Labaton Sucharow

Reporting Without Regrets:

The SEC Whistleblower Handbook

In addition to the information contained in this Handbook, we encourage readers to visit our website here to review Frequently Asked Questions about the program, the reporting process and our Firm.

Table of contents

Introduction

At Labaton Sucharow, we work to protect and empower SEC whistleblowers, so they can successfully report securities violations—without personal or professional regrets. As first-hand witnesses to wrongdoing, whistleblowers are a formidable opponent to corruption. Their courageous actions safeguard jobs and investors, ensure fair markets and facilitate capital formation. When courageous individuals speak out against wrongdoing, we stand up, we step closer and use every tool in our arsenal to make their voices heard.

This handbook is a guide to this revolutionary process.

The Birth of the SEC Whistleblower Program

By 2010, a long series of corporate scandals had harmed numerous companies and countless individuals. Investor confidence was devastated. As the country debated how to break the cycle of fraud and corruption, financial watchdogs agreed on two fundamental truths: the investor protection status quo was failing and law enforcement could not effectively and efficiently police the marketplace without the help of individuals with actionable intelligence.

In response, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, one of the most significant financial reforms since the Great Depression. Under the statute, the SEC developed a revolutionary bounty program through which eligible whistleblowers can receive significant monetary awards, employment protections, and the ability to report anonymously. To qualify, an individual or group of individuals must voluntarily provide the SEC with original information that results in a successful enforcement action in which the SEC collects over $1 million in sanctions. Depending on various factors, the individual or group would receive a financial reward between 10% – 30% of the sanctions collected.

Days before the final rules were implemented in 2011, we predicted that history would reveal that in crafting the whistleblower provisions of Dodd-Frank, Congress and the SEC created a potent system to fight misconduct. Today, we can say with absolutely certainty that the SEC Whistleblower Program is one of the most successful public-private partnerships in history. The Commission has reported consistent increases in the volume and quality of tips. And, as of this writing, the SEC has awarded more than $153 million to courageous whistleblowers and secured more than $1 billion in monetary sanctions for injured investors.[1]

The ability to report possible misconduct anonymously is one of the most important pillars of the SEC Whistleblower Program.

Anonymous Reporting

In the past, fear of retaliation and blacklisting prevented corporate whistleblowers from reporting wrongdoing in the workplace. Corporate cultures of silence and complicity developed writ large and intimidated those who would speak out against misconduct. As a result, law enforcement and regulatory authorities were often unable to detect and prosecute securities violations, especially in earlier stages. Too often, hidden fraud and misconduct would fester and grow until they were discovered in the midst of a complete corporate collapse—leaving employees and companies devastated. To minimize risk of retaliation, the SEC Whistleblower Program empowers whistleblowers by allowing anonymous reporting. The vast majority of Labaton Sucharow clients, who are often senior executives, elect this option.

The ability to report possible misconduct anonymously is one of the most important pillars of the SEC Whistleblower Program To anonymously report possible violations to the SEC, a whistleblower must be represented by an attorney and must provide counsel with a copy of the whistleblower submission signed under the penalty of perjury.[2] The attorney will verify the identity of the whistleblower before submitting any information to the SEC; serve as an intermediary between the SEC and whistleblower during any investigation and related enforcement action; and advocate for the highest potential monetary award if the submission results in a successful SEC enforcement action. Prior to receiving any monetary award, for eligibility, tax and other reasons, whistleblowers must disclose their identity to the SEC.

Over the years, the SEC has carefully guarded the anonymity of whistleblowers, and is required to make every effort to protect any sensitive identifying information. In Fiscal 2016, nearly 65% of SEC Whistleblower award recipients were company insiders and almost one quarter of the award recipients submitted their information anonymously through counsel.

$368M

BALANCE OF INVESTOR PROTECTION FUND FROM WHICH AWARDS ARE PAID (AS OF FY 2016)

$153M

SEC WHISTLEBLOWER AWARDS PAID TO DATE

4,218

NUMBER OF SEC WHISTLEBLOWER SUBMISSIONS IN FY 2016

Employment Protections

Dodd-Frank also established powerful anti-retaliation protections for whistleblowers, including a new private right of action for employees subjected to retaliation by their employer. The Act also significantly improved existing whistleblower-protection laws, most notably the related provisions of the Sarbanes-Oxley Act of 2002 (SOX). Many whistleblowers may also be eligible for other federal and state whistleblower protections.

Anti-Retaliation Protections for SEC Whistleblowers

Under the SEC Whistleblower Program, an employer may not discharge, demote, suspend, threaten, harass, or take any other retaliatory action against an employee who:

- provides information about his or her employer to the SEC in accordance with the whistleblower rules;
- initiates, testifies in, or assists in an investigation or judicial or administrative action; or
- makes disclosures that are required or protected under SOX, the Exchange Act, and any other law, rule, or regulation subject to the jurisdiction of the Commission.[3]

If retaliation occurs, the employee is granted an automatic private right of action in federal court, without the need to exhaust administrative remedies prior to filing.[4] In addition, some courts have held that the private right of action extends to disclosures even if an employee does not provide the information to the SEC. While the law is currently unsettled on this question,[5] the view of the majority of federal district and appellate courts is that Dodd-Frank does confer protection from retaliation for internal reporting of possible securities violations, even if the employee would not otherwise qualify as a whistleblower for purposes of receiving an award.[6] Both the SEC and Labaton Sucharow have advocated for this favorable legal interpretation.[7]

TThe SEC Whistleblower Program was specially designed to protect courageous whistleblowers and severely punish companies that retaliate against them.

The remedies available include reinstatement to the same seniority, double back pay, and litigation costs (including attorneys' fees and expert witness fees). An employee suing under this section must file the claim no later than six years from the retaliatory conduct or three years from when the employee knew, or reasonably should have known, of the retaliatory conduct, but in no event to exceed 10 years after the date of the violation.

To qualify for these anti-retaliatory protections, the whistleblower must possess a "reasonable belief" that the information provided relates to a possible securities violation. The SEC has explained that a "reasonable belief" is a subjectively genuine belief that the information demonstrates a possible violation, and that this belief is one that a similarly situated employee might reasonably possess.[8] Furthermore, the information must demonstrate a "possible violation," which eliminates frivolous submissions from eligibility.

In 2016, Labaton whisteblowers spurred a $415 million penalty against Merrill Lynch.

Enhancement of SOX Anti-Retaliation Protections

Dodd-Frank also enhanced anti-retaliation protections established by SOX, expanding coverage beyond public companies to employees of affiliates and subsidiaries of publicly traded companies.[9] This includes foreign subsidiaries and affiliates of U.S. public companies.[10]

The largest award in the history of the SEC Whistleblower Program—more than $30 million—was paid to an international whistleblower.

Through these enhancements, Dodd-Frank now provides broad extraterritorial reach in actions brought by the SEC and the Justice Department.[11] The SEC's whistleblower program was designed with an understanding of the nature of the global economy. Since the program's initiation, the SEC has received whistleblower tips from individuals in more than 100 countries outside the United States. Furthermore, Dodd-Frank expands SOX coverage to employees of nationally recognized statistical ratings organizations, such as Moody's Investors Service Inc., A.M. Best Company Inc., and Standard & Poor's Ratings Service.[12]

Finally, Dodd-Frank doubles the statute of limitations for SOX whistleblower claims from 90 to 180 days; provides for a jury trial for claims brought under SOX whistleblower protections; and declares void any "agreement, policy form, or condition of employment, including a predispute arbitration agreement" which waives the rights and remedies afforded to SOX whistleblowers.[13]

New Anti-Retaliation Protections for Financial Service Employees

Congress also created the Consumer Financial Protection Bureau through Dodd-Frank. The Dodd-Frank extends whistleblower protection to employees of financial products or services companies. Some examples of such companies include those that conduct the following: extend credit or services or brokers loans; provide real estate settlement services or perform property appraisals; provide financial advisory services to consumers relating to proprietary financial products (including credit counseling); or collect, analyze, maintain, or provide consumer report information or other account information in connection with decisions regarding the offering or provision of a consumer financial product or service.[14]

Employees of such companies cannot be retaliated against for any of the following:

(i) testifying or expressing the willingness to testify in a proceeding for administration or enforcement of Dodd-Frank;

(ii) filing, instituting or causing to be filed or instituted, any proceeding under any federal consumer financial law; or

(iii) objecting to, or refusing to participate in any activity, practice, or assigned task that the employee reasonably believes to be a violation of any law, rule, standard, or prohibition subject to the jurisdiction of the Bureau.[15]

A financial services employee who experiences retaliation must file a complaint within 180 days of the retaliatory conduct with the Secretary of Labor, and may seek de novo review in federal district court within 120 days of the Secretary of Labor's determination (or 210 days after filing with the Secretary of Labor). The sole requirement for filing a claim is to demonstrate, by a preponderance of the evidence, that the protected conduct was a "contributing factor" to the retaliation.[16] Upon such a showing, the burden shifts to the employer to show, by clear and convincing evidence, that it would have taken the same action regardless of the employee's protected activity.[17]

New SEC Power to Enforce the Anti-Retaliation Provisions

To further protect SEC whistleblowers, Dodd Frank empowered the SEC to bring enforcement actions for wrongful retaliation.[18] Concerning this Rule, the SEC has stated:

> Rule 21F-2(b)(2) states that Section 21F(h)(1) of the Exchange Act, including any rules promulgated thereunder, shall be enforceable in an action or proceeding brought by the Commission. Because the anti-retaliation provisions are codified within the Exchange Act, we agree with commenters that we have enforcement authority for violations of Section 21F(h)(1) by employers who retaliate against employees for making reports in accordance with Section 21F.[19] A number of recent cases demonstrate the SEC's expansive view on whistleblower protections, and its determination to fight back against retaliation.

Knowing that the SEC has your back, makes doing the right thing a lot easier.

The SEC has recently begun to wield its anti-retaliation authority in earnest

The SEC is keenly aware that in order to protect and encourage whistleblowers, it must fight against measures designed to stymie transparency. A number of recent cases demonstrate the SEC's expansive view on whistleblower protections, and its determination to fight back against retaliation.

In the case of Paradigm Capital Management, Inc.,[20] the whistleblower was Paradigm's head trader and a Labaton Sucharow client. He reported to the SEC that the firm and its owner had engaged in principal transactions that created an undisclosed conflict of interest with a client. After the firm learned of the whistleblowing, it reassigned the head trader to full-time compliance assistant, stripped him of his supervisory responsibilities, and otherwise marginalized him. Paradigm agreed to settle this case for $2.2 million, and the whistleblower received the statutory maximum award.[21]

In another landmark case, the SEC brought a stand-alone enforcement action for retaliation against International Gaming Technology, even though IGT was not found to have violated any other securities laws—including those which were the subject of the whistleblower's reports.[22]

Most recently, the SEC settled charges, including a retaliation charge, brought against SandRidge Energy. This case was notable because it involved internal reporting only.[23] Office of the Whistleblower Chief, Jane Norberg stated the following in the press release announcing the settlement: "Whistleblowers who step forward and raise concerns internally to their companies about potential securities law violations should be protected from retaliation regardless of whether they have filed a complaint with the SEC."[24]

Monetary Awards

In determining who qualifies for an SEC whistleblower award, there are four general criteria. It is important to note that certain threshold requirements are set forth in the Whistleblower Program and there are certain types of individuals that are either ineligible or are subject to additional procedural requirements before they can receive an SEC whistleblower award.[25]

Qualifying for a Reward as a Whistleblower

Typically, the Whistleblower Program provides for a monetary award to any eligible individual or group of individuals (a company or other entity is not eligible), regardless of citizenship, who:

- voluntarily provide the Commission;
- with original information about a possible violation of the federal securities laws;
- that leads to a successful enforcement action;
- resulting in monetary sanctions exceeding $1,000,000.[26]

Due to their importance, we examine each of these four main criteria for qualifying for a whistleblower award in greater detail.

Voluntarily Provide

To qualify for an award as a whistleblower, the first requirement is that the individual "voluntarily provide" the information to the SEC. Information is provided voluntarily if it is provided "before a request, inquiry, or demand" for such information: (i) by the SEC; (ii) by the Public Company Accounting Oversight Board or any self-regulatory organization in connection with an investigation, inspection or examination; or (iii) in connection with an investigation by Congress, the Federal Government, or a state Attorney General or securities regulatory authority.[27] The submission also will not be considered voluntary if the whistleblower was required to provide the information to the SEC as a result of a pre-existing legal duty to the Commission, or a contractual duty owed to the Commission or to one of the other authorities enumerated in the previous sentence, or pursuant to a duty that arises out of a judicial or administrative order.[28]Only a request, inquiry, or demand made on an individual whistleblower will be considered in connection with the question of whether a submission is voluntary.

A request, inquiry or demand on the organization for which a whistleblower is employed, for example, will have no bearing. Thus, if an employee is aware that a demand for information was made to his or her employer or that the employer is being investigated, and that employee provides the SEC with information about a possible securities violation, the submission could still be deemed voluntary. But an issue could arise if the employee provides the same information to the Commission that the Commission received as part of its investigation of the company (or would have received even if the employee had not provided the information to her employer during the investigation). That could affect the determination of whether the employee's submission led to a successful enforcement action, another required element for an SEC whistleblower award.

Another important caveat is that a submission to the SEC may be deemed voluntary, even if made after receiving a request, inquiry, or demand from the SEC, if the information was voluntarily provided to another law enforcement or regulatory authority prior to the SEC's request or inquiry.

Original Information

The second requirement for receiving an award is that the individual provide original information. To be considered original, the information must be:

- derived from independent knowledge or independent analysis;
- not already known to the SEC from any other source;
- not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the media, unless the whistleblower was the original source for the information; and
- provided to the SEC after July 21, 2010.[29]

Independent Knowledge and Independent Analysis. The Commission defines independent knowledge as factual information in the individual's possession that is not derived from publicly available sources.[30] Significantly, the information could be gained from experiences, communications, and observations in business or social interactions. In other words, the individual need not have first-hand knowledge of the possible violation, but could have learned of the facts from a third party.

Independent analysis is defined as an individual's own examination and evaluation of information that may be publicly available, such as financial reports, but which reveals information that is not generally known or available to the public.[31]

There are a number of important circumstances in which the SEC will not consider information to be derived from independent knowledge or analysis. These exclusions generally apply to narrow categories of individuals, such as lawyers, consultants, and other third parties who acquire information as part of their work on behalf of a client, or company insiders who learn of the information in connection with their role in an internal investigation into wrongdoing, as well as information acquired illegally. Specifically, information is excluded in the following circumstances:

- when the information is subject to the attorney-client privilege, unless disclosure of that information would otherwise be permitted by an attorney pursuant to § 205.3(d)(2), the applicable state attorney conduct rules, or otherwise;
- the information was obtained in connection with the legal representation of a client, and the lawyer seeks to make a whistleblower submission for his or her own benefit, unless disclosure of that information would otherwise be permitted by an attorney pursuant to § 205.3(d)(2), the applicable state attorney conduct rules, or otherwise;
- the information was obtained because the individual was (a) an officer, director, trustee, or partner of an entity and was informed of the allegations by another person, or learned of the allegations in connection with the entities internal process for identifying and reporting violations of law; (b) an employee whose duties involve compliance or internal audits, or an employee of a firm retained to perform compliance or internal audit; (c) employed by a firm retained to conduct an internal investigation; or (d) an employee of a public accounting firm and the information was obtained during an engagement; or
- the information was obtained by means determined by a United States court to violate federal or state criminal law.[32]

There are a few important exceptions to the third category of exclusions—individuals who are insiders and third parties retained to perform legal, audit, or investigative work. This exclusion will not apply if the whistleblower has a reasonable basis to believe disclosure is necessary to prevent the entity from engaging in conduct that will cause substantial injury to the entity or the investing public, or that the relevant entity is engaging in conduct that will impede an investigation. In addition, the exclusion will not apply if more than 120 days have elapsed since the whistleblower provided the information to the entity's audit committee, chief legal or compliance officer, or his or her supervisor.[33]

Original Source. As stated above, for information to be considered original, it cannot already be known to the SEC from any other source. There are two exceptions to this rule. First, the SEC will consider a whistleblower the original source of information that was previously received by the SEC from another source if that source obtained the information from the whistleblower or the whistleblower's representative in the first place (and the information otherwise satisfies the definition of original). Second, the SEC will consider a whistleblower to be the original source of information if that information derives from the whistleblower's independent knowledge or analysis and materially adds to the information already known to the Commission.[34]

Successful Enforcement Action

The third requirement is that the whistleblower's voluntarily provided, original information must lead to a successful enforcement action. The applicable rules set forth three circumstances constituting a successful enforcement action:

- The information provided to the Commission caused the Commission to commence an examination, open an investigation, reopen a previously-closed investigation, or inquire about different conduct as part of a current investigation, and the Commission brings a successful action based in whole or in part on the original information provided;
- The original information relates to a conduct that is already under investigation by the Commission (or other federal authority) and significantly contributes to the success of an enforcement action based on that conduct; or
- The information is provided by an employee through his or her employer's internal reporting procedures before or at the same time the employee submits the information to the Commission, and the employer then provides the employee's information (or the results of an internal investigation) to the SEC, which leads to a successful enforcement action (the employee will get the full credit for providing the information to the SEC).[35]

This last category was not in the original rules proposed by the SEC, and many comments expressed the concern that whistleblowers would completely bypass organizations' internal reporting mechanisms.[36] This provision was therefore added, along with other procedural incentives to encourage individuals to utilize internal compliance programs, and further encourage the use of these programs in facilitating compliance with the securities laws.

In addition, the SEC will pay an award based on sanctions collected in a related proceeding brought by the Attorney General of the United States, a regulatory authority or self-regulatory organization, or a state attorney general, that is based on the same information that led to the Commission's successful enforcement action.[37]

TOP WHISTLEBLOWER TIPS RECEIVED IN FY 2016

Monetary Sanctions Exceeding $1,000,000

Generally, the monetary sanctions must exceed $1 million in a single judicial or administrative action. In some circumstances, however, the SEC will aggregate the sanctions collected in two or more proceedings if the proceedings arise out of a common nucleus of operative facts.[38] In such cases, once this threshold is met, a whistleblower is eligible for a monetary award based upon all monetary sanctions collected in related enforcement actions—regardless of amount.

Procedures for Filing an SEC Whistleblower Submission

Regulation 21F provides two methods for submitting information to the SEC: (1) online using the Commission's Tip, Complaint or Referral Portal (http://www.sec.gov), or (2) by mailing or faxing a Form TCR to the SEC Office of the Whistleblower.[39] The whistleblower must declare under penalty of perjury that the information contained in the submission is true and correct to best of his or her knowledge.[40] Additionally, if the whistleblower wishes to remain anonymous, his or her submission must be made by an attorney in accordance with the same procedures just described.[41]

While the procedures for making a whistleblower submission to the SEC are relatively simple, it is essential that they be followed correctly, or a potential whistleblower might be disqualified from receiving an award or be ineligible for the anti-retaliation protections provided by Dodd-Frank.[42] Moreover, due to the SEC's limited resources and the high-volume of tips it receives, successful SEC whistleblowers often file sophisticated and detailed submissions. On behalf of its own SEC whistleblowers clients, Labaton Sucharow regularly files 100 page legal and factual whistleblower submissions with supporting exhibits.

Procedures for Filing an SEC Application for Award

After a successful enforcement action where the monetary sanctions exceed $1 million is announced, the SEC will post a Notice of Covered Action on its website. To claim an award, SEC whistleblowers and their legal counsel are required to mail or fax a completed application for award, SEC Form WB-APP, to the SEC Office of the Whistleblower, within 90 calendar days of the notice date. If the whistleblower provided his or her original submission anonymously, the whistleblower must disclose his or her identity on the Form WB-APP.[43]

As a courtesy, the SEC Staff often notifies known SEC whistleblowers or their legal counsel about the successful enforcement action and the opportunity to apply for an award. That being said, SEC whistleblowers are solely responsible for monitoring the SEC's Notices of Covered Actions, so they do not miss the deadline for filing an application for award. On behalf of our SEC Whistleblower Program clients, Labaton Sucharow regularly monitors these notices and files lengthy applications for awards that address the governing law and highlight their many significant contributions during the SEC investigation and any related prosecution.

Determining the Amount of the Award

If all conditions are met and a whistleblower is entitled to an award, the amount of that award will be between 10 and 30 percent of the sanctions collected by the SEC or other prosecuting authority.[44] Even if there are multiple whistleblowers, the total amount awarded to all whistleblowers will still range between 10 and 30 percent of the sanctions, with the amount of the award for each whistleblower determined on an individual basis. The determination of the specific percentage within the range that will be used to calculate a reward is in the sole discretion of the SEC. There is no ceiling for an SEC whistleblower award.

In reaching its determination of specific award, the SEC considers several factors unique to the circumstances of each case. The factors that may increase a whistleblower's award include:

- the significance of the provided information to the success of the action or related action, including how the information related to the action and the degree to which the information supported one or more successful claims;
- the degree of assistance provided by the whistleblower to the Commission in the action or related action, including, among other things, the extent to which the whistleblower explained complex transactions and interpreted key evidence, and assisted the authorities in the recovery of the fruits and instrumentalities of the violation;
- law enforcement interest in prosecuting and deterring the type of securities violation involved in the submission; and
- whether the whistleblower reported the potential violation internally using organizational compliance procedures.[45]

Conversely, factors that could reduce the size of a whistleblower's award are:

- the culpability or involvement of the whistleblower in the securities violation, including the whistleblower's role in and the extent he or she benefited from the violation;
- whether the whistleblower unreasonably delayed reporting the potential violation; and
- if the whistleblower internally reported the potential violation in accordance with his or her employer's compliance program, and whether, and the extent which, the whistleblower interfered with or undermined that program.[46]

As the above indicates, an individual will not automatically be precluded from receiving an award as a whistleblower if he or she had some culpability in the underlying violation. Generally, the extent of the culpability would merely be a factor considered by the SEC in determining the size of the award.

Due to the SEC's limited resources, the probability of a successful enforcement action and the size of monetary award are dramatically enhanced when whistleblower tips are supported by expert analysis and assistance.

Common Securities Violations

With the prospect of large financial awards and robust employee protections provided by Dodd-Frank and the SEC Whistleblower Program, it is important that individuals are aware of what constitutes a qualifying violation for the program.

A whistleblower may report any possible violation of the federal securities laws that has occurred, is ongoing, or is about to occur. However, for the SEC to obtain a monetary civil penalty, the relevant securities violation(s) must have occurred, or have remained ongoing, within the past five years, even if the whistleblower did not discover the possible violation until a later date.[47]

of altering revenues, expenses, earnings, and/or losses for a reporting period. Sometimes these transactions might even be legal, but they are used unlawfully. A violation under this category could also occur when a company fails to speak truthfully when discussing its financial results, in press releases or analyst or investor presentations. Additional examples include undisclosed conflicts of interest, corporate governance/legal matters, or revenue impact of one-time events.

Offering Fraud

Offering fraud generally occurs when an individual (or group of individuals) makes misrepresentations and/or omissions of material fact to potential investors in a new company.

One example of this type of fraud is individuals contacting potential investors to induce them into investing in a new, unknown company, by making false claims about the company. Another common type of offering fraud is a Ponzi scheme, where investors are paid returns from their own money or from the money invested by subsequent investors, rather than from any actual earned profit. The operator of the scheme induces new investors by paying unusually consistent or abnormally high returns to older investors. Pyramid schemes are also an example of offering fraud.

WHISTLEBLOWER TIPS BY ALLEGATION TYPE (AVERAGE)

19%	CORPORATE DISCLOSURES AND FINANCIALS
16%	OFFERING FRAUD
14%	MARKET MANIPULATION
7%	INSIDER TRADING
5%	TRADING AND PRICING
5%	FCPA
3%	UNREGISTERED OFFERINGS
3%	MARKET EVENT
2%	MUNICIPAL SECURITIES AND PUBLIC PENSION
24%	OTHER
3%	NOT REPORTED

Market Manipulation

Market manipulation is the interference with the free and fair operation of the market by engaging in conduct that creates an artificial price or maintains an artificial price for a security. Examples of market manipulation include:

- **Pump and Dump:** Where owners of a security spread false information so that the price of the security will increase (the pump). When the price of the security does increase based on these false rumors, the owners who spread the false information sell off their shares, making a profit (the dump).
- **Bear Raid:** Attempt by investors to move the price of a stock opportunistically by selling large numbers of shares short. The investors pocket the difference between the initial price and the new, lower price after this maneuver. This technique is illegal under SEC rules, which stipulate that every short sale must be on an uptick.
- **Wash Trading:** Wash trading involves the simultaneous or near-simultaneous selling and repurchase of the same security for the purpose of generating activity and increasing the price.
- **Matched Orders:** Orders to buy or sell securities that are entered with knowledge that a matching order on the opposite side has been or will be entered.
- **Painting the Tape:** Placing successive orders in small amounts at increasing or decreasing prices.
- **Spoofing/Layering:** A tactic that has been used by high frequency traders to manipulate prices, spoofing is the placing of a bid or offer with the intent to cancel before execution. "Layering" is a form of spoofing in which the trader places multiple orders on one side of the book, in order to create a false impression of heavy buying or selling pressure.

SEC enforcement cases don't get better with age.
Tips that are over 5 years old are pretty much dead on arrival.

Insider Trading

Insider Trading is the buying or selling of a corporate security while in possession of material information that is not known to the public at the time, but which later becomes public and causes the price of the security to rise or fall significantly. Often, this information is obtained by corporate insiders who have access to this material information based on their position inside the organization. That insider then buys or sells the securities based on that information.

Insider trading may also occur when a corporate insider "tips" the nonpublic information to someone outside of the organization, who then buys or sells securities. In that case both the provider and the recipient of the information are liable for illegal insider trading. Insider trading is unlawful because trading while having special knowledge is unfair to other investors who don't have access to such knowledge. An example of illegal insider trading is when an executive at Company A learned, prior to a public announcement, that Company A will be taken over, and bought shares in Company A knowing that the share price would likely rise.

Trading and Pricing

Trading and pricing violations include any number of trading techniques that are illegal under the securities laws. For example:

- **Market Timing/Late Trading:** This occurs when a mutual fund permits certain customers to purchase shares in the fund after trading has closed for the day. Because mutual fund prices are set once a day, a customer that purchases after trading is closed can do so at that day's price and not at the following day's price.
- **Marking the Close:** Buying or selling a security near the close of the day's trading in order to affect the closing price.
- **Front Running:** The buying or selling of securities while knowing that another investor is about to make a trade that will influence the price of the security. An example would be buying stock in Company A knowing that another investor is about to make a very large purchase of the same stock, causing its price to increase.
- **Pooling:** An agreement among a group of people delegating authority to a single manager to trade in a specific stock, for a specific period of time, and then to share the resulting profits or losses.
- **Freeriding:** Buying a stock in a cash account and selling before paying for it.
- **Stock Parking/Kiting:** Forms of collusion between trading parties in which a trade is entered into with a side agreement that the seller will buy back the stock from the buyer at a later time (done to meet/avoid disclosure obligations), or that they will disregard settlement obligations so that one party can exploit the delay and continue to trade based on a position that should no longer be available.
- **Naked Shorting:** Shares are sold short without arrangements made to borrow them to deliver, then seller intentionally fails to deliver within the standard three-day settlement period.
- **Churning:** When a broker engages in excessive buying and selling of securities in a customer's account chiefly to generate commissions that benefit the broker.
- **Cherry-Picking:** Where an investment professional with both proprietary and management operations delays trade allocations until after results are in, and then allocates in an unfair manner (i.e., takes more successful trades in the proprietary account and sticks the managed accounts with most of the losers).Foreign Corrupt Practices Act (FCPA)

The Foreign Corrupt Practices Act (FCPA)

The FCPA prohibits the offer, payment, or promise to pay money or anything of value—i.e., a bribe—to any foreign official in an effort to win or retail business from that foreign official's government.

It is not a violation of the FCPA, however, if (i) the payments are legal under the written laws of the country in which the payments are made; or (ii) the payment is a reasonable expenditure directly related to the conducting of business with a foreign government.

Unregistered Offerings

With limited exception, offerings of securities in the U.S. must be registered with the SEC. An offering that is not registered, or that fails to meet or adhere to the requirements for exemption, constitutes a violation (and sales, or attempted sales, are a serious crime).

Non-public offerings are among the more common exceptions to the registration requirement. This exemption, sometimes referred to as the "private placement" exemption, is established by Section 4(a)(2) of the Securities Act, and generally applies to offerings in which purchasers are informed, "sophisticated investors" who have agreed not to resell the securities to the public.

Notwithstanding these general parameters, however, this exemption leaves much to interpretation, and thus a safe harbor is included in Rule 506 of Regulation D. In addition, in Rules 504-504, Regulation D sets forth some other common exceptions to registration, which generally turn on one or more of the following:

- the size/duration of the offering (e.g., an offering of $1 million or less over a 12-month time period faces the least restrictions in qualifying for exemption);
- the means of solicitation (public advertising is often a hitch);
- the level of disclosure provided; and
- the characteristics of the investors and/or the securities.

The JOBS Act (discussed in Section I.H., supra) required certain amendments to existing exemptions and creation of new ones to make it easier, particularly for smaller companies, to raise capital without SEC registration.

Market Events

Market events refer to disruptions or aberrations in the securities markets, such as an unexpected interruption in trading on a securities exchange, a liquidity crisis or a flash crash. While not all such market events represent securities violations, the SEC has brought enforcement actions against exchanges and related entities where the market event was caused or exacerbated by the exchange's failure to follow relevant SEC or internal rules. The SEC and other federal agencies conduct surveillance of trends and dealer and investor positions to help determine whether market events are indicative of fraudulent activities.

Municipal Securities and Public Pensions

Municipal securities are debt securities issued by state and local governments in the United States and its territories, and are generally used to fund items such as infrastructure, schools, libraries, and other general municipal expenditures. Dealers in municipal securities are required to disclose material information about the securities to investors and, as with any security, securities laws prohibit any person from making a false or misleading statement of material fact, or omitting any material fact in connection with the offer, purchase, or sale of any municipal security. Thus, a failure to comply with these laws in connection with the purchase or sale of municipal securities would be an actionable securities violation subject to SEC enforcement.

Restrictive Employment Agreements

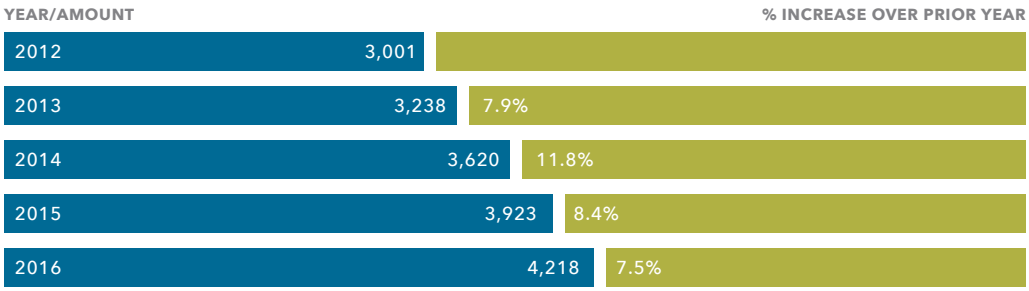
In addition to its new authority to bring enforcement actions based on retaliation against employee whistleblowers, the SEC can also pursue companies under Regulation 21F-17 for impermissible secrecy agreements that discourage employees from reporting possible securities violations to the SEC. This has been a particular point of emphasis for the regulator.

The first case brought was the Matter of KBR, Inc., which established that merely failing to make clear that a confidentiality provisions does not restrict reporting to the SEC can run afoul of the law. In that case, KBR required employees participating in an internal investigation to sign a broad confidentiality agreement which prohibited discussing particulars of an interview without the prior authorization of KBR's legal department upon threat of disciplinary action, including termination of employment. KBR agreed to pay a $130,000 fine and change its confidentiality agreement language going forward.[49]

Since the KBR case, the SEC has made clear that this is an area of continuing, keen focus. The issue also arose in the SEC's case against Merrill Lynch, which involved a group of SEC whistleblowers represented by Labaton Sucharow and settled in June 2016 for $415 million. The SEC found that Merrill Lynch had used "improper confidentiality provisions" in severance agreements for departing employees that prohibited them from disclosing confidential information to any outside entity without prior approval from the firm.[50]

In addition to the KBR and Merrill Lynch cases, there have been no less than seven other recently settled cases involving this issue, including BlueLinx Holdings Inc.,[51] Health Net, Inc.,[52] InBev,[53] NeuStar Inc.,[54] the above-discussed Sandridge Energy,[55] BlackRock Inc.,[56] and HomeStreet Inc.[57]

WHISTLEBLOWER TIPS RECEIVED BY THE SEC



Early Success of the SEC Whistleblower Program

Although the Whistleblower Program has been in effect for less than six years at the time of this writing, and SEC investigations typically take two to four years to complete, it has already had a tremendous impact on the enforcement of securities violations. Each year, the SEC receives more than 20,000 tips, complaints and referrals. Of these, more than 4,000 tips are received through the SEC Whistleblower Program. At any one time, the SEC actively conducts about 2,000 investigations. The SEC has made clear it has no patience for impeding whistleblowing in any form and has warned companies that it will sanction those that step out of line.

The SEC's Investor Protection Fund, exclusively dedicated to paying whistleblower awards, is richly endowed to continue this important work—with over $368 million in funds, as illustrated in the following chart:

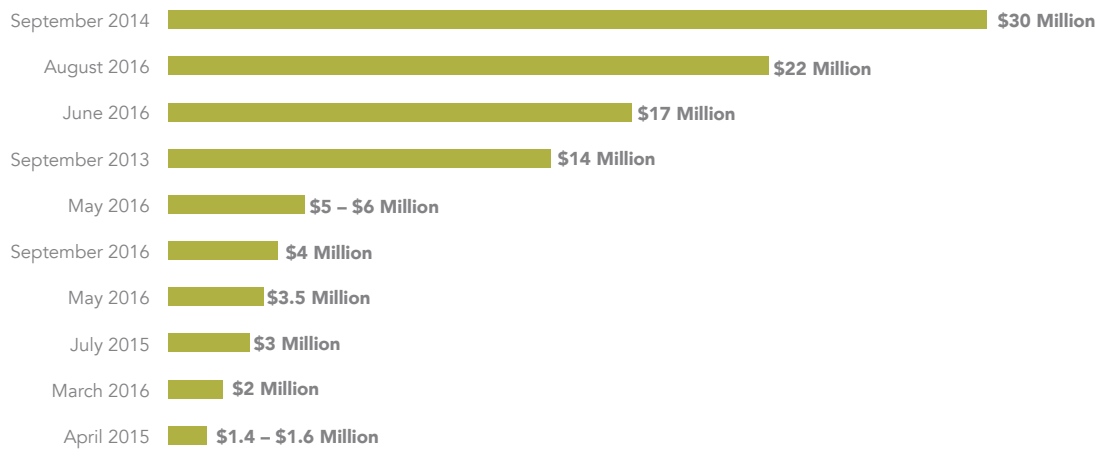
FY 2016

Balance of Fund at beginning of fiscal year	$	400,693,089.56
Amounts deposited into or credited to Fund during fiscal year	$	0.00*
Amount of earnings on investments during fiscal year	$	2,412,788.41
Amount paid from Fund during fiscal year to whistleblowers	$	(34,945,648.43)
Amount disbursed to Office of the Inspector General during fiscal year	$	(44,222.10)
Balance of Fund at end of the fiscal year	$	368,116,007.44

* Section 4D(a) of the Exchange Act, id. § 78d-4(a).

In addition, the following chart gives a sense of how whistleblower awards have been distributed so far:

TOP 10 SEC WHISTLEBLOWER AWARDS



To provide a sense of how significant SEC enforcement actions can be, in recent years, the SEC has secured more than $4 billion annually in monetary sanctions, with a number of individual actions exceeding $100 million. For example, some of our clients tipped the SEC about securities violations at Merrill Lynch that recently resulted in a staggering $415 million in sanctions!

The information provided by SEC whistleblowers has led to over $584 million in sanctions for violations or alleged violations.[58] These sanctions are commonly used to reimburse victimized investors, and can therefore literally be life-changing for individuals and their families. The program also provides immeasurable societal benefits by fostering orderly markets protecting employees and other vulnerable individuals.

Thus, we have it on good and abundant authority that participation in the whistleblower program by those situated to do so also leads to better sleep at night.

Our partners have had the pleasure of serving—for decades—in senior positions at the SEC and DOJ during both Republican and Democratic administrations. In our experience, unlike financial regulation, white collar law enforcement has been a bipartisan priority for most administrations. Given the program's early success, long-term potential and relatively low operation cost, we fully expect that the SEC Whistleblower Program will remain substantially unchanged in the years ahead.

The SEC has made clear it has no patience for discourage whistleblowing in any way.

Conclusion

The passage of Dodd-Frank and the enactment of the SEC Whistleblower Program were watershed moments in financial regulation and investor protection. Going forward, it is likely that many of the SEC's most significant enforcement actions will result from whistleblower tips, changing the landscape of securities enforcement for generations. Responsible organizations must carefully and continually evaluate their internal reporting systems and maintain cultures of integrity. However, bad actors may persist. It is vital to the safety and integrity of our markets that potential whistleblowers and their counsel familiarize themselves with the relevant statutory provisions and the rules adopted by the SEC so whistleblowers can properly and safely report and maximize their awards.

ENDNOTES

1 See https://www.sec.gov/page/whistleblower-100million.

2 As set forth in Regulation 21F-7(b), a whistleblower who wishes to submit information to the Commission anonymously must do the following: (1) . . . have an attorney represent [them] in connection with both [their] submission of information and . . . claim for an award, and [the] attorney's name and contact information must be provided to the Commission at the time [of] submi[ssion]; (2) . . . follow . . . procedures set forth in [Regulation] 21F-9 [involving, inter alia, attorney certification of certain information about the submission]; and (3) . . . disclose [their] identity to the Commission [which] must be verified [prior to payment of any award].

3 Exchange Act § 21F(h)(1)(A)(i)-(iii).

4 *Id.* at § 21F(h)(1)(B)(i). Victims of wrongful termination are commonly required to bring their claims, in the first instance, to an employment agency such as the Occupational Safety and Health Administration, the Equal Employment Opportunity Commission or their state Employment Agency. Section 21F(h) dispenses with that requirement.

5 Compare *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2d Cir. 2015) (holding that whistleblowers who report securities law violations internally but not to the SEC are nonetheless protected under Dodd-Frank from employer retaliation) and *Somers v. Digital Realty Trust, Inc.*, No. 15-17352, 2017 WL 908245 (9th Cir. March 8, 2017) (agreeing with *Berman*) with *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013) (holding to the contrary).

6 *See Feltoon v. MG2 Corp.,* No. 2:15-cv-02032, Dkt. 22, slip op. 4-5 (W.D. Wash. Sept. 30, 2016); *Lutzeier v. Citigroup, Inc.*, No. 14-cv-00183, 2015 WL 7306443, at *2 (E.D. Mo. Nov. 19, 2015); *Wadler v. Bio-Rad Labs., Inc.,* No. 15-cv-02356, 2015 WL 6438670, at **14-17 (N.D. Cal. Oct. 23, 2015); *Dressler v. Lime Energy*, No. 3:14-cv-07060, 2015 WL 4773326, at **4-16 (D.N.J. Aug. 13, 2015); *Connolly v. Remkes*, No. 5:14-cv-01344, 2014 WL 5473144, at **4-6 (N.D. Cal. Oct. 28, 2014); *Peters v. LifeLock Inc.*, No. 2:14-cv-00576, Dkt. 47, slip op. 6-13 (D. Ariz. Sept. 19, 2014); *Bussing v. COR Clearing, LLC*, 20 F. Supp. 3d 719, 727-35 (D. Neb. 2014); *Yang v. Navigators Group, Inc.*, 18 F. Supp. 3d 519, 533-34 (S.D.N.Y. 2014); *Khazin v. TD Ameritrade Holding Corp.*, No. 13-4149 (SDWQ)(MCA), 2014 WL 940703, at **3-6 (D.N.J. Mar. 11, 2014); *Azim v. Tortoise Capital Advisors, LLC*, No. 13-2267-KHV, 2014 WL 707235, at **2-3 (D. Kan. Feb. 24, 2014); *Ahmad v. Morgan Stanley & Co.*, 2 F. Supp. 3d 491, 495-97 n.5 (S.D.N.Y 2014); *Rosenblum v. Thomson Reuters (Mkts.) LLC*, 984 F. Supp. 2d 141, 146-49 (S.D.N.Y. 2013); *Murray v. UBS Securities, LLC*, No. 12-5914, 2013 WL 2190084, at *4 (S.D.N.Y. May 21, 2013); *Ellington v. Giacoumakis*, 977 F. Supp. 2d 42, 44-46 (D. Mass. 2013); *Genberg v. Porter*, 935 F. Supp. 2d 1094, 1106-07 (D. Colo. 2013); *Nollner v. Southern Baptist Convention, Inc.*, 852 F. Supp. 2d 986, 995 (M.D. Tenn. 2012); *Kramer v. Trans-Lux Corp.*, No. 3:11CV1424 SRU, 2012 WL 4444820, at **4-5 (D. Conn. Sept. 25, 2012); *Egan v. TradingScreen, Inc.*, No. 10 Civ. 8202, 2011 WL 1672066, at *5 (S.D.N.Y. May 4, 2011).

7 *See* 2016 Annual Report to Congress on the Dodd-Frank Whistleblower Program, at 21-22, available at https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf; *see also* Labaton Sucharow Petition for Rulemaking, July 18, 2014, available at https://www.sec.gov/rules/petitions/2014/petn4-677.pdf.

8 Implementation Release at 16 (emphasis in original) (citing *Livingston v. Wyeth, Inc.*, 520 F.3d 344, 352 (4th Cir. 2008); *Clover v. Total Sys. Servs., Inc.*, 176 F.3d 1346, 1351 (11th Cir.1999)).

9 Pub. L. 111-203, § 929A.

10 *Id.* at § 929P(b).

11 *Id.* at § 929P(c).

12 *Id.* at § 922(b).

13 *Id.* at § 922(c).

14 *Id.* at § 1002(15)(A).

15 Pub. L. 111-203, § 1057(a)(1)-(4).

16 *Id.* at § 1057(c)(3)(c).

17 *Id.*

18 17 C.F.R. § 240.21F-2(b)(2).

19 Implementation Release at 18.

20 Release No. 2014-118 (June 16, 2014), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542096307#.VAndkPldXxp.

21 *Id.*; *see also* Release No. 2015-75 (April 28, 2015), available at https://www.sec.gov/news/pressrelease/2015-75.html.

22 Release No. 2016-204 (Sept. 29, 2016), available at https://www.sec.gov/news/pressrelease/2016-204.html.

23 *See* Order, Release No. 79607 (Dec. 20, 2016), available at https://www.sec.gov/litigation/admin/2016/34-79607.pdf.

24 Release No. 2016-270 (Dec. 20, 2016), available at https://www.sec.gov/news/pressrelease/2016-270.html.

25 As set forth in Regulation 21F-8(c), the whistleblower cannot: (1) have been a member, officer, or employee of the Commission, the Department of Justice, an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board, or any law enforcement organization at the time they acquired the original information provided to the Commission; (2) have been a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority as that term is defined in . . . the Exchange Act (15 U.S.C. 78c(a)(52)) at the time they acquired the original information provided to the Commission; (3) be convicted of a criminal violation that is related to the Commission action or to a related action; (4) have obtained the original information through an audit of a company's financial statements, such that making a whistleblower submission would be contrary to requirements of Section 10A of the Exchange Act (15 U.S.C. 78j-a); (5) be the spouse, parent, child, or sibling of a member or employee of the Commission, or reside in the same household as a member or employee of the Commission; (6) have acquired the original information from a person or persons (i) who would be restricted under #4, above, unless the information is not excluded from their use or is about possible violations by them, or (ii) with intent to evade any provision of these rules; or (7) knowingly and willfully make any false, fictitious, or fraudulent statement or representation, or use any false writing or document knowing that it contains any false, fictitious, or fraudulent statement or entry with intent to mislead or otherwise hinder the Commission or another authority.

26 17 C.F.R. § 240.21F-3.

27 *Id.* at § 240.21F-4(a)(1).

28 *Id.* at § 240.21F-4(a)(3).

29 *Id.* at § 240.21F-4(b).

30 *Id.* at § 240.21F-4(b)(2).

31 *Id.* at § 240.21F-4(b)(3).

32 17 C.F.R. § 240.21F-4(b)(4)(i)-(iv).

33 *Id.* at § 240.21F-4(b)(4)(v).

34 *Id.* at § 240.21F-4(b)(5)-(6).

35 *Id.* at § 240.21F-4(c).

36 Implementing Release at 101-07.

37 17 C.F.R. § 240.21F-3(b).

38 *Id.* at § 240.21F-4(d).

39 *Id.* at § 240.21F-9(a). "TCR" stands for Tips, Complaints and Referrals.

40 *Id.* at § 240.21F-9(b).

41 *Id.* at § 240.21F-4(c).

42 Id. at § 240.21F-8(a).

43 17 C.F.R. § 240.21F-10(c).

44 17 C.F.R. § 240.21F-5(b).

45 *Id.* at § 240.21F-6(a).

46 *Id.* at § 240.21F-6(b).

47 *See* 28 U.S.C. § 2462; *Gabelli v. SEC,* 133 S.Ct. 1216 (2013).

48 *See* Appendix A of the SEC's 2016 Annual Report to Congress on the Dodd-Frank Whistleblower Program, available at https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf.

49 Release No. 2015-54 (April 1, 2015), available at https://www.sec.gov/news/pressrelease/2015-54.html.

50 Release No. 2016-128 (June 23, 2016), available at https://www.sec.gov/news/pressrelease/2016-128.html.

51 Release 2016-157 (Aug. 10, 2016) available at https://www.sec.gov/news/pressrelease/2016-157.html.

52 Release No. 2016-164 (Aug. 16, 2016), available at https://www.sec.gov/news/pressrelease/2016-164.html.

53 Release No. 2016-196 (Sept. 28, 2016), available at https://www.sec.gov/news/pressrelease/2016-196.html.

54 Release No. 2016-268 (Dec. 19, 2016), available at https://www.sec.gov/news/pressrelease/2016-268.html.

55 Release No. 2016-270 (Dec. 20, 2016), available at https://www.sec.gov/news/pressrelease/2016-270.html.

56 Release No. 2017-14 (Jan. 17, 2017), available at https://www.sec.gov/news/pressrelease/2017-14.html.

57 Release No. 2017-24 (Jan. 19, 2017), available at https://www.sec.gov/news/pressrelease/2017-24.html.

58 2016 Annual Report to Congress on the Dodd Frank Whistleblower Program, at 1, available at https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf.

In addition to the information contained in this Handbook, we encourage readers to visit our website here to review Frequently Asked Questions about the program, the reporting process and our Firm.

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