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SEC Issues First Large Award in Whistleblower Program

\$14 million awarded to unidentified whistleblower in unidentified enforcement action.

On October 1, 2013, the US Securities and Exchange Commission announced that it expects to pay more than \$14 million to a whistleblower whose information led to an SEC enforcement action that recovered substantial investor funds. The Commission did not identify or describe the whistleblower or the enforcement action.

Despite this opaqueness, the award is noteworthy. It is by far the largest payment made under the SEC whistleblower award program created three years ago by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and the Commission hopes the award's size will inspire a wave of new whistleblowing. In a statement attributed to SEC Chair Mary Jo White, the Commission press release announcing the award refers to that possibility: "Our whistleblower program already has had a big impact on our investigations by providing us with high quality, meaningful tips. We hope an award like this encourages more individuals with information to come forward."

The SEC's release also states that the whistleblower's information and assistance allowed the Commission to investigate more quickly than otherwise would have been possible. Less than six months after receiving the whistleblower's tip, the Commission was able to bring an enforcement action against the perpetrators and secure investor funds.

The two previous SEC whistleblower awards were relatively small and seem to have had very little public impact. The first, announced in August 2012, was less than \$50,000 awarded to a whistleblower who helped stop an unidentified multi-million dollar fraud. The second, announced in August 2013, amounted to a total of approximately \$125,000 awarded to three whistleblowers who helped the SEC bring an enforcement action against sham hedge fund Locust Offshore Management LLC and its CEO Andrey C. Hicks.

How the Whistleblower Award Program Works

When a self-identified whistleblower seeks an award from the SEC, a threshold question is whether the whistleblower meets the SEC's award eligibility requirements. Eligibility turns on multiple factors, including whether the whistleblower provided the SEC with "original information" about a violation of the securities laws that "leads to the successful enforcement by the Commission" of an action in which the Commission obtains (but does not necessarily collect) monetary sanctions exceeding \$1 million.¹ To be "original," the whistleblower's information must be "derived from the independent knowledge or analysis" of the whistleblower and cannot already be "known to the Commission from any other source, unless the whistleblower is the original source."²

To “lead[] to successful enforcement,” the original information must either:

(1) Cause the SEC staff to start an examination or investigation, or reopen an investigation, or look into different conduct as part of a current examination or investigation, leading to a successful enforcement action based in whole or in part on conduct that was the subject of the original information.

(2) Significantly contribute to the success of an SEC enforcement action and relate to conduct already under examination or investigation by the SEC or by another federal or state agency or self-regulatory organization.³

Under Dodd-Frank, once one or more whistleblowers meet the criteria for an award, the SEC must pay an award based on amounts collected, both in the SEC action and in certain related actions, including actions brought by the Department of Justice. Dodd-Frank requires the SEC to award from 10 percent to 30 percent of the monetary sanctions collected in all such actions.

Anonymity of Whistleblowers

Dodd-Frank generally requires the SEC to avoid disclosing information that might directly or indirectly reveal a whistleblower’s identity. In the case of the \$14 million award, the Commission responded to the whistleblower’s request for anonymity by redacting from the publicly-released version of its Order Determining Whistleblower Award Claim almost all information that could be used to identify the whistleblower. The Commission redacted the name of the enforcement action in question and even redacted the percentage within the range of 10 to 30 percent that the Commission determined to be appropriate in light of “the significance of the information that the Claimant provided to the Commission, the assistance the Claimant provided in the Commission action, and the law enforcement interest in deterring violations by granting awards.” Because of these redactions, we cannot deduce at this point the enforcement action that led to the award or the percentage of sanctions collected that generated the \$14 million number.

According to unredacted portions of the Commission’s Order, the claimant notified the Commission of his or her decision not to contest the Commission’s preliminary determination of award percentage and amount the day after that determination was made. Thus it seems quite possible that this is a maximum (30 percent) award. If that is the case, the total monetary sanctions collected in the SEC enforcement action and any related actions were approximately \$47 million. Of course, if the percentage was lower, the sanctions collected were higher than \$47 million, and they could have been as high as \$140 million in the unlikely event that the Commission made a minimum (10 percent) award.

Conclusion

None of the SEC whistleblower program’s previous awards paid any individual as much as \$50,000. \$14 million is something completely different — a life-changing amount of money for most people. Will this award inspire many more would-be whistleblowers to contact the SEC in hopes of getting rich? That remains to be seen. But Congress and the Commission have already bet that the answer will be yes.

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Endnotes

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- ¹ See 17 C.F.R. § 240.21F-3(a).
 - ² See Dodd-Frank Act § 922, 15 U.S.C. § 78u-6(a)(3) (2013). Additionally, the information cannot have been "exclusively derived from an allegation made in a juridical or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information." *Id.* § 78u-6(a)(3)(C).
 - ³ See 17 C.F.R. § 240.21F-4(c).