JULY 10, 2024

# Whistleblowers: US Regulatory Trends and Best Practices

CONTINUING LEGAL EDUCATION

William J. Stellmach | Neal E. Kumar | Sean Sandoloski

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# Agenda

1. U.S. Whistleblower Legal Framework
2. Background on SEC Whistleblower Program and Awards
3. Recent SEC Whistleblower Enforcement Actions
4. Background on CFTC Whistleblower Program and Awards
5. CFTC Enforcement Actions
6. DOJ Whistleblower Pilot Program
7. Best Practices for In House Counsel

## William J. Stellmach

*Partner, Co-Chair of Investigations & Enforcement and White-Collar Defense Groups*

William is a Partner in Willkie's Washington, D.C. office and Co-Chair of the firm's Investigations & Enforcement and White Collar Defense Groups, where he leads a team that is consistently recognized as one of the world's most elite investigations practices. He is a distinguished former federal prosecutor and regulator, and previously served as head of the Fraud Section of the U.S. Department of Justice's Criminal Division as well as in the Division of Enforcement at the Securities and Exchange Commission. Drawing on a unique range of experience, he regularly represents a broad range of corporations, financial institutions, and their boards and executives in matters involving securities and commodities fraud, foreign bribery, economic sanctions, the False Claims Act, antitrust, ESG, and international money laundering. He also has extensive experience representing corporations and individuals outside the United States in cross-border inquiries and investigations.

## Neal E. Kumar

*Partner, Corporate & Financial Services*

Neal Kumar is Co-Head of the Commodities & Derivatives Practice and a member of the Willkie Digital Works group. Neal represents major financial institutions, trading companies, end-users, intermediaries, dealers, exchanges, and clearing organizations, in a variety of regulatory, enforcement, legislative, and transactional matters involving commodities, derivatives, and digital assets. He is regularly ranked in Chambers USA in the area of Derivatives, and frequently speaks at conferences on a wide-variety of subjects relevant to the industry.

## Sean Sandoloski

*Counsel, Litigation*

Sean Sandoloski serves as Counsel in the firm's Litigation Department. Sean previously worked in government, advising the Executive Branch on a range of matters, including litigation and policy initiatives, and serving in the Appellate Section of the Department of Justice's Antitrust Division. His practice focuses on government investigations, including those undertaken by Congress, as well as tackling complex legal issues and appeals. Leveraging his experience in government—as well as representing clients before the full spectrum of government authorities and at every level of the federal judiciary—Sean focuses on providing holistic solutions to clients' complex problems. His multidisciplinary approach enables him to successfully tackle high-stakes, fast-moving issues, and to advise clients on strategic and regulatory matters. Additionally, Sean has extensive experience in administrative and antitrust law and litigation.

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# U.S. Whistleblower Legal Framework

- Federal statutes do not have an uniform definition.
- Some statutes only protect reporting to government agencies; others protect internal report to the company as well.
- Within the U.S., whistleblower laws and guidance include:
  - **Sarbanes-Oxley Act (SOX)**
  - **The Dodd-Frank Act (including the Consumer Financial Protection Act)**
  - Anti-Money Laundering Act
  - Foreign Corrupt Practices Act (FCPA)
  - The Occupational Safety and Health Act (OSHA)
  - False Claims Act (FCA)
  - Guidance from SEC, DOJ, DOL, NY DFS

# Who Is Protected

- **SOX and Dodd-Frank** protect employees from r**etaliation** for making a whistleblower complaint. This includes:
  - Present employees
  - Former employees, but generally only if the protected activity occurred during the course of their employment
  - Applicants
  - Supervisors
  - Managers
  - Officers
  - Independent contractors under some circumstances

# SOX vs. Dodd-Frank Whistleblower Protections

## Type of Activity Whistleblower Report Must Involve

| SOX | Dodd-Frank |
|---|---|
| (1) Securities fraud | Any violation of U.S. securities or commodities laws |
| (2) Mail fraud | |
| (3) Wire fraud | |
| (4) Bank fraud | |
| (5) Any SEC rule or regulation | |
| (6) Any other Federal law that protects shareholders from fraud | |

## Where Whistleblower Must Report

| SOX | Dodd-Frank |
|---|---|
| (1) Any federal government agency | SEC or CFTC |
| (2) Congress | |
| (3) Internally to supervisors or persons authorized by employer to investigate or terminate misconduct. | |

# Protected Whistleblower Activities

- **SOX**
  - Reporting or assisting in reporting corporate wrongdoing covered by the statute that they reasonably believe to have occurred
  - Filing, testifying, participating in, or assisting in a filed proceeding (or a proceeding about to be filed) related to alleged wrongdoing
- **Dodd-Frank**
  - Providing original information to the SEC/CFTC in any "**covered judicial or administrative action**"
  - Initiating, testifying in, or assisting in any investigation or covered judicial or administrative action of the SEC/CFTC based on information provided to the SEC/CFTC
  - Making disclosures that are required or protected under a law, rule, or regulation under the jurisdiction of the SEC, including SOX

# Eligibility Under Dodd-Frank

- **10-30% bounty**
  - The whistleblower is entitled to receive between 10-30% of sanctions obtained against a company when the SEC/CFTC or a Related Action levies at least $1 million in sanctions.
- **4 Requirements**
  1. Dodd-Frank provides for awards to whistleblowers who **voluntarily** provide **original information** to the SEC/CFTC.
  2. The SEC/CFTC **does not** require the whistleblower to make an **internal report** before providing information to the SEC/CFTC.
  3. Whistleblower rules **generally prohibit** awards based on information learned **by individuals in a compliance function**.
  4. Whistleblowers are required to **report directly** to the SEC/CFTC.

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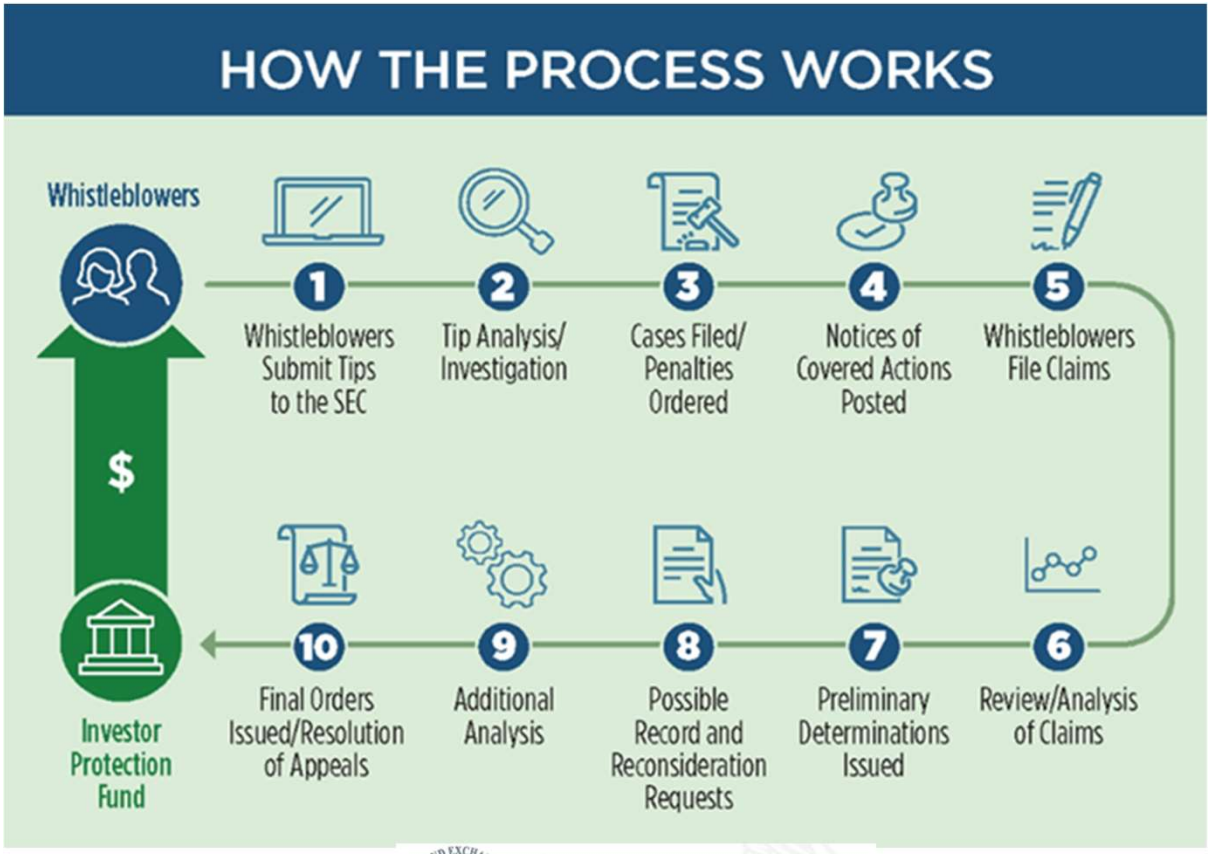
# Overview of SEC Whistleblower Program

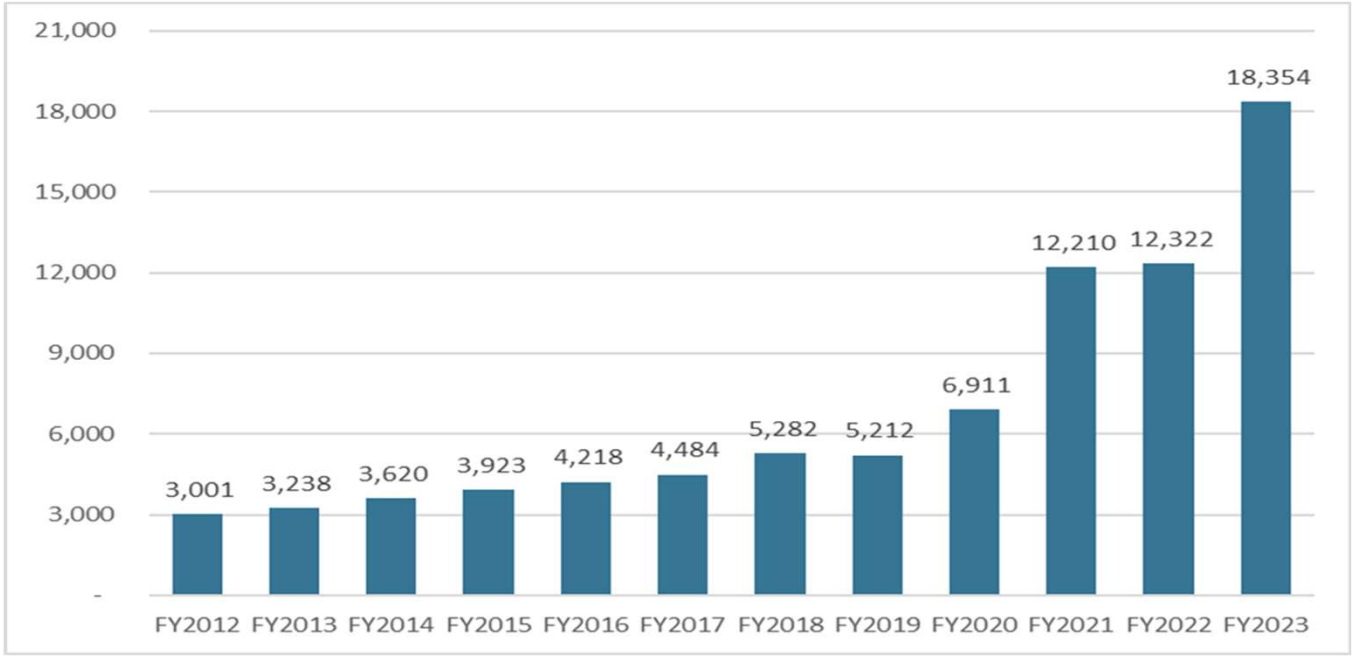


# SEC Whistleblower Developments

- From 2011 to 2023, the SEC has paid more than **$1.9 billion in 397 awards** to whistleblowers.
- Over **$17.6 million so far in 2024**.
- Whistleblower tips have resulted in more than **$6 billion** in financial remedies.
- The SEC's Office of the Whistleblower (OWB) 2023 annual report highlighted a record-breaking year for the SEC's whistleblower program in various respects:
  - Highest number of whistleblower tips ever (18,354)
  - Highest annual total in whistleblower awards ($600M)
  - Highest single whistleblower award ($279M)

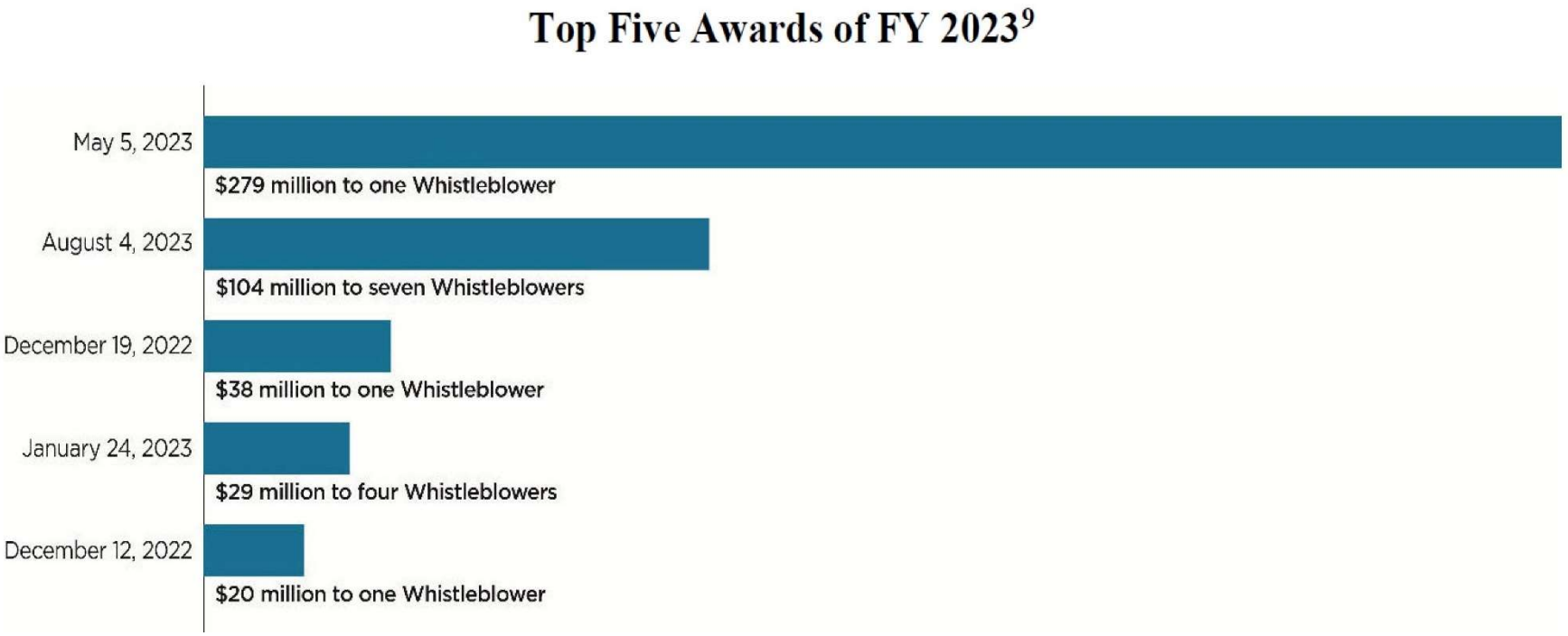

# Increase in Whistleblower Complaints to SEC

- Substantial increase in whistleblower complaints to SEC during and after pandemic.
- SEC fiscal year 2023 saw the most whistleblower tips ever (18,354)
    - **Nature of Whistleblower Allegations**: Manipulation (24%), Offering Fraud (19%), Initial Coin Offerings and Cryptocurrencies (14%), and Corporate Disclosures and Financials (10%)



# Increase in SEC Whistleblower Awards

- FY 2023 was **the highest year ever** in terms of dollar amounts awarded.



# What Makes a Whistleblower Complaint Stand Out?

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# Notable SEC Whistleblower Enforcement Actions

- **Enforcement Actions Penalizing Impediments to Reporting**
  - **Rule 21F-17 under the Exchange Act:** "[N]o person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation."
  - *In the Matter of KBR, Inc.* (Apr. 1, 2015)
    - First Rule 21F-17 action
    - KBR required internal investigation witnesses to sign confidentiality statements.
    - Statements said interviewees could face discipline if they discussed the matters with outside parties without KBR legal department's approval.
    - Without admitting or denying the charges, KBR agreed to settle for violations of Rule 21F-17, which prohibits companies from impeding the reporting of possible securities violations to the SEC.
    - KBR paid a penalty of $130,000 and voluntarily amended its confidentiality statements.

# Notable SEC Whistleblower Enforcement Actions

- **Recent Cases Based on Actions Taken to Impede Reporting**
  - *In the Matter of D.E. Shaw & Co., L.P.* (Sept. 29, 2023)
    - Company charged for requiring new employees to sign agreements prohibiting disclosure of "Confidential Information," and departing employees to sign release in exchange for severance affirming that they had not filed whistleblower complaints with any governmental agency. ($10M)
  - *In the Matter of CBRE, Inc.* (Sept. 19, 2023)
    - Company charged for requiring employees, as a condition of receiving separation pay, to represent that they had not filed a complaint with any federal agency ($375K).
  - *In the Matter of Gaia, Inc. and Paul C. Tarell* (May 23, 2023)
    - Company charged for including language in 23 employee severance agreements that required employees to waive rights to receive whistleblower awards. ($2M)
  - *In the Matter of Activision Blizzard, Inc.* (Feb. 3, 2023)
    - Company charged for lacking controls and procedures designed to ensure that information related to employee complaints of workplace misconduct would be communicated. ($35M combined penalty)

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# Background on CFTC Whistleblower Program and Awards

- In 2010, the Dodd-Frank Act created the CFTC Whistleblower Program under Section 23 of the Commodities Exchange Act (CEA). The CFTC's program largely mirrors that of the SEC.

1. Monetary Incentives

   *The [CFTC] will pay awards, subject to certain limitations and conditions, to whistleblowers who voluntarily provide the [CFTC] with original information about violations of the CEA.* 17 C.F.R. § 165.1 (2023).

2. Anti-retaliation Protections

   *No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower . . . because of any lawful act done by the whistleblower— (i) in providing information . . . ; or (ii) in assisting in any investigation or judicial or administrative action . . . .*" 7 U.S.C. § 26 (2010).

3. Confidentiality Protections

   *The CFTC may not disclose information that could reasonably be expected to reveal the identity of a whistleblower, except in connection with a public proceeding, or to accomplish the purposes of the CEA. 17 C.F.R. § 165.4.*

# Laws that Govern CFTC Whistleblower Program

- **Section 748 of the Dodd-Frank Act** added Section 23 to the CEA
- **Section 23 of the CEA**, 7 U.S.C. § 26
  - States the purpose, scope, and requirements of the Whistleblower Program
  - Defines terms critical to the operation of the Whistleblower Program
- **Regulation 165**, 17 C.F.R. § 165, implements Section 23
  - Expands on terms and definitions from Section 23
  - Outlines the procedures for applying for awards
  - Outlines procedures for making decisions on claims
  - Generally explains the scope of the whistleblower program

# Eligibility for CFTC Award

- **Prerequisites to Receive a Whistleblower Award** under Section 23 and Part 165.5
  - Voluntarily provide **original information**, or information derived from independent knowledge or analysis, that is not known to the CFTC from other sources, and is not exclusively derived from a separate allegation
  - Submit a claim in response to a **covered judicial or administrative action** which means any CFTC or related financial agency action that results in monetary sanctions exceeding $1 million
  - Upon request, provide additional information to the Whistleblower's Office
  - Upon request, agree to a confidentiality agreement with the Whistleblower's Office
- **Individuals Who are Ineligible for an Award** under Section 23(c)(2)
  - Members, officers, or employees of financial regulatory agencies and decision-making bodies, such as the CFTC and Self Regulatory Organizations
  - Individuals with a criminal conviction related to the judicial or administrative action for which the tip was submitted

# CFTC Award Amount

- **Factors Used to Determine Whistleblower's Award Size** under Section 23(c)(1)(B)
  - The significance of the information
  - Degree of assistance provided to the authorities
  - The CFTC's interest in deterring this type of violation
  - Whether and the extent to which the Whistleblower participated in the company's internal compliance systems
- The award may be diminished if
  - The participant was involved in, or culpable for, the conduct reported
  - There was an unreasonable delay in reporting the violation or
  - The Whistleblower interfered with the company's internal compliance and reporting systems
- Under Section 23, awards range from 10 % - 30 % of the total monetary sanctions

# CFTC Actively Soliciting Tips

**Soliciting Tips in Specific Markets**

- In recent years, the CFTC has begun to solicit tips on misconduct in specific markets
  - CFTC Whistleblower Alert: Blow the Whistle on Fraud or Market Manipulation in the Carbon Markets (June 20, 2023)
  - CFTC Whistleblower Alert: Blow the Whistle on Romance Investment Frauds in the Commodities and Derivatives Markets (Feb. 2, 2023)
  - CFTC Whistleblower Alert: Blow the Whistle on Corrupt Practices in the Commodities and Derivatives Markets (Apr. 30, 2021)
  - CFTC Whistleblower Alert: Be on the Lookout for Virtual Currency Fraud (June 2019)

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# Recent CFTC Whistleblower Enforcement Actions

- ***In the Matter of Trafigura Trading LLC* (June 17, 2024)**
  - **Regulation 165.19(b) implements Section 23(h)-(j)**
    - ***Regulation 165.19(b) makes it unlawful to** take any action to impede an individual from communicating directly with the Commission's staff about a possible violation of the Commodity Exchange Act, including by enforcing, or threatening to enforce, a confidentiality agreement or predispute arbitration agreement with respect to such communications.*
  - **Trafigura Violated Section 23(h)-(j) and Regulation 165.19**
    - Trafigura required employees to sign separation agreements with non-disclosure provisions that prohibited sharing confidential information with third parties.
    - The non-disclosure provisions contained the carve-out, "except to comply with applicable law."
    - The CFTC determined this carve out did not expressly permit sharing information with the CFTC or law enforcement and therefore violated Regulation 165.19.
    - Without admitting or denying culpability, Trafigura agreed to settle for a $55 million civil monetary penalty on these and other charges dealing with misappropriation and manipulative conduct.
    - Since the monetary penalty covers all three charges, it is unclear what portion the CFTC attributed to the violation of Regulation 165.19.

# Low Bar: CFTC Whistleblower Award

- In 2019, the CFTC applied factors set forth in Rule 165.9, 17 C.F. R. § 165.9 (2019) and awarded approximately $7 million to a whistleblower for "relevant information" on misconduct that led the CFTC to investigate and ultimately find a violation of the CEA.
- Despite awarding $7 million, the CFTC described the "relevant information" as not "particularly significant" or specific and ultimately, the CFTC brought different charges.

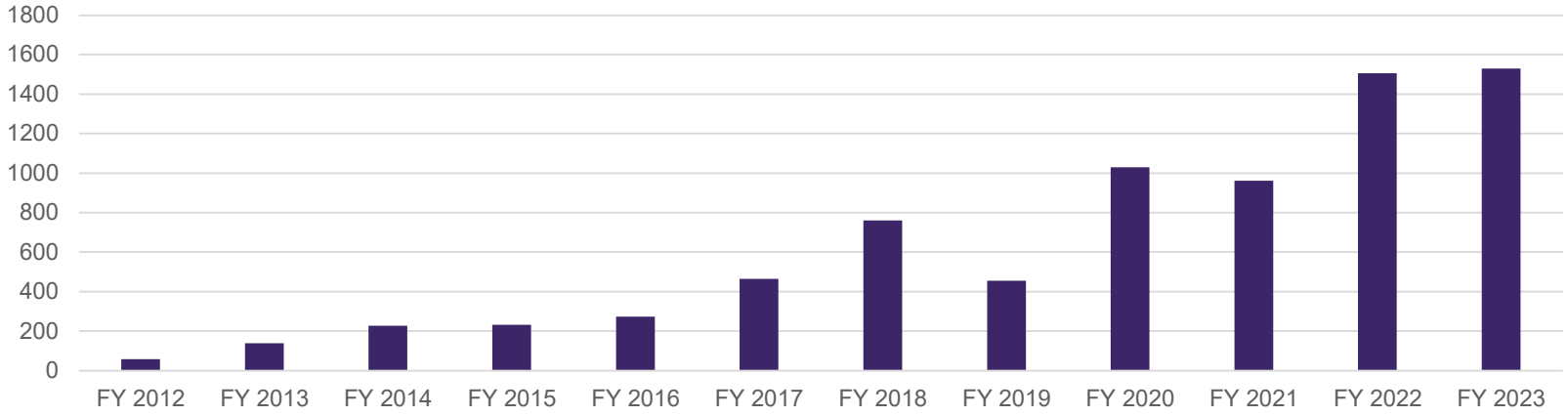
  > *As applied, Claimant [] did not provide particularly significant information to the [CFTC]. The charges the [CFTC] brought were ultimately different from Claimant[]'s allegations. In addition, Claimant [] provided limited assistance because Claimant [] could not provide specifics to CFTC staff investigating the matter and did not understand how the violations under investigation worked.* CFTC Whistleblower Award Determination No. 19-WB-05 (Sept. 2019).

- Determinations such as 19-WB-05 indicate a lenient interpretation of the factors used to determine whistleblower awards.

# Whistleblower Complaints Received by the CFTC

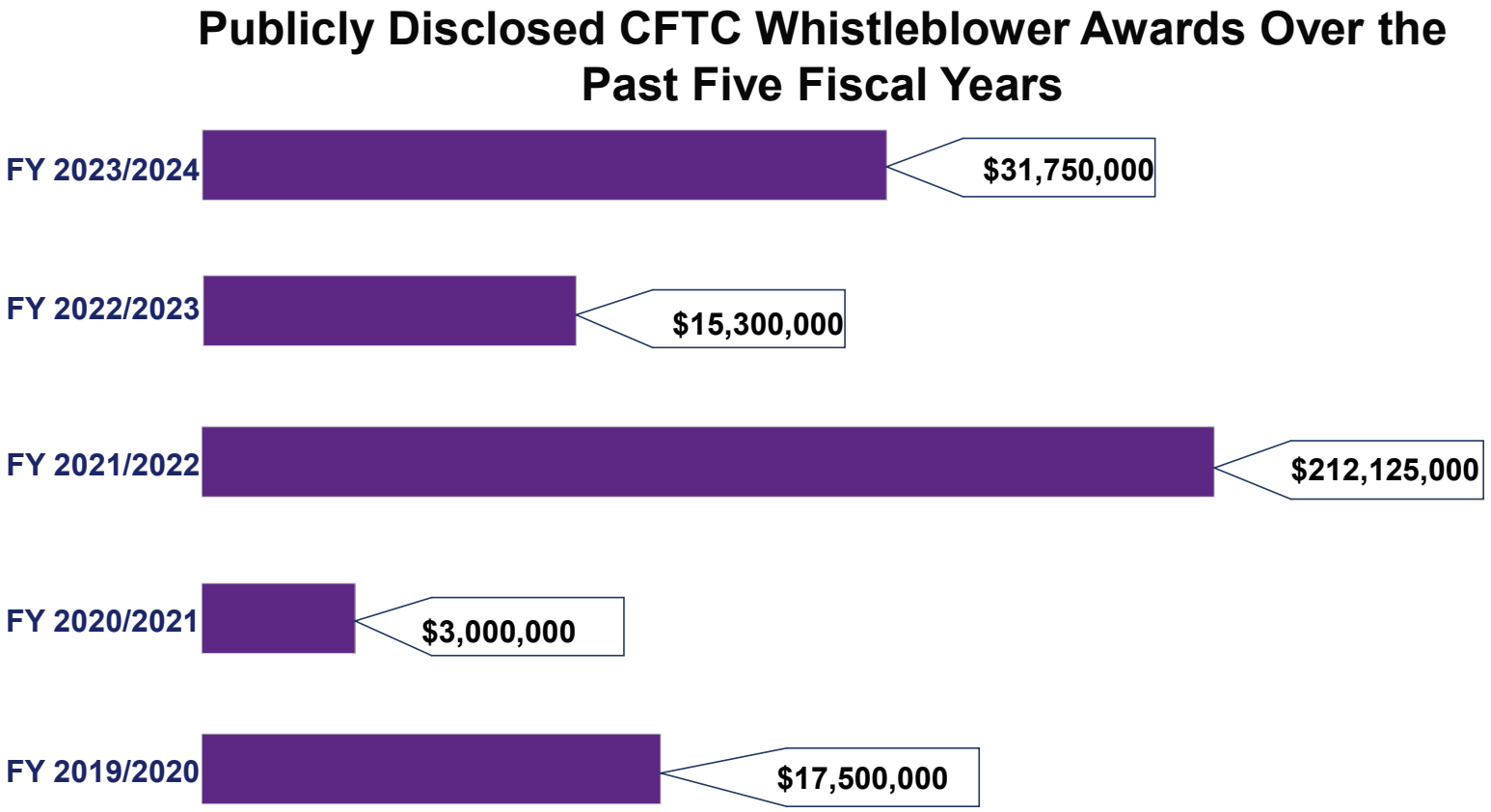
- Generally, there has been a steady increase in whistleblower tips received by the CFTC over the last 12 fiscal years.
- In fiscal year 2023, the CFTC received the most whistleblower tips (1,530), with fiscal year 2022 not far behind (1,506).

## Tips Received by the CFTC in Each of the Last 12 Fiscal Years



# Increase in CFTC Whistleblower Actions

Since issuing its first award in 2014, the CFTC has granted whistleblower awards amounting to approximately $365 million. FY 2024 was a record year for whistleblower awards, with the CFTC awarding more than $31,750,000.



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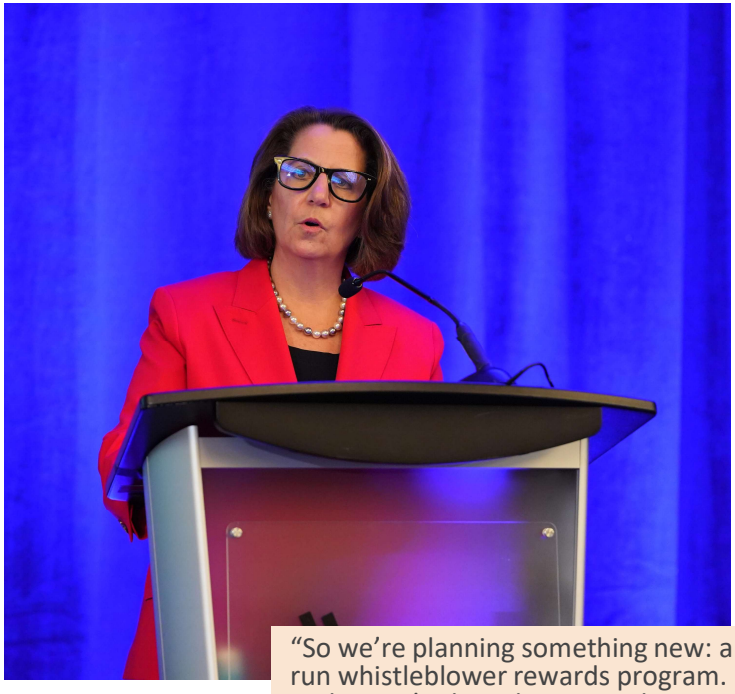
# DOJ Announces New Whistleblower Pilot Program

- "Basic Guardrails"
  - Payouts only after all victims have been properly compensated;
  - Payouts only to those who submit truthful information not already known to the government
  - Payouts only to those not involved in the criminal activity itself
  - Payouts only in cases where there isn't an existing financial disclosure incentive — including qui tam or another federal whistleblower program
- Focus On
  - Criminal abuses of U.S. financial system
  - Foreign corruption cases outside of SEC jurisdiction
    - FCPA violations by non-issuers
    - Foreign Extortion Prevention Act
  - Domestic corruption cases



"So we're planning something new: a DOJ-run whistleblower rewards program. Today, we're launching a 90-day sprint to develop and implement a pilot program, with a formal start date later this year."

Deputy Attorney General Lisa Monaco, Keynote Remarks at the ABA's 39th National Institute on White Collar Crime, March 7, 2024

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# Requirements of a Whistleblower Program

- **Best Practices: Overview**
  - Establish mechanisms, including confidential channels, and procedures for the submission of internal complaints
  - Establish procedures for the receipt, retention, and appropriate review and response/remediation to complaints received
  - Implement procedures to ensure employees are not retaliated against for making complaints


# Addressing Whistleblower Activity

1) Maintain **reporting channels** that are independent, well-publicized, easy to access, and consistent.
2) Maintain **anonymity** of whistleblower.
3) Identify **and manage potential conflicts of interest**.
4) Adequately **train staff members to receive whistleblowing complaints**; determine a course of action; and competently manage any investigation, referral, or escalation.
5) Reports should **be investigated** promptly in accordance with local law.
6) Ensure **appropriate follow-up** to valid complaints.
7) Protect whistleblowers from retaliation. **No retaliation of any form**.
8) **Confidential treatment**.
9) Appropriate **oversight of the whistleblowing function** by senior management, internal and external auditors, and the Board of Directors.
10) A top-down **culture of support** for the whistleblowing function.
    - Do not impede reporting.
    - Ensure carve-out in confidentiality clauses in severance agreements.

# Ethical Obligations of In House Counsel under SEC Rules

**Section 307 of SOX** (15 U.S.C. § 7245) requires **attorneys to report evidence of a material violation of a securities law or a breach of fiduciary dut**y or a similar violation by the client or its agents to its chief legal officer (CLO) or chief executive officer (CEO).

This obligation is commonly referred to as the "**Up the Ladder**" Rule.

# Addressing Whistleblower Activity

Lawyers practicing before the SEC, whether outside or in-house counsel, must also follow the **SEC Part 205** standards of professional conduct if they provide legal services to an issuer and either:

1) Transact any business with the SEC, including communications in any form
2) Represent the issuer in an SEC administrative proceeding or an investigation, inquiry, information request, or subpoena
3) Provide advice to the issuer about the US securities laws or the SEC rules or regulations regarding any document that they know the issuer will file or submit to the SEC
4) Advise the issuer about whether it must file with or submit to the SEC information or a statement, opinion, or another writing

# What Am I Required to Report?

An attorney subject to the Part 205 rules must report to the issuer's Chief Legal Officer (CLO) or both the CLO and Chief Executive Officer (CEO) any evidence of:

- A material violation of US federal or state securities laws
- A material breach of fiduciary duty arising under US federal or state law
- A similar violation of any US federal or state law (17 C.F.R. § 205.2(i))

# Reporting to the CEO or the CLO Would Be or is Proven to be Futile?

If the reporting attorney **reasonably believes** that it would be futile to report to the CLO and the CEO, the attorney ***may*** go directly to the issuer's **audit committee**.

→ If the issuer lacks an audit committee, then the attorney may go to the issuer's **independent committee**.

→ If the issuer lacks an independent committee, the attorney may go to the issuer's **board** (17 C.F.R. § 205.3(b)(4))

If the reporting attorney **does not reasonably believe** that the CLO or CEO **has provided an appropriate response**, the attorney ***must*** report the evidence of a material violation to the company's audit committee (or the alternatives provided above) (17 C.F.R. § 205(b)(3))

# What Is an "Appropriate Response" by the CLO or CEO?

The CLO is required to investigate the allegations and notify the reporting attorney of the results of the investigation and any remedial measures taken.

If the CLO reasonably concludes that there's **no material violation**, then he or she must provide notice to the reporting attorney of this conclusion and take reasonable steps to preserve relevant documentary evidence.

If the CLO reasonably concludes that there **was, is, or will be a material violation**, then he or she must:

→ Take reasonable steps to ensure that the issuer adopts appropriate remedial measures and/or sanctions, including appropriate disclosures;

→ Report "up the ladder" within the issuer what remedial measures have been adopted; and

→ Advise the reporting attorney of his or her conclusions.

# Fulfilling Mandatory Obligations

- The reporting attorney's climb obligation to report up the ladder ends if they receive an "appropriate response," meaning that they can reasonably believe that:
  - no material violation is occurring, has occurred, or is about to occur;
  - the company has adopted appropriate remedial measures to stop any ongoing material violations, to prevent any material violation that has yet to occur, and to remedy or appropriately address any material violation that has occurred; or
  - the company, with the consent of the Board or a sub-committee thereof, has retained an attorney to review the reported evidence of a metrical violation and either:
    - has substantially implemented any remedial recommendations by that attorney or
    - has been advised that such an attorney may, consistent with their professional obligations, assert a colorable defense on behalf of the company in any investigation or proceeding relating to the reported evidence of a material violation.

# What If I Fail to Report?

***The SEC is authorized to impose civil penalties, including permanent denial of the privilege of appearing or practicing before the SEC, if an attorney fails to meet the reporting requirements.***

# Permissive Reporting Options

Counsel ***may*** report the violation to the SEC even if the organization does not address it and without the issuer's consent, if they reasonably believe the disclosure is necessary to:

1. **Prevent** the issuer from committing a material violation likely to cause **substantial injury** to the issuer's or investors' financial interests or property.
2. **Rectify** the consequences of the material violation in which the attorney's services were used.
3. Prevent the issuer from committing or suborning perjury in an SEC proceeding (17 C.F.R. § 205.3(d)(2)).

# ABA Model Rule 1.13(b) and Mandatory Reporting

Under ABA Model Rule 1.13 (b), in-house counsel ***must*** report to a higher authority when the company is likely to be substantially injured by actions of officers and employees that either:

- Violate a legal obligation to the company.
- May render the company responsible for violating a law.

This rule does not apply to mere disagreements with decisions of company personnel.

Comment 3 to Rule 1.13(b) clarifies that: when the attorney **knows** that the organization is **likely to be substantially injured** by action of an officer or other constituent that **violates a legal obligation** to the organization or is in violation of law that might be imputed to the organization, the lawyer must proceed as is reasonably necessary in the best interest of the organization. As defined in Rule 1.0(f), knowledge can be inferred from circumstances, and a lawyer cannot ignore the obvious.

# ABA Model Rule 1.6(b)(2) & (b)(3)

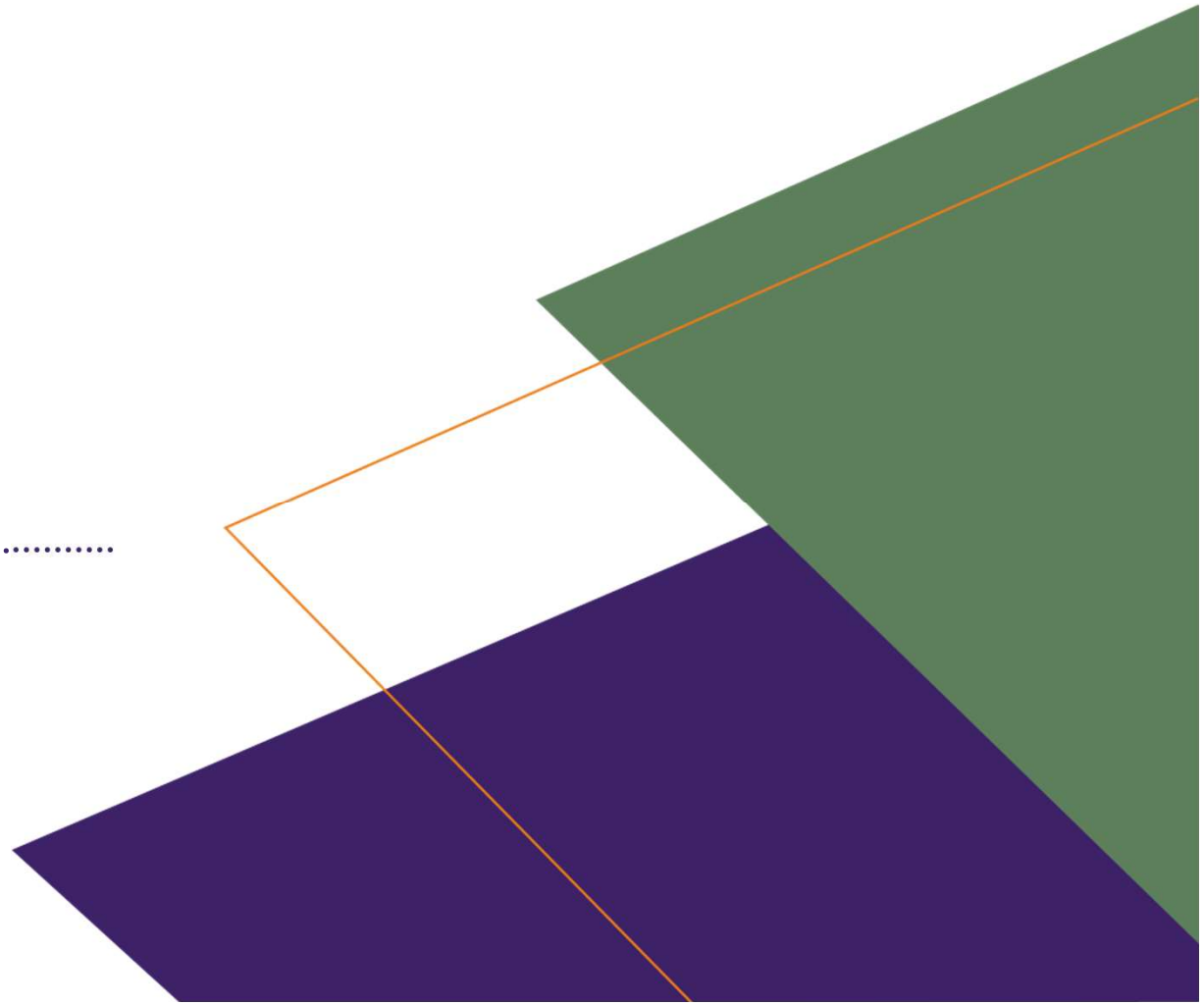
- Otherwise known as the Crime-Fraud Exception
- (b) A lawyer ***may*** reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
  - (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
  - (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services[.]

# State Rules for Attorney Whistleblowers

1. **Model Rule 1.13**
2. **Model Rule 1.6(b)(2) & (b)(3)**
3. **Conflict with SEC Rules**
    1. SEC regulations govern, but do not preempt more stringent state ethics rules
    2. "Good Faith" Safe Harbor under Rule 205.6(c) – "An attorney who complies in good faith….shall not be subject to discipline or otherwise liable under rules of the jurisdiction where the attorney is admitted or practices.

# Questions?

CLE CONTINUING LEGAL EDUCATION



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