

## The U.S. Securities and Exchange Commission Makes Largest Whistleblower Payout Even as the U.S. Government Shuts Down

On the first day of the U.S. government shutdown, the U.S. Securities and Exchange Commission ("SEC") announced its highest (by far) award to date from the Office of the Whistleblower, demonstrating its commitment to exercise its enhanced enforcement authorities gained under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

The SEC Office of the Whistleblower announced on Tuesday that it has awarded \$14 million to an anonymous tipster for providing information that allowed the SEC to recover substantial investor funds in an enforcement action.<sup>1</sup> In keeping with the confidential requirements of the program, the SEC did not identify the specific enforcement action, the role the tipster played in providing the relevant information, or the amount of recovery. The SEC did, however, report that it brought the enforcement action less than six months after receiving the tip, confirming the assurances of SEC officials who previously stated that whistleblower tips were reducing the investigation time for several cases.

Dodd-Frank created the Office of the Whistleblower, and authorized the SEC to compensate whistleblowers 10-30% of monetary sanctions collected during a successful enforcement action.<sup>2</sup> The SEC reported receiving 3,001 whistleblower tips, complaints, and referrals during the 2012 fiscal year.<sup>3</sup> Corporate Disclosures and Financials (18.2%), Offering Fraud (15.5%), and Manipulation (15.2%) were the most common complaint categories reported. The tips came from individuals in all 50 U.S. states, as well as 49 countries outside the United States.

In 2012, the SEC made its first award of the maximum percentage payout (30%) to a whistleblower that helped the SEC stop a multi-million dollar fraud.<sup>4</sup> The whistleblower submitted a tip supported by documents, which ultimately led to the filing of an

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<sup>1</sup> See Press Release, U.S. Securities and Exchange Commission, "SEC Awards More Than \$14 Million to Whistleblower" (Oct. 1, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258> ("October Press Release").

<sup>2</sup> Dodd-Frank created a similar Whistleblower Program at the U.S. Commodity Futures Trading Commission ("CFTC") that provides monetary awards to persons who report violations of the Commodity Exchange Act if the information leads the CFTC to bring an action that results in more than \$1 million in monetary sanctions. Details of the CFTC Program are available at <http://www.cftc.gov/ConsumerProtection/WhistleblowerProgram/index.htm>.

<sup>3</sup> The 2012 Report is available at <http://www.sec.gov/about/offices/owb/annual-report-2012.pdf>.

<sup>4</sup> The SEC's order granting the award can be found in SEC Release No. 34-67698.

emergency action in U.S. federal court to prevent additional loss of investor funds. The court ordered the defendants to pay more than \$1 million in sanctions. Last month, the SEC issued an award that is expected to exceed \$125,000 to whistleblowers who helped the SEC and the U.S. Department of Justice bring an end to a sham hedge fund.<sup>5</sup>

Critics of the Whistleblower Program have raised concerns that the program encourages whistleblowers to bypass internal compliance programs because they do not have to first comply with internal compliance mechanisms in order to be eligible for an award. This, they argue, could have substantial corrosive effects on companies, while undermining their ability to remediate wrongdoing in-house.

Sean McKessy, Chief of the SEC Office of the Whistleblower, has attempted to reassure critics that most SEC tipsters first reported the issue internally. The SEC has also created incentives for such internal reporting by making the whistleblower's participation in his or her own internal compliance systems a factor in determining whether to increase or decrease the percentage of an award.<sup>6</sup>

**The factors that weigh in favor of an increase in an award are:**

1. the significance of the information provided by the whistleblower;
2. the assistance provided by the whistleblower;
3. any law enforcement interest that might be advanced by a higher award; and
4. the whistleblower's participation in internal compliance systems—as in, if you reported on a company that you currently or used to work for, did you report internally first, and did you participate in any internal investigation.

**The factors that weigh in favor of a decrease in the percentage of an award are:**

1. culpability;
2. an unreasonable reporting delay by the whistleblower; and
3. interference with internal compliance and reporting systems.<sup>7</sup>

While the procedures followed by the tipster in Tuesday's award were not disclosed, the speed with which the enforcement action was investigated and brought certainly suggests that the factors in favor of an increased award weighed heavily on the final payment received by the whistleblower. In the release accompanying the announcement of the award, SEC Chairman Mary Jo White indicated that she "hope[s] an award like this encourages more individuals with information to come forward."<sup>8</sup>

The SEC's ability to investigate and file an enforcement action within six months of receiving the tip supports those who tout the merits of the program and provides credibility to those who have suggested that a number of whistleblower-initiated investigations are in the pipeline. This reported steady stream of whistleblower-assisted resolutions on the horizon potentially incentivizes tipsters even further.

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<sup>5</sup> See Press Release, U.S. Securities and Exchange Commission, "SEC Rewards Three Whistleblowers Who Helped Stop Sham Hedge Fund" (Aug. 30, 2013), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539796657>.

<sup>6</sup> Sean McKessy, SEC Chief of the SEC Office of the Whistleblower, "What Happens to Tips," available at <http://www.sec.gov/about/offices/owb/owb-what-happens-to-tips.shtml>.

<sup>7</sup> See 17 C.F.R. § 240.21F-6.

<sup>8</sup> October Press Release.

Given the attention that Tuesday's \$14 million bounty will garner, companies and their counsel must renew efforts to protect themselves by promoting a vigorous culture of compliance backed by strong policies and procedures so that whistleblowers will have confidence that claims reported internally will be taken seriously and handled expeditiously.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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