

## **THE SEC OFFICE OF THE WHISTLEBLOWER 2014 ANNUAL REPORT: HELPFUL HINTS FROM THE SEC ON BECOMING A SUCESSFUL WHISTLEBLOWER**

**BY DANIEL J. HURSON**

The recent release of the SEC's Office of the Whistleblower Annual Report did not really contain any surprises. The number of tips is rising steadily year-to-year and was up about 10% in fiscal 2014 to a total of 3,620. However, the number of tips started at about 3000 and has gone up by just 300 or so in each of the succeeding two years. Clearly, the fears of corporate lawyers and business interests that the Dodd-Frank whistleblower law would seriously injure internal reporting and compliance programs were flat wrong. In fact, of all employees who received awards, over 80% reported their concerns internally before going to the SEC. Some federal court cases that have held that one must report internally first to qualify for protection from retaliation may cause more initial internal reporting as well. Compliance officers and internal auditors have recently received some encouragement from the SEC to submit whistleblower tips, as long as they fit into certain exceptions to the general prohibition against whistleblowing by such corporate employees.<sup>1</sup>

The jury is still out on whether the SEC whistleblower program will ever reach the heights (or depths) that its respective supporters and detractors predicted. 14 awards have been made, most modest amounts with several blockbusters--\$30 and \$14 million. While the odds are far better than a power-ball lottery, a prospective whistleblower may be a bit discouraged that the SEC has sifted through almost 10,000 tips but has rendered only 14 awards. There have about the same number of recipients of the Kennedy Center Honors in the last three years as there have been successful SEC whistleblowers.

The fact is that, regardless of how good the tip may be, it can take years to bring a successful SEC case to the point where a company or individual will settle with the agency and fork over a penalty in excess of \$1 million. The public sees the result, but not the difficult process it takes to get there. It can take even longer if the case goes through trial and appeal. Likewise, some good cases never generate the \$1 million threshold in penalties needed to trigger a whistleblower award. Given that so far 10,000 or so tips have yielded only a handful of awards, we must presume that the SEC staff is being very selective in determining which whistleblower submissions to investigate. Unless the case represents an ongoing fraud which is truly harming investors and must be stopped immediately, or an active insider trading ring or ponzi scheme, the SEC may take its time in deciding to investigate the case, and an investigation does not always end up in a staff recommendation for an enforcement action. Then the case has to win the approval of superiors and the Commission itself.

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<sup>1</sup> See Daniel J. Hurson, "When Should Internal Auditors and Compliance Officers Become Whistleblowers," *Mondaq*, Dec. 10, 2014.

Moreover, the typical process by which major investigations are conducted against big corporations, with outside counsel doing much of the initial work through extensive “internal investigations,” is almost guaranteed to take months if not years before the company wraps it up and brings it to the SEC for a resolution. Outside company lawyers tend to want to investigate every aspect of the matter, and look under every rock. As long as the statute of limitations is not close to running, the SEC can afford to sit back and let the internal investigation run its course. Who knows what they may find? The delays can seem endless to the whistleblower, who often puts him or herself in a limbo of sorts waiting for the outcome. If they are still employed by the company and have chosen for whatever reason not to report the matter internally, it is more than limbo: it can be hell.

On the bright side, in various speeches and in numerous appearances at the ubiquitous conferences designed to dissect the SEC whistleblower program, SEC officials (always “speaking for themselves and not the SEC”) continually predict, if not promise, that the pipeline is full of big cases which will at some point yield significant whistleblower awards. There is also, as of the end of fiscal 2014, about \$438 million remaining in the SEC’s award kitty (formally known as the Investor Protection Fund). These assurances may give some solace to the small cadre of lawyers (including this one) and their clients who are hoping the SEC will select their case for investigation, settlement, and hopefully an award. It is interesting that, according to the 2014 report, a majority of award recipients did not use a lawyer initially, but an attorney represented most by the time they applied for an award. Also, based on the cryptic releases from the SEC in connection with the awards that have been made, things have not always gone smoothly for the whistleblower. It appears that not every whistleblower walked off with the maximum 30% award, and there was some need to retain counsel before everything was resolved. One recipient of a large award ended up being sued by someone who claimed he had come up with the information. This is not surprising given the great discretion the SEC has under the statute and rules in determining whether an award will be given, to whom, and how much. Hopefully, as more awards roll out, the SEC will give more guidance as to how it goes about making these decisions, which can literally involve millions of dollars.

Going through the process on the whistleblower side can be a roller coaster ride indeed. There are the cases in which you and your client are suddenly called in for an interview with a team of SEC and maybe DOJ lawyers, or granted a phone interview, but then you never hear from any of them again. Then there are the cases which seem to rise from the ashes, when after months of radio silence an SEC or DOJ lawyer will call, and want to speak to your client ASAP. The client, of course, is anxious to know the progress of the case, if any, and for the most part the lawyer has little if any information to go on. One suggestion to the SEC Office of the Whistleblower: don’t keep us totally in the dark. We know you can’t give us an update on how things are going, but if the case is dead, let us know somehow. We have clients who really need to get on with their lives.

## Some Helpful Hints From the SEC

In the 2014 Report, the SEC did describe certain things the winning whistleblowers shared in common. The Report described them as follows:

“There are commonalities among the tips or complaints that were submitted by these successful whistleblowers. The information provided by each award recipient was specific, in that the whistleblower identified particular individuals involved in the fraud, or pointed to specific documents that substantiated their allegations or explained where such documents could be located. In some instances, the whistleblower identified specific financial transactions that evidenced the fraud. The alleged misconduct was relatively current or ongoing. Because of the specific, credible, and timely nature of their tips, their information was forwarded to Enforcement staff, who followed up by contacting the whistleblowers. These whistleblowers then provided additional information or assistance to the staff during the course of the investigation...

Of the award recipients who were current or former employees, over 80% raised their concerns internally to their supervisors or compliance personnel before reporting their information of wrongdoing to the Commission. In these instances, the individuals reported information concerning possible securities violations to the Commission only after reporting the information internally and *understood that the entity was not taking steps to address or remedy the violative conduct.*” (italics added).

From these tidbits we may glean several distinct suggestions from the SEC for would-be whistleblowers:

1. Be specific, name names, and point out or provide relevant documents. Identify specific fraudulent financial transactions. Don't hold anything back, including hot documents. The SEC does not really care how you go about obtaining the documents. Like all prosecutors, they love emails. The staff, however, is very concerned about being provided with materials that are privileged. Please advise them (or your counsel) in advance if you have such documents, and let the staff decide how to handle it. If you feel you need to produce documents in violation of an employment or confidentiality agreement, try to limit the disclosures to documents that directly involve the alleged wrongdoing, not a huge dump of corporate information.
2. Try to identify *current*, ongoing misconduct that is harming investors *now*. The SEC clearly prefers information leading to the exposure of ongoing schemes. The biggest awards seem to go to whistleblowers that step forward in time to stop major ongoing frauds. The clear lesson to whistleblowers—act immediately and stop a fraud scheme that is then hurting the company and/or its investors. Do not wait until you are absolutely certain of all the facts—let the SEC sort that out.
3. Do not wait until months or years have passed to report the fraud, even if the statute of limitations may not have yet run. It appears the SEC may hold it against

the whistleblower that does not come forward promptly. The SEC also appears less interested in “old cases” even if the statute of limitations has not run. This was made clear in the Order determining the claim in the \$30 million case. The SEC specifically “considered [the whistleblower’s delay in reporting the violations, which under the circumstances we find unreasonable.”<sup>2</sup> It seems that the harm to investors continued while the claimant hesitated to come forward for fear the SEC might not act. It appears the award may have been reduced somewhat for this reason. There may be an important exception to the SEC’s aversion for old cases in the case of companies that have prior issues with the SEC and are or were subject to an earlier enforcement action for the same or similar behavior. The SEC does not like corporate recidivists.

Another significant hint from the SEC was not in the 2014 Report. The \$30 million award went to a foreign whistleblower. A lengthy footnote in the Order granting the award set forth a spirited defense of the SEC’s awarding a foreign resident the largest sum yet to be given. The SEC disregarded “certain extraterritorial aspects of Claimant’s application.” It found that “in our view, there is a sufficient U.S. territorial nexus whenever a claimant’s information leads to the successful enforcement of a covered action brought in the United States, concerning violations of the U.S. securities laws, by the [SEC], the U.S. regulatory agency with enforcement authority for such violations. When these key territorial connections exist, it makes no difference whether, for example, *the claimant was a foreign national, the claimant resides overseas, the information was submitted from overseas, or the misconduct comprising the U.S. securities law violation occurred entirely overseas.*” *Id.* at 2. (italics added).

This statement should be of considerable comfort to foreign nationals reporting illegal conduct occurring overseas committed by companies over whom the SEC otherwise has jurisdiction because of their presence on U.S. stock exchanges, including through the use of ADR’s. Tips regarding possible FCPA violations, which are curiously only a small slice of whistleblower tips (about 4%), come to mind as a potential growth area of whistleblower activity.

So, all in all, the 2014 Report of the Office of the Whistleblower is a good read, at least for anyone that cares about how the whistleblower program is unfolding, and for those who are looking for guidance as to what factors the SEC believes may cause it to look more (or less) favorably on a given whistleblower tip. If one hopes to enter into the ring of winners in what is at this point a very exclusive club, such wisdom from the SEC itself, the only source that matters, could prove extremely valuable.

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<sup>2</sup> *Order Determining Whistleblower Award Claim*, Release No. 73174, September 22, 2014, p.3.

