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The SEC Whistleblower Program

Part Two of a Two-Part Article

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Last month, in Part One of this article (available at http://bit.ly/1Wq12Em), we examined the overall structure, operation and experience of the SEC's Whistleblower program over the first five years of its operation. In Part Two herein, we take a closer look at how the Office of the Whistleblower (OWB) processes Whistleblower claims, and we examine the claim decisions rendered through April 2016.

A Whistleblower claim must refer to an SEC enforcement action (either administrative or federal court) for which a Notice of Covered Action (a NoCA) was posted on the OWB website. Any claim must be made within 90 days of that posting. Rule 21F-10(b). That posting is the only notice to which a claimant is entitled, and Whistleblowers who missed the posting and filed late have had their claims summarily denied. *See* Whistleblower Award Proc. No. 2016-5, Exch. Act Rel. No 77368, at 3-4 (Mar. 14, 2016) ("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."); *see also* Whistleblower Award Proc. No. 2014-3, Exch. Act Rel. No 71849, at 5 (Apr. 3, 2014).

Claim Determination

The Rules require OWB to make a preliminary determination as to each such claim, but only after the underlying case has become final beyond all appeals, and that may, of course, be long after the expiration of the 90 days. Moreover, unlike for Whistleblowers, the Rules impose no deadline on when OWB must make a preliminary determination. Once OWB issues a preliminary determination, the claimant has 60 days to accept or file objections to it. Alternatively, the Whistleblower may, within 30 days of the posting, request a copy of the material that OWB used in making the preliminary determination, and request a meeting with the OWB staff. OWB must provide the material, but may decline the meeting. Once OWB supplies the requested material (but not the meeting), the clock resets and the Whistleblower must file any objections within 60 days from then. Rule 21F-10e.

At some point — again undefined in the Rules — OWB's preliminary determination becomes a "proposed final determination" that is submitted to the Commission to be converted into a final order of the Commission. The latter will review a proposed final determination only if the applicant objects, or if a Commissioner requests a review within 30 days after OWB submits it. The Commission reviews proposed final determinations on the original papers — there will be no subsequent briefing or argument. In fact, the Rules do not provide for any notice to Whistleblowers of these end-game procedures, and there is anecdotal evidence that claimants, to their frustration, are told neither when OWB issues a proposed final determination nor when it submits it to the Commission.

If the Commission reviews a proposed final determination, it

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will issue a final order affirming or modifying it, often containing an explanatory narrative. Otherwise, a proposed final determination to which no objection is made and of which no Commissioner requests a review becomes a final order of the Commission automatically 30 days after OWB submits it. Rule F-10h.

OWB will then provide the claimant with a copy of the final order. Again, there is no deadline in the Rules, but OWB has consistently posted final award decisions on its website within days of issuance. The average time between a preliminary determination and a final order granting an award has been 128 days, ranging from a super-expedited 25 days to an almost year-long 338 days. The average number of days between preliminary determinations and final orders both granting and denying claims in each of the past few years has oscillated from 116 days in 2013, up to 142 days in 2014, down to 75 days in 2015, and back up to 261 days through April 2016.

Recent History

In the past five years, 103 substantive Whistleblower applications have gone through this process (at least 16 were added after Part One of this article went to press), and those cases reveal a few trends. Putting to the side those claims filed late, or where the information was provided before the passage of the Dodd-Frank Act on July 21, 2010, *see Stryker v. SEC*, 780 F.3d 163 (2d Cir. 2015) (discussed in Part One of this Article), recall that the Rules require an award to natural persons who: 1) voluntarily deliver to the SEC, 2) in proper form, 3) "original information," that 4) "leads to the successful enforcement" of an SEC administrative or judicial action in which the SEC obtains sanctions exceeding $1 million (that is, results in a posted NoCA). Rules 21F-2, 21F-3. Therefore, the simplest thing to say about the Whistleblower decisions is that winning claimants have run that gauntlet, while losing ones failed one or another of those tests.

A review of final orders — mostly denials — leads to the following observations:

Information must be given directly to the SEC. Information provided to other agencies — but not to the SEC — will not count, even if those other agencies thereafter do provide it to the Commission. This does not mean that it must be provided to the SEC *first*; only that, to be eligible for an award, it must be provided to the SEC directly.

Information must be provided in proper form. Claims have been denied expressly because information was not provided in the form required by Rule 21F-2(a)(2) — which refers to those provisions specifying the information requested in the "Tips, Complaints and Referrals" Form (the TCR).

Information merely regurgitated from public records will not be deemed "original." Whistleblower Award Proc. No. 2015-3, Exch. Act Rel. No 74815, at 2n.2 (Apr. 27, 2015) (*dicta*) ("information … largely copied from a third party's publicly available court filings" likely would not qualify as "original"); Final Orders relating to NoCAs 2011-78, 2011-200 and 2012-13 (Sept. 10, 2015). This appears to apply Rule 21F-4(b)(iii), which provides that "original" information cannot be "exclusively derived" from public records of which the Whistleblower is not the source. Information is not deemed to be "original" if it is not based on independent knowledge or analysis. Final Order relating to NoCA 2011-206 (Feb. 13, 2015).

A Significant Contribution?

Of course, the primary substantive criterion of a successful tip is whether the information led to the successful enforcement of an SEC action, and here, the redactions in the final orders render them not particularly instructive. Sometimes, simple timing explains the denial: A tip provided after the case had already settled, for example, is obviously of no value. But usually a denial incorporates Rule 21F-4(c)(1) to the effect that Whistleblower "information … [must be] … sufficiently specific, credible, and timely to cause the staff to commence an examination, *open* an investigation, *reopen* an investigation … , or to *inquire concerning different conduct* as part of a current examination or investigation … ." (Emphasis added.) Since all award claims presuppose a NoCA, and therefore the existence of an investigation, the question becomes one of contributory significance. The decisions simply say the information

did not significantly contribute to the prosecution, or more precisely, it did not lead to the opening, reopening or redirection of an investigation or examination — that it was, in effect, old news. *See, e.g.*, Final Order relating to NoCAs 2013-51, 2013-50, 2013-48 and 2013-14 (May 8, 2015).

However, the most recent award made it clear that a significant contribution to an investigation that is already in process can also be rewarded, even one opened as a result of news stories, on the basis of Rule 21F(c)(2), which speaks not of opening, reopening or redirecting an investigation, but simply of providing information that "significantly contributes to the success" of an enforcement action. Whistleblower Award Proc. No. 2016-9, Exch. Act Rel. No. 77833 (May 13, 2016). Although few details of substantive significance are ever provided, those decisions at least suggest a substantive evaluation of the information.

Final orders of denial have recently shifted to a more strictly procedural determination: that a tip did not contribute to a case because the prosecuting staff never got it. In a few instances, the Commission coupled such a procedural determination with a substantive assessment that the information could not have led to a successful enforcement action anyway. The bulk of the more recent denials, however, is based simply on the fact that the Office of Market Intelligence (OMI) (*see* Part One of this article) disposed of the TCR with "no further action" and did not pass it on to the enforcement staff prosecuting the case.

This is problematic. OMI is responsible for routing relevant information to those responsible for pending investigations. If OMI does not do that, and the enforcement staff remains ignorant of the TCR information, then of course the TCR information cannot actually contribute to the case. The recent decisions conclude in that event the Whistleblower is not entitled to an award — *regardless of the TCR's substantive merit*.

Those final orders that do grant awards are useful mostly for clues on how percentages are determined. OWB has suggested in public statements that in making preliminary determinations of awards, the default starting point is 20%, the exact middle of the Act's range of percentages. From there, certain negative factors will tend to push the percentage toward the minimum 10%, and others will tend to pull the percentage up toward the maximum 30%. The significance of the information provided must inevitably be a factor, but its impact is almost impossible to gauge from the decisions, which describe information only in general terms and are so redacted that even the correlating NoCA is often unascertainable. The most that can be gleaned is that the more detailed and better documented the information is, and the more involved the Whistleblower is during the investigation, the greater the impact it should have in supporting a higher award.

Delay in reporting is clearly a significant factor in pushing the percentage recovery down toward the 10% minimum. Conversely, quick action despite exposing oneself to a personal risk of retaliation tends to pull the award percentage up toward the 30% maximum. Indeed, a compliance officer (usually ineligible for an award), whose employer failed to act on his internal reports of rule violations, earned himself a $1.6 million award by promptly reporting out to the SEC despite a clear risk of retaliation by his employer. And in the most recent award, the Commission specifically identified the Whistleblower's inability to find employment "significantly due" to his whistleblowing as a factor. Whistleblower Award Proc. No. 2016-9, Exch. Act Rel. No. 77833, at p. 4 (May 13, 2016).

The Program's Effectiveness

How "effective" the Whistleblower Program has been depends on one's view of its objective. The SEC's official statements all focus on how many tips the program has developed, and the Whistleblower program surely generates many TCRs. The total 15,000 tips (Whistleblower and others) that OMI evaluates each year yield about 1,000 investigations and about 800 actual proceedings. *See* SEC FY 2017 Congressional Budget Justification at p. 62 (http://1.usa.gov/1SPD2nr). Using those same proportions of proceedings-to-tips, TCRs alone appear to have resulted in about 1,000 proceedings since the program began. So,

if the objective of the Whistleblower program is merely to increase the number of leads and cases, then perhaps the program can be deemed to some extent effective.

But if the program's goal is to reward and incentivize Whistleblowers who facilitate prosecuting *high-quality* cases, then it has not lived up to its press. The vast majority of TCRs ultimately prove useless. Despite the SEC having commenced 4,000 proceedings in the past five years, it only posted 762 NoCAs, implying that 80% of its cases resulted in sanctions of less than the $1 million minimum threshold for a Whistleblower award. And despite 1,000 cases having perhaps been opened as a result of TCRs, no more than 21 NoCAs have yielded Whistleblower awards. Thus, perhaps as many as 98% of the cases that result from TCRs do not yield the dollar minimum required for an award. And if we conservatively assume that Whistleblower awards to date relate to TCRs filed in and prior to 2013, then less than one-half of one percent of all TCRs yield awards. That means there is a 99.5+% statistical probability that a Whistleblower will get nothing.

And yet, OWB blatantly hypes the amounts awarded to Whistleblowers. It is true that the largest award to date appears to be up to $35 million, and that the next largest award was as much as $14 million. However, only four other awards appear to have exceeded $1 million each, aggregating at most $9.9 million among them. See Whistleblower Award Proc. No. 2016-9, Exch. Act Rel. No. 77833 (May 13, 2016) ($3.5 million); Whistleblower Award Proc. No. 2016-4, Exch. Act Rel. No 77322 (Mar. 8, 2016) ($1.8 million); Whistleblower Award Proc. No. 2015-5, Exch. Act Rel. No 75477 (Jul. 17, 2015)($3 million); Whistleblower Award Proc. No. 2015-2, Exch. Act Rel. No 74781 (Apr. 22, 2015) ($1.6 million). But the SEC has only awarded $62 million to all 28 Whistleblowers to date. SEC Press Release 2016-88 (May 13, 2016). Therefore, the remaining 22 award winners shared all of $3.1 million — an average of $140,909 each.

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Conclusion

Putative Whistleblowers are highly unlikely to retire from a TCR, and so-called "SEC Whistleblower Attorneys" had better have paying practices doing something else. Why the Whistleblower program has been so ineffective at ferreting out high-dollar cases inevitably calls for speculation, so this is ours. Cases involving fraud in the offering of securities are still the bread-and-butter both of SEC enforcement (as reflected in NoCAs and other notices of enforcement actions) and of tips (as seen in the TCR statistics), but they are visible, easy to unravel, and generally do not lead to high-dollar cases. Whistleblowers are most needed when the illegal conduct is obscure.

Cases involving arcane internal accounting fraud, Foreign Corrupt Practices Act (FCPA) violations, internal broker-dealer and investment adviser rule violations, and trading and pricing schemes stand out in the NoCAs as being particularly vulnerable to Whistleblowing, but only if they occur at a firm large enough to warrant a multi-million dollar sanction. This suggests that the successful Whistleblower likely will be an insider at a large institution, who can explain and document ongoing obscure violations, but who is neither actively participating in them nor in such a senior management or compliance role that he or she is disqualified from receiving a bounty for reporting them. The program's results so far show that such Whistleblowers may be rarer than Congress imagined. (*Note: For a full list of citations, kindly contact the authors.*)

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