 205.3(d)(2); 17 C.F.R. § 240.21F-4(b)(i)-(ii).

[28] Cal. R. Prof. Conduct 1.6.

[29] N.J. R. Prof. Conduct 1.13(c).

program, but otherwise attorneys are generally ineligible to receive awards and may be subject to discipline for violations of applicable state rules.

2. <u>Accountants</u>

As with the legal profession, the accounting profession has diverse rules and regulations concerning disclosure in addition to the relevant financial laws codified in state or federal statutes. The primary way for a public company to communicate its financial performance to its stakeholders is through financial statements and therefore accountants play a key role in ensuring a company's compliance with the law. For example, accountants are generally obligated to abide by accounting standards like the generally accepted accounting principles ("GAAP"), which require certain types of information to be disclosed in a business's audited financial statements. Although these rules do not have the same force of law as the SEC rules and regulations, they are widely accepted and followed by the accounting profession. Nevertheless, the circumstances under which an accountant can disclose unlawful conduct to the SEC are complex and primarily stipulated by the Securities Exchange Act of 1934 ("Exchange Act"). The Exchange Act prohibits auditors at registered public accounting firms from reporting wrongdoing to the SEC until after they have reported the problem internally. If a public accounting firm detects or becomes aware of information indicating that either an illegal act may occur or has occurred, the firm *must* determine and consider the possible effect of the illegal conduct on the financial statements of the issuer, inform the appropriate level of the company's management, and assure that an audit committee of the issuer (or in the absence of such a committee, the board of directors) is "adequately informed" of the illegal acts unless the act is "clearly inconsequential."[30] Auditors are required to report the legal violation to the SEC in the event that the company fails to take appropriate remedial action.

As it does with attorneys, the SEC restricts the ability of accountants to receive awards under the incentive program through its "original information" requirement. Specifically, the Commission does not reward information provided by an employee of a public accounting firm who has learned the information through an audit required under the federal securities laws.[31] Also similar to its treatment of attorneys, the Commission provides certain exceptions to the original information requirement if the employee has a "reasonable basis" to believe:

> (1) The disclosure to the SEC is necessary to prevent the company from engaging in conduct likely to cause substantial injury to the financial interest or property of the company or its investors;
>
> (2) The company is engaging in conduct that will impede investigation of the illegal act; or

[30] 15 U.S.C. § 78j-1(b)(1)(B).

[31] 17 C.F.R. § 240.21F-4(b)(4)(iii).

(3) At least 120 days have passed since the employee provided the information to the audit committee, chief legal officer, chief compliance officer (or their equivalents), or the employee's supervisors, or if the employee received the information under circumstances indicating that these personnel were already aware of the information.[32]

These exceptions provide the company with a period of time to investigate the alleged violation and attempt to correct it, while also making it permissible for employees to report unlawful conduct to the SEC that would likely not be addressed otherwise.

3. Compliance Officers

By contrast to attorneys and accountants, the SEC has not enacted mandatory reporting rules for compliance officers. The core function of compliance personnel is to receive, identify, and address information regarding conduct that is potentially unethical or unlawful. In other words, compliance officers are necessarily charged with detecting and correcting wrongful conduct in their organizations. It is likely for this reason that the Commission has not deemed it necessary to stipulate mandatory internal reporting requirements for compliance officers. However, the SEC does treat compliance officers who blow the whistle similar to attorneys and accountants when it comes to determining their eligibility for an award under its incentive program. For the purposes of satisfying the SEC incentive program's "original information" requirement, the Commission excludes information from (1) an employee whose principal duties involve compliance or internal audit responsibilities, or are otherwise associated with a company to perform compliance or internal audit functions and (2) an employee of a firm conducting an inquiry or investigation of unlawful conduct.[33] Accordingly, an employee whose principal duties are related to compliance or internal auditing is not eligible for an award unless an exception applies. The exceptions provided to compliance officers are the same as the three exceptions for accountants discussed above. The exclusions the SEC applies to compliance officers are reasonable since their principal role is to address matters internally, but the SEC's exceptions have allowed compliance officers to respond to the inherent tension that occurs when a compliance officer believes the company is concealing and/or refusing to address unlawful conduct. Indeed, in recent years the incentive program has made several substantial awards to compliance officers.[34]

C. Retaliation under SOX and Dodd-Frank

[32] 17 C.F.R. § 240.21F-4(b)(4)(v).

[33] 17 C.F.R. § 240.21F-4(b)(4)(iii).

[34] *See, e.g.*, "SEC Announces Million Dollar Whistleblower Award to Compliance Officer," SEC Press Release (April 22, 2015) (announcing award of $1.4-1.6 million), available at http://www.sec.gov/news/pressrelease/2015-73.html (last visited Aug. 13, 2018); "SEC Announces $300,000 Whistleblower Award to Audit and Compliance Professional Who Reported Company's Wrongdoing," SEC Press Release (Aug. 29, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542799812 (last visited Aug. 13, 2018).

Under SOX and Dodd-Frank, retaliation against employees for engaging in protected activity is prohibited. SOX prohibits issuers from retaliating against employees for providing information or otherwise assisting in the investigation of SOX violations, SEC rules and regulations, or securities fraud.[35] In 2014, the Supreme Court held that the whistleblower protections in SOX extend to employees of contractors and subcontractors of public companies, including outside investment advisors, lawyers, auditors, and accountants.[36] When Dodd-Frank was enacted in 2010, the Act expanded the coverage for protected activity. Dodd-Frank prohibits companies from retaliating against an employee for providing information to the SEC, initiating or otherwise participating an in an investigation undertaken by the agency, or making disclosures required or protected by SOX or other federal statutes within the jurisdiction of the agency. Notably, employees may be protected by these anti-retaliation provisions even if they do not qualify for an SEC award.[37] Although employees are generally protected from retaliation under these provisions, a number of complex issues emerge in the context of gatekeeper whistleblowers. For example, consider the case of an in-house attorney whose employer retaliates against them for opposing the employer's unlawful conduct. In such situations, can in-house counsel use privileged or confidential information to establish a SOX or Dodd-Frank retaliation claim?

1. <u>Attorneys</u>

The Department of Labor ("DOL") has permitted the use of privileged information provided that that the disclosures were appropriately limited in light of the scope of the claim and that measures were taken to restrict public access to the information,[38] but few courts have addressed whether attorneys can use privileged or confidential information in these cases. Indeed, there is little case law addressing whether attorneys are protected against retaliation under SOX or Dodd-Frank, although some courts have held that in-house attorneys are covered.

In one of the few instances where the specific issue of using privileged or confidential in this context has been addressed, the Ninth Circuit held that the potential disclosure of privileged information would not bar an in-house counsel from asserting SOX anti-retaliation claims, holding that Congress had considered that attorneys might play a role in reporting securities fraud and that the trial court could use equitable measures to limit harmful disclosures of confidential information.[39] In addition, an attorney who might wish to use confidential information to assert a

[35] 18 U.S.C. § 1514A(a).

[36] *Lawson v. FMR, LLC*, 124 S.Ct. 1158 (2014) (holding that § 1514A's whistleblower protection includes employees of a public company's private contractors and subcontractors).

[37] 17 C.F.R. § 240.21F-2.

[38] *Jordan v. Spring Nextel Corp.*, ARB No. 2005-SOX-41, 2009 DOLSOX LEXIS 19, *12-13 (Sept. 30, 2009) (holding that an attorney's report of material violations as required by SOX are admissible in a retaliation hearing to show that he engaged in protected activity).

[39] *Van Asdale v. International Game Technology*, 577 F.3d 989, 1002 (9th Cir. 2009); *see also Wadler v. Bio-Rad Labs., Inc.*, 212 F. Supp. 3d 829, 850- 54 (N.D. Cal. 2016) (allowing in-house counsel to bring SOX claims even though it would require a disclosure of his former employer's privileged

claim of retaliation against an employer should review their state rules of professional conduct, since these rules sometimes permit an attorney to use privileged or confidential information to establish a claim or defense. For example, North Carolina provides that an attorney may reveal information protected from disclosure "to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client."[40] On the other hand, some jurisdictions provide no such carve-out for an attorney who seeks to establish a legal claim. For instance, the District of Columbia permits disclosure to establish a "defense" to a criminal or civil claim, but it does not allow disclosure to establish a claim.[41] Similarly, Michigan permits disclosures necessary to defend against an accusation of wrongful conduct, or to collect a legal fee, but it does not provide an exception for disclosures necessary to establish a legal claim.[42]

There is a growing body of case law which holds that SOX retaliation claims are governed by the federal common law of attorney-client privilege, which includes ABA Model Rule 1.6(b) that allow a lawyer to "reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary. . . to establish a claim or defense on behalf of the lawyer in the controversy between the lawyer and the client."[43] A recent opinion from the D.C. Court of

information that might otherwise violate the California Rules of Professional Conduct); *see, e.g., Coppola v. Proulx*, 2012 U.S. Dist. LEXIS 104792, *13-14 (D. Nev. July 26, 2012) (holding that Dodd-Frank retaliation claim was not barred by ethical duties to a former client, although failure to properly plead causation was grounds for dismissal).

[40] *See, e.g.*, N.C. R. Prof. Conduct 1.6(b)(6)(["[a lawyer may reveal client confidences] to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client; to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved; or to respond to allegations in any proceeding concerning the lawyer's representation of the client."); Va. R. Prof. Conduct 1.6(b)(2)("[a lawyer may reveal] such information to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client."); Wash. R. Prof. Conduct 1.6(b)(5)("[a lawyer] may reveal information relating to the representation of a client to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client."). These exceptions have been invoked to pursue employment claims. *cf. Parker v. M&T Chemicals, Inc.*, 566 A.2d 215, 220 (N.J. 1989) (employee-attorney may bring a damage suit for wrongful discharge under New Jersey's Conscientious Employee Protection Act, as public policy in favor of whistle-blowing on illegal conduct overrides attorney's duties of confidentiality); *GTE Products Corp. v. Stewart*, 653 N.E.2d 161, 166-68 (Mass. 1995) (in-house counsel may maintain wrongful discharge action where fired for refusing to violate ethical norms).

[41] D.C. R. Prof. Conduct 1.6(b)(3).

[42] Mich. R. Prof. Conduct 1.6(c)(5).

[43] *See Willy v. ARB*, 423 F.3d 483, 495 (5th Cir. 2005) (holding that federal common law of attorney-client privilege governs in the course of adjudicating federal rights..."); *see also Weeks v. McLaughlin*, 2010 WL 11485532 at fn. 9 (D. Kan. March 11, 2000) ("when the claim or defense language

Appeals Board of Professional Responsibility illustrates this point. In *In the Matter of M Adriana Koeck*, the Board held that the in-house attorney does not run afoul of his ethical obligations if forced to disclose client confidences when litigating his SOX claims, specifically citing ABA Model Rule 1.6 as the controlling ethical rule in SOX cases.[44] The Board noted that "[the plaintiff] was authorized to disclose client confidences in her retaliation complaint," and citing several other cases, found that "this principle seemed well established."[45]

2. <u>Accountants and Compliance Officers</u>

Accountants may also be protected by the anti-retaliation provisions of SOX and Dodd-Frank for reporting fraudulent accounting practices that mislead shareholders, but they are in the same category as compliance officers with respect to another potential challenge to asserting a retaliation claim, the "step-outside" doctrine. Applying the step-outside doctrine, courts analyzing SOX and Dodd-Frank retaliation claims require a gatekeeper, *e.g.*, in-house counsel, accountants, and compliance officers, to do something outside the course of their usual job duties in order to put the employer on notice that they believe that the company is engaged in and/or refusing to remedy the effects of illegal conduct. The doctrine addresses a concern that a gatekeeper employee could essentially always be engaged in protected conduct, and an employer would be hard-pressed ever to discipline such an employee for his or her job performance.

Although this doctrine has considerable implications for gatekeeper employees who are retaliated against for reporting violations they became aware of through the exercise of their role, a 2009 Supreme Court decision in the Title VII context casts doubt on the future of the doctrine's applicability. In *Crawford v. Metropolitan Government of Nashville*, the Supreme Court essentially eliminated the step-outside requirement in the Title VII context, where the Court considered whether an employee who answered questions during an internal investigation of sexual harassment allegations against a supervisor "opposed" an unlawful employment practice within the meaning of Title VII.[46] In that case, the Court provided protection to an employee "who has taken no action at all to advance a position [concerning sexual harassment] beyond disclosing it."[31]

Notably, SOX and Dodd-Frank arguably have lower thresholds for protected activity than Title VII since they merely require the whistleblower to "provide information," which is facially less demanding than "opposition" to such conduct. In the context of gatekeeper whistleblowers, there is little case law regarding the step-outside doctrine with respect to attorneys, and it is unclear

was added to the confidentiality exception in Model Rule 1 .6(b)(2), it enlarged the exception 'to include disclosure of information relating to claims by the lawyer other than for the lawyer's fee.") (citing ABA Model Rule 1.6, Model Code Comparison (1984)).

[44] *In the Matter of M Adriana Koeck*, Bd. Docket No. 1 4-BD-05 at 20-22 (2017).

[45] *Id.* at 21.

[46] *Crawford v. Metro. Gov't of Nashville & Davidson Cty., Tenn.*, 555 U.S. 271 (2009).

[31] *Id.* at 277.

what it would mean for attorneys to step outside their roles as counselors regarding the law. With respect to compliance personnel, the DOL and courts have reached inconsistent conclusions about whether these employees must "step outside" of their job duties in to order to engage in protected activity. The DOL maintains that the anti-retaliation provisions of SOX and Dodd-Frank do not require a complainant to step outside of his or her assigned duties,[47] while courts have reached the opposite conclusion in a number of instances.[48] Thus, although SOX and Dodd-Frank may afford gatekeeper whistleblowers some protection against retaliation from their employers, the circumstances under which that protection is available remain unclear.

II. Employer-Imposed Agreements That Impede Whistleblowers[49]

Another very important protection for all employees, not just attorneys, accountants, and compliance officers, who blow the whistle on securities violations is found in Rule 21F-17(a), which states:

> No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement … with respect to such communications.

This ground-breaking rule applies to all confidentiality and non-disclosure agreements that employers require of current employees. It also applies to separation, severance or settlement agreements that employers require employees to sign when exiting a company, as these almost invariably include confidentiality provisions and non-disparagement provisions. The rule has no parallel in the Internal Revenue Service's whistleblower program or under the False Claims Act, although courts have refused to enforce confidentiality agreements in the context of the False Claims Act. The CFTC adopted rules amendments similar to the SEC's prohibition of impediments to whistleblowers on May 22, 2017.[50]

[47] *Robinson v. Morgan Stanley*, ARB Case No. 07-070, ALJ Case No. 2005-SOX-044, at 13-14, 2010 DOLSOX LEXIS 7, *24-25 (Jan. 10, 2010).

[48] *Compare Riddle v. First Tennessee Bank, 2011 U.S. Dist. LEXIS 10559*7, *24-25 (M.D. Tenn. Sept. 16, 2011) (ruling that an employee engages in protected activity only when he steps outside his role and takes "additional action," with no discussion of the ARB's contrary decision in Robinson) with *Yang v. Navigators Group, Inc., 18 F. Supp.3d 519, 529-530* (S.D.N.Y. 2014) (deferring to ARB determination that a compliance employee may engage in protected activity within the scope of normal job duties).

[49] For more information on the SEC whistleblower program, see "The SEC Whistleblower Practice Guide," by Lisa J. Banks and Michael A. Filoromo, available at https://www.kmblegal.com/resources/sec-whistleblower-practice-guide.

[50] On May 22, 2017, the CFTC adopted a series of amendments to the rules governing the CFTC Whistleblower Program. Among other changes, the amendments allow the agency, like the SEC, to take action to enforce the anti-retaliation provisions of the Dodd-Frank Act that apply to CFTC whistleblowers. The amendments also prohibit entities from impeding whistleblowers from

During the first few years of the SEC Whistleblower Program, lawyers representing whistleblowers observed a troubling trend among employers seeking to circumvent Rule 21F-17(a). Employees increasingly found themselves presented with agreements that required them to certify that they had not shared and would not share confidential information with any third party except "as required by law," to waive their right to an SEC award, to assign any award received to the government, and/or to keep the employer informed of any contact with or inquiries from government agencies. While not expressly prohibiting contact with the SEC, such terms have the purpose or effect, or both, of impeding individuals from communicating directly with the Commission.

Attorneys representing whistleblowers before the SEC started bringing employers' widespread use of restrictive agreements to the SEC's attention as early as mid-2013.[51] The SEC began addressing these concerns in late 2013 or early 2014, and since that time has taken a series of enforcement actions that have prompted companies nationwide to rewrite their employee agreements to bring them into compliance with Rule 21F-17(a).

In early 2015 the SEC sent letters to a number of companies requesting years of nondisclosure agreements in an effort to determine whether the companies had restricted their employees' ability to share information with law enforcement agencies. These investigations culminated in an enforcement action against KBR, Inc. On April 1, 2015, the SEC announced that it had entered into a settlement with KBR related to the company's confidentiality agreements. The provision at issue appeared in an agreement that KBR required employees to sign when participating in the company's internal investigations:

> I understand that in order to protect the integrity of this review I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for

reporting commodities-trading violations to the CFTC, including through the use of confidentiality and pre-dispute arbitration agreements. *See* CFTC Office of Public Affairs, Strengthening Anti-Retaliation Protections for Whistleblowers and Enhancing the Award Claims Review Process, (May 22, 2017), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/wbruleamend_factsheet052217.pdf.

[51] See David Marshall & Debra Katz, *SEC Whistleblowers' Rights Being Restricted in Severance Agreements*, Katz, Marshall & Banks, LLP (May 15, 2013), http://www.kmblegal.com/sec-whistleblower-blog/sec-whistleblowers-rights-being-restricted-severance-agreements; David Marshall & Debra Katz, Letter to SEC Commissioners re: The Use of Severance Agreements to Impede Individuals from Participating in the SEC Whistleblower Program: A Growing Problem and a Recommendation (May 8, 2013), available at http://www.kmblegal.com/wp-content/uploads/2015/04/130508-Letter-to-SEC-Commissioners.pdf.

> disciplinary action up to and including termination of employment.[52]

Without admitting to any rule violation, KBR agreed to pay a $130,000 fine and change its confidentiality agreement language going forward. The new language would read:

> Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.[53]

Following the KBR action, the SEC stepped up its efforts to combat agreements that similarly impeded whistleblowers, and broadened its targets to include additional types of provisions that could dissuade employees from approaching the SEC with concerns about securities violations. In her April 2015 speech on "The SEC as the Whistleblower's Advocate," SEC Chair White noted that "a number of other concerns have come to our attention, including that some companies may be trying to require their employees to sign agreements mandating that they forego any whistleblower award or represent, as a precondition to obtaining a severance payment, that they have not made a prior report of misconduct to the SEC. You can imagine our Enforcement Division's view of those and similar provisions under our rules."[54] The SEC has since taken nearly a dozen additional enforcement actions specifically targeting such employer-imposed restrictions in employment and severance agreements.[55]

Seeing the SEC take aggressive and rapid-fire aim at company agreements that required an employee to waive her right to receive an SEC was a welcome development for whistleblowers. As a letter from our law firm, Katz, Marshall & Banks to the SEC told the Commissioners in 2013, the attempt to require employees to waive their right to an SEC award was among the most common and insidious impediments that employers had contrived to discourage employees from communicating with the Commission.[56] In the SEC whistleblower

[52] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Exchange Act Release No. 74619, at 2 (Apr. 1, 2015), http://www.sec.gov/litigation/ admin/2015/34-74619.pdf.

[53] *Id.* at 3.

[54] *See* Mary Jo White, The SEC as the Whistleblower's Advocate (Apr. 30, 2015), http://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html.

[55] For an up-to-date list of all enforcement actions the SEC has taken based on employer actions to impede reporting, see SEC, Enforcement Actions Based on Actions Taken to Impede Reporting, https://www.sec.gov/whistleblower/retaliation#enforcement-actions (last visited Feb. 1, 2021).

[56] *See* David Marshall & Debra Katz, Letter to SEC Commissioners re: The Use of Severance Agreements to Impede Individuals from Participating in the SEC Whistleblower Program: A Growing

program, it is the government, and not the employer that pays an award to the employee. The whistleblower's right to an award is a statutory right that has nothing to do with the legal dispute the employee settled with the employer. Therefore, the only benefit an employer receives from such an agreement is to dis-incentivize employee whistleblowing to the SEC—a goal with no legitimate justification. Courts would likely find such agreements void as against public policy, but the agreement could still prevent individuals from reporting to the SEC if they believe they will receive no award and will face a breach-of-contract lawsuit and accompanying career harm.

The SEC's enforcement actions against employers who have erected barriers to whistleblowers advances the ability of the Commission (and investors) to draw on the knowledge of whistleblowers to protect investors against securities fraud. These SEC actions have not only forced employers nationwide to scramble to reform their agreements with employees, but they have no doubt rendered the outlawed provisions and ones like them effectively unenforceable in court. The removal of such onerous restrictions is especially welcome for employees who are abruptly fired or otherwise retaliated against for reporting their concerns internally, as it leaves them free to challenge the retaliation, obtain just compensation by settling the dispute prior to or during litigation, and then still participate in the SEC Whistleblower Program, if they so choose, without fear that an employer will be able to sue them and claw back whatever severance or settlement amount it may have paid them.[57]

Conclusion

Although in recent years lawmakers have established a number of whistleblower rewards and anti-retaliation laws to incentivize and protect company insiders who report fraud and corporate misconduct, gatekeeper whistleblowers (attorneys, accountants, and compliance officers) are not necessarily afforded access to these incentives and protections under the same circumstances as other employees. Lawmakers and the courts have attempted to strike a balance between the fiduciary and professional duties of gatekeepers on the one hand and the public policy to encourage employees to report corporate misconduct on the other.

The obligations of gatekeepers are complex and vary between the respective roles of attorneys, accountants, and compliance. Recognizing these various obligations, the SEC has provided rules addressing the circumstances under which gatekeeper whistleblowers can disclose

Problem and a Recommendation, at 6-7 (May 8, 2013), available at http://www.kmblegal.com/wp-content/uploads/2015/04/130508-Letter-to-SEC-Commissioners.pdf.

[57] Other agencies have also given greater scrutiny to confidentiality agreements. The National Labor Relations Board, Equal Employment Opportunity Commission, and Financial Industry Regulatory Authority, to name a few, have taken action against employer-employee confidentiality agreements in recent years. In addition, a March 2015 report by the State Department's Office of Inspector General examined confidentiality agreements that the 30 largest State Department contractors have required their employees to sign. U.S. Dep't of State Office of Inspector General, Review of the Use of Confidentiality Agreements by Department of State Contractors, Report ESP-15-03 (March 2015), https://www.stateoig.gov/system/files/esp-15-03.pdf.

information to the agency and has restricted their award eligibility, while permitting limited exceptions. However, whether courts will accept the SEC's proclamation that its rules supersede the rules of other jurisdictions remains an open question. Similarly, while the anti-retaliation provisions of SOX and Dodd-Frank generally protect a whistleblower against retaliation by a covered employer, whether these laws will effectively protect a gatekeeper will depend upon what evidence the employee can use in support of a retaliation claim, and whether a court will require the employee to have stepped outside of his or her job responsibilities in order to be afforded protection.

Fortunately for whistleblowers—and the public who depend upon them coming forward—the outdated provisions in nondisclosure agreements which have historically chilled whistleblower from coming forward have been all but eliminated. Despite the many uncertainties that exist in the context of gatekeeper whistleblowers, it is clear that companies should not assume that the ethical and legal obligations of gatekeepers will prevent these employees from taking advantage of the awards and anti-retaliation protections available to their colleagues.

Private Company Fraud

Verity Winship[*]

Fewer companies are going public in the United States, but public companies are still the focus of securities law and enforcement. A major exception is that anti-fraud provisions apply to all companies, public or private. Theranos is a prominent example. The Securities and Exchange Commission ("SEC") sued this private company for securities fraud. This Article examines one societal cost of the decline of public companies: the loss of information needed to detect and punish fraud. It analyzes the SEC's securities fraud enforcements against private companies and assesses the information costs of moving to an anti-fraud-only regime. It concludes by identifying ways to incentivize information disclosure in the newly private universe of corporations, including a proposal to expand whistleblower protection for employees of private companies.

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INTRODUCTION

"Garbage to gold." That was the promise of Indiana-based plastics manufacturer, Lucent Polymers, Inc.[1] The company's one product was plastic generated from recycled and scrap material. Corporate officers promoted the plastic as cheap to produce but able to meet tough standards for flame resistance and strength.[2] Lucent Polymers was a success. The company was sold twice, and the former Chief Executive Officer ("CEO") and Chief Operations Officer ("COO") reportedly made millions of dollars between them.

Despite the company's apparent success, its underlying product was flawed. "I am having some ethical/conscience issues here," wrote Lucent Polymer's technical director in an internal email.[3] "There is a level of dishonesty going on (which I am part of) which is troubling me greatly."[4] Subsequent correspondence expressed fears about what the buyer's due diligence might uncover, and also — belatedly — suggested that communicating by email was a bad idea.[5]

In 2019, the SEC brought an enforcement action against Lucent Polymer's CEO and COO for securities fraud.[6] "Like a modern-day Rumpelstiltskin," the SEC alleged, the company promised remarkable — and unrealistic — transformation.[7]

"One tiny drop changes everything."[8] This is the now-infamous promise of Theranos: that a single drop of blood could replace needles and blood draws for most blood tests. At the heart of the company was Elizabeth Holmes, the founder, inventor, charmer and — some say — sociopath.[9] The Theranos board was full of heavy hitters like Henry

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[1] Complaint at 1, SEC v. Kuhnash, No. 19-CV-00028 (S.D. Ind. Feb. 12, 2019) [hereinafter Complaint, Kuhnash].

[2] *Id.*

[3] *Id.* at 13.

[4] *Id.*

[5] *See id.* at 14.

[6] SEC Charges Former Executives of Plastics Manufacturer with Fraud, SEC Litigation Release No. 24397, 2019 WL 554227 (Feb. 12, 2019).

[7] *See* Complaint, Kuhnash, *supra* note 1, at 1.

[8] JOHN CARREYROU, BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP 153 (2018) (noting two Theranos slogans, "One tiny drop changes everything" and "The lab test, reinvented").

[9] *See, e.g.*, Jia Tolentino, *The Story of a Generation in Seven Scams*, *in* TRICK MIRROR: REFLECTIONS ON SELF-DELUSION 157, 184 (2019) (describing "Holmes's belief in her own significance" as "appear[ing] to border on sociopathic zealotry"); *cf.* CARREYROU, *supra* note 8, at 299 ("A sociopath is often described as someone with little or no conscience. I'll leave it to the psychologists to decide whether Holmes fits the clinical profile, but there's no question that her moral compass was badly askew.").

Kissinger and former Secretary of State, George Shultz.[10] Media and investors became caught up in the story of the intrepid and apparently altruistic young female entrepreneur.[11] Walgreens struck a deal to have Theranos blood testing in its stores.[12] Theranos was widely declared a "unicorn," a company valued at more than a billion dollars.[13]

Media and investors were equally riveted by the story of Elizabeth Holmes' fall from grace. It gradually became clear that a single drop of blood is *not* enough, and Theranos insiders scrambled to cover up the failure of the blood testing machine to provide reliable information.[14] Criminal and civil authorities, government and private citizens, the U.S. Food and Drug Administration ("FDA") — all wanted a piece of the Theranos action.[15] News headlines about Theranos had been full of puns about blood; now they were about vampires.[16] In 2018, the SEC

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10 *See* Ken Auletta, *Blood, Simpler: One Woman's Drive to Upend Medical Testing*, NEW YORKER (Dec. 8, 2014), https://www.newyorker.com/magazine/2014/12/15/blood-simpler [https://perma.cc/D737-SJWL] (noting that the Theranos board was "stocked with prominent former government officials, including George P. Shultz, Henry Kissinger, Sam Nunn, and William H. Foege, the former director of the Centers for Disease Control and Prevention"); Roger Parloff, *A Singular Board at Theranos*, FORTUNE (June 12, 2014, 4:40 AM PDT), https://fortune.com/2014/06/12/theranos-board-directors/ [https://perma.cc/N4PT-9HMN] [hereinafter *A Singular Board*] ("Little known and privately held, Theranos has assembled what may be, in terms of public service, the most illustrious board in U.S. corporate history.").

11 *See* Roger Parloff, *This CEO Is Out for Blood*, FORTUNE (June 12, 2014, 4:37 AM PDT), https://fortune.com/2014/06/12/theranos-blood-holmes/ [https://perma.cc/NKR6-C5HT] [hereinafter *This CEO Is Out for Blood*] (lauding Holmes and helping bring her to prominence).

12 Christopher Weaver & John Carreyrou, *Craving Growth, Walgreens Dismissed Its Doubts About Theranos*, WALL ST. J. (May 25, 2016, 5:14 PM ET), https://www.wsj.com/articles/craving-growth-walgreens-dismissed-its-doubts-about-theranos-1464207285 [https://perma.cc/673J-77H8].

13 CARREYROU, *supra* note 8, at 174; Aileen Lee, *Welcome to the Unicorn Club: Learning from Billion-Dollar Startups*, TECHCRUNCH (Nov. 2, 2013, 11:00 AM PDT), https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/ [https://perma.cc/YL2U-RYEL] (introducing the term "unicorn" for companies valued over a billion dollars).

14 *See generally* CARREYROU, *supra* note 8, at ch. 19-22 (detailing how Carreyrou, a WSJ journalist, uncovered the truth about Theranos's blood testing capabilities).

15 *See, e.g.*, Ludmila Leiva, *Here Are All of Elizabeth Holmes's Criminal Charges*, REFINERY29 (Mar. 11, 2019, 12:14 PM), https://www.refinery29.com/en-us/elizabeth-holmes-trial-criminal-charges-theranos-case-sec [https://perma.cc/ZM9P-WSYY] (outlining the criminal charges against Holmes).

16 *See, e.g.*, Warren, *HBO Theranos Doc to Focus on Holmes as Blood-Stealing Vampire*, BOREDROOM NEWS (Feb. 1, 2019), https://boredroomnews.com/2019/02/01/hbo-theranos-doc-to-focus-on-holmes-as-blood-stealing-vampire/ [https://perma.cc/Q48W-A3A3] (discussing an HBO film that portrays Holmes as a "centuries-old vampire").

brought an anti-fraud action against Theranos, Elizabeth Holmes, and her partner Ramesh "Sunny" Balwani.[17]

What Lucent Polymers and Theranos have in common — besides fundamental flaws in the technology at the center of their businesses — is that these are not public companies. Lucent Polymers and Theranos were both private. The definition of private company has nuances, which are taken up below, but the key characteristics are that the companies' stock is not traded on a public exchange and the companies are not subject to mandatory periodic disclosure.[18] The events at Lucent Polymers and Theranos are examples of private company fraud and the SEC enforcement actions designed to address it.

According to the SEC's co-head of enforcement, the action against Theranos, Holmes, and Balwani sent a message that "there is no exemption from the anti-fraud provisions of the federal securities laws simply because a company is non-public, development-stage, or the subject of exuberant media attention."[19] This echoed the SEC's 2016 declaration that it is "axiomatic" that "all private and public securities transactions . . . must be free from fraud."[20]

Indeed, the key securities fraud provisions apply broadly to all companies, whether private or public.[21] In particular, Section 10(b) of the Exchange Act and SEC Rule 10b-5 contain a broad prohibition on the use of any "manipulative or deceptive devices . . . in connection with the purchase or sale of *any security*."[22]

How effective are these anti-fraud measures in meeting the aims of U.S. securities regulation: "to protect investors, ensure fair and efficient

[17] Complaint at 1, SEC v. Holmes, No. 18-cv-01602 (N.D. Cal. Mar. 14, 2018) [hereinafter Complaint, Holmes]; Complaint at 1, SEC v. Balwani, No. 18-cv-01603 (N.D. Cal. Mar. 14, 2018) [hereinafter Complaint, Balwani].

[18] *See infra* Part I.A.

[19] *Theranos, CEO Holmes, and Former President Balwani Charged with Massive Fraud*, U.S. SEC. AND EXCHANGE COMMISSION (Mar. 14, 2018), https://www.sec.gov/news/press-release/2018-41 [https://perma.cc/K4F3-795Z] (quoting Steven Peikin, Co-Director of the SEC's Enforcement Division).

[20] Mary Jo White, Chair, U.S. Sec. and Exch. Comm'n, Keynote Address at the SEC-Rock Center on Corporate Governance Silicon Valley Initiative (Mar. 31, 2016), https://www.sec.gov/news/speech/chair-white-silicon-valley-initiative-3-31-16.html [https://perma.cc/ZQD8-4PCE] [hereinafter *SEC Silicon Valley Initiative Speech*].

[21] *See infra* Part II.A.

[22] Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2018) (emphasis added) (making unlawful manipulative or deceptive devices "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered"); U.S. Sec. and Exch. Comm'n Rule 10b-5, 17 C.F.R. § 240.10b-5(c) (2020) (making unlawful deception "in connection with the purchase or sale of any security").

markets, and encourage capital formation"?[23] Anti-fraud is important to these articulated aims. There is the straightforward goal of protecting investors from fraud. In addition, without some assurance that there is no fraud, investors would impose a "fraud discount," impounding the risk of fraud into the price and increasing the costs of capital.[24]

The question of anti-fraud's effect is urgent. The move towards "going private," — or "going dark" — has been well documented.[25] Journalists have called U.S. publicly listed companies "a dying breed."[26] SEC commissioners have pointed to Initial Public Offerings' ("IPO") "precipitous decline."[27]

And yet private companies, even big private companies, may commit fraud.[28] As fewer companies go public at all, or go public later in their

[23] SEC, DIVISION OF ENFORCEMENT: 2019 ANNUAL REPORT 1 (2019), https://www.sec.gov/files/enforcement-annual-report-2019.pdf [https://perma.cc/5824-QU3J] (describing "to protect investors, ensure fair and efficient markets, and encourage capital formation" as the Commission's "mandate"); SEC, AGENCY FINANCIAL REPORT: FISCAL YEAR 2018, at 4 (2018), https://www.sec.gov/files/sec-2018-agency-financial-report.pdf [https://perma.cc/E7VE-XRLB] (describing the SEC's mission as "[t]o protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation").

[24] Urska Velikonja, *The Cost of Securities Fraud*, 54 WM. & MARY L. REV. 1887, 1893 (2013) (noting that "investors demand a fraud discount").

[25] *See, e.g.*, Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445 (2017) (arguing that the decline of public companies hurts private companies by reducing available information); Renee M. Jones, *The Unicorn Governance Trap,* 166 U. PA. L. REV. ONLINE 165 (2017) (identifying costs to investors and society because of unicorns' founder-focused governance structure); Amy Deen Westbrook & David A. Westbrook, *Unicorns, Guardians, and the Concentration of the U.S. Equity Markets*, 96 NEB. L. REV. 688 (2018) (discussing how the rise in private equity has changed the meaning and role of the stock market in the United States).

[26] Andrew Ross Sorkin, *C.E.O.s Meet in Secret Over the Sorry State of Public Companies*, N.Y. TIMES (July 21, 2016), https://www.nytimes.com/2016/07/21/business/dealbook/ceos-meet-in-secret-over-sorry-state-of-public-companies.html [https://perma.cc/R89K-4KWR]; *see also* Maureen Farrell, *America's Roster of Public Companies Is Shrinking Before Our Eyes*, WALL ST. J, https://www.wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879 (last updated Jan. 6, 2017, 12:59 PM ET) [https://perma.cc/U4YQ-RQXT].

[27] Michael S. Piwowar, Comm'r, Opening Remarks at SEC-NYU Dialogue on Securities Market Regulation: Reviving the U.S. IPO Market (May 10, 2017), https://www.sec.gov/news/speech/opening-remarks-sec-nyu-dialogue-securities-market-regulation-reviving-us-ipo-market [https://perma.cc/9BU2-2BTR].

[28] *See generally* Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. (forthcoming 2020), https://ssrn.com/abstract=3551565 [https://perma.cc/SV7B-6F4Z] [hereinafter *Private Company Lies*] (describing incentives to commit fraud for actors within private companies and outlining alternative mechanisms to "increase accountability" and address securities fraud in the startup context); *cf.* E-mail from

life cycle, one of the potential costs is to detection of and enforcement against fraud. Much of the apparatus of U.S. securities law is designed to force disclosure. But some large companies are not subject to this mandatory disclosure. They do not offer securities publicly in a way that triggers transactional disclosures; nor do they fall into the categories of firms subject to periodic disclosure — what we generally think of as "public companies."

This Article examines one particular societal cost of going private: the loss of the information needed to detect and punish fraud. It analyzes the costs of moving from a disclosure ecosystem with a range of regulatory tools to a low-information regime where the only tool is anti-fraud. It does so by examining the SEC's securities fraud enforcements against private companies. It looks at what the SEC has done in a world — our world — where the balance between public companies and private companies has shifted.

The Article's proposals respond to the current trajectory towards an increasingly private marketplace, arguing that an anti-fraud-only regulatory regime needs enhanced information incentives to make up for the lack of information about private companies. The need is particularly clear when these now-private companies share characteristics such as size and investor base that are traditionally associated with public companies and that led to securities regulation in the first place.

Part One lays the groundwork, defining the private company, describing the decline in the number and percentage of U.S. public companies, and outlining the reasons for the SEC to intervene on the private side. Part Two examines what the SEC has done in this context, analyzing its power to enforce its anti-fraud provisions against private companies, and how it has used this power to police private companies and their officers and directors. (Yes, Theranos and Elizabeth Holmes, but also the action against Lucent Polymer officers and others that got less press.)

Part Three examines what SEC anti-fraud enforcement is able to do and what is lost in the move to private companies. It assesses what it is like to be in a regime where the only regulatory tool is anti-fraud, and that tool is unaccompanied by disclosure and the information from the

Christopher Gerold, President, Nat'l American Sec. Adms Ass'n, Inc., to Vanessa Countryman, Sec'y, U.S. Sec. and Exch. Comm'n (Mar. 16, 2020), https://www.nasaa.org/wp-content/uploads/2020/03/NASAA-Accredited-Investor-Comment-Letter.pdf [https://perma.cc/8FQ6-FY9A] (noting that "private offerings are often characterized by opaque disclosures, related party transactions, illiquidity, minimal financial information and, unfortunately, fraud").

market and the price. It argues that anti-fraud actions — even high-profile actions — are not a substitute for the full suite of mandatory disclosure and regulatory tools.

Part Four looks at potential substitutes for public company information. It develops one particular tool that is used in anti-fraud actions and whose scope varies depending on whether the company is public or private: corporate whistleblowers. And it suggests expansion of whistleblower protections and prizes that would generate information in the newly private universe of corporations.

I. THE SHRINKING PUBLIC MARKET

> [W]hy are companies staying more private or staying private longer[?] And, you know, not to be flip, but the kind of short answer we've come up with is because we can . . . .
>
> — Participant in the SEC's Small and Emerging Companies Advisory Committee (2017)[29]

The division between public and private companies is an organizing principle of the U.S. law that governs the way businesses raise money. Much of the apparatus of U.S. securities law is designed to force disclosure when securities are offered publicly or to force periodic disclosure for certain registered companies.[30] What companies get in return is access to large amounts of money. In fact, historically, participation in the public markets was a necessary step in growth. The public-private divide sorted companies so that smaller companies stayed private while large corporations were on the public side, providing information and drawing on a wide investor base. The trade was clear: mandatory disclosure was the price for access to large amounts of capital.[31]

[29] SEC, TRANSCRIPT: SMALL AND EMERGING COMPANIES ADVISORY COMMITTEE 48 (Feb. 15, 2017), https://www.sec.gov/info/smallbus/acsec/acsec-transcript-021517.txt [https://perma.cc/W3ZZ-MAMN] [hereinafter TRANSCRIPT].

[30] Companies that have securities listed on a national securities exchange and companies that have offered securities in an offering where the Securities Act requires registration both must make periodic disclosures. *See* Securities Exchange Act of 1934 §§ 12(a)-(b), 15(d), 15 U.S.C. §§ 78l(a)-(b), 78o(d) (2018). Companies that reach a certain size in terms of number of investors and amount of assets are also Exchange Act reporting companies. *See* Securities Exchange Act of 1934 § 12(g), 15 U.S.C. § 78l(g).

[31] *See* de Fontenay, *supra* note 25, at 448 (calling this the "disclosure bargain" and reporting that it "has largely been revoked"); George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 605 (2017) (pointing to the "implicit bargain" made by public companies: "access to large

Over the past few decades, however, the balance between public and private has shifted, with the public company in decline both in the sheer number of public companies and in the amount of capital raised in the public market. The discussion below begins with definitions, with a particular focus on the private company that is at the heart of any discussion of "private company fraud." It then outlines evidence of the shift away from the public company and discusses the main identified causes for it. Together these sections lay the groundwork for understanding how anti-fraud tools function in this new private-public balance.

A. *Defining the Private Company*

Lurking in the background is a definitional problem. What is a private company? The most straightforward way to define private companies is in opposition to the public counterpart. Private companies do not have publicly traded stock and are not subject to periodic reporting obligations (10-Ks, etc.).[32]

Companies with stock listed on a national stock exchange are clearly in the "public" category,[33] as are companies that register public offerings with the SEC.[34] These categories were put in place when the securities

and highly liquid pools of capital" in return for "provid[ing] investors and the [SEC] with information").

32 de Fontenay, *supra* note 25, at 448 n.6 (defining private companies as "businesses that are not subject to periodic reporting requirements under the securities laws and whose stock is not publicly traded"); *cf.* SEC, *Public Companies*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/basics/how-market-works/public-companies (last visited Sept. 8, 2020) [https://perma.cc/SF6N-KTRS] ("There are two commonly understood ways in which a company is considered public: first, the company's securities trade on public markets; and second, the company discloses certain business and financial information regularly to the public.").

33 *See* Securities Exchange Act of 1934 § 15(d), 15 U.S.C. § 78o(d); *see* Kevin LaCroix, *Executive Protection: Private Company D&O Insurance*, D&O DIARY (Sept. 21, 2010), https://www.dandodiary.com/2010/09/articles/d-o-insurance/executive-protection-private-company-do-insurance/ [https://perma.cc/6469-MQ58] [hereinafter *Executive Protection*] ("The critical distinction between private and public companies is that public companies have publicly traded securities and private companies do not."). Although note the question of whether companies with other types of publicly traded securities count as "private." *See* ADVISEN, THE PRIVATE EYE: SPOTLIGHT ON THE US PRIVATE D&O MARKET 3 (2013), https://www.advisenltd.com/wp-content/uploads/us-private-d-o-market-spotlight-aig-2013-08.pdf [https://perma.cc/WL3D-34XL] (listing "Private Companies with public debt" as one form private companies can take).

34 15 U.S.C. § 78l(a) (requiring registration by companies that list securities on a national securities exchange); *id.* § 78o(d) (requiring registration by companies that have filed a Securities Act registration statement that has become effective).

statutes were initially passed in the 1930s and have remained a stable part of what is generally considered a public company.[35]

Even without listing shares or registering a public offering, however, some companies are required to report to the SEC — becoming "public" — because they reach a certain size in terms of the number of investors and amount of assets.[36] Exchange Act § 12(g) is the key provision that defines this route to the public reporting system. Statutory and rule changes to the thresholds determine how big a company can become and how many investors a company can have before triggering public reporting requirements. Tweaks to the underlying definitions by the Jumpstart Our Business Startups Act (the "JOBS Act"), other legislation, and SEC rules are thus an important part of the story about the shift to raising capital privately.[37]

Private companies are those that do not fall into any of these public categories. To think about the role of the SEC in policing these private firms, however, it makes sense to break down the description further. One important division in the category of private companies, particularly when thinking about SEC supervision and enforcement, is between those companies that grow big without becoming public and those that have been or will be a public company (companies in transition).[38]

For companies in transition, the idea is that echoes of public company institutional and governance knowledge likely persist if they once were public (the companies that have gone private). And companies have incentives to get their ducks in order if they plan, someday, to go public.[39]

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35 *See* 15 U.S.C. §§ 78m(a), 78n(a) (2018).

36 *See* 15 U.S.C. § 78l(g) (triggering reporting status when a company has a minimum number of investors (for non-financial issuers the limit is 2,000 persons or 500 persons who are not accredited investors) and a minimum level of total assets ($10 million)).

37 *See infra* Part I.B. *See generally* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337 (2013) (highlighting section 12(g) as a key mechanism in defining the public-private divide); Usha R. Rodrigues, *The Once and Future Irrelevancy of Section 12(g)*, 2015 U. ILL. L. REV. 1529, 1532 (tracing the history of 12(g)).

38 A nuanced list of categories of private companies developed in the context of D&O insurance pointed to companies in transition, separately identifying "Private with a filed, pending, postponed, or withdrawn IPO" and "Private Companies that were formerly public." ADVISEN, *supra* note 33, at 3. Also on the list were "Private Companies with public debt; Private Companies with public subsidiaries; Venture Backed private companies; [and] Partnerships." *Id.*

39 *See, e.g.*, Philip Oettinger & Andrew Ellis, *Preparing a Successful IPO in 2018*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 30, 2018), https://corpgov.law.harvard.edu/

The difficulty is that the easy assumption that all growing private companies will eventually go public no longer holds. When the SEC publicly announced its pursuit of private company fraud in 2016, the SEC Chair described unicorns like Theranos as "pre-IPO."[40] In contrast, this Article does not assume that going public is always the companies' ultimate goal. One reason to move away from this assumption lies in the decline in the number of U.S. public companies overall and the increased ability of companies to go public later in their growth or not at all. The economic shift towards raising capital privately is the topic of the next section.

B. *Public Company Decline*

The decline in the number of U.S. public companies is well documented. World Bank figures show that the number of listed U.S. companies dropped by almost 50% from 1996 to 2018.[41] This total can be broken down further. Between 1997 and 2017, the number of IPOs declined and the number of acquisitions and leveraged buyouts (a mode of "going private") increased.[42] Although the number of delistings also

2018/01/30/preparing-a-successful-ipo-in-2018/ [https://perma.cc/LXJ5-G786] (advising pre-IPO companies to build up their financial team and "Create Public Company Infrastructure"). Renee Jones helpfully notes signs of planning and restructuring as a private company contemplates going public: she points to Google's hiring of Eric Schmidt as CEO three years before its IPO and Facebook's hiring of Sheryl Sandberg as COO four years before its IPO. Jones, *supra* note 25, at 178.

40 *SEC Silicon Valley Initiative Speech*, *supra* note 20.

41 The World Bank reported data on U.S. listed companies from 1980 to 2018. The high was 8,090 U.S. domestic listed companies in 1996. The low in this period was in 2012 with 4,102 companies. The number has crept up only slightly since then, reaching 4,397 in 2018. *See* WORLD FED'N OF EXCHS., *Listed Domestic Companies, Total — United States*, WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?end=2018&locations=US&start=2008&view=bar (last visited Sept. 8, 2020) [https://perma.cc/8JVK-Y3VZ]. World Bank data shows an increase in the same period in the market capitalization of US listed companies from $8.48 trillion in 1996 to $30.436 trillion in 2018. *See* WORLD FED'N OF EXCHS., *Market Capitalization of Listed Domestic Companies (Current US$) — United States*, WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.LCAP.CD?end=2018&locations=US&start=1980&view=chart (last visited Sept. 8, 2020) [https://perma.cc/Q3PP-4U8D] (comparing these two charts results in a mean of $1,048,207 per listed company in 1996, with a mean of $6,921,992 in 2018).

42 PETE WITTE & GREG BROWN, A NEW EQUILIBRIUM: PRIVATE EQUITY'S GROWING ROLE IN CAPITAL FORMATION AND THE CRITICAL IMPLICATIONS FOR INVESTORS 7 (2019), https://www.kenaninstitute.unc.edu/index.php/publication/awp-content/uploads/2019/10/A-new-equilibrium-report.FINAL_.v2-1.pdf [https://perma.cc/9UB3-8SV9] (reporting statistics from the Center for Research in Security Prices); Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANTITATIVE ANALYSIS

fell in that period, the overall result is that new listings in the U.S. have fallen below the replacement rate.[43]

Historically, access to large amounts of capital was on the public side, sorting large companies into the public markets. However, the amount of capital raised in the private market versus the public market has shifted. In 2016, the SEC chair noted that some private companies have higher valuations than their public counterparts, something that would have been impossible in earlier years when accessing the public market was the main way to raise large amounts of capital.[44] Reportedly companies raised more new capital in the private market than the public for the first time in 2017.[45]

One sign that private companies have ballooned is that unicorns are not as rare as they once were. According to a 2020 snapshot, more than two hundred U.S.-based private companies were reportedly worth a billion dollars or more.[46] Tellingly, terms have been coined for even larger private companies: the decacorn (private company valued ten billion dollars or more) may be the new unicorn.[47] And hectocorns — private companies valued at over one hundred billion dollars — may be on the horizon.[48]

The reasons for this shift to private capital-raising matter to analyzing private company fraud. In part they help identify the kinds of companies that are now private rather than public, and the availability of their securities to retail investors. Both are important considerations in evaluating an appropriate level of regulatory scrutiny.

The decline in the number of public companies in the last decades has been tracked to several potential causes, including the amount and cost of regulation on the public side, deregulation of private capital, and the availability of money seeking a good return, particularly in an environment of low interest rates.[49] The ability to exit an investment

1663, 1663 (2013) (noting that the average was 310 U.S. IPOs per year from 1980–2000, whereas the average was 99 U.S. IPOs per year for 2001–2012).

[43] WITTE & BROWN, *supra* note 42, at 7.

[44] *See SEC Silicon Valley Initiative Speech*, *supra* note 20.

[45] WITTE & BROWN, *supra* note 42, at 1.

[46] *The Global Unicorn Club: Current Private Companies Valued at $1B+*, CB INSIGHTS, https://www.cbinsights.com/research-unicorn-companies (last visited Sept. 8, 2020) [https://perma.cc/TQ8A-HYS3] [hereinafter *The Global Unicorn Club*].

[47] *See id.*

[48] *See id.*

[49] *See* CREDIT SUISSE, THE INCREDIBLE SHRINKING UNIVERSE OF STOCKS: THE CAUSES AND CONSEQUENCES OF FEWER U.S. EQUITIES 5 (2017), https://www.cmgwealth.com/wp-content/uploads/2017/03/document_1072753661.pdf [https://perma.cc/VP5E-9P9G]; *Looking Behind the Declining Number of Public Companies*, FEI DAILY (June 12, 2017),

through merger rather than IPO also disincentivizes founders from taking companies public.[50] The discussion below begins with the market context, then turns to the regulation and deregulation that affect the public-private divide.

The appetite to invest privately is driven in part by market conditions. Low interest rates mean that money is looking for investments with a higher return.[51] Some participants in private equity have also suggested that the structure of investors has changed, introducing new "deep pools of capital" that invest directly in private companies.[52] For example, venture capital funds that once focused on early stage startup investing have both become larger and "their mandates" have changed so that they are "across the spectrum, from early stage to late stage."[53] Traditional private equity funds became willing to take minority positions rather than seek control, and the shifting interest of hedge funds, sovereign wealth funds, mutual funds, and family offices (e.g., of big tech company founders) seem to have contributed to the availability of private money.[54]

Regulation too may play a part. The debate over the balance between private and public markets sometimes translates into the usual debate about the optimal level, and pros and cons, of market regulation. The U.S. Chamber of Commerce, for instance, argues that costly disclosure has pushed companies out of the public markets.[55] U.S. regulation costs

https://www.financialexecutives.org/FEI-Daily/June-2017/looking-behind-declining-number-public-companies.aspx [https://perma.cc/23LP-8K4Z].

50 *E.g.*, Gao et al., *supra* note 42, at 1663-92.

51 de Fontenay, *supra* note 25, at 448 n.7.

52 SEC, TRANSCRIPT, *supra* note 29, at 50. At the committee meeting, James ("Jamie") Hutchinson, a partner in Goodwin's private equity and technology practices, described his role as follows: "We do a lot of work representing emerging stage companies and the folks that invest in them. And we've actually kind of had a front row seat over about the past decade to what we kind of call the large cap growth equity. So a lot of the very big rounds into the high-profile tech companies, sort of the unicorn set." *Id.* at 49-50 (noting that "the capital is coming from different places than maybe was historically the case").

53 *Id.*; *see also* Miles Kruppa, *Investors Race to Tech Start-Ups Despite SoftBank Stumbles*, FIN. TIMES (Nov. 13, 2019), https://www.ft.com/content/35df8336-05a4-11ea-9afa-d9e2401fa7ca [https://perma.cc/KF4T-63CZ] (reporting that "Blackstone, Tiger Global, Lightspeed and Founders Fund are all raising huge funds for late-stage companies").

54 SEC, TRANSCRIPT, *supra* note 29, at 50; *see, e.g.*, MIKE ISAAC, SUPER PUMPED: THE BATTLE FOR UBER 96 (2019). Another private equity participant suggested that "FOMO" — fear of missing out — drives private company investors. *See id.*

55 U.S. CHAMBER OF COMMERCE CTR. FOR CAPITAL MKTS., ESSENTIAL INFORMATION: MODERNIZING OUR CORPORATE DISCLOSURE SYSTEM 17 (2017), http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-

have been of particular concern in the context of global competition for listings. Over time these concerns have motivated some relaxation of regulation on the public side, particularly through the JOBS Act.[56]

The other side of the equation is increased access to capital before, or even without ever, going public. In other words, deregulation on the private side. The Council of Institutional Investors has argued that the ability to raise private capital, and not the amount of U.S. regulation, has pushed the decline in the number of public companies.[57] The former chair of the SEC, Mary Jo White, pointed to particular SEC rule changes that made private capital more available: crowdfunding, Reg A+, and the elimination of some prohibitions on solicitation in private offerings.[58]

Not only do regulatory changes make money on the private side more available, but they also allow private companies to get much bigger without triggering mandatory public reporting. The mechanism for this private growth is changes to the amount of assets and investors that trigger public company status under Exchange Act § 12(g). As noted above, in addition to companies that are public because their shares are listed on an exchange or they have made public offerings, some companies must enter the public reporting system because of their size. The thresholds have changed over time, allowing private companies to grow bigger without triggering mandatory disclosure requirements.[59]

Essential-Information_Materiality-Report-W_FINAL.pdf?x48633 [https://perma.cc/P7VG-639N] ("Left unchecked, ineffective disclosure will further hasten the steady decline in the number of private companies seeking public listings in the U.S., which over the longer term impairs economic growth."); *see also* Editorial, *Where Are the IPOs?*, WALL ST. J., Dec. 31, 2016, at A10.

[56] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 102, 126 Stat. 306, 310 (2012) [hereinafter JOBS Act]; IPO TASK FORCE, REBUILDING THE IPO ON-RAMP: PUTTING EMERGING COMPANIES AND THE JOB MARKET BACK ON THE ROAD TO GROWTH 6-8 (2011), https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf [https://perma.cc/56WP-4QRV].

[57] *See* Letter from Jeffrey P. Mahoney, Gen. Counsel, Council of Institutional Inv'rs, to Craig S. Phillips, Counselor to the Sec'y, U.S. Dep't of Treasury 2, 3 (Aug. 23, 2017), https://www.cii.org/files/August%2023%202017%20Letter%20to%20Treasury%20v3.pdf [https://perma.cc/3T7X-7NC5].

[58] *SEC Silicon Valley Initiative Speech*, *supra* note 20.

[59] The JOBS Act increased the triggering asset amount to $10 million, increased the number of investors permitted to 2000 (as long as no more than 499 of them were not accredited investors) and excluded employee-investors from the investor count. JOBS Act § 102.

C. Reasons to Regulate Private Companies

The shift towards staying private, or staying private longer, upsets some of the assumptions underlying regulation and monitoring of private companies. Relaxed regulation on the private side results in private companies that have some of the characteristics of traditional public companies that led to regulation and disclosure in the first place.[60]

The rationale for keeping private capital-raising relatively unregulated has long been that sophisticated (wealthy) investors and institutions do not need the protections of the securities laws, including mandatory disclosure.[61] These investors had access to information, the ability to absorb it, and the capacity to sustain losses.[62] In the Supreme Court's words, they could "fend for themselves."[63] These were the investors on the private side.[64]

As more capital is raised on the private side, however, there is a regulatory push to give "Main Street investors" access to private investments.[65] The loosening of restrictions on private capital includes initiatives that, as the SEC has acknowledged, reach retail investors, the core subject of investor protection.[66] And SEC Chair Jay Clayton has

[60] *See* ADVISEN, *supra* note 33, at 5 (pointing to "large private companies that share many traits of a public firm, while maintaining private ownership, including Cargill, Hearst Corporation and Mars").

[61] *See, e.g.*, Regulation D Revisions, 52 Fed. Reg. 3015, 3016-17 (proposed Jan. 30, 1987) (codified at 17 C.F.R. pt. 230 & 239) (identifying accredited investors as "those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary"); *SEC Silicon Valley Initiative Speech*, *supra* note 20 ("From a securities law perspective, the theory behind the private markets is that sophisticated investors do not need the protections offered by the robust mandatory disclosure provisions of the 1933 Securities Act.").

[62] *See SEC Silicon Valley Initiative Speech*, *supra* note 20.

[63] *See* SEC v. Ralston Purina Co., 346 U.S. 119, 124-25 (1953) (defining what counts as a private offering).

[64] *See* SEC Rule 506, 17 C.F.R. § 230.506 (2020) (limiting some private placements to "accredited investors" and requiring sophistication from additional investors).

[65] For reasons to favor equalizing access, see Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3390 (2013) (pointing to unequal access to the private markets as the "dirty little secret of U.S. securities law": the ability of the rich to access "types of wealth-generating investments not available, by law, to the average investor").

[66] *SEC Silicon Valley Initiative Speech*, *supra* note 20 (indicating that former SEC Chair Mary Jo White noted that some "capital formation tools" could "be used to, and in certain cases are expected to, raise money from retail investors").

spoken repeatedly about connecting retail investors with "expanded investment opportunities" in the context of a declining public market.[67]

One of the ways in which the law sorts between private company investments limited to wealthy and sophisticated investors and public investments broadly open to retail investors is through the definition of "accredited investor."[68] The SEC has called it "one of the principal tests for determining who is eligible to participate in our private capital markets."[69] A large number of accredited investors can invest in private companies without making the company subject to public reporting requirements.[70] Because the definition is not indexed to inflation, over time it has included a greater swath of the U.S. population.[71] In other

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[67] *See* Jay Clayton, Chairman, SEC, Remarks on Capital Formation at the Nashville 36|86 Entrepreneurship Festival (Aug. 29, 2018), https://www.sec.gov/news/speech/speech-clayton-082918 [https://perma.cc/49V3-9RSK]; *see also* Jay Clayton, Chairman, SEC, Testimony on "Oversight of the Securities and Exchange Commission" Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (Dec. 10, 2019) [hereinafter *Testimony*] ("I believe it is our obligation to explore whether we can increase opportunities for Main Street investors in the private markets while maintaining strong and appropriate investor protections."); Dave Michaels, *SEC Chairman Wants to Let More Main Street Investors in on Private Deals: Jay Clayton Outlines Overhaul Plans in Interview, Says Changes Could Happen 'Pretty Quickly*,' WALL ST. J. (Aug. 30, 2018), https://www.wsj.com/articles/sec-chairman-wants-to-let-more-main-street-investors-in-on-private-deals-1535648208 [https://perma.cc/5K2A-N2F7].

[68] *See* Amending the "Accredited Investor" Definition, Final Rule (amending 17 C.F.R. pt. 230 & 240), Release No. 33-10824, 34 SEC Docket S7-25-19 (Aug. 26, 2020), https://www.sec.gov/rules/final/2020/33-10824.pdf [https://perma.cc/M4QM-BTFW] ("Qualifying as an accredited investor, as an individual or an institution, is significant because accredited investors may, under Commission rules, participate in investment opportunities that are generally not available to non-accredited investors, including certain investments in private companies . . . ."); *see also* U.S. Sec. and Exch. Comm'n Rule 501, 17 C.F.R. § 230.501; SEC, REPORT ON THE REVIEW OF THE DEFINITION OF "ACCREDITED INVESTOR" 5 (2015), https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf [https://perma.cc/88YB-NTUE] [hereinafter DEFINITION OF "ACCREDITED INVESTOR"] ("The accredited investor definition attempts to identify those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary.").

[69] Press Release, SEC, SEC Modernizes the Accredited Investor Definition (Aug. 26, 2020), https://www.sec.gov/news/press-release/2020-191 [https://perma.cc/YW6D-AJBJ].

[70] *See* Securities Exchange Act of 1934 § 12(g), 15 U.S.C. § 78l(g) (2018).

[71] *See, e.g.*, Tara Siegel Bernard, *Opening the Door to Unicorns Invites Risk for Average Investors*, N.Y. TIMES (Jan. 4, 2020), https://www.nytimes.com/2020/01/04/your-money/investing-private-market-startups.html [https://perma.cc/W6GZ-DZ5K] (reporting that "$200,000 in annual income requirement set in 1982 would translate into roughly $538,000 today, while the $1 million net-worth threshold is now equal to $2.7 million" and that the 1.6% of US households that qualified as accredited investors in 1982 climbed to approximately 13% in 2019); Allison Herren Lee & Caroline Crenshaw,

words, some retail investors may already have access to these private companies, and some reports suggest that private equity firms are increasingly interested in accessing this population.[72]

Moreover, more recently, the SEC has taken steps to increase access through changes to the definition of "accredited investor." After signaling changes to come,[73] the SEC finalized a rule in August 2020 that adds new categories of people and entities to the definition, expanding those who qualify.[74]

In addition to concerns about the entry of retail investors into private investments, regulation and enforcement may be justified by the sheer size of some of these new private companies. Even when sophisticated investors are involved, the concentration of money on the private side means that any failure may have broad societal consequences.[75] This justification has roots in existing U.S. securities regulation, especially the size triggers in Exchange Act § 12(g).[76] The focus of some securities regulation on company size has led some prominent scholars to suggest that "some portion of what we call securities regulation follows from an

Comm'rs, Joint Statement on the Failure to Modernize the Accredited Investor Definition (Aug. 26, 2020), https://www.sec.gov/news/public-statement/lee-crenshaw-accredited-investor-2020-08-26#_ftnref20 [https://perma.cc/G7BB-33VU] (lamenting the failure of the SEC's final rule to index amounts to inflation because it will contribute to the rise in qualified households, and noting that the "failure to update the thresholds thus far has resulted in an increase of 550% in qualifying households since 1983").

72 *See* Miriam Gottfried, *Mom and Pop Millionaires Are Driving Blackstone's Growth; Private-equity Giant Joins a Gaggle of Firms Looking to a Segment of the Market It Once Ignored*, WALL ST. J. (Feb. 14, 2020), https://www.wsj.com/articles/mom-and-pop-millionaires-are-driving-blackstones-growth-11581676203 [https://perma.cc/UV2G-X98G].

73 SEC, DEFINITION OF "ACCREDITED INVESTOR," *supra* note 68, at 2-5; *see* Bernard, *supra* note 71 (reporting that SEC Chair Clayton said to "expect more in this space").

74 Amending the "Accredited Investor" Definition, *supra* note 68 (noting that the SEC Commissioners are not unanimous in their support for this expansion); *see* Lee & Crenshaw, *supra* note 71 ("With its actions today [finalizing the rule expanding the accredited investor definition], the Commission continues a steady expansion of the private market, affording issuers of unregistered securities access to more and more investors without due regard for the risks they face . . . .").

75 *See, e.g.*, Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583 (2016) (examining case studies including Uber and Airbnb, and arguing that "although unicorns are technically private companies, their size and influence render their effect in the marketplace much more like that of a publicly held corporation").

76 *See* Securities Exchange Act of 1934 § 12(g), 15 U.S.C. § 78l (2018) (triggering reporting status when a company has a minimum number of investors (2,000 total or 500 non-accredited investors) and a minimum level of total assets ($10 million)).

effort to create more accountability of large, economically powerful business institutions."[77]

At times, the SEC has made the argument that anti-fraud protections should apply even when the investors are sophisticated.[78] This argument could be justified by general concerns about confidence in the market's integrity. The SEC's 2019 enforcement report declared that enforcement actions "removing bad actors from the markets, . . . and acting quickly to stop frauds and prevent losses . . . sent clear and important messages to market participants, and enhanced confidence in the integrity and fairness of our markets."[79]

In sum, the fundamental shift in how U.S. companies access capital unsettles existing regulatory structures and actors. One way in which the existing regime addresses problems at private companies is through broadly applicable securities fraud prohibitions. The SEC's securities fraud enforcement actions against private companies are the subject of the next Part.

II. SEC Enforcement Against Private Companies

> It is axiomatic that all private and public securities transactions, no matter the sophistication of the parties, must be free from fraud. Exchange Act Section 10(b) and Rule 10b-5 apply to all companies and we must be vigorous in ferreting out and punishing wrongdoers wherever they operate.
>
> — Mary Jo White, then-Chair of the SEC (2016)[80]

Though U.S. securities regulation is focused on public corporations and public offerings, the SEC has a key tool to address problems at private companies. Even private companies can be pursued for securities fraud.

What the SEC has done with this anti-fraud power is the subject of this Part. It begins with the statutory provisions, providing the legislative underpinnings for the uncontroversial, but also underexamined, ability of the SEC to pursue fraud at private companies. It then examines the SEC's self-declared intervention into the universe of private company fraud, made overt in 2016 with the SEC's so-called Silicon Valley Initiative.

[77] Langevoort & Thompson, *supra* note 37, at 340.
[78] *SEC Silicon Valley Initiative Speech*, *supra* note 20.
[79] SEC, Division of Enforcement: 2019 Annual Report, *supra* note 23, at 1.
[80] *SEC Silicon Valley Initiative Speech*, *supra* note 20.

The Part concludes by analyzing the SEC's securities fraud enforcement actions against private companies, focusing on the years after the SEC's announced initiative (FY 2016 through FY 2019). The actions are few enough that they resist systematic quantification, but key elements can nonetheless be identified. This Part uses case studies to provide a framework for the categories of enforcement, as well as to make more granular points about the type of investors and information involved.

A. *Scope of Anti-Fraud Provisions*

Although for a long time underemphasized, the consensus is that key anti-fraud provisions — Exchange Act section 10(b), Rule 10b-5, and Securities Act section 17(a) — cover private as well as public companies. Whereas other securities law requirements are limited to public companies or public offerings, the securities fraud provisions are not so limited.[81]

The most widely used of these provisions is Section 10(b), accompanied by SEC Rule 10b-5. The plain language of Section 10(b) prohibits manipulation or deception "in connection with the purchase or sale" of securities listed on national exchanges, but also explicitly includes "any security not so registered."[82] Rule 10b-5 similarly contains a broad prohibition on the use of "any manipulative or deceptive device . . . in connection with the purchase or sale of any security."[83]

There is notoriously a dearth of legislative history on 10(b), but it was reportedly uncontroversial.[84] The legislative history of section 10(b) also shows an evolution from proposals limited to listed securities to the broad final language. The proposed bill that contained the precursor to section 10(b) did not reach private companies. Although much of its language was similar to section 10(b), it reached only "any security

[81] Some anti-fraud provisions in the securities laws are directed at misstatements or omissions in the registration statement filed with the SEC, Securities Act of 1933 § 11, 15 U.S.C. § 77k (2018); or in the prospectus that accompanies the public offering of securities, Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l (2018). These particular provisions of the securities statutes that cover fraud in the primary market/securities offerings by issuers are limited to companies that are making public offerings, so are outside this Article's definition of private company.

[82] Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2018).

[83] U.S. Sec. and Exch. Comm'n Rule 10b-5, 17 C.F.R. § 240.10b-5 (2020).

[84] *See, e.g.*, Steven Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990) (recounting the legislative history of section 10(b)).

registered on a national securities exchange."[85] This was ultimately revised to include securities "not so registered" as well.[86] This often amounts to the short hand "in connection with the purchase or sale of any security."[87]

When the SEC drafted Rule 10b-5 to effectuate the statutory provision, that drafting was apparently uncontroversial as well. SEC lawyer Milton Freeman later described this process like this: "We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Sumner Pike who said, 'Well,' he said, 'we are against fraud, aren't we?'"[88]

The other anti-fraud provision with broad reach, including private as well as public companies, is Securities Act § 17(a).[89] The text of the provision is very similar to 10(b). Indeed, reportedly the Exchange Act's 10(b) was modeled on the earlier Securities Act provision.[90] Section 17(a) is narrower than 10(b) in that it is enforced only by the SEC rather than by private litigants as well.[91] It is also broader in the sense that it does not require any showing of scienter.[92]

[85] H.R. 7852, 73d Cong. § 9 (1934) ("It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange . . . . [t]o use or employ in connection with the purchase or sale of *any security registered on a national securities exchange* any device or contrivance which, or any device or contrivance in a way or manner which the [regulating agency] may by its rules and regulations find detrimental to the public interest or to the proper protection of investors.") (emphasis added); Thel, *supra* note 84, at 429 (canvassing the legislative history of § 10(b)).

[86] H.R. 8720, 73d Cong. § 8(a)(1)-(8), (e) (1934).

[87] *See, e.g.*, SEC v. Zandford, 535 U.S. 813, 815 (2002) ("The question presented is whether the alleged fraudulent conduct was 'in connection with the purchase or sale of any security' within the meaning of the statute and the rule.").

[88] Milton V. Freeman, *Administrative Procedures*, 22 BUS. LAW. 891, 922 (1967) (describing "what actually happened when 10b-5 was adopted").

[89] Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a)(2) (2018) ("It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."); Wendy Gerwick Couture, *Prosecuting Securities Fraud Under Section 17(a)(2)*, 50 LOY. U. CHI. L.J. 669, 672 (2019).

[90] Couture, *supra* note 89, at 672 & n.16.

[91] Aaron v. SEC, 446 U.S. 680, 702 (1980); Maldonado v. Dominguez, 137 F.3d 1, 7 (1st Cir. 1998).

[92] *Aaron*, 446 U.S. at 702. For analysis of the other textual and contextual differences between the provisions, see Couture, *supra* note 89, at 672.

The textual hook for including private companies in section 17(a)'s prohibition is its application to "any" securities.[93] Courts have also tended to interpret the section's language more broadly than 10(b), in part because it has no private right of action.[94] Some courts have considered the fact that securities are publicly traded to be enough to satisfy the "in connection with" requirement, but these opinions do not preclude other connection.[95]

Finally, the notion of "security" does not limit the type of company covered by the anti-fraud provisions. Indeed, Theranos undisputedly issued securities. However, these qualified for exemptions that made them a private rather than a public offering (which would have triggered associated registration requirements).[96]

B. *Private Company Enforcement and the Silicon Valley Initiative*

Against the backdrop of the declining number of public companies and the shrinking of the available regulatory and enforcement tools to the anti-fraud provisions, the SEC declared its intention to police these private companies. In 2016, then-SEC Chair, Mary Jo White, gave a keynote address at an event called the "Silicon Valley Initiative."[97] Regulators, lawyers, corporate directors, and academics gathered at Stanford to discuss "key regulatory issues relating to private and pre-

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93 Securities Act of 1933 § 17(a), 15 U.S.C. § 77q ("Use of interstate commerce for purpose of fraud or deceit. It shall be unlawful for any person in the offer or sale of *any* securities . . . .") (emphasis added).

94 For example, courts have not limited the scope to the '33 Act primary market context despite the reference to "in the offer or sale." United States v. Naftalin, 441 U.S. 768, 773 n.4 (1979). *But see* Couture, *supra* note 89, at 678 (arguing that this language should be interpreted more narrowly).

95 SEC v. RPM Int'l, Inc., 282 F. Supp. 3d 1, 29 (D.D.C. 2017) ("Many courts have concluded that an allegation that the company's stock was publicly traded is sufficient to plead this element under Section 17(a)(2).").

96 *See, e.g.*, Theranos Inc., Notice of Exempt Offering of Securities (Form D) (July 8, 2010), https://sec.report/Document/0001313697-10-000004/ [https://perma.cc/2P8E-GCS3] [hereinafter Form D] (claiming a Reg D exemption under Rule 506).

97 *SEC Silicon Valley Initiative Speech*, *supra* note 20; *see* STANFORD ROCK CTR. FOR CORP. GOVERNANCE, *The Silicon Valley Initiative: Protecting Investments in Pre-IPO Issuers*, YOUTUBE (Mar. 11, 2016), https://www.youtube.com/watch?v=cKwn62p2Tu0 [https://perma.cc/Y7SU-46LV].

IPO companies."[98] What the SEC Chair said there soon became known as the "SEC's Silicon Valley Initiative."[99]

In her speech, the SEC Chair recognized changes in the market, especially the tendency of companies to stay private longer.[100] She reminded listeners of the reach of securities fraud prohibitions, pointing out in particular that 10(b) and 10b-5 apply to all companies, public or private.[101] The speech detailed some of the SEC's concerns about startups, including pressure to reach sky high valuations that were analogous, according to White, to the pressures to meet earnings in the public context.[102] The absence of "robust internal controls and governance procedures" in even "quite mature" startup companies even "amplified . . . the risk of distortion and inaccuracy."[103]

The speech announced a few themes related to investor protection, noting the entry of retail investors into private investments and the need to prevent fraud even when investors are sophisticated.[104] It also acknowledged the connection between federal securities law and the state corporate law and fiduciary duties that have traditionally regulated purely private companies, pointing to an obligation of "candor and fair dealing" that is "fundamentally the same."[105]

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98 *See The Rock Center and the SEC's San Francisco Regional Office Present, "The Silicon Valley Initiative: Protecting Investments in Pre-IPO Issuers*," STAN. L. SCH. (Mar. 31, 2016, 5:00 PM), https://law.stanford.edu/event/rock-center-evening-speaker-series/ [https://perma.cc/T9TF-NVRU].

99 *See, e.g.*, FENWICK & WEST LLP, *The SEC's Silicon Valley Initiative: What You Need to Know About the SEC's Increasing Scrutiny of Private Companies and Secondary Market Trading in Pre-IPO Shares*, FENWICK (Apr. 26, 2016), https://www.fenwick.com/Events/Pages/The-SECs-Silicon-Valley-Initiative-MV.aspx [https://perma.cc/5U7Z-2CZE] (using the phrase "SEC's Silicon Valley Initiative" in the event title).

100 *SEC Silicon Valley Initiative Speech*, *supra* note 20 ("New models for how these companies are funded and how investors unlock their value are changing the landscape of private start-up financing and the IPO market . . . . All of these factors are contributing to the decision made by more and more companies to stay private longer.").

101 *Id.*

102 *Id.* ("[O]ne must wonder whether the publicity and pressure to achieve the unicorn benchmark is analogous to that felt by public companies to meet projections they make to the market with the attendant risk of financial reporting problems.").

103 *Id.*; *see* Pollman, *Private Company Lies*, *supra* note 28, at 5 (describing incentives for fraud in startups); *see also* Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 159 (2019) [hereinafter *Startup Governance*] (noting that startup governance issues such as overlapping roles and prioritization of growth are sometimes exacerbated with growth).

104 *See SEC Silicon Valley Initiative Speech*, *supra* note 20.

105 *Id.*

Following the 2016 speech, law firms offered advice on "What You Need to Know About the SEC's Increasing Scrutiny of Private Companies and Secondary Market Trading in Pre-IPO Shares."[106] They warned clients that "unicorns [were] in [the] SEC's line of sight."[107]

C. SEC Securities Fraud Enforcement Against Private Companies

The 2016 SEC Silicon Valley Initiative may have been an inflection point, an overt announcement of the SEC's intention to police some of the most extreme misbehavior in the growing private universe. This Part examines what actions the SEC Enforcement Division took against private company fraud after this initiative.

The first category is enforcement against private companies that have many of the characteristics of public companies that led to regulation and mandatory disclosure in the first place, especially size, investor type, and/or the existence of a (private) secondary market.[108]

This subpart, however, provides a broader picture of private company fraud and the SEC's actions to police it. The SEC has also pursued securities fraud allegations against private companies when companies have used the (false) promise of access to the public markets to commit a fraud. A few examples illustrate these situations where the private company fraud implicates the integrity of the public securities markets in this way.

Though enforcement actions against unicorns and Silicon Valley startups are few,[109] SEC securities fraud allegations against private companies are quite common and likely uncontroversial in another large category of cases. These are classic frauds where an individual moves money around corporate and other business entities, some or all of which are private.[110]

These classic anti-fraud actions are often characterized by allegations that some of the investments offered should have been *public* offerings, but failed to comply with the registration requirements. The discussion

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[106] FENWICK & WEST LLP, *supra* note 99.

[107] *The Silicon Valley Initiative — Unicorns in SEC's Line of Sight: Action Items*, DLA PIPER (May 26, 2016), https://www.dlapiper.com/en/us/insights/publications/2016/05/quarterly-governance-review-may-2016/the-silicon-valley-initiative/ [https://perma.cc/8NKX-5P54].

[108] *See supra* notes 59–64 and accompanying text.

[109] *See infra* Chart 1.

[110] *See, e.g.*, SEC Files Charges to Stop Fraudulent Misuse of Cancer-Fighting Investments to Fund Restaurant Businesses, SEC Litigation Release No. 23893, 117 SEC Docket 1214, 2017 WL 3278183 (July 31, 2017). *See generally infra* Appendix: SEC Securities Fraud Enforcement Actions Against Private Companies, FY2016-FY2019.

below provides a few illustrations — the Fyre Festival and the "Frack Master" — of this borderline category where the SEC has routinely used 10(b)/10b-5 and 17(a) to bring securities fraud allegations against private companies.

Finally, this Part examines several of the SEC's actions against companies in transition between being public and private, or vice versa. The aim, in part, is to provide a foil for the unicorn enforcements, isolating the types of information that are available in these transitional cases. This category also serves as another example that complicates the borders between private and public companies, introducing change over time as another element.

1. Unicorns and Other Private Companies with "Public" Characteristics

Are unicorns like Theranos really in the SEC's "line of sight"?[111] This category is an important one. The decline of the number of public companies and IPOs will impact this area, shifting more business activity to these large privately held companies. To get a sense of the number of companies in this category, consider that 238 U.S.-based private companies were reportedly worth a billion dollars or more as of September 2020.[112]

The following chart reports SEC securities fraud cases brought against unicorns and Silicon Valley startups — the subject of the SEC's 2016 announcement — after the SEC's Silicon Valley speech. It covers SEC fiscal years 2016 through 2019 (Oct. 1, 2015 to Sept. 30, 2019).

111 *See* DLA PIPER, *supra* note 107.

112 *See The Global Unicorn Club*, *supra* note 46.

Chart 1. SEC Securities Fraud Actions Against Unicorns and Silicon Valley Startups SEC FY 2016 — FY 2019

Private Company	**Company Target**	**Indiv. Target**	**Date of SEC Action**	**SEC Release**[113]	**Alleged Violations**[114]
Zenefits, Inc.	X	X	26-Oct-17	SEC Admin. Pro. No. 33-10429	Sec. Act 17(a)
Theranos, Inc.	X	X	19-Mar-18	SEC Lit. Rel. No. 24069	Sec. Act 17(a) Exch. Act 10(b) Rule 10b-5
Mozido	X	X	30-Mar-18	SEC Lit. Rel. No. 24092	Sec. Act 17(a) Exch. Act 10(b) Rule 10b-5 Sec. Act 5(a) & 5(c)
Jumio, Inc.		X	2-Apr-19	SEC Pr. Rel. 2019-50	Sec. Act 17(a) Exch. Act 10(b) Rule 10b-5

Although too few to be systematically quantified, a few themes emerge from actions against large private companies and their officers and directors, which are the focus of the discussion below: the unicorn-plus size of some of the companies; actions that protect employee-investors; and the presence in some cases of a private secondary market.

a. Zenefits

Zenefits (derived from Zen + Benefits) is a private software company based in San Francisco that promises "All-In-One" and "Automagically integrated" human resources.[115] Part of its business has been the

[113] Because some of these actions involve multiple targets and multiple stages, the SEC may have issued several public releases. The listed release reports the action against the private company (if any) or the earliest within the set of releases.

[114] Unless otherwise indicated, this lists all of the violations alleged in the complaint, including some that were brought against a subset of the defendants. It excludes allegations against relief defendants.

[115] ZENEFITS, https://www.zenefits.com/hr/?utm_source=Bing&utm_medium=Zenefits-Platform&lc=PPC&ls=Bing&cm1=Sitelink&cm2=what-is-zenefits&cm3=%5Bzenefits%5D&cm4=e&cm5=&adgroup_id=1210562309569683&campaign_id=276066989&msclkid=576d407d4f8e145dca331d947125befe&utm_campaign=B_S_Brand_Alpha&

purchase of employee health policies.[116] In fact, at one time this business accounted for most of its revenues.[117]

Zenefits raised money privately. Lots of money. Two private placements raised $565 million each from accredited investors.[118] The latter impliedly valued the company at $4.5 billion dollars, making Zenefits another private Silicon Valley unicorn.[119]

Alas for Zenefits, state insurance enforcement agencies were concerned that the company stepped into the insurance broker business without the required licensing. In particular, in 2015 the Washington state insurance enforcement agency started inquiring, and Buzzfeed quickly picked up on potential problems.[120] Around the same time, Zenefits self-reported potential violations to state insurance regulators across the country.[121] Ultimately state insurance regulators from forty-nine states brought an enforcement action, which the company settled for eleven million dollars.[122]

Zenefits' securities fraud trouble came from the positive statements it made about its insurance business in the context of its private placements. In 2017, the SEC brought and settled a securities fraud action against the company and its CEO.[123]

The resolution was relatively mild, in part reflecting the company's acknowledged cooperation with government authorities. The settlement was in administrative rather than court proceedings, acknowledged Zenefits' remedial acts and cooperation, and alleged only Section 17(a)(2) violations, which is significant because the provision

utm_term=%5Bzenefits%5D&utm_content=zenefits-ALL [https://perma.cc/9CDD-KFHA] (last visited Dec. 5, 2019) ("Minimize HR headaches so you can get back to business.").

116 YourPeople, Inc., SEC Release No. 10429, 2017 WL 4863857, at *2 (Oct. 26, 2017) [hereinafter Zenefits Settlement] (order instituting cease-and-desist proceedings).

117 *Id.* at 3.

118 *Id.* at 2.

119 *Id.*

120 William Alden, *Startup Zenefits Under Scrutiny for Flouting Insurance Laws*, BUZZFEED NEWS (Nov. 25, 2015, 11:39 AM ET), https://www.buzzfeednews.com/article/williamalden/zenefits-under-scrutiny-for-flouting-insurance-laws [https://perma.cc/B532-36U3].

121 Zenefits Settlement, *supra* note 116, at 8.

122 William Alden, *The SEC Just Fined a Unicorn Startup for the First Time: Penalties Against Zenefits and Its Former CEO for Misleading Investors Show the SEC's Aggressive New Stance in Silicon Valley*, BUZZFEED NEWS (Oct. 26, 2017, 5:41 PM ET), https://www.buzzfeednews.com/article/williamalden/the-sec-just-fined-a-unicorn-startup-for-the-first-time [https://perma.cc/X5PZ-HMCA] [hereinafter *The SEC Just Fined*].

123 Zenefits Settlement, *supra* note 116, at 2; Alden, *The SEC Just Fined*, *supra* note 122.

does not require scienter. As is the custom, Zenefits neither admitted or denied the included law or facts. In addition to agreeing to cease and desist, Zenefits agreed to pay a $450,000 money penalty, and the former CEO agreed to pay a money penalty of $160,000 and disgorgement of another $350,000.[124]

Zenefits is squarely within the target category of the SEC's Silicon Valley Initiative. Although "investors primarily consist[ed] of investment companies, venture capital firms, private equity funds and accredited individual investors," it was of unicorn size and "[s]ome of its shares also trade on secondary markets."[125]

b. Theranos

Before it all collapsed, Elizabeth Holmes' Stanford chemistry professor said: "I wish I wasn't 70 years old. I wish I was her age and could be in on this. Because this is going to be a long, exciting, fascinating, exhilarating ride."[126] He was prescient, but not in a good way. The exhilarating ride up and then down has now been recounted

[124] Zenefits Settlement, *supra* note 116, at 11.
[125] *Id.* at 2.
[126] Parloff, *This CEO Is Out for Blood*, *supra* note 11.

by articles and books,[127] movies,[128] a TV series,[129] a podcast,[130] comedy sketch,[131] and reportedly Halloween costumes.[132]

The SEC brought a securities fraud action against Theranos, Holmes, and Balwani in 2018.[133] One might question the amount of new information it needed to do so, and how much its action added to the mix given the press attention and the parallel criminal charges and the various other government actions. At the same time, Theranos illustrates both limits and promise of whistleblowers as an information source for detecting private company fraud.[134]

Theranos is also a clear example of unicorn enforcement and the SEC's pursuit of private company fraud. First, Theranos is clearly private. Theranos had filed with the SEC, but only to explain why its offerings of securities were not public offerings and fit into an

[127] *E.g.*, CARREYROU, *supra* note 8. The articles are too numerous to list, but include, for example, Auletta, *supra* note 10; Nick Bilton, *"She Never Looks Back": Inside Elizabeth Holmes's Chilling Final Months at Theranos*, VANITY FAIR (Feb. 21, 2019), https://www.vanityfair.com/news/2019/02/inside-elizabeth-holmess-final-months-at-theranos [https://perma.cc/CF8X-69A3] ("At the end, Theranos was overrun by a dog defecating in the boardroom, nearly a dozen law firms on retainer, and a C.E.O. grinning through her teeth about an implausible turnaround."); Parloff, *This CEO Is Out for Blood*, *supra* note 11; Weaver & Carreyrou, *supra* note 12.

[128] *E.g.*, THE INVENTOR: OUT FOR BLOOD IN SILICON VALLEY (HBO 2019).

[129] Nellie Andreeva, *Hulu Orders 'The Dropout' Limited Series Starring Kate McKinnon as Elizabeth Holmes from Fox Searchlight TV*, DEADLINE (Apr. 10, 2019, 2:20 PM), https://deadline.com/2019/04/the-dropout-hulu-limited-series-kate-mckinnon-star-elizabeth-holmes-fox-searchlight-television-abc-news-1202593032/ [https://perma.cc/FWK9-FM3U].

[130] Rebecca Jarvis, *The Dropout*, ABC AUDIO (2019), https://abcaudio.com/podcasts/the-dropout/ [https://perma.cc/RBY7-7Y7L] ("Money. Romance. Tragedy. Deception. The story of Elizabeth Holmes and Theranos is an unbelievable tale of ambition and fame gone terribly wrong.").

[131] Ryan Reed, *James Corden Mocks Elizabeth Holmes, Theranos With 'Poo' Company Sketch*, ROLLING STONE (Mar. 28, 2019, 9:47 AM ET), https://www.rollingstone.com/tv/tv-news/james-corden-elizabeth-holmes-theranos-the-inventor-814385/ [https://perma.cc/QWP5-36YU] ("The clip looks back at Corden's fake, 'multi-billion-dollar health company' that aimed to 'transform the landscape of modern medicine as we know it — 'no more disease, no more doctors, no more death.'").

[132] Eric Hegedus, *Black Turtleneck Shortage Linked to Elizabeth Holmes Halloween Costumes*, N.Y. POST (Oct. 29, 2019, 4:36 PM), https://nypost.com/2019/10/29/black-turtleneck-shortage-linked-to-elizabeth-holmes-halloween-costumes/ [https://perma.cc/H7JU-N89B]; Rose Minutaglio, *How to Dress Like Elizabeth Holmes This Halloween*, ELLE MAG. (Oct. 8, 2019), https://www.elle.com/fashion/trend-reports/a29341871/elizabeth-holmes-halloween-costume/ [https://perma.cc/SM6D-9RFJ].

[133] Complaint, Balwani, *supra* note 17, at 1; Complaint, Holmes, *supra* note 17, at 1.

[134] *See infra* Part IV.

exemption.[135] Second, Theranos grew large without going public. Early investors were a hodge-podge of family, friends and "aging venture capitalists," but later rounds drew in a broader range of Silicon Valley investors.[136] As its unicorn moniker suggests, its implicit claimed value reached more than $1 billion.

The action against Theranos was a high-profile signal that the SEC was willing to pursue private tech unicorns. Securities-focused law firms passed this message on to their clients with memos like this: "It's Hunting Season. For Unicorns? Lawsuit Against Theranos Signals Trend In Investors Going After Late-Stage Start-ups."[137]

c. Jumio

Jumio, Inc. was a private mobile payments company based in Palo Alto, California. Its founder and (now former) CEO was Daniel Mattes. Mattes also owned many of Jumio's shares. He allegedly told at least one potential Jumio investor that he was not selling his own shares because "there was lots of great stuff coming up" for Jumio and "he'd be stupid to sell at this point."[138] But actually Mattes did sell his own shares, making $14 million dollars. In the process, he provided overstated financial statements to investors and allegedly misled Jumio's board and lawyers so that they would sign off on his sales.[139]

Jumio went bankrupt in 2016, and investors (not Mattes) lost their investment. In April 2019, the SEC charged Mattes with securities fraud in violation of 10(b)/10b-5 and 17(a).[140] Mattes settled with the SEC, agreeing to pay $17 million dollars.[141] As part of the settlement, he was also barred from being the officer or director of a *public* company.[142] He

135 Theranos Inc., Form D, *supra* note 96.

136 CARREYROU, *supra* note 8, at 15-16, 176-78.

137 Christine Hanley, James Thompson & Jim Kramer, *It's Hunting Season. For Unicorns? Lawsuit Against Theranos Signals Trend in Investors Going After Late-Stage Start-Ups*, ORRICK BLOGS (Oct. 20, 2016), https://blogs.orrick.com/securities-litigation/2016/10/20/its-hunting-season-for-unicorns-lawsuit-against-theranos-signals-trend-in-investors-going-after-late-stage-start-ups/ [https://perma.cc/BKK8-45MW].

138 Complaint at 2, SEC v. Mattes, No. 5:19-cv-01689 (N.D. Cal. Apr. 2, 2019).

139 *Id.* at 1-2.

140 *Id.* at 8-9.

141 *SEC Charges Former CEO of Silicon Valley Startup with Defrauding Investors*, SEC (Apr. 2, 2019), https://www.sec.gov/news/press-release/2019-50 [https://perma.cc/9823-5T8V] [hereinafter *SEC Charges Former CEO*].

142 *Id.*

has since returned to Austria, where he is a judge on *2 Minuten 2 Millonen*, the Austrian version of Shark Tank.[143]

The SEC also charged Jumio's CFO with securities fraud.[144] As with Zenefits, the SEC brought administrative proceedings and alleged only § 17(a) (non-scienter) violations.[145] Although in a settlement the CFO agreed to disgorge $450,000 dollars, the SEC did not impose a civil penalty "based on [the CFO's] agreement to cooperate in a related enforcement action."[146]

Two aspects are key here. First that the SEC intervened with a securities fraud action on behalf of employees. These were small investors and may lack informational advantages, perhaps triggering an investor-protection rationale akin to that applicable to retail investors.[147] In some ways, employee-investors may even warrant more protection than ordinary retail investors given their lack of diversification.[148]

Second, the action concerned sales in the *private* secondary market.[149] Some private companies, including those that pay employees in stock, have developed a secondary private market to provide liquidity.[150] Jumio is one example. It was a private company, whose shares were not traded on an exchange. However, Mattes "made arrangements for the employees to sell their Jumio shares through a broker that specialized in private, secondary market transactions (that is, sales of shares from one investor to another, rather than from an issuer to an investor)."[151] The SEC again intervened in the context of a "public-like" private

[143] DANIEL MATTES, https://danielmattes.com/ (last visited Aug. 31, 2019) [https://perma.cc/5U7F-MTDP] (describing Mattes as an "Entrepreneur [sic], Speaker, Author, [and] Visionary").

[144] *SEC Charges Former CEO*, *supra* note 141.

[145] Chad Starkey, Securities Act of 1933 Release No. 10626, 2019 WL 1452705 (Apr. 2, 2019) (instituting cease and desist proceedings).

[146] *Id.* at *7.

[147] Not all employees may be in the same position, with early employees having access to relevant information though their employment while later employees do not. *See* Abraham J.B. Cable, *Fool's Gold? Equity Compensation & the Mature Startup*, 11 VA. L. & BUS. REV. 615, 636-37 (2017).

[148] *See* Yifat Aran, *Making Disclosure Work for Start-Up Employees*, 2019 COLUM. BUS. L. REV. 867, 873 & n.21 (noting that startup employees usually have a large proportion of their wealth concentrated in a single, employer company).

[149] *SEC Charges Former CEO*, *supra* note 141.

[150] *See* Darian M. Ibrahim, *The New Exit in Venture Capital*, 65 VAND. L. REV. 1, 21 (2012); Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 180 (2012) ("Shares in private companies, previously regarded as an illiquid, out-of-reach asset class, are being traded on websites resembling stock markets.").

[151] Complaint at 6, SEC v. Mattes, No. 5:19-cv-01689 (N.D. Cal. Apr. 2, 2019).

company, but this time the relevant characteristic was that it had an active secondary market.

Although private secondary markets are relatively new, the SEC's attention to employee-investors is not. Useful context for Jumio is the SEC's 2011 action against Stiefel Labs. This privately held company produced medicinal soap, including over the years Boracic Acid soap, Freckle soap, Oilatum, Zeasorb, and other anti-wart and anti-acne formulations.[152] Throughout its history — in fact until the events that drew the SEC's attention in the early 2000s — the business was privately held and family-run, with the Stiefel family the controlling shareholder.[153]

Starting in the 1970s, company shares were distributed to employees.[154] In a letter to employees from the 1990s, the Stiefel family members then in charge listed this as the first of the company's guiding principles: "We remain a private company. No one on Wall Street tells us what to do."[155] Despite these assurances, in 2009, GlaxoSmithKline acquired Stiefel as a wholly owned subsidiary. GlaxoSmithKline was a UK publicly traded company.[156]

In the run-up to this merger, Stiefel Labs and its chairman and CEO bought shares from employees at a discounted price. The company and its CEO allegedly knew information relevant to valuing these shares. The selling employees did not. The SEC sued the private company and its CEO for securities fraud, alleging violations of 10(b) and 10b-5[157] —

[152] STIEFEL, https://www.stiefel.com/ (last visited Sept. 2, 2020) [https://perma.cc/M8MY-E4VY].

[153] Complaint at 4-5, SEC v. Stiefel Labs. Inc., No. 1:11-cv-24438 (S.D. Fla. Dec. 12, 2011) [hereinafter Complaint, Stiefel Labs].

[154] *Id.* at 5.

[155] Plaintiff's Statement of Undisputed Material Facts, SEC v. Stiefel Labs. Inc., No. 1:11-cv-24438 (S.D. Fla. June 13, 2016), Part 67: Exhibit 412 (Letter from Werner K. Stiefel to "my Friends, Co-Workers and Fellow Owners") (Oct. 2, 1995).

[156] GlaxoSmithKline PLC, Report of Foreign Issuer (Form 6-K) (Oct. 28, 2009); *GlaxoSmithKline PLC*, COMPANIES HOUSE, https://beta.companieshouse.gov.uk/company/03888792 (last visited Sept. 7, 2020) [https://perma.cc/X7FZ-29SM].

[157] Complaint, Stiefel Labs, *supra* note 153, at 19-20. The case was reportedly settled in June 2020 with a multi-million-dollar payment to investors. Investors to Receive $37 Million from SEC Settlement with Stiefel Laboratories and Charles Stiefel., SEC Litigation Release No. 24828, 2020 WL 3034612 (June 5, 2020) ("The Securities and Exchange Commission today announced that it has obtained final judgments that will require a former privately held dermatology products manufacturer and its former chairman and CEO to pay $37 million for the benefit of shareholders whom they defrauded through share buybacks that were improperly undervalued.").

essentially insider trading.[158] As with Jumio, the fraud was of employees who were also investors.

Notably, the SEC's public commentary about the case at the time it was filed presaged the Silicon Valley Initiative. In its press release, the director of the SEC's regional office warned: "Private companies and their officers must understand that they are not immune from the federal securities laws, which protect all shareholders regardless of whether they bought stock in the open market or earned shares through a company's stock plan."[159] And the law firms followed up with warnings of SEC attention to private firms and their officers.[160]

d. Lucent Polymers

Lucent Polymers promised "garbage to gold" — a promise its officers knew it could not deliver.[161] The SEC's complaint described the scheme as "simple."[162] The CEO and COO of this private company "aimed to sell the company — including their own substantial equity stake — while hiding from potential buyers the fact that Lucent's core business model was a sham."[163] They (temporarily) succeeded, selling the company twice and making millions between them.[164]

The SEC brought an enforcement action against Lucent Polymer's CEO and COO in 2019.[165] Several private companies were "related parties."[166] Lucent Polymers, Inc., the Matrixx Group, Inc., and Citadel Plastics Holdings, LLC were interrelated "privately held plastics

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[158] *See* Peter Molk, *Uncorporate Insider Trading*, 104 MINN. L. REV. 1693, 1696 n.18 (2020).

[159] *SEC Charges GlaxoSmithKline Subsidiary and Former CEO with Defrauding Employees in Stock Plan*, SEC (Dec. 12, 2011), https://www.sec.gov/news/press/2011/2011-261.htm [https://perma.cc/G3GX-3HLR].

[160] *See* Molk, *supra* note 158, at 1696 n.18 (citing WINSTON & STRAWN LLP, SEC RENEWS FOCUS ON INSIDER TRADING IN PRIVATE COMPANY STOCK (2011), https://www.winston.com/images/content/1/0/1052.pdf [https://perma.cc/3G5P-HBUM]).

[161] *See supra* notes 1–7 and accompanying text.

[162] Complaint, Kuhnash, *supra* note 1, at 1.

[163] *Id.*; *see also Former Executives of Evansville Plastics Company Indicted*, U.S. DEP'T OF JUSTICE (Feb, 12. 2019), https://www.justice.gov/usao-sdin/pr/former-executives-evansville-plastics-company-indicted [https://perma.cc/DCL2-UGQW] (announcing criminal indictment of the Lucent Polymers CEO and COO who "filled their pockets through fraud and numerous acts of deceit").

[164] Complaint, Kuhnash, *supra* note 1, at 3.

[165] *See* SEC Charges Former Executives of Plastics Manufacturer with Fraud, SEC Litigation Release No. 24397, 2019 WL 554227 (Feb. 12, 2019).

[166] Complaint, Kuhnash, *supra* note 1, at 5-6.

manufacturing compan[ies]."[167] The SEC pursued officers but did not pursue any companies. The original private company had been acquired twice, including by a publicly traded plastics manufacturer.[168]

The SEC alleged that the corporate officers of Lucent Polymer violated 10(b)/10b-5 and 17(a).[169] The enforcement action thus provides an example of the SEC's enforcement of anti-fraud provisions against the officers of private companies. Perhaps most distinctive is the reminder that corporate groups can include both private and public business entities, further complicating the "private" company category.

2. Private Company Fraud that Impacts Public Market Integrity

The SEC has also brought enforcement actions against private companies that engage in fraud with implications for the IPO process or other parts of the public offering process. Private companies have used the false promise of upcoming IPOs to defraud potential investors. The concern is the impact of the fraud — making investors less trusting of the IPO process and using the formal signaling of the SEC-apparatus as a means of fraud.[170]

The SEC has periodically issued warnings to investors about a particular type of scam that promises participation in an IPO. A 2005 SEC Investor publication warned investors about *Risky Business: "Pre-IPO" Investing*.[171] (The scare quotes are in the original.) The SEC warned that "[m]any companies and stock promoters entice investors by promising an opportunity to make high returns by investing in a start-up enterprise at the ground floor level."[172] Part of the pitch was that the

167 *Id.*

168 *Id.* at 6, 19.

169 *Id.* at 23-24.

170 *Cf.* Complaint at 3, SEC v. Blockvest, LLC, No. 3:18-cv-002287 (S.D. Cal. Oct. 3, 2018) (noting the company lied to investors and perpetuated a fraudulent scheme in violation of the Securities Act); Blockvest, LLC, Litigation Release No. 24314, 2018 WL 4951800 (Oct. 11, 2018) (reporting enforcement action against a company that "promoted the ICO with a fake agency [they] created called the 'Blockchain Exchange Commission,' using a graphic similar to the SEC's seal and the same address as SEC headquarters").

171 *Risky Business: "Pre-IPO" Investing*, SEC (Jan. 11, 2005), https://www.sec.gov/reportspubs/investor-publications/investorpubspreipohtm.html [https://perma.cc/3YFS-QSU6] ("'Pre-IPO' investing involves buying a stake in a company before the company makes its initial public offering of securities.").

172 *Id.*

company would go public (that the company was "pre-IPO").[173] A version of this investor alert was re-issued in 2011 and 2012.[174]

A 2001 example was Prexomet Inc., a private Rhode Island company. Its founder and other officers indicated that the company owned an Arizona mine, and promised investors that the company soon would go public, resulting in returns of 500%.[175] The mine did not exist, the IPO did not happen, Prexomet dissolved, and its founder fled to Europe as soon as the SEC's securities fraud investigation began.[176]

The SEC investor warning pointed out that "companies and stock promoters" both "entice investors." As this suggests, some "pre-IPO" promises are not private company fraud. Industry professionals may also use the promise of future IPOs to sell investors somebody else's stock[177] or fraudulently sell IPO shares they simply do not have.[178] But others, like Prexomet, are companies that are and remain private, and

[173] *See id.*

[174] *Investor Alert: Pre-IPO Investment Scams (Updated)*, SEC (Apr. 1, 2012), https://www.sec.gov/investor/alerts/pre_ipo_scams.htm [https://perma.cc/7FFQ-YVDW]; *Investor Alert: Pre-IPO Investment Scams*, SEC (Mar. 18, 2011), https://www.sec.gov/investor/alerts/pre-ipo.htm [https://perma.cc/C4UZ-7F4P]; *see also Pre-IPO Offerings — These Scammers Are Not Your Friends*, FINRA, https://www.finra.org/investors/alerts/pre-ipo-offerings-these-scammers-are-not-your-friends (last updated March 15, 2011) [https://perma.cc/9J4D-NTFJ].

[175] SEC Charges Four Individuals in IPO Offering Fraud, SEC Litigation Release No. 17080, 75 SEC Docket 1234, 2001 WL 862856 (July 30, 2001).

[176] *Id.*; *see also* New World Web Vision.com, Inc., SEC Litigation Release No. 17442, 77 SEC Docket 701, 2002 WL 461357 (Mar. 27, 2002) (settling SEC securities fraud allegations in the early 2000s that they had "offered and sold 'pre-IPO shares' at $.60 per share, and fraudulently told investors that their shares would be worth $16-$17 per share when the companies went public").

[177] *See, e.g.*, Complaint at 1-2, SEC v. Shehyn, No. 04-cv-02003 (S.D.N.Y. Mar. 15, 2004) (stating the defendant's "made fraudulent statements concerning the value of these securities and none of the companies that issued the stock have had an IPO"); SEC Sues Four Individuals Behind Millennium Financial, Ltd., a $20 Million Fraudulent Boiler Room Operation, SEC Litigation Release No. 18624A, 82 SEC Docket 1683, 2004 WL 542855 (Mar. 18, 2004) (stating boiler room salespeople pushed "so-called 'pre-initial public offering' securities of small U.S. companies" using "high pressure sales tactics and ma[king] a number of fraudulent statements concerning the value of these securities" whereas "[n]one of the companies which issued these securities have had an IPO, and Millennium's investors have typically lost most, if not all, of their investment").

[178] *See, e.g.*, SEC v. Milan Capital Group, Inc., No. 00 Civ. 108, 2000 WL 1682761, at *1 (S.D.N.Y. Nov. 9, 2000) (stating the company "lacked access to and did not obtain any IPO shares for these investors"); SEC Obtains Summary Judgment Against Three Defendants in Case Involving $9 Million IPO Stock Fraud, SEC Litigation Release No. 16802, 73 SEC Docket 1876, 2000 WL 1708383 (Nov. 16, 2000) (stating "Milan did not have access to IPOs, and never provided investors with any IPO shares").

that use the empty promise of going public to sell their own securities to hopeful investors.[179] A type, in other words, of private company fraud.

3. Private Companies that Failed to Register Securities

The SEC's attention to startups and unicorns is key to the argument that as private companies increasingly have "public-like" features, the SEC may need to step in to protect investors and to promote capital formation. But another more mundane category of enforcement action provides a reminder that the reach of the securities fraud provisions to private companies plays a role in classic fraud cases as well.

The reach of the securities fraud provisions is treated as uncontroversial in part because of the clear statutory and rule language,[180] but the examples given here also demonstrate a relatively routine intervention of the SEC into the world of private companies. This category includes private companies with securities that should have been registered. It also includes (sometimes within the same action) frauds that involve the use of both private and public companies, often controlled by the same individual(s).

One could quibble about whether these should count as private company fraud, given that they involve what should have been public offerings registered with the SEC. Regardless of their categorization, however, they provide an example of the need for information about private companies in the absence of disclosure and market price. They are also a clear example of securities fraud allegations brought by the SEC against private companies.

a. BOG, Crude, Patriot, and the "Frack Master"

Chris Faulkner's oil and gas industry experience was rather indirect: he worked for a website data hosting company that had oil and gas companies as clients.[181] Nonetheless, he ultimately spent a decade appearing on television as a Texas oil man, seen in some news segments

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179 *See, e.g.*, Complaint at 22, SEC v. Giga Entm't Media, Inc, No. 18-cv-06511 (E.D.N.Y. Nov. 15, 2018) ("Almost since the inception of Giga, its management has promised its investors that the company would go public . . . . In fact, as Giga and Nerlinger knew or should have known, at this time, the company was not even close to being ready to file for an IPO.").

180 *See supra* Part II.A.

181 Complaint at 3, SEC v. Faulkner, No. 16-cv-01735 (N.D. Tex. June 24, 2016) [hereinafter Complaint, Faulkner].

with his Texas flag pin and pocket handkerchief.[182] He got his sticky nickname — the "Frack Master" — from the publication OIL & GAS MONITOR, where he also wrote advice about cautious oil and gas investing, including in a piece titled "Oil and Gas Best Kept Secrets: Secrets of Oil and Gas Investments for the Average Individual."[183]

Cautious investors would have avoided what Faulkner was selling: investments in "'turnkey' oil and gas working interests."[184] In some ways the fraud was straightforward. Faulkner simply used investor money for personal expenses. He allegedly called one credit card his "whore card"; he and an associate used company credit cards for "gentlemen's club expenses, including nearly $40,000 in charges at a Dallas gentlemen's club over a four-day period."[185]

Putting aside the details of what the SEC called Faulkner's "lifestyle of decadence and debauchery,"[186] one of the key points for understanding private company fraud more generally is that Faulkner used a mix of entities he controlled for the fraud. They included three private entities: Breitling Oil & Gas Corporation ("BOG"), Crude Energy, LLC ("Crude"), and Patriot Energy, Inc. ("Patriot").[187] The entities he controlled and used also included a publicly traded company, Breitling Energy Corporation (ticker: BECC).

In 2016, the SEC brought an enforcement action against Faulkner, seven other individuals, the publicly traded company and the three private companies controlled by Faulkner. Securities fraud was certainly one allegation, but the list of violations was long, and included claims that some of the investments should have been registered.[188] Notably, among the allegations were 17(a) and 10(b)/10b-5 securities

[182] Dalton LaFerney, *The Rise and Fall of the 'Frack Master:' How a Dallas Tech CEO Became an Expert on Hydraulic Fracturing to a Global Audience*, DALL. MORNING NEWS (Aug. 26, 2016), http://interactives.dallasnews.com/2016/frack-master/ [https://perma.cc/Z623-MRVB]; VARNEYCO, *Breitling Energy CEO Chris Faulkner on Dropping Oil Prices*, YOUTUBE (Dec. 11, 2014), https://youtu.be/-8_UtOmIVZU [https://perma.cc/F59X-78Z5].

[183] LaFerney, *supra* note 182.

[184] SEC v. Chris Faulkner, SEC Litigation Release No. 23582, 2016 WL 9086342 (June 24, 2016).

[185] Complaint, Faulkner, *supra* note 181, at 35.

[186] *Id.* at 2.

[187] *Id.* at 13-14. BOG was an LLC originally organized in Oklahoma, Crude was a Nevada LLC with its principal place of business in Dallas, Texas, and Patriot Energy, Inc., was a North Dakota corporation. None of the business entities or their securities were registered with the SEC. *Id.*

[188] *Id.* at 10, 53.

fraud allegations against BOG, Crude, and Patriot — the private companies.[189]

b. Fyre Media

The 2017 Fyre Festival was a fiasco. Its Wikipedia page describes it simply as "a fraudulent luxury music festival."[190] Articles called it a "debacle that became a national punchline."[191] Private lawsuits by festival goers said it was "closer to . . . 'Lord of the Flies' than Coachella."[192] Documentaries soon followed: "Fyre Fraud" and "Fyre: The Greatest Party That Never Happened."[193] Photos and footage show disaster relief tents and pigs in swimming pools.[194] Ja Rule even released a track, reportedly "inspired by the rapper's role in the disastrous Fyre Festival."[195] Cover artwork was a drawing of the "viral cheese sandwich" — the photo of sad pre-sliced cheese on bread that was a viral visual contradiction of the festival's claim to luxury.[196]

The SEC described the Fyre Festival as securities fraud. In 2018, it sued William Z. ("Billy") McFarland, a few other individuals, and the companies McFarland controlled for inducing investors to invest more

189 *Id.* at 48-50.

190 *Fyre Festival*, WIKIPEDIA, https://en.wikipedia.org/wiki/Fyre_Festival (last visited Jan. 15, 2020) [https://perma.cc/9XXC-W8BT].

191 Gabrielle Bluestone, *Fyre Festival's 25-Year-Old Organizer: "This Is the Worst Day of My Life,"* VICE (Apr. 28, 2017, 5:15 PM), https://www.vice.com/en_ca/article/qvz5m3/fyre-festivals-25-year-old-organizer-this-is-the-worst-day-of-my-life [https://perma.cc/65AG-7UWA].

192 Complaint at 2, Jung v. McFarland, No. 2:17-cv-03245 (C.D. Cal. Apr. 30, 2017) [hereinafter Complaint, Jung v. McFarland].

193 Melinda Newman, *Hulu Debuts Fyre Festival Doc Days Before Rival Netflix Project*, HOLLYWOOD REPORTER (Jan. 14, 2019, 8:00 AM PST), https://www.hollywoodreporter.com/news/hulu-debuts-fyre-festival-doc-days-before-rival-netflix-project-1175778 [https://perma.cc/6YKT-P3R3]; Netflix, *FYRE: The Greatest Party That Never Happened*, YOUTUBE (Jan. 10, 2019), https://youtu.be/uZ0KNVU2fV0 [https://perma.cc/Q58N-KTZM] ("He was lying to investors and making it seem we were making a ton of money, but we weren't." at 1:03).

194 *E.g.*, Complaint, Jung v. McFarland, *supra* note 192, at 8 (showing Federal Emergency Management Agency ("FEMA") disaster tents that housed festival attendees); *id.* at 9 (showing photo of pig in pool and noting that "[i]n addition to the substandard accommodations, wild animals were seen in and around the festival grounds").

195 Ilana Kaplan, *Hear Ja Rule's New Fyre Festival-Inspired Song 'FYRE,'* ROLLING STONE (Dec. 14, 2019, 1:48 PM ET), https://www.rollingstone.com/music/music-news/ja-rule-fyre-festival-song-927211/#! [https://perma.cc/3M5V-DQTS]. Some of the lyrics: "Hotter than the sun, but it wasn't that/Show of hands if you got your money back?/Just playing, I got sued for that/100 mil to be exact." *Id.*

196 *Id.*

than $24 million in Fyre Media and Fyre Festival.[197] McFarland and Fyre Media allegedly:

> Made false statements concerning key Fyre Media and Fyre Festival financial metrics and assets; Falsified financial data; Made false claims of affiliations with talent; Created a fraudulent brokerage statement . . . ; Made false statements and created a fake document concerning purported bank loans and a purported significant pending investment in Fyre Media; Claimed, falsely, that he would obtain event cancellation insurance for Fyre Festival; and Engaged in a scheme to create the illusion that Magnises was being acquired by a third party that did not exist.[198]

Fyre Media and Magnises, Inc. were both privately held corporations.[199] The SEC alleged securities fraud under 10(b)/10b-5 and 17(a), as well as violations of registration requirements.[200] The SEC's Fyre Festival action was, in other words, an example of the SEC's pursuit of securities fraud by private companies, albeit in a context where some aspects should have been pulled into the public information system through securities registration.[201]

* * * * *

The two examples explored above, involving Fyre Festival and the "Frack Master," are simply colorful examples of a more expansive category of the SEC's securities fraud actions against private companies

197 Complaint at 1, SEC v. McFarland, No. 18-CV-6634 (S.D.N.Y. July 24, 2018) [hereinafter Complaint, SEC v. McFarland]; *SEC Charges Failed Fyre Festival Founder and Others with $27.4 Million Offering Fraud*, SEC (July 24, 2018), https://www.sec.gov/news/press-release/2018-141 [https://perma.cc/R5RN-T6HZ].

198 Complaint, SEC v. McFarland, *supra* note 197, at 7.

199 *Id.* at 5. The SEC further specified that Fyre Media Inc. had "never been registered with the Commission in any capacity, and [had] never registered any securities offering with the Commission." *Id.*

200 *Id.* at 19-20; *id.* at 21 ("No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the securities and transactions issued by Fyre Media and Fyre Festival described in this Complaint, and no exemption from registration — including the Rule 3a4-1 safe harbor — applies with respect to these securities and transactions.").

201 McFarland and the companies ultimately settled with the SEC. They agreed to disgorgement that was offset by the amount given up in the parallel criminal action. The settlement did not require a civil penalty, given that the main actor went to jail. Final Judgment at 5-6, SEC v. McFarland, No. 18-CV-6634 (S.D.N.Y. Aug. 1, 2018).

that should have registered securities in the public system.[202] It is also an illustration of the need for anti-fraud tools that can address both private and public companies in order to reach this type of classic fraud in the context of a public/private mix.

4. Companies in Transition

Unlike the categories above, in which the SEC must rely on information other than a company's filings and communications with the agency, companies in transition often have more interaction with the agency. For these companies, the SEC has an inflection point at the moment of transition between public and private (or vice versa).

This section provides examples of SEC actions against companies in transition. It starts with companies that the SEC pursued for securities fraud that allegedly occurred when the company tried to go *public* through the IPO process. It then turns to enforcement actions against companies when they tried to go *private*.

a. Going Public

SEC securities fraud actions against private companies have taken place while the company is in transition from private to public, in the course of an IPO. This setting differs from the companies above because the IPO process itself generates information, some of which is in the form of public filings.[203]

A high-profile example is the reported SEC action against WeWork and its parent company The We Company.[204] The company's publicly available S-1 registration statement contained red flags such as the

[202] Another example is Inofin, Inc. a Massachusetts company that had never been registered or had securities registered with the SEC. Complaint at 5, SEC v. Inofin, Inc., No. 11-cv-10633 (D. Mass. Apr. 14, 2011); SEC Charges Subprime Auto Loan Lender and Executives with Fraud, SEC Litigation Release No. 21929, 100 SEC Docket 3259, 2011 WL 1431178 (Apr. 14, 2011); *see also* SEC Halts Sham Real Estate Investment Offering Fraud, SEC Litigation Release No. 24316, 2018 WL 5013654 (Oct. 12, 2018); SEC v. Eric J. "EJ" Dalius, SEC Litigation Release No. 24345, 2018 WL 5881787 (Nov. 8, 2018); *SEC Charges Giga Entertainment Media, Former Officers and Directors with Fraud in Pay-For-Download Campaign*, SEC (Nov. 15, 2018), https://www.sec.gov/news/press-release/2018-263 [https://perma.cc/5RSE-V2DH].

[203] *See* STEPHEN J. CHOI & ADAM C. PRITCHARD, SECURITIES REGULATION 498-500 (5th ed. 2019).

[204] *See* Matt Robinson, Robert Schmidt & Ellen Huet, *WeWork Is Facing SEC Inquiry into Possible Rule Violations*, BLOOMBERG (Nov. 15, 2019, 8:46 AM PST), https://www.bloomberg.com/news/articles/2019-11-15/wework-is-said-to-face-sec-inquiry-into-possible-rule-violations [https://perma.cc/K5QG-UPY5].

founder's (attempted) sale of the "we" trademark back to the company for almost six million dollars.[205]

Mary Jo White highlighted another example of problems at a newly public company in her Silicon Valley Initiative speech.[206] She pointed to the cautionary tale of biopesticide company Marrone Bio Innovations, a newly public company that was the subject of an SEC enforcement action for misstating its financials.[207] It had promised distributors of agricultural products that they had a right to return the product, but inappropriately recognized anything sold to distributors as revenue anyway.[208] The SEC pursued securities fraud claims under 10(b)/10b-5 and 17(a).[209] Because the company was in transition, the SEC was able to bring charges based on the content of the company's mandatory disclosure documents.[210]

Other examples of SEC enforcement include situations where there has been fraud in the conduct of the IPO. These include roadshow fraud,[211] fraud in the closing,[212] and false IPO registration statements because of other misconduct.[213] Even where some or all of the conduct took place when the company was private, these examples are characterized by the availability of filed disclosure documents that make up part of the "going public" process.

205 The We Co., Registration Statement (Form S-1) 199 (Aug. 14, 2019).

206 *See SEC Silicon Valley Initiative Speech*, *supra* note 20 ("[J]ust last month, the Commission brought charges against a company and a former executive for inflating financial results to meet projections that it would double revenues in its first year as a public company.").

207 *Id.*

208 Complaint at 1, SEC v. Marrone Bio Innovations, Inc., No. 16-cv-00321 (E.D. Cal. Feb. 17, 2016) [hereinafter Complaint, Marrone Bio]; *SEC Charges Biopesticide Company and Former Executive with Accounting Fraud*, SEC (Feb. 17, 2016), https://www.sec.gov/news/pressrelease/2016-32.html [https://perma.cc/D6LC-JPRW].

209 Complaint, Marrone Bio, *supra* note 208, at 18.

210 *See id.*

211 *In re* Benjamin H. Gordon, Securities Act of 1933 Release No. 10651, 2019 WL 2552338, at 2 (June 20, 2019).

212 *E.g.*, SEC v. Heaton, SEC Litigation Release No. 14241, 57 SEC Docket 1655, 1994 WL 527077 (Sept. 19, 1994) (discussing SEC anti-fraud action for fraudulent closing of IPO); SEC Court Enters Final Judgment Against Former Busybox General Counsel Jon M. Bloodworth For IPO Fraud Scheme, SEC Litigation Release No. 19609, 87 SEC Docket 1653, 2006 WL 655968 (Mar. 16, 2006) (same); SEC Sues Former Top Officers of Busybox.com for IPO Fraud, SEC Litigation Release No. 19284, 2005 WL 1505988 (June 24, 2005) (same).

213 SEC v. Sachdeva, SEC Litigation Release No. 15596, 66 SEC Docket 312, 1997 WL 794477 (Dec. 18, 1997); Digital Display Advertising Firm, Executives Bilk More than $2 Million from Investors, SEC Litigation Release No. 24001, 118 SEC Docket 969, 2017 WL 6016880 (Dec. 4, 2017).

b. Going Private

Companies also transition from public to private and, in fact, in recent years have increasingly done so.[214] The SEC has brought actions against public companies for going-private transactions. Because of the nature of a going-private transaction, the allegations are usually that the company and its officers defrauded a sophisticated investor in a going-private transaction.[215]

One example of the SEC's securities fraud actions against companies as they go private is the SEC's enforcement action against the CEO and CFO of Constellation Healthcare Technologies, Inc., a (now-defunct) issuer in the medical-billing business.[216] The company had been traded on the London Stock Exchange's Alternative Investment Market, but company officers and directors arranged a going-private transaction with an investor described as the "family office of a high-net-worth individual."[217]

Constellation was a holding company set up to acquire healthcare billing companies. These billing companies, however, had been created by Constellation's officers, who allegedly also backdated descriptions, invented employees and customers, and provided fictionalized documentation.[218]

An inability to use PowerPoint may have been their downfall: one billing company was modeled closely on an existing Ohio company that an investment bank had previously pitched to Constellation (using a PowerPoint presentation).[219] Constellation's officers allegedly cut and pasted the business description, but could not get rid of the background

214 *See supra* Part I.B.

215 Matt Levine, *You Never Want to Be Suckered This Badly: Even with Due Diligence, Sophisticated Investors Still Get Hoodwinked by Fraudulent Businesses*, BLOOMBERG (May 17, 2018, 3:00 PM PDT), https://www.bloomberg.com/opinion/articles/2018-05-17/securities-fraud-can-happen-with-private-transactions [https://perma.cc/Y2M4-FS7S] (describing the SEC's action against the executives of Constellation Healthcare Technologies Inc., a public company, in a going-private transaction); *e.g.*, Complaint at 1-2, SEC v. Parmar, No. 18-cv-09284 (D.N.J. May 16, 2018) [hereinafter Complaint, Parmar] (alleging that executives of a public company committed securities fraud in a going-private transaction, in violation of section 17(a), section 10(b), and Rule 10b-5).

216 Complaint, Parmar, *supra* note 215, at 4; *SEC Charges Three Former Healthcare Executives with Fraud*, SEC (May 16, 2018), https://www.sec.gov/news/press-release/2018-90 [https://perma.cc/WJ9W-ARTW] [hereinafter *SEC Charges Three*].

217 Complaint, Parmar, *supra* note 215, at 1.

218 *Id.* at 2.

219 *Id.* at 11 ("The sham MDRX report essentially left the entire description of the Real Medical-Billing Business, including the company's organizational chart, untouched, but inflated the company's financials and simply changed the company's name to MDRX, an entirely fictitious entity.").

picture of the real company.[220] According to the SEC's complaint, the cutting and pasting led to questions from the investment banker familiar with the real company, and to terse internal emails that summed up the situation: "Not good" followed by "Oh f-."[221]

As with other securities fraud actions, the SEC alleged that these officers and directors violated section 17(a), section 10(b), and Rule 10b-5.[222] The SEC action was not the only consequence: the U.S. Attorney's Office of the District of New Jersey also filed criminal charges against the corporate officers and additional directors for conspiracy to commit securities fraud.[223]

The accompanying message from the SEC about pursuing the going-private transaction was consistent with its message about fraud in other private contexts: the setting would not immunize fraud. "Using phony balance sheets, doctored bank statements, and other fabrications to conceal the theft of investor monies, which we allege occurred in this case, will not go undetected or unpunished," said Marc P. Berger, Director of the SEC's New York Regional Office.[224] At least two targets were still fugitives as of the U.S. Attorney's press release. But message sent.[225]

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220 *Id.* (quoting an email that forwarded the doctored description: "I am not able to remove the background image of [the Real Medical-Billing Business] in the presentation.")

221 *Id.* at 12 (expletive omitted).

222 *Id.* at 3.

223 Indictment at 1, United States v. Parmar, No. 18-cr-00735 (D.N.J. Dec. 13, 2018); *Former CEO, CFO and Directors of Healthcare Services Company Indicted in Elaborate $300 Million Investment Fraud Scheme*, U.S. DEP'T JUST. U.S. ATTORNEY'S OFF. DISTRICT N.J. (Dec. 13, 2018), https://www.justice.gov/usao-nj/pr/former-ceo-cfo-and-directors-healthcare-services-company-indicted-elaborate-300-million [https://perma.cc/C798-XNYS].

224 *SEC Charges Three*, *supra* note 216; *see also* Complaint, Parmar, *supra* note 215 at 1-2.

225 Other examples exist. *See also Corporate Insiders Charged for Failing to Update Disclosures Involving "Going Private" Transactions*, SEC (Mar. 13, 2015), https://www.sec.gov/news/pressrelease/2015-47.html [https://perma.cc/Z7DA-GXYA] (announcing settlement of administrative actions against companies and individuals who failed to make mandatory disclosures about beneficial ownership in the context of taking International Lottery & Totalizator Systems, Inc. ("ILTS") private); *cf.* Omega Protein Corp., Release No. 33-10679, SEC Docket 4171263, 2019 WL 4171263 (Aug. 29, 2019) (describing an action against a private company for activity when it was public).

III. ANTI-FRAUD-ONLY REGIME

To what extent does the diminishment of public companies disrupt the information available about the internal workings of these companies? This Part looks at what anti-fraud enforcement is able to do. It then analyzes the information that is lost in the move to private capital, particularly the loss of mandatory disclosure and the consequences of the absence of price information.

A. *What Anti-Fraud Enforcement Can Do*

As with other enforcement activity, it is sometimes difficult to pinpoint an optimum level. One pattern to date is the use of high-profile statements and cases to send a signal to industry participants. The SEC was not left out in the Theranos or Fyre debacles. It followed the "Silicon Valley Initiative" by fining Zenefits in a move that was reported as unprecedented and representing an aggressive new SEC approach to unicorn startups.[226]

One mechanism that may amplify the effects of this smattering of SEC actions against private companies is their influence on Director and Officer ("D&O") insurance. This could lead to greater structural change, or at least increased attention by officers and directors in private companies. Companies buy D&O Insurance to cover legal claims against the company and directors and officers in their official roles. D&O insurance has developed separate products for private and public companies, and is sensitive to monitoring the litigation and enforcement risks faced by each category.[227] Industry commentators have increasingly tracked the SEC's approach to bringing enforcement actions against private companies, noting that the distinct package sold to private companies does not take this anti-fraud enforcement into account.[228] Given current low numbers of enforcement actions against some of the largest startups,[229] this practice may make sense, although the fact there is monitoring reinforces the idea that the landscape is shifting.

226 Alden, *The SEC Just Fined*, *supra* note 122.

227 *See, e.g.*, ADVISEN, *supra* note 33 at 28-29 (describing the market for D&O insurance for private companies); LaCroix, *Executive Protection*, *supra* note 33 (noting that "the potential liability exposures and the available insurance solutions for private companies and their directors and officers are quite a bit different than for public companies").

228 ADVISEN, *supra* note 33, at 28.

229 *See supra* Chart 1.

As for the available information sources, ordinarily an SEC investigation begins with information about a potential violation from a variety of potential sources: "market surveillance activities, investor tips and complaints, other Divisions and Offices of the SEC, the self-regulatory organizations and other securities industry sources, and media reports."[230] The SEC has an active referral practice, including incoming from other agencies, units and entities.[231] It also has a formalized whistleblower program that provides protections and incentives for people to come forward with information about corporate fraud.[232] Some of these sources continue to be available even in the move to private capital, notably investor and insider tips as well as media reports (though the lack of mandatory disclosure may affect these as well).

B. *The New Low-Information Regime*

Two key sources of information are missing for private companies: mandatory disclosure and price. The consequences for anti-fraud enforcement are addressed below.

1. Loss of Public Company Disclosure

U.S. securities regulation is built around mandatory disclosure for public offerings and for public companies (Exchange Act Reporting Companies). This extensive and varied disclosure[233] is a key information source for investors. The public filings are the locus of some of a company's statements and misstatements, and also provide

[230] *How Investigations Work*, SEC (Jan. 27, 2017), https://www.sec.gov/enforce/how-investigations-work.html [https://perma.cc/9V4R-VLZR]. *See generally* KIRKPATRICK & LOCKHART PRESTON GATES ELLIS LLP, THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES (Michael J. Missal & Richard M. Phillips eds., 2d ed. 2007) [hereinafter ENFORCEMENT MANUAL] (discussing SEC enforcement investigations); SEC, ENFORCEMENT MANUAL 82-95 (2017) (same).

[231] Verity Winship, *Enforcement Networks*, 37 YALE J. ON REG. 274, 329 (2020); *see* SEC, ENFORCEMENT MANUAL, *supra* note 230, at 82-95.

[232] *Office of the Whistleblower*, SEC, https://www.sec.gov/whistleblower (last visited Sept. 20, 2020) [https://perma.cc/ZHK8-LLYP]; *see infra* Part IV.

[233] *See, e.g.*, SEC Regulation S-X, 17 C.F.R. § 210.1 (2020) (setting forth the disclosure requirements for financial statement information); SEC Regulation S-K, 17 C.F.R. § 229.10 (2020) (setting forth the disclosure requirements for non-financial statement information).

information that can be the basis for anti-fraud actions. Classic examples include Merck and Enron.[234]

Mandatory disclosures also sometimes provide additional grounds for liability. For example, corporate officers and directors must certify the accuracy of certain filings, providing an additional source of potential liability for these actors.[235]

Extensive public disclosure must be contrasted to the sparse information about private companies. Investors in private companies have a right to some information by contract or by the rules governing exemptions from securities registration.[236] And venture capital investors generally expect information rights and build them into an investors' rights agreement.[237]

However, other investors lack these rights, including employees and other minority shareholders.[238] Employees rely on the information mandated by the SEC's Rule 701.[239] However, related disclosures are limited and imperfectly aligned with what is useful to employees in this context.[240]

Moreover, even sophisticated investors may get limited information. For example, pre-IPO Uber reportedly stripped investors of information rights.[241] The governance dynamics within the startup may also limit the ability of private investors to get information.[242]

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[234] *See, e.g.*, Complaint at 5, SEC v. Fastow, No. H-02-3666 (S.D. Tex. Oct. 2, 2002) (making claims based on misrepresentations in the publicly available financial statements); Barbara Martinez, *Merck Books Co-Payments to Pharmacies as Revenue*, WALL ST. J., (June 21, 2002, 12:45 PM ET), https://www.wsj.com/articles/SB1024612521141814600 [https://perma.cc/FNW2-538D] (basing reporting on Merck's own mandatory disclosures).

[235] *See* 17 C.F.R. § 240.13a-14 (2020).

[236] *See* Fan, *supra* note 75, at 585.

[237] *Id.*

[238] *Id.* (noting that stockholders and interested parties other than venture capital investors "typically do not have rights to such information. In particular, minority investors and other stockholders, such as employees or former employees who have exercised stock options, have limited or no rights to obtain financial information and other information relevant to making an investment decision").

[239] *See* U.S. Sec. and Exch. Comm'n Rule 701, 17 C.F.R. § 230.701 (2020) (Exemption for Offers and Sales of Securities Pursuant to Certain Compensatory Benefit Plans and Contracts Relating to Compensation).

[240] Anat Alon-Beck, *Unicorn Stock Options — Golden Goose Or Trojan Horse?*, 2019 COLUM. BUS. L. REV. 107, 183 (advocating new mandatory disclosure aimed at employees); Aran, *supra* note 148, at 873, 954-55 (arguing for disclosure to employees targeted at valuation).

[241] ISAAC, *supra* note 54, at 96 (noting that Uber stripped some private investors of information rights).

[242] Pollman, *Startup Governance*, *supra* note 103, at 160.

Minimal information is publicly available about private U.S. companies. The forms for private placements are filed with the SEC, but contain limited information. The Form D that Theranos filed in July 2010 provides an example.[243] The six-page document indicates that Theranos was incorporated in Delaware "Over Five Years Ago" and had once been called "RealTime Cures, Inc." It includes the address, corporate role and identity of Elizabeth Holmes and other directors, and identifies Theranos as a company within the biotechnology industry. In response to a section on "Issuer Size" that referred to revenue range, the company checked the box labelled "Decline to Disclose." Other than that, information in the Form D is limited to the claimed exemption from a public offering, types of securities, and offering or sale amounts ($100 million).

One might cobble together information from Form D and the state-law articles or certificate of incorporation, which is publicly available from the state of incorporation.[244] However, both of these documents provide very little detail.

The decrease in mandatory disclosure affects the intended beneficiary: investors. But disclosure also has a much broader audience, including regulators, investigative journalists, and others. If the lack of mandatory disclosure affects the media as well, it may in turn limit information available for anti-fraud actions, given the SEC's reliance at times on media reports as an information source.[245] The consequences are thus broadly felt; the loss of disclosure has a ripple effect.

2. No Market, No Price

Private companies are missing the pricing and information function of an efficient market. The assumption that price reflects public information underlies both economic theories and securities regulation. SEC Chair Jay Clayton summed it up this way: "public company stock prices . . . reflect not only publicly reported information but also the

[243] Theranos Inc., Form D, *supra* note 96.

[244] Fan does this for five unicorns in *Regulating Unicorns: Disclosure and the New Private Economy*, but notes the "dearth of information." Fan, *supra* note 75, at 611-37.

[245] *See How Investigations Work*, *supra* note 230; *see also* Connie Loizos, *The SEC Has Never Been Busier Investigating Both Private and Public Companies in the Bay Area, Suggests Agency Head*, TECHCRUNCH (Sept. 6, 2018, 12:50 PM PDT), https://techcrunch.com/2018/09/06/the-sec-has-never-been-busier-investigating-both-private-and-public-companies-in-the-bay-area-suggests-agency-head/ [https://perma.cc/27BE-379L] (noting that the SEC San Francisco enforcement head "talked about how much of the agency's tips come through media accounts (the WSJ famously blew the covers off what had gone so wrong at Theranos)").

views of professional investors," benefitting, in his view, "Main Street investors."[246]

Lack of price has consequences for securities enforcement. The SEC has described its own investigations as sometimes triggered by information about a potential violation from "market surveillance activities," and have pointed to the role of trading data and brokerage records in factual development.[247] Increasing attention is being paid to the growth of *private* securities markets, and some of the SEC enforcement actions described above involved shares sold in such a market.[248] Nonetheless, market surveillance tools and other tracking of market price is generally absent in the private context.[249]

Finally, one of the consequences is the loss of any information generated by short selling. Short sellers have a built-in incentive not only to discover negative information about a company, but also to make the information public so that the short seller can benefit from a resulting decline in stock price.[250] This incentive relies on the existence of a share price and the ability of the price to reflect available information — neither of which is available in the context of the private company.

3. No Securities Class Actions

In the U.S. system, private and public enforcement of securities laws go hand in hand. But the move to private capital, even in the large companies with dispersed and retail shareholders that are of most regulatory concern, limits the ability of investors to bring anti-fraud suits as a class.

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[246] Clayton, *Testimony*, *supra* note 67.

[247] *How Investigations Work*, *supra* note 230. *See generally* KIRKPATRICK & LOCKHART PRESTON GATES ELLIS LLP, ENFORCEMENT MANUAL *supra* note 230 (discussing SEC enforcement investigations); SEC, ENFORCEMENT MANUAL *supra* note 230, at 82-95 (same).

[248] *See supra* notes 138–42 and accompanying text (describing the SEC's action against Jumio's officers).

[249] *See generally* Todd Ehret, *SEC's Advanced Data Analytics Helps Detect Even the Smallest Illicit Market Activity*, REUTERS (June 30, 2017, 10:11 AM), https://www.reuters.com/article/bc-finreg-data-analytics/secs-advanced-data-analytics-helps-detect-even-the-smallest-illicit-market-activity-idUSKBN19L28C [https://perma.cc/3W8K-DG6J] (describing the use of data analytics to surveil the stock market for insider trading).

[250] Barbara A. Bliss, Peter Molk & Frank Partnoy, *Negative Activism*, 97 WASH. U. L. REV. 1333, 1379 (2020) (defining "informational negative activism" and describing how it "decreases stock prices by revealing *bad* information about a company").

The information benefits from private securities litigation are deeply contested, as are the benefits of shareholder litigation overall. The hampering of private litigation may be a feature of growing privatization for some observers. Or it may be part of the explanatory story for the decline of public companies; reducing litigation risk may be part of the motivation to go or stay private.[251] For the purposes of this Article, however, the main point is simply that the market shift curtails this category of litigation and reduces the information — if any — that it generates.

Securities class actions that enforce federal anti-fraud provisions are very difficult in the private company context. One practical effect is that stock-drop suits are not possible (perhaps for the best). Despite the development of some private secondary trading markets, there is no equivalent to a publicly visible fall in price. Information must emerge through other means.

The absence of price information in an efficient market affects the availability of securities class actions, the key category of securities litigation. One element of a private plaintiff's claim for a misrepresentation or omission is that the investor relied on the statement/omission.[252] If each plaintiff had to show reliance, a class action would be impossible because the facts would be too particular and various to satisfy the requirements for certifying a class.[253]

The "fraud on the market" presumption enables securities class actions by requiring only reliance on the price, which is assumed to impound public information, including the misrepresentation/omission.[254] An important prerequisite is that the securities be traded in an efficient market.[255] Which brings us back to one reason that anti-fraud class actions are more difficult — perhaps near impossible — in the context of a private company. These are not traded in an efficient

[251] Eric L. Talley, *Public Ownership, Firm Governance, and Litigation Risk*, 76. U. CHI. L. REV. 335, 336 (noting the litigation risk rationale for going private).

[252] Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258, 263 (2014).

[253] FED. R. CIV. P. 23 (requiring commonality); *see Halliburton*, 573 U.S. at 266 (noting that if the "fraud on the market" presumption of reliance were overruled, each securities fraud plaintiff would be required "to prove that he actually relied on the defendant's misrepresentation in deciding to buy or sell a company's stock").

[254] Basic Inc. v. Levinson, 485 U.S. 224, 245 (1988).

[255] *Halliburton*, 573 U.S. at 268 ("[A] plaintiff must make the following showings to demonstrate that the presumption of reliance applies in a given case: (1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed.").

market, so each plaintiff should have to show reliance, preventing them from suing as a class.[256]

The fate of a putative shareholder class action against Theranos is illustrative. Theranos was sued in federal court for alleged securities fraud under California law.[257] In denying class certification, the federal court concluded:

> Rather than purchasing stocks traded at high weekly volumes in well-established, fluid markets monitored by market makers and arbitrageurs, Plaintiffs were private investors using private channels to purchase Theranos shares in discrete offerings. Thus, the Court firmly agrees with Defendants that the fraud-on-the-market presumption of reliance cannot apply here, because Theranos securities were not sold in an efficient market.[258]

The absence of an efficient market thus limits securities class actions. However, it is not to say that there are no investor actions at all against private companies.[259] Investor class actions might be based on state law with a different reliance requirement or a different legal theory.[260] And the difficulties in getting a class certified do not affect individual (or small-group) investor suits, regardless of whether they allege violations of the federal securities statutes or other laws.

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[256] Kevin LaCroix, *Though a Private Company, Uber Hit with Securities Class Action Lawsuit*, D&O DIARY (Sept. 26, 2017), https://www.dandodiary.com/2017/09/articles/securities-litigation/though-private-company-uber-hit-securities-class-action????-lawsuit/ [https://perma.cc/4DD8-ZFRD]; *see* Alison Frankel, *Uber Is a Private Company. How Can Investors Bring a Securities Class Action?*, REUTERS (Sept. 27, 2017, 12:50 PM), https://www.reuters.com/article/otc-uber-frankel/uber-is-a-private-company-how-can-investors-bring-a-securities-class-action-idUSKCN1C22UT [https://perma.cc/3RSH-GRSJ]

[257] Complaint at 48-49, Colman v. Theranos, Inc., No. 5:16-cv-06822 (N.D. Cal. Nov. 28, 2016) (bringing a class action on behalf of investors in Theranos). One of the counts was violation of the California Corporations Code, sections 25400(d) and 25500, which make material misstatements and omissions when offering securities unlawful. CAL. CORP. CODE § 25400(d) (2020); *id.* § 25500 (2020) (making liable a person who willfully participates in any act or transaction in violation of Section 25400).

[258] Colman v. Theranos, Inc., 325 F.R.D. 629, 647 (N.D. Cal. 2018). Pre-IPO Uber was also subject to a similar suit. *See* Complaint, Irving Firemen's Relief & Retirement Fund v. Uber Technologies Inc., No. 17-cv-05558 (N.D. Cal. Sept. 26, 2017) [hereinafter Complaint, Uber].

[259] *See generally* David H. Webber, *Shareholder Litigation Without Class Actions*, 57 ARIZ. L. REV. 201 (2015) (projecting what shareholder litigation would consist of without class actions, and suggesting that large institutions would still have positive-value claims).

[260] *See, e.g.*, Complaint, Uber, *supra* note 258 (making state-law allegations in an investor class action).

Theranos provides an example of individual/small group shareholder action. A hedge fund investor sued Theranos, Holmes, and Balwani in Delaware Chancery Court for making misrepresentations when soliciting its investment.[261] Using the basic facts about Theranos's "repeated lies, misrepresentations, misleading statements, and failures to disclose material information," the complaint alleged state common law fraud and contract claims,[262] as well as violations of California[263] and Delaware statutes.[264]

Pre-IPO Uber (private) provides another example. Investors sued the company for state corporate law claims that amounted to allegations that the company and its officers made misrepresentations when seeking investment in the private company.[265]

One can certainly debate the extent to which private securities litigation forces information to become available. At the very least, however, the move towards private companies cuts off the possibility of investor litigation in a major category of cases.

IV. Incentivizing Information About Private Company Fraud

The information gap between public and private companies means that it is important to pay attention to, and even cultivate, the information sources that continue to be available when companies are private. Informational substitutes are needed in this world where the companies being policed are not public companies and are not subject to disclosure requirements or trading in a public market.

This final Part puts forward one prescription to address the loss of information needed for detection and anti-fraud enforcement. The

261 Complaint at 2, Partner Investments, L.P. v. Theranos, Inc., No. 12816-VCL (Del. Ch. Ct. Apr. 6, 2016); Christopher Weaver, *Major Investor Sues Theranos*, WALL ST. J. (Oct. 10, 2016, 6:46 PM ET), https://www.wsj.com/articles/major-investor-sues-theranos-1476139613 [https://perma.cc/233V-66N8] (reporting that a "[h]edge fund accuses embattled company of a 'series of lies' to attract investment of nearly $100 million").

262 Complaint, *supra* note 261, at 52, 54, 57, 58, 62, 64 (alleging "Fraudulent Misrepresentation and Inducement," "Fraudulent Concealment," "Equitable Fraud," "Negligent Misrepresentation," "Contractual Indemnification," and "Breach of the Implied Covenant of Good Faith and Fair Dealing").

263 *Id.* at 55, 56, 61 (alleging Securities Fraud in Violation of Cal. Corp. Code §§ 25401, 25501, 25400(d), and 25500; and violation of California's Unfair Competition Law, Cal. Bus. & Prof. Code § 17200 et seq.).

264 *Id.* at 59, 60 (alleging violation of Delaware's Consumer Fraud Act, 6 Del. C. § 2511 et seq. and Deceptive Trade Practices Act, 6 Del. C. § 2531 et seq.).

265 Complaint at 2, Benchmark Capital Partners VII, L.P. v. Travis Kalanick, No. 2017-0575 (Del. Ch. Ct. Aug. 10, 2017).

proposal can be effectuated even without any change to disclosure that would pull more U.S. companies, public and private, into a mandatory disclosure regime,[266] although these types of approaches are not mutually exclusive. The attention to whistleblowers also has some advantages over an approach targeted only at one investor type, such as enhanced disclosure to startup employees,[267] particularly as retail investors are increasingly invited into private markets.[268] But incentivizing whistleblowers is not a panacea.[269] It is instead a pragmatic tool aimed particularly at the loss of information. More broadly, it is also an illustration of the type of reexamination of existing structures and tools needed in an increasingly private market.

This Part identifies the differences in how the securities laws governing whistleblowers treat private and public companies. It then outlines some of the aspects of a whistleblower regime that would need to be adapted to the private company context. It concludes with the mechanisms for making these changes, including ways in which the SEC's enforcement decisions described in this Article affect the incentives of whistleblowers and their lawyers.

Under current law, securities fraud whistleblowers are treated differently depending on whether they are employees of a public or a private company.[270] Given a decline in the number and percentage of U.S. public companies, and the presence of companies structured in a way that traditionally triggers investor-protection concerns, this Part examines extending the securities law whistleblower protections and incentives to private company fraud.

That whistleblowers are important to uncovering private company fraud is illustrated by the Theranos story, which is partly a story about

266 *See* Fan, *supra* note 75, at 586; Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules that Require Firms to Make Periodic Disclosures*, 88 IND. L.J. 151, 151 (2013); Jones, *supra* note 25, at 182 (discussing this literature); *see also* Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499, 503 (2020) (proposing expanding mandatory disclosure with stakeholders, rather than shareholders, as the intended beneficiary).

267 *See* U.S. Sec. and Exch. Comm'n Rule 701, 17 C.F.R. § 230.701 (2020); Alon-Beck, *supra* note 240, at 183-84. *See generally* Aran, *supra* note 148 (advocating for changes to the disclosures that startup companies make to their employees).

268 *See supra* notes 65–73 and accompanying text.

269 *See generally* Miriam H. Baer, *Reconceptualizing the Whistleblower's Dilemma*, 50 UC DAVIS L. REV. 2215 (2017) (noting the small number of successful SEC whistleblower tips in comparison to the total volume of tips).

270 *See* Chelsea Hunt Overhuls, *Unfinished Business: Dodd-Frank's Whistleblower Anti-Retaliation Protections Fall Short for Private Companies and Their Employees*, 6 J. BUS. ENTREPRENEURSHIP & L. 1, 13 (2012).

whistleblowers.[271] The head of SEC enforcement in San Francisco later described the two-year investigation of Theranos, emphasizing two information sources: investigative reporting and the SEC's whistleblower program.[272]

Most famous among the Theranos whistleblowers was Tyler Shultz. Tyler Shultz worked at Theranos as part of the immunoassay team.[273] Shultz's grandfather was former Secretary of State George Shultz, who was also on the Theranos board of directors.[274] When later interviewed for FRAUD MAGAZINE (maybe more aptly called "Anti-Fraud Magazine"), Tyler Shultz commented on whistleblowing to the SEC and other government agencies.[275] He said: "One thing I learned far too late was that any information you bring to the SEC or to the government is protected. Theranos couldn't even threaten to sue me for something I told to the United States government."[276] His story is about the potential for whistleblowers in the private context — after all, eventually Tyler Shultz and others emerged. But it is also a cautionary tale about delay, given the length of time and amount of damage caused before the information about Theranos and its medical device came out.

The differing treatment of private and public company employees results from the overlay of statutory provisions protecting and incentivizing securities fraud whistleblowers. These provisions were

[271] *See* John Carreyrou, *Theranos Whistleblower Shook the Company — and His Family*, WALL ST. J., https://www.wsj.com/articles/theranos-whistleblower-shook-the-companyand-his-family-1479335963 (last updated Nov. 18, 2016, 11:17 AM ET) [https://perma.cc/EKJ2-X8B2].

[272] Loizos, *supra* note 245.

[273] CARREYROU, *supra* note 8, at 184-85.

[274] Parloff, *A Singular Board*, *supra* note 10. Other Theranos employees reached out as well. Alan Beam, the Theranos lab director, reportedly called a Washington, D.C. law firm known to represent whistleblowers, but was dissuaded when he could not speak directly and immediately to an attorney. CARREYROU, *supra* note 8, at 214.

[275] Emily Primeaux, *Whistleblower Helped Dismantle Biotech Juggernaut Theranos in His 'Zero-Strategy' Defense: An Interview with Tyler Shultz*, FRAUD MAG. (Sept./Oct. 2019), https://www.fraud-magazine.com/cover-article.aspx?id=4295006794 [https://perma.cc/E98B-GSQA].

[276] *Id.* ("It wasn't until I saw the word whistleblower literally written in the newspaper that I even thought about the word . . . . If I'd recognized that I was actually in a whistleblowing situation, I would have started documenting things. I would've contacted a lawyer who could tell me what I should document and what I could bring out of Theranos in a safe way. . . . The government protects people. I had no idea about that. I was just reacting to situations."). *See generally* Tyler Shultz, *Thicker Than Water: The Untold Story of the Theranos Whistleblower*, AUDIBLE (Aug. 4, 2020), https://www.audible.com/pd/Thicker-than-Water-Audiobook/B08DDCVRRC#:~:text=From%20the%20hero%20whistleblower%20of,running%20amok%20in%20Silicon%20Valley [https://perma.cc/M6SM-H9KU].

put into place in the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")[277] and the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[278] The differing treatment of private-company and public-company whistleblowers also results from the two Supreme Court opinions interpreting the scope of anti-retaliation provisions in the two acts.[279]

Sarbanes-Oxley was the main securities statute passed in the wake of Enron's dramatic collapse. Built into this statute was whistleblower protection against retaliation against employees who provide "evidence of fraud" to a list of entities. This list includes the SEC, but also includes supervisors inside the company (internal reporting).[280] Section 806 of Sarbanes-Oxley was headed "Whistleblower Protection for Employees of Publicly Traded Companies." The key phrase for the purposes of this Article is "publicly traded." The text of the statute prohibits public companies[281] from retaliating against whistleblowing employees.

In 2014, the Supreme Court addressed the reach of this provision in *Lawson v. FMR LLC*.[282] The majority determined that whistleblower protections under Sarbanes-Oxley reach employees of public companies, but also protect employees of contractors and agents of publicly traded companies from retaliation from their (private) employers.[283] One motivating concern was that companies could too easily work around whistleblower protections by structuring the firm with a mix of private and public entities.[284]

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277 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

278 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

279 Dig. Realty Tr., Inc. v. Somers, 138 S. Ct. 767, 771 (2018) (interpreting Dodd-Frank's definition of whistleblowers); Lawson v. FMR LLC, 571 U.S. 429, 465 (2014) (interpreting the scope of Sarbanes-Oxley whistleblower protection).

280 18 U.S.C. § 1514A(a)(1) (2018); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 806, 116 Stat 745, 802-804.

281 18 U.S.C. § 1514A(a)(1) (the statute reaches retaliation by companies "with a class of securities registered under (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d))"). Although the lines between public and private companies are not necessarily straightforward, see *supra* Part I.A., this is one working definition of a public company. *See, e.g.*, *Lawson*, 571 U.S. at 461 n.1 (Sotomayor, J., dissenting) (adopting this definition in her discussion of "public company").

282 *Lawson*, 571 U.S. 429.

283 *Id.* at 430.

284 *Id.* at 434. The majority also rooted the interpretation in the concerns raised by Enron's collapse, particularly as they were reflected in the congressional response. *Id.*

In the facts of *Lawson*, the public company at issue had no employees at all: it was a mutual fund.[285] Only the private mutual fund advisor (the employer of the whistleblower) had employees.[286] Given the fact that this structure was typical of the mutual fund industry, the majority reasoned that a decision not to extend whistleblower protection in this context would leave the whole industry without this source of information and monitoring.[287]

Section 806 of Sarbanes-Oxley (modified by Dodd-Frank) does, accordingly, reach some employees of private companies: when the employer is a contractor or agent of a public company, or a private subsidiary of a public company.[288] But all depend on a connection to a public company. Multiple courts have refused to extend whistleblower protections under Sarbanes-Oxley to whistleblowers who were unable to connect their whistleblowing to a public company.[289]

Employees of private companies outside of these categories do have an additional source of protection. Dodd-Frank made two significant changes to the statute governing securities fraud whistleblowers. First, it created a "bounty" system where whistleblowers could be given a

[285] *Id.* at 433 ("Plaintiffs below, petitioners here, are former employees of private companies that contract to advise or manage mutual funds. The mutual funds themselves are public companies that have no employees. Hence, if the whistle is to be blown on fraud detrimental to mutual fund investors, the whistleblowing employee must be on another company's payroll, most likely, the payroll of the mutual fund's investment adviser or manager.").

[286] *Id.*

[287] *Id.*

[288] Dodd-Frank extended whistleblower protection explicitly to subsidiaries of a public company. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929A, 124 Stat 1376, 1852 (2010) ("Protection for employees of subsidiaries and affiliates of publicly traded companies: Amends Section 806 of the Sarbanes-Oxley Act of 2002 to make clear that subsidiaries and affiliates of issuers may not retaliate against whistleblowers . . . .").

[289] Tellez v. OTG Interactive, LLC, No. 15 CV 8984, 2019 WL 2343202, at *3 (S.D.N.Y. Jun. 3, 2019); Baskett v. Autonomous Research LLP, No. 17-CV-9237, 2018 WL 4757962, at *8 (S.D.N.Y. Sept. 28, 2018) ("[T]he contractor provision does not apply where a public company has no involvement in the conduct Congress sought to curtail by passing SOX."); Reyher v. Grant Thornton, LLP, 262 F. Supp. 3d 209, 217 (E.D. Pa. 2017) (dismissing the claim that the employee of a private company was a whistleblower under Dodd-Frank § 922 and Sarbanes-Oxley § 1514A and noting that "[a] purported whistleblower employed by a private company cannot invoke the protections of section 1514A simply because her employer happens to contract with public companies on matters unrelated to the alleged whistleblowing"); Gibney v. Evolution Mktg. Research, LLC, 25 F. Supp. 3d 741, 748 (E.D. Pa. 2014) ("[T]he specific shareholder fraud contemplated by SOX is that in which a public company — either acting on its own or acting through its contractors — makes material misrepresentations about its financial picture in order to deceive its shareholders.").

percentage of the recovery from a fraud enforcement.[290] Second, it introduced a new anti-retaliation provision, built onto the Sarbanes-Oxley one.[291] Key for this Article is that Dodd-Frank does not include any language limiting covered employers to public companies: Dodd-Frank explicitly uses the term "employer" without definition and — unlike Sarbanes-Oxley — without qualification.[292]

In *Digital Realty Trust* in 2018, the Supreme Court limited Dodd-Frank's protections by requiring employees — of public or private companies — to report misconduct "externally" to the SEC.[293] The SEC has created some workarounds within the requirement's constraints,[294] but essentially the consequence is that private company whistleblowers must report to the SEC to benefit from Dodd-Frank's retaliation protections and bounty incentives.[295] Chart 2 below summarizes the patchwork of protections and incentives available to private company employees.

290 Dodd-Frank Wall Street Reform and Consumer Protection Act § 922 (codified at 15 U.S.C. § 78u-6(b) (2018)).

291 Section 922 prohibits an employer from discharging an employee in retaliation for that employee having engaged in certain types of protected whistleblowing activity. *Id.* § 922(h)(1)(A) (codified at 15 U.S.C. § 78u-6(h)(1)(A) (2018)).

292 15 U.S.C. § 78u-6(h)(1)(A) (2018); S. REP. No. 111–176, at 46 (2010).

293 Dig. Realty Tr., Inc. v. Somers, 138 S. Ct. 767, 780 (2018).

294 17 C.F.R. § 240.21F-4(c)(3) (b)(7) (2011) (implementing reporting rules that allow some reporting to other entities as long as the report to the SEC is within 120 days of that initial information); Order Determining Whistleblower Award Claim, Exchange Act Release No. 85936, 2019 WL 2252911 (May 24, 2019) (making a whistleblower award to a whistleblower who reported internally, triggering self-reporting by the company to the SEC and an internal investigation that was provided to the SEC).

295 A 2019 opinion granting summary judgment on whistleblower retaliation claims provides an example. *See, e.g.*, Tellez v. OTG Interactive, LLC, No. 15-CV-8984, 2019 WL 10837668 (S.D.N.Y. Jun. 3, 2019) (noting employees of a private company claimed protection under Sarbanes-Oxley and Dodd-Frank, but the court reasoned that the private company did not fit into any of *Larson*'s definitions for contractors with public companies); *id.* at 3-4. The whistleblower did not qualify for protection under Dodd-Frank because he had not reported externally to the SEC. *Id.* at 4 (citing *Digital Realty*).

Chart 2. Whistleblower Protections and Incentives

Company Type		**Reported internally only**	**Reported to the SEC**
Public company		SOX*	SOX and/or Dodd-Frank
Private company	Contractor or agent of public company (*Lawson* re SOX 806)	SOX*	SOX and/or Dodd-Frank
	Subsidiary of public company (Dodd-Frank re SOX 806)	SOX*	SOX and/or Dodd-Frank
	Unconnected to public company	Nothing	Dodd-Frank

* Dodd-Frank indirectly through SOX incorporation[296]

This discussion has so far focused on treating private company whistleblowers consistently with public company whistleblowers. But the private company context certainly differs from that of a public company, and efforts to implement effective whistleblower protections would have to address these differences. Below are highlighted three aspects of structuring whistleblowing that would need attention: (1) identifying the covered private companies, (2) defining reporting requirements, and (3) pricing of awards.

Of particular policy concern are the large "public-like" companies that include unicorns and that raise some of the regulatory concerns that public companies do. To target this population of private companies, any statutory change could simply identify a size cut off for private company employers.[297] Size could be measured by number of investors and total assets, as in Exchange Act 12(g),[298] but the

296 Dodd-Frank lists the types of disclosures that the retaliation provision reaches, cross-referencing Sarbanes-Oxley: "disclosures that are required or protected under the Sarbanes-Oxley Act of 2002." 15 U.S.C. § 78u-6(h)(1)(A)(iii).

297 This limitation would also address a concern that Justice Sotomayor raised in *Lawson* that these whistleblowing rules would reach traditionally private relationships. She gave the example of "a babysitter [who could] bring a federal case against his employer — a parent who happens to work at the local Walmart (a public company) — if the parent stops employing the babysitter after he expresses concern that the parent's teenage son may have participated in an Internet purchase fraud." Lawson v. FMR LLC, 571 U.S. 429, 462 (2014) (Sotomayor, J., dissenting).

298 *See* 15 U.S.C. § 78l(g) (2018) (triggering reporting status when a company has a minimum number of investors (for non-financial issuers the limit is 2,000 persons or 500 persons who are not accredited investors) and a minimum level of total assets ($10 million)).

assessment of firm size might also include the number of employees, particularly given the concern with protection of investor-employees.[299]

Even without formal limitation in statutes or rules, however, some practical aspects of whistleblowing suggest that this population of private companies would tend to be the target, at least to the extent to which larger companies have more employees and larger amounts at stake.[300] According to whistleblower lawyers, the agency pursues actions that involve large amounts, which may be more likely in these larger companies.[301] Anonymity is also an important consideration for whistleblowers.[302] The SEC whistleblower program is somewhat unusual in that whistleblowers are able to report anonymously.[303] Whistleblowers are likely to find anonymity more difficult to maintain in companies with fewer employees, so may encounter reputational and employment deterrents more intensely in smaller companies. In short, SEC whistleblowing in private companies may be most incentivized in larger private companies because of the choices of various gatekeepers and other actors.

The reporting requirements might also play out differently in the private context. The current requirement that employees report externally to the SEC may have particular impact on private companies and private company employees. The SEC is more obviously a primary regulator of the conduct of public companies, given reporting and compliance requirements as well as, in some cases, trading of company stock on an exchange. The SEC may have less salience, however, for employees of private companies because of fewer contact points with

299 *See supra* notes 147–48 and accompanying text.

300 Cable, *supra* note 147, at 636 (noting in a section titled "Employee #5,000" that "mature startups of today appear to have more employees than the iconic startups of the dot-com era").

301 *See, e.g.*, STEPHEN MARTIN KOHN, THE NEW WHISTLEBLOWER'S HANDBOOK: A STEP-BY-STEP GUIDE TO DOING WHAT'S RIGHT AND PROTECTING YOURSELF (3d ed. 2017).

302 *Id.* at 105 (noting that anonymity "benefits the employee who fears retaliation" and reduces the risk that the "government will inadvertently disclose the identity of the whistleblower to their bosses"); LABATON SUCHAROW, REPORTING WITHOUT REGRETS: THE SEC WHISTLEBLOWER HANDBOOK 3 (2019), https://www.secwhistlebloweradvocate.com/pdf/SEC_Whistleblower_Program_Handbook.pdf [https://perma.cc/T4EV-E8EW] ("The ability to report possible misconduct anonymously is one of the most important pillars of the SEC Whistleblower Program . . . . The ability to report possible misconduct anonymously is the best protection against potential retaliation and blacklisting.").

303 17 C.F.R. § 240.21F-7(b) (2020); KOHN, *supra* note 301, at 105 (noting that Dodd-Frank allows anonymous whistleblowing and that this "new feature" was "unique in American whistleblowing law"). The whistleblower can remain anonymous until the award process, when the SEC needs the identity to confirm eligibility, but even then the name is kept confidential. *Id.*

the regulator. As a consequence, even private company employees who report externally might be more inclined to report to other regulators, such as local, state, or industry-specific regulators (e.g., insurance in the case of Zenefits).[304] Accordingly, one aspect of incentivizing private company whistleblowing would be to expand the external options for reporting.

Under current law, Dodd-Frank whistleblowers must report to the SEC rather than to other regulators to receive the protections and incentives provided by the statute, but SEC rules modify this slightly within the constraints. A whistleblower who reports to the SEC within 120 days after initially reporting to "Congress, any other authority of the Federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board" counts as having submitted information to the Commission on the same initial date.[305] Not all of the entities on this list are relevant for private companies (including, for example, SROs and the PCAOB). Nonetheless, the SEC Rule models the possibility of expanding what counts as external reporting. It also seems to acknowledge that whistleblowers may not know to go directly to the SEC. Indeed, lack of awareness should not be a surprise given statements like Tyler Shultz's that "It wasn't until I saw the word whistleblower literally written in the newspaper that I even thought about the word."[306]

Awarding and protecting whistleblowers who report internally would also address concerns about reporting in the private company context. There is some evidence of support for reinstating internal reporting, including proposed bipartisan legislation: the "Whistleblower Programs Improvement Act."[307] The Act would extend whistleblower protections to internal reporting, undoing the Supreme Court's 2018 decision in *Digital Realty Trust*.[308] The drafting and discussion would have to

[304] Thank you to Renee Jones for this observation.

[305] 17 C.F.R. § 240.21F-4(b)(7).

[306] Primeaux, *supra* note 275.

[307] *See generally* Whistleblower Programs Improvement Act, S. 2529, 116th Cong. § 2 (2019) (indicating the support for internal reporting). For an example of the argument that companies would prefer internal reporting, see Henry Cutter, *Whistleblower Ruling Adds a Risk for Companies*, DOW JONES INSTITUTIONAL NEWS (2018) (reporting the concern that requiring external reporting hurts companies by undermining their compliance functions).

[308] Whistleblower Programs Improvement Act, *supra* note 307; *see also* Whistleblower Protection Reform Act of 2019, H.R. 2515, 116th Cong. (2019) (bill enacted by the House in July 2019).

wrestle with equalizing protections for private and public employees,[309] but the rationale developed here provides additional support for legislative change that would reinstate internal reporting.

Determining awards for private company whistleblowers would have to respond to differences in the connection between employees and their companies. In the private context, particularly for startups, compensation is linked to company valuation and exit plans through stock option awards.[310] Stock options are also used in public companies[311] and reach some categories of employees who, according to whistleblower attorneys, are within their client base.[312] This kind of compensation, however, is certainly less central to the pay structure and culture of public companies than it is to private startups. A larger proportion of compensation and wealth for private company employees comes in the form of illiquid equity awards,[313] potentially creating disincentives to identify any negative information about the employer. Whistleblower awards to private company whistleblowers would accordingly have to be designed and priced in a way that addresses these potential disincentives.

Whistleblowing always has downsides for the whistleblower, and social and reputational constraints may influence the possibility of

309 The Whistleblower Protection Reform Act of 2019 (H.R. 2515) would expand protections to whistleblowers who provide information to supervisors at the employer (internal reporting), but limit "employer" to "an entity registered with or required to be registered with the Commission, a self-regulatory organization, or a State securities commission or office performing like functions." Whistleblower Protection Reform Act of 2019, *supra* note 308. *See* Jason Zuckerman & Matthew Stock, *Senators Introduce Bipartisan Legislation Strengthening Corporate Whistleblower Protections and Improving the SEC and CFTC Whistleblower Programs*, WHISTLEBLOWER PROTECTION LAW & SEC WHISTLEBLOWER AWARDS BLOG, https://www.zuckermanlaw.com/whistleblower_programs_improvement_act/ (last updated Sept. 24, 2019) [https://perma.cc/ZQW7-54GC] (noting that the proposed language would include "employees of privately owned broker-dealers and investment advisers, and employees of hedge funds that are registered with the SEC").

310 *See* Aran, *supra* note 148, at 869; Matthew T. Bodie, *Aligning Incentives with Equity: Employee Stock Options and Rule 10b-5*, 88 IOWA L. REV. 539, 548 (2003); Cable, *supra* note 147, at 631.

311 Aran, *supra* note 148, at 869 n.2 (citing data from the National Center for Employee Ownership).

312 Some law firms that represent whistleblowers suggest that senior executives make up most of their clients. *See, e.g.*, SUCHAROW, *supra* note 302, at 3.

313 David F. Larcker, Brian Tayan & Edwards M. Watts, *Cashing It In: Private-Company Exchanges and Employee Stock Sales Prior to IPO,* ROCK CTR. FOR CORP. GOVERNANCE AT STAN. U. CLOSER LOOK SERIES (Sept. 12, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247877 [https://perma.cc/5B5Z-YP55].

whistleblowing.[314] This may be particularly true in the interwoven tech employment marketplace. However, some of the changes in the characteristics of private companies detailed above make incentivizing private company whistleblowers an increasingly promising approach. Private companies grow in valuation but also sometimes in size in other respects, including the numbers of employees.[315] As these companies are bigger, whistleblowing becomes more possible. Not only may anonymity be easier to maintain in this larger setting, but also early employees may feel more constrained than employees who are later hires.

Finally, plausible mechanisms exist for implementing changes to the laws governing private company whistleblowers. Whistleblower protections and incentives is an area in which lawmakers have signaled willingness to intervene, so statutory change may be a possible route.[316] The SEC has also engaged in rulemaking in this area, most recently to revise their treatment of large awards.[317]

Even under current law, however, the SEC has some power to incentivize private company whistleblowers through its enforcement and whistleblower award decisions. In fact, the discussions of private company whistleblowers and SEC enforcement activities against private companies are intertwined. Law firms and lawyers have become specialized in representing whistleblowers, and this specialized whistleblower bar is attuned to the SEC's practices and signals.[318] The

314 S. REP. NO. 111-176, at 111 (2010) ("[W]histleblowers often face the difficult choice between telling the truth and the risk of committing 'career suicide.'"); *see, e.g.*, *Whistleblower Representation*, CONSTANTINE CANNON, https://constantinecannon.com/practice/whistleblower/ (last visited Sept. 12, 2020) [https://perma.cc/3HG5-M9SA] (noting that "[w]histleblowing can be a stressful process stretching over many years").

315 Cable, *supra* note 147, at 636.

316 *See* Whistleblower Programs Improvement Act, S. 2529, 116th Cong. (2019); Whistleblower Protection Reform Act of 2019, H.R. 2515, 116th Cong. (2019).

317 Whistleblower Program Rules, Final Rule, Exchange Act of 1934 Release No. 34-89963, 2020 WL 5763381 (Sept. 23, 2020); Press Release, SEC, SEC Adds Clarity, Efficiency and Transparency to Its Successful Whistleblower Award Program (Sept. 23, 2020), https://www.sec.gov/news/press-release/2020-219 [https://perma.cc/96NW-2KFL] (asserting the SEC's discretion to adjust award amounts).

318 *See, e.g.*, ZUCKERMAN LAW, SEC WHISTLEBLOWER PROGRAM: TIPS FROM SEC WHISTLEBLOWER ATTORNEYS TO MAXIMIZE AN SEC WHISTLEBLOWER AWARD (2017), https://www.zuckermanlaw.com/wp-content/uploads/2017/05/SEC-Whistleblower-Program-Tips-from-SEC-Whistleblower-Attorneys-to-Maximize-an-SEC-Whistleblower-Award-1.pdf [https://perma.cc/4XW6-EPWB] (detailing tips from lawyers about maximizing whistleblower awards); *Whistleblower Insider Blog*, CONSTANTINE CANNON, https://constantinecannon.com/practice/whistleblower/blog/ (last visited Oct. 20, 2020) [https://perma.cc/YL35-WLYN] (providing news about whistleblowers and highlighting a team of experienced whistleblower lawyers); Lisa M. Noller, Pamela L. Johnston, Bryan B. House & Angelica L. Novick, *A Review of Recent Whistleblower Developments*,

dearth of SEC actions against large private companies to date[319] means that the SEC has not sent signals that would encourage the representation of private company employees. If the SEC decided that it made policy sense to incentivize private company whistleblowers, SEC enforcement could simply bring more actions and give whistleblower awards in this area, knowing that the specialized whistleblower bar and other lawyers are paying attention.

CONCLUSION

The shift of investment capital towards private companies in the U.S. is well established.[320] But legal analysis has not caught up with the profound consequences of the declining role of public companies in the U.S. economy. This Article explores one of the potential effects of the diminished public sphere for U.S. corporations: the loss of information needed to detect and punish fraud. It tracks the move from a robust public disclosure-based ecosystem with a range of regulatory tools, to a low-information regime where the principal regulatory tool is anti-fraud litigation and enforcement.

Much of the apparatus of U.S. securities law is designed to force disclosure when securities are offered publicly or force periodic disclosure for certain registered companies. But some large companies are not subject to either set of securities disclosure requirements. The key anti-fraud provisions of the securities laws do, however, apply broadly to all companies, whether private or public.

The Article examines the SEC's securities fraud enforcements against private companies, identifying information that led to the detection and punishment of fraud in the private company. In the context of the current trajectory towards an increasingly private marketplace, it advocates an extension of full whistleblower protections, in contrast to the current disparate treatment of employees of public and private companies. Ultimately, the Article argues that an anti-fraud-only regulatory regime needs enhanced information incentives to make up for the lack of information about private companies under the current regulatory system.

FOLEY & LARDNER LLP (Oct. 29, 2019), https://www.foley.com/en/insights/publications/2020/04/a-review-of-recent-whistleblower-developments [https://perma.cc/HHU4-5XE4] (reporting change in SEC whistleblower awards); *SEC Whistleblower Eligibility Calculator*, LABATON SUCHAROW, https://www.secwhistlebloweradvocate.com/eligibility-calculator/ (last visited Oct. 20, 2020) [https://perma.cc/T6RD-Q6FE] (providing among other information, an "Eligibility Calculator").

319 *See supra* Chart 1.

320 *See supra* Part I.B.

APPENDIX: SEC SECURITIES FRAUD ENFORCEMENT ACTIONS AGAINST PRIVATE COMPANIES, FY2016-FY2019[321]

This appendix lists SEC enforcement actions against private companies that include an allegation of securities fraud for SEC fiscal years 2016 through 2019 (Oct. 1, 2015 to Sept. 30, 2019). It does not include actions brought against individuals only. It includes actions that also allege registration violations although, as the Article points out, these raise different informational issues given that they should have become part of the public disclosure system.

Year Filed	**Case**	**Release No.**	**Securities Fraud 17(a) &/or 10(b)**	**Registration Violations 5(a) & 5(c)**
FY2016	SEC v. Ascenergy LLC, et al.	LR-23394	X	
FY2016	SEC v. William M. Apostelos, et al.	LR-23397	X	
FY2016	SEC v. EB5 Asset Manager, LLC, et al.	LR-23409	X	
FY2016	SEC v. Earl D. Miller, et al.	LR-23405	X	

[321] The actions were identified as follows. The underlying source was the SEC's reports of its enforcement actions in 2019 SEC ENFORCEMENT DIVISION ANN. REP., *supra* note 23; SEC, ANNUAL REPORT: DIVISION OF ENFORCEMENT (2018), https://www.sec.gov/files/enforcement-annual-report-2018.pdf [https://perma.cc/Z6TM-3PG2]; SEC, SELECT SEC AND MARKET DATA: FISCAL 2017, https://www.sec.gov/files/enforcement-annual-report-2017-addendum-061918.pdf [https://perma.cc/W2Z7-M5PY]; SEC, SELECT SEC AND MARKET DATA: FISCAL 2016, https://www.sec.gov/files/2017-03/secstats2016.pdf [https://perma.cc/7LBE-632P]. The enforcement actions listed in the SEC documents were manually reviewed, including review of the SEC's public release and the underlying complaint, if available.

These data were supplemented by manual review of enforcement actions identified through a search in the LexisSecuritiesMosaic SEC Enforcement database for SEC actions commenced against companies between Oct. 1, 2015 and Sept. 30, 2019. It was limited to actions that alleged violation of Exchange Act Section 10 and/or Securities Act Section 17, but that did not include registration violations. It was also supplemented by additional searches of SEC litigation releases, as well as law firm memos and other secondary sources.

The appendix excludes SEC actions against companies for securities fraud that allegedly occurred in the transition from private to public or vice versa. Actions against financial firms like investment advisors, broker-dealers, or transfer agents are excluded. This is consistent with other lists that break down the private company category. *See* ADVISEN, *supra* note 33. Accordingly, actions that the SEC categorized as Broker-Dealer and Investment Advisors/Investment Companies were excluded from review. Delinquent Filings and Follow-on Administrative Procedures were also excluded.

Because some of these actions involve multiple targets and multiple stages, the SEC may have issued several public releases. The listed release reports the action against the private company (if any) or the earliest within the set of releases.

Year Filed	Case	Release No.	Securities Fraud 17(a) &/or 10(b)	Registration Violations 5(a) & 5(c)
FY2016	SEC v. James A. Torchia, et al.	LR-23416	X	X
FY2016	SEC v. Robert Yang, et al.	LR-23414	X	
FY2016	SEC v. Homero Joshua Garza, et al.	LR-23415	X	X
FY2016	SEC v. Vu H. Le a/k/a Vinh H. Le, et al.	LR-23432	X	X
FY2016	SEC v. CAUSwave, Inc., et al.	LR-23435	X	X
FY2016	SEC v. Southern Cross Resources Group, Inc., et al.	LR-23436	X	X
FY2016	SEC v. Marquis Properties, LLC, et al.	LR-23451	X	X
FY2016	SEC v. Kenneth W. Crumbley, et al.	LR-23453	X	
FY2016	SEC v. Optimum Income Property, LLC, et al.	LR-23464	X	
FY2016	SEC v. Nathan Halsey, et al.	LR-23473	X	
FY2016	SEC v. BIC Real Estate Development Corporation, et al.	LR-23487	X	X
FY2016	SEC v. Daniel Rivera, et al.	LR-23506	X	
FY2016	SEC v. William E. Mapp, III, et al.	LR-23515	X	X
FY2016	SEC v. Ariel Quiros, et al.	LR-23520	X	
FY2016	SEC v. James R. Trolice, et al.	LR-23532	X	X
FY2016	SEC v. Christopher R. Esposito, et al.	LR-23545	X	X
FY2016	SEC v. Charles C. Liu, et al.	LR-23556	X	
FY2016	SEC v. Thomas J. Connerton, et al.	LR-23565	X	X
FY2016	SEC v. Andrew K. Proctor, et al.	LR-23568	X	X
FY2016	SEC v. Chris A. Faulkner, et. al.	LR-23582	X	X
FY2016	SEC v. Traffic Monsoon, LLC, et al.	LR-23604	X	X
FY2016	SEC v. Jeffery A. McCollum, et al.	LR-23603	X	
FY2016	SEC v. Matthew White, et al.	LR-23607	X	
FY2016	SEC v. Edwin Ruh, Jr., et al.	LR-23614	X	
FY2016	SEC v. Secured Income Reserve, Inc., et al.	LR-23626	X	
FY2016	SEC v. Enviro Board Corporation, et al.	LR-23628	X	X
FY2016	SEC v. Donald V. Watkins Sr., Esq., et al.	LR-23634	X	
FY2016	SEC v. Contrarian Press, LLC, et al.	LR-23636	X	

Year Filed	Case	Release No.	Securities Fraud 17(a) &/or 10(b)	Registration Violations 5(a) & 5(c)
FY2016	SEC v. Tycoon Energy, Inc., et al.	LR-23643	X	X
FY2016	In the Matter of Fusion Pharm, Inc.	33-10210	X	X
FY2016	In the Matter of Microcap Management LLC, et al.	33-10213	X	X
FY2016	SEC v. Aegis Oil, LLC, et al.	LR-23663	X	X
FY2017	SEC v. Joseph Meli, et al.	LR-23731	X	
FY2017	SEC v. Brian S. Hudnall, et al.	LR-23732	X	X
FY2017	SEC v. Darrell Glenn Hardaway, et al.	LR-23753	X	X
FY2017	SEC v. Lidingo Holdings, LLC, et al.	LR-23802	X	
FY2017	SEC v. CSIR Group, LLC, et al.	LR-23802	X	
FY2017	In the Matter of Michael A. McCarthy, et al.	33-10343	X	
FY2017	In the Matter of Edward Borrelli, et al.	33-10341	X	
FY2017	SEC v. 4D Circle, LLC, a/k/a Enoetics, LLC, et al.	LR-23806	X	
FY2017	SEC v. Matthew W. Fox, et al.	LR-23809	X	
FY2017	SEC v. Hadsell Chemical Processing, LLC, et al.	LR-23835	X	X
FY2017	SEC v. Renwick Haddow, et al.	LR-23870	X	
FY2017	SEC v. Petroforce Energy, LLC, et al.	LR-23884	X	X
FY2017	SEC v. John Anthony Giunti, et al.	LR-23887	X	
FY2017	SEC v. Cash Capital, LLC, et al.	LR-23890	X	X
FY2017	SEC v. Patrick S. Muraca, et al.	LR-23893	X	
FY2017	SEC v. 7S Oil & Gas, LLC, et al.	LR-23896	X	X
FY2017	SEC v. Hidalgo Mining Corp., et al.	LR-23903	X	X
FY2017	SEC v. Jay Belson, et al.	LR-23906	X	
FY2017	SEC v. Tennstar Energy, Inc., et al.	LR-23924	X	
FY2017	SEC v. Vergeous, LLC, et al.	LR-23909	X	X
FY2017	SEC v. Christopher A. Faulkner, et al.	LR-23979	X	
FY2017	SEC v. Ronald Van Den Heuvel, et al.	LR-23938	X	
FY2017	SEC v. Edward Chen, et al.	LR-23944	X	
FY2017	SEC v. Pedro Fort Berbel, et al.	2017-208	X	X
FY2017	SEC v. Accelera Innovations, Inc., et al.	LR-23969	X	X

Year Filed	Case	Release No.	Securities Fraud 17(a) &/or 10(b)	Registration Violations 5(a) & 5(c)
FY2017	SEC v. The Leonard Vincent Group, et al.	2017-182	X	
FY2017	SEC v. REcoin Group Foundation, LLC, et al.	2017-185	X	X
FY2018	In the Matter of Mergenet Medical, Inc., et al.	33-10426	X	
FY2018	In the Matter of YourPeople, Inc., dba Zenefits FTW Insurance Services, et al.	33-10429	X	
FY2018	SEC v. PlexCorps, et al.	LR-24079	X	X
FY2018	SEC v. Donald E. MacCord, Jr., et al.	LR-24001	X	
FY2018	SEC v. David S. Haddad, et al.	LR-24028	X	
FY2018	SEC v. Daniel B. Vazquez, Sr., et al.	LR-24031	X	
FY2018	SEC v. AriseBank, et al.	LR-24088	X	X
FY2018	In the Matter of Barry M. Skinner, et al.	33-10458	X	
FY2018	SEC v. Jersey Consulting, LLC, et al.	LR-24064	X	X
FY2018	SEC v. Steven Ventre, et al.	LR-24055	X	X
FY2018	SEC v. AmeraTex Energy, Inc., et al.	LR-24057	X	X
FY2018	SEC v. Americrude, Inc., et al.	LR-24068	X	X
FY2018	SEC v. Elizabeth Holmes, et al.	LR-24069	X	
FY2018	SEC v. Michael A. Liberty, et al.	LR-24092	X	X
FY2018	SEC v. Peter H. Pocklington, et al.	LR-24098	X	X
FY2018	SEC v. The Lifepay Group, LLC, et al.	LR-24107	X	X
FY2018	SEC v. Arthur Lamar Adams, et al.	LR-24129	X	
FY2018	SEC v. The Falls Event Center, LLC, et al.	LR-24139	X	
FY2018	SEC v. Brent Borland, et al.	LR-24147	X	
FY2018	SEC v. Titanium Blockchain Infrastructure Services, Inc., et al.	LR-24160	X	X
FY2018	SEC v. Isaac Grossman, et al.	LR-24162	X	
FY2018	SEC v. Paul Gilman, et al.	LR-24156	X	
FY2018	SEC v. Ralph T. Iannelli, et al.	LR-24158	X	
FY2018	SEC v. Texas Coastal Energy Company, LLC, et al.	LR-24169	X	X
FY2018	SEC v. Perry Santillo, et al.	LR-24172	X	

Year Filed	Case	Release No.	Securities Fraud 17(a) &/or 10(b)	Registration Violations 5(a) & 5(c)
FY2018	SEC v. The Owings Group, LLC, et al.	LR-24187	X	X
FY2018	SEC v. Moddha Interactive, Inc., et al.	LR-24199	X	
FY2018	SEC v. Edward A. Young, et al.	LR-24211	X	X
FY2018	SEC v. Daniel Rudden, et al.	LR-24216	X	
FY2018	SEC v. William Z. ("Billy") McFarland, et al.	LR-24213	X	X
FY2018	SEC v. Palm House Hotel, LLLP, et al.	LR-24224	X	
FY2018	In the Matter of Tomahawk Exploration, LLC, et al.	33-10530	X	X
FY2018	SEC v. Equitybuild, Inc., et al.	LR-24237	X	X
FY2018	SEC v. 1 Global Capital, LLC, et al.	LR-24249	X	X
FY2018	SEC v. Sandy J. Masselli Jr., et al.	LR-24248	X	
FY2018	SEC v. Kevin B. Merrill, et al.	2018-201	X	
FY2018	SEC v. James Thomas Bramlette, et al.	LR-24289	X	
FY2018	SEC v. NL Technology, LLC, et al.	LR-24293	X	X
FY2018	SEC v. Russell Craig, et al.	LR-24303	X	
FY2019	SEC v. Susan Werth, a/k/a Susan Worth, et al.	LR-24316	X	X
FY2019	SEC v. Eric J. "EJ" Dalius, et al.	LR-24345	X	X
FY2019	SEC v. Blockvest, LLC, et al.	LR-24314	X	X
FY2019	SEC v. Giga Entertainment Media, Inc., et al.	LR-24355	X	X
FY2019	SEC v. Robert Alexander, et al.	LR-24392	X	
FY2019	SEC v. Daniel R. Adams et al.	LR-24411	X	
FY2019	SEC v. Jeffrey E. Wall, et al.	LR-24443	X	X
FY2019	SEC v. Natural Diamonds Investment Co., et al.	LR-24473	X	X
FY2019	SEC v. Collector's Coffee et al.	LR-24469	X	
FY2019	SEC v. Henry Ford, f/k/a Cleothus Lefty Jackson, et al.	LR-24482	X	
FY2019	SEC v. Donald A. Milne, III, et al.	LR-24484	X	X
FY2019	SEC v. Alton Perkins, et al.	LR-24502	X	X
FY2019	SEC v. Equal Earth, Inc., et al.	LR-24504	X	X
FY2019	SEC v. Bettor Investments, LLC, et al.	LR-24547	X	X

Year Filed	Case	Release No.	Securities Fraud 17(a) &/or 10(b)	Registration Violations 5(a) & 5(c)
FY2019	SEC v. Crystal World Holdings, Inc., et al.	LR-24571	X	X
FY2019	SEC v. Terry Wayne Kelly, et al.	LR-24573	X	X
FY2019	SEC v. BitQyck, Inc., et al.	LR-24582	X	X
FY2019	SEC v. John F. Thomas, et al.	LR-24585	X	X
FY2019	SEC v. Northridge Holdings, Ltd., et al.	LR-24594	X	X
FY2019	SEC v. Jay Daniel Seinfeld, et al.	LR-24596A	X	
FY2019	SEC v. John Henderson, et al.	LR-24597	X	X
FY2019	SEC v. Zvi Feiner, et al.	LR-24605	X	
FY2019	SEC v. Mark Ray, et al.	LR-24627	X	X

Selected Videos of the Theranos Whistleblowers

Erika Cheung, *TedxBerkeley Speaking Truth to Power*, https://www.youtube.com/watch?v=Rb7Wb0KzMf4

Tyler Shultz, *In His Own Words: The Theranos Whistleblower*, Markkula Center for Applied Ethics, Santa Clara University, https://www.youtube.com/watch?v=9wf_2KYRPWQ

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Theranos Whistleblower Shook the Company—and His Family

By John Carreyrou

After working at Theranos Inc. for eight months, Tyler Shultz decided he had seen enough. On April 11, 2014, he emailed company founder Elizabeth Holmes to complain that Theranos had doctored research and ignored failed quality-control checks.

The reply was withering. Ms. Holmes forwarded the email to Theranos President Sunny Balwani, who belittled Mr. Shultz's grasp of basic mathematics and his knowledge of laboratory science, and then took a swipe at his relationship with George Shultz, the former secretary of state and a Theranos director.

"The only reason I have taken so much time away from work to address this personally is because you are Mr. Shultz's grandson," wrote Mr. Balwani to his employee in an email, a copy of which was reviewed by The Wall Street Journal.

Mr. Shultz quit the same day. As he was leaving Theranos's headquarters in Palo Alto, Calif., he says he got a frantic cellphone call from his mother, who told him Ms. Holmes had just called the elder Mr. Shultz to warn that his grandson would "lose" if he launched a vendetta against the blood-testing startup.

The only reason I have taken so much time away from work to address this personally is because you are Mr. Shultz's grandson.

— Theranos President Sunny Balwani to Tyler Shultz in a 2014 email

Tyler Shultz, now 26 years old, was among several Theranos employees who tried to voice concerns inside the company about what they saw as troubling practices, and Mr. Shultz was the first to blow the whistle to a state regulator. He says he wanted to expose the problems to protect the health of patients and his grandfather's reputation.

The elder Mr. Shultz, 95, was President Richard Nixon's Treasury and labor secretary, the first Office of Management and Budget director, and secretary of state for President Ronald Reagan, with whom he had a close relationship. In 1989, Mr. Reagan awarded Mr. Shultz the Medal of Freedom, the U.S.'s highest civilian honor.

Using an alias, Tyler Shultz contacted New York state's public-health lab and alleged Theranos had manipulated a process known as proficiency testing, relied on by federal and state regulators to monitor the accuracy of lab tests. That was the first known regulatory complaint about Theranos's lab practices. In early 2015, Mr. Shultz began speaking to a Journal reporter as a confidential source.

Elizabeth Holmes, Theranos's founder and chief executive, in September 2015.
PHOTO: DAVID ORRELL/GETTY IMAGES

Theranos accused him of leaking trade secrets and violating an agreement to not disclose confidential information. Mr. Shultz says lawyers from the law firm founded by David Boies, one of the country's best-known litigators and who later became a Theranos director, surprised him during a visit to his grandfather's house.

They unsuccessfully pressured the younger Mr. Shultz to say he had talked to the reporter and to reveal who the Journal's other sources might be. He says he also was followed by private investigators hired by Theranos.

The tension opened a rift in the Shultz family. While growing up, Tyler played in the pool at his grandfather's house, and he often dropped by the elder Mr. Shultz's home or his office at the Hoover Institution think tank while attending Stanford University.

In the past year and a half, the grandson and grandfather have rarely spoken or seen one another, communicating mainly through lawyers, says Tyler Shultz. He and his parents have spent more than $400,000 on legal fees, he says. He didn't attend his grandfather's 95th birthday celebration in December. Ms. Holmes did.

"Fraud is not a trade secret," says Mr. Shultz, who hoped his grandfather would cut ties with Theranos once the company's practices became known. "I refuse to allow bullying, intimidation and threat of legal action to take away my First Amendment right to speak out against wrongdoing."

Theranos and Ms. Holmes declined to comment for this article, and Mr. Balwani couldn't be reached. He left the company earlier this year.

Fraud is not a trade secret. I refuse to allow bullying, intimidation and threat of legal action to take away my First Amendment right to speak out against wrongdoing.

— Tyler Shultz about his ordeal after quitting his job at Theranos

The elder Mr. Shultz joined Theranos's board of directors in 2011. Former Secretary of State Henry Kissinger, former Secretary of Defense William Perry, and former Sen. Sam Nunn, all fellows with Mr. Shultz at the Hoover Institution, joined the Theranos board around the same time. They couldn't be reached for comment.

The unusually high-profile board gave Theranos an aura of power, connections and gravitas as it raised money from investors and developed the blood-testing devices Ms. Holmes touted as revolutionary.

After the Journal published in October 2015 its first article detailing problems at Theranos, the company announced that all four men had been moved from the board of directors to a newly formed board of counselors.

THE DOWNFALL OF THERANOS

Big Names Take Hit on Theranos (Nov. 28)

Under Fire, Theranos CEO Stifled Bad News (July 10)

Theranos Dealt Sharp Blow as Elizabeth Holmes Is Banned From Operating Labs (July 8)

Craving Growth, Walgreens Dismissed Its Doubts About Theranos (May 25)

Tyler Shultz is cooperating with an investigation of Theranos by federal prosecutors, according to people familiar with the matter. Theranos is the subject of criminal and civil investigations by the U.S. attorney's office in San Francisco and the Securities and Exchange Commission, which are trying to determine if the company misled investors and regulators about its technology and operations. Theranos has said it is cooperating.

Mr. Shultz's allegations that Theranos's proprietary Edison machines frequently failed quality-control checks and produced widely varying results were corroborated in inspection results released in March by the federal Centers for Medicare and Medicaid Services. In April, Theranos told regulators it had voided all test results from Edison machines for 2014 and 2015, as well as some other tests it ran on conventional machines.

Theranos is appealing sanctions proposed by regulators, including a ban on Ms. Holmes from the blood-testing industry for at least two years. Last month, the company shut down all its blood-testing facilities and said it would focus on developing products that could be sold to outside labs, hospitals and doctors' offices.

The younger Mr. Shultz and Ms. Holmes met in late 2011 while he was visiting his grandfather's house next to the Stanford campus. Tyler Shultz was a junior at Stanford majoring in mechanical engineering.

Former Secretary of State George Shultz at a Senate committee hearing in January 2015.
PHOTO: ANDREW HARRER/BLOOMBERG NEWS

He says he "fell in love with her vision" of instant and painless blood tests run on tiny samples of blood collected from fingertips. "I knew I had to be part of this," he recalls thinking.

Mr. Shultz interned at Theranos that summer and went to work there full-time in September 2013. He had just graduated after changing his major to biology to better prepare for a career at the startup, he says.

Theranos began offering blood tests to the public in late 2013. The company soon achieved a valuation of $9 billion from investors, with Ms. Holmes owning a majority stake. She also is chief executive of Theranos.

The new employee was assigned to the assay validation team, which was responsible for verifying and documenting the accuracy of blood tests run on Edison machines before they were deployed in the lab for use with patients.

Mr. Shultz says he found that results varied widely when tests were rerun with the same blood samples. To reduce that variability, Theranos routinely discarded outlying values from validation reports it compiled, he says.

One validation report about an Edison test to detect a sexually-transmitted infectious disease said the test was sensitive enough to detect the disease 95% of the time. But when Mr. Shultz looked at the two sets of experiments from which the report was compiled, they showed sensitivities of 65% and 80%.

That meant that if 100 people infected with the disease were tested only with the Edison device, as many as 35 of them would likely incorrectly conclude they were disease-free.

A few months later, Mr. Shultz moved to Theranos's production team, where he quantified by how much patient tests should be allowed to vary during daily quality-control checks. Under federal rules, labs are allowed to set those parameters on their own within the bounds of accepted industry guidelines.

He says he noticed Edison machines often flunked Theranos's quality-control standards. He says Mr. Balwani, the No. 2 executive at the company, pressured lab employees to ignore the failures and run blood tests on the machines anyway, contrary to accepted lab practices.

Mr. Shultz says he took his concerns directly to Ms. Holmes. When they met in early 2014, she encouraged him to talk to Daniel Young, a Theranos vice president in charge of biostatistics.

According to Mr. Shultz, Mr. Young said the differences with the sexually-transmitted infectious disease test occurred because some results fell inside an "equivocal zone," meaning they were unclear at first but clarified later through other methods.

Theranos wouldn't make Mr. Young available for comment, and he couldn't be independently reached.

Mr. Shultz wasn't satisfied. In March 2014, he anonymously emailed his complaint to New York officials who administered a proficiency-testing program in which Theranos was enrolled.

RELATED COVERAGE

- Walgreens Claims Theranos Voided 11.3% of Test Reports
- Walgreen Terminates Partnership With Theranos (June 13, 2016)
- Theranos Voids Two Years of Edison Blood-Test Results (May 18, 2016)
- Theranos Executive Sunny Balwani to Depart Amid Regulatory Probes (May 12, 2016)
- U.S. Health Regulators Release Lightly Redacted Theranos Letter, Inspection Report (Apr. 25, 2016)
- Hot Startup Theranos Has Struggled With Its Blood-Test Technology (Oct. 16, 2015)

The director of the lab's clinical-lab evaluation program replied that the practices sounded like "a form of PT cheating," using an abbreviation for proficiency testing. New York officials decline to comment.

After emailing Ms. Holmes in April 2014 about the allegedly doctored research and quality-control failures, Mr. Shultz heard nothing for several days.

Then Mr. Balwani's response arrived. It began: "We saw your email to Elizabeth.

Before I get into specifics, let me share with you that had this email come from anyone else in the company, I would have already held them accountable for the arrogant and patronizing tone and reckless comments."

Ms. Holmes never replied, says Mr. Shultz, who decided it was time to quit his job. He says his mom called while he was on his way out and implored: "Stop whatever you're about to do!"

Mr. Shultz says he was startled. He went directly to his grandfather's office. George Shultz had his assistant photocopy the email from Mr. Balwani and put it in an office safe but seemed skeptical of his grandson's story, says Tyler Shultz.

I am sorry if this email seems attacking in any way, I do not intend it to be, I just feel a responsibility to you to tell you what I see so we can work towards solutions.

— Tyler Shultz in an April 11, 2014, email to Theranos founder Elizabeth Holmes

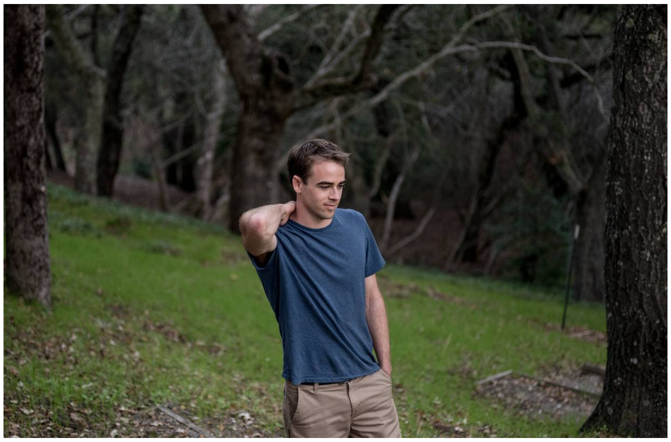
They agreed to talk again at Mr. Shultz's house that evening. Tyler Shultz brought along a Theranos colleague who shared his misgivings, he says, but it felt to him like his grandfather's allegiance to the company had grown.

As household staff served them dinner in the formal dining room, the elder Mr. Shultz said Ms. Holmes had told him Theranos's blood-testing devices worked so well that they were being used in medevac helicopters and hospital operating rooms, Tyler Shultz recalls. He and his colleague knew that wasn't true.

His grandfather urged them to move on with their lives. So Mr. Shultz did.

Seven months later, he and his parents showed up for Thanksgiving dinner at his grandfather's house. Ms. Holmes was there with her parents. Over turkey and stuffing, they discussed California's drought and the bulletproof windows on Theranos's new headquarters as if nothing had happened.

Mr. Shultz listened awkwardly as Ms. Holmes stood up and gave a toast expressing her appreciation for every member of the Shultz family, he says.



Tyler Shultz near his home in Los Altos Hills, Calif., earlier this month.
PHOTO: JASON HENRY FOR THE WALL STREET JOURNAL

In March 2015, Tyler Shultz was contacted by a Journal reporter through the professional network LinkedIn. He called the reporter several weeks later with a prepaid phone, reasoning it would be harder to track than a conventional mobile phone. They met at a Mountain View, Calif., beer garden in May 2015.

A few weeks later, Mr. Shultz was confronted by his father after arriving for dinner with his parents at their home in Los Gatos, Calif. His grandfather had called to say Theranos suspected he had talked to the Journal reporter. Theranos's lawyers wanted to meet with him the next day.

He says he called his grandfather and asked if they could meet without lawyers. The elder Mr. Shultz agreed and invited his grandson to his house. The mood was tense but cordial, Tyler Shultz recalls, and he denied talking to any reporters. He says his step-grandmother was present during the conversation.

We saw your email to Elizabeth. Before I get into specifics, let me share with you that had this email come from anyone else in the company, I would have already held them accountable for the arrogant and patronizing tone and reckless comments.

— Theranos President Sunny Balwani to Tyler Shultz in a 2014 email

His grandfather asked if he would sign a one-page confidentiality agreement to give Theranos peace of mind. According to Tyler Shultz, when he said yes, his grandfather revealed that two lawyers were waiting upstairs with the agreement.

Michael Brille and Meredith Dearborn, partners at the law firm Boies, Schiller & Flexner LLP, then came downstairs, says the younger Mr. Shultz. Mr. Brille said he was trying to identify the Journal's sources. He handed the young man a temporary restraining order, a notice to appear in court and a letter signed by Mr. Boies alleging the former employee had leaked Theranos trade secrets.

Tyler Shultz says his grandfather protested to the lawyers that this wasn't what he and Ms. Holmes had agreed to earlier, but that Mr. Brille kept pressing the younger Mr. Shultz to admit he had spoken to the Journal.

He wouldn't. "This conversation needs to end," the young man eventually declared. He says his grandparents ushered the two lawyers out of the house.

"My recollections of the events are very different than Tyler's," Mr. Brille says. "Our engagement with Tyler Shultz was at the invitation of his grandfather George. We engaged with Tyler in an effort to understand the extent to which he had disclosed trade secrets to third parties."

An assistant to George Shultz said he "does not agree with Mr. Brille's recollection."

Tyler Shultz says his grandfather called Ms. Holmes to complain about how his grandson was treated, and they reached a compromise. It called for Theranos to deliver the one-page confidentiality agreement the next morning so he could sign it. Ms. Holmes was asked to send a different lawyer.

The next day, though, Mr. Brille returned with a new document that contained another surprise, says the younger Mr. Shultz. The document was an affidavit stating that he had never spoken to the Journal or any third party about Theranos. It also said he would pledge to name every current and former employee he suspected of having done so.

His grandfather told his grandson to sign it if it was true he hadn't spoken to a reporter. The young man says he declined unless Theranos promised not to sue him.

With a pencil, the elder Mr. Shultz jotted a sentence at the bottom stating that Theranos wouldn't sue his grandson for two years. Tyler Shultz says he told his grandfather that he wanted the company to promise it would never sue him.

After the elder Mr. Shultz and Mr. Brille conferred in another room, the lawyer agreed to the grandson's condition, the younger Mr. Shultz says. By then, though, he had second thoughts and said he wanted his own lawyer.

His grandmother fished out a phone number for the elder Mr. Shultz's longtime lawyer and gave it to her grandson. That afternoon, Tyler Shultz met with his grandfather's lawyer and a partner at the same law firm and decided not to sign anything.

Mr. Brille warned that Theranos would have no choice but to sue Mr. Shultz, he recalls. He went home expecting to be summoned to court the next day. That night, though, Mr. Brille sent an email to the elder Mr. Shultz's lawyer saying the company was holding off to give both sides more time to negotiate.

With advice from a new lawyer, Tyler Shultz began settlement talks with

Theranos but couldn't persuade himself to accept the conditions sought by the company.

He says he was told by his parents that Ms. Holmes called the elder Mr. Shultz in the summer of 2015 to complain that their son was being unreasonable. Tyler Shultz says he also got a tip that private investigators were watching him.

In a conversation in his parents' kitchen, they pleaded with him to agree to whatever Theranos wanted, he says. Even though his heart sank when they discussed selling their house to cover the costs of defending him against a potential Theranos lawsuit, Mr. Shultz didn't make a deal with the company.

His parents said in a statement: "Tyler has acted exactly like the man we raised him to be, and we are extraordinarily proud of him."

Tyler Shultz says he hasn't seen his grandfather since July.
PHOTO: JASON HENRY FOR THE WALL STREET JOURNAL

The younger Mr. Shultz says he stopped hearing from Mr. Brille and Theranos after the Journal's first article was published in October 2015. The article included a description of the regulatory complaint Mr. Shultz had filed under the alias Colin Ramirez but didn't identify him by his real name.

An assistant to George Shultz said he was unavailable to comment but "wishes you to know that he deeply loves and respects his grandson Tyler, is very proud of Tyler and all he has accomplished and will accomplish, and knows Tyler to be a man of great integrity. Mr. Shultz is deeply sorry that Tyler's experience at Theranos was so unsatisfactory for Tyler."

After leaving Theranos, Tyler Shultz worked briefly for a biotechnology company and now is collaborating with a team of researchers to try to build a portable device capable of diagnosing a dozen diseases from a person's blood, saliva and vital signs. The team is vying for a multimillion-dollar cash prize in the prestigious Qualcomm Tricorder XPrize competition.

Mr. Shultz visited his grandfather in July. They hadn't spoken for seven months. He says he told his grandfather he was disappointed about not getting more support from him throughout the ordeal. He asked the elder Mr. Shultz to publicly distance himself from Theranos.

"I am pleading with you as your grandson," Tyler Shultz recalls saying, "please do the right thing." His grandfather, still on Theranos's board of counselors, remained noncommittal. They haven't seen each other since.

Write to John Carreyrou at john.carreyrou@wsj.com

Theranos Whistleblower Shook the Company—and His Family
By John Carreyrou
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The New York Times https://www.nytimes.com/2018/09/21/business/david-boies-pleads-not-guilty.html

David Boies Pleads Not Guilty

The superlawyer in such cases as Bush v. Gore and the fight for gay marriage rights makes no apologies for representing Harvey Weinstein and Theranos with zeal.

By James B. Stewart

Sept. 21, 2018

When I arrived on a late July afternoon for an interview with David Boies at his mansion in Westchester County, displaced furniture filled the foyer and workmen occupied much of the famed litigator's home. Water from an unchecked bathtub had cascaded through the house, reaching all the way to his cellar and his vast collection of rare wines. Mr. Boies, dressed in a dark-blue Lands' End suit, guided me down into the mess.

In the basement, a corridor was lined with framed tributes to milestones in his remarkable career: Westmoreland v. CBS, the landmark First Amendment case; United States v. Microsoft, in which he trust-busted on behalf of the federal government; Bush v. Gore, which needs no introduction; and Hollingsworth v. Perry, the pioneering effort to legalize gay marriage. Behind glass were a 1986 New York Times Magazine cover story ("The Wall Street Lawyer Everyone Wants"), a 2000 Time article ("Get Me David Boies!") and one from Fortune in 2010 ("Corporate America's No. 1 Hired Gun"). Mr. Boies's latest big profile was conspicuously absent. Bloomberg Businessweek had asked in December: "Can his reputation survive?"

Successfully defending CBS's "60 Minutes" in a libel suit by Gen. William C. Westmoreland in 1984 made Mr. Boies a hero to much of the press. David Handschuh/Associated Press

Mr. Boies, shown here in 1999, took on Microsoft on behalf of the federal government — part of a string of sensational cases that burnished his reputation. Justin Lane for The New York Times

The last 12 months have been an unprecedented public relations disaster for the most prominent lawyer in America. In October, his longtime client Harvey Weinstein was branded a sexual predator. Another high-profile client, Theranos, on whose board Mr. Boies served, has been exposed as a fraud. The Times publicly fired Mr. Boies's firm, which had been representing the newspaper, after learning that he had been personally involved in an undercover operation to smear Mr. Weinstein's victims and deceive Times reporters. The Manhattan district attorney is looking into the matter and Mr. Boies's role.

In May, "Bad Blood," the best-selling Theranos exposé by the Wall Street Journal reporter John Carreyrou, laid out in gripping detail the aggressive efforts by Mr. Boies and his firm to intimidate — and, in some cases, terrify — company whistle-blowers. Mr. Carreyrou compared the tactics to those of "thugs."

Of all the humiliation, scolding and criticism Mr. Boies has endured, it was this comment that seemed to eat at him as we talked in his study in July — his first extended interview since the furor peaked.

"Over all, his reporting on Theranos was excellent," Mr. Boies said of Mr. Carreyrou, between sips of 20-year-old Château Mouton Rothschild, which he had rescued from the cellar. "And overwriting aside, even his personal comments about me were within the realm of fairness. But calling me a 'thug' on his book tour was over the top."

Mr. Boies, 77, seemed more puzzled than hurt that editors of The Times, The Wall Street Journal and Bloomberg had recently spurned his letters to the editor. "I was disappointed," he allowed, in the same judicious and unflappable manner that has made him a favorite of federal judges. Mr. Boies suggested that exonerating facts about his work for Mr. Weinstein and Theranos had been omitted from media coverage. "What are letters for," he asked, "if not to air an opposing view?"

Most of all, Mr. Boies said, he felt misunderstood. While he concedes he made mistakes, he maintains he was simply defending his clients' interests to the best of his abilities, including protecting them from damaging headlines.

"You don't know all the facts when you take on a client," he said, "but once you do, you have a duty of loyalty. You can't represent them halfway. If, as a lawyer, you start to value how you are going to look to the media, as opposed to how your client will look, then you should find a new profession."

A bedrock of lawful society is that every defendant, no matter how repugnant, has the right to a zealous attorney. But — as he himself has put it — that doesn't mean the right to David Boies. He can afford to be selective about whom he represents, and he told me that he accepts as clients fewer than 20 percent of the people who approach him.

Throughout his half-century of practice, Mr. Boies has shown an almost unerring instinct for picking clients who burnish his reputation. It has made him one of the highest-paid lawyers in the country, with an hourly rate of $1,850. And it has baffled legal observers that, in what could have been his gilded years, Mr. Boies ended up representing both Mr. Weinstein and Theranos, led by Elizabeth Holmes, in ways that arguably helped prolong their misdeeds. For the first time in his career, the most vaunted advocate in the United States has been a defendant in the court of public opinion.

'The Golden Boy'

One afternoon in August, Mr. Boies occupied a prime corner table at the newly reopened Four Seasons restaurant in Manhattan. It was his third meal there in 36 hours. With tousled dark-blond hair and a rather slight build, he looked tanned and relaxed and was looking forward to a safari in Kenya. He was drinking a glass of cabernet from the vineyard he owns in Northern California, visibly relieved that he could again indulge his craving for the Four Seasons version of pigs in blankets.

From his vantage, any clouds over his reputation had dissipated. His firm, Boies Schiller Flexner, was thriving, and he was in demand. In just the first six months of this year, he had generated $35 million in billings. A lawyer for Leslie Moonves, who in early September was forced out as CBS's chief executive after allegations of sexually aggressive behavior, recently approached Mr. Boies to see if he'd consider representing Mr. Moonves. Mr. Boies demurred, saying, "I don't think that would be good for Les, and I don't think that would be good for me."

Although he's a Democrat, Mr. Boies said he'd be more than happy to represent President Trump in the investigation by Robert S. Mueller III, the special counsel. "Whether you agree with him or not, he needs to have effective representation," Mr. Boies said of the president. "This long, drawn-out morality play isn't in the country's best interests. It needs to be resolved. Of course, he'd have to agree to do what I told him."

Mr. Boies said he had no plans to retire. "People retire so they can do what they love to do," he said. "I already love what I do." He's busy on a constitutional challenge to the Electoral College. On a pro bono basis, he's representing a sex-trafficking victim in a suit against the billionaire hedge fund manager Jeffrey Epstein. And he's one of the lead lawyers representing plaintiffs in a class action against Takata, a manufacturer of defective airbags.

Within the legal establishment, Mr. Boies's reputation seems undimmed. "When you are a superstar like David Boies, there will always be some people who are jealous and want to take you down," said Jed S. Rakoff, a senior United States District Court judge in New York. "I'm not saying that everything he has ever done is beyond reproach, but he has been in my court numerous times and has always performed at the very highest level, both in terms of skill and in terms of professionalism. I think he continues to be very highly regarded by the judges of the Southern District."

"If you represent people who did bad things, the public is going to lash out at you," said Theodore B. Olson, a partner at Gibson, Dunn & Crutcher who was Mr. Boies's adversary in Bush v. Gore and his co-counsel in the gay marriage case. "David may push hard, but that's what's required sometimes."

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Every judge and lawyer I interviewed noted that few laymen fully appreciated their ethical duties. "I often have to explain to journalists that there's a divergence between legal ethics and the ethics of ordinary people," said Stephen Gillers, a professor at New York University School of Law and an expert on legal ethics. "Representing a bad person doesn't make you a bad person."

Among the general public, however, Mr. Boies's "reputation has absolutely been damaged," Professor Gillers said. "He may be a stellar lawyer. But in representing a Harvey Weinstein or Elizabeth Holmes, he's not seeking to vindicate an overarching legal principle as he did in Bush v. Gore or gay marriage.

"Criminal defense lawyers who represent vicious criminals may lead perfectly ethical and admirable lives, but their clients can harm their reputation in the larger community," he continued. "David Boies can't represent the Harvey Weinsteins and Elizabeth Holmeses of the world the way he did and still expect the public to see him as a golden boy."

That's where Mr. Boies finds himself today: still revered by the bar, but fallen in the eyes of the media and liberal constituencies, and undergoing a reappraisal of his career and tactics.

"Anyone who's been on the other side of his maneuvers knows that he and his firm are incredibly aggressive advocates who push the envelope for their clients," Mr. Carreyrou said. "That was obscured for decades by the fact that he was on the right side of history again and again."

While Mr. Boies projects a sanguine sense of his future, one thing nags at him: who will play him in the film version of Mr. Carreyrou's book. (Jennifer Lawrence is taking on the role of Ms. Holmes.) He has been portrayed on stage and screen before, always with a mix of brilliant affability — by Ed Begley Jr. in the HBO movie "Recount," and by Morgan Freeman and George Clooney in productions of the marriage-equality play "8." Whoever gets the part in "Bad Blood" may be considerably less appealing.

The Hollywood Upside

Mr. Boies got his start at Cravath, Swaine & Moore, the paradigm of the institutional corporate law firm. (We were briefly colleagues there, but never worked on a case together.) Within its staid ranks, Mr. Boies was something of a maverick. Usually a little disheveled, he wore off-the-rack Sears or Lands' End navy suits and a plastic watch strapped over his shirt cuff. He found time for gambling excursions to Las Vegas and cross-country driving trips with his four sons. (He has been married three times and also has two daughters, one deceased.)

At Cravath, staying out of the media was a cardinal virtue. But successfully defending CBS's "60 Minutes" in a libel suit by Gen. William C. Westmoreland in 1984 made Mr. Boies a hero to much of the press. He reveled in the laudatory coverage, and may well have been the firm's most famous partner since former Secretary of State William H. Seward — its only partner, in fact, who could be deemed a celebrity in his own right.

Mr. Boies was drawn to high-profile clients. He tried to bring a young Mr. Trump to Cravath, but was blocked by the firm. And he took on George Steinbrenner, the famously irascible owner of the New York Yankees. In 1997, Cravath's largest account — Time Warner, the owner of the Atlanta Braves — objected to Mr. Boies's representing Mr. Steinbrenner. Mr. Boies said he wouldn't abandon a client, and left Cravath to start his own firm: Boies Schiller Flexner.

Liberated, Mr. Boies and his firm took on all kinds of clients and embraced fee arrangements, like contingency fees and stock compensation, that weren't allowed at Cravath. The firm flourished; this year, it had 340 lawyers and average profits per partner of $3.2 million, among the highest in the country.

"I spend a lot of money," Mr. Boies told me: on his Westchester estate and a car and driver; his rare-wine collection; his vineyard; a racing sailboat; a Manhattan co-op in the Sherry-Netherland Hotel.

Four years after he started the firm, in 2001, the editor Tina Brown introduced Mr. Boies to Mr. Weinstein — her partner in a multimedia venture — to discuss a legal memoir. Mr. Weinstein hired him, and almost immediately, Mr. Boies had to confront the producer's ugly behavior with women. In 2002, he talked The New Yorker out of publishing allegations of sexual harassment. At the time, none of the victims would go on the record, and Mr. Boies argued that the encounters were consensual. Mr. Boies knew there had been settlements with some of the accusers: He had shown Ken Auletta, the reporter on the story, copies of the canceled checks from Mr. Weinstein's personal account.

Afterward, Mr. Auletta asked Mr. Boies how he could represent someone like Mr. Weinstein. "I'm loyal," Mr. Boies replied.

He stayed loyal, even as he became aware of the settlements that Mr. Weinstein had reached with women alleging inappropriate sexual behavior. "I knew of two or three over the last 20 years," Mr. Boies told me. "Harvey had a reputation as a philanderer. But there was never any evidence or indication of assault, rape or threat of force. He was emphatic that he'd never assaulted anyone or forced anyone to have sex with him." Mr. Boies also helped negotiate a 2015 settlement with a Weinstein employee, Lauren O'Connor, that required Mr. Weinstein to seek anger management therapy. (In June, Mr. Weinstein pleaded not guilty to assault and rape charges.)

Mr. Boies and his wife, Mary, with Harvey Weinstein at a 2011 party in New York City. Larry Busacca/Getty Images for Time Warner

For his part, Mr. Weinstein showered Mr. Boies with invitations for opening-night parties and celebrity-studded charity events. The Weinstein Company put one of Mr. Boies's daughters in the hit 2012 film "Silver Linings Playbook," and also distributed a movie she produced, "Jane Got a Gun." Along with the son of one of his law partners, Mr. Boies formed a film production company, which invested $5 million each in two Weinstein films, "Gold" and "The Upside," both flops.

These entanglements may have colored Mr. Boies's objectivity and judgment about Mr. Weinstein. But they weren't, in the legal sense, a conflict of interest. They more closely aligned Mr. Boies's interest with his client's, which as far as the bar is concerned is a good thing.

An Impossible Dilemma

Mr. Boies met Elizabeth Holmes in 2011, after an early Theranos investor asked him to represent her. At the time, her claim that Theranos technology could render an accurate blood test from a finger prick was being hailed across Silicon Valley as a revolutionary breakthrough with enormous profit potential.

"She showed us the lab," Mr. Boies said. "She was very well prepared, committed and intelligent. She made a terrific impression." A committee of prominent doctors and scientists served on an advisory board.

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So impressed was Mr. Boies that he took half his and his firm's fees in Theranos stock, which eventually amounted to 400,000 shares, or roughly $7 million at the company's apex. Had the company thrived, it could have been worth many times that.

Like his business and social dealings with Mr. Weinstein, a financial stake in a client risks coloring a lawyer's independent judgment. For that reason, firms like Cravath and Gibson Dunn prohibit it. But they are exceptions. It's a common and lucrative practice, especially among Silicon Valley and San Francisco firms with large venture capital divisions. Defenders of the arrangement note that scores of start-ups might not have succeeded without the expensive legal advice they were able to finance with stock, rather than cash.

The American Bar Association "has wrestled with the wisdom of the practice for over 20 years," Professor Gillers said. "The answer that has emerged," he added, "is that it's not categorically forbidden, but it has to be monitored closely to protect the client." To guard against this, clients typically consent to the arrangement in writing, as Theranos did.

Mr. Boies insists that his friendship with Mr. Weinstein, his personal admiration for Ms. Holmes and his firm's financial interest in Theranos had no impact on his professional judgment, and he seemed somewhat puzzled that anyone would think otherwise. "Anything that gives you an incentive to put the client's interest first is good for the client," he said.

During the summer of 2015, at the behest of Jim Mattis, a Theranos board member who is now the secretary of defense, Mr. Boies also agreed to join the Theranos board. The Wall Street Journal was investigating Theranos, and Mr. Mattis told him that he anticipated "a difficult period where both Theranos and Ms. Holmes would need the advice of a seasoned lawyer," Mr. Boies recalled.

That added another level of ethical complexity. As a board member, Mr. Boies assumed a fiduciary duty to shareholders. Now he was obliged to act in the best interest of two different parties: investors and company management. What if one — i.e. Ms. Holmes — acted in a way that harmed the other? Precisely because the arrangement could create an impossible dilemma, some firms prohibit such board memberships. Yet it is not explicitly forbidden by the bar's ethics rules.

As The Journal's Mr. Carreyrou stepped up his reporting on Theranos that summer, Mr. Boies used all the tools at his disposal to defend Ms. Holmes and muzzle the journalist's sources. His partners sent letters threatening suspected talkers with litigation if they disclosed trade secrets or confidential information. (One whistle-blower, a man in his 20s, incurred several hundred thousand dollars in legal fees.) And he wrote a 23-page letter to The Journal warning it about publishing Mr. Carreyrou's article.

Mr. Boies told me that he maintains a longstanding policy: He won't sue media organizations, or even threaten to do so. "There may be valid defamation actions, but I don't want to be the lawyer doing that," he said. "Going all the way back to CBS and Westmoreland, my experience has been that most reporters try to get it right." He also has long positioned himself as a friend to reporters and a champion of the First Amendment. He's a donor to the Committee to Protect Journalists and has served as its annual dinner chairman.

Mr. Carreyrou insists that the letter did "explicitly threaten" a lawsuit. Mr. Boies denies that, but he seems to be splitting hairs. The letter demands that Mr. Carreyrou and The Journal save all their notes and records, which "would doubtless be highly relevant in any lawsuit" — and then cites two cases as precedent. Mr. Boies either violated his own policy regarding media lawsuits, or came precariously close to doing so.

When I pressed Mr. Boies on this, the litigator in him wouldn't give an inch. "You don't write a 20-plus-page letter to threaten someone," he said. "I could do that in one paragraph. You write that kind of letter to persuade. You may point out things that you believe are inaccurate or reckless and that could support a lawsuit. But it's not a threat to sue."

He added: "The question is, can you make the story better, more accurate, more favorable to your client? If so, you're being an effective advocate."

From Mr. Boies's point of view, his approach worked. Among the facts that Mr. Carreyrou had uncovered, and that didn't appear in the article, was Ms. Holmes's long-running romantic relationship with Ramesh Balwani, Theranos's president.

Mr. Carreyrou's article, published in October 2015, was nonetheless a bombshell. "The reporting was excellent. He and The Wall Street Journal deserve credit," Mr. Boies said. "If I knew then what I do now," he added, "I would have written a very different letter."

The article didn't shake his confidence in Ms. Holmes, however. She agreed, at his suggestion, to an independent verification of Theranos's technology in order to rebut the Journal article and reassure investors and regulators.

In early March, she was a guest at Mr. Boies's 75th birthday bash at Las Vegas's Wynn Resort. But by the end of that month, there were still no results. Ms. Holmes began relying on other outside lawyers, and she fired the company's general counsel, a former Boies Schiller partner, who returned to the firm.

"I'd say that by summer, I wasn't exactly persona non grata, but I was pretty close," Mr. Boies said. He tried to resign from the board, but other directors dissuaded him. His own outside lawyer advised that as a director, he couldn't resign in a way that might damage shareholders.

The final straw came in August, when Ms. Holmes made an overly optimistic presentation to shareholders without consulting Mr. Boies. As he put it in an email to Ms. Holmes, he could not continue being her lawyer if she did not heed his advice: "If we are going to risk being at the scene of a serious accident, we want to have the steering wheel in our hands." He continued, "Because of the very public role we have taken in defense of the company, the firm's own credibility is at stake."

Within 72 hours of sending the email, Mr. Boies stopped representing the company. He remained a director until Theranos could find a replacement, which took until February. The next month, the Securities and Exchange Commission alleged that Ms. Holmes orchestrated a "massive fraud" that cost investors more than $700 million while putting the health of its testing subjects at risk.

'I'm Part of the Collateral Damage'

Mr. Boies's work for both Mr. Weinstein and Theranos might well have gone largely unnoticed, and his reputation might have remained unblemished, had that been the end of the story. But Mr. Boies himself became the subject of further investigative reporting.

Mr. Weinstein approached Mr. Boies in the spring of 2017, after he learned that Times reporters, as well as Ronan Farrow, then a reporter for NBC News and later for The New Yorker, were unearthing allegations of sexual assault. Mr. Weinstein asked Mr. Boies to write letters to the publications threatening legal action.

Mr. Boies said he told Mr. Weinstein that he'd be "crazy" to sue, and reminded him about his personal rule against media lawsuits. But, he said, he agreed to give Mr. Weinstein legal advice and act on his behalf as a "friend," and would not charge him for any of his work.

In his hybrid role as lawyer and friend, Mr. Boies approached The Times. He knew many of its reporters and editors, and his firm represented the paper in a libel suit. When The Times retained one of Mr. Boies's partners for the libel case, the company signed an explicit waiver of any conflict, which even gave his firm the right to sue The Times on behalf of another client.

Mr. Boies had numerous exchanges with its executive editor, Dean Baquet, maneuvering to get reporters to interview Mr. Weinstein on background. Mr. Baquet rebuffed him; The Times's policy is not to talk to subjects of investigative reports on such a basis.

The Times obviously knew that Mr. Boies was advocating Mr. Weinstein's point of view, even as his firm continued to represent The Times. What it didn't know — and what Mr. Boies never told the paper — was that he had also negotiated and signed an agreement with Black Cube, a secretive investigative agency that used undercover operatives.

The company's goal was to dig up "intelligence which will help the client's efforts to completely stop the publication of a new negative article in a leading NY Newspaper," as a contract Mr. Boies signed put it.

Mr. Boies told me that he didn't view any of this as a conflict of interest with his work for The Times. "Reporters don't have a monopoly on investigating facts," he said. To the extent that Mr. Weinstein was innocent, he said, it was in both his and The Times's interest to know that. And even if it was a conflict, he noted, there was the waiver The Times had signed.

When the Times and New Yorker articles appeared in October, Mr. Boies said, he was shocked by "the scope of what was involved, the nature of the allegations, including force and rape, and the number of people who came forward, both on the record and anonymously."

"I think even people who knew Harvey well were shocked," he added. He called the articles, which won the Pulitzer Prize for public service, "fairly reported, which is what I'd expect from The New York Times and The New Yorker." At the same time, he said, "it's not popular to say this, but Harvey is still presumed innocent until proven guilty."

On Nov. 6, another New Yorker piece by Mr. Farrow focused explicitly on Mr. Boies's work for Mr. Weinstein, and revealed the contract with Black Cube. Mr. Boies was interviewed and confirmed many of the details in the article, which, he told me, fairly presented his views and was "wonderfully well reported."

Confronted with the Black Cube revelation and the attempt to undermine its own reporters, The Times promptly fired Mr. Boies. "We never contemplated that the law firm would contract with an intelligence firm to conduct a secret spying operation aimed at our reporting and our reporters," The Times said in a statement at the time. "Such an operation is reprehensible."

"There was really no debate," Mr. Baquet told me recently. "We were outraged. A guy who was working for us was essentially trying to hurt us. It's not like he was just representing Harvey Weinstein. He was hiring private detectives to deceive journalists. You'd think he'd be ashamed of that."

Mr. Boies said he had no idea that Black Cube's work would include targeting Times reporters working on the story, but he acknowledged it was a mistake to have hired a firm that he didn't select and over which he had no oversight or control. "At the time, it seemed a reasonable accommodation for a client, but it was not thought through, and that was my mistake," he said.

Mr. Boies found it difficult to extricate himself from Mr. Weinstein. "I'm probably too reluctant to fire clients," he said. "A lawyer has a lot of leeway in deciding to take a client. But to abandon a client, especially a client in trouble, is a much higher hurdle." But in November, he said, he and Mr. Weinstein "mutually agreed" to part company. Mr. Boies said ethical constraints prevented him from saying any more.

Boies's Closing Argument

Mr. Boies said the #MeToo movement represented a "revolution that's long overdue," even though "every revolution causes collateral damage, and to some extent, I'm part of the collateral damage."

At 77, he is aware that his legacy is at stake. "I guess if it's a long obituary, this is going to be in there," he said at lunch at the Four Seasons, referring to the Weinstein and Theranos controversies. "In the context of 50 years of a high-profile law practice, there are going to be things that make people unhappy. Any time you go through something like this, you reflect on what you might have done differently."

But he added: "For 99 percent of the people I deal with, this doesn't affect them. For some people, mostly in the media, it does affect them. I get that."

Of course, I'm in the media, writing for his former client The Times, but this time he's not advocating on behalf a client. He's defending himself. I asked him what that felt like.

Mr. Boies, on a riser with his back to the camera, after arguing for Vice President Al Gore before the Supreme Court in December 2000. Paul Hosefros/The New York Times

Mr. Boies outside the Supreme Court in 2013. His risky — and successful — strategy to legalize gay marriage further enhanced his aura as a virtuous litigator. Brendan Hoffman for The New York Times

“Steve Jobs told Walter Isaacson” — his biographer — “that he wanted his children to understand him,” Mr. Boies said. “I get that. When you’re talking about yourself, you tend to be less of an overt advocate. If you want people to understand you, you have to be accurate and complete, blemishes and all.”

I asked him to assume I’m the judge and readers the jury. What’s his closing argument? He seemed to relish the challenge.

“I’m proud to be a lawyer and to serve the justice system,” he began. “That’s essential to everything we care about: liberty, equality, inclusiveness, the pursuit of happiness. The justice system protects the weak and limits the strong.

“In America, this is an adversarial process,” he continued. “In many countries it’s not. History shows that no system does more to protect individual rights and liberties than a system that provides people with a lawyer with complete dedication to the client.

“A lawyer can choose what clients to represent. A lawyer does not have the choice of how to represent a client. A lawyer is duty- and honor-bound to represent a client effectively and aggressively, within the bounds of the system itself. And once a lawyer takes on a client, you do not have the right to abandon that client under fire, except in extraordinary circumstances.”

By now he had hit his stride. “If we decide any class of accused is not deserving of aggressive representation simply because of what they’re accused of, then we undermine the protections that are essential for all of us.”

This was Boies the legendary litigator, spontaneously generating fully formed paragraphs. Evidently, though, Mr. Boies felt he had not made himself fully understood, and a few days later, on a Sunday afternoon, he wrote me an email of more than 1,000 words.

“Like I often do following a particularly good discussion (or movie or play), I keep thinking afterward about what we covered,” he began. Doing so seemed to trigger, for the first time in our interactions, an element of wistfulness.

Without naming names, but obviously referring to Theranos and Mr. Weinstein, he conceded that “greater due diligence would have led me to decline the representation” of one. Of the other, “I think I have to acknowledge that I have let loyalty to a client often outweigh revelations that, had I known them earlier, would have led me not to accept the representation initially.”

“I don’t know whether any of this adds anything to what you have,” he concluded. “But it has helped me think through how I feel about these issues.”

Press Release

Theranos, CEO Holmes, and Former President Balwani Charged With Massive Fraud

Holmes Stripped of Control of Company for Defrauding Investors

FOR IMMEDIATE RELEASE
2018-41

Washington D.C., March 14, 2018 — The Securities and Exchange Commission today charged Silicon Valley-based private company Theranos Inc., its founder and CEO Elizabeth Holmes, and its former President Ramesh "Sunny" Balwani with raising more than $700 million from investors through an elaborate, years-long fraud in which they exaggerated or made false statements about the company's technology, business, and financial performance. Theranos and Holmes have agreed to resolve the charges against them. Importantly, in addition to a penalty, Holmes has agreed to give up majority voting control over the company, as well as to a reduction of her equity which, combined with shares she previously returned, materially reduces her equity stake.

The complaints allege that Theranos, Holmes, and Balwani made numerous false and misleading statements in investor presentations, product demonstrations, and media articles by which they deceived investors into believing that its key product – a portable blood analyzer – could conduct comprehensive blood tests from finger drops of blood, revolutionizing the blood testing industry. In truth, according to the SEC's complaint, Theranos' proprietary analyzer could complete only a small number of tests, and the company conducted the vast majority of patient tests on modified and industry-standard commercial analyzers manufactured by others.

The complaints further charge that Theranos, Holmes, and Balwani claimed that Theranos' products were deployed by the U.S. Department of Defense on the battlefield in Afghanistan and on medevac helicopters and that the company would generate more than $100 million in revenue in 2014. In truth, Theranos' technology was never deployed by the U.S. Department of Defense and generated a little more than $100,000 in revenue from operations in 2014.

"Investors are entitled to nothing less than complete truth and candor from companies and their executives," said Steven Peikin, Co-Director of the SEC's Enforcement Division. "The charges against Theranos, Holmes, and Balwani make clear that there is no exemption from the anti-fraud provisions of the federal securities laws simply because a company is non-public, development-stage, or the subject of exuberant media attention."

"As a result of Holmes' alleged fraudulent conduct, she is being stripped of control of the company she founded, is returning millions of shares to Theranos, and is barred from serving as an officer or director of a public company for 10 years," said Stephanie Avakian, Co-Director of the SEC's Enforcement Division. "This package of remedies exemplifies our efforts to impose tailored and meaningful sanctions that directly address the unlawful behavior charged and best remedies the harm done to shareholders."

“The Theranos story is an important lesson for Silicon Valley,” said Jina Choi, Director of the SEC’s San Francisco Regional Office. “Innovators who seek to revolutionize and disrupt an industry must tell investors the truth about what their technology can do today, not just what they hope it might do someday.”

Theranos and Holmes have agreed to settle the fraud charges levied against them. Holmes agreed to pay a $500,000 penalty, be barred from serving as an officer or director of a public company for 10 years, return the remaining 18.9 million shares that she obtained during the fraud, and relinquish her voting control of Theranos by converting her super-majority Theranos Class B Common shares to Class A Common shares. Due to the company’s liquidation preference, if Theranos is acquired or is otherwise liquidated, Holmes would not profit from her ownership until – assuming redemption of certain warrants – over $750 million is returned to defrauded investors and other preferred shareholders. The settlements with Theranos and Holmes are subject to court approval. Theranos and Holmes neither admitted nor denied the allegations in the SEC’s complaint. The SEC will litigate its claims against Balwani in federal district court in the Northern District of California.

The SEC’s investigation was conducted by Jessica Chan, Rahul Kolhatkar, and Michael Foley and supervised by Monique Winkler and Erin Schneider in the San Francisco Regional Office. The SEC’s litigation will be led by Jason Habermeyer and Marc Katz of the San Francisco office.

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Related Materials

- SEC Complaint - Theranos and Holmes
- SEC Complaint - Balwani

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. ELIZABETH HOLMES and THERANOS, INC. Defendants.	Case No. **COMPLAINT**

Plaintiff Securities and Exchange Commission (the "Commission") alleges:

SUMMARY OF THE ACTION

1. This case involves the fraudulent offer and sale of securities by Theranos, Inc. ("Theranos"), a California company that aimed to revolutionize the diagnostics industry, its Chairman and Chief Executive Officer Elizabeth Holmes, and its former President and Chief Operating Officer, Ramesh "Sunny" Balwani. The Commission has filed a separate action against Balwani.

2. Holmes, Balwani, and Theranos raised more than $700 million from late 2013 to 2015 while deceiving investors by making it appear as if Theranos had successfully developed a commercially-ready portable blood analyzer that could perform a full range of laboratory tests from a small sample of blood. They deceived investors by, among other things, making false and misleading statements to the media, hosting misleading technology demonstrations, and overstating the extent of Theranos' relationships with commercial partners and government entities, to whom they had also made misrepresentations.

3. Holmes, Balwani, and Theranos also made false or misleading statements to investors about many aspects of Theranos' business, including the capabilities of its proprietary analyzers, its commercial relationships, its relationship with the Department of Defense ("DOD"), its regulatory status with the U.S. Food and Drug Administration ("FDA"), and its financial condition. These statements were made with the intent to deceive or with reckless disregard for the truth.

4. Investors believed, based on these representations, that Theranos had successfully developed a proprietary analyzer that was capable of conducting a comprehensive set of blood tests from a few drops of blood from a finger. From Holmes' and Balwani's representations, investors understood Theranos offered a suite of technologies to (1) collect and transport a fingerstick sample of blood, (2) place the sample on a special cartridge which could be inserted into (3) Theranos' proprietary analyzer, which would generate the results that Theranos could transmit to the patient or care provider. According to Holmes and Balwani, Theranos' technology could provide blood testing that was faster, cheaper, and more accurate than existing blood testing laboratories, all in one analyzer that could be used outside traditional laboratory settings.

5. At all times, however, Holmes, Balwani, and Theranos were aware that, in its clinical laboratory, Theranos' proprietary analyzer performed only approximately 12 tests of the over 200 tests on Theranos' published patient testing menu, and Theranos used third-party

commercially available analyzers, some of which Theranos had modified to analyze fingerstick samples, to process the remainder of its patient tests.

6. In this action, the Commission seeks an order enjoining Holmes and Theranos from future violations of the securities laws, requiring Holmes to pay a civil monetary penalty, prohibiting Holmes from acting as an officer or director of any publicly-listed company, requiring Holmes to return all of the shares she obtained during this period, requiring Holmes to relinquish super-majority voting shares she obtained during this period, and providing other appropriate relief.

JURISDICTION AND VENUE

7. The Commission brings this action pursuant to Sections 20(b), 20(d), and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b), 77t(d), and 77v(a)] and Sections 21(d), 21(e), and 27 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

8. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1) and 22(a) of the Securities Act [15 U.S.C. §§ 77t(b), 77t(d)(1), and 77v(a)] and Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa].

9. Defendants, directly or indirectly, made use of the means and instrumentalities of interstate commerce or of the mails in connection with the acts, transactions, practices, and courses of business alleged in this complaint.

10. Venue is proper in this District pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27(a) of the Exchange Act [15 U.S.C. § 78aa(a)]. Theranos is headquartered in Newark, California, and Holmes resides in the District. In addition, acts, transactions, practices, and courses of business that form the basis for the violations alleged in this complaint occurred in this District. Defendants met with and solicited prospective Theranos investors in this District, and the relevant offers or sales of securities took place in this District.

11. Under Civil Local Rule 3-2(d), this civil action should be assigned to the San Jose Division, because a substantial part of the events or omissions which give rise to the claims alleged herein occurred in Santa Clara County.

DEFENDANTS

12. **Elizabeth Holmes**, age 34, of Los Altos Hills, California, is the Chief Executive Officer ("CEO") and Chairman of the Board of Theranos, Inc. Holmes was paid a salary of approximately $200,000 to $390,000 per year between 2013 and 2015. During the same period, she also exercised approximately 53.7 million stock options and received super-majority voting, Class B common shares, which granted her almost complete voting control over the company. Holmes has never sold any of her Theranos stock.

13. **Theranos, Inc.** is a Delaware corporation, established by Holmes in 2003, with its principal place of business in Newark, California. From 2013 through 2015 (the "relevant time period"), Theranos' principal place of business was in Palo Alto, California and its sole managing executives were Holmes and Balwani.

RELEVANT INDIVIDUAL

14. **Ramesh "Sunny" Balwani**, age 52, of Atherton, California, was the President and Chief Operating Officer of Theranos, Inc. from September 2009 to May 2016.

FACTUAL ALLEGATIONS

A. Background

15. Elizabeth Holmes founded Theranos, a diagnostics company, in 2003 after leaving college during her second year. Holmes had a vision of developing new diagnostic technologies, with a focus on small sample testing and easier access to testing results for prevention and earlier diagnosis.

16. For the first five years of its existence, Theranos focused its efforts on developing its proprietary analyzer, the Theranos Sample Processing Unit, or "TSPU," to analyze blood taken from a fingerstick and on assisting pharmaceutical companies with their clinical trials. The earliest generation TSPU was a small point-of-care device that was capable of performing only a

few tests. A point-of-care device can be used to obtain results near where patients provide samples, such as medical offices.

17. In 2009, as Theranos was on the verge of running out of money, Holmes turned to Balwani to guarantee a line of credit for the company. Balwani joined the company and became its President and COO.

18. From the time that Balwani joined Theranos until his departure in 2016, Theranos had no other senior managing executives besides Holmes and Balwani. Holmes generally focused on device innovation, board interaction, and strategic relationships, while Balwani concentrated on developing software for Theranos' technology and managing personnel and operations. Still, they collaborated closely with each other and made decisions about the company together.

B. In 2010, Theranos Decided to Pursue the Retail Clinical Laboratory Space Even Though Its Analyzer Was Not Commercially Ready

19. Theranos spent years in research and development to develop an earlier-generation TSPU. The earlier-generation TSPU was designed to perform only one method of testing – immunochemistries – and could process only one sample at a time. In 2009, Holmes and Balwani turned the company's efforts towards developing a new version of the TSPU, which they hoped would one day be able to perform a broader range of laboratory testing by incorporating additional methods of testing. They later referred to this version of the TSPU as the miniLab.

20. In early 2010, even though the miniLab was not commercially ready, Holmes and Balwani decided to focus on the retail clinical laboratory market by pursuing contracts with a large national pharmacy chain ("Pharmacy A") and a large national grocery chain ("Grocery A"). Their vision was to place miniLabs at designated "Patient Service Centers" in retail stores so that patients could get their diagnostic tests performed while shopping.

21. In connection with discussions about a potential partnership with Pharmacy A, Holmes approved and provided presentations and other written materials to Pharmacy A

executives representing that Theranos had the ability to conduct a broad range of tests on its proprietary analyzer, including general chemistry tests, wellness tests, and some predictive and diagnostic health tests (which involved methods beyond immunochemistries). These materials stated that Theranos would be ready to begin blood testing on its proprietary analyzer at Pharmacy A stores by the fourth quarter of 2010.

22. Holmes also told Pharmacy A executives that Theranos could conduct hundreds of blood tests through fingerstick (or the puncture of a finger), that its testing could be conducted in a rapid timeframe (in less than one hour), and that it could be offered for a reasonable price (much less than Theranos' competitors). Holmes also told Pharmacy A that its analyzer was already deployed on military helicopters.

23. Based on these representations, Pharmacy A executives thought that the miniLab was capable of performing, in a clinical lab setting, a wide range of the tests offered by traditional laboratories. For example, Holmes told Pharmacy A that Theranos could, on its analyzer – the miniLab – perform approximately 90 percent of the tests that a large, traditional central lab could perform. In July 2010, Pharmacy A entered into a contract with Theranos to roll out Theranos' service to Pharmacy A stores.

24. Holmes also made similar statements to Grocery A. She told Grocery A's then-CEO that Theranos had successfully miniaturized the conventional laboratory. Holmes also told him that Theranos' analyzers were being deployed in the battlefield. Based on these representations, in September 2010, Grocery A contracted with Theranos to offer Theranos patient testing in Grocery A stores.

C. In 2013, On the Eve of the Pharmacy A Launch, Theranos Began Modifying Commercially-Available Analyzers and Running Misleading Demonstrations

25. Between 2010 and 2013, Theranos continued to work on developing its miniLab with an eye towards launching its services in Pharmacy A and Grocery A stores.

26. In 2011, Pharmacy A executives raised concerns it had with Theranos' regulatory strategy, and told Holmes and Balwani that Theranos might need to obtain FDA approval for its

miniLab and certify each of its stores as a laboratory in order for the analyzers to be used in Pharmacy A stores.

27. Based on these concerns, in 2012, Theranos and Pharmacy A agreed to modify their original contract to reflect a roll-out of Theranos' service in two phases. In the first phase, before Theranos received regulatory approvals for its analyzers, patient samples would be transported from Pharmacy A stores to centralized laboratories operated by Theranos and tested on Theranos' miniLab there. Theranos opened and operated two centralized laboratories to test patient samples collected from Pharmacy A stores. In the second phase, after Theranos had received the necessary regulatory approvals, Theranos' retail offering at Pharmacy A would be performed on miniLabs placed in Pharmacy A stores.

28. But as September 2013 approached – the date for the launch of the first phase of the roll out of Theranos services in Pharmacy A stores – it became clear to Holmes that the miniLab would not be ready. At the time, Theranos had not fully integrated other testing methods into the miniLab and had not completed the scientific verification steps needed to make any of its blood tests available on the miniLab for patient testing. As a result, Holmes and Balwani made the decision to use Theranos' earlier-generation TSPUs, which could only be used to perform immunochemistries, for patient testing.

29. In order to offer a broader range of fingerstick tests at Pharmacy A, Holmes and Balwani asked Theranos' engineers in July 2013 to modify third-party analyzers from commercial manufacturers so they could analyze fingerstick samples. Theranos scientists spent the two months leading up to the retail launch preparing as many fingerstick tests as possible on the third-party analyzers, which could typically process only venous samples.

30. Holmes and Theranos never told Pharmacy A and Grocery A about Theranos' technological challenges. For instance, in July and August 2013, Theranos coordinated technology demonstrations for various Pharmacy A executives in advance of the retail launch. Holmes instructed Theranos employees to place both earlier generation TSPUs and miniLabs in a demonstration room where Theranos collected fingerstick samples from Pharmacy A

executives. Instead of using these machines to process the tests on these samples, and unbeknownst to the Pharmacy A executives, Theranos used the modified third-party machines to process a portion of the tests.

31. Holmes also instructed Theranos employees to place numerous miniLabs – which could only be used for research and development purposes and could not be used for clinical testing – in a room in Theranos' clinical lab. This made it appear as if Theranos used its miniLab for clinical purposes. Holmes then led a group of Pharmacy A executives on a tour of that room, and those Pharmacy A executives saw rows of miniLabs in Theranos' clinical lab.

32. Based on Holmes' presentation, Pharmacy A executives understood that the blood from their demonstration samples would be tested on Theranos' miniLabs. Holmes never told the executives that Theranos was actually testing some of their blood on modified third-party analyzers.

33. At the end of 2013, Pharmacy A agreed to accelerate a portion of a $100 million "innovation fee" to help Theranos broaden its roll-out of services to Pharmacy A stores. Unbeknownst to Pharmacy A, Theranos was scaling its retail offering by relying on third-party analyzers.

34. Neither Holmes nor Theranos ever told anyone at Pharmacy A that Theranos used third-party analyzers, including those that had been modified to test fingerstick blood. Holmes and Theranos also never told Pharmacy A that Theranos was using third-party analyzers to perform the majority of its testing. If Pharmacy A had known that Theranos was using third-party analyzers for a majority of its patient testing, it would not have accelerated the payment of the innovation fee.

35. Holmes and Balwani also denied there were problems with Theranos' technology in discussions with Grocery A. For example, in response to a question about a rumor that Theranos was facing technological challenges with its proprietary analyzers, Holmes and Balwani assured Grocery A's General Counsel that there was no technological problem with the

analyzers and that the TSPU was capable of performing 90 percent of the blood tests typically requested by doctors for their patients.

36. From its retail launch in September 2013 to the time it closed its clinical laboratories in 2016, Theranos never used its miniLab for patient testing in its clinical laboratory. Theranos conducted – at its height –12 tests using the earlier-generation TSPU, and processed about 50 to 60 tests using the modified third-party analyzers. Theranos processed the remaining 100-plus tests it offered at Pharmacy A using the same types of industry standard technology as other traditional laboratories, or sent tests out to third-party laboratories.

D. Starting in September 2013, Holmes and Theranos Began Publicly Touting Theranos' Proprietary Analyzers in Interviews with the Media, Notwithstanding Theranos' Use of Commercially-Available Analyzers for Patient Testing

37. From 2013 to 2014, Theranos and Holmes emerged into the spotlight by issuing a press release touting the launch of its retail offering with Pharmacy A and granting a number of media interviews for articles that Holmes later used to solicit investors. In September 2013, Theranos announced a partnership with Pharmacy A to offer a "new lab testing service through Pharmacy A pharmacies nationwide." By going to a Pharmacy A store in Palo Alto, California, the first location to offer Theranos testing, consumers could "complete any clinician-directed lab tests with as little as a few drops of blood and results available in a matter of hours."

38. Around the same time, Holmes sat down with a reporter for the *Wall Street Journal* purportedly to discuss the state of Theranos' business. A *Wall Street Journal* article accompanying the Pharmacy A launch announcement stated:

> The secret that hundreds of employees are now refining involves devices that automate and miniaturize more than 1,000 laboratory tests, from routine blood work to advanced genetic analyses. Theranos' processes are faster, cheaper, and more accurate than the conventional methods and require only microscopic blood volumes, not vial after vial of the stuff.

39. Additional articles written after interviews with Holmes continued to raise Theranos' public profile and tout its technological capabilities. An April 2014 *Wired* article

stated that "[i]nstead of vials of blood – one for every test needed – Theranos requires only a pinprick and a drop of blood. With that they can perform hundreds of tests, from standard cholesterol checks to sophisticated genetic analyses."

40. Similarly, a June 2014 *Fortune* article noted that "[Theranos] currently offers more than 200 – and is ramping up to offer more than 1,000 – of the most commonly ordered blood diagnostic tests, all without the need for a syringe." *Fortune* also distinguished Theranos from other blood testing companies because "Theranos [] does not buy any analyzers from third parties." In contrast to the large traditional blood analyzers that occupied whole rooms, Theranos' proprietary analyzers "look[ed] like large desktop computer towers."

41. By the end of 2014, *Forbes* declared that Holmes was "the youngest self-made woman billionaire" whose company could, "[w]ith a painless prick, . . . quickly test a drop of blood at a fraction of the price of commercial labs which need more than one vial."

42. Holmes sat for interviews and communicated with journalists about Theranos and its technology. In email conversations with the *Fortune* reporter, Holmes stated that "it is ok to say the analytical systems are about the size of a desktop computer." Holmes also suggested describing Theranos' miniLab as "much smaller than in conventional laboratories or have a smaller space requirement than conventional laboratories." The *Fortune* reporter used a version of this statement in his article on Theranos. As Holmes knew, or was reckless in not knowing, this was misleading because the device she was describing – the miniLab – was not in use in Theranos' clinical laboratory.

43. Holmes did not correct the false or misleading statements in the articles that were published between 2013 and 2015. In fact, in some instances, she and Theranos provided some of the articles containing untrue or misleading statements to potential investors.

E. Beginning in 2013, Holmes and Theranos Raised Over $700 Million from Investors and Holmes Obtained Super-Voting Control of Theranos While Misleading Investors

44. In late 2013, Theranos had approximately $30 million in cash and short-term securities, which would fund the company's operations for only a few months. As Holmes

knew, Theranos needed cash to continue spending money on research and development to advance the miniLab, which at that time was not ready for commercial use.

45. Holmes anticipated that Theranos would need to raise much more money than it had in its earlier financing rounds and that such fundraising likely would dilute her ownership of the company. In order to retain her control of the company, Holmes in early 2014 convinced Theranos' board and shareholders to pass a resolution creating a new, separate class of shares ("Class B Shares").

46. This resolution (1) split Theranos' stock in a 1 to 5 ratio to allow for future fundraising, and (2) created Class B Shares, which had super-voting (100x) power and would be given only to Holmes. Shareholders were given only a few days to consider and vote on this resolution. Following the resolution's passage, Holmes owned just over half of the company's outstanding shares, but over 99 percent of its voting power. Holmes obtained the Class B Shares during the relevant time period.

47. From late 2013 to 2015, Holmes, Balwani, and Theranos raised over $700 million from investors in two financing rounds. These investors believed – based on false and misleading statements by Holmes – that Theranos had successfully developed a proprietary analyzer that could conduct the full range of laboratory testing from a small sample of blood.

1. The Investor Solicitation Process Generally Included a Face-to-Face Meeting, a Technology Demonstration, and a Binder of Materials

48. After an introduction to Holmes, potential investors would typically meet face-to-face with Holmes, and at times, Balwani. During this meeting, which normally took place at Theranos' headquarters, Holmes described her vision for the company, including her motivation to develop a technology that could perform blood testing on small samples – spurred by her own fear of needles – and her larger desire to provide cheaper, faster, and more accurate laboratory testing so that diagnoses of serious conditions and diseases could take place sooner.

49. This initial meeting was often followed by a purported demonstration of Theranos' proprietary analyzers, the TSPU, and the miniLab. In several instances, potential

investors would be taken by Holmes and Balwani to a different room to view Theranos' desktop computer-like analyzers. A phlebotomist would arrive to draw their blood through fingerstick, using a nanotainer, a Theranos-developed collection device. Then the sample was either inserted into the TSPU or taken away for processing. Based on what they saw, potential investors believed that Theranos had tested their blood on either an earlier-generation TSPU or the miniLab. As Holmes knew, or was reckless in not knowing, however, Theranos often actually tested their blood on third-party analyzers, because Theranos could not conduct all of the tests it offered prospective investors on its proprietary analyzers.

50. Theranos also sent investors a binder of background materials, which Holmes instructed employees to compile. In addition to incorporation documents and shareholder agreements, the typical investor binder included (1) a cover letter drafted and signed by Holmes; (2) a company overview slide deck presentation; (3) reports of clinical trials work Theranos performed with its pharmaceutical companies; (4) financial projections; and (5) articles and profiles about Theranos, including the 2013 and 2014 articles from *The Wall Street Journal*, *Wired*, and *Fortune* that were written after Holmes provided them with interviews. These materials were important to investors in considering whether to invest in Theranos.

51. One section of the investor binders touted Theranos' work with pharmaceutical companies and contained a number of reports purportedly related to the clinical trials work Theranos had performed with those pharmaceutical companies. The reports prominently featured the company logos of well-known pharmaceutical companies, suggesting that the reports were drafted by these pharmaceutical companies. However, as Holmes knew, only one report in the investor binder was co-written by a pharmaceutical client. The other two reports were drafted by Theranos employees, despite displaying the logos of pharmaceutical companies. Investors believed that pharmaceutical companies had written their own endorsements of Theranos' technology, when the pharmaceutical companies had not.

2. Holmes and Theranos Made a Series of False or Misleading Statements to Investors That Confirmed the Company's Public Narrative

52. Holmes made statements to investors about the status of Theranos' technology, historical contracts, commercial relationships, regulatory strategy, and financial performance that were consistent with the public image she and Theranos were promoting of Theranos as a company that was revolutionizing the diagnostics industry.

a. Holmes and Theranos Represented That Theranos' Proprietary Analyzer Was Capable of Conducting the Full Range of Testing When It Could Not

53. Holmes represented to investors that Theranos' miniLab was capable of processing a full range of laboratory tests. For instance, Holmes and Balwani told one investor that Theranos' proprietary analyzer could process over 1,000 Current Procedural Terminology ("CPT") codes and that Theranos had developed a technological solution for an additional 300 CPT codes. She made similar representations to other investors, claiming that Theranos could run all of its blood tests on one analyzer using chemicals from one consumable cartridge.

54. Theranos' company overview presentation that Theranos included in investor binders also echoed these same statements. The presentation noted, among other things, that "Theranos' proprietary, patented technology runs comprehensive blood tests from a finger-stick and tests from micro-samples of other matrices, and generates significantly higher integrity data than currently possible."

55. But Theranos' analyzers never performed comprehensive testing or processed 1,000 CPT codes in its clinical lab. In fact, as Holmes knew, or was reckless in not knowing, Theranos' clinical lab used the TSPU only to perform 12 of the tests offered to patients.

56. In addition to not disclosing the use of third-party analyzers to conduct the demonstrations, Holmes' and Theranos' actions made it appear as if Theranos' proprietary analyzer had more extensive capabilities than it actually did. When potential investors tried out Theranos' services by bringing a physician's laboratory requisition to a Pharmacy A store,

Holmes instructed Theranos employees to remove certain tests from the order if Theranos was unable to perform those tests using a fingerstick collection.

57. This conduct led investors to believe that Theranos' proprietary analyzers were broadly in use by Theranos and that they produced results on a broader range of tests than they actually did. Investors would not have invested had they known Theranos' promises about its ability to run a broad range of tests were untrue and that the TSPU was being used to run only a limited number of tests in its lab. When presenting to investors, Holmes knew, or was reckless in not knowing, that the miniLab was not presently capable of processing a full range of laboratory tests.

58. Holmes' statements about the capabilities of Theranos' proprietary analyzer were important to many potential investors because the technology was a basis of their investments.

b. Holmes and Theranos Stated That Theranos Manufactured All of Its Own Analyzers When It Actually Used Third-Party Analyzers to Run the Majority of Its Tests

59. Holmes also represented to investors that Theranos manufactured all of its own analyzers, when Theranos had in fact only manufactured its own TSPUs. For instance, Holmes told one investor that Theranos used its own analyzer equipment and did not buy analyzer equipment from third parties. She and Balwani explained to another investor that 100 percent of Theranos' analyzers were manufactured in Theranos' facility in Newark, California.

60. The company overview presentation in some investor binders also showed pictures of the TSPU and miniLab under the heading "Theranos Systems," but excluded pictures of the third-party analyzers Theranos was using.

61. Finally, the *Fortune* article – for which Holmes was extensively interviewed and which she included in materials sent to investors – stated that "Theranos [] does not buy any analyzers from third parties."

62. These statements gave potential investors the impression that Theranos was only using its own TSPUs and miniLabs for patient testing.

63. As Holmes knew, or was reckless in not knowing, statements that Theranos manufactured all of its analyzers were false or misleading in light of Theranos' broad use of third-party analyzers. Theranos conducted the majority of its testing using third-party analyzers.

64. Theranos' capability to run the full range of laboratory testing on its proprietary analyzer was a key competitive advantage potential investors considered when deciding whether to invest in the company.

c. Holmes and Theranos Made False or Misleading Statements About Theranos' Historical Contracts with the DOD

65. Holmes also made false or misleading statements concerning Theranos' historical business contracts with the DOD. In Holmes' cover letter, which she included in investor binders, she highlighted the company's "historical" work with "military clients." The third page of the company overview presentation introduces the company with the following statement, "[c]urrent and past clients include . . . U.S. and foreign government health and military organizations."

66. Holmes also made other statements that gave potential investors the impression that these historical relationships were meaningful. Holmes told multiple investors that Theranos' technology had been deployed by the DOD in the battlefield and in Afghanistan. Holmes told investors that the DOD had deployed Theranos' miniLab on medevac helicopters.

67. Holmes also included a comment in her cover letter that "Theranos has grown from cash from its contracts for some time," which misled investors into believing that these contracts funded Theranos' operations. She made the same comment verbally to other potential investors. Although Theranos had discussions with different military and government entities, the company earned limited revenues from those efforts, and Theranos primarily grew from investor capital raises.

68. Holmes knew, or was reckless in not knowing, that these statements were false and misleading. While Theranos' technology was used in a DOD burn study, it was never deployed by the DOD in the battlefield, in Afghanistan, or on medevac helicopters. From 2011

to 2014, Holmes had discussions with multiple divisions of the DOD. However, Theranos generated only approximately $300,000 from three DOD contracts.

69. Holmes' statements about Theranos' history with the DOD were important to potential investors because these relationships lent legitimacy to Theranos' business and its proprietary analyzer.

d. Holmes and Theranos Told Investors That Theranos' Relationships with Pharmacy A and Grocery A Were Thriving When They Were Stalled

70. During meetings and in investor binders, Holmes described Theranos' thriving relationships with Pharmacy A and Grocery A. Much of the company overview presentation was dedicated to Theranos' relationship with Pharmacy A, showing pictures of the patient service centers where patients would get their fingers pricked, and a map of the number of Pharmacy A stores across the country that would soon be offering Theranos' blood testing.

71. Holmes also noted, in her cover letter, that since the launch of Theranos' roll-out in Pharmacy A stores, the company had also begun "operating in the consumer, physician, and hospital laboratory testing business," highlighting the importance of the Pharmacy A relationship in paving the way for these other lines of business.

72. Most importantly, Holmes represented to numerous investors in late 2014 that Theranos was expected to roll out its retail services to hundreds of Pharmacy A stores in 2015. This information was also included in financial projections that Theranos sent to investors that were based on the assumption that Theranos would be rolling out to 800 or 900 stores by year-end 2015.

73. However, by late 2014, while Theranos was raising the bulk of the over $700 million it raised during the relevant time period, Holmes was aware that Theranos' retail roll out with Pharmacy A was stalled due to, among other issues, some concerns Pharmacy A executives had with regard to Theranos' performance.

74. Holmes knew that patient traffic and the percentage of collections being performed by fingerstick were important metrics for Pharmacy A and also knew that Pharmacy

A had concerns regarding the lower than expected number of fingerstick collections being performed in its stores.

75. In December 2014, Holmes met with Pharmacy A executives to discuss potentially modifying the parties' relationship to a landlord and tenant model, whereby Theranos would rent space in Pharmacy A stores. Holmes did not share any of these developments with investors. Holmes knew, or was reckless in not knowing, that Theranos would not be expanding into Pharmacy A as quickly as she represented it would.

76. Holmes also told investors in late 2014 that Theranos services would be rolled out in more than 100 Grocery A stores in January 2015. But the relationship with Grocery A had already begun to stall in 2013, during which the parties had started discussing the possibility of modifying the contract so that Theranos would rent space in individual supermarkets. The parties were still engaged in these discussions in 2014.

77. By June 2014, Holmes told a Theranos board member that she was contemplating terminating Theranos' relationship with Grocery A. By August 2014, the parties ceased to be in communication with one another. Nevertheless, when meeting with investors in the fall of 2014, Holmes continued to discuss Theranos' relationship with Grocery A to investors. Holmes knew, or was reckless in not knowing, that her statements about Theranos' relationship with Grocery A were false or misleading.

78. The statements made by Holmes about the status of the Pharmacy A and Grocery A relationships were important to investors because these contracts gave potential investors confidence that Theranos' technologies were commercially ready. Pharmacy A and Grocery A were also the major drivers of future revenues for the company. In reality, Holmes and Theranos were attempting to renegotiate Theranos' agreements with these retail businesses in light of the delays in rolling out.

e. Holmes Claimed That Theranos Was Not Required to Seek FDA Approval Despite Repeatedly Being Told That Approval Was Necessary for Its Analyzers and Tests

79. When speaking to potential investors in late 2013 through 2015, Holmes consistently stated that Theranos did not need to obtain approval from the FDA for its miniLab and tests, and instead said that Theranos was applying for FDA approval voluntarily because it was the "gold standard." For instance, Holmes told multiple investors that approval was not required for the miniLab because Theranos was not selling its devices to other companies.

80. Holmes represented to business partners and investors that FDA approval was not necessary because she believed that Theranos' tests were laboratory developed tests ("LDTs"), or tests developed and used inside a clinical laboratory, over which the FDA had historically exercised its enforcement discretion to not require FDA clearance. However, she and Balwani were told by multiple parties, including Pharmacy A, that the FDA might reject this regulatory strategy because Theranos' miniLab had not previously obtained approval from the FDA. Holmes and FDA representatives discussed Theranos' regulatory strategy in late 2013 through 2014 while Theranos continued to offer LDTs to retail patients.

81. By the time of Theranos' financing round in 2014, FDA representatives told Holmes that clearance or approval would be necessary for Theranos' analyzer and tests. In late 2013 and throughout 2014, FDA representatives met with Holmes and sent letters to Theranos stating that they did not believe Theranos was offering LDTs, and that even if Theranos was not selling its miniLab or tests, FDA clearance or approval was necessary. Based on these communications, Holmes agreed to submit all components of Theranos' testing technology to the FDA for clearance or approval. However, Holmes continued to raise additional funds while telling investors Theranos was seeking FDA approval voluntarily. But Holmes knew, or was reckless in not knowing, that FDA approval was necessary for Theranos' analyzer and tests.

82. Holmes' statements that Theranos did not need FDA approval or clearance were important to investors because approval or clearance would have been an obstacle in the company's path to realizing full commercialization.

f. Holmes Told Investors That Theranos Had Generated or Would Generate Over $100 Million in Revenues in 2014 and That It Was On Track to Make $1 Billion in Revenues in 2015, But This Information Had No Basis

83. Theranos included financial information in the investor binders that projected that Theranos would generate over $100 million in revenues and break even in 2014. These documents, which were drafted by Balwani, and which Holmes reviewed and shared with potential investors, also represented that Theranos expected to generate approximately $1 billion in revenues in 2015.

84. The projections further indicated that Theranos would obtain revenue from several lines of business, including retail pharmacies (Pharmacy A and Grocery A), samples collected from physicians' offices, samples collected from hospitals, and pharmaceutical services.

85. Holmes also provided historical financial information to one potential investor. In August 2015, Holmes met with a potential investor, during which she provided Theranos' financial results for fiscal year 2014. These financials showed 2014 net revenues of $108 million, and 2015 and 2016 net revenue projections of $240 million and $750 million, respectively.

86. But Theranos' actual financial performance bore no resemblance to the financial information Holmes shared with investors. Theranos recorded little more than $100,000 in revenue in 2014 and was nowhere near generating $100 million in revenue by the end of 2014.

87. Holmes knew, or was reckless in not knowing, that Theranos sent different financial information containing Theranos' actual revenue numbers (a little over $100,000) to a third-party valuation firm that it had retained to value the company's common stock. Some of Theranos' projections, provided to potential investors in October 2014, stated Theranos would earn $40 million from pharmaceutical services, $46 million from lab services provided to hospitals, and $9 million from lab services provided to physicians' offices, all by the end of 2014. In reality, Theranos had no revenues from any of those lines of business.

88. Holmes also knew, or was reckless in not knowing, that the 2015 $1 billion revenue projections were unreasonable. By late 2014, Holmes knew Theranos' roll outs in Pharmacy A and Grocery A stores were not going as planned. Theranos and Holmes also knew the company had made limited progress in advancing the other lines of business reflected in the projections. Holmes knew that Theranos had no active discussions with pharmaceutical companies, had partnered with only a handful of hospitals, and had no knowledge of any contracts between Theranos and physicians' offices.

89. These financial projections were important to investors because they gave the impression that Theranos had already secured contracts to deliver these revenues and that the company's business was growing rapidly.

F. Theranos Exited the Commercial Laboratory Business in 2016, and By the End of 2017, Was On the Verge of Bankruptcy

90. In 2016, after regulatory inspections of Theranos' clinical laboratories and manufacturing facility, Theranos and Holmes exited the retail laboratory business and shifted the company's focus away from retail clinical testing and back to developing the miniLab. Additionally, Grocery A and Pharmacy A terminated their relationships with Theranos.

91. In 2017, Theranos and Holmes settled a lawsuit with an investor that alleged it was defrauded by Theranos. Theranos also settled a lawsuit with Pharmacy A, which brought an action for breach of contract against the company.

92. In 2017, Theranos conducted a tender offer to recapitalize certain investors from its later fundraising rounds. As part of that recapitalization, Holmes returned approximately 34 million of her shares to Theranos to prevent other investors from being diluted as a result of the tender offer. As part of the tender offer, Theranos agreed not to take certain corporate actions – including the decisions to issue new equity or amend the company's bylaws – without a vote of the majority of shareholders who invested during the relevant time period.

93. Due to the company's liquidation preference, if Theranos is acquired or is otherwise liquidated, Holmes would not profit from her ownership until – assuming redemption

of certain warrants – over $750 million is returned to defrauded investors and other preferred shareholders.

94. In late 2017, on the verge of bankruptcy, Theranos obtained a term loan, secured on the value of Theranos' patent portfolio, that it anticipated would allow the company to continue work on the miniLab for approximately one year.

FIRST CLAIM FOR RELIEF

Violations of Section 10(b) of the Exchange Act and Rule 10b-5

By Both Defendants

95. The Commission re-alleges and incorporates by reference Paragraph Nos. 1 through 94.

96. By engaging in the conduct described above, Defendants Holmes and Theranos, directly or indirectly, in connection with the purchase or sale of securities, by the use of means or instrumentalities of interstate commerce, or the mails, with scienter:

(a) Employed devices, schemes, or artifices to defraud;

(b) Made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and

(c) Engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons, including purchasers and sellers of securities.

97. By reason of the foregoing, Defendants violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. §§ 240.10b-5].

SECOND CLAIM FOR RELIEF

Violations of Sections 17(a)(1), (2), and (3) of the Securities Act

By Both Defendants

98. The Commission re-alleges and incorporates by reference Paragraph Nos. 1 through 94.

99. By engaging in the conduct described above, Defendants Holmes and Theranos, directly or indirectly, in the offer or sale of securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails,

(1) with scienter, employed devices, schemes, or artifices to defraud;

(2) obtained money or property by means of untrue statements of material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and

(3) engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon purchasers.

100. By reason of the foregoing, Defendants violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act [15 U.S.C. §§ 77q(a)].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

I.

Permanently enjoin Defendants Holmes and Theranos from directly or indirectly violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], and Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

II.

Issue an order requiring Defendant Holmes to pay a civil monetary penalty pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)(3)].

III.

Issue an order requiring Defendant Holmes to return 18,897,137 Class B common stock shares in Theranos to Theranos within 14 days of entry of judgment pursuant to the Court's equitable powers.

IV.

Issue an order requiring Defendant Holmes to provide written notice to Theranos that she elects to convert all shares of Class B common stock shares in Theranos to Class A common stock shares, and take all necessary administrative actions to effectuate the conversion of these Class B common stock shares to Class A common stock shares within 28 days of entry of judgment pursuant to the Court's equitable powers.

V.

Prohibit Defendant Holmes from serving as an officer or director of any entity having a class of securities registered with the Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78*l*] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)], pursuant to Section 20(e) of the Securities Act [15 U.S.C. § 77t(e)] and Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)].

VI.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

VII.

Grant such other and further relief as this Court may determine to be just and necessary.

Dated: March 14, 2018

Respectfully submitted,

/s/ Jessica W. Chan
JESSICA W. CHAN
Attorney for Plaintiff
SECURITIES AND EXCHANGE COMMISSION

United States District Court

FOR THE
NORTHERN DISTRICT OF CALIFORNIA

VENUE: SAN JOSE

UNITED STATES OF AMERICA,

V.

ELIZABETH A. HOLMES and
RAMESH "SUNNY" BALWANI,

CR 18-0258 EJD

DEFENDANT(S).

FILED
Jul 28 2020
SUSAN Y. SOONG
CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO

THIRD SUPERSEDING INDICTMENT

118 U.S.C. § 1349 – Conspiracy;
18 U.S.C. § 1343 – Wire Fraud;
18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) – Forfeiture

A true bill.

/s/ Foreperson of the Grand Jury

Foreman

Filed in open court this 28th day of

July, 2020.

M Jock
Clerk

Sallie Kim
Magistrate Judge Sallie Kim

Bail, $ No Process

ADAM A. REEVES
Attorney for the United States,
Acting Under Authority Conferred By 28 U.S.C. § 515

FILED

Jul 28 2020

SUSAN Y. SOONG
CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

UNITED STATES OF AMERICA, Plaintiff, v. ELIZABETH A. HOLMES and RAMESH "SUNNY" BALWANI, Defendants.	Case No. CR 18-258 EJD VIOLATIONS: 18 U.S.C. § 1349 – Conspiracy; 18 U.S.C. § 1343 – Wire Fraud; 18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) – Forfeiture SAN JOSE VENUE

THIRD SUPERSEDING INDICTMENT

The Grand Jury charges that, at all relevant times:

Introductory Allegations

1. The defendant Elizabeth A. Holmes ("HOLMES") resided in the Northern District of California, and owned and operated a health care and life sciences company called Theranos, Inc. ("Theranos" or "Company"). HOLMES founded Theranos in 2003, and served in the role of Chief Executive Officer from 2003 through 2018.

2. The defendant Ramesh "Sunny" Balwani ("BALWANI") resided in the Northern District of California, and was employed by Theranos from September 2009 through 2016. BALWANI served in various roles at Theranos: as a member of its Board of Directors, as its President, and as its Chief Operating Officer.

3. Theranos was a corporation organized under the laws of the State of Delaware with its principal place of business in Palo Alto, California. Theranos opened and maintained a corporate bank account in Palo Alto, California at Comerica Bank. Comerica Bank is headquartered in Dallas, Texas. When Theranos solicited and received financial investments from investors, the money was deposited into its Comerica Bank account. Theranos's investors included individuals, entities, certain business partners, members of its board of directors, and individuals and entities who invested through firms formed for the exclusive or primary purpose of investing in Theranos's securities.

The Business of Theranos

4. Theranos was a private health care and life sciences company. Its stated mission was to revolutionize medical laboratory testing through allegedly innovative methods for drawing blood, testing blood, and interpreting the resulting patient data—all for the purpose of improving outcomes and lowering health care costs.

5. During its first ten years, from approximately 2003 to approximately 2013, Theranos operated in what HOLMES called "stealth mode," with little public attention. While operating in "stealth mode," Theranos pursued the development of proprietary technology that could run clinical tests using only tiny drops of blood instead of the vials of blood typically drawn from an arm vein for traditional analysis. Theranos also worked to develop a method for drawing only a few drops of capillary blood from a patient's finger using a small lancet, and collecting and storing that blood in a proprietary device called the "nanotainer." Theranos's stated goal was to produce a second proprietary device that could quickly and accurately analyze blood samples collected in nanotainers. Theranos referred to these devices using several terms, including "TSPU" (or "Theranos Sample Processing Unit"), "Edison," and "miniLab."

6. In or around 2013, Theranos began to publicize its technological advances. According to Theranos, its proprietary methods and technologies carried several advantages over conventional blood testing. For example, Theranos claimed that its laboratory infrastructure yielded test results in less time than conventional labs—requiring hours instead of days. Theranos claimed that its proprietary technology and methods would minimize the risk of human error and generate results with the highest accuracy. According to Theranos, the small blood sample size required for Theranos's proprietary tests,

and its method of collecting blood by finger stick, would also benefit elderly individuals with collapsed veins, individuals who required frequent blood tests due to chronic health conditions, and any individual who feared needles. In addition, Theranos claimed that its blood tests provided substantial cost savings, advertising that it billed all of the tests on the Medicare Clinical Laboratory Fee Schedule at rates 50% or more below the published reimbursement rate.

7. Prior to its commercial launch, HOLMES heavily promoted Theranos's supposed technological and operational capabilities. In a September 2013 press release, Theranos claimed that it had "eliminat[ed] the need for larger needles and numerous vials of blood" by relying instead on samples "taken from a tiny finger stick or a micro-sample taken from traditional methods." In another press release, dated November 13, 2013, Theranos touted its use of "blood sample[s] as small as a few drops—1/1000th the size of a typical blood draw." In that same statement, the Company again declared that it had "eliminat[ed] the need for large needles and numerous vials of blood typically required for diagnostic lab testing."

8. In addition to directing the actions of the Company, HOLMES also made statements to the media advertising the capabilities of Theranos's technology. In an interview for a *Wall Street Journal* article published on September 9, 2013, HOLMES said that Theranos could "run any combination of tests, including sets of follow-on tests" at once, very quickly, all from a single small blood sample.

9. Theranos also used its website to increase awareness of its technology. On its website, Theranos displayed a nanotainer of blood balanced on a fingertip along with the slogan, "one tiny drop changes everything." The website also assured visitors that "for the first time," Theranos's laboratory could perform tests "quickly and accurately on samples as small as a single drop."

<u>Theranos's Partnership with Walgreens</u>

10. As part of its commercial launch, as early as 2010, Theranos pursued a partnership with national pharmacy chain Walgreens. On September 9, 2013, Theranos announced that it would be rolling out Theranos "Wellness Centers" inside Walgreens retail locations. In a press release on that date, Theranos promoted its testing services by stating that "consumers can now complete any clinician-directed lab test with as little as a few drops of blood and results available in a matter of hours."

Theranos offered tests to the public beginning in late 2013 through its Wellness Centers located in Walgreens stores in Palo Alto, California as well as in Phoenix, Arizona and surrounding areas.

The Scheme to Defraud Investors

11. From a time unknown but no later than 2010 through 2015, HOLMES and BALWANI, and others known and unknown to the Grand Jury, through their company, Theranos, engaged in a scheme, plan, and artifice to defraud investors as to a material matter, and to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, by making materially false and misleading statements, and failing to disclose material facts with a duty to disclose.

12. Beginning in approximately 2010, HOLMES and BALWANI made materially false and misleading statements to investors and failed to disclose material facts, using, among other things: (1) false and misleading written and verbal communications; (2) marketing materials containing false and misleading statements; (3) false and misleading financial statements, models, and other information; and (4) false and misleading statements to the media. HOLMES and BALWANI:

(A) represented to investors that, at the time the statement was made, Theranos's proprietary analyzer—the TSPU, Edison, or miniLab—was presently capable of accomplishing certain tasks, such as performing the full range of clinical tests using small blood samples drawn from a finger stick and producing results that were more accurate and reliable than those yielded by conventional methods—all at a faster speed than previously possible; when, in truth, HOLMES and BALWANI knew that Theranos's proprietary analyzer had accuracy and reliability problems, performed a limited number of tests, was slower than some competing devices, and could not compete with larger, conventional machines in high-throughput, or the simultaneous testing of blood from many patients, applications;

(B) represented to investors that Theranos was presently a financially strong and stable company, including that Theranos would generate over $100 million in revenues and break even in 2014, and that Theranos expected to generate approximately $1 billion in revenues in 2015; when, in truth, HOLMES and BALWANI knew that Theranos had and would generate only modest revenues, roughly a few hundred thousand dollars or so, in 2014 and 2015;

(C) deceived investors through misleading technology demonstrations intended to cause potential investors to believe that blood tests were being conducted on Theranos's proprietary analyzer; when, in truth, HOLMES and BALWANI knew that Theranos's proprietary analyzer was running a "null protocol" during the demonstration to make the analyzer appear to be operating, but was not testing the potential investor's blood, and yet failed to disclose that fact;

(D) represented to investors that Theranos presently had an expanding partnership with Walgreens, that is, Theranos would soon dramatically increase the number of Wellness Centers within Walgreens stores; when, in truth, HOLMES and BALWANI knew, by late 2014, that Theranos's retail Walgreens rollout had stalled because of several issues, including that Walgreens's executives had concerns with Theranos's performance;

(E) represented to investors that Theranos presently had a profitable and revenue-generating business relationship with the United States Department of Defense, and that Theranos's technology had deployed to the battlefield; when, in truth, HOLMES and BALWANI knew that Theranos had limited revenue from military contracts and its technology was not deployed in the battlefield;

(F) represented to investors that Theranos did not need the Food and Drug Administration ("FDA") to approve its proprietary analyzer and tests, but instead that Theranos was applying for FDA approval voluntarily because it was the "gold standard"; when, in truth, HOLMES and BALWANI knew that by late 2013 and throughout 2014, the FDA was requiring Theranos to apply for clearance or approval for its analyzer and tests;

(G) represented to investors that Theranos conducted its patients' tests using Theranos-manufactured analyzers; when, in truth, HOLMES and BALWANI knew that Theranos purchased and used for patient testing third party, commercially-available analyzers;

(H) represented to investors that Theranos's technology had been examined, used, and validated by several national or multinational pharmaceutical companies and research institutions; when, in truth, HOLMES and BALWANI knew that these pharmaceutical companies and research institutions had not examined, used, or validated Theranos's technology; and

(I) represented to members of the media for publication many of the false and misleading statements described above within paragraph 12(A) – 12(H), and shared the resulting articles with potential investors both directly and via the Theranos website, knowing their statements to members of the media were false and misleading.

13. After receiving false and misleading statements, misrepresentations, and omissions from HOLMES and BALWANI, persons known to the Grand Jury as Investors 1, 2, 3, 4, 5, and 6 initiated electronic wire transfers for the purpose of investing money in Theranos. These wires, specifically alleged in paragraph 24 of this Third Superseding Indictment, used a domestic electronic funds transfer system known as the Fedwire system, which is owned and operated by the United States Federal Reserve System. All Fedwire wire transfers alleged in this Third Superseding Indictment were electronically routed through Fedwire centers in East Rutherford, New Jersey, Dallas, Texas, or outside California and into Theranos's bank account in the Northern District of California. All of the wire transfers alleged in this Third Superseding Indictment travelled between one state and another state.

The Scheme to Defraud Patients

14. Between approximately 2013 and 2016, HOLMES and BALWANI, through advertisements and solicitations, encouraged and induced doctors and patients to use Theranos's blood testing laboratory services.

15. HOLMES and BALWANI devised a scheme to defraud patients, through advertisements and marketing materials, through explicit and implicit claims concerning Theranos's ability to provide accurate, fast, reliable, and cheap blood tests and test results, and through omissions concerning the limits of and problems with Theranos's technologies. Based on these representations, many hundreds of patients paid Theranos, or Walgreens acting on behalf of Theranos, for blood tests and test results, sometimes following referrals from their misled doctors.

16. Despite representing to doctors and patients that Theranos could provide accurate, fast, reliable, and cheap blood tests and test results, HOLMES and BALWANI knew—through, among other means, their involvement in Theranos's day-to-day operations and their knowledge of complaints received from doctors and patients—that Theranos's technology was, in fact, not capable of consistently producing accurate and reliable results. In particular, HOLMES and BALWANI knew that Theranos

was not capable of consistently producing accurate and reliable results for certain blood tests, including but not limited to bicarbonate, calcium, chloride, cholesterol/HDL/LDL, gonorrhea, glucose, HbA1c, hCG, HIV, LDH, potassium, PSA, PT/INR, sodium, testosterone, TSH, vitamin D (25-OH), and all assays conducted on Theranos's TSPU version 3.5, including estradiol, prolactin, SHBG, thyroxine (T4/free T4), triiodothyronine, and vitamin B-12.

17. Despite their knowledge of Theranos's accuracy and reliability problems, HOLMES and BALWANI used interstate electronic wires to purchase advertisements intended to induce individuals to purchase Theranos blood tests at Walgreens stores in California and Arizona. Through these advertisements, HOLMES and BALWANI explicitly represented to individuals that Theranos's blood tests were cheaper than blood tests from conventional laboratories to induce individuals to purchase Theranos's blood tests. HOLMES and BALWANI held Theranos's blood tests out to individuals as accurate and reliable. HOLMES and BALWANI:

(A) transmitted, caused to be transmitted, or otherwise delivered to doctors and patients, including in the form of marketing materials and advertisements, materially false and misleading information concerning the accuracy and reliability of Theranos's blood testing services;

(B) posted on the Theranos website, or otherwise represented to a broad audience including doctors and patients, materially false and misleading information concerning the accuracy and reliability of Theranos's blood testing services;

(C) transmitted, caused to be transmitted, or otherwise delivered to doctors and patients Theranos blood test results where HOLMES and BALWANI knew that the tests performed on Theranos technology contained or were likely to contain:

(1) inaccurate and unreliable results;

(2) improperly adjusted reference ranges;

(3) improperly removed "critical" results; and

(4) results generated from improperly validated assays.

18. Knowing that the accuracy and reliability of Theranos test results was questionable and suspect, HOLMES and BALWANI oversaw the electronic wiring of test results to patients, including persons known to the Grand Jury as Patients B.B, E.T., and M.E. in paragraph 26 of this Third

Superseding Indictment. These wires, specifically, the wires alleged in paragraph 26 of this Third Superseding Indictment, travelled between one state and another.

COUNT ONE: 18 U.S.C. § 1349 (Conspiracy to Commit Wire Fraud against Theranos Investors)

19. Paragraphs 1 through 18 are realleged and incorporated as if fully set forth herein.

20. From a time unknown but no later than approximately 2010 through approximately 2015, within the Northern District of California, and elsewhere, the defendants,

ELIZABETH A. HOLMES and
RAMESH "SUNNY" BALWANI,

and others known and unknown to the Grand Jury, did knowingly and intentionally conspire and agree together and with each other to commit wire fraud, in violation of Title 18, United States Code, Section 1343, by devising a scheme and artifice to defraud as to a material matter and to obtain money by means of materially false and fraudulent representations, specifically by soliciting investments through making the false and fraudulent representations as set forth in this Third Superseding Indictment.

All in violation of Title 18, United States Code, Section 1349.

COUNT TWO: 18 U.S.C. § 1349 (Conspiracy to Commit Wire Fraud against Theranos Patients)

21. Paragraphs 1 through 18 are realleged and incorporated as if fully set forth herein.

22. From in or about 2013 through 2016, within the Northern District of California, and elsewhere, the defendants,

ELIZABETH A. HOLMES and
RAMESH "SUNNY" BALWANI,

and others known and unknown to the Grand Jury, did knowingly and intentionally conspire and agree together and with each other to commit wire fraud, in violation of Title 18, United States Code, Section 1343, by devising a scheme and artifice to defraud as to a material matter and to obtain money by means of materially false and fraudulent representations, specifically by soliciting, encouraging, or otherwise inducing doctors to refer and patients to pay for and use its laboratory and blood testing services under the false and fraudulent pretense that Theranos technology produced reliable and accurate blood test results.

All in violation of Title 18, United States Code, Section 1349.

COUNTS THREE THROUGH EIGHT: 18 U.S.C. § 1343 (Wire Fraud)

23. Paragraphs 1 through 22 are realleged and incorporated as if fully set forth herein.

24. On or about the dates set forth below, within the Northern District of California, and elsewhere, the defendants,

ELIZABETH A. HOLMES and
RAMESH "SUNNY" BALWANI,

for the purpose of executing the material scheme and artifice to defraud investors, and for obtaining money and property from investors by means of materially false and fraudulent pretenses, representations, promises, and material omissions with a duty to disclose, did knowingly transmit and cause to be transmitted by means of wire communication in interstate commerce certain writings, signs, signals, and pictures, that is, electronic funds transfers and payments from investor bank accounts to Theranos, as further set forth below:

COUNT	DATE	ITEM WIRED	WIRED FROM	WIRED TO
3	12/30/2013	$99,990	Investor #1's Charles Schwab/Wells Fargo Bank account	Theranos's Comerica Bank account
4	12/31/2013	$5,349,900	Investor #6's Pacific Western Bank account	Theranos's Comerica Bank account
5	12/31/2013	$4,875,000	Investor #2's Texas Capital Bank account	Theranos's Comerica Bank account
6	2/6/2014	$38,336,632	Investor #3's Citibank account	Theranos's Comerica Bank account
7	10/31/2014	$99,999,984	Investor #4's Northern Chicago Bank account	Theranos's Comerica Bank account
8	10/31/2014	$5,999,997	Investor #5's JP Morgan Chase account	Theranos's Comerica Bank account

Each in violation of Title 18, United States Code, Section 1343.

COUNTS NINE THROUGH TWELVE: 18 U.S.C. § 1343 (Wire Fraud)

25. Paragraphs 1 through 24 are realleged and incorporated as if fully set forth herein.

26. On or about the dates set forth below, within the Northern District of California, and elsewhere, the defendants,

ELIZABETH A. HOLMES and
RAMESH "SUNNY" BALWANI,

for the purpose of executing the material scheme and artifice to defraud patients, and for obtaining money and property from patients by means of materially false and fraudulent pretenses, representations, promises, and material omissions with a duty to disclose, did knowingly transmit and cause to be transmitted by means of wire communication in interstate commerce certain writings, signs, signals, and pictures, that is, laboratory and blood test results, telephonic communications regarding test results, and payments for the purchase of advertisements soliciting patients and doctors for its laboratory business, as further set forth below, in violation of Title 18, United States Code, Section 1343:

COUNT	DATE	WIRED FROM	WIRED TO	DESCRIPTION
9	10/12/2015	Arizona	California	Telephone call from Patient B.B to Theranos regarding laboratory blood test results
10	5/11/2015	California	Arizona	Patient E.T.'s laboratory blood test results
11	5/16/2015	California	Arizona	Patient M.E.'s laboratory blood test results
12	8/3/2015	Theranos's Wells Fargo Bank account in California	Horizon Media, Inc.'s J.P. Morgan Chase Bank account in New York	Electronic Funds Transfer in the amount of $1,126,661.00 to purchase advertisements for Theranos Wellness Centers

Each in violation of Title 18, United States Code, Section 1343.

<u>FORFEITURE ALLEGATION</u>: 18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) (Forfeiture of Wire Fraud Proceeds)

27. The allegations of paragraphs 1 through 26 of this Third Superseding Indictment are realleged and by this reference fully incorporated herein for the purposes of alleging forfeiture pursuant to the provisions of 18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c).

28. Upon a conviction for the offense alleged in Counts One through Twelve, the defendants,

ELIZABETH A. HOLMES and
RAMESH "SUNNY" BALWANI,

shall forfeit to the United States all property, constituting and derived from proceeds traceable to said offenses, including but not limited to the following property:

(a) a sum of money equal to the amount of proceeds obtained as a result of the offense.

If any of said property, as a result of any act or omission of the defendant-

(a) cannot be located upon the exercise of due diligence;

(b) has been transferred or sold to or deposited with a third person;

(c) has been placed beyond the jurisdiction of the Court;

(d) has been substantially diminished in value; or

(e) has been commingled with other property which cannot be subdivided without difficulty;

Any and all interest defendant has in any other property (not to exceed the value of the above forfeitable property) shall be forfeited to the United States pursuant to Title 21, United States Code, Section 853(p), as incorporated by Title 18, United States Code, Section 982(b)(1).

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The forfeiture is authorized by Title 18, United States Code, Section 981(a)(1)(C) and Title 28, United States Code, Section 2461(c); Title 21, United States Code, Section 853(p) as incorporated by Title 18, United States Code, Section 982(b)(1); and the Federal Rules of Criminal Procedure 32.2.

DATED: July 28, 2020

A TRUE BILL

/s/

FOREPERSON

ADAM A. REEVES
Attorney for the United States,
Acting Under Authority Conferred By 28 U.S.C. § 515

/s Robert S. Leach

JEFFREY SCHENK
ROBERT S. LEACH
JOHN C. BOSTIC
VANESSA BAEHR-JONES
Assistant United States Attorneys

DEFENDANT INFORMATION RELATIVE TO A CRIMINAL ACTION - IN U.S. DISTRICT COURT

BY: ☐ COMPLAINT ☐ INFORMATION ☒ INDICTMENT ☒ SUPERSEDING

Name of District Court, and/or Judge/Magistrate Location

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

OFFENSE CHARGED

18 U.S.C. § 1349 – Conspiracy;
18 U.S.C. § 1343 – Wire Fraud;
18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) – Forfeiture

☐ Petty
☐ Minor
☐ Misde-meanor
☒ Felony

PENALTY: All per count:
20 years imprisonment
$250,000 fine
3 years supervised release
$100 special assessment

DEFENDANT - U.S

Elizabeth Holmes

DISTRICT COURT NUMBER

CR 18-00258 EJD

FILED

Jul 28 2020

SUSAN Y. SOONG
CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO

PROCEEDING

Name of Complaintant Agency, or Person (& Title, if any)

FBI, USPS, FDA

☐ person is awaiting trial in another Federal or State Court, give name of court

☐ this person/proceeding is transferred from another district per (circle one) FRCrp 20, 21, or 40. Show District

☐ this is a reprosecution of charges previously dismissed which were dismissed on motion of:
☐ U.S. ATTORNEY ☐ DEFENSE
SHOW DOCKET NO.

☐ this prosecution relates to a pending case involving this same defendant

☐ prior proceedings or appearance(s) before U.S. Magistrate regarding this defendant were recorded under
MAGISTRATE CASE NO.

Name and Office of Person Furnishing Information on this form: ADAM A. REEVES

Acting ☒ U.S. Attorney ☐ Other U.S. Agency

Name of Assistant U.S. Attorney (if assigned): Robert Leach, AUSA

DEFENDANT

IS *NOT* IN CUSTODY

1) ☐ Has not been arrested, pending outcome this proceeding. If not detained give date any prior summons was served on above charges

2) ☐ Is a Fugitive

3) ☒ Is on Bail or Release from (show District)

NDCA

IS IN CUSTODY

4) ☐ On this charge

5) ☐ On another conviction ☐ Federal ☐ State

6) ☐ Awaiting trial on other charges

If answer to (6) is "Yes", show name of institution

Has detainer been filed? ☐ Yes ☐ No — If "Yes" give date filed

DATE OF ARREST Month/Day/Year

Or... if Arresting Agency & Warrant were not

DATE TRANSFERRED TO U.S. CUSTODY Month/Day/Year

☐ This report amends AO 257 previously submitted

ADDITIONAL INFORMATION OR COMMENTS

PROCESS:

☐ SUMMONS ☒ NO PROCESS* ☐ WARRANT

Bail Amount:

If Summons, complete following:
☐ Arraignment ☐ Initial Appearance

** Where defendant previously apprehended on complaint, no new summons or warrant needed, since Magistrate has scheduled arraignment*

Defendant Address:

Date/Time: Before Judge:

Comments:

DEFENDANT INFORMATION RELATIVE TO A CRIMINAL ACTION - IN U.S. DISTRICT COURT

BY: ☐ COMPLAINT ☐ INFORMATION ☒ INDICTMENT ☒ SUPERSEDING

Name of District Court, and/or Judge/Magistrate Location
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

OFFENSE CHARGED

18 U.S.C. § 1349 – Conspiracy;
18 U.S.C. § 1343 – Wire Fraud;
18 U.S.C. § 981(a)(1)(C) and 28 U.S.C. § 2461(c) – Forfeiture

☐ Petty
☐ Minor
☐ Misde-meanor
☒ Felony

PENALTY: All per count:
20 years imprisonment
$250,000 fine
3 years supervised release
$100 special assessment

DEFENDANT - U.S

Ramesh "Sunny" Balwani

DISTRICT COURT NUMBER
CR 18-00258 EJD

FILED
Jul 28 2020
SUSAN Y. SOONG
CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO

PROCEEDING

Name of Complaintant Agency, or Person (& Title, if any)

FBI, USPS, FDA

☐ person is awaiting trial in another Federal or State Court, give name of court

☐ this person/proceeding is transferred from another district per (circle one) FRCrp 20, 21, or 40. Show District

☐ this is a reprosecution of charges previously dismissed which were dismissed on motion of:
☐ U.S. ATTORNEY ☐ DEFENSE
SHOW DOCKET NO.

☐ this prosecution relates to a pending case involving this same defendant

☐ prior proceedings or appearance(s) before U.S. Magistrate regarding this defendant were recorded under
MAGISTRATE CASE NO.

Name and Office of Person Furnishing Information on this form: ADAM A. REEVES

Acting ☒ U.S. Attorney ☐ Other U.S. Agency

Name of Assistant U.S. Attorney (if assigned): Robert Leach, AUSA

DEFENDANT

IS *NOT* IN CUSTODY

1) ☐ Has not been arrested, pending outcome this proceeding. If not detained give date any prior summons was served on above charges

2) ☐ Is a Fugitive

3) ☒ Is on Bail or Release from (show District)

NDCA

IS IN CUSTODY

4) ☐ On this charge

5) ☐ On another conviction } ☐ Federal ☐ State

6) ☐ Awaiting trial on other charges

If answer to (6) is "Yes", show name of institution

Has detainer been filed? ☐ Yes ☐ No } If "Yes" give date filed

DATE OF ARREST Month/Day/Year

Or... if Arresting Agency & Warrant were not

DATE TRANSFERRED TO U.S. CUSTODY Month/Day/Year

☐ This report amends AO 257 previously submitted

ADDITIONAL INFORMATION OR COMMENTS

PROCESS:

☐ SUMMONS ☒ NO PROCESS* ☐ WARRANT

Bail Amount:

If Summons, complete following:
☐ Arraignment ☐ Initial Appearance

** Where defendant previously apprehended on complaint, no new summons or warrant needed, since Magistrate has scheduled arraignment*

Defendant Address:

Date/Time: Before Judge:

Comments:

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

USA, Plaintiff, v. ELIZABETH A. HOLMES, Defendant.	Case No. 18-cr-00258-EJD-1 (NC) **ORDER GRANTING PLAINTIFF'S MOTION TO DETERMINE THAT DEFENDANT LACKS INDIVIDUAL PRIVILEGE INTEREST IN DISPUTED DOCUMENTS** Re: ECF 559

The government seeks to have certain Theranos corporate documents deemed admissible for trial against Defendant Elizabeth A. Holmes. Holmes opposes admission asserting that the documents are confidential communications with her attorney subject to her individual attorney-client privilege. After a careful review of the briefing and documents in dispute, the Court GRANTS the government's motion and deems all thirteen documents admissible in light of the Theranos Assignee's waiver of corporate privilege.

I. BACKGROUND

In 2011, Boies Schiller Flexner LLP ("BSF") began representing Holmes and Theranos in an intellectual property dispute. ECF 619 at 6. After the representation began, BSF continued to offer Holmes and Theranos a variety of legal services in relation to Theranos' patent portfolio, press interactions, and inquiries from government agencies and departments. *Id.* at 6-8. Despite the breadth and duration of BSF's involvement, Holmes and BSF did not sign an engagement letter or establish any formal guidelines describing the scope of BSF's legal representation. *Id.* at 6. Holmes believed that BSF and BSF partner, David Boies, were her attorneys up to the point when she retained separate counsel to represent her in the Securities and Exchange Commission and Department of Justice investigations into Theranos in 2016. *Id.* at 8.

In June 2020, the government served Holmes with its Exhibit List for trial, which included thirteen documents that Holmes claims implicate her attorney client privilege. ECF 559 at 5, ECF 619 at 5. The government worked with the Theranos Assignee, "the controller of any remaining Theranos corporate privilege," to handle the documents. ECF 559 at 4. Holmes' claim for attorney client privilege is predicated on her understanding that Boies and BSF jointly represented Theranos and Holmes as an individual, not as a representative of the company. ECF 619 at 5. The government contests this assertion, insisting that there was no joint representation, so the documents are subject only to corporate privilege. ECF 559 at 5.

On November 20, 2020, the government moved for an order establishing that Holmes lacks an individual privilege interest in Theranos' corporate documents. ECF 559. Holmes opposed the motion. ECF 619. I held a hearing on the motion on December 16, 2020. ECF 647. At the hearing, the Court ordered Holmes to submit a privilege log and the disputed documents for in camera review. *Id.*

II. DISCUSSION

A. Attorney Client Privilege

Attorney-client privilege is the oldest common law privilege for confidential communications. *Upjohn Co. v. U.S.*, 449 U.S. 383, 390 (1981). "Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." *Id.* Information is covered by attorney-client privilege:

> (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself of by the legal adviser, (8) unless the protection be waived.

U.S. v. Ruehle, 583 F.3d 600, 607 (9th Cir. 2009) (citing *In re Grand Jury Investigation*, 974 F.2d 1068, 1071 n.2 (9th Cir. 1992)). Communications between a lawyer and their clients are presumed confidential; the burden to prove otherwise is on the party seeking disclosure. *Id.* at 609 (citing *Gordon v. Superior Court of L.A. County*, 55 Cal. App. 4th 1546, 1565 (1997)).

B. Joint Representations for Privilege Purposes

Holmes opposes the government's motion on the grounds that Boies and BSF jointly represented her and Theranos. ECF 619 at 13. The parties disagree on whether the Court should apply a subjective belief test or the *Graf* test. *See id.* at 13; *see also* ECF 559 at 8. Following Ninth Circuit case law, the Court applies the *Graf* test. *See e.g., Waymo LLC v. Uber Techs., Inc.*, Case No. 17-cv-00939-WHA (JSC), 2017 U.S. Dist. LEXIS 88411*, at *16-17 (N.D. Cal. June 8, 2017), *United States v. Roscoe*, Case No. 07-cr-00373-RMW, 2010 U.S. Dist. LEXIS 149186*, at *6 (N.D. Cal. Mar. 17, 2009). At the December 16, 2020 hearing, Holmes argued that the Court should not use the *Graf* test because it does not apply to this case. The Court disagrees for three reasons.

First, contrary to Holmes' assertion, the Ninth Circuit's discussion of two joint representation tests in the *Graf* opinion does not limit the *Graf* test's application to specific cases. The *Graf* opinion describes the two possible tests for joint representation—the *Bevill* test and the subjective belief test—but after extensive discussion of policy and the case law in other circuits, the Ninth Circuit unambiguously chose to adopt the *Bevill*/*Graf* test. *U.S. v. Graf*, 610 F.3d 1148, 1161 (9th Cir. 2010).

Second, the facts of *Graf* are analogous to this case. Like Holmes, Graf was indicted for his involvement in the fraudulent operation of a company. *Graf*, 610 F.3d at 1152. Like Holmes, Graf was the founder of the company, and he sought to exclude the testimony of attorneys who represented the company by asserting his individual attorney-client privilege. *Id.* Although Graf was not listed as an employee of the company, the Ninth Circuit determined that this classification was an effort to circumvent several cease-and-desist orders against him so it treated Graf as a "functional employee, not an independent outside consultant." *See id.* at 1153, 1159. These factual parallels reinforce that even if the *Graf* test did not apply to *all* joint representation disputes, *this* case would fall within its purview.

Finally, Holmes argues that *Graf* does not apply here because *Graf* addresses the question of formation while *In re Teleglobe Communications Corp.*, 493 F.3d 345, 378 (3rd Cir. 2007), addresses the question of scope. The Court disagrees with this characterization of the cases. To demonstrate: envision a Venn diagram with one circle for "company legal matters," another circle for "individual legal matters," and a small area of overlap for "common interests." The *Graf* test establishes that communications with corporate counsel about "individual legal matters" are controlled by the individual's privilege. *See Graf*, 610 F.3d at 1160. *Teleglobe* states that communications in the overlapping "common interests" area are controlled by the individual's privilege *and* the company's privilege. *Teleglobe*, 493 F.3d at 378. Because the two tests govern different parts of the diagram, they are not conflicting tests that apply at different times; rather they work together to define who holds the privilege for what at any moment. Aside from the fact that the *Teleglobe* decision is not binding on this Court, it does not apply to this case because Holmes asserts that the documents at issue regard her individual legal matters, not "common interests." *See* ECF 619 at 15-16. Therefore, the Court must apply the Ninth Circuit's *Graf* test.

1. The *Graf* Test

Graf requires the person seeking to assert individual privilege to satisfy all of the following factors to establish a joint representation:

> *First*, they must show they approached counsel for the purpose of seeking legal advice. *Second*, they must demonstrate that when they approached counsel they made it clear that they were seeking legal advice in their individual rather than in their representative capacities. *Third*, they must demonstrate that the counsel saw fit to communicate with them in their individual capacities, knowing that a possible conflict could arise. *Fourth*, they must prove that their conversations with counsel were confidential. And *fifth*, they must show that the substance of their conversations with counsel did not concern matters within the company or the general affairs of the company.

Graf, 610 F.3d at 1160. Before analyzing admissibility of the exhibits, the Court must first apply *Graf* to determine if Holmes has an individual privilege to assert.

2. The *Graf* Test Applied

The Court finds that Holmes fails to establish a joint representation because she cannot satisfy the second, fourth, and fifth elements of the *Graf* test. To satisfy the *Graf* test, Holmes must show that when she approached Boies and BSF for legal advice, she made it clear that she was seeking legal advice in her personal capacity. *See Graf*, 610 F.3d at 1160. Holmes fails to make this showing. In her opposition, Holmes insists that "Boies Schiller's representation of Ms. Holmes (in addition to Theranos) is a matter of public record and thus there is no relationship to be implied," but she is unable to point to any documents supporting this allegedly obvious joint representation. ECF 619 at 13. Holmes admits that "there was no engagement letter relating to Mr. Boies' or his firm's representation of Ms. Holmes and/or Theranos." *See id.* at 6. And Holmes does not point to any financial records showing that she paid Boies or BSF from her own accounts, not Theranos'. *See id.*; *see also Graf*, 610 F.3d at 1161 (weighing the fact that the company, not Graf, paid the firm's bills against a finding that Graf had a joint representation[1]). Holmes heavily relies on her belief that Boies and BSF jointly represented her and Theranos, however, Holmes' subjective belief is not the standard. The standard is a "clear" communication that the individual sought legal advice as an individual, not as a representative of the company; and on that Holmes falls short. *See Graf*, 610 F.3d at 1160.

Holmes also cannot show that her conversations with Boies and BSF were confidential. *See Graf*, 610 F.3d at 1160. None of the contested documents include conversations exclusively between Holmes and Boies or BSF. Holmes argues that "with one exception, the communications are between Ms. Holmes or other senior Theranos

[1] At the December 16, 2020 hearing, Holmes argued that the payment of legal fees is not an issue here because companies routinely enter into agreements to pay legal fees for the joint representation of a company officer. Holmes stated that, "there's an indemnification agreement that obligated Theranos to pay legal fees for Ms. Holmes in connection with joint representation." ECF 655 at 33. However, beyond this assertion, Holmes has not provided evidence of such an agreement to the Court.

employees, Theranos in-house attorneys, and Boies Schiller attorneys." ECF 619 at 18. However, if Holmes is arguing that she sought individual legal advice, the presence of Theranos employees and attorneys destroys the privilege.

Lastly, Holmes fails to show that that the substance of her conversations with Boies and BSF did not concern matters within the general affairs of the company. *See Graf*, 610 F.3d at 1160. None of the contest exhibits discuss Holmes' individual legal interests. All thirteen documents related to her "official duties" or the "general affairs" of the company like conversations with investors, billing, and media strategy. *See Graf*, 610 F.3d at 1162.

In sum, the Court finds that Boies and BSF did not jointly represent Holmes and Theranos because Holmes does not satisfy the second, fourth, and fifth factors of the *Graf* test. Therefore, the holder of attorney-client privilege over the contested documents Theranos' Assignee, and admissibility of the documents hinges on their waiver of corporate privilege. *See Commodity Futures Trading Com v. Weintraub*, 471 U.S. 343, 349 (1985) (finding that "when control of a corporation passes to new management, the authority to assert and waive the corporation's attorney-client privilege passes as well.").

III. CONCLUSION

For the foregoing reasons, the Court GRANTS the government's motion and finds that the thirteen disputed documents, labeled as Exhibits 1-13 in ECF 559-12, are not subject to Holmes' individual privilege. The documents are only subject to the Theranos Assignee's corporate privilege, which the Assignee has waived. *See* ECF 559 at 3 ("The Assignee has informed the government that it will not assert privilege over the materials addressed by this motion.") Thus, the Court deems Exhibits 1-13 admissible.

IT IS SO ORDERED.

Dated: June 3, 2021

NATHANAEL M. COUSINS
United States Magistrate Judge

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Geisinger Community Medical Center v. Secretary U.S. Dept. of Health and Human Services, 3rd Cir.(Pa.), July 23, 2015

134 S.Ct. 1158
Supreme Court of the United States

Jackie Hosang LAWSON and
Jonathan M. Zang, Petitioners
v.
FMR LLC et al.

No. 12–3.
|
Argued Nov. 12, 2013.
|
Decided March 4, 2014.

Synopsis
Background: Former employees of private companies that contracted to advise or manage mutual funds brought actions against their former employers, alleging employers unlawfully retaliated against them in violation of the Sarbanes–Oxley Act's whistleblower protection provision. In a joint order, the United States District Court for the District of Massachusetts, Douglas P. Woodlock, J., denied employers' motions to dismiss, 724 F.Supp.2d 141, but, subsequently, certified a question of law for interlocutory appeal, 724 F.Supp.2d 167. On interlocutory appeal, the United States Court of Appeals for the First Circuit, Lynch, Chief Circuit Judge, 670 F.3d 61, reversed. Certiorari was granted.

[Holding:] The Supreme Court, Justice Ginsburg, held that whistleblower protection under Sarbanes–Oxley extended to employees of private contractors and subcontractors serving public companies.

Reversed and remanded.

Justice Scalia filed an opinion concurring in part and concurring in the judgment in which Justice Thomas joined.

Justice Sotomayor filed a dissenting opinion in which Justice Kennedy and Justice Alito joined.

Procedural Posture(s): Motion to Dismiss.

West Headnotes (5)

[1] **Labor and Employment** Judicial review and enforcement

A determination by the Department of Labor's (DOL) Administrative Review Board (ARB) on a claim under the Sarbanes–Oxley Act's whistleblower protection provision constitutes the agency's final decision and is reviewable in federal court under the standards stated in the Administrative Procedure Act (APA). 5 U.S.C.A. § 706; 18 U.S.C.A. § 1514A.

22 Cases that cite this headnote

[2] **Labor and Employment** Reporting or Opposing Wrongdoing; Criticism and "Whistleblowing"

Labor and Employment Persons protected, persons liable, and parties; standing

Whistleblower protection under the Sarbanes–Oxley Act extends to employees of private contractors and subcontractors serving public companies. 18 U.S.C.A. § 1514A(a).

45 Cases that cite this headnote

[3] **Statutes** Language

Statutes Plain Language; Plain, Ordinary, or Common Meaning

In determining the meaning of a statutory provision, courts look first to its language, giving the words used their ordinary meaning.

30 Cases that cite this headnote

[4] **Labor and Employment** Persons protected, persons liable, and parties; standing

Independent investment advisers that manage mutual funds are "contractors" prohibited from retaliating against their own employees for engaging in whistleblowing activity under the Sarbanes–Oxley Act. 18 U.S.C.A. § 1514A(a).

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27 Cases that cite this headnote

[5] **Courts** Previous Decisions as Controlling or as Precedents

The courts of appeals are not the only lodestar for determining whether a proposition of law is plainly established.

5 Cases that cite this headnote

****1158** *Syllabus* [*]

***429** To safeguard investors in public companies and restore trust in the financial markets following the collapse of Enron Corporation, Congress passed the Sarbanes–Oxley Act of 2002. One of the Act's provisions protects whistleblowers; at the ****1159** time relevant here, that provision instructed: "No [public] company ..., or any ... contractor [or] subcontractor ... of such company, may discharge, demote, suspend, threaten, harass, or ... discriminate against an employee in the terms and conditions of employment because of [whistleblowing activity]." 18 U.S.C. § 1514A(a).

Plaintiffs below, petitioners here, are former employees of respondents (collectively FMR), private companies that contract to advise or manage mutual funds. As is common in the industry, the mutual funds served by FMR are public companies with no employees. Both plaintiffs allege that they blew the whistle on putative fraud relating to the mutual funds and, as a consequence, suffered retaliation by FMR. Each commenced suit in federal court. Moving to dismiss the suits, FMR argued that the plaintiffs could state no claim under § 1514A, for that provision protects only employees of public companies, and not employees of private companies that contract with public companies. On interlocutory appeal from the District Court's denial of FMR's motion to dismiss, the First Circuit reversed, concluding that the term "an employee" in § 1514A(a) refers only to employees of public companies.

Held : The judgment is reversed and the case is remanded.

670 F.3d 61, reversed and remanded.

Justice GINSBURG delivered the opinion of the Court, concluding that § 1514A's whistleblower protection includes employees of a public company's private contractors and subcontractors. Pp. 1165 – 1176.

(a) This reading of § 1514A is supported by the provision's text. Pp. 1165 – 1169.

(1) The Court looks first to the ordinary meaning of the provision's language. See *Moskal v. United States,* 498 U.S. 103, 108, 111 S.Ct. 461, 112 L.Ed.2d 449. As relevant here, § 1514A(a) provides that "no ... contractor ... may discharge ... an employee." The ordinary meaning of "an employee" in this proscription is the contractor's own employee. FMR's "narrower construction" requires inserting "of a public company" after "an employee," but where Congress meant "an employee of a public company," it said so.

***430** The provision as a whole supports this reading. The prohibited retaliatory measures enumerated in § 1514A(a)—discharge, demotion, suspension, threats, harassment, or discrimination in employment terms and conditions—are actions an employer takes against its own employees. Contractors are not ordinarily positioned to take adverse actions against employees of the public company with whom they contract. FMR's interpretation of § 1514A, therefore, would shrink to insignificance the provision's ban on retaliation by contractors. The protected activity covered by § 1514A, and the provision's enforcement procedures and remedies, also indicate that Congress presumed an employer-employee relationship between the retaliator and the whistleblowing employee. Pp. 1165 – 1168.

(2) FMR's textual arguments are unpersuasive. It urges that "an employee" must be read to refer exclusively to public company employees to avoid the absurd result of extending protection to the personal employees of company officers and employees, *e.g.,* their housekeepers or gardeners. This concern appears more theoretical than real and, in any event, is outweighed by the compelling arguments opposing FMR's reading of § 1514A. FMR also urges that its reading is supported by the provision's statutory headings, but those headings are "not meant to take the place of the detailed provisions of the text." *Trainmen v. Baltimore &* ****1160** *Ohio R. Co.,* 331 U.S. 519, 528, 67 S.Ct. 1387, 91 L.Ed. 1646. Pp. 1168 – 1169.

(b) Other considerations support the Court's textual analysis. Pp. 1169 – 1175.

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(1) The Court's reading fits § 1514A's aim to ward off another Enron debacle. The legislative record shows Congress' understanding that outside professionals bear significant responsibility for reporting fraud by the public companies with whom they contract, and that fear of retaliation was the primary deterrent to such reporting by the employees of Enron's contractors. Sarbanes–Oxley contains numerous provisions designed to control the conduct of accountants, auditors, and lawyers who work with public companies, but only § 1514A affords such employees protection from retaliation by their employers for complying with the Act's reporting requirements. Pp. 1169 – 1171.

(2) This Court's reading of § 1514A avoids insulating the entire mutual fund industry from § 1514A. Virtually all mutual funds are structured so that they have no employees of their own; they are managed, instead, by independent investment advisors. Accordingly, the "narrower construction" endorsed by FMR would leave § 1514A with no application to mutual funds. The Court's reading of § 1514A, in contrast, protects the employees of investment advisors, who are often the only firsthand witnesses to shareholder fraud involving mutual funds. Pp. 1171 – 1172.

***431** (3) There is scant evidence that today's decision will open any floodgates for whistleblowing suits outside § 1514A's purposes. The Department of Labor's regulations have interpreted § 1514A as protecting contractor employees for almost a decade, yet FMR is unable to identify a single case in which the employee of a private contractor has asserted a § 1514A claim based on allegations unrelated to shareholder fraud. Plaintiffs and the Solicitor General suggest various limiting principles to dispel any overbreadth problems. This Court need not determine § 1514A's bounds here, however, because, if plaintiffs' allegations prove true, plaintiffs are precisely the "firsthand witnesses to [the shareholder] fraud" Congress anticipated § 1514A would protect. S.Rep. No. 107–146, p. 10. Pp. 1172 – 1174.

(4) The 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act does not affect this Court's task of determining whether Congress in 2002 afforded protection to whistleblowing contractor employees. Pp. 1173 – 1175.

(c) AIR 21's whistleblower protection provision has been read to cover, in addition to employees of air carriers, employees of contractors and subcontractors of the carriers. Given the parallel statutory texts and whistleblower protective aims, the Court reads the words "an employee" in AIR 21 and in § 1514A to have similar import. Pp. 1175 – 1176.

Justice SCALIA, joined by Justice THOMAS, relying only on 18 U.S.C. § 1514A's text and broader context, agreed that § 1514A protects employees of private contractors from retaliation when they report covered forms of fraud. Pp. 1176 – 1177.

GINSBURG, J., delivered the opinion of the Court, in which ROBERTS, C.J., and BREYER and KAGAN, JJ., joined, and in which SCALIA and THOMAS, JJ., joined in principal part. SCALIA, J., filed an opinion concurring in principal part and concurring in the judgment, in which THOMAS, J., joined. SOTOMAYOR, J., filed a dissenting opinion, in which KENNEDY and ALITO, JJ., joined.

Attorneys and Law Firms

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****1161** Nicole A. Saharsky, for the United States as amicus curiae, by special leave of the Court, supporting the petitioners.

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Opinion

Justice GINSBURG delivered the opinion of the Court.

***432** To safeguard investors in public companies and restore trust in the financial markets following the collapse of Enron Corporation, Congress enacted the Sarbanes–Oxley Act of 2002, 116 Stat. 745. See S.Rep. No. 107–146, pp. 2–11 (2002). A provision of the Act, 18 U.S.C. § 1514A, protects whistleblowers. Section 1514A, at the time here relevant, instructed:

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> "No [public] company ..., or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of [whistleblowing or other protected activity]." § 1514A(a) (2006 ed.).

***433** This case concerns the definition of the protected class: Does § 1514A shield only those employed by the public company itself, or does it shield as well employees of privately held contractors and subcontractors—for example, investment advisers, law firms, accounting enterprises—who perform work for the public company?

We hold, based on the text of § 1514A, the mischief to which Congress was responding, and earlier legislation Congress drew upon, that the provision shelters employees of private contractors and subcontractors, just as it shelters employees of the public company served by the contractors and subcontractors. We first summarize our principal reasons, then describe this controversy and explain our decision more comprehensively.

Plaintiffs below, petitioners here, are former employees of private companies that contract to advise or manage mutual funds. The mutual funds themselves are public companies that have no employees. Hence, if the whistle is to be blown on fraud detrimental to mutual fund investors, the whistleblowing employee must be on another company's payroll, most likely, the payroll of the mutual fund's investment adviser or manager.

Taking the allegations of the complaint as true, both plaintiffs blew the whistle on putative fraud relating to the mutual funds and, as a consequence, suffered adverse action by their employers. Plaintiffs read § 1514A to convey that "[n]o ... contractor ... may ... discriminate against [its own] employee [for whistleblowing]." We find that reading consistent with the text of the statute and with common sense. Contractors are in control of their own employees, but are not ordinarily positioned to control someone else's workers. Moreover, we resist attributing to Congress a purpose to stop a contractor from retaliating against whistleblowers employed ****1162** by the public company the contractor serves, while leaving the contractor free to retaliate against its own employees when they reveal corporate fraud.

***434** In the Enron scandal that prompted the Sarbanes–Oxley Act, contractors and subcontractors, including the accounting firm Arthur Andersen, participated in Enron's fraud and its coverup. When employees of those contractors attempted to bring misconduct to light, they encountered retaliation by their employers. The Sarbanes–Oxley Act contains numerous provisions aimed at controlling the conduct of accountants, auditors, and lawyers who work with public companies. See, *e.g.,* 116 Stat. 750–765, 773–774, 784, §§ 101–107, 203–206, 307. Given Congress' concern about contractor conduct of the kind that contributed to Enron's collapse, we regard with suspicion construction of § 1514A to protect whistleblowers only when they are employed by a public company, and not when they work for the public company's contractor.

Congress borrowed § 1514A's prohibition against retaliation from the wording of the 2000 Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR 21), 49 U.S.C. § 42121. That Act provides: "No air carrier or contractor or subcontractor of an air carrier may discharge an employee or otherwise discriminate against an employee with respect to compensation, terms, conditions, or privileges of employment" when the employee provides information regarding violations "relating to air carrier safety" to his or her employer or federal authorities. § 42121(a)(1). AIR 21 has been read to cover, in addition to employees of air carriers, employees of contractors and subcontractors of the carriers. Given the parallel statutory texts and whistleblower protective aims, we read the words "an employee" in AIR 21 and in § 1514A to have similar import.

I

A

The Sarbanes–Oxley Act of 2002 (Sarbanes–Oxley or Act) aims to "prevent and punish corporate and criminal fraud, protect the victims of such fraud, preserve evidence of such fraud, and hold wrongdoers accountable for their actions." ***435** S.Rep. No. 107–146, p. 2 (2002) (hereinafter S. Rep.).[1] OF PARTICULAR CONcern to congress was abuNdant evidence that enron had succeeded in perpetuating its massive shareholder fraud in large part due to a "corporate code of silence"; that code, Congress found, "discourage[d] employees from reporting fraudulent behavior not only to the proper authorities, such as the FBI and the SEC, but even internally." *Id.,* at 4–5 (internal quotation marks omitted). When employees of Enron and its accounting firm,

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Arthur Andersen, attempted to report corporate misconduct, Congress learned, they faced retaliation, including discharge. As outside counsel advised company officials at the time, Enron's efforts to "quiet" whistleblowers generally were not proscribed under then-existing law. *Id.,* at 5, 10. Congress identified the lack of whistleblower protection ****1163** as "a significant deficiency" in the law, for in complex securities fraud investigations, employees "are [often] the only firsthand witnesses to the fraud." *Id.,* at 10.

Section 806 of Sarbanes–Oxley addresses this concern. Titled "Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud," § 806 added a new provision to Title 18 of the United States Code, 18 U.S.C. § 1514A, which reads in relevant part:

> "**Civil action to protect against retaliation in fraud cases**
>
> "(a) WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. § 78*l*), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. § 78*o* (d)), or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—
>
> "(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341 [mail fraud], 1343 [wire fraud], 1344 [bank fraud], or 1348 [securities or commodities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by [a federal agency, Congress, or supervisor]...." § 806, 116 Stat. 802. [2]

Congress has assigned whistleblower protection largely to the Department of Labor (DOL), which administers some 20 United States Code incorporated whistleblower protection provisions. See 78 Fed.Reg. 3918 (2013). The Secretary has delegated investigatory and initial adjudicatory responsibility over claims under a number of these provisions, including § 1514A, to DOL's Occupational Safety and Health Administration (OSHA). *Ibid.* OSHA's order may be appealed ***437** to an administrative law judge, and then to DOL's Administrative Review Board (ARB). 29 CFR §§ 1980.104 to 1980.110 (2011).

[1] In common with other whistleblower protection provisions enforced by DOL, see 77 Fed.Reg. 3912 (2012), the ARB's determination on a § 1514A claim constitutes the agency's final decision and is reviewable in federal court under the standards stated in the Administrative Procedure Act, 5 U.S.C. § 706. If, however, the ARB does not issue a final decision within 180 days of the filing of the complaint, and the delay is not due to bad faith on the claimant's part, the claimant may proceed to federal district court for *de novo* review. 18 U.S.C. § 1514A(b). An employee prevailing in a proceeding under § 1514A is entitled to "all relief necessary to make the employee whole," including "reinstatement with the same seniority status that the employee would have had, but for the discrimination," backpay with interest, and ****1164** compensation for litigation costs. § 1514A(c).

Congress modeled § 1514A on the anti-retaliation provision of the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR 21), 49 U.S.C. § 42121, a measure enacted two years earlier. See S. Rep., at 30 (corporate whistleblower protections "track [AIR 21's] protections as closely as possible"). Section 1514A incorporates by cross-reference AIR 21's administrative enforcement procedures. 18 U.S.C. § 1514A(b)(2).

B

Petitioners Jackie Hosang Lawson and Jonathan M. Zang (plaintiffs) separately initiated proceedings under § 1514A against their former employers, privately held companies that provide advisory and management services to the Fidelity family of mutual funds. The Fidelity funds are not parties to either case; as is common in the mutual fund industry, the Fidelity funds themselves have no employees. Instead, they contract with investment advisers like respondents to handle their day-to-day operations, which include making investment decisions, preparing reports for shareholders, and ***438** filing reports with the Securities and Exchange Commission (SEC). Lawson was employed by Fidelity Brokerage Services, LLC, a subsidiary of FMR Corp., which was succeeded by FMR LLC. Zang was employed by a

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different FMR LLC subsidiary, Fidelity Management & Research Co., and later by one of that company's subsidiaries, FMR Co., Inc. For convenience, we refer to respondents collectively as FMR.

Lawson worked for FMR for 14 years, eventually serving as a Senior Director of Finance. She alleges that, after she raised concerns about certain cost accounting methodologies, believing that they overstated expenses associated with operating the mutual funds, she suffered a series of adverse actions, ultimately amounting to constructive discharge. Zang was employed by FMR for eight years, most recently as a portfolio manager for several of the funds. He alleges that he was fired in retaliation for raising concerns about inaccuracies in a draft SEC registration statement concerning certain Fidelity funds. Lawson and Zang separately filed administrative complaints alleging retaliation proscribed by § 1514A. After expiration of the 180–day period specified in § 1514A(b)(1), Lawson and Zang each filed suit in the U.S. District Court for the District of Massachusetts.

FMR moved to dismiss the suits, arguing, as relevant, that neither plaintiff has a claim for relief under § 1514A. FMR is privately held, and maintained that § 1514A protects only employees of public companies—*i.e.,* companies that either have “a class of securities registered under section 12 of the Securities Exchange Act of 1934,” or that are “required to file reports under section 15(d)” of that Act. § 1514A(a). [3] In a joint order, the District Court rejected FMR's interpretation of § 1514A and denied the dismissal motions in both suits. 724 F.Supp.2d 141 (Mass.2010).

***439** On interlocutory appeal, a divided panel of the First Circuit reversed. 670 F.3d 61 (2012). The Court of Appeals majority acknowledged that FMR is a “contractor” [4] within the meaning of § 1514A(a), and thus among the actors prohibited from retaliating ****1165** against “an employee” who engages in protected activity. The majority agreed with FMR, however, that “an employee” refers only to employees of public companies and does not cover a contractor's own employees. *Id.,* at 68–80. Judge Thompson dissented. In her view, the majority had “impose[d] an unwarranted restriction on the intentionally broad language of the Sarbanes–Oxley Act” and “bar[red] a significant class of potential securities-fraud whistleblowers from any legal protection.” *Id.,* at 83.

Several months later, the ARB issued a decision in an unrelated case, *Spinner v. David Landau & Assoc., LLC,* No. 10–111 etc., ALJ No. 2010–SOX–029 (May 31, 2012), [5] disagreeing with the Court of Appeals' interpretation of § 1514A. In a comprehensive opinion, the ARB explained its position that § 1514A affords whistleblower protection to employees of privately held contractors that render services to public companies. *Ibid.* [6]

***440** We granted certiorari, 569 U.S. ––––, 133 S.Ct. 2387, 185 L.Ed.2d 1103 (2013), to resolve the division of opinion on whether § 1514A extends whistleblower protection to employees of privately held contractors who perform work for public companies.

II

A

[2] **[3]** In determining the meaning of a statutory provision, “we look first to its language, giving the words used their ordinary meaning.” *Moskal v. United States,* 498 U.S. 103, 108, 111 S.Ct. 461, 112 L.Ed.2d 449 (1990) (citation and internal quotation marks omitted). As Judge Thompson observed in her dissent from the Court of Appeals' judgment, “boiling [§ 1514A(a)] down to its relevant syntactic elements, it provides that ‘no ... contractor ... may discharge ... an employee.’ ” 670 F.3d, at 84 (quoting § 1514A(a)). The ordinary meaning of “an employee” in this proscription is the contractor's own employee.

FMR's interpretation of the text requires insertion of “of a public company” after “an employee.” But where Congress meant “an employee of a public company,” it said so: With respect to the actors governed by § 1514A, the provision's interdictions run to the officers, employees, contractors, subcontractors, and agents “of such company,” *i.e.,* a public company. § 1514A(a). Another anti-retaliation provision in Sarbanes–Oxley provides: “[A] broker or dealer and persons employed by a broker or dealer who are involved with ****1166** investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate against any securities analyst *employed by that broker or dealer or its affiliates....*” 15 U.S.C. § 78*o*–6(a)(1)(C) (emphasis added). In contrast, nothing ***441** in § 1514A's language confines the class of employees protected to those of a

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designated employer. Absent any textual qualification, we presume the operative language means what it appears to mean: A contractor may not retaliate against its own employee for engaging in protected whistleblowing activity. [7]

Section 1514A's application to contractor employees is confirmed when we enlarge our view from the term "an employee" to the provision as a whole. The prohibited retaliatory measures enumerated in § 1514A(a)—discharge, demotion, suspension, threats, harassment, or discrimination in the terms and conditions of employment—are commonly actions an employer takes against its *own* employees. Contractors are not ordinarily positioned to take adverse actions against employees of the public company with whom they contract. FMR's interpretation of § 1514A, therefore, would shrink to insignificance the provision's ban on retaliation by contractors. The dissent embraces FMR's "narrower" construction. See *post,* at 1178, 1178 – 1179, 1179, 1180 – 1181.

FMR urges that Congress included contractors in § 1514A's list of governed actors simply to prevent public companies from avoiding liability by employing contractors to effectuate retaliatory discharges. FMR describes such a contractor as an "ax-wielding specialist," illustrated by George Clooney's character in the movie Up in the Air. [8] Brief for Respondents 24–25 (internal quotation marks omitted). As portrayed by Clooney, an ax-wielding specialist is a contractor engaged only as the bearer of the bad news that the employee has been fired; he plays no role in deciding ***442** who to terminate. If the company employing the ax-wielder chose the recipients of the bad tidings for retaliatory reasons, the § 1514A claim would properly be directed at the company. Hiring the ax-wielder would not insulate the company from liability. Moreover, we see no indication that retaliatory ax-wielding specialists are the real-world problem that prompted Congress to add contractors to § 1514A. [9]

Moving further through § 1514A to the protected activity described in subsection ****1167** (a)(1), we find further reason to believe that Congress presumed an employer-employee relationship between the retaliator and the whistleblower. Employees gain protection for furnishing information to a federal agency, Congress, or "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)." § 1514A(a)(1) (emphasis added). And under § 1514A(a)(2), employees are protected from retaliation for assisting "in a proceeding filed or about to be filed (*with any knowledge of the employer*) relating to an alleged violation" of any of the enumerated fraud provisions, securities regulations, or other federal law relating to shareholder fraud. § 1514A(a)(2) (emphasis added). ***443** The reference to employer knowledge is an additional indicator of Congress' expectation that the retaliator typically will be the employee's employer, not another entity less likely to know of whistleblower complaints filed or about to be filed.

Section 1514A's enforcement procedures and remedies similarly contemplate that the whistleblower is an employee of the retaliator. As earlier noted, see *supra,* at 1163 – 1164, § 1514A(b)(2)(A) provides that a claim under § 1514A "shall be governed under the rules and procedures set forth in section 42121(b) of title 49," *i.e.,* AIR 21's anti-retaliation provision. Throughout § 42121(b), the respondent is referred to as "the employer." See 49 U.S.C. § 42121(b)(2)(B)(ii) (The Secretary shall not conduct an investigation into a retaliation claim "if the employer demonstrates, by clear and convincing evidence, that the employer would have taken the same unfavorable personnel action in the absence of that behavior."); § 42121(b)(2)(B)(iv) ("Relief may not be ordered ... if the employer demonstrates by clear and convincing evidence that the employer would have taken the same unfavorable personnel action in the absence of that behavior.").

Regarding remedies, § 1514A(c)(2) states that a successful claimant shall be entitled to "reinstatement with the same seniority status that the employee would have had, but for the discrimination," as well as "the amount of back pay, with interest." As the Solicitor General, for the United States as *amicus curiae,* observed, "It is difficult, if not impossible, to see how a contractor or subcontractor could provide those remedies to an employee of a public company." Brief for United States as *Amicus Curiae* 15. The most sensible reading of § 1514A's numerous references to an employer-employee relationship between the respondent and the claimant is that the provision's protections run between contractors and their own employees.

Remarkably, the dissent attributes to Congress a strange design. Under the dissent's "narrower" construction, *post,* at 1178, 1178 – 1179, 1179, 1180 – 1181, a public company's contractor may not ***444** retaliate against a public company's employees, academic here because the public company has no employees. According to the dissent, this coverage is necessary to prevent "a gaping hole" that would allow

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public companies to "evade § 1514A simply by hiring a contractor to engage in the very retaliatory acts that an officer or employee could not." *Post,* at 1182. This cannot be right—even if Congress had omitted any reference to contractors, subcontractors, or agents in § 1514A, the remaining language surely would prohibit a public company from directing someone else to engage in retaliatory conduct against the public company's employees; hiring an ax-wielder to announce an employee's demotion does not change the fact that the public company is the entity commanding the demotion. Under the dissent's reading ****1168** of § 1514A, the inclusion of contractors as covered employers does no more than make the contractor secondarily liable for complying with such marching orders—hardly a hole at all. [10]

There would be a huge hole, on the other hand, were the dissent's view of § 1514A's reach to prevail: Contractors' employees would be disarmed; they would be vulnerable to retaliation by their employers for blowing the whistle on a scheme to defraud the public company's investors, even a scheme engineered entirely by the contractor. Not only would mutual fund advisers and managers escape § 1514A's control. Legions of accountants and lawyers would be denied § 1514A's protections. See *infra,* at 1170 – 1172. Instead of indulging in fanciful visions of whistleblowing babysitters and the like, *post,* at 1177 – 1178, 1180, 1183 – 1184, 1187 – 1188, the dissent might pause to consider whether a Congress, prompted by the Enron debacle, ***445** would exclude from whistleblower protection countless professionals equipped to bring fraud on investors to a halt.

B

We turn next to two textual arguments made by FMR. First, FMR urges that "an employee" must be read to refer exclusively to public company employees to avoid the absurd result of extending protection to the personal employees of company officers and employees, *e.g.,* their housekeepers or gardeners. See Brief for Respondents 19–20; *post,* at 1177 – 1178, 1180, 1183 – 1184, 1187 – 1188. Plaintiffs and the Solicitor General do not defend § 1514A's application to personal employees. They argue, instead, that the prohibition against an "officer" or "employee" retaliating against "an employee" may be read as imposing personal liability only on officers and employees who retaliate against other public company employees. Brief for Petitioners 12; Brief for United States as *Amicus Curiae* 16. [11] FMR calls this reading "bizarre," for it would ascribe to the words "an employee" in § 1514A(a) "one meaning if the respondent is an 'officer' and a different meaning if the respondent is a 'contractor.' " Brief for Respondents 20–21.

We agree with FMR that plaintiffs and the Solicitor General offer an interpretation at odds with the text Congress enacted. If, as we hold, "an employee" includes employees of contractors, then grammatically, the term also includes employees of public company officers and employees. Nothing suggests Congress' attention was drawn to the curiosity its drafting produced. The issue, however, is likely more theoretical than real. Few housekeepers or gardeners, we ***446** suspect, are likely to come upon and comprehend evidence of their employer's complicity in fraud. In any event, FMR's point is outweighed by the compelling arguments opposing FMR's contention that "an employee" refers simply and only to public company employees. See *supra,* at 1165 – 1168. See also ****1169** *infra,* at 1172 – 1174 (limiting principles may serve as check against overbroad applications).

Second, FMR argues that the statutory headings support the exclusion of contractor employees from § 1514A's protections. Although § 1514A's own heading is broad ("Civil action to protect against retaliation in fraud cases"), subsection (a) is captioned "Whistleblower Protection for Employees of Publicly Traded Companies." Similarly, the relevant public law section, § 806 of Sarbanes–Oxley, is captioned "Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud." 116 Stat. 802. The Court of Appeals described the latter two headings as "explicit guides" limiting protection under § 1514A to employees of public companies. 670 F.3d, at 69.

This Court has placed less weight on captions. In *Trainmen v. Baltimore & Ohio R. Co.,* 331 U.S. 519, 67 S.Ct. 1387, 91 L.Ed. 1646 (1947), we explained that where, as here, "the [statutory] text is complicated and prolific, headings and titles can do no more than indicate the provisions in a most general manner." *Id.,* at 528, 67 S.Ct. 1387. The under-inclusiveness of the two headings relied on by the Court of Appeals is apparent. The provision indisputably extends protection to employees of companies that file reports with the SEC pursuant to § 15(d) of the 1934 Act, even when such companies are not "publicly traded." And the activity protected under § 1514A is not limited to "provid[ing] evidence of fraud"; it also includes reporting violations of

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SEC rules or regulations. § 1514A(a)(1). As in *Trainmen,* the headings here are "but a short-hand reference to the general subject matter" of the provision, "not meant to take the place of the detailed provisions of the text." 331 U.S., at 528, 67 S.Ct. 1387.Section 1514A is attended by numerous indicators ***447** that the statute's prohibitions govern the relationship between a contractor and its own employees; we do not read the headings to "undo or limit" those signals. *Id.,* at 529, 67 S.Ct. 1387. [12]

III

A

Our textual analysis of § 1514A fits the provision's purpose. It is common ground that Congress installed whistleblower protection in the Sarbanes–Oxley Act as one means to ward off another Enron debacle. S. Rep., at 2–11. And, as the ARB observed in *Spinner,* "Congress plainly recognized that outside professionals—accountants, law firms, contractors, agents, and the like—were complicit in, if not integral to, the shareholder fraud and subsequent cover-up [Enron] officers ... perpetrated." ALJ No. 2010–SOX–029, pp. 12–13. Indeed, the Senate Report demonstrates that Congress was as focused on the role of Enron's outside contractors in facilitating the fraud as it was on the actions of Enron's own officers. See, *e.g.,* S. Rep., at 3 (fraud "occurred with extensive participation and structuring advice from Arthur Andersen ... which was simultaneously serving as both consultant and independent auditor for Enron" (internal quotation marks and brackets omitted)); *id.,* at 4 ("professionals from accounting firms, law firms and business consulting firms, who were paid millions to advise Enron on these practices, assured others that Enron was a solid investment"); *id.,* at 4–5 (team of Andersen employees were ****1170** tasked with destroying "physical evidence and documents" relating to Enron's fraud); *id.,* at 5 ("Enron and Andersen were taking advantage of a system that allowed them to behave in an apparently fraudulent manner"); *id.,* at 11 (Enron's fraud partly attributable to "the ***448** well-paid professionals who helped create, carry out, and cover up the complicated corporate ruse when they should have been raising concerns"); *id.,* at 20–21 ("Enron's accountants and lawyers brought all their skills and knowledge to bear in assisting the fraud to succeed and then in covering it up.").

Also clear from the legislative record is Congress' understanding that outside professionals bear significant responsibility for reporting fraud by the public companies with whom they contract, and that fear of retaliation was the primary deterrent to such reporting by the employees of Enron's contractors. Congressional investigators discovered ample evidence of contractors demoting or discharging employees they have engaged who jeopardized the contractor's business relationship with Enron by objecting to Enron's financial practices. See, *e.g.,* Oppel, Merrill Replaced Research Analyst Who Upset Enron, N.Y. Times, July 30, 2002, p. A1 ("In the summer of 1998, when it was eager to win more investment banking business from Enron, Merrill Lynch replaced a research analyst who had angered Enron executives by rating the company's stock 'neutral' with an analyst who soon upgraded the rating, according to Congressional investigators."); Yost, Andersen Whistleblower Was Removed, Associated Press (Apr. 3, 2002) (Congressional investigation reveals that Andersen removed one of its partners from its Enron team after Enron officials expressed unhappiness with the partner's questioning of certain accounting practices); Oppel, The Man Who Paid the Price for Sizing up Enron, N.Y. Times, Mar. 27, 2002, p. C1 ("Enron executives pressed UBS Paine–Webber to take action against a broker who advised some Enron employees to sell their shares in August and was fired by the brokerage firm within hours of the complaint, according to e-mail messages released today by Congressional investigators.").

In the same vein, two of the four examples of whistleblower retaliation recounted in the Senate Report involved ***449** outside professionals retaliated against by their own employers. S. Rep., at 5 (on Andersen and UBS Paine–Webber employees); see also *id.,* at 4–5 (Andersen employees who " attempted to report or 'blow the whistle' on [Enron's] fraud ... were discouraged at nearly every turn"). Emphasizing the importance of outside professionals as "gatekeepers who detect and deter fraud," the Senate Report concludes: "Congress must reconsider the incentive system that has been set up that encourages accountants and lawyers who come across fraud in their work to remain silent." *Id.,* at 20–21. From this legislative history, one can safely conclude that Congress enacted § 1514A aiming to encourage whistleblowing by contractor employees who suspect fraud involving the public companies with whom they work. [13]

****1171** FMR argues that Congress addressed its concerns about the role of outside accountants and lawyers in facilitating Enron's wrongdoing, not in § 1514A, but

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exclusively in other provisions of Sarbanes–Oxley "*directly* regulat[ing] accountants and lawyers." Brief for Respondents 40. In particular, FMR points to sections of the Act requiring accountants and lawyers for public companies to investigate and report misconduct, or risk being banned from further practice before the SEC. *Id.,* at 41 (citing 15 U.S.C. §§ 7215(c)(4), ***450** 7245). These requirements, however, indicate why Congress would have wanted to extend § 1514A's coverage to the many lawyers and accountants who perform outside work for public companies. Although lawyers and accountants are subject to extensive regulations and sanctions throughout Sarbanes–Oxley, no provision of the Act other than § 1514A affords them protection from retaliation by their employers for complying with the Act's reporting requirements. [14] In short, we cannot countenance the position advanced by FMR and the dissent, see *post,* at 1184 – 1186, that Congress intended to leave these professionals vulnerable to discharge or other retaliatory action for complying with the law.

B

Our reading of § 1514A avoids insulating the entire mutual fund industry from § 1514A, as FMR's and the dissent's "narrower construction" would do. As companies "required to file reports under section 15(d) of the Securities Exchange Act of 1934," 18 U.S.C. § 1514A(a), mutual funds unquestionably are governed by § 1514A. Because mutual funds figure prominently among such report-filing companies, Congress presumably had them in mind when it added to "publicly traded companies" the discrete category of companies "required to file reports under section 15(d)."

[4] Virtually all mutual funds are structured so that they have no employees of their own; they are managed, instead, by independent investment advisers. See S.Rep. No. 91–184, p. 5 (1969) (accompanying the 1970 amendments to the Investment Company Act of 1940). The United States investment ***451** advising industry manages $14.7 trillion on behalf of nearly 94 million investors. See 2013 Investment Company Fact Book 7 (53d ed.), available at http://www.icifactbook.org/pdf/2013_factbook.pdf (as visited Feb. 20, 2014, and available in Clerk of Court's case file). These investment advisers, under our reading of § 1514A, are contractors prohibited from retaliating against their own employees for engaging in whistleblowing activity. This construction protects the "insiders [who] are the only firsthand witnesses to the [shareholder] fraud." S. Rep., at 10. Under FMR's and the dissent's reading, in contrast, § 1514A has no application to mutual funds, for all of the potential whistleblowers are employed by the privately held investment management ****1172** companies, not by the mutual funds themselves. See Brief for Respondents 45 (describing this glaring gap as "merely a consequence of the corporate structure" of mutual funds).

The Court of Appeals found exclusion of the mutual fund industry from § 1514A tenable because mutual funds and their investment advisers are separately regulated under the Investment Company Act of 1940, 15 U.S.C. § 80a–1 *et seq.*, the Investment Advisers Act of 1940, 15 U.S.C. § 80b–1 *et seq.,* and elsewhere in Sarbanes–Oxley. 670 F.3d, at 72–73. See also *post,* at 1186, n. 10. But this separate regulation does not remove the problem, for nowhere else in these legislative measures are investment management employees afforded whistleblower protection. Section 1514A alone shields them from retaliation for bringing fraud to light.

Indeed, affording whistleblower protection to mutual fund investment advisers is crucial to Sarbanes–Oxley's endeavor to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws." 116 Stat. 745. As plaintiffs observe, these disclosures are written, not by anyone at the mutual funds themselves, but by employees of the investment advisers. "Under FMR's [and the dissent's] proposed interpretation of section 1514A, FMR could dismiss any FMR employee who ***452** disclosed to the directors of or lawyers for the Fidelity funds that there were material falsehoods in the documents being filed by FMR with the SEC in the name of those funds." Reply Brief 13. It is implausible that Congress intended to leave such an employee remediless. See *id.,* at 14.

C

Unable credibly to contest the glaring under-inclusiveness of the "narrower reading" FMR urges, the dissent emphasizes instead FMR's claim that the reading of § 1514A we adopt is all too inclusive. See *post,* at 1177 – 1178, 1180, 1183 – 1184, 1187 – 1188. FMR's *amici* also press this point, observing that the activity protected under § 1514A(a)(1) encompasses reporting not only securities fraud (18 U.S.C. § 1348), but also mail, wire, and bank fraud (§§ 1341, 1343, 1344). Including contractor employees in the protected class, they therefore assert, could "cas[t] a wide net over employees who have

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no exposure to investor-related activities and thus could not possibly assist in detecting investor fraud." Brief for Chamber of Commerce of the United States of America as *Amicus Curiae* 3. See also Brief for Securities Industry and Financial Markets Association as *Amicus Curiae* 7–16.

There is scant evidence, however, that these floodgate-opening concerns are more than hypothetical. DOL's regulations have interpreted § 1514A as protecting contractor employees for almost a decade.[15] See 69 Fed.Reg. 52105–52106 (2004). Yet no "narrower construction" advocate has identified even a single case in which the employee of a private contractor has asserted a § 1514A claim based on allegations unrelated to shareholder fraud. FMR's parade of horribles rests solely on ***453** *Lockheed Martin Corp. v. ARB,* 717 F.3d 1121 (C.A.10 2013), a case involving mail and wire fraud claims asserted by an employee of a *public* company—*i.e.,* claims in no way affected by today's decision. The dissent's fears that ****1173** household employees and others, on learning of today's decision, will be prompted to pursue retaliation claims, *post,* at 1184, and that OSHA will find them meritorious under § 1514A, seem to us unwarranted. If we are wrong, however, Congress can easily fix the problem by amending § 1514A explicitly to remove personal employees of public company officers and employees from the provision's reach. But it would thwart Congress' dominant aim if contractors were taken off the hook for retaliating against their whistleblowing employees, just to avoid the unlikely prospect that babysitters, nannies, gardeners, and the like will flood OSHA with § 1514A complaints.

Plaintiffs and the Solicitor General observe that overbreadth problems may be resolved by various limiting principles. They point specifically to the word "contractor." Plaintiffs note that in "common parlance," "contractor" does not extend to every fleeting business relationship. Instead, the word "refers to a party whose performance of a contract will take place over a significant period of time." Reply Brief 16. See also *Fleszar v. United States Dept. of Labor,* 598 F.3d 912, 915 (C.A.7 2010) ("Nothing in § 1514A implies that, if [a privately held business] buys a box of rubber bands from Wal–Mart, a company with traded securities, the [business] becomes covered by § 1514A.").

The Solicitor General further maintains that § 1514A protects contractor employees only to the extent that their whistleblowing relates to "the contractor ... fulfilling its role as a contractor for the public company, not the contractor in some other capacity." Tr. of Oral Arg. 18–19 (Government counsel). See also *id.,* at 23 ("[I]t has to be a person who is in a position to detect and report the types of fraud and securities violations that are included in the statute.... [W]e think that 'the contractor of such company' refers to the contractor in that role, working for the public company.' ").

***454** Finally, the Solicitor General suggests that we need not determine the bounds of § 1514A today, because plaintiffs seek only a "mainstream application" of the provision's protections. *Id.,* at 20 (Government counsel). We agree. Plaintiffs' allegations fall squarely within Congress' aim in enacting § 1514A. Lawson alleges that she was constructively discharged for reporting accounting practices that overstated expenses associated with managing certain Fidelity mutual funds. This alleged fraud directly implicates the funds' shareholders: "By inflating its expenses, and thus understating its profits, [FMR] could potentially increase the fees it would earn from the mutual funds, fees ultimately paid by the shareholders of those funds." Brief for Petitioners 3. Zang alleges that he was fired for expressing concerns about inaccuracies in a draft registration statement FMR prepared for the SEC on behalf of certain Fidelity funds. The potential impact on shareholders of false or misleading registration statements needs no elaboration. If Lawson and Zang's allegations prove true, these plaintiffs would indeed be "firsthand witnesses to [the shareholder] fraud" Congress anticipated § 1514A would protect. S. Rep., at 10.

D

FMR urges that legislative events subsequent to Sarbanes–Oxley's enactment show that Congress did not intend to extend § 1514A's protections to contractor employees.[16] In particular, FMR calls our ****1174** attention to the 2010 ***455** Dodd–Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376 (Dodd–Frank). Dodd–Frank amended § 1514A(a) to read:

> "No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*), or that is required to file reports under [section 12] of the [1934 Act] (15 U.S.C. 78*o* (d)) *including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of*

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such company, or nationally recognized statistical rating organization (as defined in section 3(a) of the [1934 Act] (15 U.S.C. 78c), or any officer, employee, contractor, subcontractor, or agent of such company *or nationally recognized statistical rating organization,* may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any [protected activity]." 18 U.S.C. § 1514A(a) (2012 ed.) (emphasis added; footnote omitted.)

The amended provision extends § 1514A's protection to employees of public company subsidiaries and nationally recognized statistical rating organizations (NRSROs). FMR asserts that Congress' decision to add NRSROs to § 1514A shows that the provision did not previously cover contractor employees: "If [§ 1514A] already covered every private company contracting with a public company, there would have been no need for Congress to extend [§ 1514A] to certain private companies." Brief for Respondents 35–36. This argument fails at the starting gate, for FMR concedes that not all NRSROs are privately held, and not all NRSROs contract with public companies. *Id.,* at 36.

We see nothing useful to our inquiry in Congress' decision to amend § 1514A to include public company subsidiaries and NRSROs. More telling, at the time of the Dodd–Frank amendments, DOL regulations provided that § 1514A protects contractor employees. See 29 CFR § 1980.101 (2009). ***456** Congress included in its alterations no language gainsaying that protection. As Judge Thompson's dissent from the First Circuit's judgment observes, "Congress had a miles-wide opening to nip [DOL's] regulation in the bud if it had wished to do so. It did not." 670 F.3d, at 88.

Dodd–Frank also establishes a corporate whistleblowing reward program, accompanied by a new provision prohibiting any employer from retaliating against "a whistleblower" for providing information to the SEC, participating in an SEC proceeding, or making disclosures required or protected under Sarbanes–Oxley and certain other securities laws. 15 U.S.C. § 78u–6(a)(6), (b)(1), (h). FMR urges that, as this provision covers employees of all companies, public or private, "[t]here is no justification" for reading § 1514A to cover employees of contractors: "Any 'gap' that might, *arguendo,* have existed for employees of private entities between 2002 and 2010 has now been closed." Brief for Respondents 44. [17]

****1175** FMR, we note, somewhat overstates Dodd–Frank's coverage. Section 1514A's protections include employees who provide information to any "person with supervisory authority over the employee." § 1514A(a)(1)(C). Dodd–Frank's whistleblower provision, however, focuses primarily on reporting to federal authorities. See Brief for United States as *Amicus Curiae* 30 ("[I]f employees of contractors of public companies are not protected under Section 1514A, they are not protected for making internal complaints under ... the Dodd–Frank Act.").

In any event, our task is not to determine whether including contractor employees in the class protected by § 1514A remains necessary in 2014. It is, instead, to determine whether Congress afforded protection to contractor employees when it enacted § 1514A in 2002. If anything relevant to our inquiry can be gleaned from Dodd–Frank, it is ***457** that Congress apparently does not share FMR's concerns about extending protection comprehensively to corporate whistleblowers. [18]

IV

We end by returning to AIR 21's whistleblower protection provision, 49 U.S.C. § 42121, enacted two years before Sarbanes–Oxley. Congress designed § 1514A to "track ... as closely as possible" the protections afforded by § 42121. S. Rep., at 30. To this end, § 1514A incorporates by cross-reference § 42121's administrative enforcement regime, see 18 U.S.C. § 1514A(b)(2), and contains parallel statutory text. Compare § 1514A(a) ("No [public] company ... or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment" for engaging in protected activity) with 49 U.S.C. § 42121(a) ("No air carrier or contractor or subcontractor of an air carrier may discharge an employee or otherwise discriminate against an employee with respect to compensation, terms, conditions, or privileges of employment" for engaging in protected activity). [19]

[5] Section 42121 has been read to protect employees of contractors covered by the provision. The ARB has consistently construed AIR 21 to cover contractor employees. *E.g., Evans v. Miami Valley Hospital,* ARB No. 07–118 etc., ALJ No. 2006–AIR–022, pp. 9–11 (June 30, 2009); *Peck v. Safe Air Int'l, Inc.,* ARB No. 02–028, ALJ ***458** No.

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2001–AIR–3, p. 13 (Jan. 30, 2004). [20] And DOL's regulations adopting this interpretation of § 42121 date back to April 1, 2002, before § 1514A was enacted. 67 Fed.Reg. 15454, 15457–15458 (2002). The Senate Report for AIR ****1176** 21 supports this reading, explaining that the Act "provide[s] employees of airlines, and employees of airline contractors and subcontractors, with statutory whistleblower protection." S.Rep. No. 105–278, p. 22 (1998). [21]

The Court of Appeals recognized that Congress modeled § 1514A on § 42121, and that § 42121 has been understood to protect contractor employees. 670 F.3d, at 73–74. It nonetheless declined to interpret § 1514A the same way, because, in its view, "important differences" separate the two provisions. First, unlike § 1514A, § 42121 contains a definition of "contractor": "a company that performs safety-sensitive functions by contract for an air carrier." 49 U.S.C. § 42121(e). Second, unlike § 1514A, § 42121 does not include "officers" or "employees" among governed actors. 670 F.3d, at 74. These distinctions, the Court of Appeals reasoned, render § 1514A less amenable to an inclusive construction of the protected class. *Ibid.* [22]

***459** We do not find these textual differences overwhelming. True, Congress strayed from § 42121's pattern in failing to define "contractor" for purposes of § 1514A, and in adding "officers" and "employees" to § 1514A's list of governed actors. And we agree that § 1514A covers a far wider range than § 42121 does. But in our view, neither difference warrants the determination that § 1514A omits employees of contractors while § 42121 includes them. The provisions' parallel text and purposes counsel in favor of interpreting the two provisions consistently. And we have already canvassed the many reasons why § 1514A is most sensibly read to protect employees of contractors. See *supra,* at 1165 – 1172.

* * *

For the reasons stated, we hold that 18 U.S.C. § 1514A whistleblower protection extends to employees of contractors and subcontractors. The judgment of the U.S. Court of Appeals for the First Circuit is therefore reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice SCALIA, with whom Justice THOMAS joins, concurring in principal part and concurring in the judgment.

I agree with the Court's conclusion that 18 U.S.C. § 1514A protects employees of private contractors from retaliation when they report covered forms of fraud. As the Court carefully demonstrates, that conclusion logically flows from § 1514A's text and broader context. I therefore join the Court's opinion in principal part.

I do not endorse, however, the Court's occasional excursions beyond the interpretative terra firma of text and context, into the swamps of legislative history. Reliance on legislative history rests upon several frail premises. First, and most important: That the statute means what Congress intended. It does not. Because we are a government of laws, not of men, and are governed by what Congress ***460** enacted rather than by what it intended, the ****1177** sole object of the interpretative enterprise is to determine what a law *says*. Second: That there *was* a congressional " intent" apart from that reflected in the enacted text. On most issues of detail that come before this Court, I am confident that the majority of Senators and Representatives had no views whatever on how the issues should be resolved—indeed, were unaware of the issues entirely. Third: That the views expressed in a committee report or a floor statement represent those of all the Members of that House. Many of them almost certainly did not read the report or hear the statement, much less agree with it—not to mention the Members of the other House and the President who signed the bill.

Since congressional "intent" apart from enacted text is fiction to begin with, courts understandably allow themselves a good deal of poetic license in defining it. Today's opinion is no exception. It cites parts of the legislative record that are consistent with its holding that § 1514A covers employees of private contractors and subcontractors, but it ignores other parts that unequivocally cut in the opposite direction. For example, the following remark by the Sarbanes–Oxley Act's lead sponsor in the Senate: "[L]et me make very clear that [the Act] applies exclusively to public companies—that is, to companies registered with the Securities and Exchange Commission. It is not applicable to pr[i]v[at]e companies, [*] who make up the vast majority of companies across the country." 148 Cong. Rec. 14440 (2002) (remarks of Sen. Sarbanes).

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Two other minor points in the Court's opinion I do not agree with. First, I do not rely on the fact that a separate anti-retaliation provision, 49 U.S.C. § 42121(a), "has been read" by an administrative tribunal to cover contractor employees ***461** . *Ante,* at 1176. Section 1514A(b)(2), entitled "Procedure," contains cross-references to the procedural rules set forth in § 42121(b), but the substantive provisions of § 1514A(a) are worded quite differently from the substantive prohibition of § 42121, which is contained in subsection (a) —thus making interpretation of the latter an unreliable guide to § 1514A's meaning. Second, I do not agree with the Court's acceptance of the possible validity of the Government's suggestion that "§ 1514A protects contractor employees only to the extent that their whistleblowing relates to 'the contractor ... fulfilling its role as a contractor for the public company.' " *Ante,* at 1173 (quoting Tr. of Oral Arg. 18–19). Although that "limiting principl[e]," *ibid.,* may be appealing from a policy standpoint, it has no basis whatsoever in the statute's text. So long as an employee works for one of the actors enumerated in § 1514A(a) and reports a covered form of fraud in a manner identified in § 1514 (a)(1)-(2), the employee is protected from retaliation.

For all the other reasons given by the Court, the statute's text is clear, and I would reverse the judgment of the Court of Appeals and remand the case.

Justice SOTOMAYOR, with whom Justice KENNEDY and Justice ALITO join, dissenting.

Section 806 of the Sarbanes–Oxley Act of 2002, 116 Stat. 802, forbids any public company, [1] or any "officer, employee, contractor, ****1178** subcontractor, or agent of such company," to retaliate against "an employee" who reports a potential fraud. 18 U.S.C. § 1514A(a). The Court recognizes that the core purpose of the Act is to "safeguard investors in public companies." *Ante,* at 1161. And the Court points out that Congress ***462** entitled the whistleblower provision, "Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud." § 806, 116 Stat. 802. Despite these clear markers of intent, the Court does not construe § 1514A to apply only to public company employees who blow the whistle on fraud relating to their public company employers. The Court instead holds that the law encompasses any household employee of the millions of people who work for a public company and any employee of the hundreds of thousands of private businesses that contract to perform work for a public company.

The Court's interpretation gives § 1514A a stunning reach. As interpreted today, the Sarbanes–Oxley Act authorizes a babysitter to bring a federal case against his employer—a parent who happens to work at the local Walmart (a public company)—if the parent stops employing the babysitter after he expresses concern that the parent's teenage son may have participated in an Internet purchase fraud. And it opens the door to a cause of action against a small business that contracts to clean the local Starbucks (a public company) if an employee is demoted after reporting that another nonpublic company client has mailed the cleaning company a fraudulent invoice.

Congress was of course free to create this kind of sweeping regime that subjects a multitude of individuals and private businesses to litigation over fraud reports that have no connection to, or impact on, the interests of public company shareholders. But because nothing in the text, context, or purpose of the Sarbanes–Oxley Act suggests that Congress actually wanted to do so, I respectfully dissent.

I

Although the majority correctly starts its analysis with the statutory text, it fails to recognize that § 1514A is deeply ambiguous. Three indicators of Congress' intent clearly resolve this ambiguity in favor of a narrower interpretation of § 1514A: the statute's headings, the statutory context ***463** , and the absurd results that follow from the majority's interpretation.

A

The majority begins its textual analysis by declaring that the " 'relevant syntactic elements' " of § 1514A are that " ' "no ... contractor ... may discharge ... an employee." ' " *Ante,* at 1165. After " 'boiling ... down' " the text to this formulation, the majority concludes that the "ordinary meaning of 'an employee' " is obviously "the contractor's own employee." *Ibid.*

If that were what the statute said, the majority's decision would undoubtedly be correct. But § 1514A(a) actually provides that "[n]o [public] company ... or any officer, employee, contractor, subcontractor, or agent of such company ... may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee."

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The provision thus does not speak only (or even primarily) to "contractors." It speaks to public companies, and then includes a list of five types of representatives that companies hire to carry out their business: "officer[s], employee[s], ****1179** contractor[s], subcontractor[s], [and] agent[s]."

Read in full, then, the statute is ambiguous. The majority is correct that it may be read broadly, to create a cause of action both for employees of public companies and for employees of the enumerated public company representatives. But the statute can also be read more narrowly, to prohibit the public company and the listed representatives—all of whom act on the company's behalf—from retaliating against just the public company's employees.

The narrower reading of the text makes particular sense when one considers the other terms in the list of company representatives. The majority acknowledges that, as a matter of "gramma[r]," the scope of protected employees must be consistent with respect to all five types of company representatives listed in § 1514A(a). *Ante,* at 1168 – 1169. Yet the Government and petitioners readily concede that § 1514A is ***464** meant to bar two of the enumerated representatives —"officer[s]" and "employee[s]"—from retaliating against other employees of the public company, as opposed to their own babysitters and housekeepers. See Brief for United States as *Amicus Curiae* 16 (§ 1514A "impose[s] personal liability on corporate officers and employees who are involved in retaliation against other employees of their employer"); Brief for Petitioners 12 (similar). The Department of Labor's Administrative Review Board (ARB) agrees. *Spinner v. David Landau & Assoc., LLC,* No. 10–111 etc., ALJ No. 2010–SOX–029, p. 8 (May 31, 2012). And if § 1514A prohibits an "officer" or "employee" of a public company from retaliating against only the public company's own employees, then as the majority points out, the same should be true "grammatically" of contractors, subcontractors, and agents as well,*ante,* at 1168 – 1169. [2]

The majority responds by suggesting that the narrower interpretation could have been clearer if Congress had added the phrase " 'of a public company' after 'an employee.' " *Ante,* at 1165 – 1166. Fair enough. But Congress could more clearly have dictated the majority's construction of the statute, too: It could have specified that public companies and their officers, employees, contractors, subcontractors, and agents may not retaliate against "their own employees." In any case, that Congress could have spoken with greater specificity in both directions only underscores that the words Congress actually chose are ambiguous. To resolve this ambiguity, we must rely on other markers of intent.

***465** B

We have long held that where the text is ambiguous, a statute's titles can offer "a useful aid in resolving [the] ambiguity." *FTC v. Mandel Brothers, Inc.,* 359 U.S. 385, 388–389, 79 S.Ct. 818, 3 L.Ed.2d 893 (1959). Here, two headings strongly suggest that Congress intended § 1514A to apply only to employees of public companies. First, the title of § 806—the section of the Sarbanes–Oxley Act that enacted § 1514A— speaks clearly to the scope of employees protected by the provision: "Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud." 116 Stat. 802. Second, the ****1180** heading of § 1514A(a) reinforces that the provision provides "[w]histleblower protection for employees of publicly traded companies."

The majority suggests that in covering "employees of publicly traded companies," the headings may be imprecise.*Ante,* at 1169. Section 1514A(a) technically applies to the employees of two types of companies: those "with a class of securities registered under section 12 of the Securities Exchange Act of 1934," and those that are "required to file reports under section 15(d) of the" same Act. Both types of companies are "public" in that they are publicly owned. See *ante,* at 1164 – 1165. The difference is that shares of the § 12 companies are listed and traded on a national securities exchange; § 15(d) companies, by contrast, exchange their securities directly with the public. The headings may therefore be inexact in the sense that the phrase "publicly traded" is commonly associated with companies whose securities are traded on national exchanges. Congress, however, had good reason to use the phrase to refer to § 15(d) companies as well: Section 15(d) companies are traded publicly, too. For instance, as the majority recognizes, *ante,* at 1171, a mutual fund is one paradigmatic example of a § 15(d) company. And mutual funds, like other § 15(d) companies, are both publicly owned and widely traded; the trades just take place typically between the fund and its investors directly.

***466** In any case, even if referring to employees of § 12 and § 15(d) companies together as "employees of publicly traded companies" may be slightly imprecise, the majority's competing interpretation of § 1514A would stretch the statute's headings far past the point of recognition. As the majority understands the law, Congress used the term

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"employees of publicly traded companies" as shorthand not just for (1) employees of § 12 and § 15(d) companies, but also for (2) household employees of any individual who works for a § 12 or § 15(d) company; (3) employees of any private company that contracts with a § 12 or § 15(d) company; (4) employees of any private company that, even if it does not contract with a public company, subcontracts with a private company that does; and (5) employees of any agent of a § 12 or § 15(d) company. If Congress had wanted to enact such a far-reaching provision, it would have called it something other than "[w]histleblower protection for employees of publicly traded companies."

Recognizing that Congress chose headings that are inconsistent with its interpretation, the majority notes that the Court has "placed less weight on captions." *Ante,* at 1169. But where the captions favor one interpretation so decisively, their significance should not be dismissed so quickly. As we have explained, headings are important " 'tools available for the resolution of a doubt' about the meaning of a statute." *Almendarez–Torres v. United States,* 523 U.S. 224, 234, 118 S.Ct. 1219, 140 L.Ed.2d 350 (1998).

C

1

Statutory context confirms that Congress intended § 1514A to apply only to employees of public companies. To start, the Sarbanes–Oxley Act as a whole evinces a clear focus on public companies. Congress stated in the Act's preamble that its objective was to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws," 116 Stat. 745, disclosures ***467** that public companies alone must file. The Act thus created enhanced disclosure obligations for public companies, § 401; added new conflict of interest rules for their executives, ****1181** § 402; increased the responsibilities of their audit committees, § 301; and created new rules governing insider trading by their executives and directors, § 306. The common denominator among all of these provisions is their singular focus on the activities of public companies.

When Congress wanted to depart from the Act's public company focus to regulate private firms and their employees, it spoke clearly. For example, § 307 of the Act ordered the Securities and Exchange Commission (SEC) to issue rules "setting forth minimum standards of professional conduct for attorneys appearing and practicing before the [SEC]," including a rule requiring outside counsel to report violations of the securities laws to public company officers and directors. 15 U.S.C. § 7245. Similarly, Title I of the Act created the Public Company Accounting Oversight Board (PCAOB) and vested it with the authority to register, regulate, investigate, and discipline privately held outside accounting firms and their employees. §§ 7211–7215. And Title V required the SEC to adopt rules governing outside securities analysts when they make public recommendations regarding securities. § 78*o*–6.

Section 1514A, by contrast, does not unambiguously cover the employees of private businesses that contract with public companies or the employees of individuals who work for public companies. Far from it, for the reasons noted above. Yet as the rest of the Sarbanes–Oxley Act demonstrates, if Congress had really wanted § 1514A to impose liability upon broad swaths of the private sector, it would have said so more clearly.

Congress' intent to adopt the narrower understanding of § 1514A is also clear when the statute is compared to the whistleblower provision that served as its model. That provision, enacted as part of the Wendell H. Ford Aviation Investment ***468** and Reform Act for the 21st Century, 49 U.S.C. § 42121, provides that "[n]o air carrier or contractor or subcontractor of an air carrier" may retaliate against an employee who reports a potential airline safety violation.

Section 42121 protects employees of contractors. But as the majority acknowledges, "Congress strayed" from § 42121 in significant ways when it wrote § 1514A. *Ante,* at 1176. First, § 42121 specifically defines the term "contractor," limiting the term to "a company that performs safety-sensitive functions by contract for an air carrier." § 42121(e). That is in notable distinction to § 1514A, which does not define the word "contractor" as a particular type of company, instead placing the term in a list alongside individual "officer[s]" and "employee[s]" who act on a company's behalf. Second, unlike § 42121, § 1514A sets off the term "contractor" in a separate clause that is subsidiary to the primary subject of the provision—the public company itself. Third, the title of § 42121 is "[p]rotection of employees providing air safety information," a title that comfortably encompasses the employees of contractors. Not so of § 1514A's headings, as explained above. In short, § 42121 shows that Congress had an easy-to-follow model if it wanted to protect the employees

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of contractors, yet chose to depart from that model in several important ways. We should not presume that choice to be accidental. See *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 734, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975).

2

The majority relies on statutory context as well, but its examples are unconvincing. It first argues that the types of conduct prohibited by the statute—"discharge, demotion, suspension, threats, harassment, [and] discrimination in the terms and conditions **1182 of employment"—are "commonly actions an employer takes against its *own* employees." *Ante,* at 1166. The problem is that § 1514A does not forbid retaliation by an "employer"; it forbids retaliation by a "[public] company ... or any officer, employee, contractor, subcontractor, or agent of such company." For the reasons already discussed *469 , Congress could have reasonably included the five types of representatives not in their capacity as employers, but rather as representatives of the company who are barred from retaliating against a public company's employees on the company's behalf.

The majority next suggests that contractors are rarely "positioned to take adverse actions against employees of the public company with whom they contract." *Ante,* at 1166. That misconceives the nature of modern work forces, which increasingly comprise a mix of contractors and persons laboring under more typical employment relationships. For example, public companies often hire "independent contractors," of whom there are more than 10 million, [3] and contract workers, [4] of whom there are more than 11 million. [5] And they employ outside lawyers, accountants, and auditors as well. While not every person who works for a public company in these nonemployee capacities may be positioned to threaten or harass employees of the public company, many are. See, *e.g.,* *Tides v. The Boeing Co.,* 644 F.3d 809, 811 (C.A.9 2011) (noting that "approximately seventy contract auditors from [an] accounting firm" possessed "managerial authority" over the 10 Boeing employees in the company's audit division). Congress therefore had as much reason to shield a public company's employees from retaliation by the company's contractors as it had to bar retaliation by officers and *470 employees. Otherwise, the statute would have had a gaping hole—a public company could evade § 1514A simply by hiring a contractor to engage in the very retaliatory acts that an officer or employee could not. [6]

**1183 The majority also too quickly dismisses the prominence of "outplacement" firms, or consultants that help companies determine whom to fire. See *ante,* at 1166 – 1167. Companies spent $3.6 billion on these services in 2009 alone. [7] Congress surely could have meant to protect public company employees against retaliation at the hands of such firms, especially in the event that the public company itself goes bankrupt (as companies engaged in fraud often do). See, *e.g.,Kalkunte v. DVI Financial Servs., Inc.,* No. 05–139 etc., ALJ No. 2004–SOX–056, 2009 WL 901018 (Feb. 27, 2009) (former employee of bankrupt public company permitted to bring § 1514A action against corporate restructuring firm that terminated her employment). [8]

*471 The majority points next to the remedies afforded by § 1514A(c), which authorizes "all relief necessary to make the employee whole," in addition to "reinstatement," "back pay," and "special damages ... including litigation costs, expert witness fees, and reasonable attorney fees." The majority posits that Congress could not have intended to bar contractors from retaliating against public company employees because one of the remedies (reinstatement) would likely be outside of the contractor's power. *Ante,* at 1167 – 1168. But there is no requirement that a statute must make every type of remedy available against every type of defendant. A contractor can compensate a whistleblower with backpay, costs, and fees, and that is more than enough for the statute's remedial scheme to make sense. The majority's reference to the affirmative defense for public company "employers" who lack " knowledge" that an employee has participated in a proceeding relating to the fraud report, *ante,* at 1167 (citing § 1514(A)(a)(2)), fails for a similar reason. There is no rule that Congress may only provide an affirmative defense if it is available to every conceivable defendant.

D

1

Finally, the majority's reading runs afoul of the precept that "interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available."

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Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982). ***472** The majority's interpretation transforms § 1514A into a sweeping source of litigation that Congress could not have intended. As construed by the majority, the Sarbanes–Oxley Act regulates employment relationships between individuals and their nannies, housekeepers, and caretakers, subjecting individual employers to litigation ****1184** if their employees claim to have been harassed for providing information regarding any of a host of offenses. If, for example, a nanny is discharged after expressing a concern to his employer that the employer's teenage son may be participating in some Internet fraud, the nanny can bring a § 1514A suit. The employer may prevail, of course, if the nanny cannot prove he was fired "because of" the fraud report. § 1514A. But there is little reason to think Congress intended to sweep such disputes into federal court.

Nor is it plausible that Congress intended the Act to impose costly litigation burdens on any private business that happens to have an ongoing contract with a public company. As the majority acknowledges, the purpose of the Act was to protect public company investors and the financial markets. Yet the majority might well embroil federal agencies and courts in the resolution of mundane labor disputes that have nothing to do with such concerns. For instance, a construction worker could file a § 1514A suit against her employer (that has a long-term contract with a public company) if the worker is demoted after reporting that another client has mailed the company a false invoice. [9]

***473** The majority's interpretation also produces truly odd distinctions. Under the rule it announces, a babysitter can bring a § 1514A retaliation suit against his employer if his employer is a checkout clerk for the local PetSmart (a public company), but not if she is a checkout clerk for the local Petco (a private company). Likewise, the day laborer who works for a construction business can avail himself of § 1514A if her company has been hired to help remodel the local Dick's Sporting Goods store (a public company), but not if it is remodeling a nearby Sports Authority (a private company).

In light of the reasonable alternative reading of § 1514A, there is no reason to accept these absurd results. The majority begs to differ, arguing that "[t]here is scant evidence" that lawsuits have been brought by the multitude of newly covered employees " 'who have no exposure to investor-related activities and thus could not possibly assist in detecting investor fraud.' " *Ante,* at 1172. Until today, however, no court has deemed § 1514A applicable to household employees of individuals who work for public companies; even the Department of Labor's ARB rejected that view. *Spinner,* ALJ No. 2010–SOX–029, at 8. And as the District Court noted, prior to the ARB's 2012 decision in *Spinner,* the ARB "ha[d] yet to provide ... definitive clarification" on the question whether § 1514A extends to the employees of a public company's private contractors. 724 F.Supp.2d 141, 155 (Mass.2010). So the fact that individuals and private businesses have yet to suffer burdensome litigation offers little assurance that the majority's capacious reading of § 1514A will produce no untoward effects.

Finally, it must be noted that § 1514A protects the reporting of a variety of frauds—not only securities fraud, but also mail, wire, and bank fraud. By interpreting a statute that already protects an expansive class of conduct also to cover a large class of employees, today's opinion ****1185** threatens to subject private companies to a costly new front of employment litigation ***474** . Congress almost certainly did not intend the statute to have that reach.

2

The majority argues that the broader reading of § 1514A is necessary because a small number of the millions of individuals and private companies affected by its ruling have a special role to play in preventing public company fraud. If § 1514A does not bar retaliation against employees of contractors, the majority cautions, then law firms and accounting firms will be free to retaliate against their employees when those employees report fraud on the part of their public company clients.

It is undisputed that Congress was aware of the role that outside accountants and lawyers played in the Enron debacle and the importance of encouraging them to play an active part in preventing future scandals. But it hardly follows that Congress must have meant to apply § 1514A to every employee of every public company contractor, subcontractor, officer, and employee as a result. It is far more likely that Congress saw the unique ethical duties and professional concerns implicated by outside lawyers and accountants as reason to vest regulatory authority in the hands of experts with the power to sanction wrongdoers.

Specifically, rather than imposing § 1514A's generic approach on outside accounting firms, Congress established the PCAOB, which regulates "every detail" of an accounting

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firm's practice, including "supervision of audit work," "internal inspection procedures," "professional ethics rules," and " 'such other requirements as the Board may prescribe.' " *Free Enterprise Fund v. Public Company Accounting Oversight Bd.,* 561 U.S. 477, ––––, 130 S.Ct. 3138, 3148, 177 L.Ed.2d 706 (2010). Importantly, the PCAOB is empowered to levy "severe sanctions in its disciplinary proceedings, up to and including the permanent revocation of a firm's registration ... and money penalties of $15 million." *Id., at* ––––, 130 S.Ct., at 3148 (citing 15 U.S.C. § 7215(c)(4)). Such sanctions could well provide a more powerful incentive to prevent ***475** an accounting firm from retaliating against its employees than § 1514A.

The Sarbanes–Oxley Act confers similar regulatory authority upon the SEC with respect to attorneys. The Act requires the SEC to establish rules of professional conduct for attorneys, § 307 (codified at 15 U.S.C. § 7245), and confers broad power on the SEC to punish attorneys for "improper professional conduct," which would include, for example, a law firm partner's decision to retaliate against an associate who reports fraud. § 602 (codified at 15 U.S.C. § 78d–3). Indeed, the Act grants the SEC the power to censure culpable attorneys and to deny "permanently" to any such attorney the "privilege of appearing of practicing before" the SEC "in any way." § 602.

Congress thus evidently made the judgment that decisions concerning how best to punish law firms and accounting firms ought to be handled not by the Department of Labor, but by the SEC and the PCAOB. Such judgment should not be disturbed under usual circumstances, much less at the cost to congressional intent produced by today's ruling. The majority does offer cogent policy arguments for why Congress might have been wiser to include certain types of contractors within § 1514A, noting for example that a law firm or accounting firm might be able to retaliate against its employees for making reports required under the Sarbanes–Oxley Act. *Ante,* at 1170 – 1171. But as the majority recognizes, Congress has since remedied that precise concern, enacting a comprehensive whistleblower incentive ****1186** and protection program that unequivocally "prohibit[s] any employer"—public or private—"from retaliating against 'a whistleblower' for providing information to the SEC, participating in an SEC proceeding, or making disclosures required or protected under Sarbanes–Oxley and certain other securities laws." *Ante,* at 1174 (citing 15 U.S.C. §§ 78u–6(a)(6), (b)(1), (h)). The majority thus acknowledges that, moving forward, retaliation claims like the petitioners' may "procee[d] under ***476** [§ 78u–6]," *ante,* at 1174, n. 17. In other words, to the extent the majority worries about a "hole" in FMR's interpretation, *ante,* at 1168, Congress has already addressed it. [10]

II

Because the statute is ambiguous, and because the majority's broad interpretation has also been adopted by the ARB, there remains the question whether the ARB's decision in *Spinner,* ALJ No. 2010–SOX–029, is entitled to deference under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). [11] Under *United States v. Mead Corp.,* 533 U.S. 218, 226–227, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001), an agency may claim *Chevron* deference "when it appears [1] that Congress delegated authority to the agency generally to make rules carrying the force of law, and [2] that the agency interpretation claiming deference was promulgated in the exercise of that authority." Neither requirement is met here.

First, the agency interpretation for which petitioners claim deference is the position announced by the ARB, the ***477** board to which the Secretary of Labor has delegated authority "in review or on appeal" in connection with § 1514A proceedings. 75 Fed.Reg. 3924 (2010). According to petitioners, the ARB's rulings are entitled to deference because the "Secretary is responsible for enforcing Section 1514A both through investigation and through formal adjudication." Brief for Petitioners 61. That is right as far as it goes, but even if the Secretary has the power to investigate and adjudicate § 1514A claims, Congress did not delegate authority to the Secretary to "make rules carrying the force of law," *Mead,* 533 U.S., at 226–227, 121 S.Ct. 2164. Congress instead delegated that power to the SEC: Section 3(a) of the Sarbanes–Oxley Act, codified at 15 U.S.C. § 7202(a), provides that the SEC "shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in ****1187** furtherance of this Act." So if any agency has the authority to resolve ambiguities in § 1514A with the force of law, it is the SEC, not the Department of Labor. See *Martin v. Occupational Safety and Health Review Comm'n,* 499 U.S. 144, 154, 111 S.Ct. 1171, 113 L.Ed.2d 117 (1991). The

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SEC, however, has not issued a regulation applying § 1514A whistleblower protection to employees of public company contractors. And while the majority notes that the SEC may share the (incorrect) view that the Department of Labor has interpretive authority regarding § 1514A, *ante,* at 1165, n. 6, the majority cites nothing to suggest that one agency may transfer authority unambiguously delegated to it by Congress to a different agency simply by signing onto an *amicus* brief.

That Congress did not intend for the Secretary to resolve ambiguities in the law is confirmed by § 1514A's mechanism for judicial review. The statute does not merely permit courts to review the Secretary's final adjudicatory rulings under the Administrative Procedure Act's deferential standard. It instead allows a claimant to bring an action in a federal district court, and allows district courts to adjudicate such actions *de novo,* in any case where the Secretary has ***478** not issued a final decision within 180 days. That is a conspicuously short amount of time in light of the three-tiered process of agency review of § 1514A claims. See *ante,* at 1163 – 1164. As a result, even if Congress had not delegated to the SEC the authority to resolve ambiguities in § 1514A, the muscular scheme of judicial review suggests that Congress would have wanted federal courts, and not the Secretary of Labor, to have that power. See *Mead,* 533 U.S., at 232, 121 S.Ct. 2164 (declining to defer to Customs Service classifications where, among other things, the statute authorized "independent review of Customs classifications by the [Court of International Trade]").

As to the second *Mead* requirement, even if Congress had delegated authority to the Secretary to make "rules carrying the force of law," the "agency interpretation claiming deference" in this case was not "promulgated in the exercise of that authority." *Id.,* at 226–227, 121 S.Ct. 2164. That is because the Secretary has explicitly vested any policymaking authority he may have with respect to § 1514A in the Occupational Safety and Health Administration (OSHA) instead of the ARB. See 67 Fed.Reg. 65008 (2002). In fact, the Secretary has expressly withdrawn from the ARB any power to deviate from the rules OSHA issues on the Department of Labor's behalf. 75 Fed.Reg. 3925 ("The [ARB] shall not have jurisdiction to pass on the validity of any portion of the Code of Federal Regulations that has been duly promulgated by the Department of Labor and shall observe the provisions thereof, where pertinent, in its decisions").

OSHA has promulgated regulations supporting the majority's reading of § 1514A. See 29 CFR § 1980.101(f)-(g) (2013). The Secretary, however, has expressly disclaimed any claim of deference to them. See Brief for United States as *Amicus Curiae* 33, n. 8. As a result, the ARB's understanding of § 1514A's coverage in *Spinner* was not an "exercise of [the Secretary's] authority" to make rules carrying the force of law, *Mead,* 533 U.S., at 226–227, 121 S.Ct. 2164, but rather the ***479** ARB's necessary compliance with a regulation that no one claims is deserving of deference in the first place. See *Spinner,* ALJ No. 2010–SOX–029, at 10 (recognizing that "the ARB is bound by the [Department of Labor] regulations").

In the absence of *Chevron* deference, the ARB's decision in *Spinner* may claim only "respect according to its persuasiveness" ****1188** under *Skidmore v. Swift & Co.,* 323 U.S. 134, 65 S.Ct. 161, 89 L.Ed. 124 (1944). See *Mead,* 533 U.S., at 221, 121 S.Ct. 2164. But the ARB's decision is unpersuasive, for the many reasons already discussed.

* * *

The Court's interpretation of § 1514A undeniably serves a laudatory purpose. By covering employees of every officer, employee, and contractor of every public company, the majority's interpretation extends § 1514A's protections to the outside lawyers and accountants who could have helped prevent the Enron fraud.

But that is not the statute Congress wrote. Congress envisioned a system in which public company employees would be covered by § 1514A, and in which outside lawyers, investment advisers, and accountants would be regulated by the SEC and PCAOB. Congress did not envision a system in which employees of other private businesses—such as cleaning and construction company workers who have little interaction with investor-related activities and who are thus ill suited to assist in detecting fraud against shareholders —would fall within § 1514A. Nor, needless to say, did it envision § 1514A applying to the household employees of millions of individuals who happen to work for public companies—housekeepers, gardeners, and babysitters who are also poorly positioned to prevent fraud against public company investors. And to the extent § 1514A may have been underinclusive as first drafted, Congress has shown itself capable of filling in any gaps. See, *e.g.,* Dodd–Frank

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Wall Street Reform and Consumer Protection Act, §§ 922, 929A, 124 Stat. 1848, 1852 (extending § 1514A to credit rating agencies and public company subsidiaries); § 922, *id.,* at 1841–1848 ***480** (codifying additional whistleblower incentive and protection program at 15 U.S.C. § 78u–6).

The Court's decision upsets the balance struck by Congress. Fortunately, just as Congress has added further protections to the system it originally designed when necessary, so too may Congress now respond to limit the far-reaching implications of the Court's interpretation. [12] But because that interpretation relies on a debatable view of § 1514A's text, is inconsistent with the statute's titles and its context, and leads to absurd results that Congress did not intend, I respectfully dissent.

All Citations

571 U.S. 429, 134 S.Ct. 1158, 188 L.Ed.2d 158, 97 Empl. Prac. Dec. P 45,023, 82 USLW 4144, Fed. Sec. L. Rep. P 97,838, 37 IER Cases 1193, 2014 O.S.H.D. (CCH) P 33,358, 14 Cal. Daily Op. Serv. 2269, 2014 Daily Journal D.A.R. 2622, 24 Fla. L. Weekly Fed. S 580

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 Title VIII of the Act, which contains the whistleblower protection provision at issue in this case, was authored by Senators Leahy and Grassley and originally constituted a discrete bill, S. 2010. We thus look to the Senate Report for S.2010, S.Rep. No. 107–146, as the Senate Report relevant here. See 148 Cong. Rec. S7418 (daily ed. July 26, 2002) (statement of Sen. Leahy) ("unanimous consent" to "includ[e] in the CONGRESSIONAL RECORD as part of the official legislative history" of Sarbanes–Oxley that Title VIII's "terms track almost exactly the provisions of S. 2010, introduced by Senator Leahy and reported unanimously from the Committee on the Judiciary").

2 As discussed *infra,* at 1173 – 1175, Congress amended § 1514A in 2010 to extend whistleblower coverage to employees of public companies' subsidiaries and nationally recognized statistical ratings organizations. 124 Stat. 1848. Plaintiffs do not fall in either category and, in any event, their claims are governed by the prior version of § 1514A. Unless otherwise noted, all citations to § 1514A are to the original text in the 2006 edition of the United States Code.

3 Here, as just noted, the public company has no employees. See *supra,* at 1161 – 1162.

4 As § 1514A treats contractors and subcontractors identically, we generally refer simply to "contractors" without distinguishing between the two.

5 The whistleblower in *Spinner* was an employee of an accounting firm that provided auditing, consulting, and Sarbanes–Oxley compliance services to a public company.

6 The dissent maintains that the ARB's interpretation of § 1514A is not entitled to deference because, "if any agency has the authority to resolve ambiguities in § 1514A with the force of law, it is the SEC, not the Department of Labor." *Post,* at 1187. Because we agree with the ARB's conclusion that § 1514A affords protection to a contractor's employees, we need not decide what weight that conclusion should carry. We note, however, that the SEC apparently does not share the dissent's view that it, rather than DOL, has interpretive authority over § 1514A. To the contrary, the SEC is a signatory to the Government's brief in this case, which takes the position that Congress has charged the Secretary of Labor with interpreting § 1514A. Brief for United States as *Amicus Curiae* 9–11, 31–34. That view is hardly surprising given the lead role played by DOL in administering whistleblower statutes. See *supra,* at 1163. The dissent observes that the SEC "has not issued a regulation applying § 1514A whistleblower protection to employees of public company

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contractors," *post,* at 1187, but omits to inform that the SEC has not promulgated *any* regulations interpreting § 1514A, consistent with its view that Congress delegated that responsibility to DOL.

7 We need not decide in this case whether § 1514A also prohibits a contractor from retaliating against an employee of one of the other actors governed by the provision.

8 This hypothetical originates in a Seventh Circuit opinion, *Fleszar v. United States Dept. of Labor,* 598 F.3d 912, 915 (2010), and is mentioned in a footnote in the First Circuit's opinion in this case, 670 F.3d 61, 69, n. 11 (2012).

9 When asked during oral argument for an example of actual circumstances in which a contractor would have employment decisionmaking authority over public company employees, FMR's counsel cited *Kalkunte v. DVI Financial Servs., Inc.,* No. 05–139 etc., ALJ No. 2004–SOX–056, 2009 WL 901018 (Feb. 27, 2009). Tr. of Oral Arg. 33. That case involved a bankrupt public company that hired a private company to handle its dissolution. The ARB found the private company liable under § 1514A because it acted as a "contractor, subcontractor, *or agent* " of the public company in discharging the claimant. ALJ No. 2004–SOX–056, at 10 (emphasis added). Neither FMR nor its *amici* have pointed us to any actual situation in which a public company employee would be vulnerable to retaliatory conduct by a contractor not already covered as an "agent" under § 1514A. Notably, even in *Tides v. The Boeing Co.,* 644 F.3d 809 (C.A.9 2011), the case cited by the dissent for the proposition that contractors may possess "managerial authority" over public company employees, *post,* at 1182, the alleged retaliation was by the public company itself.

10 The dissent suggests that we "fai[l] to recognize" that its construction also makes contractors primarily liable for retaliating of their own volition against employees of public companies. *Post,* at 1182 – 1183, n. 6. As explained *supra,* at 1166, n. 9, however, FMR and its supporters have identified not even one real-world instance of a public company employee asserting a § 1514A claim alleging retaliatory conduct by a contractor. Again, no "gaping hole," practically no hole at all.

11 The ARB endorsed this view in *Spinner v. David Landau & Assoc., LLC,* No. 10–111 etc., ALJ No. 2010–SOX–029, p. 8 (May 31, 2012). We have no occasion to determine whether the ARB would be entitled to deference in this regard, for, as explained in text, we find that the statutory text unambiguously affords protection to personal employees of public company officers and employees. § 1514A(a).

12 AIR 21's anti-retaliation provision, on which § 1514A is based, includes a similarly composed heading, "Discrimination against airline employees." 49 U.S.C. § 42121(a). Nevertheless, that provision has been read to cover employees of companies rendering contract services to airlines. See*infra,* at 1175 – 1176.

13 FMR urges that the Senate Report's references to "employees of publicly traded companies" demonstrate that Congress wanted to limit whistleblower protection to such employees. Brief for Respondents 30–31. This argument fails for the same reason that FMR's reliance on the statutory section headings fails: "employees of publicly traded companies" must be understood as shorthand not designed to capture every employee covered by § 1514A. See *supra,* at 1167 – 1169. Senator Sarbanes' statement, cited in the concurring opinion, *post,* at 1178, is similarly imprecise. The Act indisputably covers private accounting firms and law firms that provide services to public companies. See, *e.g.*, 15 U.S.C. §§ 7215, 7245. Indeed, Senator Sarbanes acknowledged this point in his very next sentence. See 148 Cong. Rec. 14440 (2002) (remarks of Sen. Sarbanes) ("This legislation prohibits accounting firms from providing certain specified consulting services if they are also the auditors of the company.").

14 The dissent suggests that the Public Company Accounting Oversight Board's and the SEC's authority to sanction unprofessional conduct by accountants and lawyers, respectively, "could well provide" a disincentive to retaliate against other accountants and lawyers. See *post,* at 1185. The possibility of such sanctions, however, is cold comfort to the accountant or lawyer who loses her job in retaliation for her efforts to comply with the Act's requirements if, as the dissent would have it, § 1514A does not enable her to seek reinstatement or backpay.

15 Although the dissent suggests that the ARB had not provided "definitive clarification" on the issue prior to *Spinner,post* at 1184 – 1185, the ARB "repeatedly interpreted [§ 1514A] as affording whistleblower protection

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to employees of [private] contractors" before *Spinner*. See *Spinner,* No. 10–111 etc., ALJ No. 2010–SOX–029, p. 5 (citing prior decisions).

16 We can easily dismiss FMR's invocation of a failed bill from 2004, the Mutual Fund Reform Act, S. 2059, 108th Cong., 2d Sess., § 116(b), which would have amended § 1514A explicitly to cover employees of investment advisers and affiliates. Brief for Respondents 34–35. "[F]ailed legislative proposals are a particularly dangerous ground on which to rest an interpretation of a prior statute." *United States v. Craft,* 535 U.S. 274, 287, 122 S.Ct. 1414, 152 L.Ed.2d 437 (2002) (internal quotation marks omitted). Where, as here, the proposed amendment amounted to six lines in a 51–page bill that died without any committee action, its failure is scarcely relevant to Congress' intentions regarding a different bill enacted two years earlier.

17 FMR acknowledges that plaintiffs' claims could have proceeded under Dodd–Frank, but for the date of enactment. Brief for Respondents 43.

18 Section 1107 of the Act is of similar breadth, declaring it a criminal offense to "tak[e] any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense." 18 U.S.C. § 1513(e).

19 For other provisions borrowing from AIR 21, see 49 U.S.C. § 20109, governing rail carriers, which incorporates AIR 21's enforcement procedures, and § 31105, governing motor carriers, which incorporates AIR 21's proof burdens.

20 The ARB has also interpreted similarly worded whistleblower protection provisions in the Pipeline Safety Improvement Act of 2002, 49 U.S.C. § 60129(a), and the Energy Reorganization Act of 1974, 42 U.S.C. § 5851(a), as protecting employees of contractors. See *Rocha v. AHR Utility Corp*., ARB No. 07–112, ALJ No. 2006–PSI–001 etc., p. 2, 2009 WL 2407945 (June 25, 2009); *Robinson v. Triconex Corp*., ARB No. 10–013, ALJ No. 2006–ERA–031, pp. 8–9 (Mar. 28, 2012).

21 FMR protests that there is no court of appeals precedent on point, Brief for Respondents 24, n. 6, but the courts of appeals are not, of course, the only lodestar for determining whether a proposition of law is plainly established.

22 The dissent suggests the provisions' headings are also distinguishable because § 42121's title—"Protection of employees providing air safety information"—"comfortably encompasses the employees of contractors." *Post,* at 1181. The dissent omits, however, the subsection heading directly following the title: "Discrimination against airline employees." § 42121(a).

* The Congressional Record reads "provide companies," but context as well as grammar makes clear that this is a scrivener's error for "private companies."

1 The majority uses the term "public company" as shorthand for 18 U.S.C. § 1514A's reference to companies that either have " 'a class of securities registered under section 12 of the Securities Exchange Act of 1934,' " or that are " 'required to file reports under section 15(d).' " *Ante,* at 1164 – 1165. I do the same.

2 In reaching the opposite conclusion, the majority rejects the concessions by the Government and petitioners and gives no weight to the ARB's interpretation. If § 1514A creates a cause of action for contractor employees, the majority concludes, so too must it create a cause of action for "housekeepers" and "gardeners" against their individual employers if they happen to work for a public company. *Ante,* at 1168 – 1169. In reaching this result, however, the majority only adds to the absurdities produced by its holding. See *infra,* at 1167 – 1168.

3 Dept. of Labor, Bureau of Labor Statistics, News, Contingent and Alternative Employment Arrangements, Feb. 2005, (July 27, 2005), online at http://www.bls.gov/news.release/conemp.nr0.htm (all Internet materials as visited on Feb. 28, 2014, and available in Clerk of Court's case file).

4 The Bureau of Labor Statistics distinguishes contract workers from independent contractors, defining the former as "[w]orkers who are employed by a company that provides them or their services to others under contract and who ... usually work at the customer's worksite." *Id.,* at 2 (Table A).

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5 Penn, Staffing Firms Added Nearly 1 Million Jobs Over Four Years Since Recession, ASA Says, Bloomberg Law (Oct. 8, 2012), online at http:// about.bloomberglaw.com/law–reports/staffing–firms–added–nearly–1–million–jobs–over–four–years–since–recession–asa–says/.

6 The majority submits that the hole might not be so problematic because § 1514A "surely" prohibits a "public company from directing someone else to engage in retaliatory conduct against the public company's employees." *Ante,* at 1167. It surely does, but that is the point—the whole reason § 1514A(a) clearly does so is because it expressly forbids a public company to retaliate against its employees through "any officer, employee, contractor, subcontractor, or agent." The prohibition on retaliation through a contractor would be far less certain (hence the hole) if Congress had merely forbidden a public company to retaliate through its "officers and employees." Moreover, while the majority concedes that, under the narrower reading of § 1514A, Congress' inclusion of the term "contractor" imposes secondary liability in the event a public company is judgment proof, *ante,* at 1167 – 1168, the majority fails to recognize that Congress' use of the term also imposes primary liability against contractors who threaten public company employees without direction from the company. Thus, for example, FMR's interpretation of § 1514A would prevent an outside accountant from threatening or harassing a public company employee who discovers that the accountant is defrauding the public company and who seeks to blow the whistle on that fraud.

7 Rogers, Do Firing Consultants Really Exist, Slate, Jan. 7, 2010, www.slate.com/articles/news_and_politics/explainer/2010/01/getting_the_ax_ from_george_clooney.html.

8 The majority suggests that an outplacement firm would likely be acting as an "agent" for the public company, such that Congress' additional inclusion of the word "contractor" would be superfluous under the narrower reading of § 1514A. *Ante,* at 1166, n. 9. The two words are not legally synonymous, however. An outplacement firm and public company might, for example, enter into a contract with a provision expressly disclaiming an agency relationship. Moreover, Congress' use of the term "contractor" would in all events have an independent and important effect: If Congress had not included the term, no one could be held liable if a contractor were to threaten or harass a public company employee without the company's direction. While the majority may speculate that such occurrences are rare, *ibid.,* it is hardly unthinkable. See n. 6, *supra*.

9 Recognizing that the majority's reading would lead to a "notably expansive scope untethered to the purpose of the statute," the District Court in this case sought to impose an extratextual limiting principle under which an employee who reports fraud is entitled to protection only if her report "relat[es] to fraud against shareholders." 724 F.Supp.2d 141, 160 (Mass.2010). The District Court acknowledged, however, that "the language of the statute itself does not plainly provide such a limiting principle," *id.,* at 158, and the majority does not attempt to revive that limitation here.

10 The majority also contends that its reading is necessary to avoid "insulating the entire mutual fund industry from § 1514A." *Ante,* at 1171. But that argument is misguided for a reason similar to the majority's concern about lawyers and accountants. As this Court has observed, Congress responded to the " 'potential for abuse inherent in the structure of investment companies,' " *Daily Income Fund, Inc. v. Fox,* 464 U.S. 523, 536, 104 S.Ct. 831, 78 L.Ed.2d 645 (1984), by enacting the Investment Company Act of 1940 and the Investment Advisers Act of 1940. 15 U.S.C. § 80a–1 *et seq.*; § 80b–1 *et seq*. The Advisers Act in particular grants the SEC broad regulatory authority to regulate mutual fund investment advisers. § 80b–11. The Act also authorizes fines and imprisonment of up to five years for violations of SEC rules. The SEC thus has broad discretion to punish retaliatory actions taken by mutual fund advisers against their employees. And to the extent these provisions may have been insufficient to protect mutual fund adviser employees, § 78u–6's extensive whistleblower incentive and protection program now unambiguously covers such employees.

11 Although it claims not to reach the issue, *ante,* at 1165, n. 6, the majority implicitly declines to defer to a portion of the ARB's ruling as well, rejecting the ARB's ruling that § 1514A does not apply to the household employees of public company officers and employees, *ante,* at 1168 – 1169, and n. 11.

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12 Congress could, for example, limit § 1514A to contractor employees in only those professions that can assist in detecting fraud on public company shareholders, or it could restrict the fraud reports that trigger whistleblower protection to those that implicate the interests of public company investors, see n. 9, *supra*.

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Community Health Choice, Inc. v. United States, Fed.Cl., February 15, 2019

138 S.Ct. 767
Supreme Court of the United States

DIGITAL REALTY TRUST, INC., Petitioner
v.
Paul SOMERS.

No. 16–1276.
|
Argued Nov. 28, 2017.
|
Decided Feb. 21, 2018.

Synopsis
Background: Former employee brought action against employer for violation of whistleblower anti-retaliation provision of Dodd–Frank Wall Street Reform and Consumer Protection Act. The United States District Court for the Northern District of California, No. 3:14–cv–05180–EMC, Edward M. Chen, J., 119 F.Supp.3d 1088, denied employer's motion to dismiss and certified interlocutory appeal. Employer appealed. The United States Court of Appeals for the Ninth Circuit, Schroeder, Circuit Judge, 850 F.3d 1045, affirmed. Certiorari was granted.

Holdings: The Supreme Court, Justice Ginsburg, held that:

[1] employee who did not report any securities-law violations to SEC did not qualify as a whistleblower, abrogating *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145, and

[2] reporting requirement in whistleblower definition applied to Act's anti-retaliation provision, not just to Act's award program.

Reversed and remanded.

Justice Sotomayor filed concurring opinion in which Justice Breyer joined.

Justice Thomas filed opinion concurring in part and concurring in the judgment with which Justice Alito and Justice Gorsuch joined.

Procedural Posture(s): On Appeal; Petition for Writ of Certiorari; Motion to Dismiss.

West Headnotes (19)

[1] **Labor and Employment** Reporting or Opposing Wrongdoing; Criticism and "Whistleblowing"

The Sarbanes–Oxley Act created new protections for employees at risk of retaliation for reporting corporate misconduct. 18 U.S.C.A. § 1514A.

3 Cases that cite this headnote

[2] **Labor and Employment** Protected activities

An employee qualifies for protection under the whistleblower anti-retaliation provision of the Sarbanes-Oxley Act when he or she provides information or assistance either to a federal regulatory or law enforcement agency, Congress, or any person with supervisory authority over the employee. 18 U.S.C.A. § 1514A(a)(1)(A–C).

9 Cases that cite this headnote

[3] **Labor and Employment** Exhaustion

To recover under the whistleblower anti-retaliation provision of the Sarbanes-Oxley Act, an aggrieved employee must exhaust administrative remedies by filing a complaint with the Secretary of Labor. 18 U.S.C.A. § 1514A(b)(1)(A).

6 Cases that cite this headnote

[4] **Labor and Employment** Reporting or Opposing Wrongdoing; Criticism and "Whistleblowing"

The whistleblower provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act affords covered whistleblowers

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both incentives and protection. Securities Exchange Act of 1934, § 21F, 15 U.S.C.A. § 78u-6.

[5] **Labor and Employment** Protected activities

By cross-referencing the Sarbanes-Oxley Act and other laws, the whistleblower anti-retaliation provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act protects disclosures made to a variety of individuals and entities in addition to the Securities and Exchange Commission (SEC). Securities Exchange Act of 1934, § 21F(h)(1)(A)(iii), 15 U.S.C.A. § 78u-6(h)(1)(A)(iii); 18 U.S.C.A. § 7201 et seq.

2 Cases that cite this headnote

[6] **Labor and Employment** Protected activities

The whistleblower anti-retaliation provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act shields an employee's reports of wrongdoing to an internal supervisor if the reports are independently safeguarded from retaliation under the Sarbanes–Oxley Act. Securities Exchange Act of 1934, § 21F(h)(1)(A)(iii), 15 U.S.C.A. § 78u-6(h)(1)(A)(iii); 18 U.S.C.A. § 7201 et seq.

1 Cases that cite this headnote

[7] **Labor and Employment** Exhaustion

Labor and Employment Time for proceedings; limitations

Unlike the Sarbanes–Oxley Act, which contains an administrative-exhaustion requirement and a 180–day administrative complaint-filing deadline, the Dodd-Frank Wall Street Reform and Consumer Protection Act permits a whistleblower to sue a current or former employer directly in federal district court, with a default limitation period of six years. Securities Exchange Act of 1934, § 21F(h)(1)(B)(i), (h)(1)(B)(iii)(I)(aa), 15 U.S.C.A. § 78u-6(h)(1)(B)(i), (h)(1)(B)(iii)(I)(aa); 18 U.S.C.A. § 1514A(b)(1)(A), (b)(2)(D).

1 Cases that cite this headnote

[8] **Labor and Employment** Measure and amount

The Dodd-Frank Wall Street Reform and Consumer Protection Act instructs a court to award to a prevailing plaintiff under the whistleblower anti-retaliation provision double backpay with interest, while the Sarbanes–Oxley Act limits recovery to actual backpay with interest. Securities Exchange Act of 1934, § 21F(h)(1)(C)(ii), 15 U.S.C.A. § 78u-6(h)(1)(C)(ii); 18 U.S.C.A. § 1514A(c)(2)(B).

1 Cases that cite this headnote

[9] **Labor and Employment** Reinstatement

Labor and Employment Costs

Labor and Employment Attorney fees

Like the Sarbanes–Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act authorizes reinstatement and compensation for litigation costs, expert witness fees, and reasonable attorney fees to a prevailing plaintiff under the whistleblower anti-retaliation provisions. Securities Exchange Act of 1934, § 21F(h)(1)(C)(i, iii), 15 U.S.C.A. § 78u-6(h)(1)(C)(i, iii); 18 U.S.C.A. § 1514A(c)(2)(A, C).

2 Cases that cite this headnote

[10] **Labor and Employment** Grounds and subjects

Labor and Employment Judgment and Relief

Unlike the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Sarbanes–Oxley Act explicitly entitles a prevailing employee under the whistleblower anti-retaliation provisions to all relief necessary to make the employee whole, including compensation for any special damages sustained

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as a result of the discrimination. Securities Exchange Act of 1934, § 21F, 15 U.S.C.A. § 78u-6; 18 U.S.C.A. § 1514A(c)(1), (c)(2)(C).

3 Cases that cite this headnote

[11] **Statutes** Defined terms; definitional provisions

When a statute includes an explicit definition, a court must follow that definition, even if it varies from a term's ordinary meaning.

17 Cases that cite this headnote

[12] **Labor and Employment** Reporting or Opposing Wrongdoing; Criticism and "Whistleblowing"

An individual who meets both the whistleblower definition and engages in conduct that falls within the scope of the anti-retaliation provision may invoke the protections of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Securities Exchange Act of 1934, § 21F(a)(6), (h)(1)(A), 15 U.S.C.A. § 78u-6(a)(6), (h)(1)(A).

4 Cases that cite this headnote

[13] **Labor and Employment** Reporting or Opposing Wrongdoing; Criticism and "Whistleblowing"

An individual who falls outside the definition of a whistleblower in the Dodd-Frank Wall Street Reform and Consumer Protection Act is ineligible to seek redress under the Act, regardless of the conduct in which that individual engages. Securities Exchange Act of 1934, § 21F(a)(6), (h)(1)(A), 15 U.S.C.A. § 78u-6(a)(6), (h)(1)(A).

3 Cases that cite this headnote

[14] **Statutes** Express mention and implied exclusion; expressio unius est exclusio alterius

When Congress includes particular language in one section of a statute but omits it in another, a court presumes that Congress intended a difference in meaning.

18 Cases that cite this headnote

[15] **Labor and Employment** Monetary Relief; Damages

The whistleblower protection program under the Dodd-Frank Wall Street Reform and Consumer Protection Act provides substantial monetary rewards to whistleblowers who furnish actionable information to the Securities and Exchange Commission (SEC). Securities Exchange Act of 1934, § 21F(b), 15 U.S.C.A. § 78u-6(b).

24 Cases that cite this headnote

[16] **Labor and Employment** Protected activities

With the Sarbanes-Oxley Act, Congress sought to disturb the corporate code of silence that discouraged employees from reporting fraudulent behavior not only to the proper authorities, such as the FBI and the Securities and Exchange Commission (SEC), but even internally. 18 U.S.C.A. § 1514A(a)(1).

2 Cases that cite this headnote

[17] **Labor and Employment** Protected activities

Employee did not qualify as a "whistleblower" under anti-retaliation provision of Dodd-Frank Wall Street Reform and Consumer Protection Act, where employee did not provide any information concerning suspected securities-law violations to Securities and Exchange Commission (SEC) prior to his termination, rather he made report to senior management, and Act's definition of whistleblower expressly included SEC-reporting requirement; abrogating *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145. Securities Exchange Act of 1934, § 21F(a)(6), (h), 15 U.S.C.A. § 78u-6(a)(6), (h).

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27 Cases that cite this headnote

[18] **Labor and Employment** Protected activities

Requirement to report suspected securities-law violations to Securities and Exchange Commission (SEC) in definition of whistleblower in Dodd-Frank Wall Street Reform and Consumer Protection Act applied to Act's anti-retaliation provision, not just to Act's award program, since definition stated it applied throughout whistleblower section, requiring whistleblower to report to SEC in addition to any other entity to receive protection served purpose of Act, which was to encourage SEC disclosures, and ignoring reporting requirement could provide protection to an employee who reported information bearing no relationship to securities laws. Securities Exchange Act of 1934, § 21F(a)(6), (h), 15 U.S.C.A. § 78u-6(a)(6), (h).

19 Cases that cite this headnote

[19] **Statutes** Giving effect to statute or language; construction as written

It is a function of the court to give a statute the effect its language suggests, however modest that may be.

5 Cases that cite this headnote

***769** *Syllabus* [*]

Endeavoring to root out corporate fraud, Congress passed the Sarbanes–Oxley Act of 2002 (Sarbanes–Oxley) and the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank). Both Acts shield whistleblowers from retaliation, but they differ in important respects. Sarbanes–Oxley applies to ***770** all "employees" who report misconduct to the Securities and Exchange Commission (SEC or Commission), any other federal agency, Congress, or an internal supervisor. 18 U.S.C. § 1514A(a)(1). Dodd–Frank defines a "whistleblower" as "any individual who provides ... information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission." 15 U.S.C. § 78u–6(a)(6). A whistleblower so defined is eligible for an award if original information provided to the SEC leads to a successful enforcement action. § 78u–6(b)–(g). And he or she is protected from retaliation in three situations, see § 78u–6(h)(1)(A)(i)–(iii), including for "making disclosures that are required or protected under" Sarbanes–Oxley or other specified laws, § 78u–6(h)(1)(A)(iii). Sarbanes–Oxley's anti-retaliation provision contains an administrative-exhaustion requirement and a 180–day administrative complaint-filing deadline, see 18 U.S.C. § 1514A(b)(1)(A), (2)(D), whereas Dodd–Frank permits a whistleblower to sue an employer directly in federal district court, with a default six-year limitation period, see § 78u–6(h)(1)(B)(i), (iii)(I)(aa).

The SEC's regulations implementing the Dodd–Frank provision contain two discrete whistleblower definitions. For purposes of the award program, Rule 21F–2 requires a whistleblower to "provide the Commission with information" relating to possible securities-law violations. 17 C.F.R. § 240.21F–2(a)(1). For purposes of the anti-retaliation protections, however, the Rule does not require SEC reporting. See § 240.21F–2(b)(1)(i)–(ii).

Respondent Paul Somers alleges that petitioner Digital Realty Trust, Inc. (Digital Realty) terminated his employment shortly after he reported to senior management suspected securities-law violations by the company. Somers filed suit, alleging, *inter alia,* a claim of whistleblower retaliation under Dodd–Frank. Digital Realty moved to dismiss that claim on the ground that Somers was not a whistleblower under § 78u–6(h) because he did not alert the SEC prior to his termination. The District Court denied the motion, and the Ninth Circuit affirmed. The Court of Appeals concluded that § 78u–6(h) does not necessitate recourse to the SEC prior to gaining "whistleblower" status, and it accorded deference to the SEC's regulation under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694.

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Held : Dodd–Frank's anti-retaliation provision does not extend to an individual, like Somers, who has not reported a violation of the securities laws to the SEC. Pp. 776 – 782.

(a) A statute's explicit definition must be followed, even if it varies from a term's ordinary meaning. *Burgess v. United States,* 553 U.S. 124, 130, 128 S.Ct. 1572, 170 L.Ed.2d 478. Section 78u–6(a) instructs that the statute's definition of "whistleblower" "shall apply" "[i]n this section," that is, throughout § 78u–6. The Court must therefore interpret the term "whistleblower" in § 78u–6(h), the anti-retaliation provision, in accordance with that definition.

The whistleblower definition operates in conjunction with the three clauses of § 78u–6(h)(1)(A) to spell out the provision's scope. The definition first describes *who* is eligible for protection—namely, a "whistleblower" who provides pertinent information "to the Commission." § 78u–6(a)(6). The three clauses then describe what *conduct,* when engaged in by a "whistleblower," is shielded from employment discrimination. An individual who meets both measures may invoke Dodd–Frank's protections. But an individual who falls ***771** outside the protected category of "whistleblowers" is ineligible to seek redress under the statute, regardless of the conduct in which that individual engages. This reading is reinforced by another whistleblower-protection provision in Dodd–Frank, see 12 U.S.C. § 5567(b), which imposes no requirement that information be conveyed to a government agency. Pp. 776 – 778.

(b) The Court's understanding is corroborated by Dodd–Frank's purpose and design. The core objective of Dodd–Frank's whistleblower program is to aid the Commission's enforcement efforts by "motivat[ing] people who know of securities law violations to *tell the SEC*." S. Rep. No. 111–176, p. 38 (emphasis added). To that end, Congress provided monetary awards to whistleblowers who furnish actionable information to the Commission. Congress also complemented the financial incentives for SEC reporting by heightening protection against retaliation. Pp. 777 – 778.

(c) Somers and the Solicitor General contend that Dodd–Frank's "whistleblower" definition applies only to the statute's award program and not, as the definition plainly states, to its anti-retaliation provision. Their concerns do not support a departure from the statutory text. Pp. 778 – 782.

(1) They claim that the Court's reading would vitiate the protections of clause (iii) for whistleblowers who make disclosures to persons and entities other than the SEC. See § 78u–6(h)(1)(A)(iii). But the plain-text reading of the statute leaves the third clause with substantial meaning by protecting a whistleblower who reports misconduct *both* to the SEC and to another entity, but suffers retaliation because of the latter, non-SEC, disclosure. Pp. 778 – 779.

(2) Nor would the Court's reading jettison protections for auditors, attorneys, and other employees who are required to report information within the company before making external disclosures. Such employees would be shielded *as soon as they also provide relevant information to the Commission*. And Congress may well have considered adequate the safeguards already afforded to such employees by Sarbanes–Oxley. Pp. 779 – 780.

(3) Applying the "whistleblower" definition as written, Somers and the Solicitor General further protest, will allow "identical misconduct" to "go punished or not based on the happenstance of a separate report" to the SEC. Brief for Respondent 37–38. But it is understandable that the statute's retaliation protections, like its financial rewards, would be reserved for employees who have done what Dodd–Frank seeks to achieve by reporting information about unlawful activity to the SEC. P. 780.

(4) The Solicitor General observes that the statute contains no apparent requirement of a "temporal or topical connection between the violation reported to the Commission and the internal disclosure for which the employee suffers retaliation." Brief for United States as *Amicus Curiae* 25. The Court need not dwell on related hypotheticals, which veer far from the case at hand. Pp. 780 – 782.

(5) Finally, the interpretation adopted here would not undermine clause (ii) of § 78u–6(h)(1)(A), which prohibits retaliation against a whistleblower for "initiating, testifying in, or assisting in any investigation or ... action of the Commission based upon" information conveyed to the SEC by a whistleblower in accordance with the statute. The statute delegates authority to the Commission to establish the "manner" in which a whistleblower may provide information to the SEC. § 78u–6(a)(6). Nothing prevents the Commission from enumerating additional means of SEC reporting, ***772** including through testimony protected by clause (ii). P. 781.

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(d) Because "Congress has directly spoken to the precise question at issue," *Chevron,* 467 U.S., at 842, 104 S.Ct. 2778 deference is not accorded to the contrary view advanced by the SEC in Rule 21F–2. Pp. 781 – 782.

850 F.3d 1045, reversed and remanded.

GINSBURG, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, BREYER, SOTOMAYOR, and KAGAN, JJ., joined. SOTOMAYOR, J., filed a concurring opinion, in which BREYER, J., joined. THOMAS, J., filed an opinion concurring in part and concurring in the judgment, in which ALITO and GORSUCH, JJ., joined.

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Opinion

Justice GINSBURG delivered the opinion of the Court.

Endeavoring to root out corporate fraud, Congress passed the Sarbanes–Oxley Act of 2002, 116 Stat. 745 (Sarbanes–Oxley), and the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376 (Dodd–Frank). Both Acts shield whistleblowers from retaliation, but they differ in important respects. Most notably, Sarbanes–Oxley applies to all "employees" who report misconduct to the Securities and Exchange Commission (SEC or Commission), any other federal agency, Congress, or an internal supervisor. 18 U.S.C. § 1514A(a)(1). Dodd–Frank delineates a more circumscribed class; it defines "whistleblower" to mean a person who provides "information relating to a violation of the securities laws to the Commission." 15 U.S.C. § 78u–6(a)(6). A whistleblower so defined is eligible for an award if original information he or she provides to the SEC leads to a successful enforcement action. § 78u–6(b)–(g). And, most relevant here, a whistleblower is protected from retaliation for, *inter alia,* "making disclosures that are required or protected under" Sarbanes–Oxley, the Securities Exchange Act of 1934, the criminal anti-retaliation proscription at 18 U.S.C. § 1513(e), or any other law subject to the SEC's jurisdiction. 15 U.S.C. § 78u–6(h)(1)(A)(iii).

The question presented: Does the anti-retaliation provision of Dodd–Frank extend to an individual who has not reported a violation of the securities laws to the SEC and therefore falls outside the Act's definition of "whistleblower"? Pet. for Cert. (I). We answer that question "No": To sue under Dodd–Frank's anti-retaliation provision, a person must first "provid [e] ... information relating to a ***773** violation of the securities laws to the Commission." § 78u–6(a)(6).

I

A

[1] **[2]** "To safeguard investors in public companies and restore trust in the financial markets following the collapse of Enron Corporation," Congress enacted Sarbanes–Oxley in 2002. *Lawson v. FMR LLC,* 571 U.S. 429, ——, 134 S.Ct. 1158, 1161, 188 L.Ed.2d 158 (2014). Most pertinent here, Sarbanes–Oxley created new protections for employees at risk of retaliation for reporting corporate misconduct. See 18 U.S.C. § 1514A. Section 1514A prohibits certain companies from discharging or otherwise "discriminat[ing] against an employee in the terms and conditions of employment because" the employee "provid[es] information ... or otherwise assist[s] in an investigation regarding any conduct which the employee reasonably believes constitutes a violation" of certain criminal fraud statutes, any SEC rule or regulation, or "any provision of Federal law relating to fraud against shareholders." § 1514A(a)(1). An employee qualifies for protection when he or she provides information or assistance either to a federal regulatory or law enforcement agency, Congress, or any

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"person with supervisory authority over the employee." § 1514A(a)(1)(A)-(C).[1]

[3] To recover under § 1514A, an aggrieved employee must exhaust administrative remedies by "filing a complaint with the Secretary of Labor." § 1514A(b)(1)(A); see *Lawson,* 571 U.S., at –––– – ––––, 134 S.Ct., at 1163–1164. Congress prescribed a 180–day limitation period for filing such a complaint. § 1514A(b)(2)(D). If the agency "does not issue a final decision within 180 days of the filing of [a] complaint, and the [agency's] delay is not due to bad faith on the claimant's part, the claimant may proceed to federal district court for *de novo* review." *Id.,* at ––––, 134 S.Ct., at 1163 (citing § 1514A(b)). An employee who prevails in a proceeding under § 1514A is "entitled to all relief necessary to make the employee whole," including reinstatement, backpay with interest, and any "special damages sustained as a result of the discrimination," among such damages, litigation costs. § 1514A(c).

B

1

At issue in this case is the Dodd–Frank anti-retaliation provision enacted in 2010, eight years after the enactment of Sarbanes–Oxley. Passed in the wake of the 2008 financial crisis, Dodd–Frank aimed to "promote the financial stability of the United States by improving accountability and transparency in the financial system." 124 Stat. 1376.

Dodd–Frank responded to numerous perceived shortcomings in financial regulation. Among them was the SEC's need for additional "power, assistance and money at its disposal" to regulate securities markets. S. Rep. No. 111–176, pp. 36, 37 (2010). To assist the Commission "in identifying securities law violations," the Act established "a new, robust whistleblower program designed to motivate people who know of securities law violations to tell the SEC." *Id.,* at 38. And recognizing that "whistleblowers often face the difficult ***774** choice between telling the truth and ... committing 'career suicide,' " Congress sought to protect whistleblowers from employment discrimination. *Id.,* at 111, 112.

Dodd–Frank implemented these goals by adding a new provision to the Securities Exchange Act of 1934: 15 U.S.C. § 78u–6. Section 78u–6 begins by defining a "whistleblower" as "any individual who provides ... information relating to a violation of the securities laws *to the Commission,* in a manner established, by rule or regulation, by the Commission." § 78u–6(a)(6) (emphasis added). That definition, the statute directs, "shall apply" "[i]n this section"—*i.e.,* throughout § 78u–6. § 78u–6(a).

[4] Section 78u–6 affords covered whistleblowers both incentives and protection. First, the section creates an award program for "whistleblowers who voluntarily provid[e] original information to the Commission that le[ads] to the successful enforcement of [a] covered judicial or administrative action." § 78u–6(b)(1). A qualifying whistleblower is entitled to a cash award of 10 to 30 percent of the monetary sanctions collected in the enforcement action. See § 78u–6(b)(1)(A)–(B).

[5] **[6]** Second, § 78u–6(h) prohibits an employer from discharging, harassing, or otherwise discriminating against a "whistleblower" "because of any lawful act done by the whistleblower" in three situations: first, "in providing information to the Commission in accordance with [§ 78u–6]," § 78u–6(h)(1)(A)(i); second, "in initiating, testifying in, or assisting in any investigation or ... action of the Commission based upon" information provided to the SEC in accordance with § 78u–6, § 78u–6(h)(1)(A)(ii); and third, "in making disclosures that are required or protected under" either Sarbanes–Oxley, the Securities Exchange Act of 1934, the criminal anti-retaliation prohibition at 18 U.S.C. § 1513(e),[2] or "any other law, rule, or regulation subject to the jurisdiction of the Commission," § 78u–6(h)(1)(A)(iii). Clause (iii), by cross-referencing Sarbanes–Oxley and other laws, protects disclosures made to a variety of individuals and entities in addition to the SEC. For example, the clause shields an employee's reports of wrongdoing to an internal supervisor if the reports are independently safeguarded from retaliation under Sarbanes–Oxley. See *supra,* at 772 – 773.[3]

[7] **[8]** **[9]** **[10]** The recovery procedures under the anti-retaliation provisions of Dodd–Frank and Sarbanes–Oxley differ in critical respects. First, unlike Sarbanes–Oxley, which contains an administrative-exhaustion requirement and a ***775** 180–day administrative complaint-filing deadline,

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see 18 U.S.C. § 1514A(b)(1)(A), (2)(D), Dodd–Frank permits a whistleblower to sue a current or former employer directly in federal district court, with a default limitation period of six years, see § 78u–6(h)(1)(B)(i), (iii)(I)(aa). Second, Dodd–Frank instructs a court to award to a prevailing plaintiff double backpay with interest, see § 78u–6(h)(1)(C)(ii), while Sarbanes–Oxley limits recovery to actual backpay with interest, see 18 U.S.C. § 1514A(c)(2)(B). Like Sarbanes–Oxley, however, Dodd–Frank authorizes reinstatement and compensation for litigation costs, expert witness fees, and reasonable attorneys' fees. Compare § 78u–6(h)(1)(C)(i), (iii), with 18 U.S.C. § 1514A(c)(2)(A), (C). [4]

2

Congress authorized the SEC "to issue such rules and regulations as may be necessary or appropriate to implement the provisions of [§ 78u–6] consistent with the purposes of this section." § 78u–6(j). Pursuant to this authority, the SEC published a notice of proposed rulemaking to "Implemen[t] the Whistleblower Provisions" of Dodd–Frank. 75 Fed.Reg. 70488 (2010). Proposed Rule 21F–2(a) defined a "whistleblower," for purposes of both the award and anti-retaliation provisions of § 78u–6, as one or more individuals who "provide the Commission with information relating to a potential violation of the securities laws." *Id., at* 70519 (proposed 17 C.F.R. § 240.21F–2(a)). The proposed rule, the agency noted, "tracks the statutory definition of a 'whistleblower' " by requiring information reporting to the SEC itself. 75 Fed.Reg. 70489.

In promulgating the final Rule, however, the agency changed course. Rule 21F–2, in finished form, contains two discrete "whistleblower" definitions. See 17 C.F.R. § 240.21F–2(a)–(b) (2017). For purposes of the award program, the Rule states that "[y]ou are a whistleblower if ... you *provide the Commission* with information ... relat[ing] to a possible violation of the Federal securities laws." § 240.21F–2(a)(1) (emphasis added). The information must be provided to the SEC through its website or by mailing or faxing a specified form to the SEC Office of the Whistleblower. See *ibid.*; § 240.21F–9(a)(1)–(2).

"For purposes of the anti-retaliation protections," however, the Rule states that "[y]ou are a whistleblower if ... [y]ou possess a reasonable belief that the information you are providing relates to a possible securities law violation" and "[y]ou provide that information in a manner described in" clauses (i) through (iii) of § 78u–6(h)(1)(A). 17 C.F.R. § 240.21F–2(b)(1)(i)–(ii). "The anti-retaliation protections apply," the Rule emphasizes, "whether or not you satisfy the requirements, procedures and conditions to qualify for an award." § 240.21F–2(b)(1)(iii). An individual may therefore gain anti-retaliation protection as a "whistleblower" under Rule 21F–2 without providing information to the SEC, so long as he or she provides information in a manner shielded by one of the anti-retaliation provision's three clauses. For example, a report to a company supervisor would qualify if the report garners protection under the Sarbanes–Oxley anti-retaliation provision. [5]

***776** C

Petitioner Digital Realty Trust, Inc. (Digital Realty) is a real estate investment trust that owns, acquires, and develops data centers. See Brief for Petitioner 3. Digital Realty employed respondent Paul Somers as a Vice President from 2010 to 2014. See 119 F.Supp.3d 1088, 1092 (N.D.Cal.2015). Somers alleges that Digital Realty terminated him shortly after he reported to senior management suspected securities-law violations by the company. See *ibid.* Although nothing impeded him from alerting the SEC prior to his termination, he did not do so. See Tr. of Oral Arg. 45. Nor did he file an administrative complaint within 180 days of his termination, rendering him ineligible for relief under Sarbanes–Oxley. See *ibid.*; 18 U.S.C. § 1514A(b)(2)(D).

Somers brought suit in the United States District Court for the Northern District of California alleging, *inter alia,* a claim of whistleblower retaliation under Dodd–Frank. Digital Realty moved to dismiss that claim, arguing that "Somers does not qualify as a 'whistleblower' under [§ 78u–6(h)] because he did not report any alleged law violations to the SEC." 119 F.Supp.3d, at 1094. The District Court denied the motion. Rule 21F–2, the court observed, does not necessitate recourse to the SEC prior to gaining "whistleblower" status under Dodd–Frank. See *id., at* 1095–1096. Finding the statutory scheme ambiguous, the court accorded deference

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to the SEC's Rule under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). See 119 F.Supp.3d, at 1096–1106.

On interlocutory appeal, a divided panel of the Court of Appeals for the Ninth Circuit affirmed. 850 F.3d 1045 (2017). The majority acknowledged that Dodd–Frank's definitional provision describes a "whistleblower" as an individual who provides information to the SEC itself. *Id.,* at 1049. But applying that definition to the anti-retaliation provision, the majority reasoned, would narrow the third clause of § 78u–6(h)(1)(A) "to the point of absurdity": The statute would protect employees only if they "reported possible securities violations both internally and to the SEC." *Ibid.* Such dual reporting, the majority believed, was unlikely to occur. *Ibid.* Therefore, the majority concluded, the statute should be read to protect employees who make disclosures privileged by clause (iii) of § 78u–6(h)(1)(A), whether or not those employees also provide information to the SEC. *Id.,* at 1050. In any event, the majority held, the SEC's resolution of any statutory ambiguity warranted deference. *Ibid.* Judge Owens dissented. In his view, the statutory definition of whistleblower was clear, left no room for interpretation, and plainly governed. *Id.,* at 1051.

Two other Courts of Appeals have weighed in on the question before us. The Court of Appeals for the Fifth Circuit has held that employees must provide information to the SEC to avail themselves of Dodd–Frank's anti-retaliation safeguard. See *Asadi v. G.E. Energy (USA), L.L.C.,* 720 F.3d 620, 630 (2013). A divided panel of the Court of Appeals for the Second Circuit reached the opposite conclusion, over a dissent by Judge Jacobs. See *Berman v. Neo @Ogilvy LLC,* 801 F.3d 145, 155 (2015). We granted certiorari to resolve this conflict, 582 U.S. —— (2017)582 U.S. —— (2017), and now reverse the Ninth Circuit's judgment.

II

[11] "When a statute includes an explicit definition, we must follow that definition," even if it varies from a term's ordinary meaning. ***777** *Burgess v. United States,* 553 U.S. 124, 130, 128 S.Ct. 1572, 170 L.Ed.2d 478 (2008) (internal quotation marks omitted). This principle resolves the question before us.

A

Our charge in this review proceeding is to determine the meaning of "whistleblower" in § 78u–6(h), Dodd–Frank's anti-retaliation provision. The definition section of the statute supplies an unequivocal answer: A "whistleblower" is "any individual who provides ... information relating to a violation of the securities laws *to the Commission*." § 78u–6(a)(6) (emphasis added). Leaving no doubt as to the definition's reach, the statute instructs that the "definitio[n] shall apply" "[i]n this section," that is, throughout § 78u–6. § 78u–6(a)(6).

[12] **[13]** The whistleblower definition operates in conjunction with the three clauses of § 78u–6(h)(1)(A) to spell out the provision's scope. The definition first describes *who* is eligible for protection—namely, a whistleblower who provides pertinent information "to the Commission." § 78u–6(a)(6). The three clauses of § 78u–6(h)(1)(A) then describe what *conduct,* when engaged in by a whistleblower, is shielded from employment discrimination. See § 78u–6(h)(1)(A)(i)–(iii). An individual who meets both measures may invoke Dodd–Frank's protections. But an individual who falls outside the protected category of "whistleblowers" is ineligible to seek redress under the statute, regardless of the conduct in which that individual engages.

Reinforcing our reading, another whistleblower-protection provision in Dodd–Frank imposes no requirement that information be conveyed to a government agency. Title 10 of the statute, which created the Consumer Financial Protection Bureau (CFPB), prohibits discrimination against a "covered employee" who, among other things, "provide[s] ... information to [his or her] employer, the Bureau, or any other State, local, or Federal, government authority or law enforcement agency relating to" a violation of a law subject to the CFPB's jurisdiction. 12 U.S.C. § 5567(a)(1). To qualify as a "covered employee," an individual need not provide information to the CFPB, or any other entity. See § 5567(b) ("covered employee" means "any individual performing tasks related to the offering or provision of a consumer financial product or service").

[14] "[W]hen Congress includes particular language in one section of a statute but omits it in another[,] ... this Court presumes that Congress intended a difference in meaning." *Loughrin v. United States,* 573 U.S. ––––, ––––, 134 S.Ct. 2384, 2390, 189 L.Ed.2d 411 (2014) (internal quotation marks and alteration omitted). Congress placed a government-reporting requirement in § 78u–6(h), but not elsewhere in the same statute. Courts are not at liberty to dispense with the condition—tell the SEC—Congress imposed.

[16] When enacting Sarbanes–Oxley's whistleblower regime, in comparison, Congress had a more far-reaching objective: It sought to disturb the "corporate code of silence" that "discourage[d] employees from reporting fraudulent behavior not only to the proper authorities, such as the FBI and the SEC, but even internally." *Lawson,* 571 U.S., at ––––, 134 S.Ct., at 1162 (internal quotation marks omitted). Accordingly, the Sarbanes–Oxley anti-retaliation provision covers employees who report fraud not only to the SEC, but also to any other federal agency, Congress, or an internal supervisor. See 18 U.S.C. § 1514A(a)(1).

B

[15] Dodd–Frank's purpose and design corroborate our comprehension of § 78u–6(h)'s reporting requirement. The "core objective" of Dodd–Frank's robust whistleblower program, as Somers acknowledges, Tr. of Oral Arg. 45, is "to motivate people who know of securities law violations to *tell the SEC,*" S. Rep. No. 111–176, at 38 (emphasis added). By enlisting whistleblowers to "assist the Government [in] identify[ing] and prosecut[ing] persons who have violated securities laws," Congress undertook to improve SEC enforcement and facilitate the Commission's "recover[y][of] money for victims of financial fraud." *Id.,* at 110. To that end, § 78u–6 provides substantial monetary rewards to whistleblowers ***778** who furnish actionable information to the SEC. See § 78u–6(b).

Financial inducements alone, Congress recognized, may be insufficient to encourage certain employees, fearful of employer retaliation, to come forward with evidence of wrongdoing. Congress therefore complemented the Dodd–Frank monetary incentives for SEC reporting by heightening protection against retaliation. While Sarbanes–Oxley contains an administrative-exhaustion requirement, a 180–day administrative complaint-filing deadline, and a remedial scheme limited to actual damages, Dodd–Frank provides for immediate access to federal court, a generous statute of limitations (at least six years), and the opportunity to recover double backpay. See *supra,* at 774 – 775. Dodd–Frank's award program and anti-retaliation provision thus work synchronously to motivate individuals with knowledge of illegal activity to "tell the SEC." S. Rep. No. 111–176, at 38.

C

[17] In sum, Dodd–Frank's text and purpose leave no doubt that the term "whistleblower" in § 78u–6(h) carries the meaning set forth in the section's definitional provision. The disposition of this case is therefore evident: Somers did not provide information "to the Commission" before his termination, § 78u–6(a)(6), so he did not qualify as a "whistleblower" at the time of the alleged retaliation. He is therefore ineligible to seek relief under § 78u–6(h).

III

[18] Somers and the Solicitor General tender a different view of Dodd–Frank's compass. The whistleblower definition, as they see it, applies only to the statute's award program, not to its anti-retaliation provision, and thus not, as the definition plainly states, throughout "this section," § 78u–6(a). See Brief for Respondent 30; Brief for United States as *Amicus Curiae* 10–11. For purposes of the anti-retaliation provision alone, they urge us to construe the term "whistleblower" in its "ordinary sense," *i.e.,* without any SEC-reporting requirement. Brief for Respondent 18.

Doing so, Somers and the Solicitor General contend, would align with our precedent, specifically *Lawson v. Suwannee Fruit & S.S. Co.,* 336 U.S. 198, 69 S.Ct. 503, 93 L.Ed. 611 (1949), and *Utility Air Regulatory Group v. EPA,* 573 U.S. ––––, 134 S.Ct. 2427, 189 L.Ed.2d 372 (2014). In those decisions, we declined to apply a statutory definition that ostensibly governed where doing so would have been

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"incompatible with ... Congress' regulatory scheme," *id.,* at ——, 134 S.Ct., at 2433 (internal quotation marks omitted), or would have "destroy[ed] one of the [statute's] major purposes," *Suwannee Fruit,* 336 U.S., at 201, 69 S.Ct. 503.

This case is of a piece, Somers and the Solicitor General maintain. Applying the statutory definition here, they variously charge, would "create obvious incongruities," Brief for United States as *Amicus* ***779** *Curiae* 19 (internal quotation marks omitted), "produce anomalous results," *id.,* at 22, "vitiate much of the [statute's] protection," *id.,* at 20 (internal quotation marks omitted), and, as the Court of Appeals put it, narrow clause (iii) of § 78u–6(h)(1)(A) "to the point of absurdity," Brief for Respondent 35 (quoting 850 F.3d, at 1049). We next address these concerns and explain why they do not lead us to depart from the statutory text.

A

It would gut "much of the protection afforded by" the third clause of § 78u–6(h)(1)(a), Somers and the Solicitor General urge most strenuously, to apply the whistleblower definition to the anti-retaliation provision. Brief for United States as *Amicus Curiae* 20 (internal quotation marks omitted); Brief for Respondent 28–29. As earlier noted, see *supra,* at 773 – 774, clause (iii) prohibits retaliation against a "whistleblower" for "making disclosures" to various persons and entities, including *but not limited to* the SEC, to the extent those disclosures are "required or protected under" various laws other than Dodd–Frank. § 78u–6(h)(1)(A)(iii). Applying the statutory definition of whistleblower, however, would limit clause (iii)'s protection to "only those individuals who report to the Commission." Brief for United States as *Amicus Curiae* 22.

The plain-text reading of the statute undoubtedly shields fewer individuals from retaliation than the alternative proffered by Somers and the Solicitor General. But we do not agree that this consequence "vitiate[s]" clause (iii)'s protection, *id*., at 20 (internal quotation marks omitted), or ranks as "absur [d]," Brief for Respondent 35 (internal quotation marks omitted). [6] In fact, our reading leaves the third clause with "substantial meaning." Brief for Petitioner 32.

With the statutory definition incorporated, clause (iii) protects a whistleblower who reports misconduct *both* to the SEC and to another entity, but suffers retaliation because of the latter, non-SEC, disclosure. That would be so, for example, where the retaliating employer is unaware that the employee has alerted the SEC. In such a case, without clause (iii), retaliation for internal reporting would not be reached by Dodd–Frank, for clause (i) applies only where the employer retaliates against the employee "because of" the SEC reporting. § 78u–6(h)(1)(A). Moreover, even where the employer knows of the SEC reporting, the third clause may operate to dispel a proof problem: The employee can recover under the statute without having to demonstrate whether the retaliation was motivated by the internal report (thus yielding protection under clause (iii)) or by the SEC disclosure (thus gaining protection under clause (i)).

[19] While the Solicitor General asserts that limiting the protections of clause (iii) to dual reporters would "shrink to insignificance the [clause's] ban on retaliation," Brief for United States as *Amicus Curiae* 22 (internal quotation marks omitted), he offers scant evidence to support that assertion. Tugging in the opposite direction, he reports that approximately 80 percent of the whistleblowers who received awards in 2016 "reported internally before reporting to the Commission." *Id.,* at 23. And Digital Realty cites real-world examples of dual reporters seeking Dodd–Frank or Sarbanes–Oxley recovery for alleged retaliation. See Brief for Petitioner 33, and n. 4 (collecting cases). Overlooked by Somers and the Solicitor General, in dual- ***780** reporting cases, retaliation not prompted by SEC disclosures (and thus unaddressed by clause (i)) is likely commonplace: The SEC is required to protect the identity of whistleblowers, see § 78u–6(h)(2)(A), so employers will often be unaware that an employee has reported to the Commission. In any event, even if the number of individuals qualifying for protection under clause (iii) is relatively limited, "[i]t is our function to give the statute the effect its language suggests, however modest that may be." *Morrison v. National Australia Bank Ltd.,* 561 U.S. 247, 270, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010).

B

Somers and the Solicitor General express concern that our reading would jettison protection for auditors, attorneys, and other employees subject to internal-reporting requirements.

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See Brief for Respondent 35; Brief for United States as *Amicus Curiae* 21. Sarbanes–Oxley, for example, requires auditors and attorneys to report certain information within the company before making disclosures externally. See 15 U.S.C. §§ 78j–1(b), 7245; 17 C.F.R. § 205.3. If the whistleblower definition applies, Somers and the Solicitor General fear, these professionals will be "le[ft] ... vulnerable to discharge or other retaliatory action for complying with" their internal-reporting obligations. Brief for United States as *Amicus Curiae* 22 (internal quotation marks omitted).

Our reading shields employees in these circumstances, however, *as soon as they also provide relevant information to the Commission*. True, such employees will remain ineligible for Dodd–Frank's protection until they tell the SEC, but this result is consistent with Congress' aim to encourage SEC disclosures. See S. Rep. No. 111–176, at 38; *supra,* at 773 – 774, 777 – 778. Somers worries that lawyers and auditors will face retaliation quickly, before they have a chance to report to the SEC. Brief for Respondent 35–36. But he offers nothing to show that Congress had this concern in mind when it enacted § 78u–6(h). Indeed, Congress may well have considered adequate the safeguards already afforded by Sarbanes–Oxley, protections specifically designed to shield lawyers, accountants, and similar professionals. See *Lawson,* 571 U.S., at ——, 134 S.Ct., at 1182.

C

Applying the whistleblower definition as written, Somers and the Solicitor General further protest, will create "an incredibly unusual statutory scheme": "[I]dentical misconduct"—*i.e.,* retaliating against an employee for internal reporting—will "go punished or not based on the happenstance of a separate report" to the SEC, of which the wrongdoer may "not even be aware." Brief for Respondent 37–38. See also Brief for United States as *Amicus Curiae* 24. The upshot, the Solicitor General warns, "would [be] substantially diminish[ed] Dodd–Fran[k] deterrent effect." *Ibid.*

Overlooked in this protest is Dodd–Frank's core objective: to prompt reporting to the SEC. *Supra,* at 773 – 744, 777 – 778. In view of that precise aim, it is understandable that the statute's retaliation protections, like its financial rewards, would be reserved for employees who have done what Dodd–Frank seeks to achieve, *i.e.,* they have placed information about unlawful activity before the Commission to aid its enforcement efforts.

D

Pointing to another purported anomaly attending the reading we adopt today, the Solicitor General observes that neither the whistleblower definition nor § 78u–6(h) ***781** contains any requirement of a "temporal or topical connection between the violation reported to the Commission and the internal disclosure for which the employee suffers retaliation." Brief for United States as *Amicus Curiae* 25. It is therefore possible, the Solicitor General posits, that "an employee who was fired for reporting accounting fraud to his supervisor in 2017 would have a cause of action under [§ 78u–6(h)] if he had reported an insider-trading violation by his previous employer to the Commission in 2012." *Ibid.* For its part, Digital Realty agrees that this scenario could arise, but does not see it as a cause for concern: "Congress," it states, "could reasonably have made the policy judgment that individuals who report securities-law violations to the SEC should receive broad protection over time against retaliation for a variety of disclosures." Reply Brief 11.

We need not dwell on the situation hypothesized by the Solicitor General, for it veers far from the case before us. We note, however, that the interpretation offered by Somers and the Solicitor General—*i.e.,* ignoring the statutory definition when construing the anti-retaliation provision—raises an even thornier question about the law's scope. Their view, which would not require an employee to provide information relating to a securities-law violation to the SEC, could afford Dodd–Frank protection to an employee who reports information bearing no relationship whatever to the securities laws. That prospect could be imagined based on the broad array of federal statutes and regulations cross-referenced by clause (iii) of the anti-retaliation provision. *E.g.,* 18 U.S.C. § 1513(e) (criminalizing retaliation for "providing to a law enforcement officer any truthful information relating to the commission ... of *any Federal offense* " (emphasis added)); see *supra,* at 774, and n. 2. For example, an employee fired for reporting a coworker's drug dealing to the Federal Bureau of Investigation might be protected. Brief for Petitioner 38. It would make scant sense, however, to rank an FBI drug-trafficking informant a whistleblower under Dodd–Frank, a law concerned only with encouraging the reporting of

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"*securities* law violations." S. Rep. No. 111–176, at 38 (emphasis added).

E

Finally, the interpretation we adopt, the Solicitor General adds, would undermine not just clause (iii) of § 78u–6(h)(1)(A), but clause (ii) as well. Clause (ii) prohibits retaliation against a whistleblower for "initiating, testifying in, or assisting in any investigation or ... action of the Commission based upon" information conveyed to the SEC by a whistleblower in accordance with the statute. § 78u–6(h)(1)(A)(ii). If the whistleblower definition is applied to § 78u–6(h), the Solicitor General states, "an employer could fire an employee for giving ... testimony [to the SEC] if the employee had not previously reported to the Commission online or through the specified written form"—*i.e.,* the methods currently prescribed by Rule 21F–9 for a whistleblower to provide information to the Commission. Brief for United States as *Amicus Curiae* 20–21 (citing 17 C.F.R. § 240.21F–9(a)(1)–(2)).

But the statute expressly delegates authority to the SEC to establish the "manner" in which information may be provided to the Commission by a whistleblower. See § 78u–6(a)(6). Nothing in today's opinion prevents the agency from enumerating additional means of SEC reporting—including through testimony protected by clause (ii).

IV

For the foregoing reasons, we find the statute's definition of "whistleblower" clear ***782** and conclusive. Because "Congress has directly spoken to the precise question at issue," *Chevron,* 467 U.S., at 842, 104 S.Ct. 2778 we do not accord deference to the contrary view advanced by the SEC in Rule 21F–2. See 17 C.F.R. § 240.21F–2(b)(1); *supra,* at 775 – 776. The statute's unambiguous whistleblower definition, in short, precludes the Commission from more expansively interpreting that term. See *Burgess,* 553 U.S., at 130, 128 S.Ct. 1572.

* * *

The judgment of the Court of Appeals for the Ninth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice SOTOMAYOR, with whom Justice BREYER joins, concurring.

I join the Court's opinion in full. I write separately only to note my disagreement with the suggestion in my colleague's concurrence that a Senate Report is not an appropriate source for this Court to consider when interpreting a statute.

Legislative history is of course not the law, but that does not mean it cannot aid us in our understanding of a law. Just as courts are capable of assessing the reliability and utility of evidence generally, they are capable of assessing the reliability and utility of legislative-history materials.

Committee reports, like the Senate Report the Court discusses here, see *ante,* at 773 – 774, 777 – 778, 780 – 781, are a particularly reliable source to which we can look to ensure our fidelity to Congress' intended meaning. See *Garcia v. United States,* 469 U.S. 70, 76, 105 S.Ct. 479, 83 L.Ed.2d 472 (1984) ("In surveying legislative history we have repeatedly stated that the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill, which 'represen[t] the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation' " (quoting *Zuber v. Allen,* 396 U.S. 168, 186, 90 S.Ct. 314, 24 L.Ed.2d 345 (1969))). Bills presented to Congress for consideration are generally accompanied by a committee report. Such reports are typically circulated at least two days before a bill is to be considered on the floor and provide Members of Congress and their staffs with information about "a bill's context, purposes, policy implications, and details," along with information on its supporters and opponents. R. Katzmann, Judging Statutes 20, and n. 62 (2014) (citing A. LaRue, Senate Manual Containing the Standing Rules, Orders, Laws, and Resolutions Affecting the Business of the United States Senate, S. Doc. No. 107–1, p. 17 (2001)). These materials "have long been important means of informing the whole chamber about proposed legislation," Katzmann, Judging Statutes, at 19, a point Members themselves have emphasized over the years.[*] It is thus no surprise ***783** that legislative staffers view committee and conference reports

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as the most reliable type of legislative history. See Gluck & Bressman, Statutory Interpretation From the Inside—An Empirical Study of Congressional Drafting, Delegation and the Canons: Part I, 65 Stan. L. Rev. 901, 977 (2013).

Legislative history can be particularly helpful when a statute is ambiguous or deals with especially complex matters. But even when, as here, a statute's meaning can clearly be discerned from its text, consulting reliable legislative history can still be useful, as it enables us to corroborate and fortify our understanding of the text. See, *e.g., Tapia v. United States,* 564 U.S. 319, 331–332, 131 S.Ct. 2382, 180 L.Ed.2d 357 (2011); *Carr v. United States,* 560 U.S. 438, 457–458, 130 S.Ct. 2229, 176 L.Ed.2d 1152 (2010). Moreover, confirming our construction of a statute by considering reliable legislative history shows respect for and promotes comity with a coequal branch of Government. See Katzmann, Judging Statutes, at 35–36.

For these reasons, I do not think it wise for judges to close their eyes to reliable legislative history—and the realities of how Members of Congress create and enact laws—when it is available.

Justice THOMAS, with whom Justice ALITO and Justice GORSUCH join, concurring in part and concurring in the judgment.
I join the Court's opinion only to the extent it relies on the text of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), 124 Stat. 1376. The question in this case is whether the term "whistleblower" in Dodd–Frank's antiretaliation provision, 15 U.S.C. § 78u–6(h)(1), includes a person who does not report information to the Securities and Exchange Commission. The answer is in the definitions section of the statute, which states that the term "whistleblower" means a person who provides "information relating to a violation of the securities laws to the Commission." § 78u–6(a)(6). As the Court observes, this statutory definition "resolves the question before us." *Ante,* at 777. The Court goes on, however, to discuss the supposed "purpose" of the statute, which it primarily derives from a single Senate Report. See *ante,* at 773 – 774, 777 – 778, 780 – 781. Even assuming a majority of Congress read the Senate Report, agreed with it, and voted for Dodd–Frank with the same intent, "we are a government of laws, not of men, and are governed by what Congress enacted rather than by what it intended." [*] *Lawson v.* ***784** *FMR LLC,* 571 U.S. 429, ––––, 134 S.Ct. 1158, 1176, 188 L.Ed.2d 158 (2014) (Scalia, J., concurring in part and concurring in judgment). And "it would be a strange canon of statutory construction that would require Congress to state in committee reports ... that which is obvious on the face of a statute." *Harrison v. PPG Industries, Inc.,* 446 U.S. 578, 592, 100 S.Ct. 1889, 64 L.Ed.2d 525 (1980). For these reasons, I am unable to join the portions of the Court's opinion that venture beyond the statutory text.

All Citations

138 S.Ct. 767, 200 L.Ed.2d 15, 102 Empl. Prac. Dec. P 45,981, 86 USLW 4048, Fed. Sec. L. Rep. P 100,021, 42 IER Cases 697, 18 Cal. Daily Op. Serv. 1629, 2018 Daily Journal D.A.R. 1591, 27 Fla. L. Weekly Fed. S 54

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 Sarbanes–Oxley also prohibits retaliation against an "employee" who "file[s], ... testif[ies], participate[s] in, or otherwise assist[s] in a proceeding filed or about to be filed ... relating to an alleged violation of" the same provisions of federal law addressed in 18 U.S.C. § 1514A(a)(1). See § 1514A(a)(2).

2 Section 1513(e) provides: "Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both."

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3 Section 78u–6(h)(1)(A) reads in full:

"No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—

"(i) in providing information to the Commission in accordance with this section;

"(ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or

"(iii) in making disclosures that are required or protected under the Sarbanes–Oxley Act of 2002 (15 U.S.C. § 7201 et seq.), this chapter, including section 78j-l(m) of this title, section 1513(e) of title 18, and any other law, rule, or regulation subject to the jurisdiction of the Commission."

4 Unlike Dodd–Frank, Sarbanes–Oxley explicitly entitles a prevailing employee to "all relief necessary to make the employee whole," including "compensation for any special damages sustained as a result of the discrimination." 18 U.S.C. § 1514A(c)(1), (2)(C).

5 In 2015, the SEC issued an interpretive rule reiterating that anti-retaliation protection is not contingent on a whistleblower's provision of information to the Commission. See 80 Fed.Reg. 47829 (2015).

6 The Solicitor General, unlike Somers, acknowledges that it would not be absurd to apply the "whistleblower" definition to the anti-retaliation provision. Tr. of Oral Arg. 52.

* See, *e.g.,* Hearings on the Nomination of Judge Antonin Scalia, To Be Associate Justice of the Supreme Court of the United States before the Senate Committee on the Judiciary, 99th Cong., 2d Sess., 65–66 (1986) (Sen. Charles E. Grassley) ("[A]s one who has served in Congress for 12 years, legislative history is very important to those of us here who want further detailed expression of that legislative intent"); Mikva, Reading and Writing Statutes, 28 S. Tex. L. Rev. 181, 184 (1986) ("The committee report is the bone structure of the legislation. It is the road map that explains why things are in and things are out of the statute"); Brudney, Congressional Commentary on Judicial Interpretations of Statutes: Idle Chatter or Telling Response? 93 Mich. L. Rev. 1, 28 (1994) (compiling the views of former Members on "the central importance of committee reports to their own understanding of statutory text"). In fact, some Members "are more likely to vote ... based on a reading of the legislative history than on a reading of the statute itself." Gluck & Bressman, Statutory Interpretation From the Inside—An Empirical Study of Congressional Drafting, Delegation and the Canons: Part I, 65 Stan. L. Rev. 901, 968 (2013).

* For what it is worth, I seriously doubt that a committee report is a "particularly reliable source" for discerning "Congress' intended meaning." *Ante,* at 783 (SOTOMAYOR, J., concurring). The following exchange on the Senate floor is telling:

"Mr. ARMSTRONG. Mr. President, will the Senator tell me whether or not he wrote the committee report?

"Mr. DOLE. Did I write the committee report?

"Mr. ARMSTRONG. Yes.

"Mr. DOLE. No; the Senator from Kansas did not write the committee report.

"Mr. ARMSTRONG. Did any Senator write the committee report?

"Mr. DOLE. I have to check.

"Mr. ARMSTRONG. Does the Senator know of any Senator who wrote the committee report?

"Mr. DOLE. I might be able to identify one, but I would have to search. I was here all during the time it was written, I might say, and worked carefully with the staff as they worked....

"Mr. ARMSTRONG. Mr. President, has the Senator from Kansas, the chairman of the Finance Committee, read the committee report in its entirety?

"Mr. DOLE. I am working on it. It is not a bestseller, but I am working on it.

"Mr. ARMSTRONG. Mr. President, did members of the Finance Committee vote on the committee report?

"Mr. DOLE. No.

"Mr. ARMSTRONG.... The report itself is not considered by the Committee on Finance. It was not subject to amendment by the Committee on Finance. It is not subject to amendment now by the Senate.... If there

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were matter within this report which was disagreed to by the Senator from Colorado or even by a majority of all Senators, there would be no way for us to change the report. I could not offer an amendment tonight to amend the committee report.... [L]et me just make the point that this is not the law, it was not voted on, it is not subject to amendment, and we should discipline ourselves to the task of expressing congressional intent in the statute." *Hirschey v. FERC,* 777 F.2d 1, 7–8, n. 1 (C.A.D.C.1985) (Scalia, J., concurring) (quoting 128 Cong. Rec. 16918–16919 (1982)). See also Kethledge, Ambiguities and Agency Cases: Reflections After (Almost) Ten Years on the Bench, 70 Vand. L. Rev. En Banc 315, 317–318 (2017) (describing his experience as a Senate staffer who drafted legislative history "like being a teenager at home while your parents are away for the weekend: there was no supervision. I was able to write more or less what I pleased.... [M]ost members of Congress ... have no idea at all about what is in the legislative history for a particular bill").

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KeyCite Yellow Flag - Negative Treatment
Declined to Extend by Kravitz as Trustee of Aegean Litigation Trust v. Tavlarios, S.D.N.Y., July 8, 2020

212 A.3d 805
Supreme Court of Delaware.

Jack L. MARCHAND II, Plaintiff Below, Appellant,
v.
John W. BARNHILL, Jr., Greg Bridges, Richard Dickson, Paul A. Ehlert, Jim E. Kruse, Paul W. Kruse, W.J. Rankin, Howard W. Kruse, Patricia I. Ryan, Dorothy McLeod MacInerney and Blue Bell Creameries USA, Inc., Defendants Below, Appellee.

No. 533, 2018
|
Submitted: April 24, 2019
|
Decided: June 18, 2019
|
Corrected: June 19, 2019

Synopsis
Background: Stockholder brought derivative suit against key executives and directors of corporation, an ice cream manufacturer, claiming breaches of their fiduciary duties arising from listeria outbreak. The Court of Chancery, No. 2017-0586-JRS, dismissed complaint. Stockholder appealed.

Holdings: The Supreme Court, Strine, C.J., held that:

[1] stockholder adequately pleaded demand futility against one of corporation's directors, and

[2] stockholder adequately pleaded that directors and executives breached their duty of loyalty.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion to Dismiss.

West Headnotes (12)

[1] **Appeal and Error** Corporations and other organizations

The Supreme Court reviews a motion to dismiss for failure to plead demand futility against a corporation's board and executives de novo.

2 Cases that cite this headnote

[2] **Corporations and Business Organizations** Allegations of excuse for failure to demand; futility

For purposes of a claim of demand futility, a lack of independence of a corporate director turns on whether the plaintiffs have pled facts from which the director's ability to act impartially on a matter important to the interested party can be doubted because that director may feel either subject to the interested party's dominion or beholden to that interested party.

14 Cases that cite this headnote

[3] **Corporations and Business Organizations** Allegations of excuse for failure to demand; futility

In claiming a lack of independence on the part of a corporate director in support of a claim of demand futility, the plaintiff cannot just assert that a close relationship exists, but when the plaintiff pleads specific facts about the relationship—such as the length of the relationship or details about the closeness of the relationship—then the court is charged with making all reasonable inferences from those facts in the plaintiff's favor.

9 Cases that cite this headnote

[4] **Corporations and Business Organizations** Interest of director or officer in lawsuit or lack of independence

Stockholder adequately pleaded demand futility against one of corporation's directors; one could reasonably infer that director's successful career

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was in large measure due to opportunities and mentoring given to him by members of family that had led company, one could infer that director was added to board due to support of family, and family spearheaded charitable efforts that led to large donation to key local college, resulting in director being honored by having college's new agricultural facility named after him.

2 Cases that cite this headnote

[5] **Corporations and Business Organizations** Interest of director or officer in lawsuit or lack of independence

The fact that fellow directors are social acquaintances who occasionally have dinner or go to common events does not, in itself, raise a fair inference of non-independence, for purposes of a claim of demand futility.

[6] **Corporations and Business Organizations** Oversight

For a plaintiff to prevail on a claim that a director breached his or her duty of loyalty by failing to make a good faith effort to oversee the company's operations, the plaintiff must show that a fiduciary acted in bad faith—the state of mind traditionally used to define the mindset of a disloyal director.

2 Cases that cite this headnote

[7] **Corporations and Business Organizations** Oversight

Bad faith is established, for purposes of a claim that a director breached his or her duty of loyalty by failing to make a good faith effort to oversee the company's operations, when the directors completely fail to implement any reporting or information system or controls, or having implemented such a system or controls, consciously fail to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

17 Cases that cite this headnote

[8] **Corporations and Business Organizations** Oversight

To satisfy their duty of loyalty, corporate directors must make a good faith effort to implement an oversight system and then monitor it.

5 Cases that cite this headnote

[9] **Corporations and Business Organizations** Fiduciary Duties as to Management of Corporate Affairs in General

Directors have great discretion to design context- and industry-specific approaches tailored to their companies' businesses and resources.

6 Cases that cite this headnote

[10] **Corporations and Business Organizations** Oversight

A director may be held liable for breaching his or her duty of loyalty if she acts in bad faith in the sense that she made no good faith effort to ensure that the company had in place any system of controls.

5 Cases that cite this headnote

[11] **Corporations and Business Organizations** Oversight

Stockholder adequately pleaded that corporation's directors and executives breached their duty of loyalty by failing to make good faith efforts to ensure that corporation, an ice cream manufacturer, knowingly disregarded contamination risks and failed to oversee safety of corporation's food-making operations, which allegedly led to listeria outbreak; stockholder alleged that there was no committee addressing food safety, that there was no regular process or protocols that required management to keep board apprised of food safety compliance practices or risks, and that board meetings were devoid of any suggestion that there was any regular discussion of food safety issues.

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5 Cases that cite this headnote

[12] **Corporations and Business Organizations** Oversight

When a plaintiff can plead an inference that a board has undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation, then that supports an inference that the board has not made the good faith effort required for a claim that a director breached his or her duty of loyalty by failing to make a good faith effort to oversee the company's operations.

7 Cases that cite this headnote

***807** Court Below: Court of Chancery of the State of **Delaware**, C.A. No. 2017-0586-JRS

Upon appeal from the Court of Chancery. **REVERSED** and **REMANDED**.

Attorneys and Law Firms

Robert J. Kriner, Jr., Esquire (Argued), and Vera G. Belger, Esquire, CHIMICLES SCHWARTZ KRINER & DONALDSON-SMITH LLP, Wilmington, **Delaware**; Michael Hawash, Esquire, and Jourdain Poupore, Esquire, HAWASH CICACK & GASTON LLP, Houston, Texas, Attorneys for Appellant, Jack L. **Marchand** II.

Paul A. Fioravanti, Jr., Esquire (Argued), and John G. Day, Esquire, PRICKETT, JONES & ELLIOT, P.A., Wilmington, **Delaware**, Attorneys for Appellees, John W. **Barnhill**, Jr., Richard Dickson, Paul A. Ehlert, Jim E. Kruse, W.J. Rankin, Howard W. Kruse, Patricia I. Ryan, Dorothy McLeod MacInerney, and nominal defendant Blue Bell Creameries USA, Inc.

Srinivas M. Raju, Esquire, and Kelly L. Freund, Esquire, RICHARDS, LAYTON & FINGER, P.A., Wilmington, **Delaware**, Attorneys for Appellees, Greg Bridges and Paul W. Kruse.

Before STRINE, Chief Justice; VALIHURA, VAUGHN, SEITZ, and TRAYNOR, Justices, constituting the Court en Banc.

Opinion

STRINE, Chief Justice:

Blue Bell Creameries USA, Inc., one of the country's largest ice cream manufacturers, suffered a *listeria* outbreak in early 2015, causing the company to recall all of its products, shut down production at all of its plants, and lay off over a third of its workforce. Blue Bell's failure to contain *listeria*'s spread in its manufacturing plants caused *listeria* to be present in its products and had sad consequences. Three people died as a result of the *listeria* outbreak. Less consequentially, but nonetheless important for this litigation, stockholders also suffered losses because, after the operational shutdown, Blue Bell suffered a liquidity crisis that forced it to accept a dilutive private equity investment.

Based on these unfortunate events, a stockholder brought a derivative suit against two key executives and against Blue Bell's directors claiming breaches of the defendants' fiduciary duties. The complaint alleges that the executives —Paul Kruse, the President and CEO, and Greg Bridges, the Vice President of Operations—breached their duties of care and loyalty by knowingly disregarding contamination risks and failing to oversee the safety of Blue Bell's food-making operations, and that the directors breached their duty of loyalty under *Caremark.* [1]

The defendants moved to dismiss the complaint for failure to plead demand futility. ***808** [2] The Court of Chancery granted the motion as to both claims. As to the claim against management, the Court of Chancery held that the plaintiff "failed to plead particularized facts that raise a reasonable doubt as to whether a majority of [Blue Bell's] Board could impartially consider a demand." [3] Although the complaint alleged facts sufficient to raise a reasonable doubt as to the impartiality of a number of Blue Bell's directors, the plaintiff ultimately came up one short in the Court of Chancery's judgment: the plaintiff needed eight directors for a majority, but only had seven.

As to the *Caremark* claim, the Court of Chancery held that the plaintiff did not plead any facts to support "his contention that the [Blue Bell] Board 'utterly' failed to adopt or implement any reporting and compliance systems." [4] Although the plaintiff argued that Blue Bell's board had no supervisory structure in place to oversee "health, safety and

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sanitation controls and compliance," the Court of Chancery reasoned that "[w]hat Plaintiff really attempts to challenge is not the existence of monitoring and reporting controls, but the effectiveness of monitoring and reporting controls in particular instances," and "[t]his is not a valid theory under ... *Caremark*."[5]

In this opinion, we reverse as to both holdings.

We first hold that the complaint pleads particularized facts sufficient to create a reasonable doubt that an additional director, W.J. Rankin, could act impartially in deciding to sue Paul Kruse, Blue Bell's CEO, and his subordinate Greg Bridges, Blue Bell's Vice President of Operations, due to Rankin's longstanding business affiliation and personal relationship with the Kruse family.[6] According to the complaint, Rankin worked at Blue Bell for decades and owes his entire career to Ed Kruse, the current CEO's father, who hired Rankin as his administrative assistant in 1981 and promoted him five years later to the position of CFO, a position Rankin maintained until his retirement in 2014. In 2004, while serving as CFO, Rankin was elected to Blue Bell's board, and has served since then. Moreover, the complaint alleges that the Kruse family showed its appreciation for Rankin not only by supporting his career, but also by leading a campaign that raised over $450,000 to name a building at the local university after Rankin. Despite the defendants' contentions that Rankin's relationship with the Kruse family was just an ordinary business relationship from which Rankin would derive no strong feelings of loyalty toward the Kruse family, these allegations are "suggestive of the type of very close personal [or professional] relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment."[7] Rankin's apparently deep business and personal ties to the Kruse family raise a reasonable doubt as to whether Rankin could "impartially or ***809** objectively assess whether to bring a lawsuit against the sued party."[8]

As to the *Caremark* claim, we hold that the complaint alleges particularized facts that support a reasonable inference that the Blue Bell board failed to implement any system to monitor Blue Bell's food safety performance or compliance. Under *Caremark* and this Court's opinion in *Stone v. Ritter*,[9] directors have a duty "to exercise oversight" and to monitor the corporation's operational viability, legal compliance, and financial performance.[10] A board's "utter failure to attempt to assure a reasonable information and reporting system exists" is an act of bad faith in breach of the duty of loyalty.[11]

As a monoline company that makes a single product—ice cream—Blue Bell can only thrive if its consumers enjoyed its products and were confident that its products were safe to eat. That is, one of Blue Bell's central compliance issues is food safety. Despite this fact, the complaint alleges that Blue Bell's board had no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments. Consistent with this dearth of any board-level effort at monitoring, the complaint pleads particular facts supporting an inference that during a crucial period when yellow and red flags about food safety were presented to management, there was no equivalent reporting to the board and the board was not presented with any material information about food safety. Thus, the complaint alleges specific facts that create a reasonable inference that the directors consciously failed "to attempt to assure a reasonable information and reporting system exist[ed]."[12]

I. Background[13]

A. Blue Bell's History and Operating Environment

i. History

Founded in 1907 in Brenham, Texas, Blue Bell Creameries USA, Inc. ("Blue Bell"), a **Delaware** corporation, produces and distributes ice cream under the Blue Bell banner.[14] By 1919, Blue Bell's predecessor was struggling financially. Blue ***810** Bell's board turned to E.F. Kruse, who took over the company that year and turned it around. Under his leadership, the company expanded and became profitable.[15]

E.F. Kruse led the company until his unexpected death in 1951.[16] Upon his death, his sons, Ed F. Kruse and Howard Kruse, took over the company's management. Rapid expansion continued under Ed and Howard's leadership.[17] In 2004, Ed Kruse's son, Paul Kruse, took over management, becoming Blue Bell's President and CEO.[18] Ten years later, in 2014, Paul Kruse also assumed the position of Chairman of the Board, taking the position from his retiring father.[19]

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ii. The Regulated Nature of Blue Bell's Industry

As a U.S. food manufacturer, Blue Bell operates in a heavily regulated industry. Under federal law, the Food and Drug Administration ("FDA") may set food quality standards, require food manufacturing facilities to register with the FDA, prohibit regulated manufacturers from placing adulterated food into interstate commerce, and hold companies liable if they place any adulterated foods into interstate commerce in violation of FDA rules. [20] Blue Bell is "required to comply with regulations and establish controls to monitor for, avoid and remediate contamination and conditions that expose the Company and its products to the risk of contamination." [21]

Specifically, FDA regulations require food manufacturers to conduct operations "with adequate sanitation principles" [22] and, in line with that obligation, "must prepare ... and implement a written food safety plan." [23] As part of a manufacturer's food safety plan, the manufacturer must include processes for conducting a hazard analysis that identifies possible food safety hazards, identifies and implements preventative controls to limit potential food hazards, implements process controls, implements sanitation controls, and monitors these preventative controls. Appropriate corporate officials must monitor these preventative controls. [24]

Not only is Blue Bell subject to federal regulations, but it must also adhere to various state regulations. At the time of the *listeria* outbreak, Blue Bell operated in three states, and each had issued rules and regulations regarding the proper handling and production of food to ensure food safety. [25]

B. Plaintiff's Complaint

With that context out of the way, we briefly summarize the plaintiff's well-pled factual allegations and the reasonable inferences drawn from them.

The complaint starts by observing that, as a single-product food company, food safety is of obvious importance to Blue ***811** Bell. [26] But despite the critical nature of food safety for Blue Bell's continued success, the complaint alleges that management turned a blind eye to red and yellow flags that were waved in front of it by regulators and its own tests, and the board—by failing to implement any system to monitor the company's food safety compliance programs—was unaware of any problems until it was too late. [27]

i. The Run-Up to the Listeria *Outbreak*

According to the complaint, Blue Bell's issues began to emerge in 2009. At that time, Paul Kruse, Blue Bell's President and CEO, and his cousin, Paul Bridges, were responsible for the three plants Blue Bell operated in Texas, Oklahoma, and Alabama. [28] The complaint alleges that, despite being responsible for overseeing plant operations, Paul Kruse and Bridges failed to respond to signs of trouble in the run up to the *listeria* outbreak. From 2009 to 2013 several regulators found troubling compliance failures at Blue Bell's facilities:

- In July 2009, the FDA's inspection of the Texas facility revealed "two instances of condensation, one from a pipe carrying liquid caramel [that] was dripping into three gallon cartons waiting to be filled, and one dripping into ice cream sandwich wafers." [29] The FDA reported these observations directly to Paul Kruse, who assured the FDA that "condensation is treated by Blue Bell as a serious concern." [30]

- In March 2010, the Alabama Department of Health inspected the Alabama plant and "found equipment left on the floor and a ceiling in disrepair in the container forming room." [31]

- Two months later, in May 2010, the FDA returned to the Texas plant "and observed ten violations that were cited to Paul Kruse including, again, a condensation drip." [32] While the condensation drip persisted from the FDA's last inspection of the Texas plant, the FDA also observed "ripped and open containers of ingredients, inconsistent hand-washing and glove use and a spider and its web near the ingredients." [33]

- In July 2011, an inspection by "the Alabama Department of Public Health cited drips from a ceiling unit and pipelines, standing water, open tank lids and unprotected measuring cups." [34]

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- Nine months later, in March 2012, an inspection of the Oklahoma facility revealed the plant's " '[f]ailure to manufacture foods under conditions and controls necessary to minimize contamination' and '[f]ailure to handle and maintain equipment, containers and utensils used to hold food in [sic] manner that protects against contamination.' "[35]

- That same month, in March 2012, "[t]he Alabama Department of Public Health required five changes" to the ***812** Alabama facility, "including instructions to clean various rooms and items, make repairs and [sic] after fruit processing to prevent contamination."[36] A year later, "in March 2013, the Alabama Department of Public Health again ordered cleaning and repairs and observed an uncapped fruit tank."[37] The Alabama Department of Public Health made similar observations in a July 2014 inspection.[38]

Regulatory inspections during this time were not the only signal that Blue Bell faced potential health safety risks. In 2013, "the Company had five positive tests" for *listeria*,[39] and in January 2014, "the Company received a presumptive positive *[l]isteria* result reports from the third party laboratory for the [Oklahoma] facility on January 20, 2014 and the samples reported positive for a second time on January 24, 2014."[40]

Although management had received reports about *listeria*'s growing presence in Blue Bell's plants, the complaint alleges that the board never received any information about *listeria* or more generally about food safety issues. Minutes from the board's January 29, 2014 meeting "reflect no report or discussion of the increasingly frequent positive tests that had been occurring since 2013 or the third party lab reports received in the preceding two weeks."[41] Board meeting minutes from February and March likewise reflect no board-level discussion of *listeria*.[42]

During the rest of 2014, Blue Bell's problems accelerated, but the board remained uninformed about Blue Bell's problems. In April, "[t]he Company received further positive *[l]isteria* lab tests regarding [the Oklahoma facility]."[43] That same month, the company had three "positive coliform tests far above the known legal regulator limits."[44] Yet, minutes from the April board meeting reflected no discussion of *listeria*. Instead, the minutes note only that the Oklahoma and Alabama facilities' "plant operations were discussed briefly" and that Bridges also discussed "a good report from the TCEQ [Texas Commission on Environmental Quality]."[45]

Over the course of 2014, Blue Bell received ten positive tests for *listeria*. According to the complaint, these positive tests "included repeated positive results from the Company's third party laboratory in 2014, on consecutive samples, evidencing the inadequacy of the Company's remedial methods to eliminate the contamination."[46]

Despite management's knowledge of the growing problem, the complaint alleges that this information never made its way to the board, and the board continued to be uninformed about (and thus unaware of) the problem. Minutes from the board's 2014 meetings are bereft of reports on the *listeria* issues. Only during the September meeting is sanitation discussed, when ***813** Bridges informed the board that "[t]he recent Silliker audit [Blue Bell's third-party auditor for sanitation issues in 2014] went well."[47] This lone reference to a third-party audit is the only instance, until the *listeria* outbreak forced the recall of Blue Bell's products, of *any* board-level discussion regarding food safety.

At this stage of the case, we are bound to draw all fair inferences in the plaintiff's favor from the well-pled facts. Based on this chronology of events, the plaintiffs have fairly pled that:

- Blue Bell had no board committee charged with monitoring food safety;

- Blue Bell's full board did not have a process where a portion of the board's meetings each year, for example either quarterly or biannually, were specifically devoted to food safety compliance; and

- The Blue Bell board did not have a protocol requiring or have any expectation that management would deliver key food safety compliance reports or summaries of these reports to the board on a consistent and mandatory basis. In fact, it is inferable that there was no expectation of reporting to the board of any kind.

In short, the complaint pleads that the Blue Bell board had made no effort at all to implement a board-level system of mandatory reporting of any kind.

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ii. The Listeria *Outbreak and the Board's Response*

Blue Bell's *listeria* problem spread in 2015. Starting in January 2015, one of Blue Bell's product tests had positive coliform levels above legal limits. [48] The same result appeared in February 2015. [49] And by this point, the problem spread to Blue Bell's products and spiraled out of control.

On February 13, 2015, "Blue Bell received notification that the Texas Department of State Health Services also had positive tests for *[l]isteria* in Blue Bell samples." [50] The Texas Department of State Health Services was alerted to these positive tests by the South Carolina Health Department. [51] Company swabs at the Texas facility on February 19 and 21, 2015 tested positive for *listeria*. [52] Yet despite these reports to management, Blue Bell's board was not informed by management about the severe problem. The board met on February 19, 2015, following Blue Bell's annual stockholders meeting, but there was no *listeria* discussion. [53]

Four days later, Blue Bell initiated a limited recall. [54] Two days after that, Blue Bell's board met, and Bridges reported that "[t]he FDA is working with Texas health inspectors regarding the Company's recent recall of products. More information is developing and should be known within the next days or weeks." [55] Despite two years of evidence that *listeria* was a growing ***814** problem for Blue Bell, this is the first time the board discussed the issue, according to the complaint and the incorporated board minutes. Instead of holding more frequent emergency board meetings to receive constant updates on the troubling fact that life-threatening bacteria was found in its products, Blue Bell's board left the company's response to management.

And the problem got worse, with awful effects. "In early March 2015, health authorities reported that they suspected a connection between human [*l*]*isteria* infections in Kansas and products made by Blue Bell's [Texas] facility." [56] The outbreak in Kansas matched a *listeria* strain found in Blue Bell's products in South Carolina. And by March 23, 2015, Blue Bell was forced to recall more products. Two days later, Blue Bell's board met and adopted a resolution "express[ing] support for Blue Bell's CEO, management, and employees and encourag[ing] them to ensure that everything Blue Bell manufacture[s] and distributes is a wholesome and good testing [sic] product that our consumers deserve and expect." [57]

Blue Bell expanded the recall two weeks later, and less than a month later, on April 20, 2015, Blue Bell "instituted a recall of all products." [58] By this point, the Center for Disease Controls and Prevention ("CDC") had begun an investigation and discovered that the source of the *listeria* outbreak in Kansas was caused by Blue Bell's Texas and Oklahoma plants. [59] Ultimately, five adults in Kansas and three adults in Texas were sickened by Blue Bell's products; three of the five Kansas adults died because of complications due to *listeria* infection. [60] The CDC issued a recall to grocers and retailers, alerting them to the contamination and warning them against selling the products. [61]

After Blue Bell's full product recall, the FDA inspected each of the company's three plants. Each was found to have major deficiencies. In the Texas plant, the FDA found a "failure to manufacture foods under conditions and controls necessary to minimize the potential for growth of microorganisms," inadequate cleaning and sanitizing procedures, "failure to maintain buildings in repair sufficient to prevent food from coming [sic] adulterated," and improper construction of the building that failed to prevent condensation from occurring. [62] Likewise, at the Oklahoma facility, "[t]he FDA found that the Company had been receiving increasingly frequent positive [*l*]*isteria* tests at [the Oklahoma facility] for over three years," failed "to manufacture and package foods under conditions and controls necessary to minimize the potential growth of microorganisms and contamination," failed to perform testing to ferret out microbial growth, implemented inadequate cleaning and sterilization procedures, failed to provide running water at an appropriate temperature to sanitize equipment, and failed to store food in clean and sanitized portable equipment. [63]

***815** Although the Alabama facility fared better, the FDA still found contamination and several issues, including the "failure to perform microbial testing where necessary to identify possible food contamination," "failure to maintain food contact surfaces to protect food from contamination by any source," and inadequate construction of the facility such that condensation was likely. [64] Most of these findings, the complaint alleges, are unsurprising because similar deficiencies were found by the FDA and state regulators in

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the run up to the *listeria* outbreak, yet according to the FDA's inspection after the fact, it appeared that neither management nor the board made progress on remedying these deficiencies.

After the fact, various news outlets interviewed former Blue Bell employees who "claimed that Company management ignored complaints about factory conditions in [the Texas facility]." [65] One former employee "reported [that] spilled ice cream was left to pool on the floor, 'creating an environment where bacteria could flourish.' " [66] Another former employee described being "instructed to pour ice cream and fruit that dripped off his machine into mix to be used later." [67]

iii. The Aftermath of the Listeria *Outbreak*

With its operations shuttered, Blue Bell faced a liquidity crisis. Blue Bell initially sought a more traditional credit facility to bridge its liquidity, but after Blue Bell director W.J. Rankin informed his brother-in-law, Bill Reimann, about Blue Bell's liquidity crunch, Blue Bell ended up striking a deal with Moo Partners, a fund controlled by Sid Bass and affiliated with Reimann. [68] Moo Partners provided Blue Bell with a $125 million credit facility and purchased a $100 million warrant to acquire 42% of Blue Bell at $50,000 per share. [69] As part of Moo Partners's investment conditions, Blue Bell also amended its certificate of incorporation to grant Moo the right to appoint one member of Blue Bell's board who would be entitled to one-third of the board's voting power (or five votes based on a then-10-member board).

After investing in Blue Bell, Moo named Reimann to Blue Bell's board, expanding the board to 11 members with Reimann possessing five votes. [70] In February 2016, Reimann suggested that the board separate the roles of CEO and Chairman (both held by Paul Kruse). The board voted to follow Reimann's recommendation at its February 18th meeting, but after Paul Kruse disagreed with the recommendation and threatened to resign as President and CEO if the split occurred, the board held another vote in which all members, except Reimann and Rankin, voted to restore the position of CEO and Chairman of the board. [71]

C. The Court of Chancery Dismisses the Case

After requesting Blue Bell's books and records through a § 220 request, the plaintiff, ***816** a Blue Bell stockholder, sued Blue Bell's management and board derivatively, asserting two claims based on management's alleged failure to respond appropriately to the red and yellow flags about growing food safety issues and the board's violation of its duty of loyalty, under *Caremark*, by failing to implement any reporting system and therefore failing to inform itself about Blue Bell's food safety compliance. The Court of Chancery dismissed both claims, holding that the plaintiff failed to plead demand futility.

As to the first claim, the plaintiff alleges that Paul Kruse, Blue Bell's President and CEO, and Bridges, Blue Bell's Vice President of Operations, had breached their duties of loyalty and care by knowingly disregarding contamination risks and failing to oversee Blue Bell's operations and food safety compliance process. [72] "Because directors are empowered to manage, or direct the management of, the business and affairs of the corporation," the plaintiff's complaint must allege facts suggesting that "demand is excused because the directors are incapable of making an impartial decision regarding such litigation." [73] The plaintiff's complaint claims that "[a] demand upon the Board of the Company to pursue claims against Paul Kruse and Bridges ... would be futile" because "the Kruse family—of which both Paul Kruse and Bridges are members—ha[s] long dominated Blue Bell" and the majority of directors are "long-time employees and/or otherwise beholden and loyal to the Kruse family." [74]

But the Court of Chancery held that the plaintiff "failed to plead particularized facts to raise a reasonable doubt that a majority of the [Blue Bell board] members could have impartially considered a pre-suit demand." [75] Without belaboring the details of the Court of Chancery's thorough analysis, which is somewhat complicated due to the unusual structure of Blue Bell's board, we note that the court essentially ruled that the plaintiff came up one vote short. To survive the Rule 23.1 motion to dismiss, the complaint needed to allege particularized facts raising a reasonable doubt that directors holding eight of the 15 votes could have impartially considered a demand, but the court held that the plaintiff had done so for directors holding only seven votes.

One of the directors who the trial court held could consider demand impartially was Rankin, Blue Bell's recently retired former CFO. Although Rankin worked at Blue Bell for 28 years, the court emphasized that he was no longer employed

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by Blue Bell, having retired in 2014. As to the allegations that donations from the Kruse family resulted in a building at Blinn College being named for Rankin, the court noted that "the Complaint provide[d] no more specifics regarding the donation (i.e., who gave how much), and ma[de] no attempt to characterize the materiality of the gesture." [76] That failure, the Court of Chancery concluded, fell short of Rule 23.1's particularity requirement. Further, the court noted that Rankin voted against rescinding a board initiative to split the CEO ***817** and Chairman positions held by Paul Kruse. [77] In the court's view, that act was evidence that Rankin was not beholden to the Kruse family. Ultimately, the Court of Chancery concluded that the plaintiff's "allegation that Rankin lacks independence falls flat." [78]

The Court of Chancery also rejected the plaintiff's second claim that Blue Bell's directors breached their duty of loyalty under *Caremark* by failing to "institute a system of controls and reporting" regarding food safety. [79] In support of this claim, the plaintiff asserted, based on the facts alleged in the complaint and reasonable inferences from those facts, that: (1) the Blue Bell board had no committee overseeing food safety; (2) Blue Bell's board did not have any reporting system in place about food safety; (3) management knew about the growing *listeria* issues but did not report those issues to the board, further evidence that the board had no food safety reporting system in place; and (4) the board did not discuss food safety at its regular board meetings.

Rejecting the plaintiff's *Caremark* claim, the Vice Chancellor started by observing that "[d]espite the far-reaching regulatory schemes that governed Blue Bell's operations at the time of the [*l*]*isteria* contamination, the Complaint contains no allegations that Blue Bell failed to implement the monitoring and reporting systems required by the FDCA [Federal Food, Drug, and Cosmetic Act], FDA regulations or state statutes (or that it was ever cited for such a failure)." [80] In fact, the Court of Chancery concluded that "documents incorporated by reference in the Complaint reveal that Blue Bell distributed a sanitation manual with standard operating and reporting procedures, and promulgated written procedures for processing and reporting consumer complaints." [81] And at the board level, the Vice Chancellor noted that "[b]oth Bridges and Paul Kruse ... provided regular reports regarding Blue Bell operations to the ... Board," including reports about audits of Blue Bell's facilities. [82]

Based on Blue Bell's compliance with FDA regulations, ongoing third-party monitoring for contamination, and consistent reporting by senior management to Blue Bell's board on operations, the Court of Chancery concluded that there was a monitoring system in place. At bottom, the Court of Chancery opined that "[w]hat Plaintiff really attempts to challenge is not the *existence* of monitoring and reporting controls, but the *effectiveness* of monitoring and reporting controls in particular instances." [83] That, the Court of Chancery held, does not state a *Caremark* claim. As a result, the court held that demand was not excused as to the *Caremark* claims and dismissed the complaint.

The plaintiff timely appealed from that dismissal.

II. Analysis

[1] We review a motion to dismiss for failure to plead demand futility *de novo*. [84]

***818** *A. Rankin's Independence*

We first address the plaintiff's claim that the Court of Chancery erred by holding that the complaint did not allege particularized facts that raise a reasonable doubt as to whether directors holding a majority of the board's votes could impartially consider demand as to the management claims. The Court of Chancery concluded that four directors representing eight votes were independent and that seven directors representing seven votes were not independent. On appeal, the plaintiff challenges the Court of Chancery's conclusion as to only Rankin and one other director, Paul Ehlert. Holding that the Court of Chancery erred as to either director would be dispositive. Because we hold that Rankin was not independent for demand futility purposes, we reverse and need not and do not address whether Ehlert was independent.

[2] On appeal, both parties agree that the *Rales* standard applies, [85] and we therefore use it to determine whether the Court of Chancery erred in finding that a majority of the board was independent for pleading stage purposes. "[A] lack of independence turns on 'whether the plaintiffs have pled facts from which the director's ability to act impartially on a matter

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important to the interested party can be doubted because that director may feel either subject to the interested party's dominion or beholden to that interested party."[86] When it comes to life's more intimate relationships concerning friendship and family, our law cannot "ignore the social nature of humans" or that they are motivated by things other than money, such as "love, friendship, and collegiality."[87]

[3] The standard for conducting this inquiry at the demand futility stage is well balanced, requiring that the plaintiff plead facts with particularity, but also requiring that this Court draw all reasonable inferences in the plaintiff's favor.[88] That is, the plaintiff cannot just assert that a close relationship exists, but when the plaintiff pleads specific facts about the relationship—such as the length of the relationship or details about the closeness of the relationship—then this Court is charged with making all reasonable inferences from those facts in the plaintiff's favor.[89]

[4] From the pled facts, there is reason to doubt Rankin's capacity to impartially decide whether to sue members of the Kruse family. For starters, one can reasonably infer that Rankin's successful ***819** career as a businessperson was in large measure due to the opportunities and mentoring given to him by Ed Kruse, Paul Kruse's father, and other members of the Kruse family. The complaint alleges that Rankin started as Ed Kruse's administrative assistant and, over the course of a 28-year career with the company, rose to the high managerial position of CFO.[90] Not only that, but Rankin was added to Blue Bell's board in 2004,[91] which one can reasonably infer was due to the support of the Kruse family. Capping things off, the Kruse family spearheaded charitable efforts that led to a $450,000 donation to a key local college, resulting in Rankin being honored by having Blinn College's new agricultural facility named after him.[92] On a cold complaint, these facts support a reasonable inference that there are very warm and thick personal ties of respect, loyalty, and affection between Rankin and the Kruse family, which creates a reasonable doubt that Rankin could have impartially decided whether to sue Paul Kruse and his subordinate Bridges.

[5] Even though Rankin had ties to the Kruse family that were similar to other directors that the Court of Chancery found were sufficient at the pleading stage to support an inference that they could not act impartially in deciding whether to cause Blue Bell to sue Paul Kruse,[93] the Court of Chancery concluded that because Rankin had voted differently from Paul Kruse on a proposal to separate the CEO and Chairman position, these ties did not matter.[94] In doing so, the Court of Chancery ignored that the decision whether to sue someone is materially different and more important than the decision whether to part company with that person on a vote about corporate governance, and our law's precedent recognizes that the nature of the decision at issue must be considered in determining whether a director is independent.[95] As important, at the pleading stage, ***820** the Court of Chancery was bound to accord the plaintiff the benefit of all reasonable inferences, and the pled facts fairly support the inference that Rankin owes an important debt of gratitude and friendship to the Kruse family for giving him his first job, nurturing his progress from an entry level position to a top manager and director, and honoring him by spearheading a campaign to name a building at an important community institution after him. Although the fact that fellow directors are social acquaintances who occasionally have dinner or go to common events does not, in itself, raise a fair inference of non-independence,[96] our law has recognized that deep and longstanding friendships are meaningful to human beings and that any realistic consideration of the question of independence must give weight to these important relationships and their natural effect on the ability of the parties to act impartially toward each other. As in cases like *Sandys v. Pincus*[97] and ***Delaware*** *County Employees Retirement Fund v. Sanchez*,[98] the important personal and business relationship that Rankin and the Kruse family have shared supports a pleading-stage inference that Rankin cannot act independently.

Because the complaint pleads particularized facts that raise a reasonable doubt as to Rankin's independence, we reverse the Court of Chancery's dismissal of the plaintiff's claims against management for failure to adequately plead demand futility.

B. The Caremark *Claim*

The plaintiff also challenges the Court of Chancery's dismissal of his *Caremark* claim. Although *Caremark* claims are difficult to plead and ultimately to prove out,[99] we nonetheless disagree with the Court of Chancery's decision to dismiss the plaintiff's claim against the Blue Bell board.

[6] Under *Caremark* and *Stone v. Ritter*, a director must make a good faith effort to oversee the company's

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operations. [100] Failing to make that good faith effort breaches the duty of loyalty and can expose a director to liability. In other words, for a plaintiff to prevail on a *Caremark* claim, the plaintiff must show that a fiduciary acted in bad faith —"the state of mind traditionally used to define the mindset ***821** of a disloyal director." [101]

[7] **[8]** Bad faith is established, under *Caremark*, when "the directors [completely] fail[ ] to implement any reporting or information system or controls[,] or ... having implemented such a system or controls, consciously fail[ ] to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." [102] In short, to satisfy their duty of loyalty, directors must make a good faith effort to implement an oversight system and then monitor it.

[9] As with any other disinterested business judgment, directors have great discretion to design context- and industry-specific approaches tailored to their companies' businesses and resources. [103] But *Caremark* does have a bottom-line requirement that is important: the board must make a good faith effort—*i.e.*, try—to put in place a reasonable board-level system of monitoring and reporting. [104] Thus, our case law gives deference to boards and has dismissed *Caremark* cases even when illegal or harmful company activities escaped detection, when the plaintiffs have been unable to plead that the board failed to make the required good faith effort to put a reasonable compliance and reporting system in place. [105]

For that reason, our focus here is on the key issue of whether the plaintiff has pled facts from which we can infer that Blue Bell's board made no effort to put in place a board-level compliance system. That is, we are not examining the effectiveness of a board-level compliance and reporting system after the fact. Rather, we are focusing on whether the complaint pleads facts supporting a reasonable inference that the board did not undertake good faith efforts to put a board-level system of monitoring and reporting in place.

***822** **[10]** **[11]** Under *Caremark*, a director may be held liable if she acts in bad faith in the sense that she made no good faith effort to ensure that the company had in place any "system of controls." [106] Here, the plaintiff did as our law encourages and sought out books and records about the extent of board-level compliance efforts at Blue Bell regarding what has to be one of the most central issues at the company: whether it is ensuring that the only product it makes—ice cream—is safe to eat. [107] Using these books and records, the complaint fairly alleges that before the *listeria* outbreak engulfed the company:

- no board committee that addressed food safety existed;
- no regular process or protocols that required management to keep the board apprised of food safety compliance practices, risks, or reports existed;
- no schedule for the board to consider on a regular basis, such as quarterly or biannually, any key food safety risks existed;
- during a key period leading up to the deaths of three customers, management received reports that contained what could be considered red, or at least yellow, flags, and the board minutes of the relevant period revealed no evidence that these were disclosed to the board;
- the board was given certain favorable information about food safety by management, but was not given important reports that presented a much different picture; and
- the board meetings are devoid of any suggestion that there was any regular discussion of food safety issues.

And the complaint goes on to allege that after the *listeria* outbreak, the FDA discovered a number of systematic deficiencies in all of Blue Bell's plants—such as plants being constructed "in such a manner as to [not] prevent drip and condensate from contaminating food, food-contact surfaces, and food-packing material"—that might have been rectified had any reasonable reporting system that required management to relay food safety information to the board on an ongoing basis been in place. [108]

[12] In sum, the complaint supports an inference that no system of board-level compliance monitoring and reporting existed at Blue Bell. Although *Caremark* is a tough standard for plaintiffs to meet, the plaintiff has met it here. When a plaintiff can plead an inference that a board has undertaken no efforts to make sure it is informed of a compliance issue intrinsically critical to the company's business operation, then that supports an inference that the board has not made the good faith effort that *Caremark* requires.

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In defending this case, the directors largely point out that by law Blue Bell had to meet FDA and state regulatory requirements for food safety, and that the company ***823** had in place certain manuals for employees regarding safety practices and commissioned audits from time to time.[109] In the same vein, the directors emphasize that the government regularly inspected Blue Bell's facilities, and Blue Bell management got the results.[110]

But the fact that Blue Bell nominally complied with FDA regulations does not imply that the *board* implemented a system to monitor food safety *at the board level*.[111] Indeed, these types of routine regulatory requirements, although important, are not typically directed at the board. At best, Blue Bell's compliance with these requirements shows only that management was following, in a nominal way, certain standard requirements of state and federal law. It does not rationally suggest that the board implemented a reporting system to monitor food safety or Blue Bell's operational performance. The mundane reality that Blue Bell is in a highly regulated industry and complied with some of the applicable regulations does not foreclose any pleading-stage inference that the directors' lack of attentiveness rose to the level of bad faith indifference required to state a *Caremark* claim.

In answering the plaintiff's argument, the Blue Bell directors also stress that management regularly reported to them on "operational issues." This response is telling. In decisions dismissing *Caremark* claims, the plaintiffs usually lose because they must concede the existence of board-level systems of monitoring and oversight such as a relevant committee, a regular protocol requiring board-level reports about the relevant risks, or the board's use of third-party monitors, auditors, or consultants.[112] For example, in *Stone v. Ritter*, ***824** although the company paid $50 million in fines related "to the failure by bank employees" to comply with "the federal Bank Secrecy Act,"[113] the"[b]oard dedicated considerable resources to the [Bank Secrecy Act] compliance program and put into place numerous procedures and systems to attempt to ensure compliance."[114] Accordingly, this Court affirmed the Court of Chancery's dismissal of a *Caremark* claim. Here, the Blue Bell directors just argue that because Blue Bell management, in its discretion, discussed general operations with the board, a *Caremark* claim is not stated.

But if that were the case, then *Caremark* would be a chimera. At every board meeting of any company, it is likely that management will touch on some operational issue. Although *Caremark* may not require as much as some commentators wish,[115] it does require that a board make a good faith effort to put in place a reasonable system of monitoring and reporting about the corporation's central compliance risks. In Blue Bell's case, food safety was essential and mission critical. The complaint pled facts supporting a fair inference that no board-level system of monitoring or reporting on food safety existed.

If *Caremark* means anything, it is that a corporate board must make a good faith effort to exercise its duty of care. A failure to make that effort constitutes a breach of the duty of loyalty. Where, as here, a plaintiff has followed our admonishment to seek out relevant books and records[116] and then uses those books and records to plead facts supporting a fair inference that no reasonable compliance system and protocols were established as to the obviously most central consumer safety and legal compliance issue facing the company, that the board's lack of efforts resulted in it not receiving official notices of food safety deficiencies for several years, and that, as a failure to take remedial action, the company exposed consumers to *listeria*-infected ice cream, resulting in the death and injury of company customers, the plaintiff has met his onerous pleading burden and is entitled to discovery to prove out his claim.

III. Conclusion

We therefore reverse the Court of Chancery's decision and remand for proceedings consistent with this opinion.

All Citations

212 A.3d 805

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Footnotes

1 *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch.1996) (Allen, C.); *see also* App. to Opening Br. at A67–68 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).

2 App. to Answering Br. at B48–134 (Defendants' Opening Br. in Support of their Joint Motion to Dismiss (Oct. 30, 2017)); *see also* Court of Chancery Rule 23.1.

3 ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *16 (**Del**. Ch. Sept. 27, 2018).

4 *Id.* at ***18**.

5 *Id.*

6 Because we hold that the complaint pleads particularized facts supporting a reasonable inference that Rankin could not be impartial as to suing a member of the Kruse family, we need not, and do not, reach that issue as to the other director whose impartiality the plaintiff challenges on appeal.

7 *Sandys v. Pincus*, 152 A.3d 124, 130 (**Del**. 2016).

8 *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 942 (**Del**. Ch. 2003).

9 911 A.2d 362 (**Del**. 2006).

10 *Id.* at 364 (quoting *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 971 (**Del**. Ch.1996)); *see also* *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 125 (**Del**. Ch. 2009) (Chandler, C.).

11 *Caremark*, 698 A.2d at 971.

12 *Id.*

13 The facts come from the plaintiff's complaint, documents incorporated by reference into the complaint, and the Court of Chancery's opinion based on these same documents.

14 Blue Bell Creameries USA, Inc. is a holding company. Its only assets are a 69.6 percent interest in Blue Bell Creameries, L.P., which actually produces and distributes ice cream, and a 100 percent interest in Blue Bell Creameries, Inc., the general partner of Blue Bell Creameries, L.P. Because the plaintiff is a stockholder of Blue Bell Creameries USA, the Court of Chancery requested supplemental briefing regarding the fiduciary duties of dual fiduciaries—because the holding company and the general partner have the same executives—and a board's responsibilities when its only asset is a majority stake in a subsidiary. App. to Opening Br. at A275–83 (Letter from Vice Chancellor Slights to counsel requesting supplement submissions (May 11, 2018)). But in its decision, the Court of Chancery sensibly and properly collapsed the enterprise for purposes of analyzing the complaint. ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *3 (**Del**. Ch. Sept. 27, 2018).

15 App. to Opening Br. at A20 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).

16 *Id.* at A20–21.

17 *Id.* at A21.

18 *Id.* at A28–29.

19 *Id.*

20 *See* 21 U.S.C. §§ 333, 341, 342, 350.

21 App. to Opening Br. at A28 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).

22 21 C.F.R. § 110.80.

23 *Id.* § 117.3.

24 ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *9–11 (**Del**. Ch. Sept. 27, 2018).

25 *Id.*

26 App. to Opening Br. at A9 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017))

27 *Id.* at A9–11.

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28 *Id.* at A21.
29 *Id.* at A25.
30 *Id.* at A33.
31 *Id.*
32 *Id.*
33 *Id.* at A34.
34 *Id.*
35 *Id.*
36 *Id.*
37 *Id.*
38 *Id.*
39 *Id.* at A49–50.
40 *Id.* at A52.
41 *Id.*
42 *Id.* ("[T]here is no reference to *Listeria* or the lab reports in the minutes of the February or March 2014 meetings.").
43 *Id.*
44 *Id.* at A49–50.
45 *Id.* at A170 (Minutes to April 29, 2014 board meeting).
46 *Id.* at A49 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).
47 *Id.* at A180 (Minutes to September 30, 2014 board meeting). *See also* ***Marchand***, 2018 **WL** 4657159, at *6 n.72.
48 App. to Opening Br. at A49–50 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).
49 *Id.*
50 *Id.* at A36, A54.
51 *Id.* at A54–55.
52 *Id.*
53 *Id.* at A55.
54 ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *7 (**Del**. Ch. Sept. 27, 2018).
55 App. to Opening Br. at A55 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).
56 *Id.* at A36.
57 *Id.* at A56–57.
58 *Id.* at A37.
59 *Id.* at A37–38.
60 *Id.* at A37.
61 *Id.*
62 *Id.* at A38; *see also id.* at A77–80 (Food and Drug Administration Inspection Report for Blue Bell Creameries facility in Brenham, Texas (May 1, 2015)).
63 *Id.* at A38–39 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)); *see also id.* at A82–91 (Food and Drug Administration Inspection Record for Blue Bell Creameries facility in Broken Arrow, Oklahoma (Apr. 23, 2015)).
64 *Id.* at A40–41 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)); *see also id.* at A94–96 (Food and Drug Administration Inspection Report for Blue Bell Creameries facility in Sylacauga, Alabama (Apr. 30, 2015)).
65 *Id.* at A35 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).
66 *Id.*
67 *Id.* at A35–36.
68 *Id.* at A42–43.

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69 *Id.*
70 *Id.* at A46.
71 *Id.* at A57–59.
72 *Id.* at A67 (asserting a "derivative claim for breach of fiduciary duties of loyalty and care for knowingly disregard of contammination [sic] risks and failure to oversee Blue Bell's operation and compliance").
73 *Rales v. Blasband*, 634 A.2d 927, 932 (**Del**. 1993).
74 App. to Opening Br. at A62 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).
75 ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *2 (**Del**. Ch. Sept. 27, 2018).
76 *Id.* at *15.
77 *Id.*
78 *Id.*
79 App. to Opening Br. at A68–69 (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017)).
80 ***Marchand***, 2018 **WL** 4657159, at *11.
81 *Id.* at *17.
82 *Id.*
83 *Id.* at ***18*** (emphasis in original).
84 *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1048 (**Del**. 2004) ("This Court reviews de novo a decision of the Court of Chancery to dismiss a derivative suit under Rule 23.1.").
85 *See* *Rales v. Blasband*, 634 A.2d 927, 932–34 (**Del**. 1993).
86 *Sandys v. Pincus*, 152 A.3d 124, 128 (**Del**. 2016) (quoting ***Del****. Cty. Emps. Ret. Fund v. Sanchez*, 124 A.3d 1017, 1024 n.25 (**Del**. 2015)).
87 *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 938 (**Del**. Ch. 2003) ("**Delaware** law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement."); *see also* *Sanchez*, 124 A.3d at 1022 ("Close friendships of that duration are likely considered precious by many people, and are rare. People drift apart for many reasons, and when a close relationship endures for that long, a pleading stage inference arises that it is important to the parties.").
88 *Sanchez*, 124 A.3d at 1022 ("In that consideration, it cannot be ignored that although the plaintiff is bound to plead particularized facts in pleading a derivative complaint, so too is the court bound to draw all inferences from those particularized facts in favor of the plaintiff, not the defendant, when dismissal of a derivative complaint is sought.").
89 *Id.* (holding that at the pleading stage this Court is "bound to draw all inferences from those particularized facts in favor of the plaintiff, not the defendant, when dismissal of a derivative complaint is sought").
90 App. to Opening Br. at A17–**18** (Verified Stockholder Derivative Action Complaint (Aug. 14, 2017).
91 *Id.*
92 *Id.*
93 ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *14–15 (**Del**. Ch. Sept. 27, 2018) (holding that two directors who both worked at Blue Bell for most, if not all, of their entire careers were beholden to the Kruse family and therefore not independent for demand futility).
94 *Id.* at *15.
95 *See* *Sandys v. Pincus*, 152 A.3d 124, 134 (**Del**. 2016) ("Causing a lawsuit to be brought against another person is no small matter, and is the sort of thing that might plausibly endanger a relationship.");

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Sciabacucchi v. Liberty Broadband Corp., 2018 WL 3599997, at *14 (Del. Ch. July 26, 2018) ("It is reasonable to infer that, if Zinterhofer voted to authorize a derivative suit against Malone, the relationship between Searchlight and Liberty Global might be in jeopardy. After all, '[c]ausing a lawsuit to be brought against another person is no small matter, and is the sort of thing that might plausibly endanger a relationship.' "); In re Oracle Corp. Derivative Litig., 824 A.2d 917, 940 (Del. Ch. 2003) ("In evaluating the independence of a special litigation committee, this court must take into account the extraordinary importance and difficulty of such a committee's responsibility. It is, I daresay, easier to say no to a friend, relative, colleague, or boss who seeks assent for an act (*e.g.,* a transaction) that has not yet occurred than it would be to cause a corporation to sue that person. This is admittedly a determination of so-called 'legislative fact,' but one that can be rather safely made. Denying a fellow director the ability to proceed on a matter important to him may not be easy, but it must, as a general matter, be less difficult than finding that there is reason to believe that the fellow director has committed serious wrongdoing and that a derivative suit should proceed against him.") (footnotes omitted).

96 *See* Beam ex rel. Martha Stewart Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1051–52 (Del. 2004).

97 152 A.3d 124, 130 (Del. 2016) (holding that owning an airplane with the interested party "is suggestive of the type of very close personal relationship that, like family ties, one would expect to heavily influence a human's ability to exercise impartial judgment").

98 124 A.3d 1017, 1020–22 (Del. 2015) (holding that being "close personal friends for more than five decades" with the interested party gives rise to "a pleading stage inference ... that it is important to the parties" and suggests that the director is not independent).

99 *See* Stone v. Ritter, 911 A.2d 362, 372 (Del. 2006) ("[A] claim that directors are subject to personal liability for employee failures is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.") (internal quotation marks omitted); Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003) ("A *Caremark* claim is a difficult one to prove."); In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) ("The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.").

100 Caremark, 698 A.2d at 970 ("[I]t is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility.").

101 Desimone v. Barrows, 924 A.2d 908, 935 (Del. Ch. 2007).

102 Stone, 911 A.2d at 370–72.

103 In re Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 125–26 (Del. Ch. 2009) (Chandler, C.) (noting that *Caremark* "does not eviscerate the core protections of the business judgment rule"); Caremark, 698 A.2d at 970 ("Obviously the level of detail that is appropriate for such an information system is a question of business judgment."); Desimone, 924 A.2d at 935 n.95 (noting that the approaches boards take to monitoring the corporation under their *Caremark* duty "will obviously vary because of the different circumstances corporations confront"); *see also* Caremark, 698 A.2d at 971 ("But, of course, the duty to act in good faith to be informed cannot be thought to require directors to possess detailed information about all aspects of the operation of the enterprise. Such a requirement would simple [sic] be inconsistent with the scale and scope of efficient organization size in this technological age.").

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104 Stone, 911 A.2d at 370; *see also* Caremark, 698 A.2d at 971 ("Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, ... only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.").

105 *See, e.g.*, Stone, 911 A.2d at 372–73 (dismissing a *Caremark* claim despite the fact that the company violated the Bank Secrecy Act and was fined $50 million); *In re General Motors Derivative Litig.*, 2015 WL 3958724, at *1, *17 (Del. Ch. 2015) (dismissing a *Caremark* claim despite the fact that the company's actions "led to monetary loss on the part of the corporation, via fines, damages and punitive damages from lawsuits; reputational damage; and most distressingly, personal injury and death to GM customers"); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d at 127 (dismissing a *Caremark* claim despite the fact that the company suffered billions of dollars in losses because of its exposure to subprime mortgages).

106 Stone, 911 A.2d at 370; *see also* Caremark, 698 A.2d at 971 ("Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, ... only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.").

107 Though, to be fair and completely accurate, Blue Bell does make a few other related products, such as frozen yogurt.

108 App. to Opening Br. at A94–96 (Food and Drug Administration Inspection Report for Blue Bell Creameries facility in Sylacauga, Alabama (Apr. 30, 2015)).

109 Answering Br. at 28–29.

110 Answering Br. at 28–29; *see also* ***Marchand*** *v.* ***Barnhill***, 2018 **WL** 4657159, at *17 (**Del**. Ch. Sept. 27, 2018) ("[D]ocuments incorporated by reference in the Complaint reveal that Blue Bell distributed a sanitation manual with standard operating and reporting procedures, and promulgated written procedures for processing and reporting consumer complaints. Blue Bell engaged a third-party laboratory and food safety auditor to test for the presence of dangerous contaminates in its facilities.").

111 Stone, 911 A.2d at 368 ("To the contrary, the *Caremark* Court stated, 'it is important that the *board* exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the *board* that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility.' ") (quoting Caremark, 698 A.2d at 970) (emphasis added).

112 *See, e.g.*, *City of Birmingham Ret. Sys. v. Good*, 177 A.3d 47, 59 (Del. 2017) (affirming the Court of Chancery's dismissal of a *Caremark* claim because "reports to the board showed that the board 'exercised oversight by relying on periodic reports' from the officers" and that board presentations "identified issues with the coal ash disposal ponds, but also informed the board of the actions taken to address the regulatory concerns"); Stone, 911 A.2d at 372–73 (affirming the Court of Chancery's dismissal of a *Caremark* claim, in part, because an outside auditor's report "reflect[s] that the Board received and approved relevant policies and procedures, delegated to certain employees and departments the responsibility for filing [suspicious activity reports] and monitoring compliance, and exercised oversight by relying on periodic reports from them"); *In re General Motors Derivative Litig.*, 2015 WL 3958724, at *14 (Del. Ch. 2015) (dismissing a *Caremark* claim where "GM *had* a system for reporting risk to the Board, but in the Plaintiffs' view it should have been a better system"); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 127 (Del. Ch.

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2009) (dismissing a *Caremark* claim because "[p]laintiffs do not contest that Citigroup had procedures and controls in place that were designed to monitor risk"); *Desimone v. Barrows*, 924 A.2d 908, 940 (**Del**. Ch. 2007) (dismissing a *Caremark* claim premised on the plaintiff's allegations that a properly formed and well-functioning audit committee must have known about options backdating despite the fact that management intentionally kept this information from the audit committee); *Guttman v. Huang*, 823 A.2d 492, 506–07 (**Del**. Ch. 2003) (dismissing a *Caremark* claim because the plaintiff failed to plead any particularized facts about the audit committee's lack of reporting or information systems).

113 911 A.2d at 365–66.

114 *Id.* at 371.

115 *See, e.g.*, John Armour, et al., *Board Compliance*, 104 MINNESOTA L. REV. (forthcoming 2020) (manuscript at 47), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3205600; John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. LEGAL ANALYSIS 35, 46 (2014); Hillary A. Sale, *Monitoring* Caremark*'s Good Faith*, 32 **DEL**. J. CORP. L. 719, 753 (2007).

116 *See* *Sandys v. Pincus*, 152 A.3d 124, 128 (**Del**. 2016) ("For many years, this Court and the Court of Chancery have advised derivative plaintiffs to take seriously their obligations to plead particularized facts justifying demand excusal.").

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WHITE COLLAR PROGRAM BIOS 2021

Guest Panelists:

Debra Katz is a founding partner of Katz, Marshall & Banks, LLP, where she concentrates her practice on employment discrimination, sexual harassment, wrongful discharge, Sarbanes-Oxley, corporate, environmental, and other whistleblower retaliation claims, SEC whistleblower tips, and contractual employment disputes. She has developed extensive litigation experience in federal and local courts and has achieved significant courtroom successes in a number of high-profile cases. Throughout her legal career, Ms. Katz has successfully represented hundreds of whistleblowers in the nuclear, financial, pharmaceutical and medical-device industries. Currently, she represents Dr. Rick Bright, the former director of the Department of Health and Human Services' Biomedical Advanced Research and Development Authority, who was removed from his position after raising concerns over the administration's inadequate preparation for the Coronavirus pandemic, and the subsequent interference into vaccine and treatment approval processes. Among her other noteworthy matters, she represented Dr. Christine Blasey Ford during the confirmation hearings of Justice Kavanaugh; and she currently represents more than a dozen former employees of the Washington Football Team who have documented a hostile and sexually charged work environment. She also regularly handles cases involving fraud in government contracts, including most recently at the U.S. Embassy in Kabul, Afghanistan.

Among her many awards, she has been recognized as "Civil Rights Lawyer of the Year" for Washington, D.C. by *The Best Lawyers© In America* for 2018, as one of the "toughest" employment lawyers in Washington, D.C. by *Washingtonian* magazine, and as an expert in sexual harassment, employment, and whistleblower law by *The New York Times*, *The Washington Post*, *TIME magazine* and others. *Washingtonian* Magazine selected Ms. Katz for its "Top Lawyers" list from 2004 to 2020, naming her one of the magazine's top 30 "**Stars of the Bar**" in its biennial listings, and calling Ms. Katz, "Washington's top attorney for women who want to fight back," in a 2018 profile. Law360 recognized her as a 2019 "**Titan of the Plaintiffs Bar**," in 2018, and the National Law Journal honored Ms. Katz as a **Washington D.C. Trailblazer** in 2020.

Ms. Katz has been profiled as one of Washington D.C.'s "**Women Who Mean Business**" by the Washington Business Journal in 2020, as a pioneering #MeToo attorney by the Washington Post in "**The feared attorney of the #MeToo moment**," and a "**Leading #MeToo Lawyer**" by *Washingtonian* Magazine. Additionally, in a 2021 profile piece, the Associated Press called Ms. Katz and partner Lisa Banks the "**top #MeToo legal duo**." For her extraordinary work representing victims of sexual harassment and assault, as well as advocating for legislative change, the Metropolitan Washington Employment Lawyers Association recognized Ms. Katz with its 2019 Lawyers of the Year Award. And for her work as part of Dr. Christine Blasey Ford's legal team, the Women's Bar Association recognized Ms. Katz with the "Dare to Make an Impact" award. Additionally, the Victim Rights Law Center honored Ms. Katz and her partner Lisa Banks at its Shining Star Gala with the **2019 Leadership Award** for their representation of Dr. Christine Blasey Ford.

Ms. Katz serves as Vice Chair on the Board of Directors of the Project on Government Oversight (POGO), a nonpartisan independent government watchdog. POGO's mission is to strengthen laws and regulations to protect whistleblowers from intimidation and retaliation and to create a more accountable and effective federal government by investigating allegations of government corruption and misconduct.

She received her Bachelor of Arts degree, *summa cum laude*, from Union College, where she was a member of Phi Beta Kappa. She received her J.D. degree, *cum laude*, from the University of Wisconsin Law School, where she served as a member of the Wisconsin Law Review and as Articles Editor of the *Wisconsin Women's Law Journal*. Following law school, Ms. Katz clerked for the Hon. William Bablitch on the Wisconsin Supreme Court and held a Women's Law and Public Policy Fellowship at Georgetown University Law Center.

Linda Severin has over 35 years of experience in criminal and civil enforcement actions, investigations, and complex litigation. Her background as an SDNY federal prosecutor, a white-collar defense attorney, and an in-house litigation attorney at a Fortune 100 corporation enables her to analyze whistleblower fraud matters from multiple perspectives.

Ms. Severin became a member of the Whistleblower Law Collaborative in 2018. Before joining the firm full-time, she had been a solo practitioner working on False Claims Act matters with Bob Thomas and Suzanne Durrell, most notably *United States ex rel. Westmoreland v. Amgen, Inc.*, 707 F. Supp. 2d 123 (D. Mass. 2010), which was part of the $762 million global criminal and civil settlement against Amgen, the largest single such settlement against a biotechnology company.

She served for eight years as an Assistant U.S. Attorney in the Southern District of New York. As a federal prosecutor, she investigated and tried cases involving fraud, racketeering, drug trafficking, money laundering, and extortion, and she briefed and argued criminal appeals before the Second Circuit Court of Appeals. Her supervisory positions included Deputy Chief of the Appeals Unit, Deputy Chief and Acting Chief of the Narcotics Unit, and Chief of the New York/New Jersey Organized Crime Drug Enforcement Task Force. She received numerous commendations from law enforcement agencies for her outstanding contributions. Before joining the U.S. Attorney's Office, Ms. Severin was a law clerk to the Honorable John E. Sprizzo, District Judge for the Southern District of New York, and a litigation associate at Curtis, Mallet-Prevost, Colt & Mosle. While at Curtis, Mallet-Prevost, she was part of a trial team that successfully represented plaintiffs suing Standard Oil Company and Amoco for damages caused by the grounding of the *Amoco Cadiz* oil tanker off the coast of France.

After leaving the U.S. Attorney's Office, Linda Severin moved to Seattle and entered private practice, where her work focused on white-collar criminal defense and internal investigations. She was a partner at Bogle & Gates and later founded the firm of Tallman & Severin LLP with Richard C. Tallman. After Mr. Tallman became a United States Judge for the Ninth Circuit Court of Appeals, Linda worked in-house for The Boeing Company and, later, for Garvey Schubert Barer.

Ms. Severin has taught trial advocacy as an adjunct instructor at both the University of Washington Law School and New York Law School. In Seattle, she was a member of the Criminal Justice Act panel for the Western District of Washington, representing indigent criminal defendants in federal court. She also was part of a team of pro bono attorneys representing clients who successfully challenged Washington State ballot initiatives seeking to restrict civil rights for LGBTQ persons. She has been a frequent speaker at continuing legal education programs and other legal conferences.

Ms. Severin received her Bachelor of Arts degree from the University of Michigan, where she was a letter winner on Michigan's first women's basketball team, and earned her J.D. degree from the University of Virginia Law School. She currently serves on the Board of Governors of the University of Michigan Alumnae Council and the Board of Governors of Henderson House, a cooperative residence that the Alumnae Council established in the 1940s for financially disadvantaged women students.

NY American Inn of Court 2021 White Collar Team

Laurie Brecher is a litigator who focused her practice on white-collar criminal and regulatory enforcement defense and prosecutions, internal investigations, and complex federal and state civil litigation. She served for a decade as an AUSA in the Criminal Division of the U.S. Attorney's Office for the Southern District of NY, holding several positions, including Chief of the General Crimes Unit and Senior Trial Counsel of the Securities & Commodities Fraud Task Force. After her government service, she was Deputy General Counsel, Litigation & Regulatory for Pitney Bowes, Inc. Prior to her government service, she was a litigation associate at Cravath, Swaine & Moore, and Howard, Darby & Levin. (now Covington & Burling). She was also honored to have served as a law clerk to the Hon. Jon O. Newman, U.S. Court of Appeals for the Second Circuit. She earned her law degree with highest honors from New York University School of Law (1983), where she was the Senior Articles Editor of the *NYU Law Review.* She received her undergraduate degree, *summa cum laude*, from Union College in 1980, where she was elected to *Phi Beta Kappa.* She has been active in the NY City Bar Assn. (former member of International Law and Judiciary Committees) and the ABA (former Chair of Criminal Litigation Committee and former Division Director for the Litigation Section). Among her public service commitments, she is a college coach for Yonkers Partners in Education, a former board and founding member of Friends of Chappaqua Performing Arts Center, and a member of the Legal Advisory Council for Sanctuary for Families.

Evan Brustein is the founder of Brustein Law PLLC, where he represents individuals who have had their civil rights violated by their employers, the police, or other institutions. Prior to entering private practice, Evan served as Senior Counsel in the New York City Law Department's Special Federal Litigation Division, where he defended Section 1983 cases in the Southern and Eastern Districts of New York. The New York City Bar Association awarded Evan the Municipal Affairs Award for outstanding achievement for his work representing the City of New York. Evan has also been honored by the New York City Law Department with the Division Chief Awards for both the Special Federal Litigation Division and the Family Court Division. In his spare time, Evan coaches the Brooklyn Latin School Mock Trial team.

Glenn Colton is a partner in the White Collar and Government Investigations practice at Arent Fox. He represents individuals, companies, and boards of directors in white collar criminal and civil enforcement investigations. Glenn previously served for nearly 10 years as an Assistant United States Attorney in both the civil and criminal divisions in the Southern District of New York. In that capacity, he was lead or co-lead trial counsel in approximately 25 trials, and all but one ended in conviction, government verdict (in civil cases) or resolution on terms favorable to the government. He has served as an instructor at the FBI Academy at Quantico, the US DOJ National Advocacy Center, and the National Institute of Trial Advocacy. Glenn frequently is called upon to provide expert legal analysis to a wide variety of publications and media outlets, including *The New York Times*, *The Wall Street Journal*, *The National Law Journal*, TruTV, CNBC, CBS Radio, Law360, The Street.com, Reuters.com, and The Deal.com. In addition to his law practice, Glenn is a sports radio host on SiriusXM, and one of approximately 20 members of the Fantasy Sports and Gaming Association Hall of Fame, in large part for his work on the save the industry litigation. He received his Bachelor of Science degree, *summa cum laude*, from SUNY-Binghamton, and his J.D. degree from the New York University School of Law.

Mary Diaz is a law clerk at Walden Macht & Haran LLP where she focuses on white collar defense and investigations. She is a member of the Hispanic National Bar Association and the Cafecitos Network and enjoys international travel, cooking, dancing, and running during her free time. After graduating from Wesleyan University with a Bachelor of Arts degree in Government in 2014, Mary earned her Juris Doctor from Fordham University School of Law in 2020. While at Fordham Law she was a member of the Fordham Moot Court, *Environmental Law Review,* Stein Scholars for Public Interest, LALSA, Fordham Law Advocates for Voter Rights, and held internships at the U.S. Securities and Exchange Commission and Department of Justice. Prior to law school, Mary spent three years as a paralegal at the U.S. Attorney's Office for the Southern District of New York in the Securities and Commodities Fraud Unit. Mary is a new member of the Inn and is looking forward to meeting everyone and collaborating on programs

Eugene Frenkel is an attorney in the public sector, protecting consumers and markets from fraud. He has helped negotiate settlements in the hundreds of millions of dollars with companies and stopped several businesses with harmful and unfair practices, including several that attempted to take advantage of the health crisis. In his downtime, Eugene serves as co-program chair for the Inn and as co-chair of the Young Lawyers Section at NYCLA. He enjoys reading fantasy books and is always ready to talk about Star Wars or Marvel tv shows or movies.

Milosz Gudzowski is a Trial Attorney at the Department of Justice – Antitrust Division. Milosz has been at the Antitrust Division for ten years and has prosecuted both criminal and civil antitrust matters in a variety of industries, including construction, municipal contracting, airlines, telecommunications, and automotive. Milosz likes to play tennis and lives on the upper east side in Manhattan.

Diana Haladey is happy to be celebrating her 15^{th} anniversary on the White Collar Team, serving as co-leader for 10 years, and winning two national American Inns of Court Outstanding Program awards (for Insider Trading Under the Microscope and Orange is the New Varsity Blue – From Bribe Agreement to Plea Agreement). She was previously at White & Case LLP, and interned at the U.S. Attorney's Office EDNY Civil Division. She went to Fordham University School of Law where she won best oralist in the first-year moot court competition and competed on the Jessup International Law and National Moot Court teams. She received an A.B. in English from Dartmouth College where she co-captained the women's rugby club. She loves being part of a team and wishes to thank all her White Collar teammates over the years.

Meredith Jones is General Counsel of New York City Economic Development Corporation. NYCEDC's mission is to create shared prosperity across the City's five boroughs by strengthening neighborhoods and growing good jobs. It is the City's official economic development corporation. Before joining NYCEDC, she was a transactional lawyer in Palo Alto, California. Prior thereto, she served as Chief of the Cable Services Bureau of the Federal Communication Commission in Washington, D.C., involved in multichannel video and telecom competition issues. Before joining the FCC, she was General Counsel to the National Oceanic and Atmospheric Administration in Washington, D.C., which includes the National Weather Service and is the nation's trustee for marine mammals and anadromous fish and the lead agency for oceanic and atmospheric issues. She was a member of the legal team of the Bechtel group of companies in San Francisco, California and was a partner in a San Francisco law firm. Jones began her legal career in New York City.

David Kerschner is a senior associate at Arnold & Porter Kaye Scholer. David focuses on complex product liability and commercial litigation and has worked on teams that have tried cases to jury verdicts in multiple jurisdictions. His experiences include representing major life science companies in product liability actions, contractual disputes, and on antitrust claims relating to restraint of generic competition. This is David's third year participating in the Inn's White Collar program. He previously participated in "White Collar Sports on Inn of Court Radio Network," and "Orange is the new Varsity Blue." David received his BA from Colgate University and JD from NYU School of law.

Jared M. Rosen is an Assistant District Attorney with the Bronx District Attorney's Office. As an ADA with the Public Integrity Bureau, he is involved in the prosecution and investigation of corruption committed by public servants, including government employees and appointed and elected officials, as well as excessive uses of force and misconduct by police officers. He was formerly in the Rikers Island Prosecution Bureau, where he was involved in the investigation and prosecution of criminal activity in New York City jails, including gang assaults and contraband smuggling. Previously, Mr. Rosen was an Executive Agency Counsel and the Market Manager at the Business Integrity Commission, an agency tasked with eliminating organized crime influence, anti-competitive practices and corruption from New York City's trade-waste industry and public wholesale markets. Prior to this, Mr. Rosen was an Assistant Counsel at the Waterfront Commission of New York Harbor, a bi-state agency created to eliminate corruption and unfair hiring practices in the Port of New York/New Jersey. Mr. Rosen graduated from Cornell University with a B.S. in Industrial & Labor Relations and received his law degree from Brooklyn Law School.

Brian Steinwascher is an associate at Thompson Hine LLP's New York office. He splits his practice between business litigation and white-collar criminal defense. Brian has been involved in a wide variety of cases and proceedings, from complex international arbitration to federal bank fraud trials. On the side, Brian is a Professor of Lawyering and Legal Writing at his alma mater, Benjamin N. Cardozo School of Law.

Steven Tugander is a Trial Attorney in the New York Office of the United States Justice Department's Antitrust Division and has investigated and prosecuted numerous criminal antitrust cases affecting various industries in jurisdictions located throughout the Northeast. In 2017 and 2018, Mr. Tugander served as the Antitrust Division's Criminal Special Projects Coordinator, reporting directly to the Deputy Assistant Attorney General and the Director of Criminal Enforcement. Mr. Tugander has served on the Executive Committee of the New York State Bar Association's Antitrust Law Section since January 2000. He served as Chair of the Section from January 2005 through January 2006, having previously served as Vice-Chair and Secretary of the Section. In addition, he also currently serves on the Section's Cartel and Criminal Practice sub-committee. Since 2004, Mr. Tugander has been a member of the New York American Inn of Court. During his tenure with the Inn, Mr. Tugander has organized a number of Continuing Legal Education programs related to various white collar criminal law topics. In December 2017, Mr. Tugander was honored as the first recipient of Antitrust Division's Ralph T. Giordano Award. The award recognizes excellence in cartel enforcement.

We thank **Apeksha Vora** (Government Enforcement and White Collar Associate, Arent Fox LLP), **Eugene Meyers** (Partner, Meister, Seelig & Fein LLP) and **Steven Cummings** (Associate, Schulte Roth & Zabel LLP) for playing roles in the program.