

## It's Not Over Until the Last Whistle Blows: Beware of the Mid-Investigation Tip

By Tracy Cole, Jonathan A. Forman and A. Mackenna Mosier

On May 13, 2016, the Securities and Exchange Commission (SEC) caught many off guard when it issued an award to a whistleblower whose mid-investigation tip "significantly contributed" to the success of the resulting enforcement action pursuant to SEC Rule 21F-4(c)(2).<sup>1</sup> SEC Director of the Division of Enforcement Andrew Ceresney underscored the importance of this award, stating: "Whistleblowers can receive an award not only when their tip initiates an investigation, but also when they provide new information or documentation that advances an existing inquiry."<sup>2</sup> Although the SEC's Whistleblower Program has been in effect since 2011, this award is the first publicized approval of a claim under this particular provision of the whistleblower protection rules. Accordingly, it has far-reaching implications, particularly on compliance programs and cooperation during regulatory investigations.

### Whistleblower Awards for Tips That Lead to a Successful Enforcement Action

Under the whistleblower protection rules, whistleblowers are eligible to recover an award if they voluntarily provide the SEC with original information about a possible federal securities law violation and that information leads to a successful enforcement action resulting in an order of monetary sanctions exceeding \$1 million.<sup>3</sup> As set forth in Rule 21F-4(c), a whistleblower's tip leads to a "successful enforcement action" where:

1. You gave the Commission original information that was sufficiently specific, credible, and timely to cause the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation, and the Commission brought a successful

judicial or administrative action based in whole or in part on conduct that was the subject of your original information; or

2. You gave the Commission original information about conduct that was already under examination or investigation...and your submission significantly contributed to the success of the action.
3. You reported original information through an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law before or at the same time you reported them to the Commission; the entity later provided your information to the Commission, or provided results of an audit or investigation initiated in whole or in part in response to information you reported to the entity; and the information the entity provided to the Commission satisfies either paragraph (c)(1) or (c)(2) of this section. Under this paragraph (c)(3), you must also submit the same information to the Commission in accordance with the procedures set forth in §240.21F-9 within 120 days of providing it to the entity.<sup>4</sup>

Due to the confidential nature of whistleblower awards, most disposition orders are circumspect in identifying the facts and circumstances surrounding the tip. As a result, up until this award, it was unclear whether, and under what circumstances, the SEC would award a whistleblower for a tip after an investigation had already begun.

### The SEC's First Whistleblower Award for a Mid-Investigation Tip

The May 13 award marks the first time that the SEC has approved an award specifically under Rule 21F-4(c)(2), for information that "significantly contributed to the success of the action" relating to conduct that already was under examination or investigation. The SEC stated that the award stemmed from information submitted by a company employee during the course of an investigation that the SEC initiated after media reports about the potential misconduct.<sup>5</sup> The employee thereafter reported to the SEC new information relating to the misconduct, submitted supporting documentation, and spoke directly with the SEC staff conducting the investigation.

The Claims Review Staff preliminarily recommended that the SEC deny the employee's whistleblower claim because it did not lead or contribute to the success of the eventual enforcement action. The employee contested this determination, arguing both that the information led to the success of the enforcement action under Rule 21F-4(c)(1) because the information caused the Enforcement staff to open a new line of inquiry, and that the information significantly contributed to the success of the enforcement action under Rule 21F-4(c)(2). The Commission disagreed with the employee's Rule 21F-4(c)(1) argument,

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stating that “the staff was already generally aware of” the misconduct and the information provided “was not substantially different from the misconduct generally under investigation.” The Commission reasoned that “[i]n such circumstances ... the appropriate analysis is governed by Rule 21F-4(c)(2).” As such, the Commission held that the employee’s information “made a substantial and important contribution to the successful resolution of the Covered Action” by causing Enforcement staff to focus on an area of the investigation that they “might otherwise not have done” that resulted in “evidentiary development [that] strengthened the Commission’s case by meaningfully increasing the Enforcement staff’s leverage during the settlement negotiations.”<sup>6</sup>

The Commission ultimately awarded the employee \$3.5 million. In awarding such a large amount, the Commission noted that it took into consideration the “unique hardships” experienced by the whistleblower as a result of the decision to report the misconduct, including, among other things, the whistleblower’s inability to secure employment as a direct result of the whistleblowing activities.<sup>7</sup> The Commission’s order did not expressly address whether delay factored into the amount of the award. However, given the size of the award, it appears unlikely that the SEC penalized the whistleblower for any delay in reporting the misconduct.

### Compliance Takeaways

More than \$85 million has been awarded to 32 whistleblowers from the SEC’s Whistleblower Program.<sup>8</sup> These significant financial incentives continue to increase the number of whistleblower reports that the SEC receives each year. And it is now apparent that the SEC rewards not only whistleblowers who bring cases to their attention, but also those who significantly contribute to the successful enforcement of pending investigations. As a result, it is imperative that compliance programs address these incentives.

In particular, this award emphasizes that the incentive to blow the whistle does not end once a regulator’s attention has been drawn to a company. While most compliance programs focus, for good reason, on encouraging employees to make a prompt internal report upon discovering potential misconduct, it is important to also encourage continued communications about any ongoing concerns. Many employees resort to external reporting because they believe, rightly or wrongly, that internal reporting will not address their concerns. One study found that 90 percent of False Claims Act plaintiffs reported internally prior to bringing suit but were ignored.<sup>9</sup> Moreover, companies must be equally invested in their internal investigation process, to ensure that they are ready to act promptly in the event they become aware of potential misconduct. As recent SEC awards to compliance personnel and corporate officers have demonstrated, a company that successfully encourages internal reporting must also engage in effective response to and investigation of complaints. Companies that promptly investigate potential misconduct, remediate any existing misconduct and cooperate with a regulatory investigation also stand to gain credit from regulators in the form of decreased sanctions or even avoiding an enforcement action altogether.

This award may also reopen a discussion as to whether companies want to consider educating their employees about the whistleblower protections. As most companies are aware, Rule 21F-4(c)(3) provides a placeholder for up to 120 days so that those who report internally will receive credit for the purposes of an award. Moreover, Rule 21F-6(a)(4) indicates that internal reporting is a factor that may increase the amount of a whistleblower’s award. These rules could help mitigate

the tension between companies’ efforts to maintain and enforce their culture of compliance through their own internal investigation and remediation, and the government’s continued emphasis on incentivizing whistleblowers.

That said, it is important that a company’s efforts be directed toward encouraging internal reporting, and that it avoid any appearance of discouraging good faith external reporting. As shown by the SEC’s enforcement actions against Paradigm Capital Management<sup>10</sup> and KBR Inc.,<sup>11</sup> the SEC is determined to prevent retaliation against whistleblowing employees, and will broadly interpret actions that it believes may have a chilling effect on a whistleblower’s report of potential securities violations to the SEC.

In short, this award demonstrates that the SEC’s enthusiasm to reward whistleblowers appears only to be growing. And it reminds us that after a company becomes aware of potential misconduct, time is of the essence. Unless a company responds promptly and effectively to a report, a whistleblower – even one reporting after the initiation of an investigation – may get the last word. ★

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[1] In the Matter of the Claim for Award, Exchange Act Rel. No. 77833 (May 13, 2016).

[2] Whistleblower Earns \$3.5 Million Award for Bolstering Ongoing Investigation, SEC Rel. No. 2016-88 (May 13, 2016).

[3] 17 CFR 240.21F.

[4] 17 CFR 240.21F-4(c).

[5] In the Matter of the Claim for Award, Exchange Act Rel. No. 77833 (May 13, 2016).

[6] *Id.*

[7] *Id.*

[8] Closely following the May 13 award, the SEC announced four additional whistleblower awards. On May 17, 2016, the SEC announced an additional whistleblower award of at least \$5 million to a company insider “whose detailed tip led the agency to uncover securities violations that would have been nearly impossible for it to detect but for the whistleblower information.” SEC Awards More Than \$5 Million to Whistleblower, SEC Rel. No. 2016-91 (May 17, 2016). Then on May 20, 2016, the SEC announced a joint whistleblower award of more than \$450,000 to two individuals for a tip that led the SEC to open a corporate accounting investigation and for the individuals’ assistance once the investigation was underway. Two Individuals Share Whistleblower Award of More Than \$450,000, SEC Rel. No. 2016-94 (May 20, 2016). And finally on June 9, 2016, the SEC announced an award of more than \$17 million to “a former company employee whose detailed tip substantially advanced the agency’s investigation and ultimate enforcement action.” SEC Issues \$17 Million Whistleblower Award, SEC Rel. No. 2016-114 (June 9, 2016).

[9] National Whistleblowers Center, *Impact of Qui Tam Laws on Internal Compliance: A Report to the Securities Exchange Commission* (Dec. 17, 2010).

[10] SEC Charges Hedge Fund Adviser With Conducting Conflicted Transactions and Retaliating Against Whistleblower, SEC Rel. No. 2014-118 (June 16, 2014).

[11] SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements, SEC Rel. No. 2015-54 (Apr. 1, 2015).