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PERSPECTIVE

## Whistleblower award is a bellwether

By Thomas A. Zaccaro, Eleanor K. Mercado and Sarah Kelly-Kilgore

On Oct. 1, the U.S. Securities and Exchange Commission announced an award of more than \$14 million to an anonymous whistleblower for providing information leading to a successful enforcement action and the recovery of substantial investor funds. The magnitude of the award, and the publicity that is likely to accompany its announcement, will almost certainly result in increased whistleblowing activity as greater numbers of potential whistleblowers — including well-compensated executives previously unimpressed with the SEC's payouts — learn of the potential for significant monetary payouts.

The SEC launched its whistleblower program Aug. 12, 2011, to implement Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which greatly expanded the SEC's authority to reward whistleblowers and vested it with enforcement authority over employers who wrongfully retaliate against whistleblowers. In its first full year, the SEC reported that the program received more than 3,000 tips and that it was "getting very, very high-quality information from whistleblowers." Andrew Tangel, "SEC Whistleblower Program Starts Paying Off for Agency, Tipsters," L.A. Times (Aug. 22, 2012). The SEC has reported that tips have increased by approximately 125 percent per quarter from the program's inception, with the largest categories of tips involving allegations related to manipulation, offering fraud, corporate disclosure and financials, and insider trading. See SEC Annual Report on the Dodd-Frank Whistleblower Program: Fiscal Year 2012, at app. A.

The first award under the SEC's whistleblower program was approximately \$50,000 (or 30 percent of the amount collected in the enforcement action) and was announced little more than one year ago. That award was granted to an individual who "provided documents and other significant information that allowed the SEC's

investigation to move at an accelerated pace and prevent [a multi-million dollar] fraud." "SEC Issues First Whistleblower Program Award," SEC Press Release (Aug. 21, 2012).

The second award was announced in June, and was granted to three anonymous whistleblowers for providing information leading to a successful enforcement action against a sham hedge fund, Locust Offshore Management, and its CEO Andrey C. Hicks. Two of the whistleblowers were awarded for information that prompted the SEC to open the investigation into Locust and Hicks. The third whistleblower was awarded for confirming information provided by the other whistleblowers and iden-

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tifying key witnesses. Although the three whistleblowers have received a combined \$50,000 to date (or 15 percent of the amount collected in the enforcement action and the related criminal action), the total payout once all sanctions are collected is expected to exceed \$125,000. "SEC Rewards Three Whistleblowers Who Helped Stop Sham Hedge Fund," SEC Press Release (Aug. 30, 2013).

The \$14 million award announced Oct. 1 — the SEC's third award under its whistleblower program — was granted to an individual who had provided original information allowing the SEC to bring an enforcement action against the perpetrators less than six months after the award-recipient's tip was received. In connection with the SEC's announcement, SEC Chair Mary Jo White stated the SEC's hope that the game-changing award "encourages more individuals with information to come forward." "SEC Awards More Than \$14 Million to Whistleblower," SEC Press Release (Oct. 1, 2013). The award is the third made in the two years since the whistleblower program was launched and the second made in the last four months.

Notwithstanding the apparent influx of information, the relative modesty of

the first two awards had caused some to question whether the whistleblower program would be the success the SEC expected. Larger awards, like the one issued Oct. 1, likely will encourage more whistleblowers, and particularly high-level whistleblowing by well-compensated executives — the kind of tips needed to ensnare top-level corporate wrongdoers.

In response, senior SEC officials made statements suggesting that the first two awards were not indicative of the frequency and amounts of awards to be made in the future. At least one official may have even hinted at the enormity of the latest whistleblower award by stating earlier this year that the SEC expected to pay "some

extremely significant whistleblower awards" to whistleblowers that had provided information leading to "incredibly impactful cases." See Erica Kelton, "SEC Whistleblower Rewards: Larger Ones Are Coming," Forbes (June 21, 2013).

Other statements by senior SEC officials have suggested that whistleblower awards will only continue to increase in the future. Sean McKessy, director of the SEC's Whistleblower Office, said in an interview: "We are likely to see more awards at a faster pace now that the program has been up and running and the tips we have gotten are leading to successful cases." Rachel Louise Ensign, "SEC Hands Out Second-Ever Dodd-Frank Whistleblower Award," The Wall Street Journal (June 14, 2013).

Similarly, Michelle Wein Layne, the regional director of the SEC's Los Angeles office, speaking at the American Bar Association's annual conference, explained that the process of sorting through tips and bringing enforcement actions is a time-consuming one. Because the whistleblowers receive their awards only after an enforcement action yields more than \$1 million in sanctions, the pipeline should be growing and the likelihood

of more frequent awards is increasing as the program enters its third full year. See Jacqueline Palank, "'Substantial' Whistleblower Awards May Take a While, SEC Official Says," The Wall Street Journal Blog (Aug. 12, 2013 5:13 PM).

The \$14 million award suggests that both the frequency and amount of whistleblower awards are on the rise. In light of the two awards made this year, including the colossal \$14 million award to a single recipient, whistleblowing activity is almost certain to pick up. As the rewards increase so too should media attention and employee awareness of the whistleblower program. These developments likely will spur further whistleblowing activity as individuals become increasingly aware of the significant monetary incentives to report frauds. The SEC's recent, highly publicized insider trading cases, such as that against Raj Rajaratnam and Galleon Management LP, have led some to suggest that insider trading will be one of the most common types of whistleblower complaints in coming years.

In light of these developments, it is increasingly important for public companies and other regulated entities to revisit their compliance programs to ensure that they include effective whistleblower and hotline reporting policies and programs. These programs should be widely publicized and top leadership should support the programs to set a tone of compliance and transparency throughout the organization. Whistleblower complaints should be taken seriously, and investigated in a prompt and objective manner. Companies that fail to take appropriate steps to build compliance into their culture and encourage their employees to make internal reports may soon find themselves paying the price.

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