

Securities Enforcement & Litigation Alert

SEC's Second Annual Report Summarizing Whistleblower Program Shows Little Change

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- For a discussion of the SEC's renewed focus on valuation decisions, see our [Valuation Alert](#).
- For a discussion of the first award issued under the SEC's whistleblower program, please see our [Whistleblower Alert](#).
- For a comprehensive analysis of the SEC's whistleblower program, see our [Whistleblower PowerPoint](#).

On November 15, 2013, the US Securities and Exchange Commission (SEC or the Commission) released its Annual Report to Congress on the Dodd-Frank Whistleblower Program (the Report).¹ The Report is remarkable for three reasons. First, the Report shows that, despite very significant efforts to publicize the program, the SEC is not seeing a meaningful increase in the number of tips it receives. Indeed, the SEC received essentially the same number of tips in the same categories in 2013 as it did in 2012 (3,283 and 3,001, respectively). Second, consistent with the few awards made under the program, the Report fails to shed any light at all on the SEC's thought process in making these awards, and provides no insight into how the SEC is applying the highly nuanced factors applicable to award decisions. Finally, the Report does not acknowledge that, for the second year in a row, the largest category of tips were in the "other" category, which suggests that many of these tips are probably meritless, nor does the Report illuminate at all the critical question of how many of the tips the SEC receives actually result in meaningful investigations and cases.

Metrics

According to the Report, for FY13, which ended September 30, 2013, the Commission received 3,238 whistleblower tips, up just eight percent from the 3,001 tips received in 2012. At least one whistleblower in every state provided a tip in 2013, with whistleblowers in California providing the greatest number of tips at 375, followed by New York with 215, Florida with 187, and Texas with 135. The Commission also received tips from individuals in 55 foreign countries, with the greatest number of tips coming from individuals in the UK, Canada, and China.

During FY13, the SEC's Office of the Whistleblower posted notices of 118 "covered actions." These are Commission enforcement actions that resulted in monetary sanctions over \$1,000,000, for which a whistleblower who provided original information that led to the success of that enforcement action may seek an award. Since the whistleblower program began in August 2011, the Commission has posted 431 Notices of Covered Action to its website.² The SEC's Investor Protection Fund, established under the Dodd-Frank Act to provide funding for the whistleblower award program, had \$439,196,609.36 available for awards at the end of 2013.

Whistleblower Complaints by Category

For the second year in a row, nearly a quarter of whistleblowers categorized the subject matter of their tips as “other,” making it the most common category of complaint, with 764 tips categorized as “other” in 2013 and 703 tips categorized as “other” in 2012. Interestingly, the text of the Report does not address the large number of tips categorized as “other,” and instead reports that the top three categories of tips were Corporate Disclosures and Financials (17.2 percent), Offering Fraud (17.1 percent), and Manipulation (16.2 percent). These were the same top three categories of tips the SEC reported in its 2012 report.

Moreover, despite recent suggestions by senior SEC officials that they are seeing a substantial increase in tips relating to potential violations of the Foreign Corrupt Practices Act (FCPA), such tips represented a very small percentage of the total in 2013, just as in 2012. Thus, there were only 149 FCPA tips (4.6 percent) in 2013, up just slightly over the 115 FCPA tips (3.8 percent) received in 2012.

Office of the Whistleblower Activities and Priorities

The Report devotes substantial space to explaining the operations of the SEC’s Office of the Whistleblower (OWB). According to the Report, the OWB worked with Enforcement Division staff to identify and track all enforcement cases potentially involving a whistleblower to assist in the documentation of the whistleblower’s information and cooperation in anticipation of a potential claim for award.³ Once a claim for award is submitted in a covered action, OWB attorneys also confer with Enforcement Division staff on the relevant covered action to determine the applicant’s assistance or contribution on the matter.⁴

Retaliation

In what is clearly a sign of the importance of this issue to the SEC, the Report specifically notes that the OWB has focused on identifying and monitoring whistleblower complaints alleging retaliation for reporting possible securities law violations.⁵ Dodd-Frank specifically gives the SEC the power to bring an enforcement action against any entity that retaliates

against a whistleblower, and the Chief of the OWB recently suggested that he believes the SEC will bring a retaliation case in 2014.⁶ The Report states that OWB monitors federal court cases addressing the anti-retaliation provision of the Dodd-Frank Act and the Sarbanes-Oxley Act and, in a footnote, specifically mentions the Fifth Circuit’s recent controversial holding in *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013) that the anti-retaliation provisions of the Dodd-Frank Act provide a private cause of action only for those employees who provide allegations of possible securities law violations directly to the Commission.⁷ The Report asserts that *Asadi*’s holding is contrary to several district court decisions and may contradict a Commission regulation that provides protection for employees from retaliation where they report possible securities violations to persons or authorities other than the Commission, including reporting internally.⁸

On the same topic, the Report indicates that OWB reviews employee confidentiality and other agreements provided by whistleblowers for potential concerns arising under the provisions of the whistleblower rules prohibiting any action that impedes an individual from communicating directly with the Commission staff about a possible securities law violation.⁹ This issue has also recently received a lot of attention, and senior SEC enforcement officials have emphasized that they will look hard at such cases.¹⁰

Awards

On June 12, 2013, the Commission issued an award to three whistleblowers that helped the SEC stop a sham hedge fund.¹¹ The SEC’s Order Determining Whistleblower Award Claim did not name the whistleblowers, but did reveal that the award resulted from an enforcement action against Locust Offshore Management LLC and its CEO Andrey C. Hicks and that the three whistleblowers would receive five percent of any sanctions the SEC collected in that case.¹² On August 30, 2013, the Commission announced it had approved payouts of \$8,505 to each of the three whistleblowers resulting from funds that had been administratively forfeited in a related criminal proceeding against Hicks.¹³ The SEC’s August 30, 2013 announcement also stated that the whistleblowers are expected to ultimately receive

approximately \$125,000 in total resulting from assets seized from Hicks.¹⁴ The Report does not state whether or not the whistleblowers have received any additional payouts yet.

On September 30, 2013, the SEC issued a \$14 million award – by far the largest to date – to a whistleblower whose original information “recovered substantial investor funds.”¹⁵ Neither the Report, the SEC’s press release announcing the award, nor the Order Determining Whistleblower Award Claim revealed anything about the underlying case, the nature of the tip, or even the percentage of recovered funds the whistleblower was awarded.¹⁶ Indeed, in an effort to preserve the anonymity of the whistleblower, the SEC redacted everything but the amount of the award from the relevant documents.¹⁷ The Report and the SEC’s press release announcing the award emphasized that the whistleblower’s tip enabled the SEC to bring an enforcement action against the perpetrators less than six months after receiving the whistleblower’s tip.¹⁸

On October 30, 2013, just after the end of FY13, the SEC announced that it made a \$150,000 award payment to a whistleblower whose information and continued cooperation enabled the Commission to detect and halt an ongoing fraudulent scheme.¹⁹ The award recipient and related enforcement action were not identified in the Report, the SEC’s press release announcing the award, or the Order Determining Whistleblower Award Claim, but the SEC did disclose that the award constituted 30 percent of the monetary sanctions collected or to be collected in the relevant covered action.²⁰

The foregoing awards, coupled with the award to a whistleblower announced on August 21, 2012, brings the total number of individuals that have received payouts since the inception of the whistleblower program to six.²¹ The Report also notes that the SEC made three more payments to the whistleblower who received the August 2012 award in connection with additional amounts that had been collected by the Commission in the underlying enforcement action. In total, the Commission made \$14,831,965.4 in award payments to whistleblowers during 2013, suggesting that the additional payments to the recipient of the August 2012 award must have been rather large.

What the Report Does Not Include

As indicated above, the SEC has gone to quite extraordinary lengths to comply with Dodd-Frank’s requirement that it protect the identity of whistleblowers. In its orders and press releases announcing the awards, the Commission has not disclosed any information regarding who the whistleblowers were (i.e., whether they were employees, former employees, consultants, competitors, etc.), what the information they provided was and how it was helpful to the SEC, or how the SEC reached its conclusion as to the amount of the award. Indeed, the SEC has only revealed the name of one of the enforcement actions producing an award, and, in the \$14 million award, the Commission did not even disclose the percentage amount of the award (i.e., where on the 10 percent–30 percent statutory range the award fell), for fear that the public would deduce from that percentage which enforcement action was involved.²²

Senior SEC officials have acknowledged that this is less than ideal, but insist that they are required to take these steps by Dodd-Frank. Accordingly, until the Commission makes an award to a whistleblower who is willing to be identified, we are likely to learn very little regarding how the SEC is really approaching these decisions and handling the numerous nuanced issues under the Rules. For example, under the Rules, the SEC may award even a culpable whistleblower, and it seems likely that at least one of the six awardees to date may have been involved in the underlying misconduct. If so, it would seem to be in the public interest to know how that whistleblower’s culpability factored into the size of the award.

The Report also fails to address one of the most central questions about the program: How many of the thousands of tips the SEC is getting are real and result in formal, full-fledged investigations and cases? The fact that nearly a quarter of whistleblowers in both 2012 and 2013 categorized their complaints as “other” rather than as fitting into one of the nine specific securities law allegations listed on the whistleblower questionnaire suggests that these tips may have had little or nothing to do with securities law violations. Unfortunately, the Report does not address this issue.

However, the overall quality of tips has been addressed in other contexts. The SEC's Inspector General reviewed the whistleblower program in January 2013 and concluded that the program was working well.²³ Among other things, the IG found that, of a sample of 74 tips, 69 percent were deemed to require "No Further Action" (NFA) by the staff after initial review. SEC officials have informally indicated that they think this metric is probably about right across the board, and that only a small percentage of tips end up resulting in actual settled or litigated cases. Moreover, a tip might be deemed NFA not because it was unmeritorious but because it might relate to a matter already under investigation. And, senior SEC officials have suggested that the Enforcement Division staff learns a lot from tips that do not necessarily lead to investigations; in what might be characterized as "market intelligence," they will sometimes piece together cases or theories from several different tips.

1. US Securities and Exchange Commission, Annual Report on the Dodd-Frank Whistleblower Program, Fiscal Year 2013, (Nov. 2013), *available at* <http://www.sec.gov/about/offices/owb/annual-report-2013.pdf> (the Report).
2. *Id.* at 13; *See also* Notices of Covered Action, SEC Office of the Whistleblower, *available at* <http://www.sec.gov/about/offices/owb/owb-awards.shtml#nocas>.
3. Report at 5.
4. Report at 6.
5. *Id.*
6. Rule 21F-2(b)(2); Sean McKessy, Chief, Office of the Whistleblower, SEC, Remarks at "Fraud, Anti-Corruption, FCPA & Whistleblowers: Latest Developments: 'Enforcement with Teeth'" (Oct. 3, 2013).
7. Report at 6.
8. *Id.*
9. *Id.*; *See also* Rule 21F-17(a).
10. *See, e.g.,* Jane Norberg, Deputy Chief, Office of the Whistleblower, SEC, Remarks at Compliance Week's Annual Conference, "Whistleblower Directors Speak" (May 22, 2013).
11. Report at 15; *See also* Press Release, SEC Announces Whistleblower Action (June 12, 2013), *available at* <http://www.sec.gov/news/press/2013/2013-06-announcement.htm>.
12. Order Determining Whistleblower Award Claim, SEC Release No. 69749 (June 12, 2013), *available at* <http://www.sec.gov/rules/other/2013/34-69749.pdf>.
13. Report at 15; *See also* Press Release, SEC Rewards Three Whistleblowers Who Helped Stop Sham Hedge Fund (Aug. 30, 2013), SEC Release 2013-169, *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539796657>.
14. *See* Press Release, SEC, *supra* note 14.
15. *Id.*; *See also* Press Release, SEC Awards More Than \$14 Million to Whistleblower (Oct. 1, 2013), SEC Release No. 2013-209, *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258>.
16. *Id.*; *See also* Order Determining Whistleblower Award Claim, SEC Release No. 70554 (Sept. 30, 2013), *available at* <http://www.sec.gov/rules/other/2013/34-70554.pdf>. Awards can range in size from 10 to 30 percent of the money collected in an enforcement action – including any related action – with sanctions exceeding \$1 million, meaning the award must have resulted from an enforcement action yielding penalties ranging from \$46.7 million to \$140 million.
17. *Id.*
18. *See* Report and Press Release, SEC *supra* note 17.
19. Report at 15; *See also* Press Release, SEC Rewards Whistleblower With \$150,000 Payout (Oct. 30, 2013), SEC Release No. 2013-231, *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540158194>.
20. *Id.*; *See also* Order Determining Whistleblower Award Claim, SEC Release No. 70775 (Oct. 30, 2013), *available at* <http://www.sec.gov/rules/other/2013/34-70775.pdf>.
21. Report at 14; *See also* Press Release, SEC Issues First Whistleblower Program Award (Aug. 21, 2012), SEC Release 2012-162, *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171483972>. Order Determining Whistleblower Award Claim, SEC Release No. 67698 (Aug. 21, 2012), *available at* <http://www.sec.gov/rules/other/2012/34-67698.pdf>.
22. Although the SEC has never identified the enforcement action producing the first award or the whistleblower's identity, it has been revealed in the media that the award stemmed from an enforcement action against China Voice Holding Corp. for operating a Ponzi scheme, and the whistleblower, an outside tax consultant working for the company, has also been identified.
23. SEC Office of Inspector General, Report No. 511, Evaluation of the SEC's Whistleblower Program (Jan. 18, 2013), *available at* <http://www.sec-oig.gov/Reports/AuditsInspections/2013/511.pdf>.

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