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In Defense of SEC Whistleblower Short Sellers: They Deserve to Have Their Cake and Eat It Too

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Recently, criticism has been leveled against the practice of the federal securities laws to the SEC under its whistleblower program. Under this “double dip” scenario, short sellers profit not only from successfully covering their short positions on the company they have bet against, but also from receiving anywhere between 10% to 30% of the financial payments made by that same company to the SEC on a judgment entered against it of at least \$1 million.

The position that short sellers should be denied the benefits of their critically important whistleblowing efforts is short-sighted and contrary to the notions of our capitalistic markets. Moreover, it will serve only to disincentive a vital constituency of the SEC Whistleblower Program, which, in turn, will degrade the effectiveness of the SEC’s enforcement program.



Scott Silver, left, of Silver Law Group, and David R. Chase, right, of the law firm of David R. Chase.

Courtesy photos

Short sellers conduct their analysis of suspect companies from the “outside” through the review and dissection of publicly available information, including company’s financial statements, SEC filings, industry trends and engaging in sophisticated market analyses. Unlike traditional “insiders” who have personal knowledge and, in some cases, documentary evidence of the illegal securities conduct, short sellers must invest substantial time, due diligence, human resources and financial capital in uncovering and identifying red flags that strongly suggest that publicly traded

companies are engaged in ongoing federal securities laws violations. Quite often, short sellers are successful in uncovering massive accounting frauds and stock manipulations, the bread and butter of the SEC's enforcement program.

Statistics clearly evidence the increasing importance of short sellers to the SEC's Whistleblower Program. Since its inception in 2012, the SEC's Office of the Whistleblower has paid over \$300 million to outsider tipsters, including professional short sellers. In 2018, for example, outsider tipsters received only 1% of the total whistleblower awards. By 2022, however, this figure grew to 38% and, based upon current trends, will likely significantly increase.

Short sellers thus, in effect, supplement the SEC's limited resources, and but for their efforts, a considerable swath of fraud in the financial markets would likely go undetected. The SEC's Whistleblower Program, borne out of the Madoff Ponzi era, is an explicit acknowledgement that financially incentivizing members of the public to report fraud to the SEC is highly effective and necessary. Such a program is not a "privatization of government functions," as some have argued, but rather is a practical acknowledgment that the SEC cannot do it alone or, at the least, can do it better with the assistance of whistleblowers, including short sellers.

It is this reality that highlights the mutually beneficial intersection of the interests of short sellers and the SEC that inures to the benefit of investors and the integrity of the financial markets. That short sellers doubly profit from their time, efforts and investment of capital as a result is capitalism at its best, and should neither detract nor distract from the public good accomplished by their work.

As legal counsel who routinely represent SEC short seller whistleblowers in the SEC Whistleblower Program, we appreciate the critically important role they play. We have seen first-hand the success they have helped to achieve by exposing ongoing frauds, thereby protecting the investing public: a result wholly consistent with a core goal of the SEC's Enforcement Division. Given the risks short sellers take, the capital they invest in intensive research, with no guarantees of success, they deserve to reap the financial benefits from their success, even if it means they get to have their cake and eat it too.

David R. Chase is a former SEC enforcement attorney and is principal of the law firm of David R. Chase. **Scott Silver** is a plaintiffs investor rights lawyer and principal of the Silver Law Group. Both firms work together in co-representing SEC whistleblowers in the SEC's Whistleblower Program. Learn more about us at secwhistleblowerattorneys.com.