Re: File No. S7-16-18, Proposed Amendments to the SEC’s Whistleblower Program Rules

Dear SEC Commissioners,

I want to reiterate a comment Harry Markopolos provided to you regarding the Proposed Amendments to Whistleblower Rules.

I appreciate his detailed and well thought out positions regarding multiple components of the proposed amendments, and I would like to note his point on Clarifying Payments for Cases in Federal Bankruptcy. Mr. Markopolos cited the need for the Commission to treat recoveries by a Commission-forced bankruptcy trustee as qualifying for an award under the whistleblower program in the same manner it would recoveries by a Commission-forced receiver.

The Life Partners Holdings Inc. (“LPHI”) example cited by Mr. Markopolos involved a legal maneuver by bad actors at the company to stave off the likely appointment of a Commission-forced receiver. It has been reported that in the eleventh hour the company filed for bankruptcy protections and attempted to have a LPHI hand-picked examiner appointed. Ultimately a trustee was appointed by the bankruptcy court, and this trustee was reported to be the same person who had previously been considered for the receiver role, if a receiver had been appointed prior to the bankruptcy filing. Had LPHI been put into receivership, the receiver immediately would have replaced the company management, and the executives at LPHI knew that. As such, whistleblowers should not be disqualified (for purposes of calculating an award) when perpetrators attempt to game the system – in this example, by filing for bankruptcy to avoid a receivership.

In late 2017 the LPHI bankruptcy case was selected to receive the 2017 Turnaround Management Association’s (“TMA”) Large Company Turnaround and Transaction of the Year Award. To date, thousands of harmed investors have received distributions, and the trustee has projected that more than $1.2 Billion will be distributed back to Main Street Investors (which will exceed 90% of the amounts initially invested). (https://turnaround.org/sites/default/files/Turnaround%20-%20Life%20Partners_FINAL.pdf)

I believe the Commission has previously given guidance that it views bankruptcy and receivership recoveries in the same regard.

The Report Pursuant to Section 308(c) of the Sarbanes Oxley Act of 2002 provides some clarity on how the Commission has historically viewed the similarities and correlation between receivers and trustees (https://www.sec.gov/news/studies/sox308creport.pdf). The staff of the Commission conducted a review and analysis of its enforcement actions over the five years preceding the enactment of the Sarbanes-Oxley Act to identify how such proceedings may best be utilized to provide restitution for injured investors. This report discussed a number of topics, including how “the appointment of a receiver, where appropriate, enhances the Commission’s ability to maximize investor recovery” (page 1). The report also highlighted the Commission’s desire to “improve its record of compensating (injured) investors,” (page 1) and listed some initiatives taken to help further this cause.

When discussing Distributions in Federal District Court Actions on pages 10-12, the Commission stated (with my underlines added for emphasis):
Most of the money returned to investors comes from the successful conclusion of actions filed in federal district court. Eighty-seven district court actions involving 358 defendants were reviewed in which, at the outset of the litigation, there was reason to believe that a payment to investors might result. In 34 of these cases, payments totaling a little over one billion dollars were made directly to approximately 125,000 investors. The cases reviewed also included 14 where a payment to investors is expected, but has not yet been made. In four cases, payment of disgorgement was made to investors through an alternative method, e.g., payment into an investor fund established in a private shareholder lawsuit, or payment to a bankruptcy trustee for distribution to creditors, including investors. (page 10)

In some cases, the Commission may ask a court to place an entity in receivership, to continue operating a business until the receivership estate can be wound up and a distribution of assets made to investors. Similarly, the Commission may seek the appointment of a trustee or distribution agent (or claims administrator) to take control of assets, or otherwise collect and liquidate assets from the defendants and their agents and assigns, and distribute the money collected to investors. For purposes of this report, a receiver, distribution agent or trustee will each be referred to as a “receiver.” As an agent of the court, a receiver acts independently of both the Commission and the defendant in carrying out its prescribed duties. Generally, the appointment of a receiver, where appropriate, facilitates investor recovery. (page 11 – Payment By Receivers)

In SEC v. John Aptt, et al., approximately 200 investors recovered an estimated $4,500,000 based in large part on the efforts of the receiver. Applying his international business, international law and real estate expertise, the receiver took over the defendants’ primary asset (a real estate development in Costa Rica), finished the real estate projects in process and sold them for the investors’ benefit. He also forced the entity into bankruptcy for the investors’ protection. (page 12 – Payment By Receivers)

The fact that a distribution in a Commission action has not been made does not necessarily mean that investors have not been compensated. During the course of some civil actions, assets that would have ordinarily been distributed through a receiver may be turned over to a bankruptcy trustee for disposition through a bankruptcy proceeding. For example, in John F. Aptt, supra, the Commission first obtained an asset freeze against the defendant corporation, securing approximately $5,000,000. When the company filed for liquidation in bankruptcy, the frozen amount was transferred to the bankruptcy estate. After receiver and bankruptcy trustee fees, 200 investors received a net payment of $4,500,000. (page 12 – Payment By Alternative Methods)

The Commission also highlighted on page 29 its Improved Status in Bankruptcy Proceedings since the enactment of the Sarbanes-Oxley Act. In summary, I was encouraged to see that the
Commission referred to a trustee interchangeably as a receiver, and also highlighted how a receiver forced a bankruptcy and then utilized the bankruptcy trustee to return funds to harmed investors.

Fast forward to the current whistleblower rules, and I believe that the definition of monetary sanctions applies to investor recoveries in both bankruptcy and receivership matters. I agree with Mr. Markopolos that it is ideal for the Commission to clarify any possible confusion on the definition of monetary sanctions for the purpose of calculating whistleblower awards. Listing out examples such as an asset freeze, court appointed receiver or court appointed bankruptcy trustee would help to provide clarity to potential whistleblowers who may be reluctant to come forward due to concerns that traditional disgorgement and penalties may not exceed the $1M threshold needed to qualify for a whistleblower award. The Commission has already made Award Orders for Notice of Covered Actions involving hundreds of millions in asset freezes as well as a recovery through a court appointed receiver, so explaining further the definition of monetary sanctions in the amendments is a good suggestion.

Thank you for considering my comments.