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Year Three of the SEC Whistleblower Program: Will It Turbocharge SEC Enforcement?

BY WILLIAM MCLUCAS, LAURA WERTHEIMER, AND ARIAN JUNE

When the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law on July 21, 2010, it added a whistleblower bounty program to offer financial rewards to individuals who provide ''original information'' to the Securities and Exchange Commission about securities law violations that leads to successful enforcement actions resulting in monetary sanctions of at least $1 million.[1] The SEC intended the whistleblower program to incentivize individuals to come forward with high quality information which would enhance the Commission's ability to detect securities law violations, provide another avenue for the Commission to promptly intervene to stop ongoing frauds, and increase deterrence of future violations.[2] Has the Whistleblower Program delivered on its promise as it approaches year three? As we discuss in the first part of this article, the SEC's Program is the most recent in a long and storied history of bounty programs. Where the possible bounty is sufficiently large, the incentive has proven irresistible to individuals who believe they have valuable information of wrongdoing. Experience with qui tam actions brought under the False Claims Act (''FCA'') over the last two decades suggests that the slow start in SEC whistleblower payments is not unusual and that whistleblower complaints may become an important source for SEC enforcement investigations. Whistleblower complaints are likely to rise over the next few years for a variety of reasons: (1) Recent headlines involving massive SEC settlements in insider trading, Ponzi scheme and other highly publicized cases may whet the appetite of potential whistleblowers; (2) any significant whistleblower awards in 2013 will heighten awareness of the Whistleblower Program and may stimulate whistleblower complaints; and (3) a sophisticated plaintiffs' bar, which has been lauded by SEC officials for efforts in assisting whistleblowers in documenting their complaints, continues its efforts to identify potential whistleblowers and persuade them to file complaints with the SEC. While only time will tell whether SEC whistleblower complaints will ultimately lead to a significant number of additional enforcement actions, organizations should prepare for

[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010), 15 U.S.C. § 78u-6.

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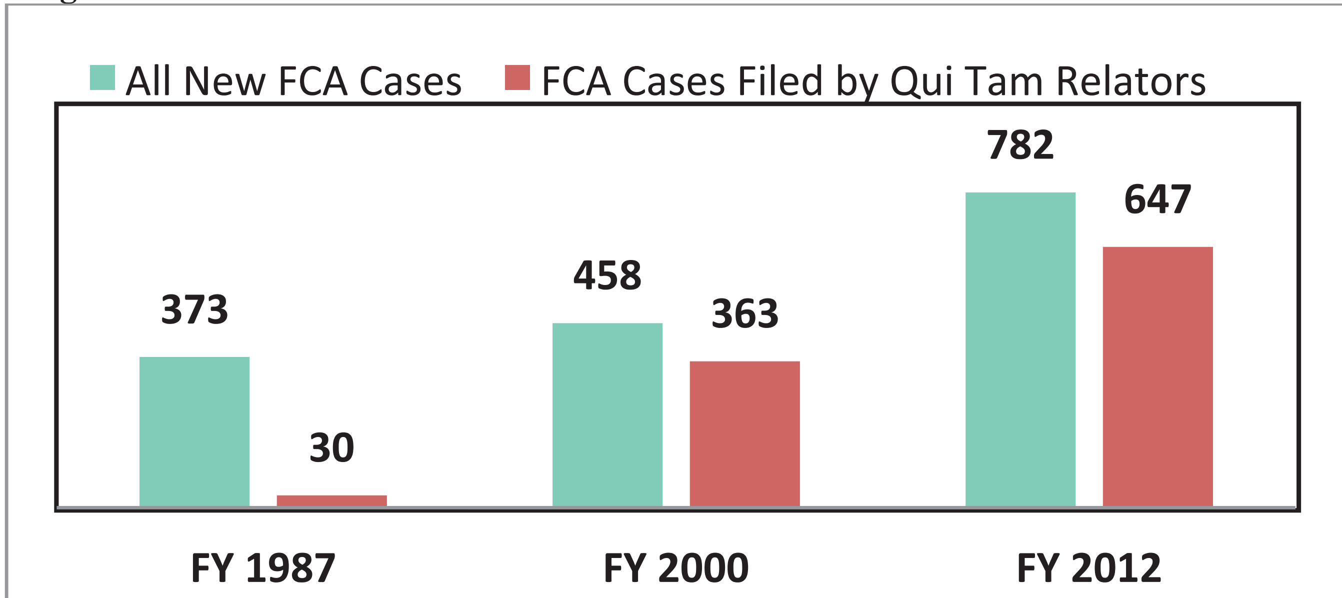
[2] Remarks of SEC Commissioner Luis Aguilar, ''Incentivizing Whistleblowers to Bring Fraud to Light,'' U.S. Securities and Exchange Commission Open Meeting (May 25, 2011), *available at* http://www.sec.gov/news/speech/2011/spch052511laa-item2.htm.

Figure 1:



continued increases in whistleblower complaints. In the second part of this article, we offer observations on the likely areas of focus for those complaints and how the improving quality of those tips is likely to shape the enforcement landscape.

Historical Lessons on Bounty Payments: Using a Rogue to Catch a Rogue

In the late 7th century, King Wihtred of Kent issued a written declaration in which he announced that a freeman who worked on the Sabbath would be fined and that an informant would be rewarded with half of the fine as well as profits earned from forbidden labors. That declaration, and countless others that followed, sought to incentivize individuals to report legal violations, even if they suffered no personal injuries as a result of the violations. By the 14th century, the English Parliament adopted statutory provisions that authorized individual whistleblowers to bring suit on behalf of and in the name of the King and receive a portion of any recovery. The term, ''qui tam,'' derives from the Latin ''*qui tam pro domino rege quam pro se ipso*,'' roughly translated as ''one who pursues this action on behalf of the King and himself.''

Over the next 200 years, English common law permitted qui tam private individuals to bring suit and litigate claims on the sovereign's behalf involving a broad range of economic activities.[3] Enforcement of laws through qui tam litigation was said to have given rise to ''a class of bounty hunters who unscrupulously exploited weaknesses in the system. . . . Litigation was stirred up simply in order that the informer might compound [i.e., settle] for a sum of money.''[4] Lord Coke, who served as Attorney General for Elizabeth I and on the Court of King's Bench under James I, labeled qui tam relators as ''viperous Vermin'' and observed that they acted for ''malice or private ends [but] never for love of Justice.''[5]

Colonial American legislatures readily enacted whistleblower and qui tam provisions to assist in the enforcement of numerous statutes and regulations. The U.S. Congress provided anti-retaliation protection for certain categories of whistleblowers as early as 1778.[6] During the Civil War, reports of rampant fraud by suppliers to the Union Army led President Lincoln to lobby Congress to pass the FCA. At his urging, Congress included a qui tam provision authorizing private citizens to act as private attorneys general and bring suit in the name of the United States in exchange for a sizeable portion of any recovery. But for more than 100 years, this qui tam provision was rarely used.

In 1986, significant amendments to the FCA were adopted to revive the qui tam mechanism, including expansion of the rights of and protections for qui tam relators and enlargement of potential bounty payments up to a total of 30 percent of any recovery.[7] Since the 1986 amendments, FCA litigation has risen steadily, driven largely by qui tam relators. In FY 1987, the first fiscal year after passage of the FCA amendments, only 8 percent of new FCA cases were filed as qui tam actions.[8] Thirteen years later, in FY 2000, that number rose to 79 percent.[9] For FY 2012, qui tam relator actions represented 82.7 percent of new FCA matters filed.[10] *See* Figure 1.

Not only has the number of FCA qui tam cases risen dramatically since the 1986 amendments but FCA qui tam recoveries have skyrocketed as well. Post amend-

[3] *See Charles Doyle, Cong. Research Serv*.,QUI TAM: THE FALSE CLAIMS ACT AND RELATED FEDERAL STATUTES, at 2 (2009), *available at* http://www.fas.org/sgp/crs/misc/R40785.pdf.

[4] *Id.*

[5] J. Randy Beck, *The False Claims Act and the English Eradication of Qui Tam Legislation*, 78 N. C. L. REV. 539, 578 (2000).

[6] *See* Doyle, *supra* note 3, at 3-4 & nn. 14-18.

[7] *See Fraud Statistics*, U.S. Dep't of Justice (Dec. 7, 2011), http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf.

[8] *See Fraud Statistics*, U.S. Dep't of Justice (Oct. 24, 2012), http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf.

[9] *Id.*

[10] *Id.*

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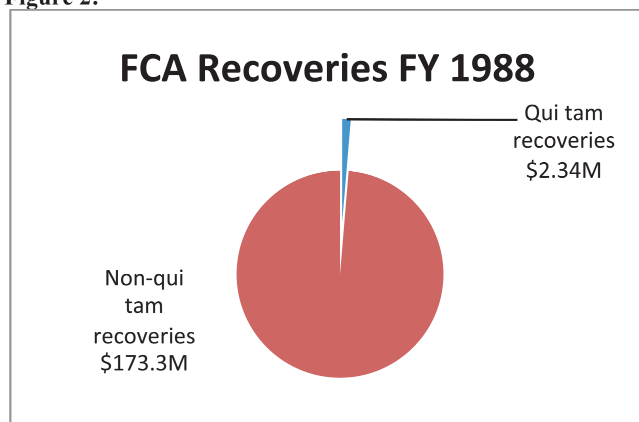
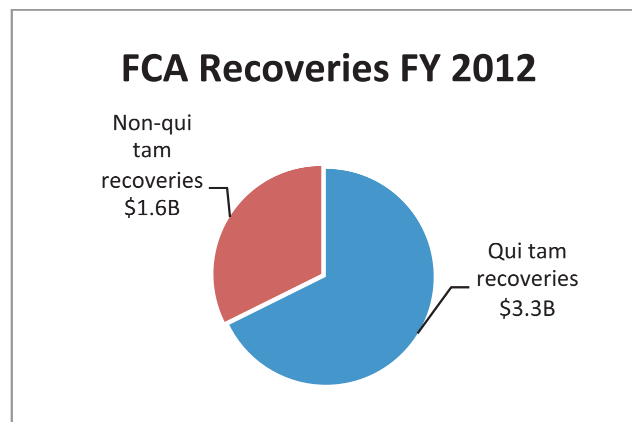
Figure 2:





ment, the first recoveries in FCA actions brought by qui tam relators were obtained in FY 1988 and totaled $2.34 million, which were quite modest when compared to the $173.3 million recovered in FY 1988 in non-qui tam litigation brought by the U.S. government.[11] For FY 2012, a record total of $4.9 billion was recovered in FCA actions of which $3.3 billion was recovered in suits originally brought by qui tam relators.[12] *See* Figure 2. During this 25 year period, FCA recoveries totaled more than $35 billion, of which $24.285 billion was recovered in actions initiated by qui tam relators.[13] A steady rise in recoveries in qui tam actions has led to a concomitant increase in relator awards. For FY 1988, qui tam relators were awarded a total of $97,188 which soared to $439 million in FY 2012.[14] During this same 25 year period, qui tam relators have been awarded more than $3.8 billion.

Experience of SEC Whistleblower Program

As Lord Coke observed in the 16th century, whistleblowers were motivated by ''malice or private ends'' not ''love of Justice.'' Since human nature has not changed very much in the last 500 years, it should come as no surprise that the SEC reported that it received 3,335 whistleblower complaints through the end of FY 2012.

The hurdles for potential SEC whistleblowers are far less difficult to navigate that the hurdles for FCA qui tam relators. Qui tam relators must investigate the suspected FCA claim on their own and decide whether to bring suit. Once a complaint is filed, qui tam relators are no longer anonymous and often themselves shunned at work; ''[h]ome foreclosures, divorce, suicide and depression all go with this territory.''[15] Since the U.S. government intervenes in only 20 percent of the cases filed by relators, most relators ''often put significant time and effort into matters that may never result in a recovery.''[16] Whether or not the government intervenes, qui tam FCA actions often take many years before they are resolved. In contrast, a SEC whistleblower can submit a complaint anonymously and remain anonymous up to the point of receiving payment of a bounty, at which time the whistleblower's identity must be disclosed to the SEC.[17] Where a whistleblower submits a complaint on a non-anonymous basis to the SEC, the SEC will keep confidential the identity of the whistleblower, subject to limited exceptions, such as a court order to disclose that identity.[18] The SEC determines whether to investigate the allegation, provides the requisite staff and funds the costs of that investigation and any ensuing litigation.

The SEC has long relied on tips and complaints as an important source of information about potential securities violations. Commission staff has observed that the quality of information provided by whistleblowers under the Whistleblower Program has ''greatly improved'' when compared to information previously offered in tips and complaints.[19] Then-Enforcement Division Director Khuzami explained that the quantity and ''quality of [whistleblower] tips has increased with more detail and greater supporting documentation'' which he attributed to ''the fact that a greater percentage of tip-

[11] *See id.*

[12] *See* Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Justice Department Recovers Nearly $5 Billion in False Claims Act Cases in Fiscal Year 2012 (Dec. 4, 2012), http://www.justice.gov/opa/pr/2012/December/12-ag-1439.html.

[13] *Id. See also Fraud Statistics*, U.S. Dep't of Justice (Oct. 24, 2012), http://www.justice.gov/civil/docs_forms/C-FRAUDS_FCA_Statistics.pdf.

[14] *See Fraud Statistics*, *supra* note 13.

[15] Paul Sullivan, *The Price Whistle-Blowers Pay for Secrets*, N.Y. Times, Sept. 21, 2012, *available at* http://www.nytimes.com/2012/09/22/your-money/for-whistle-blowers-consider-the-risks-wealth-matters.html?pagewanted=all&_r=0.

[16] *See* Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Acting Assistant Attorney General Stuart F. Delery Speaks at the American Bar Association's Ninth National Institute on the Civil False Claims Act and Qui Tam Enforcement (June 7, 2012), http://www.justice.gov/iso/opa/civil/speeches/2012/civ-speech-1206071.html.

[17] In an administrative or court proceeding, the SEC may be required to produce documents or other information which would reveal the identity of a whistleblower. In appropriate circumstances, the SEC may also provide information, including the identity of a whistleblower, subject to confidentiality requirements, to other governmental or regulatory entities. *See* 17 C.F.R. §§ 240.21F-7(b); 240.21F-9(c) & 240.21F-10(c).

[18] 15 U.S.C. § 78u-6(h)(2); 17 C.F.R. § 240.21F-7.

[19] Ian Thoms, *Official Lauds Quality Of SEC Tips Under New Program*, Law 360 (June 26, 2012) (quoting George Canellos, then-Deputy Director of the SEC's Enforcement Division), *available at* http://www.law360.com/whitecollar/articles/354406?nl_pk=45d32bd4-c994-4c88-906f-64c2e37a215b&utm_source=newsletter&utm_medium=email&utm_campaign=whitecollar.

sters are hiring lawyers to help them.''[20] George Canellos, then-Deputy Director of the SEC's Enforcement Division, observed that complaints made under the Whistleblower Program now consist of ''multipage reports complete with supporting evidence and proffers of assistance from company insiders.''[21] Director Sean McKessy, Office of the Whistleblower (''OWB'') highlighted the high quality whistleblower complaints received from lawyers, compliance officers, current and former employees, spouses and ex-spouses, corporate officers, and market observers, among others.[22] He estimated that ''two of the tips received each day [by the SEC] warranted additional inquiry, with about 300 turning into full-scale investigations.''[23]

In its recently completed Congressionally-mandated audit of the Whistleblower Program, the SEC's Office of Inspector General (''OIG'') found that the SEC's efforts to publicize that program and explain its operation were user-friendly and effective and that the SEC had directed significant resources to reviewing information submitted in whistleblower complaints expeditiously.[24] Unlike the FCA statutory scheme where successful qui tam relators are awarded a percentage from the recoveries collected by the U.S. government, the bounties paid under the Whistleblower Program are funded by the SEC's Investor Protection Fund, which contained ''nearly $452 million'' for FY 2013.[25] The recent audit by the SEC's OIG found that this funding mechanism is adequate for the foreseeable future.[26] Director McKessy has remarked repeatedly that the award monies are ''burning a hole in his pocket''[27] and has stressed that the Commission's payment of a whistleblower bounty ''after just one year of operation shows that we are open for business and ready to pay people who bring us good, timely information.''[28]

Some critics of the Program point to the fact that the SEC has made only one whistleblower award under the program, totaling $46,000. What is perhaps most surprising is not that the SEC has only made one award but that it was in a position to make it so quickly. According to Reuters, the SEC had investigated allegations of accounting fraud at China Voice, a small telecommunications firm, for more than three years but had not been able to make a case.[29] In November 2010, Dee Dee Stone, a tax consultant doing work for a firm affiliated with China Voice, became concerned about the number of complaints from investors in China Voice and related partnerships and contacted the SEC with information about suspicious money transfers she had detected.[30] (Ms. Stone has publicly confirmed that she was the anonymous whistleblower in the China Voice inquiry.[31]) Within five months of receiving information from Ms. Stone, the SEC completed its investigation and sued China Voice, entities affiliated with China Voice, and China Voice executives alleging they had duped investors out of $8.6 million in a Ponzi scheme.[32] The SEC attributed its ability ''to uncover the full dimensions of the scheme'' quickly and protect investors from further losses due to the inside information provided by the then-anonymous whistleblower.[33] On December 5, 2011, a federal district court entered final judgment against the founder of China Voice, several related entities, and China Voice and imposed monetary penalties in excess of $1 million[34] and posted a Notice of Covered Action on February 1, 2012.[35] Less than 18 months after the SEC received Ms. Stone's complaint, the SEC's Claims Review Staff reached a preliminary determination on May 18, 2012, that she should receive an award of 30 percent of the monetary sanctions collected by the SEC.[36] Even though the SEC collected only $150,000 as of the date of the whistleblower award, the Whistleblower Program authorizes the SEC to

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[20] Interview with Robert Khuzami, Thomson Reuters News and Insights, April 27, 2012, *available at* http://newsandinsight.thomsonreuters.com/Securities/News/2012/04_-_April/Interview__SEC_Enforcement_Division_Director_Robert_Khuzami.

[21] Thoms, *supra* note 19.

[22] Securities Regulation Institute Live Blog, ''Ethical Issues with Whistleblowers and Investigations,'' (Nov. 5, 2012), *available at* http://seclawcenter.pli.edu/2012/11/09/securities-regulation-institute-live-blog-ethical-issues-with-whistleblowers-and-investigations/.

[23] Jack Buehrer, *SEC Touts Higher-Quality Fraud Tips*, Agenda (September 4, 2012), *available at* http://agendaweek.com/c/403411/45461/SEC_Touts_HigherQuality_Fraud_Tips?referrer_module=searchResults&module_order=1&highlight=sec.

[24] SEC Office of the Inspector General, *Evaluation of the SEC's Whistleblower Program*, January 18, 2013, at 10-14, *available at* http://www.sec-oig.gov/Reports/AuditsInspections/2013/511.pdf. The OIG tested a statistical sample of whistleblower complaints and found that the ''average time it takes OMI staff to initially review a whistleblower [complaint] once [that office] has received it, is less than one day'' and that more than 50 percent of the sampled whistleblower complaints were reviewed the same day the SEC received them. *Id.* at 15-16.

[25] *See id.* at 26.

[26] *Id.* at 26-27.

[27] Susan Beck, *Summary Judgment: SEC's Whistleblower Chief Disappointed in Questions from Corporate America*, The AmLaw Litigation Daily (Nov. 26, 2012), *available at* http://www.americanlawyer.com/digestTAL.jsp?id=1202579387875&slreturn=20130303163258.

[28] SEC Press Release 2012-162, SEC Issues First Whistleblower Program Award (Aug. 21, 2012), *available at* http://www.sec.gov/news/press/2012/2012-162.htm.

[29] Sarah N. Lynch & Matthew Goldstein, *Exclusive: SEC builds new tips machine to catch the next Madoff*, Reuters (July 27, 2011), *available at* http://www.reuters.com/article/2011/07/27/us-sec-investigations-idUSTRE76Q2NY20110727.

[30] *Id.*

[31] Ben Protess & Nathaniel Popper, *Hazy Future for Thriving S.E.C. Whistle-Blower Effort*, N.Y. Times, April 24, 2013, *available at* http://dealbook.nytimes.com/2013/04/23/hazy-future-for-s-e-c-s-whistle-blower-office/?ref=todayspaper.

[32] *SEC v. Allen et al.*, Civil Action No. 3:11-CV-882-0 (N.D. Tex. Apr. 29, 2011), *available at* http://www.sec.gov/litigation/complaints/2011/comp21953.pdf.

[33] SEC Press Release 2012-162, SEC Issues First Whistleblower Program Award (Aug. 21, 2012), *available at* http://www.sec.gov/news/press/2012/2012-162.htm.

[34] SEC Litigation Release No. 22178, December 5, 2011, *SEC v. Allen et al.*, *available at* https://www.sec.gov/litigation/litreleases/2011/lr22178.htm.

[35] Notice of Covered Action 2012-5, *SEC v. Allen et al.*, Qualifying Judgment/Order: December 22, 2011, posted February 2, 2012, *available at* https://www.sec.gov/about/offices/owb/owb-awards/2012-nocas.shtml.

[36] *See* SEC Office of the Inspector General, *Evaluation of the SEC's Whistleblower Program*, January 18, 2013, at 17-18, *available at* http://www.sec-oig.gov/Reports/AuditsInspections/2013/511.pdf.

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award a whistleblower bounty on the amount collected, even if less than a million dollars, and that flexibility enabled the SEC to make the $46,000 whistleblower award, amounting to roughly 30 percent of what it collected.[37]

One federal court judge has observed that, in his experience, FCA qui tam claims are often brought by people who have ''an ax to grind'' or are ''driven by greed.''[38] In an effort to reduce the number of false FCA complaints, FCA qui tam relators, like SEC whistleblowers, are required to attest to the truthfulness of their allegations. However, it would not be surprising if the lure of significant financial bounties led some employees to question the lawfulness of observed conduct under the FCA or under the federal securities laws, especially in those instances where the legal boundaries are less than clear. A statistical sampling of whistleblower complaints conducted as part of the OIG audit found that OMI, on average, reviewed each whistleblower complaint in the sample within one day of receipt and determined that 69 percent of the sample required ''no further action.''[39] Its finding that 69 percent warranted ''no further action'' suggests that there may be a large number of non-meritorious complaints, although OMI applies the ''no further action'' determination to complaints involving matters already under investigation by the SEC and complaints more appropriately investigated by another agency as well as complaints lacking in merit.[40]

Assuming that the SEC can promptly screen out unmeritorious whistleblower complaints and focus its resources on investigating meritorious complaints, such complaints may require considerable cost to investigate and may not yield evidence of a securities law violation. For example, The New York Times reported on the significant efforts of a former Lehman analyst to substantiate a report he made to the SEC about insider trading involving allegedly shared analyst research at Lehman. Those efforts included (1) evidence that Lehman sales representatives were tipped off to upcoming research changes; (2) organizational charts and floor plans showing that some Lehman executives who were part of the research department were located near sales and trading desks; and (3) a thirdparty analysis of price movements of stocks in 361 downgrades by Lehman analysts between 2004 and 2008 showing that the stocks ''exhibited significantly different price behavior on the two trading days preceding a rating downgrade by Lehman Brothers than they did on other days.''[41] After receiving the analyst's report, Commission staff conducted a thorough investigation of the tipping claim, including a review of nearly 100,000 e-mails between 46 Lehman employees and 56 Lehman clients, ''the circumstances surrounding each of the research reports specifically identified by [the whistleblower]'' and ''trading by Lehman clients in all companies in which there was a material change in the stock price following the issuance of a Lehman research report'' before concluding that there was no case of insider trading.[42] More experience will be needed before an assessment can be made whether the benefits from the Whistleblower Program warrant the resources required.

Where (and How Often) Will the Whistle Be Blown?

From August 2011, when the SEC's Final Rules became effective, through September 30, 2012 (the end of FY 2012), the SEC received 3,335 whistleblower complaints.[43] We expect that this flow of whistleblower complaints will only increase over the next few years for a number of reasons. In light of the significant lead time often required to build and bring a SEC enforcement case, it is likely that some of these 3,335 whistleblower complaints will result in whistleblower awards in the next two years. Attendant publicity of these awards, especially if they are sizeable, may increase employee awareness of the Whistleblower Program, including the Program's promises to keep a whistleblower's identity confidential and to protect a whistleblower from retaliation. During 2012, the news was filled with headlines involving aggressive SEC enforcement of the federal securities laws and substantial multi-million dollar financial penalties and forfeitures imposed on financial institutions, hedge funds and corporations for conduct allegedly in violation of the federal securities laws. These settlements may alter the internal cost-benefit analysis of potential whistleblowers who may conclude that the lure of a non-discretionary multi-million dollar bounty of 10-30 percent of financial penalties significantly in excess of $1 million warrants the possible costs. Over the past 25 years, lawyers and law firms have developed expertise in representing FCA qui tam relators and litigating FCA cases. Encouraged by the SEC's whistleblower rules, many of these specialized counsel are actively recruiting possible whistleblowers and offering to organize their complaints and supporting documentation. Statements by Commission staff suggest that these marketing efforts have borne fruit: then-SEC Enforcement Director Khuzami attributed the increase in the quantity and quality of whistleblower complaints to outside counsel retained by whistleblowers.[44] For all of these reasons, we anticipate

[37] SEC Press Release 2012-162, SEC Issues First Whistleblower Program Award (Aug. 21, 2012), *available at* http://www.sec.gov/news/press/2012/2012-162.htm.

[38] Jaclyn Jaeger, *Judge Jed Rakoff: The Crucial Role of In-House Corporate Counsel*, Compliance Week (June 8, 2012) http://www.complianceweek.com/judge-jed-rakoff-the-crucial-role-of-in-house-corporate-counsel/article/244894/.

[39] *See* SEC Office of the Inspector General, *supra* note 24, at 16.

[40] *See* Heidi L. Hansberry, *In Spite of Its Good Intentions, The Dodd-Frank Act Has Created a FCPA Monster*, 102 J. Crim. L. & Criminology 195 (2012).

[41] Gretchen Morgenson, *Is Insider Trading Part of the Fabric?*, N.Y. Times, May 19, 2012, *available at* http://www.nytimes.com/2012/05/20/business/is-insider-trading-part-of-the-fabric-on-wall-street.html?pagewanted=all&_r=0.

[42] *Id*.

[43] U.S. Securities and Exchange Commission, *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2011* (Nov. 2011), 5, *available at* http://www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf; U.S. Securities and Exchange Commission, *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012* (Nov. 2012), 4, *available at* http://www.sec.gov/about/offices/owb/annual-report-2012.pdf.

[44] *See Interview with Robert Khuzami*, Thomson Reuters News & Insights, April 27, 2012, *available at* http://newsandinsight.thomsonreuters.com/Securities/News/2012/04_-_April/Interview__SEC_Enforcement_Division_Director_Robert_Khuzami.

that the volume of whistleblower complaints will increase over the next few years.

What Will be the Most Likely Areas of Whistleblower Complaints?

Insider Trading. Under Director Khuzami, the Enforcement Division adopted an ''intense focus'' on insider trading because it viewed the crime as one which ''destroys confidence in public markets, giving an upper hand to Wall Street's well-connected elite and putting average investors at a disadvantage.''[45] Of the 734 enforcement cases brought by the SEC in FY 2012, 58 (or 7.9 percent) involved insider trading against 131 individuals and entities.[46] Some of those actions involved ''financial professionals, hedge fund managers, corporate insiders, and attorneys.''[47] Over the past three years, the SEC has filed 168 insider trading actions, more than in any other three-year period in the agency's history.[48] The increasing focus by the SEC on insider trading investigations is underscored by the record-breaking number of settlements of insider trading claims reached in FY 2012: in that year, the SEC settled insider trading allegations with 118 individuals and eight organizations, almost double the total number of settlements from FY 2011.[49]

There has been significant mainstream media coverage of the criminal conviction of Raj Rajaratnam for insider trading and attendant $10 million fine and 11-year prison sentence and of the SEC's investigations into so-called ''expert networks,'' which pass material non-public information about companies and industries to hedge funds, mutual funds and other investment firms in exchange for large fees.[50] But media reports have also made clear that the SEC focus on ''expert networks'' is not limited solely to research firms who provide confidential information to hedge funds, mutual funds and other investment firms yielding multi-million dollar profits. Insider trading ''networks'' can involve those in all walks of life, not just savvy traders and research firms, and in some cases, amount to nothing more than a group of friends and family who trade on the basis of material, non-public information received from others. For example, the SEC recently brought insider trading charges against seven individuals, who belonged to a wine club and were New Jersey high school friends, alleging that three of the seven exploited their access to material, non-public information at two pharmaceutical companies and a medical technology company and regularly tipped the others, who passed that information on to other friends and family.[51] In its complaint, the SEC alleged that the seven often passed along information using code words while playing basketball, sharing dinner with friends or morning jogs, and charged that they collectively made $1.7 million in profits by trading on this inside information.[52] Six of the 7 were also criminally charged for the same conduct.[53] Similarly, significant press attention was directed to the charges brought by the SEC against an attenuated network of friends and colleagues, including former Baltimore Orioles baseball player Doug DeCinces, his neighbor James Mazzo, his teammate and Baseball Hall of Fame member Eddie Murray, David Parker, a businessman from Utah and others. According to the SEC, Mazzo provided DeCinces with material, non-public information on which DeCinces traded, and DeCinces tipped three others with that information in addition to Murray. DeCinces and the first three tippees allegedly made more than $1.7 million in profits from trades on this material nonpublic information and they agreed to pay more than $3.3 million to settle the SEC's charges.[54] Subsequently, they were indicted on criminal charges for the same insider trading behavior.[55] Mr. Murray allegedly made $235,314 in profits

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[45] Ben Protess & Azam Ahmed, *With New Firepower, S.E.C. Tracks Bigger Game*, N.Y. Times, May 21, 2012, *available at* http://dealbook.nytimes.com/2012/05/21/with-new-firepower-s-e-c-tracks-bigger-game/?pagemode=print.

[46] Select SEC and Market Data Fiscal 2012, at 3, *available at* http://www.sec.gov/about/secstats2012.pdf; SEC Enforcement Actions: Insider Trading Cases, *available at* http://www.sec.gov/spotlight/insidertrading/cases.shtml.

[47] SEC Enforcement Actions: Insider Trading Cases, *supra* note 46.

[48] *Id.*

[49] Elaine Buckberg, James Overdahl & Jorge Baez, *SEC Settlement Trends: 2H12 Update, Emphasis on Individual Accountability Drives Individual Settlement Values to a Post-SOX High*, NERA Economic Consulting (Jan. 14, 2013) at 8, available at http://www.securitieslitigationtrends.com/PUB_SEC_Trends_Update_2H12_0113.pdf.pdf.

[50] *See, e.g.*, Ronald D. Orol, *Expert networks key to SEC insider-trading cases*, Market Watch, Wall Street J., Nov. 21, 2012 (discussing charges brought by the SEC alleging that hedge fund portfolio manager Mathew Martoma traded on material non-public information about a drug trial provided by Dr. Sidney Gilman, chairman of a safety-monitoring committee overseeing the clinical trial and a paid consultant to an expert networking firm), *available at* http://articles.marketwatch.com/2012-11-21/economy/35250133_1_primary-global-research-expert-network-expert-network-firms; Joshua Gallu & Patricia Hurtado, ''Ex-Abaxis Employee Will Pay $145,000 in SEC Insider Case,'' Bloomberg, April 8, 2013, (reporting that sister of a participant in a research firm was charged with tipping her brother in advance of her employer's release of quarterly earnings, which enabled her brother to trade for his own account and to tip the managing director of Sonar Capital, an investment advisor, who pled guilty to criminal charges alleging that Sonar Capital used that information to reap profits and avoid losses totaling over $5.4 million, and the founder of Bari Capital, who pled guilty to criminal charges alleging that Bari Capital used that information to achieve trading profits of over $1.7 million), available at http://www.bloomberg.com/news/2013-04-08/ex-abaxis-employee-will-pay-145-000-in-sec-expert-network-case.html.

[51] David Voreacos, *Celgene, Sanofi Executives Charged With Insider Trading*, Bloomberg, Nov. 20, 2012, *available at* http://www.bloomberg.com/news/2012-11-19/celgene-s-lazorchak-five-others-charged-with-insider-trading.html.

[52] *SEC v. Lazorchak et al.*, C.A. No. 2:12-cv-07164-KSH-PS (D.N.J. filed Nov. 19, 2012), *available at* http://www.sec.gov/news/press/2012/2012-234.htm.

[53] FBI Press Release, Three Pharmaceutical/Medical Technology Executives Among Six People Charged with Insider Trading, (Nov. 19, 2012), *available at* http://www.fbi.gov/newark/press-releases/2012/three-pharmaceutical-medical-technology-executives-among-six-people-charged-with-insider-trading.

[54] *Former Angel Doug DeCinces Charged With Insider Trading*, CBS News, Aug. 4, 2011, *available at* http://losangeles.cbslocal.com/2011/08/04/former-angel-doug-decinces-charged-with-insider-trading;

[55] *Former MLB All-Star Doug DeCinces indicted for insider trading*, USA Today, Nov. 28, 2012, *available at* http://www.usatoday.com/story/sports/mlb/2012/11/28/former-all-star-doug-decinces-indicted-insider-trading/1733479/.

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from his trades and agreed to settle the SEC's charges by paying $358,151.[56]

The SEC has long received tips from the public about insider trading activity. For example, its investigation of Raj Rajaratnam and his expert network sprang from a complaint alleging that his brother, Rengan Rajaratnam, the founder of Sedna Capital Management, ''was doling out a disproportionate share of his best trades to the beneficiaries of a 'friends and family' account.''[57] It would not be surprising if SEC whistleblowers surfaced from within an improper trading network, much like David Slaine, a former Galleon partner, who cooperated with the FBI in its investigation of Wall Street insider trading.[58] For FY 2012, the SEC received 190 SEC whistleblower complaints related to insider trading, amounting to 6.3 percent of the total complaints.[59] As recent insider trading cases brought by the SEC make clear, illegal insider trading is not limited to Wall Street: accountants, doctors, and baseball players as well as former classmates, neighbors and friends have engaged in illegal trading. Heightened public awareness of the SEC's focus on insider trading and of the unfair advantages obtained by individuals who trade on the basis of material non-public information, combined with the outsized penalties and fines sought from Raj Rajaratnam, Matthew Martoma and others, may incentivize potential whistleblowers to come forward and report allegedly improper trading because of the potential payday.

Ponzi Schemes. Post Madoff, the SEC has focused considerable resources on not missing the next Ponzi scheme. The SEC reports that, since FY 2010, it ''has brought more than 100 enforcement actions against nearly 200 individuals and 250 entities for carrying out Ponzi schemes.''[60] Individual investors are often lured to invest in Ponzi schemes because of their personal relationships with the scheme operators. Take the recent civil action filed by the SEC against Jim Donnan, a College Football Hall of Fame inductee, and his business partner Gregory Crabtree. The SEC alleged that Donnan raised $80 million from investors for a wholesale liquidation business that supposedly bought leftover merchandise from major retailers and resold it to discount retailers. Mr. Donnan sought out former players and coaches as investors. According to the SEC's complaint, Mr. Donnan told one former player, ''Your Daddy is going to take care of you'' and ''If you weren't my son, I wouldn't be doing this for you'' and the player invested $800,000.[61]

Complaints by investors about Ponzi or Pyramid schemes led the list of the ten most common complaints made to the SEC during FY 2012: the SEC reports that it received 4,083 such complaints, an increase of 1,328 percent over the 286 complaints relating to Ponzi schemes received in FY 2011, and attributes the ''vast majority . . . to a particular highly publicized SEC enforcement action.''[62] Assuming that whistleblower complaints alleging Ponzi schemes are classified by the OWB in the category ''Offering Fraud,'' roughly 15.5 percent of whistleblower complaints received during FY 2011 and FY 2012 involved Ponzi schemes.[63]

As noted above, Dee Dee Stone has been credited with heating up a ''cold trail'' of a Texas Ponzi scheme that the SEC had pursued for years without success when she produced documents to the SEC that ''laid bare a [growing Ponzi] scheme hidden in the company's books.''[64] Ms. Stone explained that she blew the whistle on the China Voice Ponzi scheme because she ''just wanted to stop the scheme before the investors lost everything they worked for.''[65] The SEC's continuing efforts to root out Ponzi schemes, combined with investors willingness to voice complaints to the SEC about suspected Ponzi schemes, are likely to stimulate additional whistleblower complaints.

Foreign Corrupt Practices Act. Another area where whistleblower complaints will likely increase involves possible violations of the Foreign Corrupt Practices Act (''FCPA''). Both the U.S. Department of Justice (''DoJ'') and SEC have repeatedly made clear their intent to prosecute alleged FCPA violations vigorously.[66] The SEC established a specialized unit to focus ''on new and proactive approaches to identifying violations of the [FCPA].''[67] Over the last two fiscal years, the work of that unit has borne fruit: the SEC brought more than 21 corporate FCPA enforcement actions yielding more than $266 million in corporate FCPA penalties.[68] In September 2012, then-Director Khuzami reiterated that FCPA enforcement would continue to be a top enforcement priority because violations represent ''a signifi-

[56] *See* Walter Hamilton, *Baseball star Eddie Murray settles insider-trading investigation*, L. A. Times (Aug. 17, 2012), *available at* http://articles.latimes.com/2012/aug/17/business/la-fi-sec-murray-20120818; Ashby Jones, *Hall-of-Famer Eddie Murray Hit With, Settles, Insider-Trading Charges*, Wall Street J., Aug. 17, 2012, *available at* http://blogs.wsj.com/law/2012/08/17/hall-of-famer-eddie-murray-hit-with-settles-insider-trading-charges/.

[57] Devin Leonard, *The SEC: Outmanned, Outgunned, and On a Roll*, Bloomberg Businessweek, April 19, 2012, *available at* http://www.businessweek.com/printer/articles/20972-the-sec-outmanned-outgunned-and-on-a-roll.

[58] David Glovin & David Voreacos, *Dream Insider Informant Led FBI From Galleon to SAC*, Bloomberg, Dec. 3, 2012, *available at* http://www.bloomberg.com/news/2012-12-03/dream-insider-informant-led-fbi-from-galleon-to-sac.html.

[59] *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012*, *supra* note 43, Appendix A.

[60] SEC Enforcement Actions Against Ponzi Schemes, modified April 2, 2013, *available at* http://www.sec.gov/spotlight/enf-actions-ponzi.shtml.

[61] Complaint, *SEC v. Donnan*, Case 1:12-cv-02831-ODE, para. 7 (N.D. Ga., Aug. 16, 2012).

[62] Select SEC and Market Data, Fiscal 2012, at 21 n.1, *available at* http://www.sec.gov/about/secstats2012.pdf.

[63] *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012*, *supra* note 43, Appendix A. *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2011*, *supra* note 43, Appendix A.

[64] Protess & Popper, *supra* note 31.

[65] *Id.*

[66] For example, former SEC Chair Schapiro explained that the SEC's strong enforcement of the FCPA ''incentivizes companies to self-assess and update their compliance and internal controls—all of which benefits companies' operations overall and provides greater transparency to investors.'' Letter of Chairman Schapiro to Senator Mike Crapo, September 23, 2011, *available at* http://www.scribd.com/doc/67832400/SEC-Chairman-Schapiro-FCPA-Letter-to-Senator-Crapo.

[67] Remarks by Robert Khuzami Before the New York City Bar, *My First 100 Days as Director of Enforcement*, Aug. 5, 2009, *available at* http://www.sec.gov/news/speech/2009/spch080509rk.htm.

[68] SEC Enforcement Actions: FCPA Cases, *available at* http://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml.

cant evil that has a big impact on the costs of goods and services that harms legitimate companies that are playing by the rules and losing business and losing competitive edges to those that break the rules.''[69] In December 2012, Kara Brockmeyer, chief of the SEC's specialized FCPA unit, observed that ''we are getting a pretty steady number of FCPA whistleblower complaints. . . . These are people who are in the middle of it, people who have the documents, who have good information.''[70] Chuck Duross, deputy chief of the DOJ's Foreign Corrupt Practices team, seconded her observation, stating that ''the quality of the information is on the whole better as a result of Dodd-Frank. . . . We are receiving information through lawyers—and getting that information is a force multiplier for us. It will have a significant impact.''[71]

For FY 2012, the SEC collected $118 million in corporate FCPA enforcement actions against 8 entities.[72] For FY 2011 and 2012, FCPA-related whistleblower complaints amounted roughly to 3.8 percent of the total volume of whistleblower complaints submitted to the SEC.[73] While it is too early to tell whether whistleblower complaints will impact SEC enforcement of the FCPA as substantially as the 1986 amendments affected FCA enforcement, it is quite likely that SEC whistleblowers will significantly impact the SEC's enforcement of the FCPA cases.

Financial Statement and Accounting Fraud Cases. In 2009, then-Enforcement Director Khuzami, speaking at the AICPA National Conference, explained that ''[f]inancial statement and accounting fraud is central to our Enforcement program—routinely comprising nearly 25 percent of all enforcement actions we bring annually. This constitutes the single largest category of actions we file, and is a main artery of our Enforcement program.''[74] However, SEC enforcement actions involving financial statement and/or accounting fraud have been on the wane since FY 2007. In FY 2007, the SEC brought 219 financial statement and issuer disclosure cases, amounting to 33 percent of all SEC enforcement actions;[75] in FY 2009, the SEC brought 143 such cases, or 22 percent of all enforcement actions;[76] in FY 2011, the number of such cases dropped to 89, or 12.1 percent of all enforcement actions;[77] and in FY 2012, the number of cases declined further to 79, or 10.8 percent of the total, the lowest in the past 9 years.[78]

As part of the 2009 reorganization of the Enforcement Division, five specialized units were created and the existing task force devoted to financial statement and accounting cases was eliminated. Then-Director Khuzami explained that the Enforcement Division was ''already 'specialized' in this area, and for that reason did not make it the subject of one of the new specialized units.''[79] Two years later in September 2011, he explained the downward trend in SEC financial statement and accounting cases on the grounds that ''people are considering things better, or the economic shakeout has resulted in people being more candid, or maybe everybody's communal efforts from [Sarbanes-Oxley Act of 2002] on down, and more conscientiousness and more attention in board rooms and amongst auditors.''[80] The following year, he added: ''In a world of limited resources, we must prioritize our efforts. . . . The reorganization helped to focus us on where the fraud is and not where the fraud isn't, while allowing us to remain fully capable of addressing cases of accounting and disclosure fraud.''[81]

Director Khuzami's explanation that the decline in SEC accounting and disclosure fraud cases is driven by significant reductions in accounting and disclosure fraud is challenged by recent survey findings. The Quarterly Corporate Fraud Index which measures internally reported complaints of fraud against reports of all compliance issues from more than 1,400 organizations worldwide, found that, for the second quarter of 2012, reports of possible corruption, misuse of corporate assets, accounting irregularities, and other reports of fraud accounted for 22.9 percent of all compliance reporting activity and the fifth consecutive quarter of record-high fraud reporting since the Fraud Index began in 2005.[82] In a similar vein, business professors at Duke and Emory Universities who surveyed 169 public company chief financial officers reported that the sur-

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[69] *Bingham Presents 2011: Enforcement After Dodd-Frank*, Edited Transcript, SEC Historical Society, Sept. 13, 2011, *available at* http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/programs/sechistorical-09132011-transcript.pdf.

[70] Bruce Carton, *A Look at the 'Intersection of Dodd-Frank's Whistleblower Provisions and the FCPA*, Compliance Week, Dec. 13, 2012, *available at* http://www.complianceweek.com/a-look-at-the-intersection-of-dodd-franks-whistleblower-provisions-and-the-fcpa/article/272584/

[71] *Id.*

[72] 72 SEC Enforcement Actions: FCPA Cases, *supra* note 68.

[73] *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012*, *supra* note 43, Appendix A. *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2011*, *supra* note 43, Appendix A.

[74] Speech by Robert Khuzami, Director, Division of Enforcement, Remarks at AICPA National Conference on Current SEC and PCAOB Developments, Dec. 8, 2009, *available at* http://www.sec.gov/news/speech/2009/spch120809rsk.htm.

[75] *See* SEC Select and Market Data: FY 2007, at 3, *available at* http://www.sec.gov/about/secstats2007.pdf.

[76] *See* SEC Select and Market Data: FY 2009, at 3, *available at* http://www.sec.gov/about/secstats2009.pdf.

[77] *See* SEC Select and Market Data: FY 2011, at 3, *available at* http://www.sec.gov/about/secstats2011.pdf.

[78] *See* Year-by-Year SEC Enforcement Statistics, 2003-2012, *available at* http://www.sec.gov/news/newsroom/images/enfstats.pdf.

[79] Remarks at AICPA National Conference on Current SEC and PCAOB Developments, *supra* note 74.

[80] Remarks of Director Robert Khuzami, ''Bingham Presents 2011: Enforcement After Dodd-Frank,'' Audiocast, SEC Historical Society, September 13, 2011, at minutes 15:25-15:48, http://www.sechistorical.org/museum/programs/bingham/.

[81] Francine McKenna, *Is The SEC's Ponzi Crusade Enabling Companies To Cook The Books, Enron-Style?*, Forbes (Nov. 5, 2012), *available at* http://www.forbes.com/sites/francinemckenna/2012/10/18/is-the-secs-ponzi-crusade-enabling-companies-to-cook-the-books-enron-style/1/.

[82] Caroline McDonald, *Fraud Reports Climb Still Higher*, CFO.com, Sept. 26, 2012, *available at* http://www3.cfo.com/article/2012/9/regulation_fraud-whistleblower-sec-jimmy-lin-jonny-frank.

The findings of the Corporate Fraud Index mirror the conclusions of a 2010 study by the Committee of Sponsoring Organizations of the Treadway Commission and a 2010-2011 report by Kroll, both of which found that corporate fraud has continued to increase in depth and breadth despite Sarbanes-Oxley and that methods of committing financial fraud have not materially changed.

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veyed CFOs believe that roughly 20 percent of public companies manage earnings, in any given period, to misrepresent economic performance and that such earnings manipulation is hard to unravel from the outside.[83]

The former chief of the SEC's Office of Market Intelligence observed recently that accounting fraud is one of the ''most challenging'' securities violations to investigate without help from insiders.[84] The recent episode involving accounting irregularities at Autonomy provides a real world example of that insight. In 2010, an Autonomy executive surfaced concerns about problematic accounting within the company and then brought those concerns to the attention of the SEC.[85] The SEC had no jurisdiction over Autonomy, however, because it was not a U.S. registrant.[86] After Hewlett-Packard bought Autonomy in October 2011 for more than $11 billion, a different Autonomy executive raised issues about problematic accounting practices within the company which were validated by an internal investigation by Hewlett-Packard and addressed with a write-down of much of the goodwill booked from the acquisition.[87]

There has been no shortage of SEC whistleblowers with complaints relating to corporate disclosure and financial reporting misconduct: for FY 2011 and 2012, the only two years in which the SEC has reported data on whistleblower complaints, complaints involving corporate disclosures and financial fraud constituted the greatest volume of whistleblower complaints received by the SEC (apart from the category ''other'').[88] Indeed, for FY 2012, such complaints amounted to almost 20 percent of the total received.[89]

[83] Ilia Dichev, John Graham, Campbell Harvey & Shivaram Rajgopal, *Earnings Quality: Evidence from the Field*, Feb. 21, 2013, *available at* http://dx.doi.org/10.2139/ssrn.2103384.

[84] McKenna, *supra* note 81.

[85] Ben Worthen, Paul Sonne & Justin Scheck, *Long Before H-P Deal, Autonomy's Red Flags*, Wall Street J., Nov. 26, 2012, *available at* http://online.wsj.com/article/SB10001424127887324784404578141462744040072.html.

[86] *Id.*

[87] Matt Egan, *H-P Discovers Fraud at Autonomy, Takes $8.8B Charge*, FoxBusiness, Nov. 20, 2012, *available at* http://www.foxbusiness.com/technology/2012/11/20/h-p-posts-mixed-4q-results-reveals-88b-autonomy-charge/.

[88] *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012*, *supra* note 43, Appendix A. *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2011*, *supra* note 43, Appendix A (whistleblower complaints involving corporate disclosure and financial reporting in FY 2011 amounted to 15.3 percent of the total, second to offering fraud at 15.6 percent).

[89] U.S. Securities and Exchange Commission, *Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012*, *supra* note 43, Appendix A.

SEC whistleblowers plainly perceive that accounting and disclosure improprieties are occurring at a greater rate than the SEC. A financial bounty paid to a whistleblower in connection with an enforcement action for accounting fraud or disclosure will likely provide a further incentive for corporate insiders to become SEC whistleblowers.

Conclusions

During a February 2013 industry conference, Acting Enforcement Director Canellos remarked that the Division was at an ''inflection point'' in redefining enforcement priorities as its focus shifted away from investigations relating to the 2008 credit crisis.[90] Will the SEC Whistleblower Program be a game changer in the shifting SEC enforcement landscape? While it may take a number of years before any reliable conclusions can be drawn, whistleblower complaints will almost certainly increase in the next few years and the quality of such tips will likely continue to improve as more whistleblowers engage counsel.

In this challenging regulatory environment, it is crucial for organizations regulated by the SEC to optimize their compliance infrastructure. We have previously written about a number of complimentary enhancements to existing compliance frameworks that should enable an organization to identify potential risks in its business operations and quickly act to mitigate or significantly reduce those risks.[91] We have also recommended a number of measures for organizations to consider so that they will be prepared to review reports of potential problems and, as appropriate, address wrongdoing. While we recognize that implementation of these recommendations will not be cost-free, an up-front investment in strengthening a compliance program should materially reduce the risk of a significant enforcement proceeding.

[90] Joshua Gallu, *SEC Enforcement Chief Sees Priority Shift From Crisis Cases*, Bloomberg, February 22, 2013, *available at* http://www.bloomberg.com/news/2013-02-22/sec-enforcement-chief-sees-priority-shifting-from-crisis-cases.html.

[91] William McLucas, Laura Wertheimer & Arian June, *Preparing for the Deluge: How to Respond When Employees Speak Up and Report Possible Compliance Violations*, 44 Bloomberg BNA Sec. Reg. & L. Report No. 19, 922 (May 7, 2012); William McLucas, Laura Wertheimer & Arian June, *Get Ahead of the Bus or Be Hit by the Bus: Practical Strategies for Meeting the Challenges and Mitigating the Risks of the Dodd-Frank Whistleblower Program*, 44 Bloomberg BNA Sec. Reg. & L. Report No. 11, 526 (March 12, 2012).