

SEC Issues Second Whistleblower Program Award

Award to three whistleblowers sheds considerable light on SEC award program.

On August 30, 2013, the US Securities and Exchange Commission announced that it expects to pay a combined \$125,000 (which is 15 percent of monetary sanctions collected) to three whistleblowers who helped the SEC and the US Department of Justice stop the CEO of a sham hedge fund, Andrey Hicks, from continuing to operate a fraudulent scheme that had already defrauded investors of \$2.7 million. The award is noteworthy as only the second payment made under the whistleblower award program created three years ago by the Dodd-Frank Act. The award also offers a helpful study in how the program works in practice.

The Three Successful Whistleblowers and How They Differ

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, or
- (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

In the *Hicks* case, the SEC released a partially-redacted order regarding the three whistleblowers and the information they provided that led to an SEC enforcement action in which the Commission obtained monetary sanctions exceeding \$1 million and to a related DOJ criminal proceeding.⁴ The SEC reported that two of the whistleblowers "provided information that prompted the SEC to open an investigation and stop the scheme before more investors were harmed."⁵ This fits the first category above of information

“leading to successful enforcement.” The description of the third whistleblower’s information — that it “identified key witnesses and confirmed information the other two whistleblowers provided”⁶ — meets the standard of the second category regarding significantly contributing to the success of an ongoing investigation.

Amount and Division of Whistleblower Awards

The SEC brings only civil cases, but it works closely with criminal prosecutors at the DOJ. Those prosecutors often bring parallel criminal cases in SEC matters. That is what happened in the *Hicks* case.

In the SEC’s civil enforcement action, a federal district court ordered Hicks (and the company he controlled that purported to manage the sham hedge fund) to pay approximately \$7.5 million in disgorgement and penalties. The SEC apparently expects to collect none of that money. But in the parallel criminal proceeding, in which Hicks was ordered to pay \$2.3 million in restitution, the SEC expects a total of approximately \$845,000 in assets to be administratively forfeited. Under Dodd-Frank, once one or more whistleblowers voluntarily provide the SEC with original information that leads to a monetary sanction greater than \$1 million in a SEC enforcement action, the SEC must pay whistleblower awards based on amounts collected both in the SEC action and in certain related actions, including judicial or administrative actions brought by the DOJ. In *Hicks*, the assets administratively forfeited in the DOJ proceeding will be deemed collected for purposes of the SEC’s whistleblower award. Thus, the SEC release states that the three whistleblowers are expected to ultimately receive a combined total of approximately \$125,000 (15 percent of approximately \$845,000).

Interestingly, the SEC approved equal award payments to each of the three whistleblowers even though the SEC has discretion to increase, decrease, and apportion awards according to various factors, including the significance of the information provided.⁷ By giving each whistleblower one third of the 15 percent award, the SEC gave equal weight to the third whistleblower’s information even though that information, in part, merely confirmed information from the other two whistleblowers that led to the investigation.

Also notably, the SEC awarded only 15 percent of the collected monetary sanctions to the whistleblowers, even though Dodd-Frank permits the SEC to award up to 30 percent of collected monetary sanctions and even though senior members of the SEC staff have frequently indicated that the SEC is eager to promote the whistleblower award program by making large awards. The three whistleblowers had the opportunity to contest their awards as too low, but none did. We surmise that at least one of the factors that, under the SEC’s rules, may decrease the amount of an award — which include the whistleblower’s culpability in the misconduct — was in play in the *Hicks* case.

The 15 percent *Hicks* award demonstrates that the SEC is not going to freely hand out awards at the top of the 10 to 30 percent range despite its desire to raise the profile of the award program. The equal apportionment of the award demonstrates that follow-on, corroborative whistleblowers can, in certain circumstances, profit as much from reporting to the SEC as those who walk a new case in the door.

Timeline of the Award Process

Hicks also provides insight into why the award process takes a long time. In the three-plus years since Dodd-Frank was enacted, speculation has run rampant regarding the number and amount of awards that would be paid. The SEC staff has raised expectations about the success of the program by claiming it is receiving eight tips a day and predicting that large awards will be announced soon.⁸ So far, those raised expectations have not been met. *Hicks* demonstrates that the award process can be delayed in unexpected ways, including by a claimant who provides information the SEC deems useless.

It remains unclear when the three *Hicks* whistleblowers' tips reached the SEC and when the SEC began investigating, but we know that to have become eligible for an award, the first tip must have reached the SEC after July 21, 2010 (*i.e.*, the enactment date of Dodd-Frank). On October 26, 2011, the SEC filed the *Hicks* enforcement action in federal district court, and on March 20, 2012, the court entered final judgment by default.⁹ Within two weeks, on April 3, 2012, the SEC's Office of the Whistleblower posted a Notice of Covered Action — the document that opens the award application process.¹⁰ The three whistleblowers filed timely award claims by July 2, 2012,¹¹ and on December 19, 2012, the SEC's Claims Review Staff issued a Preliminary Determination recommending the SEC approve the three claims in the amount of 5 percent of monetary sanctions collected each.¹² The Preliminary Determination recommended that a fourth timely-filed claim be denied, and the fourth claimant contested that determination on February 19, 2013.¹³ On June 12, 2013, the SEC issued an order approving the three 5 percent awards and denying the fourth claim, noting that the information provided by the fourth claimant did not even mention the *Hicks* defendants.¹⁴ The fourth claimant apparently opted not to appeal the SEC's final determination.¹⁵

The SEC issued the final whistleblower eligibility order in *Hicks* approximately 20 months after filing an enforcement action in the case. If the case had been settled before it was filed in court, the time elapsed likely would have been shorter. If the case had been actively litigated instead of ending in a default judgment, the time elapsed probably would have been much longer, possibly by several years. Perhaps the most useful data point is that the SEC's whistleblower eligibility order came approximately 15 months after the court entered judgment in the SEC enforcement action. Now that we have seen how the award process worked in *Hicks*, it is easier to understand why there have been just two SEC whistleblower awards announced in the three years since Dodd-Frank created the award program and the two years since the SEC adopted the whistleblower rules that created the award application and determination process.

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Endnotes

- 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).
- ⁴ *SEC v. Andrey C. Hicks and Locust Offshore Management, LLC*, 1:11-cv-11888-RGS (D. Mass. 2011); *United States v. Hicks*, 1:11-cr-10407-PBS (D. Mass. 2011).
- ⁵ SEC Press Release No. 2013-169, *SEC Rewards Three Whistleblowers Who Helped Stop Sham Hedge Fund* (Aug. 30, 2013).
- ⁶ *Id.*
- ⁷ See 15 U.S.C. § 78u-6(c)(1).
- ⁸ See SEC Press Release No. 2012-162, *SEC Issues First Whistleblower Program Award* (Aug. 21, 2012) ("Sean McKessy, Chief of the SEC's Whistleblower Office, said that since the program was established in August 2011, about eight tips a day are flowing into the SEC."); *SEC's Cohen Predicts Major Whistleblower Awards Soon*, Corporate Crime Reporter, June 12, 2013.
- ⁹ See SEC Litigation Release No. 22302, *Court Orders Purported Hedge Fund Manager and Principal to Pay Over \$7.5 Million* (Mar. 22, 2012).
- ¹⁰ See SEC Release No. 69749, In the Matter of the Claim for Award in connection with *SEC v. Andrey C. Hicks and Locust Offshore Management, LLC*, 1:11-cv-11888-RGS (D. Mass. 2011) Notice of Covered Action 2012-27, *Order Determining Whistleblower Award Claim* (June 12, 2013).
- ¹¹ See 17 C.F.R. § 240.21F-10(a).
- ¹² See SEC Release No. 69749, In the Matter of the Claim for Award in connection with *SEC v. Andrey C. Hicks and Locust Offshore Management, LLC*, 1:11-cv-11888-RGS (D. Mass. 2011) Notice of Covered Action 2012-27, *Order Determining Whistleblower Award Claim* (June 12, 2013).
- ¹³ *Id.*
- ¹⁴ *Id.*
- ¹⁵ See 17 C.F.R. § 240.21F-10(f); 17 C.F.R. § 240.21F-13 (permitting an appeal of the determination of whether or to whom to make an award within 30 days after the SEC issues its final decision); SEC Press Release No. 2013-169, *SEC Rewards Three Whistleblowers Who Helped Stop Sham Hedge Fund* (Aug. 30, 2013).