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AN EMPIRICAL ANALYSIS OF SEC ENFORCEMENT
ACTIONS IN LIGHT OF THE DODD-FRANK
WHISTLEBLOWER PROGRAM

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This Note examines the Securities and Exchange Commission's (SEC) enforcement decisions in light of the creation of the Office of the Whistleblower (OWB), which was enacted through the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Specifically, this Note looks at whether the types of violations that are pursued by the SEC have changed after the creation of the OWB. In addition, it examines the change in the monetary sanctions for actions in which a whistleblower is likely to be present. After conducting an empirical analysis using data contained in the Securities Enforcement Empirical Database, I find support for the conclusions that (1) enforcement actions in which a whistleblower is likely to be present increased after the creation of the OWB in 2011 and (2) the median disgorgement and civil penalty amounts for actions in which a whistleblower is likely to be present have decreased as compared to enforcement actions in which a whistleblower is unlikely to be present. Lastly, this Note examines possible policy implications of the Dodd-Frank Whistleblower Program (DFWP) and how a reliance on tips from whistleblowers may affect enforcement policy going forwards. Although there is not enough data at this point to support a robust statistical analysis, I conclude that the evidence supports the conclusion that the SEC has changed its enforcement policy after the creation of the DFWP and continued monitoring should take place to determine the role the OWB plays in the SEC's enforcement strategy.

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INTRODUCTION

The Dodd-Frank Whistleblower Program (DFWP), created through the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), represents a new resource for the Securities and Exchange Commission (SEC). The program rewards individuals who provide original information to the SEC with the purpose of helping the SEC to find more fraud and securities violations in the market place. The DFWP differs from previous bounty programs run by the SEC because it includes a mandatory award provision.¹

In the four years since its creation, the DFWP has been considered a success.² With the success of the program, it is possible that the SEC will change its enforcement policies to better utilize the program and to encourage more tips by third parties. This paper offers empirical evidence on certain SEC enforcement trends surrounding the creation of the DFWP and possible policy implications for those trends. The data to support these hypotheses comes from the NYU Pollack Center's Securities Enforcement Empirical Database.³

In this paper, I first assess the impact the creation of the DFWP has had on the types of violations the SEC pursues in its enforcement actions. I hypothesize that areas of focus for enforcement actions will change after the creation of the DFWP.

1. See S. REP. NO. 111-176, at 111 (2010).

2. See, e.g., Press Release, U.S. Sec. & Exch. Comm'n, SEC Receives More Than 3,000 Whistleblower Tips in FY2012 (Nov. 15, 2012), <http://www.sec.gov/news/press/2012/2012-229.htm>.

3. For a description of this data set and the methodology behind its creation, see Part II.A.

My first hypothesis is that violations that are more easily identifiable by individuals will increase. For evidence of these violations, I look at the frequency of enforcement actions categorized as either: issuer reporting and disclosure, market manipulation or securities offering. Since more individuals are involved in the commitment of these violations, I hypothesize there is more likely to be a whistleblower present to report these actions and therefore these types of actions will increase after the creation of the Office of the Whistleblower (OWB). Through my analysis, I find that these types of actions have increased since the creation of the OWB.

I also consider whether the creation of the DFWP has impacted the monetary sanctions charged by the SEC. I have two possible hypotheses regarding the change in monetary sanction amounts. First, I predict that because the SEC wants to incentivize individuals to provide tips to the OWB, monetary sanctions will increase after creation of the DFWP. In addition, the better use of resources and more complete information may help the SEC form stronger cases. My alternative hypothesis is that after the creation of the OWB, median monetary sanction amounts will decrease because the SEC is better able to find small violations it would not have been able to focus on without the aid of whistleblowers. To test these hypotheses, I compare various statistics relating to disgorgement and civil penalty amounts over time. I find that the median for both disgorgement and civil penalties has increased for actions in which a whistleblower is unlikely to be present as compared to those actions in which a whistleblower is likely to be present.

A number of variables could confound my results, such as the presence of cooperation, additional changes in law brought about by Dodd-Frank, the SEC's increased use of administrative proceedings and the SEC's new policy towards enforcement actions. I discuss the effects of these variables and conclude that they most likely affect the outcome of my hypotheses, but that I do not have sufficient data to support a robust statistical analysis at this point.

This paper proceeds as follows. Part I provides a brief history of the Dodd-Frank Whistleblower Program. Specifically, I discuss the history of whistleblower programs in general and how prior programs may have influenced Congress's choice in creating the DFWP. I also discuss the requirements for an individual to receive a whistleblower award after the successful re-

porting of a tip. Part II contains my empirical analysis and is organized as follows: Part A describes my sample and discusses the Securities Enforcement Empirical Database and the collection methodology for the information on enforcement actions contained in the database; Part B describes my methodology for testing both hypotheses described above; and Part C discusses results, providing possible explanations as well as a discussion of possible confounding variables. Part III of this paper discusses possible policy implications of the DFWP and the trends observed in my analysis. I discover that other SEC enforcement trends could impact my analysis, but that the creation of the OWB has played a part in the types of violations the SEC pursues and the sanctions it seeks in those actions. In looking at trends, I question whether the emphasis demonstrated on certain types of actions is appropriate when considering the role the SEC plays in the regulatory environment. Part IV concludes and notes the importance of continued monitoring of the DFWP in light of changing SEC enforcement policies.

I.

A BRIEF HISTORY OF THE DODD-FRANK WHISTLEBLOWER PROGRAM

Whistleblowing programs play an important historical role in regulating government and have been used often to aid the U.S. regulatory scheme. In general, a whistleblower is a person who exposes information that is either illegal or dishonest within an organization. Whistleblowers can report that information to an outside authority (such as a regulatory agency or the media) or within the organization to management. Generally whistleblowing is viewed as “[a]n important source of information vital to honest government, the enforcement of laws, and the protection of public health and safety.”⁴ Whistleblowers aid government regulatory agencies by pin pointing specific violations, thus allowing the agencies to save scarce resources.⁵

4. STEPHEN M. KOHN & MICHAEL D. KOHN, *THE LABOR LAWYER’S GUIDE TO THE RIGHTS AND RESPONSIBILITIES OF EMPLOYEE WHISTLEBLOWERS* 1 (1988).

5. Norman D. Bishara, Elletta S. Callahan & Terry M. Dworkin, *The Mouth of Truth*, 10 N.Y.U. J.L. & BUS. 37, 39 (2013).

To encourage increased whistleblower activity, regulatory agencies in the U.S. have focused on two methods to increase tips: (1) anti-retaliation measures and (2) monetary rewards. Whistleblower statutes have included anti-retaliation measures from 1926, with the creation of the Railway Labor Act (RLA).⁶ The National Labor Relations Act (NLRA) followed the RLA in 1935,⁷ and also included an anti-retaliation provision, specifically the protection of employees from termination as a result of joining in union-related activities. Many statutes include similar provisions that protect employees who internally or externally report violations from retaliation within the organization.⁸

Monetary rewards are a newer technique used by the legislature in creating effective whistleblower programs. The idea began with the False Claims Act of 1986,⁹ which rewards whistleblowers who successfully prosecute *qui tam* actions (those in the name of the government), against parties who have fraudulently claimed federal funds.¹⁰ “Research and experience show that significant financial rewards are the most effective legislative incentive to whistleblowing,”¹¹ and thus many new whistleblower programs designed by Congress include a mandatory reward provision.

Although whistleblower programs present an important opportunity to improve the efficiency of the U.S. regulatory scheme, there are consequences to consider when including a whistleblower provision in a statute. A reliance on tips from whistleblowers can lead an enforcement agency to focus on a too narrow enforcement area. Regulatory agencies that plan on using a whistleblower program must also ensure they have enough resources to examine every tip received. Agencies often have to filter through many tips, only to find a small per-

6. 45 U.S.C. §§ 151–188 (2012).

7. 29 U.S.C. §§ 151–169 (2012).

8. *See, e.g.*, Sarbanes-Oxley Act § 806, 18 U.S.C. § 1514A (2012); Occupational Safety and Health Act § 11(c), 29 U.S.C. § 660(c) (2012); Federal Surface Mining Act § 703(a), 30 U.S.C. § 1293(a) (2012); Title VII of the Civil Rights Act of 1964 § 704(a), 42 U.S.C. § 2000e-3(a) (2012).

9. 31 U.S.C. §§ 3729–3733 (2012).

10. 31 U.S.C. § 3730(d)(1)–(2) (2012). These whistleblowers receive up to 30% of the damages recovered in a *qui tam* action if brought in their individual capacity.

11. Bishara, *supra* note 5, at 93.

centage that is reliable and credible. Although there are potential downsides, whistleblower programs have been used successfully in the past, leading to an increased presence in future regulation.

Using the whistleblower principles established in the False Claims Act and other regulation passed by Congress, the DFWP was created as a part of Dodd-Frank in hopes of increasing the efficacy of SEC whistleblower programs already in place. In addition, the SEC recognized the constraints on its resources and hoped to increase public involvement in generating more enforcement actions.¹²

The DFWP builds on the whistleblower program signed into law as a part of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). Sarbanes-Oxley provided for protection from retaliation against whistleblowers but financial incentives were optional and limited to tips related to insider trading actions.¹³ As a result of the limitations, Sarbanes-Oxley was not successful in helping the SEC find fraud and other securities violations with the use of whistleblowers.¹⁴ In addition to the financial limits, possible whistleblowers feared retaliation. Whistleblowers who believed they had been discriminated against in retaliation had to file a complaint through the Department of Labor, who could then choose to pursue legal action against the company.¹⁵ Prior to the creation of the DFWP,

12. Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Opening Statement at SEC Open Meeting: Item 2-Whistleblower Program (May 25, 2011).

13. Bishara, *supra* note 5, at 49 (citing OFFICE OF AUDITS, OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, REPORT NO. 474, ASSESSMENT OF THE SEC'S BOUNTY PROGRAM, at ii (2010)). The existing program provided an award for tips from insider trading whistleblowers of an amount up to 10%, if the information led to a civil penalty. See Jayne W. Barnard, *Evolutionary Enforcement at the Securities and Exchange Commission*, 71 U. PITT. L. REV. 403, 414 (Spring 2010).

14. Sarah L. Reid and Serena B. David, *The Evolution of the SEC Whistleblower: From Sarbanes-Oxley to Dodd-Frank*, 129 BANKING L.J. 907, 908-09 (2012).

15. See OCCUPATIONAL SAFETY & HEALTH ADMIN., U.S. DEP'T OF LABOR, OSHA FACT SHEET: FILING WHISTLEBLOWER COMPLAINTS UNDER THE SARBANES-OXLEY ACT (2011), <http://www.osha.gov/Publications/osha-fact-sheet-sox-act.pdf>.

“the SEC only paid six whistleblowers, and the payment of all six claims totaled just over \$1.15 million.”¹⁶

In addition to allowing the SEC to seek monetary penalties against anyone for a securities law violation,¹⁷ Dodd-Frank included an enhanced whistleblower program. This enhanced whistleblower program was designed to encourage people to submit tips by removing the obstacles faced when reporting violations to the SEC.¹⁸ Dodd-Frank amended the Securities Exchange Act of 1934 (Exchange Act) to include Section 21F, titled “Securities whistleblower incentives and protection”¹⁹ to create the DFWP. Congress left the details of the DFWP to the SEC,²⁰ but required an office to be established within the Commission. On June 13, 2011, the SEC published its final rules regarding the DFWP, establishing the program, and these rules became effective on August 12, 2011.²¹

There are a few key requirements for an individual to receive an award through the DFWP. The DFWP rewards individual whistleblowers an amount ranging between ten and thirty percent of total monetary sanctions if they voluntarily provide original information to the SEC.²² This whistleblower award is mandatory and is not appealable, an important factor noted in

16. Reid & David, *supra* note 14, at 910; *see also* Marc S. Raspanti and Bryan S. Neft, *What’s Next for the Year-Old SEC Whistleblower Program?*, THE LEGAL INTELLIGENCER, Nov. 1, 2011), <http://www.thelegalintelligencer.com/id=1202520706258/Whats-Next-for-the-YearOld-SEC-Whistleblower-Program?slreturn=20150818175419>.

17. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 929P(a), 15 U.S.C. §§ 77h-1, 78u-2(a), 80a-9(d)(1), 80b-3(i)(1) (2012).

18. For example, it has been pointed out that prior to the DFWP, individuals were reluctant to come forward with information if they did not face investigation, especially because the SEC cannot provide immunity in a related criminal investigation. *See* 7 ALAN R. BROMBERG, LEWIS D. LOWENFELS, AND MICHAEL J. SULLIVAN, *The Madoff Affair and the SEC—SEC adopts changes—Cooperation by individuals*, in BROMBERG & LOWENFELS ON SECURITIES FRAUD § 19:16, at 9 (2014).

19. 15 U.S.C. § 78u-6 (2012).

20. 15 U.S.C. § 78u-6(j), 78u-7(a) (2012).

21. *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300 (June 13, 2011) (to be codified at 17 C.F.R. pts. 240, 249).

22. *See* Amanda M. Rose, *Better Bounty Hunting: How the SEC’s New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1260–61 (2014).

the legislative history surrounding the DFWP.²³ The information provided must lead to a successful enforcement action that results in more than \$1 million in monetary sanctions (including disgorgement, penalties and prejudgment interest).²⁴ There are certain whistleblowers that are ineligible for awards, including those that are employees of certain government agencies or those individuals who obtain the information through privileged conversations.²⁵ The SEC must also reward whistleblowers if the original information provided leads to other related actions.²⁶ A further description of each of these requirements is provided below.

To be considered voluntary, the whistleblower must provide the information before it is requested by a government body or regulatory agency.²⁷ The whistleblower is not considered to provide voluntary information if the information was required to be reported as a result of a preexisting duty.²⁸ Section 21F defines original information as “information that is derived from the independent knowledge of a whistleblower; is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and is not exclusively derived from an allegation made in a judicial or administrative hearing, in a government report, hearing, audit or investigation, or from the news media, unless the whistleblower is a source of the information.”²⁹ The OWB determines if information provided leads to a successful action depending on whether or not an investigation is already taking place. If no investigation has begun, the information must be “sufficiently specific, credible, and timely” and the SEC must bring the action based on the information.³⁰ If an investiga-

23. See S. REP. NO. 111-176, at 111 (2010) (“The Committee feels the critical component of the Whistleblower Program is the minimum payout that any individual could look towards in determining whether to take the enormous risk of blowing the whistle in calling attention to fraud.”).

24. 15 U.S.C. § 78u-6(a)(1), (4) (2012); 17 C.F.R. § 240.21F-3(a)(3)–(4) (2015); see also Rose, *supra* note 22, at 1260.

25. See Rose, *supra* note 22, at 1266.

26. 15 U.S.C. § 78u-6(b)(1) (2012); 17 C.F.R. § 240.21F-3(b) (2015).

27. 17 C.F.R. § 240.21F-4(a)(1)–(2) (2015).

28. 17 C.F.R. § 240.21F-4(a)(iii)(3) (2015).

29. 15 U.S.C. § 78u-6(a)(3) (2012).

30. 17 C.F.R. § 240.21F-4(c)(1) (2015).

tion is already in place, the information must “significantly contribute to the success” of the SEC.³¹

The SEC has wide latitude in determining the reward a whistleblower receives.³² Section 21F requires that whistleblowers receive no less than ten percent and no more than thirty percent of the total monetary sanctions.³³ Certain factors will be considered by the SEC in determining the reward amount, including, but not limited to, the significance of information provided, assistance provided by the whistleblower, extent to which the whistleblower participated in internal compliance systems, the culpability of the whistleblower, and any delay taken by the whistleblower in reporting the violation.³⁴ As a part of Dodd-Frank, and to protect the amount recoverable by victims of violations, Congress established the Investor Protection Fund (IPF),³⁵ from which whistleblowers are paid.

The SEC issued its first whistleblower award one year after the program started in the amount of \$50,000, representing thirty percent of the monetary sanctions in that case.³⁶ In 2014, the SEC announced that the amount this original whistleblower received would be increased by \$150,000 because of additional collections from defendants.³⁷ In 2014, the SEC awarded its largest whistleblower award to date in the amount of \$30 million.³⁸ The OWB reached its determination in the amount by considering “the significance of the claimant’s information, the assistance provided by the claimant, and

31. 17 C.F.R. § 240.21F-4(c)(2) (2015).

32. *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,331 (June 13, 2011) (to be codified at 17 C.F.R. pts. 240, 249).

33. 15 U.S.C. § 78u-6(b)(1) (2012).

34. 15 U.S.C. § 78u-6(c)(1)(B)(i) (2012); *see also* 17 C.F.R. § 240.21F-6(a)(1)–(4) (2015); § 240.21F-6(b)(1)–(3).

35. Dodd-Frank Act § 922, 124 Stat. 1376, 1841–49 (2010).

36. Press Release, U.S. Sec. & Exch. Comm’n, SEC Issues First Whistleblower Program Award (Aug. 21, 2012).

37. Press Release, U.S. Sec. & Exch. Comm’n, SEC Announces Additional \$150,000 Payment to Recipient of First Whistleblower Award (Apr. 4, 2014).

38. OFFICE OF THE WHISTLEBLOWER, U.S. SEC. & EXCH. COMM’N, 2014 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 10 (2014) [hereinafter DFWP REPORT 2014], <http://www.sec.gov/about/offices/owb/annual-report-2014.pdf>; *see* Order Determining Award Claim, Exchange Act Release No. 73,174 (Sept. 22, 2014).

the law enforcement interests at issue.”³⁹ In total in 2014, the SEC provided whistleblower awards to nine individuals in the amount of approximately \$1.9 million.⁴⁰ In 2013, the SEC made over \$14 million in payments to whistleblowers, the majority in a single award of \$14 million.⁴¹ The majority of individuals receiving whistleblower awards are either employees or contractors.⁴² To date the OWB has made awards to fourteen whistleblowers.⁴³

Overall, the SEC considers the DFWP to be a success.⁴⁴ As Mary Jo White stated, “Our whistleblower program already has had a big impact on our investigations by providing us with high quality, meaningful tips. We hope an award like this [referring to the \$14 million award made in 2013] encourages more individuals with information to come forward.”⁴⁵

The number of tips received by the OWB has increased each year since its formation. Since August 2011, the SEC has received a total of 10,193 tips and in 2014 alone received 3620 tips.⁴⁶ The OWB breaks down the tips it receives into whistleblower allegation type. The most common complaint categories (besides “other”) are: corporate disclosures and financials (16.9%), offering fraud (16%), and manipulation (15.5%).⁴⁷ These categories have remained consistent over the life of the DFWP.⁴⁸ Categories with year over year growth from 2013 to 2014 include: market event (56.2% growth), insider

39. DFWP REPORT 2014, *supra* note 38, at 10.

40. DFWP REPORT 2014, *supra* note 38, at 26. Note that this number is the amount paid from the fund during the fiscal year to whistleblowers and doesn't necessarily represent the total amount awarded in 2014.

41. OFFICE OF THE WHISTLEBLOWER, U.S. SEC. & EXCH. COMM'N, 2013 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 15 (2013) [hereinafter DFWP REPORT 2013], <http://www.sec.gov/about/offices/owb/annual-report-2013.pdf>.

42. DFWP REPORT 2014, *supra* note 38, at 16.

43. DFWP REPORT 2014, *supra* note 38, at 10.

44. *See e.g.*, U.S. Sec. & Exch. Comm'n, *supra* note 2 (“In just its first year, the whistleblower program already has proven to be a valuable tool in helping us ferret out financial fraud.”).

45. Press Release, U.S. Sec. & Exch. Comm'n, SEC Awards More Than \$14 Million to Whistleblower (Oct. 1, 2013).

46. DFWP REPORT 2014, *supra* note 38, at 20.

47. DFWP REPORT 2014, *supra* note 38, at 21.

48. DFWP REPORT 2014, *supra* note 38, at 22.

trading (30.6% growth), and FCPA (6.7% growth).⁴⁹ Some speculate that as a result of increased tips in certain areas, “companies operating abroad might face increased scrutiny due to whistleblower tips regarding anti-bribery and related accounting provisions set forth in the Foreign Corrupt Practices Act. A successful FCPA enforcement action can result in substantial monetary sanctions, thereby making it attractive to bounty-seeking tipsters.”⁵⁰ The OWB also tracks from where whistleblower tips originate. The most common states are California, Florida, New York, and Texas.⁵¹ The SEC also accepts tips from individuals abroad.

The DFWP provides for protection against retaliation. Employers are subject to investigation by the SEC if they discriminate against whistleblowers in terms or conditions of employment as a result of the employee providing information to the SEC.⁵² Unlike Sarbanes-Oxley, the DFWP allows whistleblowers the ability to sue their employers directly in federal court for reinstatement and back pay.⁵³ The SEC is prohibited from disclosing information regarding the identity of the whistleblower or the information provided by the whistleblower to further protect whistleblowers.⁵⁴

On June 16, 2014, the SEC brought its first enforcement action under the anti-retaliation provisions of Dodd-Frank.⁵⁵ In that case, the defendant, Paradigm Capital Management, was ordered to pay \$2.2 million: a portion to settle the trading violation and a portion to settle the retaliation charge against its head trader who had previously reported prohibited trans-

49. DFWP REPORT 2014, *supra* note 38, at 27 (percentages calculated). Note that a market event is defined as “disruption[] or aberration[] in the securities markets.” JORDAN A. THOMAS, SEC WHISTLEBLOWER PROGRAM HANDBOOK 13 (2013).

50. Donald Davidson & Benjamin Kimberly, *The Recent Increase in SEC Whistleblower Awards: A Sign of Things to Come?*, 19 No. 23 WESTLAW J. SEC. LITIG. & REG. 3, 6 (Mar. 20, 2014).

51. DFWP REPORT 2014, *supra* note 38, at 22.

52. 15 U.S.C. § 78u-6(h)(1)(A) (2012).

53. 15 U.S.C. § 78u-6(h)(1)(C) (2012); 15 U.S.C. § 78u-6(h)(1)(B)(i) (2012).

54. *See* 7 U.S.C.A. § 26(h)(B)(1); 15 U.S.C. § 78u-6(h)(1)(C) (2012).

55. *See* Press Release, U.S. Sec. & Exch. Comm’n, SEC Charges Hedge Fund Adviser with Conducting Conflicted Transactions and Retaliating Against Whistleblower (June 16, 2014).

actions to the SEC.⁵⁶ Even though the head trader was not fired, under Section 21F(h)(1), the SEC has authority to act on any retaliatory action. This case is an example of the seriousness with which the SEC takes the OWB. As Andrew J. Ceresney, director of the SEC Enforcement Division stated, “[t]hose who might consider punishing whistleblowers should realize that such retaliation, in any form, is unacceptable.”⁵⁷

II.

EMPIRICAL ANALYSIS

The success of the DFWP has consequences for SEC enforcement actions. The ability of the OWB to use outside sources for information may allow the SEC to better utilize its resources and may change the landscape of SEC enforcement actions. To test whether the DFWP has had an effect on enforcement actions, I created an empirical test to study before and after effects of the program.

A. *Sample Description and Data*

The data used in this paper comes from the Pollack Center’s Securities Enforcement Empirical Database (SEED). The documents within this database are public SEC enforcement documents available on the SEC website from years 2009 to 2014. The sample begins with every SEC enforcement document listed on the SEC website including: litigation releases, complaints, administrative proceedings, ALJ initial decisions, ALJ orders, and commission orders.⁵⁸ From the larger sample, documents that relate only to delinquent filings by companies are eliminated. This is done by identifying actions in which the SEC claimed only that the defendant violated Section 12(j) of the Exchange Act. Eliminating these documents makes sense for my purpose, as enforcement actions brought under 12(j) are unlikely to create a whistleblower award (since any monetary sanctions would be below \$1 million). Furthermore, the database eliminates actions in which only individuals are defendants. Although individual defendants can be the cause of whistleblower awards, for simplicity purposes these were re-

56. *Id.*

57. *Id.*

58. See *Litigation*, U.S. Sec. & Exch. Comm’n, <http://www.sec.gov/litigation.shtml> (last modified June 20, 2014).

moved. Finally, the SEED database focuses on public companies, so private companies and subsidiaries are removed from the dataset.

In total, 719 unique enforcement documents were examined. Each document and defendant was assigned a case ID and a defendant ID. To ensure no duplication in the hypothesis test, documents relating to the same defendant ID and case ID were aggregated. Within these 719 documents, there were 263 unique public company defendants; these 263 data points provide the basis of my analysis. None of the documents reviewed within the database indicated the presence of an SEC whistleblower.⁵⁹

B. *Hypothesis Testing*

Due to the large awards possible under the DFWP, I assess the impact the program has had on SEC enforcement actions as a whole. I hypothesize that the type of actions brought by the SEC has changed, both as a total and as a percentage of the whole. First, I predict that actions more easily identifiable by individuals will be more prevalent. These actions include: issuer reporting and disclosure cases, market manipulation cases and securities offering cases. Because more individuals are involved with the process of these violations, it is more likely that a person present will become a whistleblower.

In addition to assessing the types of violations that have changed since the introduction of the DFWP, I also assess the impact on monetary sanction amounts. I have two possible hypotheses. First, I hypothesize that as a result of the program and the large payouts, that monetary sanctions assessed in enforcement actions will increase on an aggregate basis. The increase would result from better cases and the SEC having better evidence in the case. It could also result from individuals tipping the SEC to bigger and more complex cases in hopes of receiving a larger award. My second hypothesis is that as a result of whistleblower tips, the SEC is better able to find smaller violations of the securities laws. It is likely that enforcement actions with high profile defendants and numerous violations would be found by the SEC's own enforcement staff. The abil-

59. Note that whistleblowers can choose to keep their identity confidential and so it is not possible to match whistleblower actions with data within the SEED database.

ity of the SEC to use public tips could lead to more enforcement actions that result in smaller monetary sanctions because the SEC can better use its resources to pursue cases of all sizes, especially those in which it would be difficult to prove scienter without inside information. To test these hypotheses, I compare median disgorgement and civil penalty amounts over time. Specifically, I look at the monetary sanction amounts involved with actions that are likely to have a whistleblower present and those unlikely to have a whistleblower present.

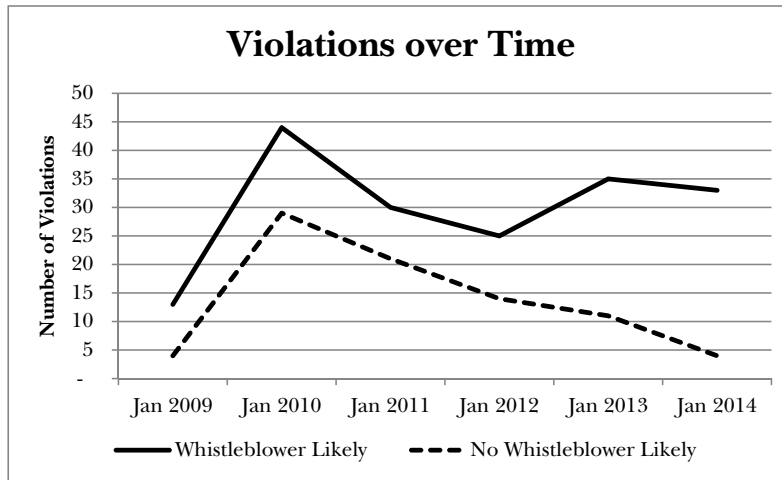
To test both hypotheses I use the difference in differences approach to determine the impact the DFWP has had on the variables. The difference in differences approach is a statistical technique to compare data measured at two or more periods of time. To compute the amount, I calculate the difference in amounts between Variable 1 and Variable 2 at a time before the creation of the OWB in 2011. I also calculate the difference in amounts between Variable 1 and Variable 2 at a time after the creation of the OWB. I then compare these two differences and examine how they have changed.

To test the first hypothesis, I began by creating summary statistics. I chose to look at the primary category classification to test this hypothesis. When each document is reviewed as a part of the SEED project, it is given one of eight primary categories based on the information in the document.⁶⁰ “Issuer reporting and disclosure” is assigned to documents that include misrepresentation or omission of information about securities. “Securities offering” is assigned to enforcement actions that include an offering, and generally relate to a misrepresentation or omission of important information about securities in a prospectus or offering document. “Market manipulation” is given to documents that describe a deliberate attempt to interfere with the free and fair operation of the market. I selected these three categories as types of violations in which whistleblowers are most likely to be present because there are more likely to be many individuals involved, and thus more opportunities for individuals to witness wrongdoing and report that to the SEC. This expectation lines up with tips re-

60. The possible categories available are: securities offering, issuer reporting and disclosure, FCPA, investment advisor/ investment companies, transfer agent, delinquent filings, broker dealer, insider trading, market manipulation, contempt, municipal securities & public pensions, and other.

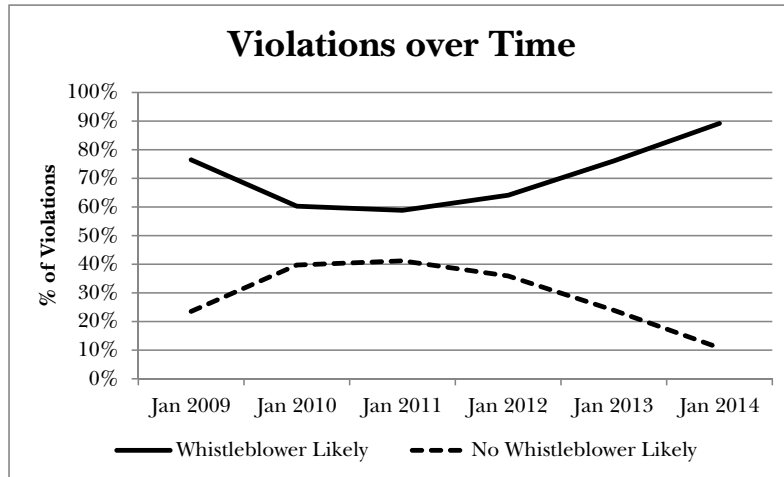
ceived by the OWB, as these are the three most popular categories of tips reported.⁶¹

As seen in the chart below, types of violations in which a whistleblower was likely to be present increased over time relative to those violations in which no whistleblower was likely to be present. There were 15 more whistleblower-likely violations at year-end 2010 compared with 29 more whistleblower-likely violations at year-end 2014. This difference in differences is a positive 14.

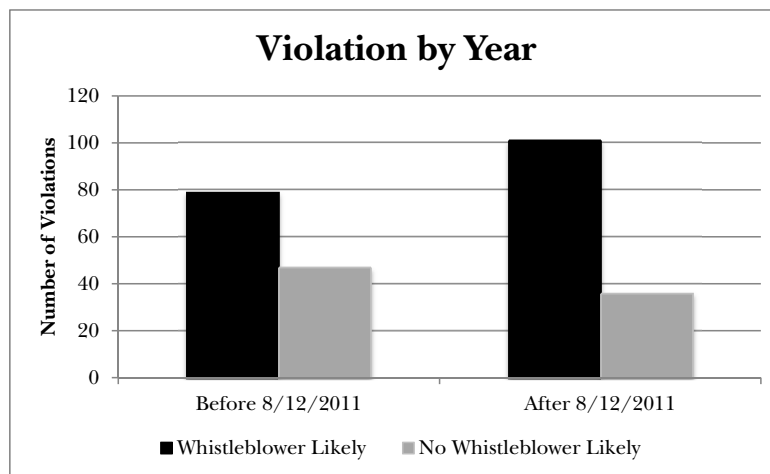


As a percent of total actions brought by the SEC, these whistleblower-likely violations also increased over time.

61. See DFWP Report 2014, *supra* note 38, at 21. Note that “other” is the most common category listed by whistleblowers and is used when the whistleblower doesn’t think their complaint fits into any allegation category listed on the questionnaire.



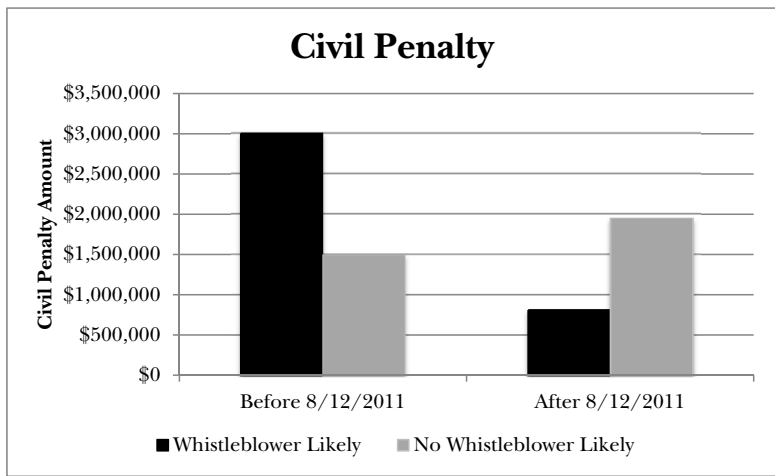
By comparing the two categories before and after the creation of the OWB (the date the SEC's final rules became effective), which took place on August 12, 2011, we see that violations that are likely to include a whistleblower increased, while those that are not likely to include a whistleblower decreased. Before the OWB, there were 32 more whistleblower-likely violations compared to no whistleblower-likely violations. After the OWB, there were 65 more whistleblower-likely violations in comparison. The difference in differences here is positive 33.



My second set of hypotheses focuses on the change in monetary sanctions after the creation of the whistleblower office. The SEED database records monetary sanction amounts when listed in enforcement documents. The SEC can seek either disgorgement, prejudgment interest on that disgorgement or a civil penalty. Prejudgment interest is calculated based on the disgorgement amount ordered by the SEC, so for the purpose of testing my hypotheses, I compare amounts only for disgorgement and civil penalty.

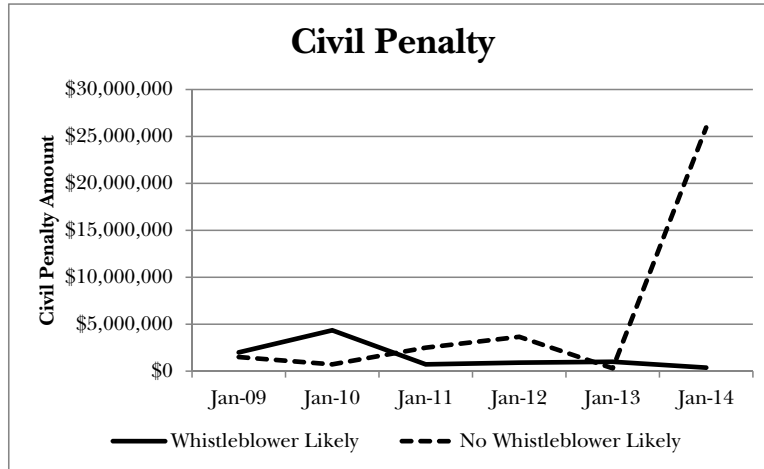
The SEED data contains a number of outlier cases that have massive monetary sanctions. A number of these are either cases that relate to the financial crisis or those that derive from FCPA actions, which typically have large penalties. Consequently, I computed medians to test my hypotheses.

The first set of graphs compares median civil penalty amounts. The first graph shows the median civil penalty for both whistleblower-likely actions and no whistleblower-likely actions before and after creation of the OWB. The median civil penalty charged in whistleblower-likely cases decreased below that of no whistleblower-likely actions after creation of the OWB. The difference in the differences here is around \$2.6 million.



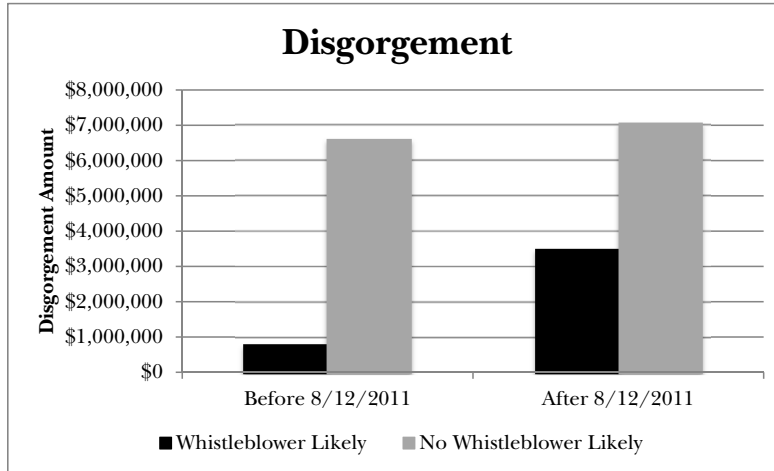
The following graph shows the median civil penalty amount over time for whistleblower-likely and no whistleblower-likely actions. The median civil penalty for

whistleblower-likely actions has remained fairly constant over the past five years; however, the median civil penalty for no whistleblower-likely actions increased dramatically above the median civil penalty for whistleblower-likely actions in 2014.

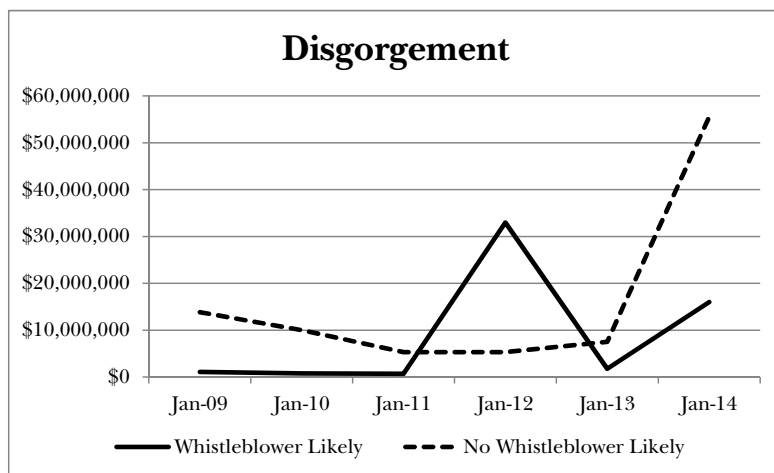


Taken together, these two graphs show that the median civil penalty for whistleblower-likely violations decreased after creation of the OWB, and that the median civil penalties in this category have not increased as dramatically as those in the no whistleblower-likely category.

The second set of graphs compares median disgorgement amounts. The first graph shows the median disgorgement for both whistleblower-likely actions and no whistleblower-likely actions before and after creation of the OWB. The median disgorgement charged in whistleblower-likely cases remained below that of no whistleblower-likely actions before and after creation of the OWB. However, the disgorgement amount in whistleblower-likely cases increased relative to the disgorgement amount in no whistleblower-likely cases. The difference in differences here is about \$2.2 million.



The following graph shows the median disgorgement amount over time for whistleblower-likely and no whistleblower-likely actions. The median disgorgement for whistleblower-likely actions rose above that of the median disgorgement for no whistleblower-likely actions in 2012, but has remained below otherwise. Like the median civil penalty, the median disgorgement for no whistleblower-likely actions increased dramatically above the median disgorgement for whistleblower-likely actions in 2014.



Taken together, these two graphs show that although the median disgorgement for whistleblower-likely actions increased after creation of the OWB, it did not increase to amounts greater than the median disgorgement for no whistleblower-likely actions.

C. *Explanation of Results and Proxy for Complication*

My first hypothesis, that enforcement actions in which a whistleblower was likely would increase, was demonstrated by the data. This trend confirms the SEC's focus in creating the DFWP, because one of the goals behind the DFWP was to create "an early warning system to detect fraud"⁶² and a major driver behind creation was the SEC's perceived failure to detect the Madoff scandal.⁶³ A trend of all primary categories shows that issuer reporting and disclosure represents the largest percentage of violations over the life of the SEED data, in line with this goal.⁶⁴ However, one of the SEC's stated goals is to monitor the entire marketplace,⁶⁵ which is not demonstrated by my hypothesis test. The SEC notes that it responds to certain problem areas,⁶⁶ which may explain this focus on these types of violations after the financial crisis. However, it appears the SEC has trends of enforcement based on response to market events and programs in place at the agency.

The hypothesis test for monetary sanctions seems to demonstrate both of my theories regarding the change in

62. Luis A. Aguilar, Comm'r., U.S. Sec. & Exch. Comm'n, Incentivizing Whistleblowers to Bring Fraud to Light, Speech at the Open Meeting (May 25, 2011), <http://www.sec.gov/news/speech/2011/spch052511laa-item2.htm>. This sentiment was also echoed by Chairman Mary L. Schapiro in her remarks on the program: "The new whistleblower program is a part of our effort to enhance the agency's capacity to detect and prevent fraud." Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm'n, Whistleblower Program, Opening Statement at SEC Open Meeting (May 25, 2011), <http://www.sec.gov/news/speech/2011/spch052511mls-item2.htm>.

63. OFFICE OF AUDITS, OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N., REPORT NO. 474, ASSESSMENT OF THE SEC'S BOUNTY PROGRAM, at ii (2010).

64. See *infra* graph in Appendix A.

65. U.S. SEC. & EXCH. COMM'N., 2014 AGENCY FIN. REP. 19 (2014), <http://sec.gov/about/secpar/secafr2014.pdf> [hereinafter SEC AFR 2014] ("In FY 2014, the SEC built an impressive record of cases that spanned the spectrum of the securities industry.").

66. See Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors?*, 63 BUS. LAW. 317, 343 (Feb. 2008).

monetary sanctions after creation of the OWB. In the disgorgement graphs, we see an increase of median disgorgement amounts for whistleblower-likely violations as opposed to no whistleblower-likely violations after the creation of the OWB. Perhaps this demonstrates the theory that the SEC is now pursuing larger cases as a result of large tips and better information from individuals. However, we see an opposite effect in the civil penalties graphs. The median civil penalty for whistleblower-likely violations has decreased in comparison to the median civil penalty for no whistleblower-likely violations. This trend may demonstrate my second theory, that the SEC is now able to go after more marginal violations of securities laws, or ones in which it would have been difficult to prove scienter without inside information from an informant.

There are a number of explanations for the observed decrease. The SEC is normally able to detect violations in large issuers because of increased media scrutiny and many of these cases lead to large monetary sanctions.⁶⁷ Perhaps, with whistleblower tips the SEC is better able to learn of smaller violations, or better use its resources to find smaller violations. In addition, because FCPA actions are included in the “No whistleblower likely” category, it’s possible there has been an increase in FCPA monetary sanctions that have increased the median disgorgement and civil penalty. Although FCPA actions pursued by the SEC have leveled off,⁶⁸ the large monetary sanctions usually involved in those cases could incentivize whistleblowers to report violations.

Some have hypothesized that because of the lengthy litigation process in these cases, whistleblowers often don’t receive awards until years after providing their tip.⁶⁹ Because of this, demonstrated effects of the whistleblower program may not be seen until a few years after initiation of the program, meaning

67. See Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 415 (2008).

68. See, e.g., Securities & Derivatives Enforcement and Regulatory Practice, 2014 SEC Enforcement Quarterly 4th Quarter 2014, SIDLEY AUSTIN LLP 2 (Dec. 17, 2014), http://www.sidley.com/~media/update-pdfs/2015/02/sec_enforcement-quarterly—4th-quarter-2014.pdf. In the last 3 years, the SEC pursued a steady amount of FCPA actions (12 in 2012, 8 in 2013 and 9 in 2014).

69. See Davidson & Kimberley, *supra* note 50, at 4.

sanctions could increase in the future. In further support of this theory are statements made by the SEC; the Associate Director of the Enforcement Division in 2013 said that results of the whistleblower initiative would be seen in five to ten years.⁷⁰

There are a number of factors that may have a confounding effect on the outcome of my hypotheses including: the SEC's increased use of administrative proceedings, the SEC's changed stance on enforcement policy, the SEC's use of cooperation and other changes in law arising from Dodd-Frank.

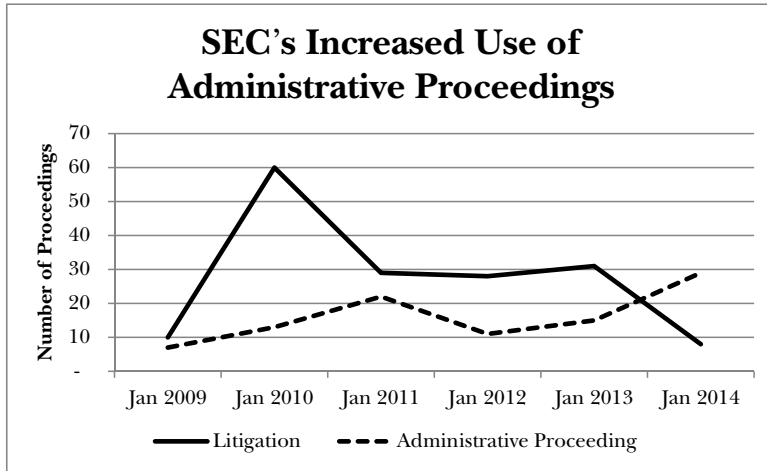
The SEC's increased use of administrative proceedings

The first possible confounding variable has received significant attention in the news: the recent trend in the SEC's use of administrative proceedings as opposed to litigation in federal court.⁷¹ This change may affect the penalty amounts and types of violations pursued by the SEC. Critics allege the SEC prefers to use the administrative proceeding solely because it has a better chance of winning and the fact its findings are given deference on appeal.⁷² The SEED database confirms the increased use of administrative proceedings as opposed to litigation. Seen below is the number of enforcement cases recorded as administrative proceedings versus litigation.

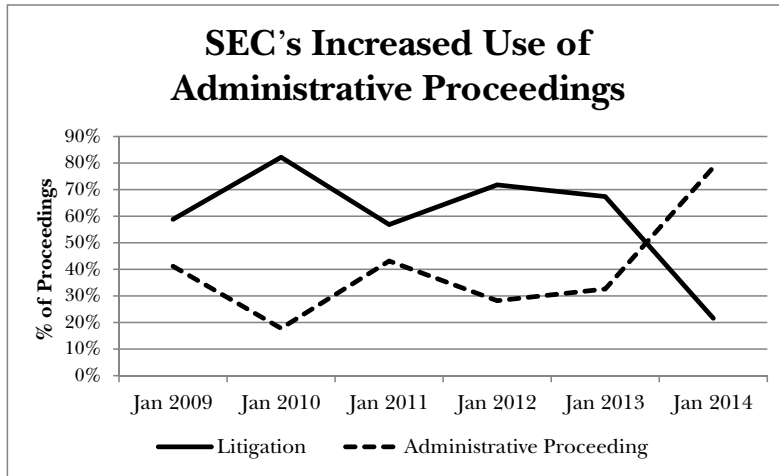
70. See *SEC's Cohen Predicts Major Whistleblower Awards Soon*, CORP. CRIME REP., Jun. 12, 2013, <http://www.corporatecrimereporter.com/news/200/sec-cohenwhistleblower06122013/>.

71. See, e.g., Jean Eaglesham, *SEC is Steering More Trials to Judges it Appoints*, WALL ST. J., Oct. 21, 2014, <http://online.sj.com/articles/sec-is-steering-more-trials-to-judges-it-appoints-1413849590>.

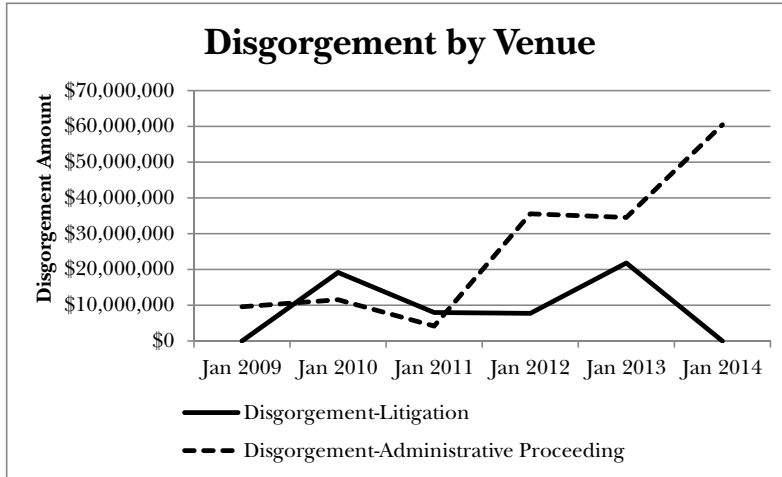
72. See Nate Raymond, *U.S. Judge Criticizes SEC Use of In-House Court for Fraud Cases*, REUTERS, Nov. 5, 2014, <http://www.reuters.com/article /2014/22/05/us-sec-rakoff-idUSKBN0IP2EG20141105> (citing facts that the SEC won 100% of administrative proceedings as opposed to 61% of federal court trials). Judge Rakoff has warned that through increased use of administrative proceedings, the SEC would "become, in effect, a law unto itself." See *Securities & Derivatives Enforcement and Regulatory Practice, 2014 SEC Enforcement Quarterly 4th Quarter 2014*, SIDLEY AUSTIN LLP 2 (Dec. 17, 2014), http://www.sidley.com/~media/update-pdfs/2015/02/sec_enforcement-quarterly—4th-quarter-2014.pdf.



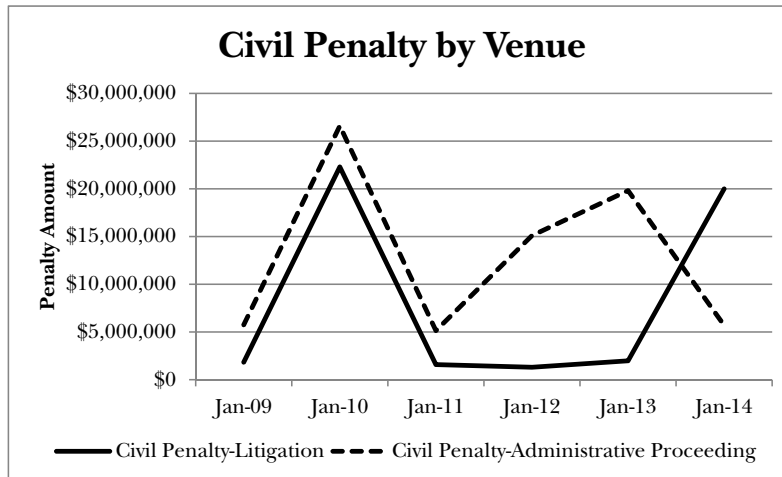
The result is also demonstrated through the increasing percentage of administrative proceedings as a whole.



The following series of graphs show that generally administrative proceedings provide for higher average monetary sanctions than litigation in federal court. Therefore, the increase in administrative proceedings may have caused a portion of the increase in disgorgement seen above.

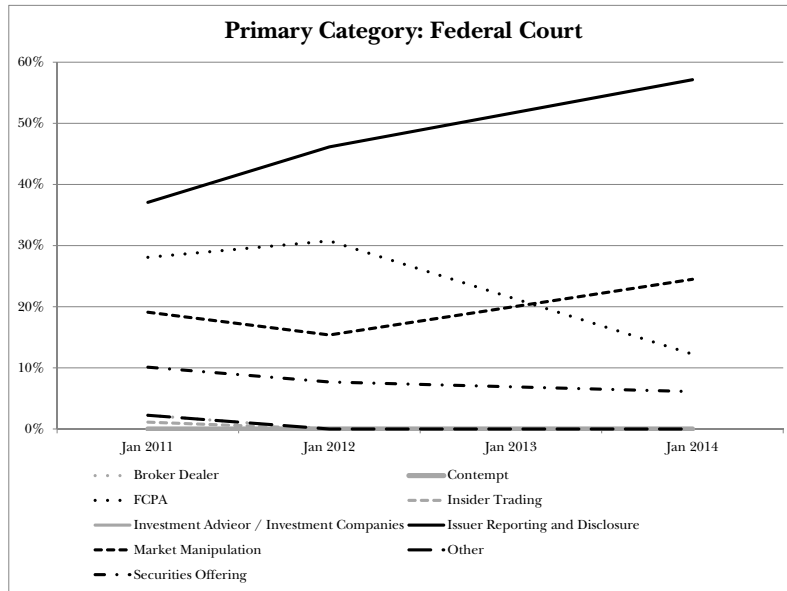


The trend as observed for civil penalties demonstrates that generally civil penalties are higher in administrative proceedings, with the exception of 2014.

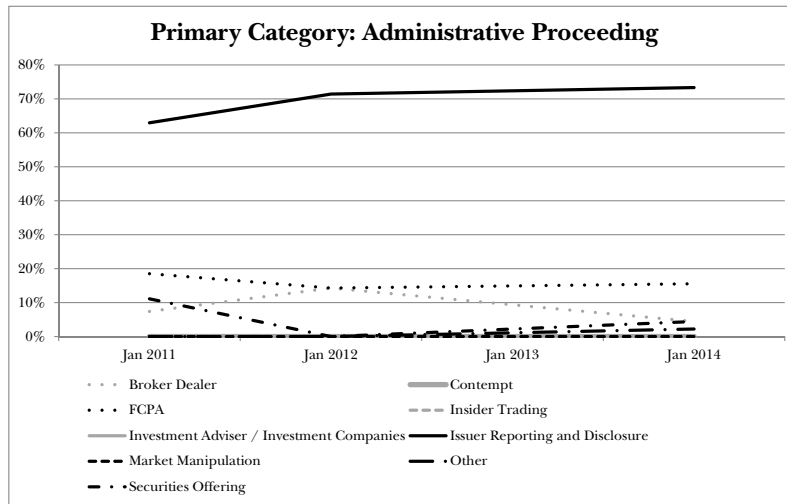


The increased use of administrative proceedings may also affect the types of violations and cases brought by the SEC.

The choice by the SEC to use either litigation or an administrative proceeding does not seem to affect the total mix of types of actions the agency brings when looking at the primary category. The graph below demonstrates the total mix of actions based on primary category for all proceedings held in federal court (those denoted as litigation proceedings in the SEED data). Issuer reporting and disclosure has increased in both venues.



In comparison, the graph below demonstrates the total mix of actions based on primary category for all administrative proceedings.



The SEC's change in enforcement policy

Outside factors may also influence the overall mix of types of cases the SEC pursues, which would influence the outcome of my hypotheses. The SEC desires to maintain constant enforcement in all areas, with no area receiving a majority of the attention.⁷³ However, the agency is responsive to changes in the financial environment and at times has devoted greater resources to “problem areas.”⁷⁴ In response to the financial crisis of 2008, the SEC and other regulatory agencies brought numerous cases against financial institutions, many of which allege fraud violations.⁷⁵ The number of these financial crisis vi-

73. See Black, *supra* note 66, at 343 (citing U.S. SEC. & EXCH. COMM’N., 2006 PERFORMANCE & ACCOUNTABILITY REP. 11 (2006), <http://www.secgov/about/secpar2006.shtml>). See also Jean Eaglesham, *As SEC Enforcement Cases Rise, Big Actions Are Sparse*, WALL ST. J., Sept. 29, 2014, <http://www.wsj.com/articles/assecenforcementcasesrisebigactionsaresparse1412028262>.

74. See Black, *supra* note 66, at 343 (emphasizing that the SEC can choose to devote resources to high-profile areas).

75. As of year-end 2013, the SEC had “filed 96 separate enforcement actions against 161 individuals and corporate entities relating to the financial crisis.” U.S. SEC. & EXCH. COMM’N., 2013 PERFORMANCE & ACCOUNTABILITY REP. 18 (2013), <http://www.sec.gov/about/secpar2013.shtml>. For example,

olations may have increased immediately after the financial crisis and continued for a number of years as the SEC was able to gather more information and resources to pursue the cases. This trend may explain the increase in cases containing issuer reporting and disclosure violations.⁷⁶ These cases also generated huge monetary sanctions, which could have an influence on my second hypothesis test.⁷⁷ As the SEC wraps up many of its cases related to the financial crisis, cases marked as issuer reporting and disclosure may decrease. However, the amount of fraud cases has remained fairly constant over the past five years, as it is a constant concern for the SEC. In 2013, the agency created the Financial Reporting and Audit (FRAud) Task Force in order “to improve the Enforcement Division’s ability to detect and prevent financial statement and other accounting frauds.”⁷⁸ As time passes, though, the SEC must find additional violations. In 2014, the SEC began showing its focus

in 2010, the SEC brought actions against Goldman Sachs, Citigroup and New Century. In all three deals, the SEC alleged violations of 17(a) or 10(b). See Press Release, U.S. Sec. & Exch. Comm’n, SEC Charges Goldman Sachs with Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages (April 16, 2010), <https://www.sec.gov/news/press/2010/2010-59.htm>; Press Release, U.S. Sec. & Exch. Comm’n, SEC Charges Citigroup Inc. in Connection with Misleading Disclosures Regarding its Exposure to Sub-Prime Assets, (July 29, 2010) <http://www.sec.gov/litigation/litreleases/2010/lr21605.htm>; Litigation Release, U.S. Sec. & Exch. Comm’n, No. 21609, SEC Settles with Former Officers of Subprime Lender New Century (July 30, 2010), <http://www.sec.gov/litigation/litreleases/2010/lr21609.htm>.

76. By comparing the SEC’s Performance and Accountability Reports, this trend appears to be true. The cumulative number of financial crisis cases filed according to the SEC are: 2010: 21 total; 2011: 36 total; 2012: 80 total; 2013: 96 total. See U.S. SEC. & EXCH. COMM’N, 2011 PERFORMANCE & ACCOUNTABILITY REP. 13 (2011), <http://www.sec.gov/about/secpar/secpar2011.pdf>; U.S. SEC. & EXCH. COMM’N, 2012 AGENCY FIN. REP. 13 (2012), <http://www.sec.gov/about/secpar/secafr2012.pdf>; U.S. SEC. & EXCH. COMM’N, 2013 AGENCY FIN. REP. 18 (2013), <http://www.sec.gov/about/secpar/secafr2013.pdf>.

77. See, e.g., Conduct Cost Project, *International Table and Results* (2014), <http://foreigners.textovirtual.com/ccp-research-conduct-costs/274/169353/ccp4-international-table-and-results-w-14b.pdf>, (last visited Feb. 17, 2015). This project compiles regulatory sanctions from financial institution financial statements and provides total worldwide sanction amounts (in GBP). Over half of the total penalties were attributed to U.S. regulators.

78. See Press Release, U.S. Sec. & Exch. Comm’n, SEC Announces Enforcement Results for FY 2013 (Oct. 1, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540503617>.

on enforcement in new areas, by filing cases that are the first of its kind, including two enforcement actions relating to the market access rule and one relating to the anti-retaliation provisions of the DFWP.⁷⁹ However, in 2014, actions related to the financial crisis still accounted for more than half of the SEC's large penalty cases.⁸⁰

In general, the SEC has taken a hard stance on enforcement policy in response to the criticism it received as a result of the financial crisis.⁸¹ Elected as Chairwoman in 2009, Mary Schapiro partially blamed the financial crisis on deregulation.⁸² As a response, she began a number of initiatives to strengthen the power of the enforcement division, stating, “[n]o one should be heard credibly to question whether enforcement is a priority at the SEC. It is, and always will remain, a foundation for our mission.”⁸³ For example, Schapiro made a number of changes expanding penalty powers within the enforcement division in hopes of reinvigorating the program.⁸⁴ In 2009, she ended the Commission's two-year penalty pilot experiment.⁸⁵ This program required staff within the enforcement division to obtain approvals from the Commission before imposing civil penalties on public companies⁸⁶ and was designed to create consistency in monetary sanction amounts.⁸⁷

79. Securities & Derivatives Enforcement and Regulatory Practice, 2014 SEC Enforcement Quarterly 4th Quarter 2014, SIDLEY AUSTIN LLP 2 (Dec. 17, 2014), http://www.sidley.com/~/media/update-pdfs/2015/02/sec_enforcement-quarterly—4th-quarter-2014.pdf.

80. See Eaglesham, *supra* note 73.

81. See *e.g.*, ALAN R. BROMBERG, LEWIS D. LOWENFELS, AND MICHAEL J. SULLIVAN, *The Madoff Affair and the SEC Bromberg*, in 7 BROMBERG & LOWENFELS ON SECURITIES FRAUD § 19:16, at 1 (Nov. 2014) (“the SEC launched a number of initiatives, focused primarily in the enforcement area, designed to enable the agency to ‘do better.’”).

82. Stephen Labaton, *SEC Nominee Offers Plan for Tighter Regulation*, N.Y. TIMES, (Jan. 15, 2009), <http://www.nytimes.com/2009/01/16/business/economy/16sec.html>.

83. Randall J. Fons and Michael V. Sachdev, *The Dawn of the Schapiro Era: Enforcement to be Top Priority at SEC*, 23 NO. 18 ANDREWS DEL. CORP. LITIG. REP. 1, 4 (Mar. 2009).

84. See 1D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *Mary Schapiro takes charge at the SEC—Changes in corporate settlement policy*, in GOING PUBLIC AND THE PUBLIC CORPORATION § 17:58.20 (2015).

85. See *id.*

86. See *id.*

87. RANDALL J. FONS & MICHAEL V. SACHDEV, *supra* note 83, at 1.

Now the enforcement staff is able to impose civil penalties more easily, and the change was “designed to expedite the Commission’s enforcement efforts to ensure that justice is swiftly served to those public companies who commit serious acts of securities fraud.”⁸⁸ The increased ability to impose civil penalties may have affected the outcome of my second hypothesis test.

This stance has continued at the SEC with the hiring of new leaders that are former prosecutors (Mary Jo White as Chairwoman in 2013 and Andrew Ceresney as Head of Enforcement in 2013). Mary Jo White has enacted an enforcement policy based on a similar criminal law strategy pursued by mayor Rudy Giuliani in New York City in the 1990s.⁸⁹ The so-called broken windows policy requires the agency to pursue all violations, no matter the size.⁹⁰ Ceresney stated the policy is not about pursuing all violations, but “about targeting important rules [where] we’ve seen a pattern of lack of compliance.”⁹¹ The SEC has not been afraid to use this theory to initiate enforcement actions. In one month alone in 2014, the SEC obtained fifty-four new cases using this strategy.⁹² On November 5, 2014, the SEC announced enforcement actions against ten defendants for failing to make disclosures about financing deals that diluted the value of their common stock; each of the companies agreed to settle with the SEC for amounts ranging between \$25,000 and \$50,000. This new focus on smaller violations may have contributed to the decrease in monetary sanctions observed above.

The SEC’s changing policy on penalties may have also influenced the observed results for my second hypothesis test. For example, in September of 2013, Mary Jo White declared that “[the SEC] must make aggressive use of [its] existing pen-

88. Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, Address to Practising Law Institute’s “SEC Speaks in 2009” Program (Feb. 6, 2009), <http://www.sec.gov/news/speech/2009/spch020609mls.htm>.

89. Jacquelyn Lumb, *White Expands upon Plan to Create Perception that SEC is Everywhere*, 2013 SEC TODAY, Oct. 10, 2013, at 197.

90. *Id.*

91. Jenna Greene, *SEC Enforcement Leaders Debate Broken-Windows Policy*, LEGAL TIMES (Oct. 14, 2014), <http://www.nationallawjournal.com/legal-times/id=1202673370778/SEC-Enforcement-Leaders-Debate-Broken-Windows-Policy?slreturn=20150212123327>.

92. See Eaglesham, *supra* note 73.

alty authority, recognizing that meaningful monetary penalties—whether against companies or individuals—play a very important role in a strong enforcement program.”⁹³ In discussing the 2014 enforcement year, she has also stated that “the cases span the spectrum of the securities markets and that [the SEC] demanded tough remedies”⁹⁴ and that penalties will be considered in every case.⁹⁵ Similarly, Director of Enforcement, Andrew Ceresney, followed up by stating that “[m]onetary penalties speak very loudly and in a language any potential defendant understands Enforcement needs to be aggressive in our use of penalties.”⁹⁶ This new leadership at the SEC will almost certainly affect the types of cases pursued and outcomes achieved, and may skew the results observed previously.

Cooperation

Another confounding variable that may possibly affect the monetary sanctions seen above is the SEC’s focus on cooperation and its new cooperation initiatives. From the start of its penalty authority, the SEC has used cooperation as a factor in the determination of how much of a penalty to impose.⁹⁷ The SEC often gives substantial reductions in penalties when a defendant cooperates.⁹⁸ The agency has introduced new cooper-

93. Sonia Steinway, *SEC “Monetary Penalties Speak Very Loudly,” But What Do They Say? A Critical Analysis of the SEC’s New Enforcement Approach*, 124 *YALE L. J.* 209, 209 (2014), quoting Mary Jo White, Chair, U.S. SEC. & EXCH. COMM’N, *Remarks at the Council of Institutional Investors Fall Conference in Chicago, IL: Deploying the Full Enforcement Arsenal* (Sept. 26, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539841202>.

94. See Eaglesham, *supra* note 73.

95. Thomas O. Gorman, *Toward a New SEC Enforcement Doctrine*, *SEC. LIT. COMMENTATOR*, Nov 2013, at 1.

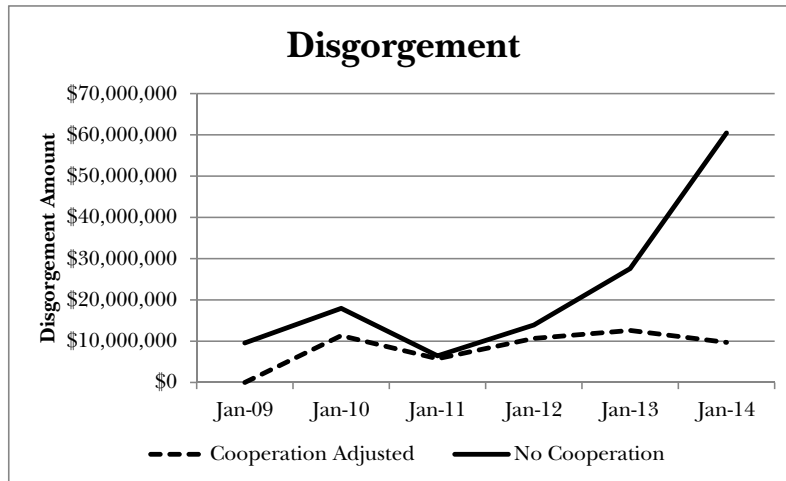
96. Steinway, *supra* note 93 (citing Jean Eaglesham, *SEC Ramps Up Fine Amounts to Deter Misconduct*, *WALL ST. J.* (Oct. 1, 2013), <http://online.wsj.com/news/articles/SB10001424052702303918804579109554149460532>).

97. Press Release, U.S. Sec. & Exch. Comm’n, *Statement of the Securities and Exchange Commission Concerning Financial Penalties* (Jan. 4, 2006), <https://www.sec.gov/news/press/2006-4.htm> (listing extent of cooperation with Commission and other law enforcement as a factor).

98. The SEC first elucidated its unofficial cooperation policy in what is commonly known as the “Seaboard Report.” Press Release, U.S. Sec. & Exch. Comm’n, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions* (Oct. 23, 2001),

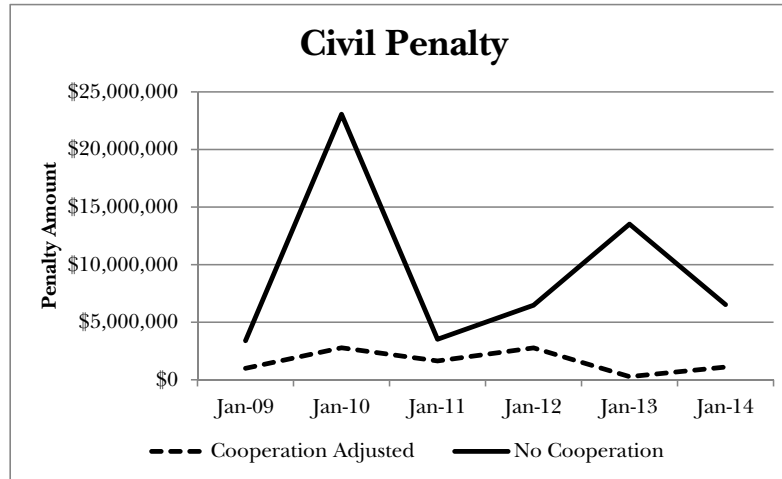
ation programs that offer standardized and favorable settlements.⁹⁹ This factor could influence the results of my second hypothesis.

To see if the presence of cooperation affected the trends identified above, I created an additional set of monetary sanction tables. The SEED database includes a variable to record whether or not cooperation was present prior to settlement of the action. These tables compare the average monetary sanction in two scenarios: no cooperation and cooperation present-adjusted. To compute the cooperation present-adjusted amount, I removed three outliers that affected the disgorgement and civil penalty totals: two FCPA actions and one fraud action against a bank relating to the financial crisis. Both graphs show that average monetary sanctions charged by the SEC are lower if cooperation is present.



<http://www.sec.gov/litigation/investreport/34-44969.htm>. The SEC stated a number of factors it would consider in measuring the level of cooperation that could possibly lead to reduced charges and sanction amounts. One researcher has tested these factors and found that companies that complete an independent investigation pay \$30 million less in penalties. Rebecca Files, *SEC Enforcement: Does Forthright Disclosure and Cooperation Really Matter?*, 53 J. OF ACCT. AND ECON., 353, 368 (2012).

99. In 2014, the SEC launched the Municipalities Continuing Disclosures Cooperation (MCDC) initiative. See SEC AFR 2014, *supra* note 65, at 25.



There is a general upward increase in average penalty amounts seen in these graphs, especially for disgorgement figures for cases in which no cooperation was present. Generally the trends match the results seen above, but the presence of cooperation may decrease the monetary sanctions, contributing to the decrease seen in my hypothesis test.

Additional changes in law arising from Dodd-Frank

Another possible confounding variable on penalty amounts not demonstrated in the SEED data is the change implemented through Dodd-Frank that allows the SEC to impose monetary penalties on non-regulated persons through administrative proceedings.¹⁰⁰ Prior to the passage of Dodd-Frank, a non-regulated person was only subject to a cease and desist order in administrative proceedings. Non-regulated persons are those that aren't directly regulated by the SEC, in comparison to broker dealers and investment advisors.¹⁰¹ Because of this change, the SEC is able to seek monetary penalties in administrative actions; the combination of this change and the

100. See Dodd-Frank Act § 929P(a). This power applies to all four major securities acts.

101. See, e.g., *2013 Mid-Year Securities Enforcement Update* (Gibson Dunn & Crutcher) July 15, 2013, at 3, <http://www.gibsondunn.com/publications/Documents/2013-Mid-Year-Securities-Enforcement-Update.pdf>.

SEC's new preference for using administrative actions may have upwardly affected penalty amounts.

III. POLICY IMPLICATIONS

The trends seen above implicate a number of policy issues including the creation of the Dodd-Frank Whistleblower Program and the SEC's enforcement and penalty strategy.

The use of whistleblowers as a source for enforcement tips can help the resource deprived SEC, but may also cause problems if the SEC is not able to process tips. In the past, the SEC has received tips but did not act on them either because it did not have the resources or the capability to understand the information.¹⁰² Some have expressed concern that the SEC won't be able to handle the increased tip volume. There is also a concern that a number of the tips might be baseless and the OWB will be bogged down by attempting to ferret out legitimate tips.¹⁰³ For example, there has been an individual who has submitted claims in close to 200 covered actions; the OWB has determined that this individual is ineligible for awards in those matters, as well as all future ones.¹⁰⁴ The creation of an entity whose sole purpose is to process these tips may help the SEC overcome previous obstacles. An initial report from the SEC's Office of the Inspector General indicates that the "SEC generally is prompt in responding to information that is provided by whistleblowers, applications for whistleblower awards, and in communicating with interested parties."¹⁰⁵

Overall, it seems the advantages of a whistleblower program outweigh the possible disadvantages. The main advantage of a whistleblower program is that it allows the SEC to

102. For example, leading up to the discovery of the Bernie Madoff Ponzi scheme, the SEC received a number of tips (specifically from Harry Markopolos) regarding the scheme. However, the SEC failed to act on this information. *See, e.g.* Barnard, *supra* note 13, at 412.

103. *See* Geoffrey Christopher Rapp, *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act*, 2012 *BYU L. Rev.* 73, 124–25 (2012); Rose, *supra* note 22, at 1282–83 (2014).

104. DFWP REPORT 2014, *supra* note 38, at 14.

105. OFFICE OF AUDITS, OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N. REP. NO. 511, EVALUATION OF THE SEC'S WHISTLEBLOWER PROGRAM, at v (2013).

gather information at a low cost.¹⁰⁶ Whistleblower programs can also act as a fraud deterrent within organizations without requiring the SEC to pass substantive regulation.¹⁰⁷ By increasing the likelihood of detection, the program may encourage corporate managers and officers to put in place more substantial fraud detections, further decreasing fraud.¹⁰⁸ Certain aspects of the DFWP encourage tippees to come forward with credible information. The mandatory payment provision, confidentiality provision and anti-retaliation provision of the DFWP make the benefits available to tippees while decreasing possible costs they might experience, leading to increased tipping activity.¹⁰⁹ The possibility of increased credible tips outweighs the potential burden on the SEC, which is also alleviated through the creation of the OWB.

There are concerns that the DFWP may encourage manipulative whistleblower delay as well as discourage internal reporting mechanisms. Throughout the prior decade, internal corporate compliance programs were strengthened as a result of SEC and regulatory action. For example, the “Seaboard Report” published by the SEC discusses cooperation from corporate defendants, mainly in the form of increased internal information that would be gathered through internal compliance programs.¹¹⁰ Through Sarbanes-Oxley, Congress determined that public issuers would be required to report on the function and success of their internal controls. Now, however, insiders who witness securities violations may be encouraged to first report this information to the OWB, as opposed to using traditional internal compliance program.¹¹¹ Since the payment of a whistleblower award requires that the information be original, insiders may not risk the chance that by notifying an internal compliance system, someone else will report the

106. See Barnard, *supra* note 13, at 413–14.

107. See *id.* at 414.

108. See Rose, *supra* note 22, at 1275.

109. Rose, *supra* note 22, at 1275.

110. See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44969 (Oct. 23, 2001), <http://www.sec.gov/litigation/investreport/34-44969.htm>.

111. See Ted Uliassi, *Addressing the Unintended Consequences of an Enhanced SEC Whistleblower Bounty Program*, 63 ADMIN. L. REV. 351, 363 (2011). See also Rose, *supra* note 22, at 1277.

violation to the SEC.¹¹² In addition, whistleblowers who report violations directly to the SEC will receive greater anti-retaliation benefits than those who first report information to an internal compliance program.¹¹³ Since cooperation is rewarded by the SEC in determining its penalty amounts, individuals hoping to receive a larger whistleblower payout may attempt to keep the knowledge of existence of a securities violation secret for as long as possible, so cooperation is not an option.¹¹⁴ This result has been criticized by the Chamber of Commerce and Institute for Legal Reform, who have warned that the lack of an internal reporting requirement “will make it harder and slower to detect and stop corporate fraud—by undermining the strong compliance systems set up under Sarbanes-Oxley.”¹¹⁵ Perhaps internal reporting better suits the goals of our securities market by increasing the speed with which problems are addressed.¹¹⁶ In addition, the possible shift from solving internal failures to defending SEC investigations will increase legal expenses for defendants.¹¹⁷ Finally, the DFWP rewards individuals even if they are involved in the underlying conduct.¹¹⁸ As a result, employees who become aware of wrongdoing may delay reporting the violation to the SEC in

112. See Mike Koehler, Public Comment on Whistleblower Award Program (Sept. 3, 2010), <http://www.sec.gov/comments/df-title-ix/whistleblower/whistleblower-10.htm> (describing the race between the company and insider individual to report the violation to the SEC).

113. Recent Legislation, *Congress Expands Incentives for Whistleblowers to Report Suspected Violations to the SEC*, 124 HARV. L. REV. 1829, 1830 (2011).

114. Uliassi, *supra* note 111, at 364–65.

115. Press Release, U.S. Chamber of Com., U.S. Chamber Warns New SEC Whistleblower Rule Will Undermine Corporate Compliance Programs (May 25, 2011), <https://www.uschamber.com/press-release/us-chamber-warns-new-sec-whistleblower-rule-will-undermine-corporate-compliance>.

116. See Recent Legislation, *Congress Expands Incentives for Whistleblowers to Report Suspected Violations to the SEC*, 124 HARV. L. REV. 1829, 1835 (2011). See also Kathleen L. Casey, Comm’r., U.S. Sec. & Exch. Comm’n, Adoption of Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Statement at Open Meeting (May 25, 2011), <https://www.sec.gov/news/speech/2011/spch052511klc-item2.htm>.

117. Casey, *supra* note 116.

118. Though a whistleblower can become ineligible if the SEC determines that it delayed reporting the information. See 15 U.S.C. § 78u-6(c)(1)(B)(i) (2012); see also 17 C.F.R. §§ 240.21F-6(a)(1)-(4), 240.21F-6(b)(1)-(3) (2015).

order to increase the mandatory payout they are entitled to.¹¹⁹ Certain provisions within the DFWP may discourage this delay, including the originality requirements and the unreasonable delay in reporting penalty in determining the bounty size.¹²⁰

The aforementioned criticisms have not appeared in the four-year history of the OWB. Results thus far show that whistleblowers that have submitted tips also reported information through internal channels.¹²¹ However, there may be benefits to not requiring internal reporting. Requiring possible whistleblowers to first report violations internally could discourage them from coming forward at all, especially when considering market manipulation or offering fraud schemes.¹²²

The SEC's recent change towards a more aggressive enforcement strategy has led to criticism that the agency has strayed from its original goals and mandates. The SEC was originally formed with three priorities: protecting investors, fostering efficient markets and facilitating capital formation.¹²³ The SEC intended to carry out these goals by enforcing and implementing disclosure and antifraud rules, not by controlling for systemic risk in the economy¹²⁴ or creating one hundred percent regulatory compliance.¹²⁵ Some have argued that the SEC post financial crisis is no longer focused on these

119. Uliassi, *supra* note 111, at 364.

120. See Rose, *supra* note 22, at 1279.

121. See Jaime Guerrero, *Most SEC Whistleblowers Tell Company First*, INSIDE COUNSEL (March 28, 2012), <http://www.insidecounsel.com/2012/03/28/regulatory-most-sec-whistleblowers-tell-company-fi>. This effect is also noticed in other whistleblower programs. See also Luis A. Aguilar, Speech by SEC Commissioner: Incentivizing Whistleblowers to Bring Fraud to Light (May 25, 2011), <https://www.sec.gov/news/speech/2011/spch052511laa-item2.htm> ("Nearly all (18 of 22) insiders first tried to fix matters internally by talking to their superiors, filing an internal complaint, or both.") (citing Aaron S. Kesselheim, David M. Studdert & Michelle M. Mello, *Whistleblowers' Experiences in Fraud Litigation Against Pharmaceutical Companies*, 362 NEW ENG. J. MED. 1832 (2010)).

122. Robert S. Khuzami, Speech by SEC Staff: Remarks at Open Meeting – Whistleblower Program (May 25, 2011), <https://www.sec.gov/news/speech/2011/spch052511rk.htm>.

123. U.S. SEC. & EXCH. COMM'N, 2006 PERFORMANCE & ACCOUNTABILITY REP. 2, <http://www.sec.gov/about/secpar/secpar2006.pdf>.

124. Spencer P. Patton, *Archangel Problems: The SEC and Corporate Liability*, 92 TEX. L. REV. 1717, 1731 (2014).

125. Sarah N. Lynch, *SEC's Piwowar Takes a Swing at 'Broken Windows' Enforcement Policy*, 20 NO. 25 WESTLAW J. DERIVATIVES 8, 8 (2014).

original goals, and instead has attempted to exert its political power and increase regulatory rents¹²⁶ by focusing on lesser violations of the securities laws. The decrease in civil penalty amounts observed above may indicate that the SEC is now focusing on smaller violations brought to light by whistleblowers. The reliance of whistleblower tips in this area could be criticized for too narrow a focus. In addition, the broken window policy unveiled by Mary Jo White has spurned criticism, as some argue that the SEC “has spent so much time on ‘little’ cases and ‘little’ defendants that it has missed the forest for the trees.”¹²⁷ Other commissioners have voiced concerns that “if every rule is a priority [for the Commission], then no rule is a priority.”¹²⁸ On the other hand, it is important for the SEC to police modest violations of the securities laws. Because these actions rarely result in large penalties, they are unlikely to be pursued by private parties.¹²⁹ However, it is possible that the disproportionately large penalties for these modest violations will discourage cooperation.¹³⁰

The SEC is often criticized for inconsistent enforcement. There is no mandate by which the SEC must prioritize its enforcement objectives and there is a lack of checks on agency action, especially when it is acting through its own administrative courts.¹³¹ In addition, the SEC has statutory authority to seek “any equitable relief that may be appropriate or necessary for the benefit of investors.”¹³² The SEC’s use of whistleblower tips to determine areas of enforcement could lead to an inconsistent enforcement strategy, further creating inefficient compliance spending within public companies. Public companies must focus spending on compliance with regulation, which reduces the funds available it could distribute to investors or use for capital investment.¹³³ The SEC rarely releases information concerning the calculation of monetary sanctions in its

126. Patton, *supra* note 124, at 1731 (citing Zachary J. Gubler, *Public Choice Theory and the Private Securities Market*, 91 N.C. L. Rev. 745, 777 (2013)).

127. See Barnard, *supra* note 13, at 404.

128. Lynch, *supra* note 125, at 8.

129. See Black, *supra* note 66, at 344.

130. Greene, *supra* note 91.

131. Steinway, *supra* note 93, at 226–27.

132. 15 U.S.C. § 78u(d)(5) (2012).

133. Patton, *supra* note 124, at 1738–39.

cases, making it difficult for issuers to plan accordingly.¹³⁴ If the SEC relies on whistleblowers to find enforcement actions, companies have little guidance as to what areas of enforcement they should monitor most closely. In addition, the SEC has been criticized for responding too much to market conditions when pursuing enforcement actions. One study found that the SEC responded to media publicity regarding which areas to pursue.¹³⁵ There is also empirical evidence that the SEC may target defendants with investors that have suffered large losses (high profile cases in the media).¹³⁶ The combination in these outside factors with a use of whistleblowers leads to market inefficiencies.

The recent increase in monetary sanction amounts observed across SEC enforcement actions leads to concern over deterrent effects and who ultimately bears the burden of the sanctions. Corporations have recognized that SEC enforcement actions are becoming a cost of doing business; it is now cheaper and more efficient for a company to settle with the SEC rather than fight the action in court, or more commonly in an administrative proceeding.¹³⁷ Company defendants are more likely to settle than take the chance of losing at trial and suffering even larger monetary sanctions. This reliance on settlement culture does not further the goal of regulated markets. Because defendants do not need to admit guilt when settling, it is unclear if the underlying actions were actually security law violations.¹³⁸ The DFWP that promotes whistleblowing directly to the SEC as opposed to internal reporting could compound the problems with settlements to prevent large

134. See Black, *supra* note 66, at 340.

135. Stephen J. Choi et al., *Scandal Enforcement at the SEC: The Arc of Option Backdating Investigation*, 15 AM. L. & ECON. REV. 542, 542–44 (2013).

136. James D. Cox et al., *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 NOTRE DAME L. REV. 893, 905–06 (2005).

137. Patton, *supra* note 124, at 1719. Encouraging quick settlements is a goal of the SEC, as stated by Robert Khuzami, former Head of the Enforcement Division. Robert Khuzami, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement (Aug. 5, 2009), <https://www.sec.gov/news/speech/2009/spch080509rk.htm>.

138. See *SEC v. Citigroup*, 827 F. Supp. 2d 328, 330 (S.D.N.Y. 2011) (explaining that a Defendant does not have to admit or deny guilt when a consent judgment is reached).

sanctions. If companies are not aware of problems in the organization and instead choose to settle with the SEC as a cheaper option, it may not resolve the underlying illegal issue.

In addition, when the SEC imposes monetary sanctions on public companies (as opposed to employees), the shareholders are harmed because the overall value of the company is decreased.¹³⁹ These shareholders are harmed both with the payment of the fine and reputational effects associated with a SEC investigation, which can be larger than the direct costs.¹⁴⁰ The deterrent effect of these monetary sanctions is lessened through issuer sanctions,¹⁴¹ which is a concern since one of the reasons the SEC initially received broader monetary sanction powers was to create the appropriate level of deterrence.¹⁴² As Judge Rakoff noted, “[w]here management deceives its own shareholders, a fine most directly serves its deterrent purpose if it is assessed against the persons responsible for the deception.”¹⁴³ Some within the SEC itself have noted that when public companies agree to settlements, the board and management are agreeing to pay with someone else’s money.¹⁴⁴ Although there is not evidence of larger sanctions for actions in which a whistleblower is likely to be present, the increased focus on smaller violations found at public companies still leads to monetary sanctions that are ultimately borne by the shareholders.

Increasing monetary sanctions over time, as seen in the data, are also a cause for concern. The SEC states that it imposes monetary sanctions in line with the underlying harm caused by the violation, but the large sanctions seen in financial crisis cases call this into question. Some have hypothesized that the SEC was able to use the public’s distrust of the finan-

139. Patton, *supra* note 124, at 1735.

140. Steinway, *supra* note 93, at 223. *See also* Jonathan M. Karpoff et al., *The Cost to Firms of Cooking the Books*, 43 J. FIN. & QUANTITATIVE ANALYSIS 581 (2008) (finding that reputational losses are far greater than the cost of legal fines, class action settlements, and the accounting write-off effect).

141. Steinway, *supra* note 93, at 223.

142. H.R. REP. NO. 101-616, at 13 (1990), *as reprinted in* 1990 U.S.C.A.N. 1379, 1381.

143. SEC v. Bank of Am. Corp., No. 09 Civ. 6829 (JSR), 2010 WL 624581, at *5 (S.D.N.Y. Feb. 22, 2010).

144. Steinway, *supra* note 93, at 222 (quoting former SEC Commissioner, Cynthia Glassman).

cial industry to pressure companies into large settlements.¹⁴⁵ The SEC seems to have strayed from its original mandate in imposing fines on corporate defendants. Legislative history from the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, which initially granted the SEC power to seek civil penalties, shows that Congress was reluctant to impose penalties when innocent shareholders were harmed.¹⁴⁶ As recent as 2006, the SEC has focused on distinguishing between cases where civil penalties would be appropriate against corporate defendants: “[T]he strongest case for the imposition of a corporate penalty is one in which the shareholders of the corporation have received an improper benefit as a result of the violation; the weakest case is one in which the current shareholders of the corporation are the principal victims of the securities law violation.”¹⁴⁷ In granting penalty powers to the SEC, Congress also expected that federal judges would review these sanctions;¹⁴⁸ with the increased use of administrative proceedings, there is no longer an impartial review. The increased focus on lesser violations of the securities laws that may be evident in the monetary sanction data above.

CONCLUSION

I test the hypothesis that the SEC has changed its enforcement policies regarding areas of focus as well as monetary sanction determinations after the creation of the Dodd-Frank Whistleblower Program. The increase in tips as well as design of the DFWP could lead the SEC to change its enforcement strategies in attempts to better utilize the program. I find that after the creation of the OWB, the SEC has initiated more enforcement actions that are classified as either: issuer reporting and disclosure, offering fraud or market manipulation. These types of actions are more likely to have a whistleblower present as more individuals are involved, and these represent the greatest proportion of tips received by the OWB. I also find that after creation of the OWB, the monetary sanctions

145. Patton, *supra* note 124, at 1738.

146. S. REP. NO. 101-337, at 17 (1990).

147. Press Release, U.S. Sec. & Exch. Comm’n, Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), <http://www.sec.gov/news/press/2006-4.htm>.

148. Atkins & Bondi, *supra* note 67, at 393.

awarded in whistleblower-likely actions decreased as compared to the sanctions charged in actions where no whistleblower was likely to be present. The evidence presented here suggests that the SEC may have changed its focus towards enforcement actions in which it received tips from the outside public. It also may suggest that the program is working as individuals are reporting large cases that create high disgorgement figures. The program may also be allowing the SEC to focus on more marginal violations, demonstrated by the decrease in civil penalties.

A number of confounding variables may affect the results I observe in my hypothesis test. These include the SEC's increased use of administrative proceedings, the SEC's change in enforcement policy after the financial crisis, the SEC's focus on cooperation and other changes that resulted from Dodd-Frank. There is not enough data available at this point to complete a regression analysis on these variables, but it is probable they affect the observed outcomes.

There are a number of policy implications when one considers the SEC's increased focus on whistleblower-likely violations and the increasing monetary sanctions. The combination of increasing monetary sanctions and the payment provisions of the DFWP (including the \$1 million threshold and mandatory payment provision) may lead the SEC to impose high sanctions on defendants to encourage more whistleblowers to come forward.¹⁴⁹ The defendants able to absorb these high penalties are most likely corporate defendants, further implicating the deterrent effects discussed previously. Although the DFWP appears to be a positive resource for the SEC, it needs to be examined in light of the SEC's changing enforcement policies to make sure it is not abused.

149. See Rose, *supra* note 22, at 1283.

