

10-1-2024

The Shortseller Enrichment Commission? Whistleblowers, Activist Short Sellers, and the New Privatization of Public Enforcement

Alexander I. Platt
University of Kansas School of Law

Follow this and additional works at: <https://digitalcommons.law.uw.edu/wlr>



Part of the [Administrative Law Commons](#), [Banking and Finance Law Commons](#), [Other Law Commons](#), and the [Securities Law Commons](#)

Recommended Citation

Alexander I. Platt, *The Shortseller Enrichment Commission? Whistleblowers, Activist Short Sellers, and the New Privatization of Public Enforcement*, 99 Wash. L. Rev. 843 (2024)

This Article is brought to you for free and open access by the Washington Law Review at UW Law Digital Commons. It has been accepted for inclusion in Washington Law Review by an authorized editor of UW Law Digital Commons. For more information, please contact lawref@uw.edu.

THE SHORTSELLER ENRICHMENT COMMISSION? WHISTLEBLOWERS, ACTIVIST SHORT SELLERS, AND THE NEW PRIVATIZATION OF PUBLIC ENFORCEMENT

Alexander I. Platt*

Abstract: Two developments have transformed the detection of corporate fraud in the last decade: the Securities and Exchange Commission’s Whistleblower Bounty Program (WBP) and the rise of activist short sellers. The WBP offers up financial bounties to individuals who bring forward actionable information about securities fraud. Activist shorts conduct due diligence to identify overvalued public companies, take short positions, reveal the negative information, and then enjoy trading profits if and when the stock tanks. Considered separately, these institutions are widely regarded as socially valuable innovations that help deter fraud.

But, it turns out, they are not fully separate. Activist shorts have been participating actively and effectively in the WBP—both directly (submitting tips, filing claims, and winning awards) and indirectly (partnering with insider tipsters). Their participation has transformed the WBP into an undercover outsourcing program: a new way for the Securities and Exchange Commission (SEC) to pay private professionals to do work that traditionally has been done by SEC staff.

This privatization might be defensible, indeed laudable, if it yielded more efficient deterrence than what the SEC could achieve on its own. Unfortunately, it likely does not. The SEC may be paying activist shorts for information they would have made public even without the prospect of bounty (because of their trading strategy). In such cases, the public bounty payment does nothing to incentivize additional fraud detection and is merely a windfall for the recipient. Those funds could be better spent by expanding the SEC’s own enforcement capacity.

| | |
|---|-----|
| INTRODUCTION | 845 |
| I. INSTITUTIONAL BACKGROUND: THE SEC WHISTLEBLOWER PROGRAM AND ACTIVIST SHORT SELLERS | 855 |

* Associate Professor, KU University of Kansas School of Law. For helpful comments, I thank Bernie Black, Albert Choi, John Coates, Patrick Corrigan, Quinn Curtis, Elisabeth de Fontenay, Chris Drahozal, Griffin Edwards, Merritt Fox, John Head, Joan Heminway, Christine Hurt, Nicole Iannaronne, Andrew Jennings, Jeremy Kidd, Guha Krishnamurthi, Rick Levy, Maria Macia, Stephen Mazza, Geeyoung Min, Josh Mitts, Peter Molk, Uma Outka, Shalev Roisman, Guy Rub, Peter Salib, James Tierney, Andrew Tuch, Urska Velikonja, Kyle Velte, Steve Ware, Gad Weiss, Verity Winship, Corey Rayburn Yung, anonymous whistleblower lawyers and activist shorts, and participants in the American Law and Economics Association Annual Meeting, BYU Winter Deals Conference, the Midwestern Law and Economics Association Workshop, the Corporate and Securities Litigation Workshop, the AALS New Voices in Securities Regulation Panel, and the University of Kansas School of Law Faculty Colloquium. The title is borrowed from Elon Musk (@elonmusk), X (Oct. 4, 2018, 1:16 PM), <https://x.com/elonmusk/status/1047943670350020608> (“the Shortseller Enrichment Commission is doing incredible work. And the name change is so on point!”).

| | | |
|------|---|-----|
| A. | SEC Whistleblower Program | 855 |
| B. | Activist Short Sellers | 858 |
| II. | LEGAL BACKGROUND: HOW OUTSIDERS LIKE ACTIVIST SHORTS CAN PARTICIPATE IN THE SEC WHISTLEBLOWER PROGRAM | 862 |
| A. | Outsiders as “Whistleblowers” | 862 |
| 1. | Legislative History: An Outsider Whistleblower Spurred the Creation of the SEC Whistleblower Program | 862 |
| 2. | The Statutory Hook: “Independent Analysis” | 863 |
| 3. | Individuals, Not Entities | 864 |
| 4. | Trading Profits Not Considered in Bounty Calculation..... | 865 |
| 5. | Anonymity Protections Apply Equally to Insider and Outsider Tipsters..... | 865 |
| B. | Outsiders Partnering with Insiders | 865 |
| 1. | Directors, Officers, and Beneficial Owners of at Least Ten Percent | 866 |
| 2. | Others | 866 |
| III. | EVIDENCE: OUTSIDER PARTICIPATION IN THE SEC WHISTLEBLOWER PROGRAM | 868 |
| A. | FOIA Data on Outsider Bounties | 869 |
| B. | Activist Shorts in the SEC Whistleblower Program | 873 |
| 1. | Carson Block / Muddy Waters | 873 |
| 2. | Nathan Anderson / Hindenburg..... | 874 |
| 3. | Kyle Bass / Hayman Capital..... | 877 |
| 4. | David Einhorn / Greenlight | 878 |
| 5. | Hunterbrook..... | 879 |
| 6. | Marc Cohodes..... | 880 |
| 7. | Fraser Perring / Viceroy Research | 881 |
| 8. | Gabriel Grego / Quintessential Capital | 882 |
| 9. | Jon Carnes / AlfredLittle.com | 883 |
| 10. | Mark Cuban / Sharesleuth.com | 884 |
| 11. | Dan David / Wolfpack..... | 886 |
| 12. | Quinton Matthews / Rota Fortuna | 886 |
| 13. | Bill Ackman / Pershing | 887 |
| 14. | Whistleblower Lawyers..... | 889 |
| C. | Other Professional Outsiders in the SEC Whistleblower Program..... | 890 |
| IV. | INTERPRETATION: THE NEW PRIVATIZATION OF PUBLIC ENFORCEMENT | 893 |
| A. | Efficiency Deficits | 898 |
| 1. | Paying Outsiders May Not Increase the Probability of Detection | 899 |
| 2. | Paying Outsiders May Not Increase the Probability of Conviction | 903 |

| | | |
|----|---|-----|
| B. | Accountability Deficits..... | 905 |
| 1. | Transparency Deficit | 907 |
| 2. | Circumventing Legal Guardrails | 907 |
| 3. | Regulatory Capture..... | 908 |
| V. | RECOMMENDATIONS..... | 909 |
| A. | Reforming the SEC Whistleblower Program | 909 |
| 1. | The SEC Should Account for Trading Profits When Determining Whistleblower Bounties | 909 |
| 2. | Congress Should Increase the Transparency of the Whistleblower Program..... | 910 |
| B. | Reforming Insider Trading Rules..... | 912 |
| | CONCLUSION | 913 |
| | APPENDIX A | 915 |
| | APPENDIX B | 916 |
| | APPENDIX C | 917 |

INTRODUCTION

In 2011, the short seller Carson Block published a report alleging substantial accounting fraud by a multi-billion dollar NASDAQ-listed Chinese company called Focus Media.¹ Drawing on months of work by a team of researchers² involving review of thousands of pages of regulatory filings and other documents and extensive on-the-ground fieldwork in Thailand and China,³ the report alleged that the digital media company “fraudulently overstat[ed] the number of screens in its LCD network by approximately 50%,” “claimed to acquire, write down, and dispose of companies that it never actually purchased,” and employed firm insiders that earned at least seventy million dollars in fraudulent transactions with the company.⁴ Following publication, Focus Media’s stock lost two thirds of its value,⁵ generating potentially substantial trading profits for Block

1. See MUDDY WATERS RSCH., REPORT ON FOCUS MEDIA HOLDING LTD. (Nov. 21, 2011) [hereinafter FOCUS MEDIA REPORT], https://muddywatersresearch.com/wp-content/uploads/2011/11/MW_FMCN_11212011.pdf.

2. Compare *id.* at 4 (“Muddy Waters’s team had a team of 12 people with expertise in accounting, finance, law, advertising, and entrepreneurship began working on FMCN this summer.”), with Complaint for Damages & Related Relief ¶ 11, *Block v. Barnes*, No. 1:22-cv-869 (W.D. Tex. Aug. 25, 2022) (“Mr. Barnes was one of a team of five researchers working under the direction of Mr. Block.”).

3. See Complaint ¶¶ 4, 52–60, *Barnes v. Block*, No. 1:22-cv-7236 (S.D.N.Y. Sept. 26, 2022).

4. FOCUS MEDIA REPORT, *supra* note 1, at 1.

5. Melanie Lee & Soham Chatterjee, *Short-Seller Report Batters China’s Focus Media*, REUTERS (Nov. 21, 2011, 7:42 PM), <https://www.reuters.com/article/business/short-seller-report-batters-china-s-focus-media-idUSTRE7AK27Q/> (last visited Aug. 18, 2024).

and associates,⁶ and leading to a barrage of regulatory investigations,⁷ litigation,⁸ and ultimate delisting of the firm.⁹

In 2010, the short seller David Einhorn accused a NYSE-listed real estate development firm called The St. Joe Company of significantly overvaluing many properties on its balance sheet.¹⁰ According to Einhorn, many of these developments were “ghost towns.”¹¹ The company’s stock quickly dropped by about a third, potentially generating substantial trading profits for Einhorn and his fund, Greenlight Capital.¹² Investor

6. See FOCUS MEDIA REPORT, *supra* note 1, at 1 (“You should assume that as of the publication date of any report or letter, Muddy Waters, LLC (possibly along with or through our members, partners, affiliates, employees, and/or consultants) along with our clients and/or investors has a short position in the stock (and/or options of the stock) covered herein, and therefore stands to realize significant gains in the event that the price of stock declines.”); Complaint, *Barnes v. Block*, *supra* note 3, ¶ 68 (alleging that Block separately profited by selling the Focus Media research to a separate short seller fund); Plaintiff Carson Block’s Memorandum of Law in Opposition to Defendant’s Motion to Dismiss at 4, *Block v. Barnes*, No. 1:22-cv-869-DAE (W.D. Tex. Oct. 11, 2022) (noting that Block’s associate was “primarily compensated” for his work on the Focus Media report “by being allowed to trade for his own account in securities of Focus Media”); cf. Mengqi Sun, *Short Seller Carson Block Sued Over \$14 Million Whistleblower Award*, WALL ST. J. (July 28, 2022), <https://www.wsj.com/articles/short-seller-carson-block-sued-over-14-million-whistleblower-award-11659049816> (last visited Aug. 18, 2024) (“Mr. Barnes declined to say how much money he and Mr. Block made from shorting Focus Media stock.”); see also Katia Porzecanski & Tom Schoenberg, *A Short Seller’s Life Upended: Carson Block Questions Future*, BLOOMBERG (July 15, 2022 10:28 PM), <https://www.bloomberg.com/news/articles/2022-07-15/how-muddy-waters-carson-block-is-dealing-with-us-short-selling-investigation?embedded-checkout=true> (last visited Aug. 18, 2024) (“Block doesn’t hide that he takes money off the table quickly. . . . If his research causes the price to plunge, Block quickly locks in his gains, reduces his risk over the next few days and maintains a small bearish position from there on out.”).

7. E.g., Press Release, SEC, China-Based Company and CEO To Pay \$55.6 Million for Inaccurate Disclosures (Sept. 30, 2015), <https://www.sec.gov/news/press-release/2015-223> [<https://perma.cc/X2W8-P7H9>].

8. See, e.g., *Yang v. Focus Media Holding Ltd.*, No. 11 Civ. 9051, 2014 WL 4401280 (S.D.N.Y. Sept. 4, 2014) (approving \$3.7 million settlement of securities class action).

9. See Neil Gough, *Focus Media Reaches \$7.4 Billion Deal to List in Shenzhen*, N.Y. TIMES (June 3, 2015), <https://www.nytimes.com/2015/06/04/business/dealbook/focus-media-in-shenzhen-listing-deal.html> (last visited July 22, 2024) (noting that Focus Media was “delisted from the Nasdaq two years ago after being targeted by short-sellers”). The firm was later relisted on a Chinese exchange. *Id.* See Russell Flannery, *Focus Media’s Return Home Lifts Profit at China’s Hedy Holding*, FORBES (Mar. 31, 2016), <https://www.forbes.com/sites/russellflannery/2016/03/31/focus-medias-return-home-lifts-profit-at-chinas-hedy-holding/> [<https://perma.cc/4EMT-LYJ5>]; Yifan Xie, *Focus Media Comes Up with New Relisting Plan*, WALL ST. J. (Sept. 2, 2015, 12:10 PM), <https://archive.is/hXc5Z> [<https://perma.cc/9ZRW-NWJH>].

10. Gregory White, *Here Are the Details Behind David Einhorn’s Latest Big Short*, BUS. INSIDER (Oct. 13, 2010), <https://www.businessinsider.com/david-einhorn-joe-2010-10> (last visited Sept. 14, 2024).

11. *Id.*

12. See Stephen Taub, *The Morning Brief: Einhorn Short St. Joe Settles With SEC*, INSTITUTIONAL INV. (Oct. 29, 2015), <https://www.institutionalinvestor.com/article/2bsv5rokkag59w6g46tq8/portfolio/the-morning-brief->

litigation and a United States Securities and Exchange Commission (SEC) investigation quickly followed, ultimately leading to a multi-million dollar settlement and the forced departures of the company's senior management team.¹³

So much is familiar. Activist short sellers like Einhorn and Block are now a well-established feature of contemporary markets. They hunt for frauds, short targets, trumpet their allegations, and reap profits if and when the market reacts by dumping the stock.¹⁴ These actors have received

einhorn-short-st-joe-settles-with-sec [<https://perma.cc/R79C-BU2K>] (noting that Einhorn shorted the company at \$27.07 and closed the position at \$17.17).

13. See *St. Joe Co.*, Exchange Act Release No. 76275, 2015 WL 6467959 at 7 (Oct. 27, 2015) (settling case and crediting that in 2010 “a short-seller gave a public presentation alleging that St. Joe was overvaluing its real estate development assets and failing to take material impairment charges”); cf. *Meyer v. Greene*, 710 F.3d 1189, 1202 (11th Cir. 2013) (affirming dismissal of investor class action); Valerie Garman, *St Joe Settles SEC Investigation*, PAN. CITY NEWS HERALD (Oct. 29, 2015, 12:31 PM), <https://www.newsherald.com/story/news/politics/government/2015/10/29/st-joe-settles-sec-investigation/33181894007/> [<https://perma.cc/4958-AA9F>] (discussing management turnover).

14. *Infra* section I.B.

substantial attention from regulators,¹⁵ courts,¹⁶ academics,¹⁷ journalists,¹⁸ and defense lawyers.¹⁹ Some have even gotten the Hollywood treatment.²⁰

But, notwithstanding all this attention, one important page from the activist short playbook has been overlooked. Block, Einhorn, and company have been turning to a surprising source to pad their trading profits: the SEC.

In the two cases described above, the SEC determined that both Block and Einhorn qualified as “whistleblowers” and awarded each a “bounty.”

15. See *infra* section IV.B.

16. *E.g.*, Farmland Partners Inc. v. Rota Fortuna, No. 18-cv-02351, 2020 WL 12574993 (D. Colo. May 15, 2020); MiMedx Grp., Inc. v. Sparrow Fund Mgmt. LP, No. 17 Civ. 7568, 2018 WL 4735717 (S.D.N.Y. Sept. 29, 2018); Sugarman v. Muddy Waters Cap. LLC, No. 19-cv-04248, 2020 WL 633596 (N.D. Cal. Feb. 3, 2020); Deer Consumer Prod., Inc. v. Little, 938 N.Y.S.2d 767 (Sup. Ct. 2012); Silvercorp Metals Inc. v. Anthion Mgmt. LLC, 948 N.Y.S.2d 895 (N.Y. Sup. Ct. 2012); Med. Properties Tr., Inc. v. Viceroy Rsch., No. 2:23-cv-00408, 2023 WL 4356355 (N.D. Ala. June 30, 2023); Overstock.com, Inc. v. Gradient Analytics, Inc., 61 Cal. Rptr. 3d 29 (Ct. App. 2007); Aurelius v. Bofl Fed. Bank, No. MC 16-71 DSF, 2016 WL 8925145 (C.D. Cal. Sept. 20, 2016); Greenlaw v. Klimek, No. 4:20-CV-311, 2021 WL 6112784 (E.D. Tex. Dec. 27, 2021); NOVAGOLD Res., Inc. v. J Cap. Rsch. USA LLC, No. 20-CV-2875, 2022 WL 900604 (E.D.N.Y. Mar. 28, 2022); Alpine 4 Holdings Inc. v. Finn Mgmt. GP LLC, No. CV-21-01494, 2022 WL 3598246 (D. Ariz. Aug. 23, 2022); Bass v. United Dev. Funding, L.P., No. 05-18-00752-CV, 2019 WL 3940976 (Tex. Ct. App. Aug. 21, 2019); see also Charles F. Walker & Colin D. Forbes, *SEC Enforcement Actions and Issuer Litigation in the Context of a “Short Attack,”* 68 BUS. LAW. 687 (2013) (collecting cases).

17. See *infra* note 44 (collecting law and finance scholarship on activist shorts).

18. See, *e.g.*, *infra* notes 219 (covering whistleblower activity) & 238 (detailing accomplishments of one such whistleblower, who has been featured in many major news outlets).

19. *E.g.*, Corey Worcester, Michael Liftik, Renita Sharma, Jomaira Crawford, Hope Skibitsky & Emily Kapur, “*That Is Not An Opinion*”: *How to Sue Short Sellers*, QUINN EMANUEL URQUHART & SULLIVAN (June 25, 2021), <https://www.quinnemanuel.com/media/yo0jyalj/that-is-not-an-opinion-how-to-sue-short-sellers-1.pdf> [<https://perma.cc/GBG7-DMET>]; SULLIVAN & CROMWELL LLP, REVIEW AND ANALYSIS OF 2020 U.S. SHAREHOLDER ACTIVISM AND ACTIVIST SETTLEMENT AGREEMENTS 16–18 (2020), https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/sc-publication-review-analysis-2020-US-shareholder-activism.pdf [<https://perma.cc/878J-S48S>]; Jeff Katz & Annie Hancock, *Short Activism: The Rise in Anonymous Online Short Attacks*, HARV. L. SCH. F. ON CORP. GOV. (Nov. 27, 2017), <https://corpgov.law.harvard.edu/2017/11/27/short-activism-the-rise-in-anonymous-online-short-attacks/> [<https://perma.cc/8MMG-5NNQ>]; Walker & Forbes, *supra* note 16.

20. *E.g.*, *Dirty Money: The Drug Short* (Netflix Jan. 26, 2018); THE CHINA HUSTLE (2929 Productions 2017); THE BIG SHORT (Paramount Pictures 2015).

In Block's case, the payment was \$14 million.²¹ In Einhorn's case, the size of the bounty is unknown.²²

These are not isolated instances but rather the tip of the iceberg. Activist shorts and other outsider tipsters account for a significant portion of whistleblower awards issued in recent years. Drawing on data obtained from the SEC under the Freedom of Information Act, I find that the SEC's Whistleblower Bounty Program (WBP) has paid nearly \$300 million (and more than a third of all awards) to activist shorts and other "outsider" tipsters.²³ The share going to outsiders is increasing. In recent years, the WBP has paid about forty percent of all awards and all dollars to this group.²⁴ And, drawing on a comprehensive review of SEC reports, podcast and media appearances by activist shorts, litigation filings, news reports, and other public sources, as well as several interviews with market participants (activist shorts, whistleblower lawyers, and other outsider whistleblowers), I show that many leading activist shorts and other professional outsider tipsters have been participating successfully in the WBP—both directly (submitting tips, filing claims, and winning awards) and indirectly (recruiting and subsidizing others who do so).²⁵

21. See Order Determining Whistleblower Award Claims, Exchange Act Release No. 94398, 2022 WL 768309, at 1 (Mar. 11, 2022) (redacted order issuing award for fourteen million dollars to "Claimant 1"); Complaint, *Barnes v. Block*, *supra* note 3, ¶ 10 (alleging that Block was the claimant referenced in the redacted order); Defendants' Reply to Plaintiff Carson Block's Memorandum of Law in Opposition to Defendant's Motion to Dismiss at 7–8, *Barnes v. Block* 1:22-cv-7236 (S.D.N.Y. Oct. 18, 2022) ECF No. 15 (admitting same); Complaint, *Block v. Barnes*, *supra* note 2, ¶ 14 (same). Immediately following publication of Block's Focus Media report in November 2011, the SEC opened an investigation that led to a fifty-five-million-dollar settlement. See Complaint, *Barnes v. Block*, *supra* note 3, ¶ 71 (alleging that SEC opened a Matter Under Inquiry concerning Focus Media in December 2011); Letter from Focus Media Holding Ltd. to Shareholders of Focus Media Holding Ltd., Notice of Extraordinary General Meeting of Shareholders 78–79 (Mar. 25, 2013), <https://www.sec.gov/Archives/edgar/data/1330017/000119312513124513/d461081dex99a1.htm> (last visited Sept. 8, 2024) ("On March 14, 2012, the SEC informed the Company that it was initiating a non-public investigation into whether there had been any violations of the federal securities laws related to the Company"); Focus Media Holding Ltd. & Jasion Jiang, Order Instituting Cease and Desist Proceedings, Exchange Act Release No. 76030, 112 SEC Docket 2905 (Sept. 30, 2015).

22. See Greenlight Capital Inc., Q4 Investor Letter at 5 (Jan. 21, 2021), <https://seekingalpha.com/article/4400463-greenlight-capital-q4-2020-letter> (last visited Sept. 8, 2024) [hereinafter Greenlight Investor Letter] ("After initially denying our claim, the SEC agreed that David was, upon appeal, entitled to a whistleblower award. The award was remitted to the funds in November 2020.").

23. The "insider" / "outsider" terminology comes from the SEC's WBP annual reports which define "insider" tipsters as current or former employees, actual or prospective consultants and contractors, and other "close affiliates" of the subject company, and "outsiders" as individuals with "special expertise" in the market, actual or prospective investors, and professionals working in the same or related industry. See *infra* section III.A.

24. *Id.*

25. *Infra* sections III.B–C.

The active involvement of these sophisticated professional outsider tipsters in the WBP represents a new form of privatization of public enforcement. When the WBP rewards *insider* tipsters, the SEC is paying for information that it would not have been able to obtain any other way.²⁶ Where a fraud is held closely by a few corporate insiders, no amount of expert surveillance or investigation by an outsider may be able to uncover the truth. Incentivizing insiders to come forward is the only way to bring the truth to light. And because insiders are legally barred from trading or profiting from material non-public information about their firms,²⁷ the prospect of a public bounty is the exclusive financial incentive eliciting such information from these actors.

But when the WBP rewards *outsiders*, this justification falls apart. A private professional outsider who spots a fraud through sophisticated market surveillance and diligent investigation is doing the same sort of work that is done every day by thousands of civil servants employed directly by the SEC. The same is true when an outsider provides the SEC with detailed legal analysis, witness interviews, and draft legal documents related to the fraud. When the WBP rewards outsiders for this work, it uses public funds²⁸ to pay private professionals to do precisely the kind of work that traditionally would have been done by government employees.

In other words, the WBP has become a covert outsourcing program for SEC enforcement. And it's a big one—in recent years, the SEC's awards to outsider tipsters equate to roughly twelve percent of the agency's total enforcement budget.²⁹

Although once controversial, privatization of government programs has become ubiquitous.³⁰ Proponents have emphasized efficiency, arguing that privatization gives taxpayers more “bang for the buck,”³¹ while critics typically warn about compromising non-efficiency values like political accountability embedded in public programs.³²

26. See *infra* section IV.A.1.

27. *Infra* section II.B.

28. See *infra* note 58 (explaining source of whistleblower awards).

29. *Infra* Part IV.

30. Cf. JON D. MICHAELS, CONSTITUTIONAL COUP: PRIVATIZATION'S THREAT TO THE AMERICAN REPUBLIC 3, 99 (2017) (“We’re all privatizers now.”); Julie E. Cohen, *The Regulatory State in the Information Age*, 17 THEORETICAL INQ. L. 369, 395 (2016) (describing the “deep capture” by which “industry groups and neoliberal think tanks have worked to shape thought processes about optimal regulatory structure . . . , positioning privatization and competition as core governance strategies”).

31. E.g., DAVID OSBORNE & TED GAEBLER, REINVENTING GOVERNMENT (1992); E.S. SALVAS, PRIVATIZATION: THE KEY TO BETTER GOVERNMENT 288–91 (1987); JOHN D. DONAHUE, THE PRIVATIZATION DECISION: PUBLIC ENDS, PRIVATE MEANS 57–78.

32. E.g., MICHAELS, *supra* note 30.

Unfortunately, the covert outsourcing program I uncover here seems to reduce both the efficiency and accountability of SEC enforcement. Outsourcing SEC enforcement to private professional outsider tipsters would be laudable if it yielded more efficient deterrence than the SEC could produce by devoting these same resources to expand its own staff. But there is good reason to doubt that it does so.

The SEC may be paying bounties for information that the tipster would have brought forward even without the prospect of a bounty. According to activist shorts' public statements as well as my own conversations with some of these players (and additional evidence), the lure of trading profits typically does *all of the work* in motivating these actors to come forward publicly with this information.³³ They often merely "throw in" the same information as a tip to the SEC (shortly before making it public) as it costs basically nothing to do so.³⁴ In such cases, any bounty payment to these actors constitutes a *windfall*, not any kind of forward-looking incentive. The SEC (along with the rest of the public) would have had access to the same information with or without the existence of a whistleblower bounty. In such cases, whistleblower payments do not enhance deterrence. To the contrary, compared to the hypothetical alternative world in which the SEC used these funds to pay insider whistleblowers or hire additional investigatory and enforcement staff, paying activist shorts may *reduce* deterrence.³⁵

In cases where the SEC initiates serious investigation or enforcement activity against a target flagged by an activist short, the activist short may provide substantial additional support to the SEC's efforts.³⁶ Indeed, the SEC explicitly considers such assistance in setting the amount of the award.³⁷ But, in these cases, where the SEC is paying outsiders to do the kind of legal analysis and other litigation work that could be performed by the agency's own professional staff, the SEC appears to be *dramatically overpaying* for these basic legal services.³⁸ Again, it seems like the SEC would have achieved more deterrence by spending the hundreds of millions of dollars to expand its own professional litigation and investigation capacity than by paying a small number of private professionals huge sums to do this work in a few cases.³⁹

33. *Infra* section IV.A.1.

34. *Infra* section IV.A.1.

35. *Infra* Part IV.

36. *Infra* section IV.A.2.

37. *Infra* section IV.A.2.

38. *Infra* section IV.A.2.

39. *Infra* section IV.A.

Further, privatization in this context not only compromises the efficiency of the SEC's efforts to deter fraud, it also compromises the political accountability embedded in traditional SEC enforcement. The mechanisms of transparency, constitutional limits, and other good governance practices help ensure traditional SEC enforcement serves the goals established by its principals (i.e., Congress, the Executive, and the public). In the context of privatized investigation and enforcement by professional outsider tipsters, these mechanisms are largely jettisoned.⁴⁰

Practical political considerations all but foreclose the possibility of reallocating funds away from compensating outsider tipsters back towards expanding the SEC's enforcement staff.⁴¹ As a second-best approach, this paper offers moderate reforms designed to encourage socially beneficial outsider participation in the WBP, while mitigating some of the potential costs to efficiency and accountability such participation may cause.⁴²

In sum, this paper documents outsider participation in the WBP, shows how this participation has transformed the WBP into a covert privatization program, raises concerns that this privatization has undermined both the efficiency of SEC enforcement and the core value of political accountability embedded in that program, and offers some moderate reforms.

40. *Infra* section IV.B.

41. *See infra* text accompanying note 333.

42. *Infra* Part V.

This Article contributes to several bodies of scholarship. Most directly, it contributes to literatures on both the WBP⁴³ and activist short selling.⁴⁴ Although scholars in law and finance have carefully studied both institutions, they have overlooked the connection between the two.⁴⁵

43. For legal scholarship on the WBP, 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 (2014); Anthony J. Casey & Anthony Niblett, *Noise Reduction: The Screening Value of Qui Tam*, 91 WASH. U. L. REV. 1169, 1177–78 (2014); David Freeman Engstrom, *Whither Whistleblowing? Bounty Regimes, Regulatory Context, and the Challenge of Optimal Design*, 15 THEORETICAL INQ. L. 605, 606, 611–12 (2014); Julie Rose O'Sullivan, "Private Justice" and FCPA Enforcement: Should the SEC Whistleblower Program Include a Qui Tam Provision?, 53 AM. CRIM. L. REV. 67 (2016); Usha R. Rodrigues, *Optimizing Whistleblowing*, 94 TEMP. L. REV. 255, 285–86, 302 (2022); Christina Parajon Skinner, *Whistleblowers and Financial Innovation*, 94 N.C. L. REV. 861, 908–09 (2016); 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; Emily Strauss & Joseph A. Grundfest, *Mutiny for a Bounty*, 66 ARIZ. L. REV. 191 (2024); Amy Deen Westbrook, *Cash for Your Conscience: Do Whistleblower Incentives Improve Enforcement of the Foreign Corrupt Practices Act?*, 75 WASH. & LEE L. REV. 1097 (2018); Jennifer M. Pacella, *Making Whistleblowers Whole*, 12 UC IRVINE L. REV. 1291 (2022); Justin W. Evans, Stephanie R. Sipe, Mary Inman & Caroline Gonzalez, *Reforming Dodd-Frank from the Whistleblower's Vantage*, 58 AM. BUS. L.J. 453, 479 (2021); Amanda M. Rose, *Calculating SEC Whistleblower Awards: A Theoretical Approach*, 72 VAND. L. REV. 2047 (2019); Miriam H. Baer, *Reconceptualizing the Whistleblower's Dilemma*, 50 U.C.D. L. REV. 2215 (2017); Alexander I. Platt, *The Whistleblower Industrial Complex*, 40 YALE J. ON REG. 688 (2023) [hereinafter Platt, *WBIC*].

For finance and accounting scholarship on the WBP, see Philip G. Berger & Heemin Lee, *Did the Dodd-Frank Whistleblower Provision Deter Accounting Fraud?*, PROGRAM ON CORP. COMPLIANCE & ENF'T N.Y.U. SCH. L., https://wp.nyu.edu/compliance_enforcement/2023/01/30/did-the-dodd-frank-whistleblower-provision-deter-accounting-fraud/#:~:text=The [<https://perma.cc/JB5E-JC2S>]; Christine Wiedman & Chunmei Zhu, *Do the SEC Whistleblower Provisions of Dodd Frank Deter Aggressive Financial Reporting?*, CAN. ACAD. ACCT. ASS'N ANN. CONF. (Mar. 3, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3105521 (last visited Sept. 14, 2024); Qingjie Du & Yuna Heo, *Political Corruption, Dodd-Frank Whistleblowing, and Corporate Investment*, 73 J. CORP. FIN. 1, 7–45 (2022).

44. For legal scholarship on activist short selling, see, e.g., Peter Molk & Frank Partnoy, *The Long-Term Effects of Short Selling and Negative Activism*, 2022 U. ILL. L. REV. 1, 19; Barbara A. Bliss, Peter Molk & Frank Partnoy, *Negative Activism*, 97 WASH. U. L. REV. 1333 (2020); Joshua Mitts, *Short and Distort*, 49 J. LEGAL STUD. 287 (2020).

For finance and accounting scholarship on activist short selling, see, e.g., Janja Brendel & James Ryans, *Responding to Activist Short Sellers: Allegations, Firm Responses, and Outcomes*, 59 J. ACCT. RSCH. 487 (2021); Alexander Ljungqvist & Wenlan Qian, *How Constraining are Limits to Arbitrage?*, (Inst. Glob. Fin. Working Paper, Paper No. 7, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2356414 (last visited Sept. 18, 2024); Lei Chen, *The Informational Role of Short Sellers: The Evidence from Short Sellers' Reports on US-Listed Chinese Firms*, 43 J. BUS. FIN. & ACCT. 1444 (2016); Ian Appel & Vyacheslav Fos, *Short Campaigns by Hedge Funds* (Euro. Corp. Governance Inst. - Fin. Working Paper, Paper No. 609/2019, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3242516 (last visited Sept. 18, 2024).

45. The sole academic treatment directly on point seems to be a 2011 law student note published just as the WBP was getting up and running, which urged the SEC to allow (and perhaps even encourage) short sellers to "double-dip"—that is to not count tipster's trading or other market profits

Understanding the real operation of the WBP is particularly important, as other federal agencies, states, and foreign jurisdictions increasingly look to adopt similar programs.⁴⁶ The paper also contributes to the study of privatization and, particularly, the outsourcing of public enforcement.⁴⁷ Prominent commentators have periodically called on the SEC to

against them in determining whether to issue an award. Luke R. Hornblower, *Outsourcing Fraud Detection: The Analyst as Dodd-Frank Whistleblower*, 6 J. BUS. & TECH. L. 287, 287, 318–25 (2011). Professors Bliss, Molk, and Partnoy have called on the SEC to “subsidize” negative activism and “more explicitly engag[e] with negative activists” without discussing how the SEC may already be doing this through the WBP. Molk & Partnoy, *supra* note 44, at 59; Bliss et al., *supra* note 44, at 1341, 1385.

Numerous finance and accounting scholars have documented a strong correlation between activist short reports and subsequent SEC enforcement but have stopped short of addressing any mechanism that connects the two. Brendel & Ryans, *supra* note 44, at 513–15; Appel & Fos, *supra* note 44, at 25–26; Chen, *supra* note 44, at 1474–75.

I have also shared some of the preliminary findings of this project with journalists, who have written about it. See Austin Weinstein, *Carson Block, Nate Anderson Become SEC Tipsters for Cash Payouts*, BLOOMBERG (Nov. 15, 2023), <https://www.bloomberg.com/news/articles/2023-11-15/nate-anderson-carson-block-become-sec-tipsters-for-cash-payouts> (last visited Aug. 19, 2024).

46. *E.g.*, Anti-Money Laundering Act of 2020 § 6314, Pub. L. No. 116-283, 134 Stat. 4583, 4597–603 (codified as amended at 31 U.S.C. § 5323); Financial Compensation for Consumer Financial Protection Bureau Whistleblowers Act, H.R. 5484, 117th Cong. (2021); *NASAA Model Act to Award and Protect Whistleblowers*, NASAA (Nov. 5, 2020), <https://www.nasaa.org/policy/legislative-policy/model-state-legislation/nasaa-whistleblower-model-act> [<https://perma.cc/5UAS-C6PL>]; Helena Wood, *Reframing the UK Debate on Financial Crime Whistleblower Rewards*, ROYAL UNITED SERVS. INST. (Feb. 7, 2023), <https://www.rusi.org/explore-our-research/publications/commentary/reframing-uk-debate-financial-crime-whistleblower-rewards> [<https://perma.cc/AD78-FV9L>].

47. The concept “privatization of public enforcement” is broad with contestable boundaries. The relevant literature encompasses a vast array of topics, from governments directly contracting with private attorneys to conduct public litigation, Margaret H. Lemos, *Privatizing Public Litigation*, 104 GEO. L.J. 515 (2016), to “gatekeeper” regimes that assign public investigation and enforcement responsibilities to third parties like auditors and lawyers, JOHN C. COFFEE, JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* (2006), the “conscriptio[n]” of large corporations to take on traditionally public enforcement responsibilities themselves, Rory Van Loo, *The New Gatekeepers: Private Firms as Public Enforcers*, 106 VA. L. REV. 467 (2020); to recent controversial innovations empowering private parties (referred to critically in the literature as “vigilantes”) to enforce controversial public rights on issues like abortion, gun control, and affirmative action, Aziz Z. Huq, *The Private Suppression of Constitutional Rights*, 101 TEX. L. REV. 1259 (2023); Jon D. Michaels & David L. Noll, *Vigilante Federalism*, 108 CORNELL L. REV. 1187 (2023); Guha Krishnamurthi, *Are S.B. 8’s Fines Criminal?*, 101 TEX. L. REV. ONLINE 141 (2023); Peter N. Salib, *Ban them All; Let the Courts Sort them Out. Saving Clauses, the Texas Abortion Ban, and the Structure of Constitutional Rights*, 100 TEX. L. REV. ONLINE 13 (2021); Peter N. Salib & Guha Krishnamurthi, *Jury Nullification in Abortion Prosecutions: An Equilibrium Theory*, 72 DUKE L.J. ONLINE 41 (2022), to more traditional forms of “bounty-hunting” programs, like *qui tam* and class actions, which charge private parties of various types with enforcing public rights, Pamela H. Bucy, *Private Justice*, 76 S. CAL. L. REV. 1 (2002), and more.

outsource some or all of its enforcement activities to private attorneys.⁴⁸ The findings here suggest these calls have been at least partially answered.

The paper proceeds in five parts. Parts I and II provide institutional and legal background. Part III presents evidence regarding the participation of professional outsiders in the WBP. Part IV argues that paying professional outsider tipsters has turned the WBP into a covert outsourcing program for public enforcement and raises concerns that this privatization threatens both the efficiency and accountability of that governmental program. Part V offers regulatory and legal reforms.

I. INSTITUTIONAL BACKGROUND: THE SEC WHISTLEBLOWER PROGRAM AND ACTIVIST SHORT SELLERS

This part introduces two seemingly separate innovations that occurred in the wake of the financial crisis of 2008–2009 and which have enhanced the detection and deterrence of corporate fraud: the WBP and activist shorts.

A. *SEC Whistleblower Program*

Congress created the WBP in 2010 as part of the financial regulatory overhaul enacted in the wake of the financial crisis.⁴⁹ The WBP aims to supplement SEC enforcement efforts by incentivizing individuals to come forward with actionable information about illegal conduct, offering the prospect of financial payments (“bounties”), anonymity protections, and the right to file a lawsuit against an employer who retaliates against them.⁵⁰ Unlike “qui tam” regimes, where a private party can bring a case on behalf of the government, the SEC retains total prosecutorial discretion—it alone decides which tips to investigate and prosecute.⁵¹

After a tipster submits a tip, it is evaluated by SEC officials who work for a subdivision of the Division of Enforcement called the “Office of Market Intelligence” (OMI).⁵² Some tips are selected for further

48. JOHN C. COFFEE, JR., CORPORATE CRIME AND PUNISHMENT: THE CRISIS OF UNDERENFORCEMENT 83–84, 100–04 (2020); Tamar Frankel, *Let the Securities and Exchange Commission Outsource Enforcement by Litigation: A Proposal*, 11 J. BUS. & SEC. L. 111 (2010).

49. See Dodd-Frank Wall Street Reform and Consumer Protection Act § 922, Pub. L. No. 111-203, 124 Stat. 1376, 1841–9 (2010) (codified at 15 U.S.C. § 78u-6).

50. For an overview, see *Frequently Asked Questions*, SEC, [hereinafter SEC OWB FAQ], <https://www.sec.gov/whistleblower/frequently-asked-questions> [https://perma.cc/L3VC-5CY5].

51. For analysis of the distinction between *qui tam* and WBP, see Casey & Niblett, *supra* note 43, at 1202–07; Rose, *supra* note 43, at 1290–300; O’Sullivan, *supra* note 43; Evans et al., *supra* note 43, at 500.

52. SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 28 (2021).

investigation.⁵³ Some of those lead to actual enforcement actions.⁵⁴ And some of those lead to the payment of money by the targets to the agency via settlement or otherwise.⁵⁵ At this point, the SEC’s whistleblower office posts a notice on its website alerting the public of a new “covered action”—a pool of money the SEC has recovered for which one or more whistleblowers *may* be eligible to file a claim for up to thirty percent.⁵⁶ Whistleblowers who believe their tips helped the agency pursue this action then file claims seeking a bounty payment.⁵⁷ The agency processes these claims, makes determinations, resolves objections (if any) from affected whistleblowers, and then issues the award.⁵⁸

53. *Frequently Asked Questions*, SEC, No. 7, <https://www.sec.gov/whistleblower/frequently-asked-questions> [<https://perma.cc/L3VC-5CY5>]. For a description of the process for declining to pursue a tip, *see* U.S. GOV’T ACCOUNTABILITY OFF., GAO-20-115, SEC: SYSTEMATICALLY ASSESSING STAFF PROCEDURES AND ENHANCING CONTROL DESIGN WOULD STRENGTHEN INTERNAL OVERSIGHT 37–38 (2019).

54. *See* SEC OWB FAQ, *supra* note 53, at No. 10.

55. *Id.*

56. *Id.* at Nos. 1, 8.

57. *Id.* at No. 9.

58. Whistleblower awards are paid out of the Investor Protection Fund (IPF), which is funded by a small subset of the monetary sanctions SEC collects in enforcement actions. 15 U.S.C. § 78u-6(g). Most SEC monetary sanctions are not deposited into the IPF. When the IPF reaches \$300 million, the SEC stops depositing monetary sanctions into that account and instead send them to the general U.S. Treasury. *Id.* Further, the SEC returns a subset of monetary sanctions to harmed investors, and those sanctions are not deposited into the IPF. 15 U.S.C. § 7246(a). For instance, in FY 2022, the SEC ordered a total \$6.4 billion in sanctions, while sending just \$1.4 billion (combined) back to investors and the IPF. *See* SEC, ANNUAL WHISTLEBLOWER REPORT 1 (2022); SEC, ENFORCEMENT REPORT ADDENDUM 2 (2022). Similarly, as of November 2020, “Original information provided by whistleblowers has led to enforcement actions in which the Commission has obtained more than \$2.5 billion in financial remedies, . . . of which almost \$750 million has been or is scheduled to be returned to harmed investors” and another \$523 million distributed to whistleblowers—leaving fully *half* of all the monetary sanctions collected in WBP-linked cases up to that point (a subset of SEC’s total enforcement portfolio) were remitted to the general U.S. Treasury fund. Whistleblower Program Rules, 85 Fed. Reg. 70,898 (Nov. 5, 2020) (codified at 17 C.F.R §§ 240, 249).

Because any dollar the SEC pays out to whistleblowers is a dollar that otherwise would have gone to the general U.S. Treasury fund, I have sometimes casually referred to whistleblower bounties as being paid out of “taxpayer dollars.” *E.g.*, Weinstein, *supra* note 45 (quoting me). Some have criticized this characterization because, in fact, the funds deposited into the IPF do not come from taxes. *See* @muddywatersre, X (Nov. 15, 2023, 8:51 AM), <https://x.com/muddywatersre/status/1724832443549520014?s=12&t=G8l7fTqHZRBeqDkrB7Onb> A (last visited Sept. 15, 2024). Upon reflection, the criticism is well taken. In this paper and going forward, I refrain from referring to whistleblower awards as “taxpayer” funds and instead use the phrase “public” funds, which I think fairly encompasses the IPF, given the following: (1) each dollar the IPF pays to a whistleblower is a dollar that otherwise would have been remitted to the general Treasury fund; (2) the IPF was appropriated by Congress and established within the U.S. Treasury; and (3) the SEC is “required to annually request and obtain apportionments from OMB to use these funds.” 15 U.S.C. § 78u-6(g); SEC, OFF. OF INSPECTOR GEN., EVALUATION OF THE SEC’S WHISTLEBLOWER PROGRAM, REP. NO. 511 6 (2013) [hereinafter SEC OIG 2013].

The program is widely regarded as a success.⁵⁹ Empirical evidence shows that it has indeed deterred certain types of securities fraud.⁶⁰ After getting off to a slow start, the program kicked into high gear under Chair Jay Clayton in FY 2020.⁶¹ By the end of FY 2022, the program had awarded more than \$1.3 billion in 328 awards, and enforcement actions relying on information provided under the program have resulted in orders for more than \$6.3 billion in total monetary sanctions, including \$1.5 billion returned to harmed investors.⁶²

59. *E.g.*, Digit. Realty Trust, Inc. v. Somers, 538 U.S. ___, 138 S. Ct 767, 773, 777 (2018) (describing Dodd-Frank’s WBP as “robust”); Gary Gensler, Chair, SEC, Remarks at the Securities Enforcement Forum (Nov. 4, 2021) (“[W]e benefit greatly from . . . our robust whistleblower program.”); Jay Clayton, Chairman, SEC, Statement at SEC Open Meeting: Strengthening Our Whistleblower Program (Sept. 23, 2020) (“[T]he whistleblower program has been a critical component of the Commission’s efforts to detect wrongdoing and protect investors and the marketplace”); Mary Jo White, Chair, SEC, Speech at the Ray Garrett Jr. Corporate and Securities Law Institute, Northwestern University School of Law: The SEC as the Whistleblower’s Advocate (Apr. 30, 2015) (describing the WBP as a “game changer”); Letter from Sen. Sherrod Brown, et al., to Jay Clayton, Chairman, SEC (Sept. 17, 2020), <https://www.sec.gov/comments/s7-16-18/s71618-7801845-223661.pdf> [(describing the WBP as “an unqualified success”); Letter from Sen. Chuck Grassley to Hon. Gary Gensler, Chair, SEC (Mar. 12, 2021), <https://whistleblowersblog.org/wp-content/uploads/2021/03/Sen-Grassley-Letter-to-Gensler-3-12-21.pdf> (describing the WBP as “a critical component of the SEC’s enforcement arsenal”); Robert J. Jackson Jr., Comm’r, SEC, Statement on Proposed Rules Regarding SEC Whistleblower Program (June 28, 2018) (describing the WBP as “crucial to our enforcement efforts” and “among our Staff’s most successful endeavors”); Kara M. Stein, Comm’r, SEC, Statement on Proposed Amendments to the Commission’s Whistleblower Program Rules (June 28, 2018) (describing the program as “a resounding success”); Hester M. Peirce, Comm’r, SEC, Statement at Open Meeting on Amendments to the Commission’s Whistleblower Program Rules (June 28, 2018) (describing the WBP as “a critical part of our enforcement program”); Elad L. Roisman, Comm’r, SEC, Statement on the Commission’s New and Improved Whistleblower Program Rules (Sept. 23, 2020) (“To call this program a success is an understatement.”); Caroline A. Crenshaw, Comm’r, SEC, Statement of Commissioner Caroline Crenshaw on Whistleblower Program Rule Amendments (Sept. 23, 2020) (“I am proud of our whistleblower program.”); COFFEE, *supra* note 48, at 114 (characterizing WBPs as “dramatically successful”); Rose, *Better Bounty Hunting*, *supra* note 43, at 1237 (describing WBPs as “the proverbial nail in the [fraud on the market] class action coffin”); LATHAM & WATKINS LLP, SEC INVESTIGATIONS: A GUIDE FOR PUBLIC COMPANY DIRECTORS 2 (2d ed. 2022) (“the SEC’s whistleblower program is a significant driver of enforcement investigations and actions.”).

60. Berger & Lee, *supra* note 43, at 3; Wiedman & Zhu, *supra* note 43; Du & Heo, *supra* note 43.

61. See SEC, 2020 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 1–2 (2020) (noting that the number of awards issued in FY 2020 was “triple the number awarded in 2018, the next highest fiscal year,” and that “[t]he awards made in FY 2020 represent 31% of the total dollars awarded to all whistleblowers and 37% of the individual award recipients since the beginning of the program.”).

62. *Id.* But see John Holland, *SEC Payouts to Whistleblowers Plummet Amid Record Surge in Tips*, BLOOMBERG L. (Dec. 26, 2023) [hereinafter Holland, *SEC Payouts*], <https://news.bloomberglaw.com/securities-law/sec-payouts-to-whistleblowers-plummet-amid-record-surge-in-tips> (last visited Aug. 20, 2024) (“only 68 tipsters got any money, compared to more than 100 in each of the previous two years”).

Not that everything is perfect. Critics (including appellate courts), have increasingly raised concerns about the program's administration.⁶³ Others (including one SEC Commissioner) worry about the extreme secrecy that cloaks the program, which may inhibit participation by some would-be tipsters and tilt the playing field in favor of some powerful and well-connected repeat players.⁶⁴

B. *Activist Short Sellers*

Activist short sellers are individuals or hedge funds⁶⁵ who aim to make returns by selling short a company's stock⁶⁶ and then publicly revealing

63. *E.g.*, *Doe v. SEC*, No. 22-1652, 2023 WL 3562977, at *3 n.3 (3d Cir. Mar. 23, 2023) (criticizing the SEC's reasoning in an award determination as leaving "something to be desired"); *Hong v. SEC*, 41 F.4th 83, 102 (2d Cir. 2022) (noting that SEC's award denial in the case "may strike some as inconsistent with the principal statutory goal of the Program—namely, Congress's desire to incentivize and reward whistleblowers who may risk their reputations and careers to help hold financial institutions responsible for unlawful behavior"); Oral Argument at 16:05–10, 17:00–30, *Doe v. SEC*, 28 F.4th 1306 (D.C. Cir. Jan. 31, 2022) (Judge Tatel) (criticizing SEC WBP award regulation as "one of the sloppiest . . . I've ever seen" and asking counsel to send "a message back to the commission: they need to get their act together."); *see also* Petitioner's Final Opening Brief at *3, *Johnston v. SEC*, No. 21-1132, 2022 WL 580483, at *3 (D.C. Cir. Feb. 25, 2022) (prominent whistleblower lawyer Stephen Kohn alleging that the SEC had issued a "a massive and undeserved financial windfall" to a tipster); John Holland, *Wall Street Whistleblowers Tip Off SEC — But Hear Nothing Back*, BLOOMBERG L. (Nov. 28, 2022), <https://www.bloomberg.com/news/features/2022-11-28/wall-street-whistleblowers-alert-sec-to-stock-fraud-but-hear-nothing-back?embedded-checkout=true> (last visited Aug. 20, 2024); John Holland, *Whistleblowers Who Exposed \$1 Billion Fraud Denied SEC Windfall*, BLOOMBERG L. (May 1, 2023), <https://news.bloomberglaw.com/securities-law/whistleblowers-who-exposed-1-billion-fraud-denied-sec-windfall> (last visited Aug. 20, 2024).

64. *E.g.*, Mark T. Uyeda, Comm'r, SEC, Statement on the Final Rules Related to the Whistleblower Program (Aug. 26, 2022), (observed that the WBP "has come under increasing scrutiny from some on the basis that it operates with a lack of transparency," and called on the Commission to "consider promoting greater visibility into its claims and award determinations"); *see also* Platt, *WBIC*, *supra* note 43 (raising concerns that the program's secrecy has given an advantage to well-connected, revolving door attorneys); Alexander I. Platt, *Going Dark(er): The SEC Whistleblower Program's FY 2022 Report is the Least Transparent in Agency History*, 2023 U. ILL. L. REV. ONLINE 66 (noting that the program is becoming even more secretive); John Holland, *SEC Tip Line Was Meant To Stop Another Madoff. Is it Working?*, BLOOMBERG (July 26, 2022), <https://www.bloomberg.com/news/articles/2022-07-26/sec-enriches-fraudsters-lawyers-as-secrecy-shrouds-tips-program?embedded-checkout=true> (last visited Aug. 20, 2024); Holland, *SEC Payouts*, *supra* note 62.

65. *See* Bliss, Molk & Partnoy, *supra* note 44, at 1345 (hedge funds are the "primary players in this space").

66. Taking "short" position involves borrowing shares for a fee, immediately selling the borrowed shares at the current market price, and then later "covering" by buying new shares at the later market price and returning those new shares. *Investor Bulletin: An Introduction to Short Sales*, SEC (Oct. 29, 2015), https://www.sec.gov/resources-for-investors/investor-alerts-bulletins/ib_shortsalesintro (last visited Aug. 20, 2024); *see also* Joshua Mitts, *Passive Exit*, 28 STAN. J.L. BUS. & FIN. 155 (2023) (analysis of share lending process).

negative information about the target.⁶⁷ The negative information often includes accounting issues, fraud, and other illegal conduct.⁶⁸ Activist shorts may gather this information using conventional tactics (e.g., review of regulatory filings, contracts, audit reports, competitor filings; hiring expert consultants),⁶⁹ as well as more controversial ones (e.g., undercover investigations, secretly recording phone calls, and paying or deceiving insiders to give up information⁷⁰). They often publish their information (sometimes anonymously or pseudonymously⁷¹) in one or more publicly available “research reports” on the target,⁷² but they also present their theses at investor conferences⁷³ and promote their views aggressively in the media.⁷⁴ Activists may take short positions themselves or share the research with others who do so.⁷⁵ Although activist short selling has existed as a trading strategy for many years, the practice rapidly escalated in the wake of the financial crisis of 2008–2009.⁷⁶

67. Ljungqvist & Qian, *supra* note 44, at 1976, 1981; Brendel & Ryans, *supra* note 44, at 488, 490; Bliss et al., *supra* note 44, at 1338; Hervé Stolowy, Luc Paugam & Yves Gendron, *Competing for Narrative Authority in Capital Markets: Activist Short Sellers vs. Financial Analysts*, 100 ACCT. ORGS. & SOC’Y, July 2022, at 2, 2 n.6; Wuyang Zhao, *Activist Short-Selling and Corporate Opacity* 1 (Oct. 19, 2016) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2852041.

68. Brendel & Ryans, *supra* note 44, at 488; Ljungqvist & Qian, *supra* note 44, at 1989–90; Molk & Partnoy, *supra* note 44, at 4; Bliss, Molk & Partnoy, *supra* note 44, at 1355.

69. Ljungqvist & Qian, *supra* note 44, at 1987.

70. *Id.* at 1987–88; e.g., Juliet Chung, *Short Seller Seeks Valley “Pretenders,”* WALL ST. J. (June 3, 2013, 12:53 A.M.), <https://www.wsj.com/articles/SB10001424127887324423904578521231385314440> (last visited Aug. 5, 2024) (noting that one activist short allegedly personally visited a target “dressed in a baseball cap and jeans, and gave a fake name” and “has combed his hair into a bowl-style cut as a sort of disguise and tried to come across as uninformed in order to get people to talk freely”); Hughes, *infra* note 148 (noting that leading activist short sellers use “muckraking tactics that would be forbidden at most news organizations: undercover work, paid sources, covert recordings. They’ll spy on factories and trick security guards into revealing precious information.”).

71. See Mitts, *Short & Distort*, *supra* note 44.

72. Ljungqvist & Qian, *supra* note 44, at 1989; Appel & Fos, *supra* note 44 at, 19–20.

73. Appel & Fos, *supra* note 44, at 19.

74. *Id.*

75. See Michelle Celarier, *The Dark Money Secretly Bankrolling Activist Short-Sellers — and the Insiders Trying to Expose It*, INSTITUTIONAL INV. (Nov. 30, 2020), <https://www.institutionalinvestor.com/article/2bsxbe3qsygknlfaolibk/portfolio/the-dark-money-secretly-bankrolling-activist-short-sellers-and-the-insiders-trying-to-expose-it> [<https://perma.cc/922N-345S>].

76. See Brendel & Ryans, *supra* note 44, at 488 (“the number of short seller reports has grown substantially in recent years, from an average of 2.5 reports per year during the period 1996–2009, to 35 reports per year from 2010 to 2018”); Appel & Fos, *supra* note 44, at 3 (“The number of campaigns has increased considerably in recent years. Prior to 2008, the number of campaigns averaged fewer than five per year. Since 2008, however, the annual number of campaigns more than quintupled,

Professors Bliss, Molk and Partnoy usefully frame activist shorts as the negative analogue to traditional shareholder activists.⁷⁷ Traditional activists quietly buy up a substantial portion of an underperforming public company's stock at a low price, announce their presence, launch a public campaign to force the company to change in some value-increasing way through a proxy fight (or, more often, a settlement negotiated in the shadow of such a proxy fight), and then sell shares at the (hopefully) higher price they have helped create.⁷⁸ Activist shorts, by contrast, aim to profit by causing *decreases* in the target stock.⁷⁹ They make returns by identifying an *over-valued* public company, taking a short position in that company's stock, loudly revealing negative information about that company in the hopes of spurring investors to sell the stock, and then (hopefully) cover their short bets at the new, lower stock price.⁸⁰

Activist shorts are also usefully distinguished from traditional short sellers, who identify suitable targets and *quietly* short the stock until the price adjusts.⁸¹ Activist shorts do not quietly wait for the price to drop; they take an active role in causing it to do so.⁸²

The strategy appears to be effective. Research has shown that firms targeted by activist short campaigns experience significant abnormal negative returns over the short,⁸³ medium,⁸⁴ and long terms;⁸⁵ receive lower target prices from analysts;⁸⁶ and are more likely than untargeted

peaking at 45 in 2015.”); Stolowy, Paugam & Gendron, *supra* note 67, at 2 (noting the emergence of activist shorts “[e]specially since the 2008–09 financial crisis”); Zhao, *supra* note 67, at 2 (reporting in 2017 a “rapidly increasing trend of activist short-selling in the past decade”).

77. See Bliss, Molk & Partnoy, *supra* note 44, at 1338; see also Appel & Fos, *supra* note 44, at 20–22 (comparing short and long activism).

78. See Alexander I. Platt, *Beyond “Market Transparency”: Investor Disclosure and Corporate Governance*, 74 STAN. L. REV. 1393, 1429 (2022) (reviewing literature on traditional positive hedge fund activism).

79. *Supra* notes 65–69.

80. *Supra* notes 65–69.

81. See Bliss, Molk & Partnoy, *supra* note 44, at 1339

82. See Ljungqvist & Qian, *supra* note 44, at 1976; Zhao, *supra* note 67, at 9–10.

83. Ljungqvist & Qian, *supra* note 44, at 1991; see Chen, *supra* note 44, at 1460; Molk & Partnoy, *supra* note 44, at 16; Bliss, Molk & Partnoy, *supra* note 44, at 1350; Zhao, *supra* note 67, at 5.

84. Brendel & Ryans, *supra* note 44, at 498; Ljungqvist & Qian, *supra* note 44, at 1993; Appel & Fos, *supra* note 44, at 16–18.

85. Molk & Partnoy, *supra* note 44, at 18; Bliss, Molk & Partnoy, *supra* note 44, at 1354–55.

86. Stolowy, Paugam & Gendron, *supra* note 67, at 16.

firms to be delisted,⁸⁷ have management turnover,⁸⁸ restate earnings,⁸⁹ and face investor litigation.⁹⁰

And, most importantly for purposes of this Article, the strategy appears to be effective at detecting and punishing corporate fraud. Targeted firms are significantly more likely to face subsequent SEC investigations and enforcement actions than others.⁹¹

But activist shorts remain controversial.⁹² Research has also shown that some of the positive effects described above disappear when the sample is limited to pseudonymous campaigns.⁹³ This raises the concern that such campaigns are manipulative, generating short-lived stock drops that allow a trader to make a quick profit on a short sale without contributing to any real price discovery.⁹⁴ This research has been used in a government investigation into the activist short industry.⁹⁵ The SEC also invoked concerns about manipulation by activist shorts in support of a proposed rule mandating monthly reporting by certain investors of large short positions.⁹⁶ The SEC recently finalized a version of that rule.⁹⁷

87. Brendel & Ryans, *supra* note 44, at 513; Ljungqvist & Qian, *supra* note 44, at 2007.

88. Ljungqvist & Qian, *supra* note 44, at 2009; Appel & Fos, *supra* note 44, at 26; Molk & Partnoy, *supra* note 44, at 48.

89. Ljungqvist & Qian, *supra* note 44, at 2009; Molk & Partnoy, *supra* note 44, at 48–49.

90. Ljungqvist & Qian, *supra* note 44, at 2007; Chen, *supra* note 44, at 1474; Appel & Fos, *supra* note 44, at 26; Molk & Partnoy, *supra* note 44, at 8. *But see* Joshua Mitts, *Short Sellers and Plaintiffs' Firms: A Symbiotic Ecosystem*, CLS BLUE SKY BLOG (Oct. 14, 2020), <https://clsbluesky.law.columbia.edu/2020/10/14/short-sellers-and-plaintiffs-firms-a-symbiotic-ecosystem/> [<https://perma.cc/NQ54-42BV>] (discussing Ninth Circuit case making it more difficult for investors to sue in the wake of activist short reports).

91. Brendel & Ryans, *supra* note 44, at 513–15; Appel & Fos, *supra* note 44, at 27; Chen *supra* note 44, at 1474–75; Antonis Kartapanis, *Activist Short-Sellers and Accounting Fraud Allegations* (May 2019) (Ph.D. Dissertation, University of Texas at Austin) (ProQuest); Ljungqvist & Qian, *supra* note 44, at 2007–08; *see also* Molk & Partnoy, *supra* note 44, at 43.

92. Molk & Partnoy, *supra* note 44, at 6–7 (discussing academic and regulatory skepticism of activist short selling).

93. *See generally* Mitts, *Short & Distort*, *supra* note 44.

94. *Id.* For one activist short's critique of this paper, see Carson Block, *Distorting the Shorts* (Feb. 23, 2022) (unpublished manuscript), <https://ssrn.com/abstract=4041541> (last visited Aug. 20, 2024). *But see also* Eric L. Talley, *Short Sellers, Persuasion Games, and Predicting the "V"* (Mar. 14, 2022) (unpublished manuscript), <https://ssrn.com/abstract=4052076> (last visited Aug. 20, 2024).

95. Hughes, *infra* note 148.

96. *Short Position and Short Activity Reporting by Institutional Investment Managers*, 87 Fed. Reg. 14,950, 14,991–92 (proposed Mar. 16, 2022) (to be codified at 17 C.F.R. pt. 240.13f-2).

97. *Short Position and Short Activity Reporting by Institutional Investment Managers*, 88 Fed. Reg. 75,100 (Nov. 1, 2023) (to be codified at 17 C.F.R. pt. 240.13f-2).

II. LEGAL BACKGROUND: HOW OUTSIDERS LIKE ACTIVIST SHORTS CAN PARTICIPATE IN THE SEC WHISTLEBLOWER PROGRAM

Before proceeding to evaluate the extent to which activist shorts and other outsiders have participated in the WBP, this Part reviews the legal rules that permit them to do so.

A. *Outsiders as “Whistleblowers”*

1. *Legislative History: An Outsider Whistleblower Spurred the Creation of the SEC Whistleblower Program*

Perhaps the single most important event driving the creation of the WBP—the SEC’s failure to investigate credible tips from Harry Markopolos about the Ponzi scheme being run by Bernie Madoff—involved an outsider tipster. Markopolos was a financial analyst working for a rival investment manager when he was asked by his supervisor to replicate Madoff’s astronomically successful trading strategy.⁹⁸ Markopolos found that he could not do it—because Madoff’s investment strategy was not real.⁹⁹ Markopolos brought his findings to the SEC, which ignored him.¹⁰⁰ When the market finally crashed and Madoff could no longer hide his fraud, it was too late to prevent massive harm.¹⁰¹ The SEC’s failure to investigate Markopolos’ tips was the subject of a lengthy SEC Office of Inspector General (OIG) report¹⁰² and a series of brutal congressional hearings,¹⁰³ and ultimately led to the adoption of the WBP in the Dodd-Frank Act.¹⁰⁴

98. HARRY MARKOPOLOS, *NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER* 25–35 (2010).

99. *Id.* at 30.

100. *Id.* at 59–60, 86; *see also* SEC, OFF. OF INVESTIGATIONS, *OIG-509, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF’S PONZI SCHEME*, 27–28 (2009) [hereinafter *INVESTIGATION OF SEC FAILURE*].

101. *INVESTIGATION OF SEC FAILURE*, *supra* note 100, at 456.

102. *Id.* at 1.

103. *E.g.*, *Assessing the Madoff Ponzi Scheme and Regulatory Failures: Hearing before the Subcomm. on Cap. Mkts., Ins., and Gov’t Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. (Feb. 4, 2009); *Oversight of the SEC’s Failure to Identify the Bernard L. Madoff Ponzi Scheme and How to Improve SEC Performance: Hearing Before the S. Comm. on Banking, Hous. and Urb. Affs.*, 111th Cong. (Sept. 10, 2009).

104. *See* Whistleblower Program Rules, 83 Fed. Reg. 34,702, 34,729 (proposed July 20, 2018) (to be codified at 17 C.F.R. pts. 240, 249) (referring to Markopolos’ tips on Madoff as “the model that Congress had before it at the time it enacted the whistleblower program”); *The Securities and Exchange Commission Post-Madoff Reforms*, SEC (July 15, 2019), <https://www.sec.gov/spotlight/secpostmadoffreforms.htm#whistleblower> (last visited Aug. 5, 2024).

2. *The Statutory Hook: “Independent Analysis”*

Dodd-Frank’s key provision directs the SEC to pay bounties to individuals who provide information “derived from the independent knowledge *or analysis* of a whistleblower.”¹⁰⁵ An outsider like Markopolos might lack independent *knowledge* of misconduct, but he may still be able to recover a bounty by providing independent *analysis* of publicly available information revealing the misconduct.

Critically, at the time Congress considered and enacted Dodd-Frank, activist short selling had not yet emerged as a major force.¹⁰⁶ Thus, when Congress deliberately drafted the statute to allow outsider tipsters like Markopolos to participate in the WBP, they would not have thought about activist shorts or any other category of outsider tipsters who could privately profit from the information by selling it to activist shorts.

In implementing this statutory mandate, the SEC has expressly declined to require that whistleblowers provide information “based upon facts of which the whistleblower has direct, first-hand knowledge,” because doing so would “preclude award consideration even for highly-probative, expert analysis of data that may suggest an important new avenue of inquiry, or otherwise materially advance an existing investigation.”¹⁰⁷ Instead, the Commission authorized awards based on a tipster’s “examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.”¹⁰⁸

In 2020, the Commission issued interpretive guidance clarifying that, in such cases, a “whistleblower’s examination and evaluation should contribute ‘significant independent information’ that ‘bridges the gap’ between the publicly available information and the possible securities violations.”¹⁰⁹ The Commission explained that this guidance was intended

(listing SEC’s legislative advocacy for authority to create a new whistleblower program as one of the “decisive and comprehensive steps” it took in the wake of the Madoff scandal to prevent recurrence).

105. 15 U.S.C. § 78u-6(a)(3) (emphasis added).

106. *Supra* note 76 (collecting several studies showing that activist short selling became widespread only after the financial crisis of 2008–09).

107. Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,312 (June 13, 2011) (codified at 17 C.F.R. § 240.21F (2010)).

108. *Id.* at 34,364. The SEC explained that the whistleblower in such cases had to “do more than merely point the staff to disparate publicly available information that the whistleblower has assembled, whether or not the staff was previously ‘aware of’ the information,” and actually “bring to the public information some additional evaluation, assessment, or insight.” *Id.* at 34,312.

109. Whistleblower Program Rules, 85 Fed. Reg. 70,898, 70,928 (Nov. 5, 2020) (to be codified at 17 C.F.R. pts. 240, 249).

to ensure that the kind of information provided by Harry Markopolos would qualify for an award.¹¹⁰

3. *Individuals, Not Entities*

One wrinkle for activist short participation in the WBP is the program requirement that only individuals and not entities may participate. The statute defines a whistleblower as an “individual,”¹¹¹ and program rules confirm that a whistleblower “must be an individual” and that “[a] company or other entity is not eligible to be a whistleblower.”¹¹² When the SEC pays whistleblower awards, it pays them to individuals—and these payments are recorded as taxable income.¹¹³

The WBP’s prohibition on entity tips and awards may raise thorny issues for activist shorts that are organized as hedge fund advisers or other entities. By refusing to accept submissions from or pay awards to entities, the WBP essentially forces individuals who have chosen to organize their research, investing activities, and associated relationships through an entity, to instead take information that may essentially belong to that entity and submit it in their own individual capacity. With the assistance of counsel, these individuals may negotiate contractual arrangements regarding the allocation of any whistleblower bounty back to the entity¹¹⁴ (or any other individuals), but such bargaining is not a panacea. First, parties sometimes fail to appropriately bargain in this context, leading to difficult disputes over who is entitled to what share of the award.¹¹⁵ Second, some parties (such as fund investors) may be in a weak position to bargain contractually for bounty-sharing agreements because they may not even be aware the tip was submitted.¹¹⁶ Third, even where bargaining is completed, there may be significant tax consequences associated with the policy of paying a very large amount of income to an individual who

110. *Id.*

111. 15 U.S.C. § 78u-6(a)(6).

112. 17 C.F.R. § 240.21F-2(a)(2) (2010); *see also* 76 Fed. Reg. at 34,303 (“We have decided not to extend the definition of whistleblower beyond natural persons because we believe that this is consistent with the statutory definition, which provides that a whistleblower must be an ‘individual.’”).

113. *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. at 34,348 n.370 (“we notify the IRS and issue Form 1099 for any whistleblower payment . . .”).

114. *Cf.* Greenlight Investor Letter, *supra* note 22, at 5 (noting that after “SEC agreed that *David* was, upon appeal, entitled to a whistleblower award,” “The award was remitted to the funds in November 2020”) (emphasis added).

115. *See, e.g.,* Block v. Barnes, No. 1:22-CV-869, 2023 WL 4582396, at *1 (W.D. Tex. July 18, 2023) (discussing legal dispute over right to share in whistleblower bounty).

116. *Cf.* Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPS. 89 (2017).

then transfers it to an entity rather than paying it directly to the entity in the first instance.¹¹⁷

4. *Trading Profits Not Considered in Bounty Calculation*

A particularly attractive feature of the WBP for outsiders is that the program rules do not require the SEC to account for a tipster's trading profits when making awards determinations. As one senior SEC official who now represents whistleblowers before the SEC recently put it: "The statute doesn't say to ask, 'Does the person have a short position?'"¹¹⁸

This is in contrast to other program rules which carefully limit bounty eligibility for tipsters who receive (or seek) bounties from other whistleblower programs.¹¹⁹ Thus, under the current WBP rules, if Tipster A has previously earned five million dollars by using the information to short the target's stock or selling that information to other traders, and Tipster B has earned five million dollars in a bounty by supplying the information to a different government whistleblower program, only Tipster B's prior earnings will count against his prospective SEC award.

5. *Anonymity Protections Apply Equally to Insider and Outsider Tipsters*

As noted above, many activist shorts choose to pursue their campaigns anonymously or pseudonymously.¹²⁰ The WBP's strict anonymity protections are, therefore, an important precondition for participation by these activist shorts. Program rules do not distinguish between insider and outsider whistleblowers for purposes of anonymity.¹²¹

B. *Outsiders Partnering with Insiders*

Activist shorts and other outsider tipsters may partner with other outsiders, current or former employees, contractors, and other affiliates of a target to gain access to information that helps them build their case against the company and make their SEC whistleblower submission more

117. Interview between anonymous whistleblower/short seller and author (interview notes on file with author).

118. Weinstein, *supra* note 45.

119. 17 C.F.R. § 240.21F-3(b)(3) (2010). The National Whistleblower Center, an organization founded and led by private whistleblower lawyers, opposed even this restriction. Securities Whistleblower Incentives and Protections, 76 Fed. Reg 34,300, 34,305 (June 13, 2011) (codified at 17 C.F.R. § 240.21F (2010)).

120. *Infra* section I.B.

121. 17 C.F.R § 240.21F-7 (2010).

compelling. Several legal restrictions may come into play, but none absolutely bars such coordination.

1. *Directors, Officers, and Beneficial Owners of at Least Ten Percent*

Section 16(c) of the Exchange Act prohibits any director, officer, or beneficial owner of more than ten percent of any public company from “directly or indirectly” selling short the securities of such company.¹²² This provision could make it legally treacherous for activist shorts to partner with such covered individuals. It likely prohibits an activist short from giving a covered individual a share of the trading profits in exchange for the information provided. But the prohibition on “indirect” short selling may also prohibit such individuals from sharing information with an activist short in exchange for other benefits, such as indemnification, legal assistance, or coordination with a whistleblower submission. Indeed, a covered insider may violate this provision merely by sharing information with an activist short even if they receive nothing in return.¹²³

2. *Others*

Under insider trading rules, other individuals in possession of material non-public information (MNPI)—including information regarding corporate illegality¹²⁴—are legally prohibited from passing that information along to a trader under some circumstances.¹²⁵ This prohibition applies to corporate insiders who obtained the information “by reason of their position with that corporation,”¹²⁶ as well as to others who “misappropriated” the information,¹²⁷ such as an individual who has signed a standard non-disclosure agreement covering the subject information.¹²⁸ The prohibition also applies when such individuals

122. 15 U.S.C. § 78p(a)(1), (c); *see also* LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 420–21 (3d ed. 2001); Bliss, Molk & Partnoy, *supra* note 44, at 1374.

123. One potential avenue around this restriction: Rule 16c-4 allows covered insiders to use derivatives to bet against the stock, but only up to the amount of securities they otherwise own. *See* 17 C.F.R. § 240.16c-4 (2010).

124. *See* Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899, 1910–14 (2007); *see also* Robert A. Prentice & Dain C. Donelson, *Insider Trading as a Signaling Device*, 47 AM. BUS. L.J. 1, 52 (2010) (surveying debate on this issue).

125. *Salman v. United States*, 580 U.S. ___, 137 S. Ct. 420 (2016).

126. *Chiarella v. United States*, 445 U.S. 222, 228 (1980).

127. *United States v. O’Hagan*, 521 U.S. 642 (1997).

128. *United States v. Chow*, 993 F.3d 125 (2d Cir. 2021); *see also* 17 C.F.R. § 240.10b5-2(b)(1) (2010).

exchange information for a “personal benefit,” and in such cases, liability potentially attaches to both the tipper and the tippee.¹²⁹

One might think the government would be unlikely to use its prosecutorial discretion to pursue insider trading charges based on MNPI concerning corporate illegality, but such prosecutions are not unheard of.¹³⁰

Activist shorts looking to extract information from well-placed individuals must be careful regarding information from individuals covered by the insider trading prohibition (whether because of a position, a non-disclosure agreement, or otherwise), and must be careful regarding any potential “personal benefit” given to such individuals. Offering a share of the trading profits, legal indemnification, or even coordination and support in filing an SEC whistleblower submission in exchange for MNPI from a covered individual may all give rise to potential liability.

Indeed, recent developments in the law may sweep even further. It is now an open question whether criminal prosecution of insider trading is even available for some gratuitous information sharing where *no* personal benefit was received.¹³¹

The bottom line is that, for activist shorts, there is significant legal risk involved in partnering with employees, contractors, and others with access to MNPI.¹³² But, so long as activist shorts take care to ensure that

129. *Dirks v. SEC*, 463 U.S. 646, 662 (1983); *Salman*, 137 S. Ct. 420; *see also SEC v. Obus*, 693 F.3d 276, 285–86 (2d Cir. 2012) (stating that the “personal benefit” test applies both to an “insider or misappropriator”).

130. For instance, the iconic case *Dirks*, 463 U.S. 646 involved trading on MNPI regarding the alleged “vastly overstated” assets of a company “as a result of fraudulent corporate practices.” *Id.* at 649.

One activist short who has worked with the SEC stated that:

People would always say to me: “Boy, this must be a great day for the SEC. You go down there with all this time lapse, surveillance, just a [r]ock-solid case, and they really have nothing to prove because you’ve proved it all.”

And I say: “No, that’s a *good* day for the SEC. A *great* day for the SEC is we’ve done all of that *and* we’ve made a mistake as well and they get two cases for one. ‘Cause they don’t give a fuck.”

The Wolf Den Podcast, *Episode 3 – Jon Carnes*, WOLFPACK RSCH., at 1:51:40–1:52:04 (Oct. 22, 2020), <https://wolfpackresearch.podbean.com/e/episode-2-jon-carnes/> (last visited Aug. 21, 2024).

131. A 2019 Second Circuit decision held that the “personal benefit” element was not required for certain criminal insider trading prosecutions. *United States v. Blaszcak*, 947 F.3d 19, 36 (2d Cir. 2019). The Supreme Court vacated the opinion on other grounds, *Olan v. United States*, ___ U.S. ___, 141 S. Ct. 1040 (2021), and the Second Circuit did not reach the issue on remand. *United States v. Blaszcak*, 56 F.4th 230 (2d Cir. 2022).

132. *Cf.* Barron’s Live Podcast, *Carson Block on Meme Stocks, ESG, Fraud Hunting in China and Beyond Barron’s Live Podcast*, BARRON’S, at 42:00–42:40 (Sept. 7, 2022), <https://www.barrons.com/podcasts/barrons-live/carson-block-on-meme-stocks-esg-fraud-hunting-in-china-and-beyond/> (last visited Aug. 21, 2024)

these individuals they work with do not fall into any category of covered individuals, activist shorts are free to offer any personal benefits to them in exchange for their information, including subsidizing their efforts in submitting information to the WBP.¹³³

III. EVIDENCE: OUTSIDER PARTICIPATION IN THE SEC WHISTLEBLOWER PROGRAM

This Part presents evidence regarding participation by professional outsiders in the WBP. Section A presents data gathered under the Freedom of Information Act (FOIA) and from WBP Annual Reports regarding the success of outsiders in the WBP. Sections B and C collect evidence regarding activist short and other types of outsiders' participation in the WBP. Collectively, the evidence suggests that professional outsiders are participating actively and effectively in the WBP. It also highlights several key trends:

Insider/Outsider Partnerships: In addition to supplying their own tips and claims directly to the SEC, outsiders frequently recruit and partner with other tipsters, including some conventional insider tipsters. In some cases, insiders are induced to cooperate with outsiders by the prospect of a financial benefit—either a cut of trading profits, coordination and support in submitting a whistleblower tip to the SEC, or indemnification for any potential legal claims filed against them. In others, the insiders recruit well-resourced outsiders to help finance and support their whistleblowing.

Regardless of how the collaboration is initiated, current rules do not require insiders who participate in the WBP to disclose involvement with outsiders and there is no indication that the SEC requires such disclosure. The statistics cited below on “insider” vs. “outsider” participation may therefore undercount the influence of outsiders.

Beyond “Tipping”: With financing provided by outsiders, many tipsters often go far beyond providing the SEC with factual evidence of securities fraud. They (and their whistleblower lawyers) are now often providing extensive legal analysis, expert reports, witness lists, and litigation documents for the SEC’s use in prosecuting the enforcement actions. Beyond the numerous cases discussed below, one anonymous

(noting that many participants in the WBP are “inside companies who have access to the information and see it directly” but “if you don’t have access to that information which, obviously being a market participant, we *better not* have access to that information if we’re going to trade”).

133. Another potentially fraught insider trading issue arises if and when the activist short learns that the SEC has opened a confidential information into a target. Once this occurs, it could be argued that the activist is in possession of material non-public information and is under a duty to refrain from trading in the company’s stock.

short seller told the author that he had financed the research, drafting, and direct submission of a legal brief responding in detail to the legal points made in a Wells submission¹³⁴ from the target of an SEC investigation. Tipsters are now providing a full-service auxiliary litigation team to supplement the SEC's own staff.

Double-Dipping: Conventional insider tipsters and outsider tipsters may be earning both private profits *and* a public bounty on the same information. Private profits may come from shorting the stock or selling the information to others (who may trade on it). As noted above, current rules do not require the SEC to account for such private profits when determining awards—and there is no indication that the agency does so.¹³⁵

A. *FOIA Data on Outsider Bounties*

From close to the program's inception through Fiscal Year (FY) 2021, the SEC's Annual Reports disclosed the proportion or number of awards issued to "insider" and "outsider" tipsters respectively, but not the dollar amounts issued to each of these classes.¹³⁶ Per these SEC reports, the category of "insiders" includes current or former employees, actual or prospective consultants and contractors, and other "close affiliates" of the subject company.¹³⁷ The "outsiders" category includes individuals with "special expertise" in the market, actual or prospective investors, and professionals working in the same or related industry among others.¹³⁸

134. SEC DIV. ENF'T, *infra* note 337, at 19.

135. *See* section II.A.4.

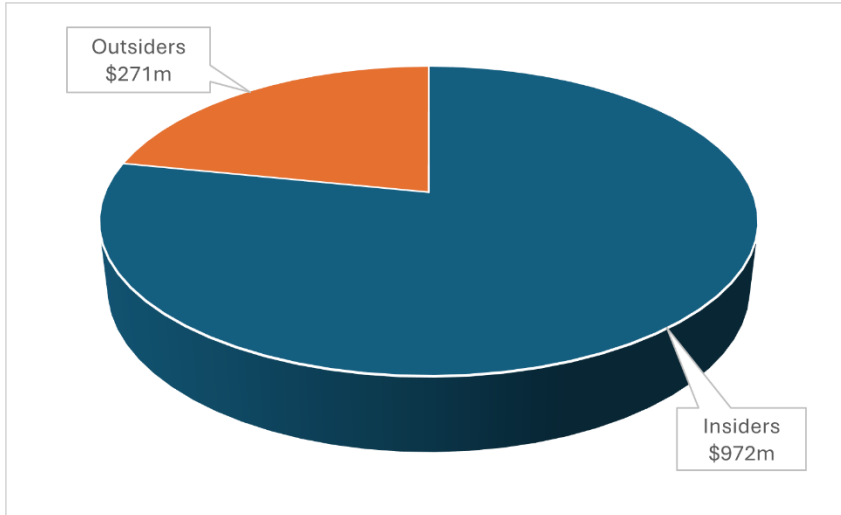
136. *See* Platt, *Going Dark(er)*, *supra* note 64.

137. *E.g.*, SEC, 2017 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 17 (2017); SEC, 2015 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 16 (2015); SEC, 2014 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 16 (2014).

138. *See* SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 24 (2021) ("Approximately 60% of the award recipients in FY 2021 were current or former insiders of the entity about which they reported information of wrongdoing to the Commission" and 40% were outsiders, including "investors who had been victims of the fraud they reported, professionals working in the same or related industry as where the misconduct occurred, or other types of outsiders, such as individuals with a special expertise in the market"); SEC, 2020 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 18 (2020) ("Approximately 40% of the individuals who received awards this year were outsiders not affiliated with the entity on which they were reporting, and certain of those outsiders also reported internally."); SEC, 2019 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 18 (2019) ("[A]pproximately 69 percent of the award recipients to date were current or former insiders of the entity about which they reported information of wrongdoing to the SEC."); SEC, 2018 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 17 (2018) ("[A]pproximately 69% of the award recipients to date were current or former insiders of the entity about which they reported information of wrongdoing to the SEC"); SEC, 2017 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 17 (2017) (breaking down the proportion of awards issued

Under FOIA, I obtained information regarding aggregate dollar amounts issued to “insider” and “outsider” tipsters for each year from 2012 through 2022.¹³⁹ Figures 1 and 2 and Table 1 below present the results.

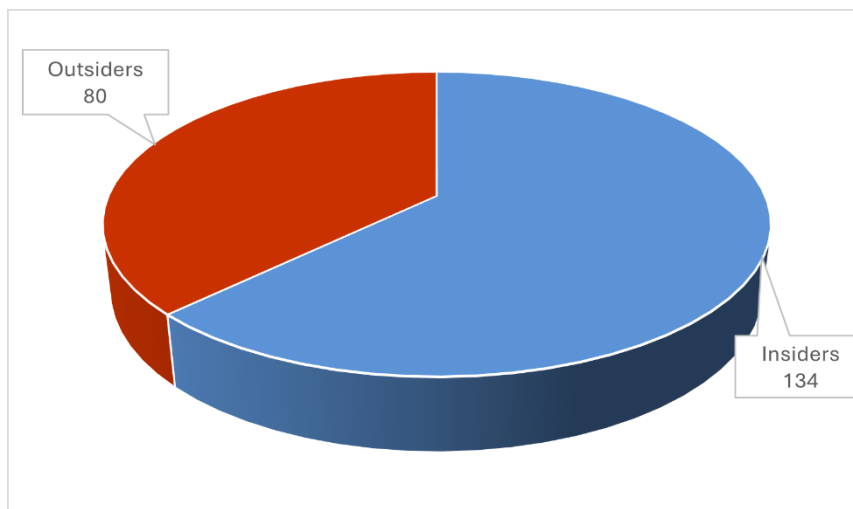
Figure 1: Dollars Paid Through FY 2022¹⁴⁰



to “Current employees”; “Former employees”; “Other types of insiders (including consultants or close affiliates of subject company)”; “Industry professionals”; “Harmed or prospective investors”; and “Other types of outsiders.”); SEC, 2016 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 18 (2016) (“[A]most 65 percent of the award recipients were insiders of the entity on which they reported information of wrongdoing to the SEC.”); SEC, 2015 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 16 (2015) (“[T]o date, almost half of the award recipients were current or former employees of the company on which they reported information of wrongdoing”); SEC, 2014 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 16 (2014) (“To date, over 40% of the individuals who received awards were current or former company employees. Furthermore, an additional 20% of the award recipients were contractors, consultants, or were solicited to act as consultants for the company committing the securities violation.”).

139. Letter from SEC, to author (Dec. 7, 2022) (on file with author). The agency provided the information even though (on its view) it was not legally obligated to do so—explaining that the agency never kept track of the percentage of money awarded to insiders and outsiders but “Nonetheless, in the interest of transparency and in response to your appeal OWB staff created a summary reflecting the total amounts awarded to insiders and outsiders for each fiscal year dating back to the program’s first award in fiscal year 2012.” *Id.*

140 As noted in this Part, “insider” tipsters include current or former employees, actual or prospective consultants and contractors, and other “close affiliates” of the subject company; and “outsiders” includes individuals with “special expertise” in the market, actual or prospective investors, professionals working in the same or related industry, and other types of outsiders.

Figure 2: Awards Issued Through FY 2021¹⁴¹

Through 2022, the SEC has paid nearly \$300 million to outsider tipsters. Through 2021, thirty-seven percent of awards and nineteen percent of dollars went to outsider tipsters.¹⁴² Outsiders' shares seem to be increasing. In FY 2022 (the most recent year for which complete data is available), thirty-eight percent of dollars went to outsider tipsters—nearly twice the prior aggregate average. And in both FY 2020 and FY 2021 (the most recent years for which data is provided in the WBP reports), about forty percent of awards went to outsiders¹⁴³—markedly higher than the thirty-one percent that went to outsiders on average in earlier years.¹⁴⁴

141. For the data of this figure, see SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 24 (2021); SEC, 2020 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 18 (2020); SEC, 2019 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 18 (2019).

142. See *supra* Figures 1 & 2; Platt, *Going Dark(er)*, *supra* note 64 (2022 is excluded from this aggregate calculation because, although I have FOIA data on dollars paid out in 2022, the SEC has for the first time and without any explanation failed to disclose the percentage of awards issued to insiders/outside in its annual report for that year.).

143. See SEC, 2021 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 24 (2021); SEC, 2020 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 18 (2020).

144. See SEC, 2019 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 18 (2019).

Table 1: Dollars Paid¹⁴⁵

| FY | Insider | Outsider | % Outsider |
|-------------|----------------|-----------------|-------------------|
| 2012 | \$ 45,136 | \$- | 0% |
| 2013 | \$ 8,505 | \$ 14,727,605 | 100% |
| 2014 | \$ 24,562,770 | \$ 3,022 | 0% |
| 2015 | \$ 6,161,272 | \$ 40,540 | 1% |
| 2016 | \$ 56,778,761 | \$ 750,000 | 1% |
| 2017 | \$ 14,134,342 | \$ 34,274,990 | 71% |
| 2018 | \$ 168,635,506 | \$ 1,040,000 | 1% |
| 2019 | \$ 55,408,156 | \$ 5,076,681 | 8% |
| 2020 | \$ 142,863,627 | \$ 31,635,670 | 18% |
| 2021 | \$ 370,138,028 | \$ 103,630,077 | 22% |
| 2022 | \$ 133,029,723 | \$ 80,225,211 | 38% |

There are a host of limits to this data. First, the SEC does not provide information regarding what types of insiders and outsiders are involved—so, for instance, the data does not show how many of the successful “outsiders” are activist shorts, as opposed to analysts or competitors. The data also does not show how many insider tipsters were recruited, financed, or affiliated with activist shorts. Nor do they show which tipsters—insiders or outsiders – might have earned private trading profits even apart from partnership with an activist short.¹⁴⁶ They also do not show which of these tips are associated with companies that cannot be shorted—such as private companies or broker-dealers. And finally, there is also definitional ambiguity at the margins: a small “equity holder” may be classified as an outsider, but a large minority owner may be better classified as an insider.

145. See SEC OIG 2013, *supra* note 58, at 6 (The apparent discrepancy here—the fact that zero awards were issued to insiders in 2013 and yet \$8,505 were paid to insiders in 2013—is likely explained by the fact that SEC sometimes makes payments “on a rolling basis if the monies are collected [from the targets] over time . . .”).

146. *Cf., e.g.,* Macey, *supra* note 124, at 1915 (“Sherron Watkins, who was widely portrayed as a heroine for calling attention to accounting irregularities at Enron, engaged in trading on the basis of the information contained in her whistleblower memorandum, and, in so doing, may have violated insider trading laws.”).

B. *Activist Shorts in the SEC Whistleblower Program*

This Section collects publicly available anecdotal evidence regarding activist short participation in the WBP.¹⁴⁷

1. *Carson Block / Muddy Waters*

Carson Block is a well-known activist short.¹⁴⁸ According to one former SEC Commissioner, Block “has uncovered more fraud and saved investors more money” than any SEC Commissioner, including himself.¹⁴⁹ Block is routinely listed among the most active and effective activist shorts.¹⁵⁰

As noted above, Block received a fourteen million dollar bounty from the SEC for bringing to light fraud by Focus Media.¹⁵¹ The SEC staff had initially determined that Block was ineligible for the award because he had not provided his information on the official required form.¹⁵² But Block appealed the denial and the Commission exercised its “discretionary authority” to waive the requirement “in light of the unusual facts and circumstances present here.”¹⁵³ At the same time, however, the Commission declined to waive the same requirement for a Block associate who claimed to have assisted in preparing the Focus Media report and separately sought a whistleblower bounty.¹⁵⁴ This associate appealed the denial to the Third Circuit, which upheld the denial while also sharply

147. The particular names, targets, and details of each story may be of more interest to some readers than others. Those who are not interested in these specifics may, of course, take my word for it that activist shorts have been participating in the WBP and skip ahead to the next section.

148. See Evan Hughes, *The Man Who Moves Markets*, THE ATL. (Feb. 2, 2023), <https://www.theatlantic.com/magazine/archive/2023/03/wall-street-muddy-waters-activist-short-sellers-tesla-gamestop/672774/> [https://perma.cc/4K6Z-EH5Z]; Michelle Celarier, *The Rage of Carson Block*, INSTITUTIONAL INV. (Apr. 19, 2021), <https://www.institutionalinvestor.com/article/2bswvw9n02kg7ksdcd62o/corner-office/the-rage-of-carson-block> [https://perma.cc/P9AX-DDXR].

149. UC Berkeley School of Law, *UC Berkley Fraud Fest 2022: The Great Debate: Carson Block v. Rob Jackson*, YOUTUBE, at 9:54–10:05 (July 15, 2022), https://www.youtube.com/watch?v=F68iHFyLppQ&list=PLIUbB46fTGWwDssGPS5K029KmM0yx2_DD&index=14 [https://perma.cc/K4AR-XS29] (statement of former SEC Commissioner Robert Jackson).

150. Ljungqvist & Qian, *supra* note 44, at 1982–83; Chen, *supra* note 44, at 1452; Bliss, Molk & Partnoy, *supra* note 44, at 1352; Brendel & Ryans, *supra* note 44, at 499.

151. *Supra* note 21 and accompanying text.

152. See Order Determining Whistleblower Award Claims, Exchange Act Release No. 94398, 2022 WL 768309, at *3–4 (Mar. 11, 2022).

153. *Id.*

154. *Id.* The nature of their relationship and the extent to which each made contributions to the Focus Media report is disputed. See *Block v. Barnes*, *supra* note 115.

questioning the SEC's determination to issue an award to Block.¹⁵⁵ The associate contended that the SEC had accorded Block favorable treatment because Block was represented by Jordan Thomas, a former senior SEC official involved in the creation of the WBP.¹⁵⁶

Block has applied for other whistleblower awards,¹⁵⁷ but it is unknown whether he has received any bounties in these other cases, what cases he submitted awards on, or whether he had taken short positions in those cases.

2. *Nathan Anderson / Hindenburg*

Nathan Anderson is another well-known activist short.¹⁵⁸ He is responsible for some of the most high-profile short attacks in recent years, including attacks on DraftKings, Carl Icahn, and Adani.¹⁵⁹ Anderson is also a prolific SEC whistleblower, having made as many as twenty-five SEC submissions regarding public companies, private companies, and private funds.¹⁶⁰ (Only the public company submissions are directly short-

155. See Mengqi Sun, *Court Questions Criteria for Carson Block's \$14 Million SEC Whistleblower Award*, WALL ST. J. (May 23, 2023), <https://www.wsj.com/articles/court-questions-criteria-for-carson-blocks-14-million-sec-whistleblower-award-42829afd> (last visited July 27, 2024); John Holland, *Bass, Block Cases Add to Questions on SEC Whistleblower Rules*, BLOOMBERG (May 23, 2023), <https://news.bloomberglaw.com/securities-law/bass-block-cases-add-to-questions-on-sec-whistleblower-rules> (last visited July 26, 2024).

156. Redacted Final Brief for Petitioner, *Doe v. SEC*, No. 22-1652, 2022 WL 3714990 at *3 (3d. Cir. 2022); Redacted Reply Brief for Respondent, *Doe v. SEC*, No. 22-1652, 2022 WL 6962664 (3d. Cir. 2022); Order, *Block v. Barnes*, No. 1:22-CV-869-DAE, slip op., 2023 WL 4582396 (W.D. Tex. July 18, 2023) (dismissing case on procedural grounds).

157. Complaint & Jury Demand ¶ 15, *Block v. Barnes*, No. 1:22-CV-869-DAE (W.D. Tex. Aug. 25, 2022) ("Mr. Block has applied for these whistleblower awards in the past with respect to other investigations he directed . . .").

158. See Matthew Goldstein & Kate Kelly, *A Skeptical Stock Analyst Wins Big by Seeking Out Frauds*, N.Y. TIMES (Aug. 16, 2021), <https://www.nytimes.com/2021/08/16/business/short-seller-wall-street-scams-hindenburg.html> (last visited July 27, 2024); Andrew Rice, *Last Sane Man on Wall Street*, N.Y. MAG. (Jan. 20, 2022), <https://nymag.com/intelligencer/2022/01/nathan-anderson-hindenburg-research-short-selling.html> [<https://perma.cc/EVL3-PMTE>]; Bernhard Warner, *An Activist Short Seller Gets His Day in Court*, N.Y. TIMES (Oct. 23, 2022), <https://www.nytimes.com/2022/10/22/business/dealbook/nathan-anderson-nikola-trial.html> (last visited July 27, 2024); Paul R. La Monica, *Meet the Short Seller Who Hopes Stocks Crash and Burn*, CNN (June 25, 2021, 12:57 PM), <https://www.cnn.com/2021/06/25/investing/hindenburg-research-short-seller-nate-anderson/index.html> [<https://perma.cc/JX3A-5LZQ>].

159. See Goldstein & Kelly, *supra* note 158; Rice, *supra* note 158; Warner, *supra* note 158; La Monica, *supra* note 158.

160. See Declan Harty, *SEC Enforcement Unit, Stretched Thin, Faces Rising Tide of Whistleblower Tips*, S&P GLOB. MKT. INTEL. (Aug. 15, 2018), <https://www.johnreedstark.com/wp-content/uploads/sites/180/2018/08/SEC-enforcement-unit-stretched-thin-faces-rising-tide-of-whistleblower-tips.pdf> [<https://perma.cc/E8AA-4UYA>] (stating Anderson had filed about 25 tips); Josh Medore, *Who Is the Short Seller That Slammed Lordstown Motors?*, BUS. J. (Mar. 13, 2021),

able, though there may be *indirect* trading profits to be made in some other cases.¹⁶¹)

Anderson's intervention in the case of the electric vehicle maker Nikola is illustrative. In 2020, Anderson published a report alleging fraud by the company and its founder Trevor Milton.¹⁶² To prepare the report, Anderson worked closely with several insiders,¹⁶³ at least one of whom had given his information to Anderson in exchange for a cut of Anderson's trading profits.¹⁶⁴ According to whistleblower lawyer Mark Pugsley, the initial investigation into Nikola began when he was contacted by insiders, and Anderson was brought in later to assist in their efforts. Pugsley decided to reach out to an activist short because he just needed more resources.¹⁶⁵ Before publishing the report, Anderson had taken an

<https://businessjournaldaily.com/what-is-hindenburg-research-author-of-the-report-on-lordstown-motors/> [<https://perma.cc/UCA8-KKYP>] (“two dozen”); *J&J Purchasing: When It Sounds Too Good to Be True*, HINDENBURG RSCH. (Mar. 24, 2022), <https://hindenburgresearch.com/jj-purchasing/> [<https://perma.cc/5DYD-XHXF>] (listing numerous submissions); see also Zuckerman, *infra* note 163 (“Starting around 2014, he developed a network of like-minded individuals eager to uncover questionable investment firms. He submitted whistleblower complaints to the government, hoping to score rewards that sometimes accrue to those who identify wrongdoing. Harry Markopolos, the fraud investigator who tried to warn authorities about Bernard Madoff's Ponzi scheme and more recently has profited from whistleblower complaints related to alleged bank misdeeds, became Mr. Anderson's model, he says.”).

161. See Alexander I. Platt, *Unicorniphobia*, 13 HARV. BUS. L. REV. 115, 147–50 (2023).

162. *Nikola: How to Parlay an Ocean of Lies Into a Partnership With the Largest Auto OEM in America*, HINDENBURG RSCH. (Sept. 10, 2020), <https://hindenburgresearch.com/nikola/> [<https://perma.cc/XE5D-J3M9>].

163. See Allie Conti, *A Dubious Truck, a Whistleblower Army and Inept Spies: Inside the Very Weird Nikola Saga*, BLOOMBERG (Sept. 13, 2022), <https://www.bloomberg.com/news/features/2022-09-13/nikola-truck-scandal-has-trevor-milton-facing-whistleblowers> (last visited July 27, 2024); Warner, *supra* note 158, ¶ 1; Gregory Zuckerman, *How Nikola Stock Got Torched by a Short Seller*, WALL ST. J. (Sept. 23, 2020), <https://www.wsj.com/articles/how-nikola-stock-got-torched-by-a-short-seller-11600867055> (last visited July 27, 2024); Rice, *supra* note 158; Bad Bets, *The Unraveling of Trevor Milton, Ep 6: “The Truth and the Whole Truth,”* WALL ST. J., at 2:47 (Nov. 11, 2022), <https://www.wsj.com/podcasts/bad-bets/the-unraveling-of-trevor-milton-ep-6-the-truth-and-the-whole-truth/d1e542ff-b46a-4e7b-a02d-c4ab9343d512> (last visited July 27, 2024) [hereinafter Bad Bets].

164. See Chris Dolmetsch & Edward Ludlow, *Nikola Whistle-Blower Made \$600,000 Off Short Sale, Jury Told*, BLOOMBERG (Sept. 14, 2022, 4:28 PM), <https://www.bloomberg.com/news/articles/2022-09-14/nikola-whistle-blower-made-600-000-off-short-sale-jury-told> (last visited July 27, 2024).

165. *How Whistleblowers Exposed the Fraud of Trevor Milton, Nikola's Founder, Ep. 32: Mark Pugsley*, FRAUD IN AMERICA at 34:08–36:26 (Jan. 27, 2023), <https://fraudinamerica.simplecast.com/episodes/fraud-of-nikola-founder> (last visited Aug. 22, 2024) [hereinafter FRAUD IN AMERICA]. Specifically, Mark Pugsley explained:

Hindenberg, at the time, had I think five researchers on staff who were very smart people—very smart about stock markets, about public filings, about trading in the markets. And they knew about SPACs. You know, my guys didn't know what a SPAC was, but Nate [Anderson]'s group [at Hindenberg] did. Hindenberg knew how this company had come together through the SPAC

“aggressive” short position, making significant trading profits¹⁶⁶ as the company’s stock initially dropped fifty percent,¹⁶⁷ and eventually lost ninety-four percent of its value.¹⁶⁸

Before going public with the report, Anderson and the insiders submitted their information to the SEC as a whistleblower tip. Pugsley has stated that the SEC WBP submission in the Nikola case looked “very similar” to the publicly available activist report on Nikola.¹⁶⁹ Their tip ultimately led to an SEC investigation, a settlement of \$125 million, and a criminal conviction of Milton, Nikola’s founder and CEO.¹⁷⁰ As of November 2022, Anderson and associates were still waiting to see if they would receive a whistleblower award.¹⁷¹ In a January 2023 interview, Pugsley said the tip was “very successful” but did not specify whether an award had been made.¹⁷²

process. They were able to track all of [Nikola CEO] Trevor [Milton]’s selling of stock. How he was able to leverage his stock to buy that \$36 million cabin. How he was able to do different things that typically people don’t do. One of the things they saw were all the podcasts and interviews that he did. And so they were able to bring more of a sophisticated financial analytical mind to this research process and began combing through all of the online materials, all the stuff on Twitter, and pull out specific representations that he had made. And then each time he made a representation about “X” we would research that. Was that true? Was it true that they had these solar panels on the roof? Was it true that all these things happened that he’d said had happened – that they got this battery technology that . . . he said it was “best in the world by far” and it was going to “really change the world.” We were able to research that. And in one case we found that the battery group he teamed up with were in litigation at that time. We were able to uncover a lot of things through public sourcing but also online resources, public filings, court filings, and put together all this stuff that ended up being in that report.

So that’s what I needed. I needed more people. I needed more researchers to really dig into all this huge volume of information. It was just overwhelming to be honest with you. And the report is very long And that’s some small fraction of the information that we had to work through.

Id.

166. Conti, *supra* note 163; Zuckerman, *supra* note 163 (Anderson earned “sizable profits” on the Nikola short); Sounak Mukhopadhyay, *After Adani Bombshell, Hindenburg Signals ‘Another Big One,’* MINT (Mar. 23, 2023, 8:15 AM), <https://www.livemint.com/news/world/after-adani-bombshell-hindenburg-report-signals-another-big-one-11679535302622.html> [<https://perma.cc/UUX4-VGFU>] (“significant win”).

167. Conti, *supra* note 163.

168. *Id.*; see also Warner, *supra* note 158.

169. FRAUD IN AMERICA, *supra* note 165, at 40:38–50.

170. Conti, *supra* note 163, ¶ 13 (“Both the criminal and civil cases sprang from the whistleblower complaint.”).

171. See Bad Bets, *supra* note 163, at 30:50; see also Conti, *supra* note 163 (noting that all the whistleblowers “stand to make millions” from their tip).

172. FRAUD IN AMERICA, *supra* note 165, at 44:22–30.

3. *Kyle Bass / Hayman Capital*

Kyle Bass is a short seller well known for predicting the crash of the subprime mortgage market,¹⁷³ and for pursuing legal challenges to pharmaceutical patents while simultaneously taking a short bet on the corporate owner's stock.¹⁷⁴ He has been listed as one of the most active and effective short sellers.¹⁷⁵

In 2015, Bass pseudonymously published a blog post alleging that a real estate investment trust (REIT) called United Development Funding was a Ponzi-like scheme on the verge of collapse.¹⁷⁶ Bass had taken a short position and earned about thirty million dollars in trading profits when the stock fell by fifty percent in just two days.¹⁷⁷

Before going public with his allegations, Bass submitted his information to the SEC and the Federal Bureau of Investigation who ultimately obtained an eight million dollar settlement and criminal convictions of several executives.¹⁷⁸ Bass applied for a whistleblower award, retaining a former senior SEC lawyer.¹⁷⁹ The SEC initially denied

173. Craig Hanley, *Cashing in on Subprime*, DALL. (Mar. 19, 2008), <https://www.dmagazine.com/publications/d-magazine/2008/april/cashing-in-on-subprime/> [<https://perma.cc/SR2D-9R2D>] (reporting that he made about half a billion dollars from the short).

174. See Joseph Walker & Rob Copeland, *New Hedge Fund Strategy: Dispute the Patent, Short the Stock*, WALL ST. J. (Apr. 7, 2015), <https://www.wsj.com/articles/hedge-fund-manager-kyle-bass-challenges-jazz-pharmaceuticals-patent-1428417408> (last visited July 27, 2024). For academic analyses, see Rabea Kruppert, *Dispute the Patent, Short the Stock: Empirical Analysis of a New Hedge Fund Strategy*, 50 INT'L REV. L. & ECON. 25 (2017); Ariel D. Multak, Note, *The Big Patent Short: Hedge Fund Challenges to Pharmaceutical Patents and the Need for Financial Regulation*, 23 FORDHAM J. CORP. & FIN. L. 301 (2017); Jennifer Robichaux Carter, Comment, *Hedge Funds Should Be Able to Challenge Patent Validity Using Inter Partes Review Despite Mixed Motives*, 54 HOUS. L. REV. 1315 (2017).

175. See Appel & Fos, *supra* note 44, at Table A1.

176. Tom Schoenberg, Matt Robinson & Katia Porzecanski, *Kyle Bass's Texas Feud Spotlights Short-Selling Tactics*, BLOOMBERG L. (Oct. 30, 2020), <https://news.bloomberglaw.com/securities-law/kyle-bass-texas-feud-spotlights-short-selling-tactics> (last visited July 27, 2024); Holland, *supra* note 155.

177. Schoenberg et al., *supra* note 176.

178. *Id.*; Gregory Zuckerman, *Convictions at Real-Estate Firm Are Win for Investor Kyle Bass*, WALL ST. J. (Jan. 24, 2022), <https://www.wsj.com/articles/convictions-at-real-estate-firm-are-win-for-investor-kyle-bass-11643058666> (last visited Aug. 5, 2024).

179. The lawyer is Kit Addleman of Haynes & Boone. See Letter from Nicole C. Kelly, Chief, Off. Whistleblower, to Kit Addleman, Att'y, Haynes & Boone, LLP, Re: Notice of Covered Action 2018-079 6 (Dec. 2, 2022) (letter from the SEC denying Bass's award directed to his lawyer, Kit Addleman), filed in Bass v. SEC, No. 22-60675 (5th Cir. Dec. 29, 2022); see also, Interview with Katherine Addleman, SEC HIST. SOC'Y (Oct. 7, 2013), https://www.sechistorical.org/collection/oral-histories/20131007_Addleman_Katherine_T.pdf (last visited Aug. 23, 2024) (interview with Addleman discussing her lengthy career at SEC).

the award on technical grounds, but ultimately reconsidered and granted an award to Bass.¹⁸⁰

4. *David Einhorn / Greenlight*

David Einhorn is a short seller well known for spotting Lehman Brothers' financial difficulties in early 2008—several months before its collapse helped set off the global financial crisis.¹⁸¹ He appears on many lists of leading activist shorts.¹⁸²

As described in the introduction above, Einhorn sought and ultimately received a whistleblower bounty of unknown magnitude for uncovering the fraud by The St. Joe Company on top of substantial trading profits earned by shorting the company.¹⁸³ Einhorn has also submitted at least one other whistleblower tip—regarding Standard & Poor's—but it appears the SEC did not act on that tip.¹⁸⁴

180. The SEC initially determined that the tip had come not from Bass, but from the general counsel of his firm Hayman Capital. On appeal to the Fifth Circuit, Bass attached an email from the general counsel to the SEC indicating that he was acting on behalf of both Hayman Capital and Bass. In response to this new evidence, the SEC reconsidered its position and moved for a remand back to the agency for reconsideration, which the court granted. On remand, the SEC granted Bass an award. Order Determining Whistleblower Award Claims, Exchange Act Release No. 99890, 2024 WL 1483884 (Apr. 3, 2024); Holland, *Bass, Block*, *supra* note 155; John Holland, *Kyle Bass Wins Reversal of SEC Move to Deny Whistleblower Award*, BLOOMBERG L. (June 6, 2024), <https://news.bloomberglaw.com/us-law-week/kyle-bass-wins-reversal-of-sec-move-to-deny-whistleblower-award> (last visited Aug. 23, 2024).

181. Gregory Zuckerman, *'This is Unbelievable': A Hedge Fund Star Dims, and Investors Flee*, WALL ST. J. (July 4, 2018, 2:53 PM), <https://www.wsj.com/articles/this-is-unbelievable-a-hedge-fund-star-dims-and-investors-flee-1530728254> (last visited Aug. 23, 2024); Hugo Lindgren, *The Confidence Man*, N.Y. MAG. (June 13, 2008), <https://nymag.com/news/businessfinance/47844/> [[https://perma.cc/WRN7-KLNW](https://perma.cc WRN7-KLNW)].

182. Bliss, Molk & Partnoy, *supra* note 44, at 1352; Appel & Fos, *supra* note 44, at Table A1.

183. *Supra* notes 10–13 and accompanying text.

184. Greenlight Investor Letter, *supra* note 22, at 5. After an initial draft of this paper was circulated, the *Institutional Investor* ran a piece about its findings which included the following quote from Greenlight's spokesman:

It is so rare for short sellers to receive a whistleblower award that the author has to go back more than a decade to highlight our success with St. Joe, which we received on appeal after the SEC improperly denied us a rightful award. The much bigger problem is that the SEC has in recent years substantially abandoned its efforts to police corporate fraud based on the flawed philosophy that the shareholders who are the victim of the fraud would be punished should the SEC act.

Michelle Celarier, *Activist Short Sellers Are the SEC's Biggest Whistleblowers*, INSTITUTIONAL INV. (May 7, 2024), <https://www.institutionalinvestor.com/article/2d7d14lmtfwc1e9yeir5s/corner-office/activist-short-sellers-are-the-secs-biggest-whistleblowers> [<https://perma.cc/9N54-U6K5>].

5. *Hunterbrook*

Hunterbrook is a much-discussed newcomer to the world of activist short selling.¹⁸⁵ It describes itself as a hybrid between journalism and finance—a media outlet engaged in “investigative and global reporting” that also seeks to “realize the full value” of this reporting,¹⁸⁶ including by sharing at least some of its investigative reports prior to publication with an affiliated hedge fund that takes short positions in the targets.¹⁸⁷

In April 2024, Hunterbrook published its first investigation—accusing United Wholesale Mortgage of engaging in widespread pattern of fraud and abuse that harmed its customers (home buyers) and investors.¹⁸⁸ Before publication, Hunterbrook shared the report with its affiliated hedge fund, which took a short position in the stock.¹⁸⁹ The company’s stock dropped 8.5% on the day Hunterbrook’s story was posted—and an additional ten percent the day before.¹⁹⁰

Before posting the report online, the Hunterbrook journalists submitted it as a tip to the SEC’s whistleblower program.¹⁹¹ They were represented by a “former S.E.C. Commissioner.”¹⁹² Hunterbrook’s General Counsel

185. For some coverage, see Clare Malone, *Is Hunterbrook Media A News Outlet or a Hedge Fund?*, NEW YORKER (May 2, 2024), <https://www.newyorker.com/news/annals-of-communications/is-hunterbrook-media-a-news-outlet-or-a-hedge-fund> (last visited Aug. 23, 2024); Kate Duguid, Joshua Franklin, Ortenca Aliaj & James Fontanella-Khan, *Inside Hunterbrook’s Plans for a “News Hedge Fund.”* FIN. TIMES (Nov. 5, 2023), <https://www.ft.com/content/1401c36e-dee3-47a0-8e0e-c362ff7bd1dd> (last visited Aug. 23, 2024); Kate Duguid, Joshua Franklin, Ortenca Aliaj & James Fontanella-Khan, *Hunterbrook’s News-Led Fund Faces Challenging Task*, FIN. TIMES, Nov. 7, 2023, at 10; Joshua Benton, *A New Kind of Activist Journalism: Hunterbrook Investigates Corporations (And Hopes to Make Bank Trading off its Reporting)*, NIEMANLAB (Apr. 3, 2024), <https://www.niemanlab.org/2024/04/a-new-kind-of-activist-journalism-hunterbrook-investigates-corporations-and-hopes-to-make-bank-trading-off-its-reporting/> [<https://perma.cc/9D5X-5YM5>]; Bradley Saacks, *This News-Driven Hedge Fund Has Made Headlines for Its Unique Approach. Here’s How It Actually Works.*, BUS. INSIDER (Apr. 29, 2024), <https://www.businessinsider.com/hunterbrook-capital-news-hybrid-hedge-fund-2024-4> (last visited Sept. 15, 2024).

186. *About Us*, HUNTERBROOK, <https://hntbrk.com/about-us/> [<https://perma.cc/GA2C-XEGK>].

187. See Malone, *supra* note 185.

188. Sam Koppelman, Fitzann “Fitz” Reid, Emily Pate & Nathaniel Horwitz, *Dear Reader – Hunterbrook Media Launch*, HUNTERBROOK (Apr. 2, 2024), <https://hntbrk.com/dear-reader/> [<https://perma.cc/G299-WPLK>].

189. *Id.*

190. Benton, *supra* note 185.

191. Koppelman et al., *supra* note 188.

192. *Id.* Hunterbrook does not specify which former SEC Commissioner is representing them before the agency, but one possibility is Commissioner Allison Herren Lee, who joined the whistleblower law firm Kohn Kohn Colapinto after departing the Commission. Andrew Goudsward, *Ex-SEC Commissioner Joins D.C. Whistleblower Law Firm*, REUTERS (Mar. 8, 2023, 4:25 PM), <https://www.reuters.com/legal/government/ex-sec-commissioner-joins-dc-whistleblower-law-firm->

and Chief Compliance Officer previously worked at the SEC and told a reporter that she still has “lots of friends at the S.E.C.”¹⁹³ As of this writing, there is no publicly disclosed government investigation into Hunterbrook’s allegations.

6. *Marc Cohodes*

Marc Cohodes is another well-known short seller.¹⁹⁴ In early 2022, Cohodes spotted red flags at the cryptocurrency exchange FTX.¹⁹⁵ Because FTX was private, Cohodes could not short it directly, and so he instead began shorting Silvergate—a small publicly traded California bank that did substantial business with FTX.¹⁹⁶ Soon thereafter, FTX collapsed, sending Silvergate’s stock down forty percent.¹⁹⁷ Around the same time, Cohodes also began shorting Signature Bank, another financial institution with significant exposure to the crypto industry. Ultimately that bank also collapsed.¹⁹⁸

As he was taking and publicizing these short bets, Cohodes also submitted whistleblower complaints to the SEC regarding both financial institutions.¹⁹⁹ Ultimately that bank also collapsed.²⁰⁰

As he was taking and publicizing these short bets, Cohodes also submitted whistleblower complaints to the SEC regarding both financial institutions.²⁰¹ It is unknown whether Cohodes will receive a whistleblower award on either tip.²⁰²

2023-03-08/ (last visited Aug. 23, 2024). Hunterbrook’s General Counsel and Chief Compliance officer previously worked directly for Lee at the SEC. Fitzann “Fitz” Reid, LINKEDIN, <https://www.linkedin.com/in/fitzann-fitz-reid-66341260/> (last visited Aug. 6, 2024) (LinkedIn page for Fitzann Reid stating that she worked as “Senior Counsel to Commissioner Allison Herren Lee” at the SEC in 2021).

193. Malone, *supra* note 185.

194. Michelle Celarier, *The Master of Destruction Rides Again*, THE INFO. (May 26, 2023), <https://www.theinformation.com/articles/the-master-of-destruction-rides-again> (last visited Aug. 23, 2024) (profiling Cohodes); RICHARD C. SAUER, *SELLING AMERICA SHORT: THE SEC AND MARKET CONTRARIANS IN THE AGE OF ABSURDITY* 32–34 (2010).

195. Celarier, *Master of Destruction*, *supra* note 194.

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.*

202. After an initial draft of this Article was circulated, the *Institutional Investor* ran a piece about its findings and stating that “Cohodes told *Institutional Investor* that he has never received a whistleblower award from the SEC” although he “recently submitted whistleblower awards for Silvergate Capital and Signature Bank, both of which collapsed last year and are under investigation by authorities.” Celarier, *Activist Short Sellers*, *supra* note 184.

Cohodes has provided information to the SEC (and other regulators) throughout his career, but it is unknown whether he has sought or received whistleblower bounties on any of these other tips.²⁰³ According to one recent profile, insiders of Cohodes' targets "often reach out" to him after he has targeted a company on Twitter, and when they do, Cohodes "instructs his lawyers to start writing letters to regulators."²⁰⁴

7. *Fraser Perring / Viceroy Research*

Fraser Perring is a former social worker who came to short-selling fame by helping expose the fraud at Wirecard.²⁰⁵ His firm, Viceroy Research, was initially founded in 2016 as a pseudonymous vehicle, but Perring revealed in 2018 that he was behind the firm.²⁰⁶ Viceroy has been listed as one of the most active and effective activist shorts.²⁰⁷

In September 2017, Viceroy published a report accusing the medical device maker MiMedx of accounting fraud by "channel stuffing."²⁰⁸ The report drew on information obtained from former MiMedx employees.²⁰⁹ Within a year, the firm announced that it would be restating its earnings for the past four years, and the company's stock dropped substantially.²¹⁰

203. *Id.*

204. Celarier, *Master of Destruction*, *supra* note 194.

205. Anita Raghavan, *The Short Seller Who Took On Wirecard Is Aiming for Bigger Target*, BARRON'S (Aug. 15, 2021), <https://www.barrons.com/articles/short-seller-wirecard-viceroy-research-fraser-perring-51628868117> (last visited Sept. 9, 2024); *see also* Molk & Partnoy, *supra* note 44, at 4 (mentioning activist shorts' role in Wirecard); John C. Coffee, Jr., *Activist Short Selling Today: The Two Sides of the Coin*, COLUM. L. SCH.: BLUE SKY BLOG (July 7, 2020), <https://clsbluesky.law.columbia.edu/2020/07/07/activist-short-selling-today-the-two-sides-of-the-coin/> [<https://perma.cc/SD77-7DYE>] (same).

206. *See* Jonathan Shapiro & Vesna Poljak, *Unmasked Short-Seller Group Viceroy Maintains the Rage*, AUST. FIN. REV. (Jan. 22, 2018), <https://www.afr.com/markets/newly-unmasked-viceroy-maintains-the-rage-against-short-targets-20180122-h0meor> [<https://perma.cc/S969-ZBEL>]; *About Viceroy Research*, VICEROY RSCH., <https://viceroyresearch.org/about/> [<https://perma.cc/U8XB-AEWX>].

207. Brendel & Ryans, *supra* note 44, at 499.

208. *MiMedx's Employment of Kickback & Bribery Scheme Makes it Uninvestable*, VICEROY RSCH. (Sept. 20, 2017) [hereinafter *MiMedx's Employment*], <https://viceroyresearch.org/wp-content/uploads/2017/10/mimedx-report-20-09-2017.pdf> [<https://perma.cc/Q3VK-97Q3>]; *see also* *What is Channel Stuffing?*, KOHN, KOHN & COLAPINTO (Nov. 2, 2023), <https://kkc.com/frequently-asked-questions/channel-stuffing/> [<https://perma.cc/89DK-5PBK>] ("Channel stuffing, also known as trade loading, is a deceptive business practice used by a company to inflate its sales and earnings figures by delivering products to dealers or distributors at an excessively rapid rate, more than what the market can sell to consumers. It involves pushing more product through a distribution channel than the actual demand.").

209. Raghavan, *supra* note 205.

210. Gretchen Morgenson, Joseph Walker & Charley Grant, *Highflying Medical Firm, a Help to Wounded Veterans, Falls to Earth*, WALL ST. J. (July 23, 2018),

Prior to publication, Viceroy also submitted a tip through the WBP.²¹¹ In 2019, the SEC brought and ultimately settled charges against the company for \$1.5 million.²¹² Senior executives were criminally charged and convicted of securities fraud.²¹³ It is unknown if the SEC has paid or will pay any whistleblower awards to Viceroy in this matter.

8. *Gabriel Grego / Quintessential Capital*

Gabriel Grego founded Quintessential Capital in 2008.²¹⁴ In April 2020, the firm published a report on the music streaming firm Akazoo, alleging that it had “profoundly overstated” its users, revenues, and profits.²¹⁵ Quintessential had taken a short position in the company prior

<https://www.wsj.com/articles/highflying-medical-firm-a-help-to-wounded-veterans-falls-to-earth-1532362069> (last visited Sept. 9, 2024) (“MiMedx’s stock, which nearly hit \$18 in January on Nasdaq, now fetches around \$4.”); Vesna Poljak & Jonathan Shapiro, *Viceroy Claims Scalp in Bitter Feud with US Biotech MiMedx*, FIN. REV. (June 8, 2018, 5:24 PM), <https://www.afr.com/markets/viceroy-claims-scalp-in-bitter-feud-with-us-biotech-mimedx-20180608-h114ub> [<https://perma.cc/XL7P-WRHJ>] (reporting a twenty-three percent drop in MiMedx share value in June one day after the firm announced the restatement); Dan McCrum, *Viceroy Research Targets ProSiebenSat1*, FIN. TIMES (Mar. 6, 2018), <https://www.ft.com/content/da6cb693-87ab-3550-9caa-9c5714d090fa> [<https://perma.cc/L4H5-M664>] (noting a one-third drop in February 2018 after the firm delayed release of 2017 financial results pending the internal investigation).

211. *MiMedx’s Employment*, *supra* note 208, at 4 (“Viceroy have submitted a whistleblower dossier with the SEC . . .”); *Ex-Employees Blow the Lid on MiMedx Sales Scheme*, VICEROY RSCH. (Oct. 5, 2017), <https://viceroyresearch.org/wp-content/uploads/2017/10/part-6-pdf-ex-employees-blow-the-lid-on-mimedx-sales-scheme.pdf> [<https://perma.cc/9TH9-9CFB>] (“Prior to Viceroy’s publications, we filed a significant data bundle of evidence to the SEC Whistleblower program.”).

212. Press Release, SEC, SEC Charges Biotech Company and Executives with Accounting Fraud (Nov. 26, 2019), <https://www.sec.gov/news/press-release/2019-243> (last visited Sept. 7, 2024); Raghavan, *supra* note 205.

213. Gretchen Morgenson, *Mimedx Ex-Senior Executives Indicted on Fraud Charges*, WALL ST. J. (Nov. 26, 2019, 4:24 PM), <https://www.wsj.com/articles/mimedx-ex-senior-executives-indicted-on-fraud-charges-11574789916> (last visited Sept. 9, 2024).

214. Edwin Dorsey, *Idea Brunch with Gabriel Grego of Quintessential Capital Management*, SUNDAY’S IDEA BRUNCH (Mar. 20, 2022), <https://www.readideabrunch.com/p/idea-brunch-with-gabriel-grego-of> [<https://perma.cc/3MGG-TDGX>].

215. Valuewalk, *Akazoo Shares Tank on Quintessential Capital’s Short Thesis*, YAHOO FIN. (Apr. 21, 2020), <https://finance.yahoo.com/news/akazoo-shares-tank-quintessential-capital-150010064.html> [<https://perma.cc/32F4-YY4U>]; *see also* Richard Teitelbaum, *Why Quintessential is Shorting This Music App*, INSTITUTIONAL INV. (Apr. 22, 2020), <https://www.institutionalinvestor.com/article/2bsx5gs0uek21z054omio/premium/why-quintessential-is-shorting-this-music-app> (last visited Sept. 9, 2024); QUINTESSENTIAL CAP. MGMT., AKAZOO S.A.: YOU ONLY LIVE TWICE! AKAZOO HAS DECEIVED INVESTORS FOR THE LAST TIME 3 (2020), <https://www.qcmfunds.com/wp-content/uploads/2020/04/Quintessential-Akazoo-Report.pdf> [<https://perma.cc/XPM9-L4EX>].

to publication which led to a precipitous drop of about seventy-five percent over the course of a few months.²¹⁶

Quintessential also submitted the report to the SEC before making it publicly available.²¹⁷ In October 2021, the SEC reached a \$38.8 million settlement with the firm based on allegations that seem closely related to those raised in the Quintessential report.²¹⁸ It is unknown whether Quintessential applied for or received a whistleblower bounty on this case.

Quintessential has also submitted tips to the SEC ahead of other short reports,²¹⁹ including several cases in which the SEC has subsequently launched an investigation.²²⁰ The firm explains that it sometimes relies on whistleblowers.²²¹

9. *Jon Carnes / AlfredLittle.com*

Jon Carnes worked alongside Carson Block before setting out on his own and launching the website AlfredLittle.com, where he initially posted short reports anonymously before revealing his identity.²²² Carnes has

216. See Richard Teitelbaum, *For Quintessential, a Campaign Both Short and Sweet*, INSTITUTIONAL INV. (May 4, 2020), <https://www.institutionalinvestor.com/article/2bsx74xioud4q3rqr8bnk/premium/for-quintessential-a-campaign-both-short-and-sweet> [https://perma.cc/7YBA-25KT].

217. QUINTESSENTIAL CAP. MGMT., INTELLIGENT INVESTING 65 (2020), <https://www.qcmfunds.com/wp-content/uploads/2020/04/Quintessential-Akazoo-FINAL.pdf> [https://perma.cc/389D-YXG5].

218. See Press Release, SEC, Post-SPAC Music Streaming Company Reaches \$38.8 Million Settlement in Ongoing Fraud Action (Oct. 27, 2021), <https://www.sec.gov/newsroom/press-releases/2021-216> (last visited Sept. 7, 2024).

219. E.g., Kevin Stankiewicz, *Shares of Medical Device Maker Penumbra Tank After Short Seller Releases Critical Report*, CNBC (Dec. 8, 2020, 4:02 PM), <https://www.cnbc.com/2020/12/08/shares-of-penumbra-tank-after-short-seller-releases-critical-report.html> [https://perma.cc/Y2ED-FQ6L] (noting that Quintessential submitted a whistleblower tip to the SEC regarding Penumbra).

220. *Cassava Sciences (SAVA): Game Over!*, QUINTESSENTIAL CAP. MGMT. (Nov. 3, 2021), <https://www.qcmfunds.com/cassava-sciences-sava-game-over/> [https://perma.cc/C6RA-2S8P] (linking to early November 2021 short report and SEC whistleblower filing on Cassava); see also Dave Michaels & Joseph Walker, *SEC Investigating Cassava Sciences, Developer of Experimental Alzheimer's Drug*, WALL ST. J. (Nov. 17, 2021, 4:55 PM), <https://www.wsj.com/articles/cassava-sciences-alzheimers-sec-investigation-11637154199> (last visited Sept. 9, 2024).

221. See Silas Brown, *'Society Benefits from Short Sellers' – Gabriel Grego, CIO of Quintessential Capital*, GLOB. CAP. (Sept. 23, 2020), <https://www.globalcapital.com/article/28muc3qhy146y31dszgu8/equity/society-benefits-from-short-sellers-gabriel-grego-cio-of-quintessential-capital> [https://perma.cc/Z57G-PXWZ].

222. See Bruce Livesey, *The Full Story of Jon Carnes, Silvercorp and the BCSC*, GLOBE & MAIL (May 14, 2015), <https://www.theglobeandmail.com/report-on-business/rob-magazine/the-strange-case-of-alfred-little/article24443237/> (last visited Sept. 9, 2024); see generally The Wolf Den, *Episode 3, supra* note 130 (interview with Jon Carnes, exploring his early life and career).

often been included on lists of the most prolific and successful activist shorts.²²³

In 2011, Carnes pseudonymously published a report alleging major fraud involving the Chinese-based U.S.-listed firm Puda Coal.²²⁴ Essentially, he alleged that the firm's chairman and CEO had secretly transferred the firm's primary asset to themselves without telling U.S. investors.²²⁵ The firm's stock dropped precipitously,²²⁶ potentially generating substantial trading profits for Carnes.

The SEC ultimately brought charges against the company's executives and its underwriter, winning a \$250 million default judgment against the former and a \$15 million settlement from the latter.²²⁷

Carnes applied for a whistleblower award from the SEC,²²⁸ paying \$50,000 in legal fees for his SEC whistleblower application.²²⁹ It is unknown if Carnes received any whistleblower award for Puda Coal.

Carnes has also filed SEC whistleblower claims for other short reports that have led to SEC investigations.²³⁰

10. *Mark Cuban / Sharesleuth.com*

Mark Cuban is a celebrity entrepreneur, well known for appearing on the TV series *Shark Tank*, being the owner of an NBA franchise, beating

223. *E.g.*, Chen, *supra* note 44, at 1452; Ljungqvist & Qian, *supra* note 44, at 1982–83; Brendel & Ryans, *supra* note 44, at 499; *see also* Livesey, *supra* note 222 (“In a 2014 survey by Activist Shorts Research that ranked short sellers according to returns from their campaigns, Alfred Little ranked first out of a field of 28.”).

224. Floyd Norris, *A Fraud Went Undetected, Although Easy to Spot*, N.Y. TIMES (Feb. 23, 2012), <https://www.nytimes.com/2012/02/24/business/sec-charges-reveal-fraud-in-chinese-company.html> (last visited Sept. 9, 2024).

225. *Id.*

226. *Id.*

227. Aruna Viswanatha, *Macquarie to Pay \$15 Million to Settle SEC Charges Tied to Puda Coal Offering*, WALL ST. J. (Mar. 27, 2015, 6:50 PM), <https://www.wsj.com/articles/macquarie-to-pay-15-million-to-settle-sec-charges-tied-to-puda-coal-offering-1427467456> (last visited Sept. 9, 2024); SEC v. Ming Zhao & Liping Zhu, SEC Litigation Release No. 23311 (July 24, 2015), <https://www.sec.gov/enforcement-litigation/litigation-releases/lr-23311> (last visited Sept. 7, 2024) (“District Court Enters \$250 Million Default Judgement Against Former Company Executives in Puda Coal Fraud.”).

228. Christopher Donville & Dune Lawrence, *Short Seller Drops Muddy Waters Model for SEC: Corporate Canada*, BLOOMBERG (May 10, 2012), <https://www.bloomberg.com/news/articles/2012-05-09/short-seller-drops-muddy-waters-model-for-sec> (last visited Sept. 9, 2024).

229. *Id.*

230. *Id.* (noting that Carnes planned to seek whistleblower status for his work on Silvercorp); Andy Hoffman, *SEC Probes Silvercorp Short-Seller Fight*, THE GLOBE & MAIL (Apr. 2, 2013), <https://www.theglobeandmail.com/report-on-business/sec-probes-silvercorp-short-seller-fight/article10646208/> (last visited Sept. 9, 2024) (noting that the SEC had opened an investigation into Silvercorp related to the allegations raised on alfredlittle.com).

the SEC's charges of insider trading,²³¹ and becoming one of the SEC's most vocal critics.²³² Cuban has appeared on some lists of the most active short sellers.²³³

In 2011, a website owned by Cuban published the first of a long series of reports alleging fraud by a stock promoter named S. Paul Kelley and several reverse mergers between Chinese and U.S.-listed shells he organized.²³⁴ Cuban "sometimes" takes short positions in the shares of companies covered by his investigations,²³⁵ though it is unknown if he did so in this particular case.

Cuban also submitted the information to the SEC, which ultimately brought numerous actions resulting in more than nine million dollars in sanctions ordered.²³⁶ In 2014, Cuban filed a claim for a whistleblower award and as of 2015 (the last publicly available information on point), he was still waiting to hear back.²³⁷

231. *E.g.*, Marc I. Steinberg, *Insider Trading — SEC v. Mark Cuban — A Litigation Saga*, 58 U. LOUISVILLE L. REV. 1, 2 (2019).

232. Cuban incessantly files Amicus briefs in support of individuals challenging federal securities enforcement actions. *E.g.*, Brief for Mark Cuban as Amicus Curiae Supporting Petitioner, *Kokesh v. SEC*, 581 U.S. ___, 137 S. Ct. 1635 (2017) (No. 16-529); Brief for Mark Cuban as Amicus Curiae Supporting Petitioner, *Lucia v. SEC*, 585 U.S. ___, 138 S. Ct. 2044 (2018) (No. 17-130); Brief for Mark Cuban as Amicus Curiae Supporting Petitioner, *Kosinski v. United States*, __ U.S. ___, 141 S. Ct. 2755 (2017) (No. 20-1161) (mem. denying certiorari); Brief for Mark Cuban et al. Supporting Petitioner, *Romeril v. SEC*, __ U.S. ___, 138 S. Ct. 2836 (2022) (No. 21-1284) (mem. denying certiorari); Brief of Phillip Goldstein et al. as Amici Curiae Supporting Respondent Cochran in Consolidated Case, *Axon Enterprise, Inc. v. FTC*, 598 U.S. ___, 143 S. Ct. 890 (2023) (Nos. 21-86 and 21-1239); Brief for Mark Cuban as Amicus Curiae Supporting Petitioner, *Salman v. United States*, 580 U.S. 39 (2016) (No. 15-628); Brief for Phillip Goldstein et al. as Amici Curiae Supporting Respondents, *SEC v. Jarkey*, __ U.S. ___, 144 S. Ct. 2117 (2024) (No. 22-859); Brief for Mark Cuban as Amicus Curiae Supporting Petitioner, *Bebo v. SEC*, 799 F.3d 765 (7th Cir. 2015) (No. 15-997). Most recently, Cuban put his own name forward to serve as SEC Chair if Kamala Harris wins the Presidential election. David Gardner, *Mark Cuban Puts Name up for Top Job in Harris Administration*, DAILY BEAST (Sept. 5, 2024), <https://www.thedailybeast.com/mark-cuban-puts-his-name-up-for-sec-job-in-harris-administration> [<https://perma.cc/XKD5-SAQ8>].

233. Chen, *supra* note 44, at 1452.

234. *See SEC Brings Fraud Charges Against Promoters of China Auto Logistics and Gunawei Recycling; Also Alleges Manipulation of Kandi Technologies Group Stock*, SHARESLEUTH, <https://sharesleuth.com/sec-brings-fraud-charges-against-promoters-of-china-auto-logistics-and-guanwei-recycling-also-alleges-manipulation-of-kandi-technologies-group-stock/> [<https://perma.cc/J2SU-B8YZ>] (collecting prior reports).

235. *About Sharesleuth*, SHARESLEUTH, <https://sharesleuth.com/about-us/> [<https://perma.cc/P9U7-YAVW>]; *see also* Patricia B. Gray, *Owner Mark Cuban Trades Stocks on Sharesleuth's Findings Before They're Published*, WIRED (Sept. 25, 2007), <https://www.wired.com/2007/09/mf-sharesleuth/> (last visited Sept. 9, 2024); Jean Eaglesham & Rachel Louise Ensign, *Whistleblowers Find SEC Rewards Slow and Scarce*, WALL ST. J. (May 25, 2015), <https://www.wsj.com/articles/whistleblowers-find-sec-rewards-slow-and-scarce-1432594234> (last visited Sept. 9, 2024).

236. Eaglesham & Ensign, *supra* note 235.

237. *Id.*

11. *Dan David / Wolfpack*

Dan David is the founder of Wolfpack research, a “short-biased activist research firm,” and co-founder of GeoInvesting, LLC.²³⁸ He has been included on lists of the most active and effective short sellers.²³⁹

In 2015, he told the *Wall Street Journal* that he had made “almost a dozen claims for whistleblower awards for alleged penny-stock frauds and those involving U.S.-listed Chinese stocks,” but had not yet received any payments.²⁴⁰

12. *Quinton Matthews / Rota Fortunae*

In 2018, Quinton Matthews used the pseudonym Rota Fortunae to publish a report claiming that a real estate investment trust called Farmland Partners was near insolvency.²⁴¹ The stock declined thirty-nine percent in one day.²⁴² Matthews had taken a short position in the stock and likely earned substantial trading profits.²⁴³ As he had done in several prior instances, Matthews partnered with Sabrepoint, a Dallas-based hedge fund on the research, which also took a short position in Farmland.²⁴⁴ The extent of the partnership has been disputed by the fund.²⁴⁵

Before publishing, Matthews also shared his information with the SEC through the whistleblower program.²⁴⁶ He stated that he thought it “was the type of research that the SEC whistleblower program was designed for.”²⁴⁷

238. *About Dan David*, WOLFPACK RSCH., <https://wolfpackresearch.com/about-us/> [<https://perma.cc/8Q4F-GZA7>].

239. Chen, *supra* note 44, at 1452; Brendel & Ryans, *supra* note 44, at 499.

240. Eaglesham & Ensign, *supra* note 235. In an April 2021 podcast, David stated that “I have so many applications in for awards in and so little awards—as in none.” The Wolf Den, *Episode 14 – Jordan Thomas*, WOLFPACK RSCH., at 03:40 (Apr. 2, 2021), <https://wolfpackresearch.podbean.com/e/episode-14-jordan-thomas/> (last visited Sept. 15, 2024).

241. Justin Baer, *Short Sellers Upended a Small Farm Real-Estate Company. This Is What It Looked Like*, WALL ST. J. (Sept. 25, 2022), <https://www.wsj.com/articles/short-sellers-upended-a-small-farm-real-estate-company-this-is-what-it-looked-like-11664076506> (last visited Sept. 9, 2024); Michelle Celarier, *Stunning Confessions of a Short Seller*, INSTITUTIONAL INV. (June 22, 2021), <https://www.institutionalinvestor.com/article/2bswuzi3me2otfve5ts/culture/stunning-confessions-of-a-short-seller> [<https://perma.cc/5GN7-VW6E>]; *Farmland Partners, Inc. v. Fortunae*, 842 F. App’x 199, 200 (10th Cir. 2021).

242. Baer, *Short Sellers*, *supra* note 241.

243. *Id.*; Celarier, *Stunning*, *supra* note 241; *Farmland Partners, Inc.*, 842 F. App’x at 200.

244. Baer, *Short Sellers*, *supra* note 241; Celarier, *Stunning*, *supra* note 241.

245. Baer, *Short Sellers*, *supra* note 241.

246. *Id.*

247. *Id.*

But Matthews' report contained substantial errors, which he later admitted while settling litigation filed by Farmland.²⁴⁸ As part of the settlement, Matthews also agreed to pay Farmland an amount equal to the profits earned on shorting their stock.²⁴⁹

13. *Bill Ackman / Pershing*

Bill Ackman is well known for high profile and controversial investments and advocacy. He is the founder and chief executive of Pershing Square Capital Management, a hedge fund with many billions of dollars under management.²⁵⁰ He has appeared on lists of the most active and influential activist shorts.²⁵¹

In 2012, Ackman publicly announced that he had taken an “enormous” short position on the company Herbalife, outlining a litany of problems with the company.²⁵² As he advocated against Herbalife in the ensuing years, Ackman engaged at least indirectly with the WBP. For instance, in 2013, Ackman secretly agreed to pay as much as \$3.6 million to a former Herbalife employee, in exchange for information about the firm.²⁵³ At the time, the insider was reportedly “seeking whistleblower status” with the SEC.²⁵⁴ Ackman also agreed to cover legal fees and damages for other whistleblowers who cooperated with unspecified “government agencies”—potentially including the WBP.²⁵⁵

In 2014, Ackman expanded his allegations to Herbalife's Chinese operations, drawing on documents he obtained from Herbalife employees who had reportedly “gained whistleblower status” and were “cooperating

248. *Id.*; Celarier, *Stunning*, *supra* note 241.

249. Baer, *Short Sellers*, *supra* note 241.

250. Maureen Farrell, *Famously Obstinate, Bill Ackman Is Now Real-Life Famous. What Next?*, N.Y. TIMES (Mar. 27, 2024), <https://www.nytimes.com/2024/03/24/business/bill-ackman.html> (last visited Sept. 9, 2024).

251. Appel & Fos, *supra* note 44, at Table A1.

252. William Alden, *Ackman Outlines Bet Against Herbalife*, N.Y. TIMES (Dec. 20, 2012), <https://archive.nytimes.com/dealbook.nytimes.com/2012/12/20/ackman-outlines-bet-against-herbalife/> (last visited Sept. 9, 2024).

253. *Bill Ackman's Secret \$\$ Deal for Herbalife Whistleblower*, ABC NEWS (Apr. 22, 2014), <https://abcnews.go.com/Blotter/bill-ackmans-secret-deal-herbalife-whistleblower/story?id=23415501> [<https://perma.cc/4F2P-X4Z2>].

254. Atossa Araxia Abrahamian, *Herbalife Saga Continues With 2011 Food Safety Concerns*, REUTERS (Aug. 13, 2013, 2:54 PM), <https://www.reuters.com/article/business/healthcare-pharmaceuticals/herbalife-saga-continues-with-2011-food-safety-concerns-idUSBRE97C0QZ/> (last visited Sept. 8, 2024).

255. Svea Herbst-Bayliss, *Ackman to Pay Herbalife Whistleblowers' Legal Fees, Not Lost Pay*, REUTERS (Apr. 24, 2014, 2:08 PM), <https://www.reuters.com/article/business/ackman-to-pay-herbalife-whistleblowers-legal-fees-not-lost-pay-idUSBREA3N260/> (last visited Sept. 8, 2024).

with US regulators”²⁵⁶ (potentially including the WBP). Ackman also helped “provide Chinese whistleblowers to the feds,”²⁵⁷ possibly via the WBP. And Ackman also provided information to the SEC directly.²⁵⁸ In late 2014, Ackman noted on television that he had reached financial agreement with numerous Herbalife distributors and insiders before they brought their information to the government in the context of an unspecified whistleblower bounty program.²⁵⁹ In 2017, Ackman abandoned his short position in Herbalife, at a one billion dollar loss.²⁶⁰ In 2019, Herbalife reached a twenty million dollar settlement to resolve charges brought by the SEC related to the Chinese operations allegations flagged by Ackman.²⁶¹ In 2020, Herbalife agreed to a further \$123 million settlement with the Department of Justice and SEC for bribing Chinese officials.²⁶² It is unclear the extent to which this was related to the Ackman

256. Michelle Celarier, *Ackman Accuses Herbalife of Breaking Chinese Law*, N.Y. POST (Mar. 11, 2014), <https://nypost.com/2014/03/11/ackman-accuses-herbalife-of-breaking-chinese-law/> [<https://perma.cc/9D47-Q9LZ>].

257. See Michelle Celarier, *Who’s Left Holding Herbalife*, INSTITUTIONAL INV. (Aug. 28, 2020), <https://www.institutionalinvestor.com/article/2bsx8cqh9m2zfoxrsqqdc/portfolio/whos-left-holding-herbalife> [<https://perma.cc/KSEG-N5J4>].

258. Michael S. Schmidt, Eric Lipton & Alexandra Stevenson, *After Big Bet, Hedge Fund Pulls the Levers of Power*, N.Y. TIMES (Mar. 9, 2014), <https://www.nytimes.com/2014/03/10/business/staking-1-billion-that-herbalife-will-fail-then-ackman-lobbying-to-bring-it-down.html> (last visited Sept. 8, 2024) (noting that Ackman presented the SEC “with a year’s worth of financial research that he said showed that Herbalife was misleading investors by failing to properly disclose that most of its sales were generated by simply recruiting more distributors, rather than by selling large amounts of its product to consumers”).

259. Market Makers, *Bill Ackman: Herbalife Distributors Turning State’s Evidence*, BLOOMBERG, at 06:14 (Dec. 17, 2014), <https://www.bloomberg.com/news/videos/2014-12-17/ackman-hlf-distributors-turning-states-evidence> (last visited Sept. 15, 2024) (noting, in the context of a discussion of Herbalife whistleblowers, that “[a] number of them have gone directly to the government, and we don’t know much about them. A number of them have come to us and look I’m scared. I want to be protected. What if the company sues me. And we’ve agreed to give indemnities to some of those people before they go talk to the government . . . The government pays whistleblowers. And so if one of the top distributors were to come forward—and some have—and they sit down with the government and they say, ‘Look here’s how this scam works and I can help you get to the company,’ the government will pay that person to the extent they make a meaningful recovery.”).

260. Svea Herbst-Bayliss, *Ackman Makes New Bet Against Herbalife with Options*, REUTERS (Nov. 1, 2017), <https://www.reuters.com/article/business/ackman-makes-new-bet-against-herbalife-with-options-idUSKBN1D159G/> (last visited Sept. 8, 2024); Samantha Chang, *Billionaire Bill Ackerman Dumps Herbalife, Ending 5-Year War Betting Against It*, INVESTOPEDIA (June 25, 2019), <https://www.investopedia.com/news/billionaire-bill-ackman-dumps-herbalife-ending-5year-war-betting-against-it/> [<https://perma.cc/SMW6-VCZ5>].

261. Matthew Goldstein, *Herbalife Settles with S.E.C., but Too Late for Hedge Fund Investor*, N.Y. TIMES (Sept. 27, 2019), <https://www.nytimes.com/2019/09/27/business/herbalife-sec-ackman.html> (last visited Sept. 8, 2024).

262. Matthew Rocco, *Herbalife Pays \$123m to Resolve Chinese Bribery Claims*, FIN. TIMES (Aug. 28, 2020), <https://www.ft.com/content/81b0142d-cf81-4380-a8e3-e7aab10a2380> (last visited Sept. 28, 2024).

allegations, or if Ackman or any of his affiliated whistleblowers received any whistleblower award.²⁶³

14. Whistleblower Lawyers

Several prominent whistleblower lawyers have promoted activist short participation in the WBP. Jordan Thomas is a dominant SEC whistleblower lawyer.²⁶⁴ He is a former SEC official who helped create the WBP and then set up a successful practice representing whistleblowers before the agency.²⁶⁵ Thomas has represented short sellers in the WBP.²⁶⁶ He has also advocated directly to the SEC more broadly for encouraging short seller participation in the WBP; when the SEC proposed allowing Commissioners to reduce payouts in large awards, Thomas reportedly warned them that doing so would put a “huge damper” on the incentives to report fraud “especially” for short sellers, who “might be viewed as undeserving or impure.”²⁶⁷ Thomas represented Carson Block in his successful effort to obtain a fourteen million dollar bounty.²⁶⁸ Thomas also represents a pair of outsider scientists who took a short position before blowing the whistle on pharmaceutical company Cassava Sciences, alleging that it falsified research underlying its sole prospective drug.²⁶⁹ The company’s stock price dropped precipitously following the allegations.²⁷⁰ The SEC and DOJ have both opened investigations.²⁷¹

263. Cf. Jon Shazar, *SEC, DoJ Say Bill Ackman Was Right About Herbalife All Along*, DEALBREAKER (May 11, 2020), <https://dealbreaker.com/2020/05/herbalife-fined-for-china-bribery> [<https://perma.cc/M85C-FDRS>] (“Any chance he’s eligible for whistleblower money on that \$123 million settlement?”).

264. Platt, *WBIC*, *supra* note 43, at 726.

265. Patrick Radden Keefe, *Jordan Thomas’s Army of Whistle-Blowers*, NEW YORKER (Jan. 17, 2022), <https://www.newyorker.com/magazine/2022/01/24/jordan-thomas-army-of-whistle-blowers> (last visited Sept. 8, 2024).

266. *Id.* (“Thomas told me that he has no scruples about representing short sellers. He has done it before, and successfully.”); The Wolf Den, *Episode 14*, *supra* note 240, at 01:11:20–32 (“I represent short sellers”).

267. Thomas filed a lawsuit challenging these regulations, which were later rescinded. See Lydia DePillis, *The SEC Undermined a Powerful Weapon Against White-Collar Crime*, PROPUBLICA (Jan. 13, 2021), <https://www.propublica.org/article/the-sec-undermined-a-powerful-weapon-against-white-collar-crime> [<https://perma.cc/P5TS-XL9V>].

268. Sun, *Short Seller Carson Block Sued*, *supra* note 6. As noted above, Block’s alleged associate, who separately applied for and was denied a whistleblower award, argued that Block received favorable treatment from the SEC because he was represented by Thomas. *Supra* section III.B.1.

269. Keefe, *supra* note 265.

270. *Id.*

271. See Timothy Annett, *Cassava Shares Drop Following Report of SEC Investigation*, BLOOMBERG, <https://www.bloomberg.com/news/articles/2021-11-17/cassava-shares-drop-following-report-of-sec-investigation> (last updated Nov. 17, 2021, 2:25 PM) (last visited Sept. 8,

Mark Pugsley, another prominent whistleblower well known for his involvement in the Nikola case described above,²⁷² has explained that activist shorts “are a lot like whistleblowers, if you think about it.”²⁷³ Pugsley explained that he reached out to an activist short to help him and his clients in the Nikola case because he “just need[ed] more resources” and more researchers to “dig in” and help draft a report.²⁷⁴

Sean McKessy, the first head of the SEC WBP and now a prominent private whistleblower lawyer, recently told a reporter that he advocated for activist shorts to be considered for bounties when he was leading the program.²⁷⁵

C. Other Professional Outsiders in the SEC Whistleblower Program

Activist shorts are not the only professional outsiders participating in the SEC whistleblower program. Analysts and other market players have also done so.²⁷⁶

Since blowing the whistle on Bernie Madoff, analyst Harry Markopolos has continued on as a prolific fraud-spotter and whistleblower. In 2019, Markopolos published a report alleging major accounting fraud at General Electric (GE), calling it “a bigger fraud than Enron.”²⁷⁷ He focused, in part, on the company’s long term care insurance unit.²⁷⁸ Markopolos was working with an undisclosed hedge fund—

2024); Marisa Taylor & Mike Spector, *Exclusive: Cassava Sciences Faces U.S. Criminal Probe Tied to Alzheimer’s Drug*, *Sources Say*, REUTERS (July 27, 2022, 10:41 AM), <https://www.reuters.com/business/healthcare-pharmaceuticals/exclusive-cassava-sciences-faces-us-criminal-probe-tied-alzheimers-drug-sources-2022-07-27/> (last visited Sept. 8, 2024); Dave Michaels & Joseph Walker, *SEC Investigating Cassava Sciences, Developer of Experimental Alzheimer’s Drug*, WALL ST. J., <https://www.wsj.com/articles/cassava-sciences-alzheimers-sec-investigation-11637154199> (last updated Nov. 17, 2021, 4:55 PM) (last visited Sept. 8, 2024).

272. *Supra* section III.B.2.

273. FRAUD IN AMERICA, *supra* note 165, at 29:10–20.

274. *Id.* at 32:10–42.

275. *See* Weinstein, *supra* note 45.

276. *Cf.* Stolowy, Paugam, & Gendron, *supra* note 67 (noting that activist short sellers and analysts “are very different, but both are information intermediaries who produce meaning and predictions about uncertain future market developments for other market participants”).

277. Harry Markopolos, *General Electric, a Bigger Fraud than Enron*, FRAUD INVESTIGATORS (Aug. 15, 2019), https://fm.cnb.com/applications/cnb.com/resources/editorialfiles/2019/8/15/2019_08_15_GE_Whistleblower_Report.pdf [<https://perma.cc/A6E3-UAAC>]; *see also* John Melloy & Kate Rooney, *GE Falls the Most in 11 Years After Madoff Whistleblower Calls It a ‘Bigger Fraud than Enron,’* CNBC (Aug. 15, 2019 4:19 PM), <https://www.cnb.com/2019/08/15/ge-shares-drop-after-madoff-whistleblower-harry-markopolos-raises-red-flags-on-its-accounting.html> [<https://perma.cc/S64R-J4XK>].

278. Markopolos, *supra* note 277; Melloy & Rooney, *supra* note 277.

reportedly “one of the largest and oldest” hedge funds²⁷⁹—and had an arrangement with that firm to share in some of the trading profits.²⁸⁰ Those profits may have been significant, given that GE’s stock fell eleven percent the day of the report.²⁸¹ Markopolos also submitted his information to the SEC as a whistleblower tip.²⁸² In December 2020, the SEC reached a \$200 million settlement against GE for accounting fraud in its long term care insurance unit (among other places).²⁸³ It is unknown if the SEC has paid or will pay any whistleblower awards to Markopolos in this matter.²⁸⁴

In 2017, Markopolos reportedly collaborated with two of the short sellers listed above—Kyle Bass and David Einhorn—before blowing the whistle unsuccessfully on mega hedge fund, Bridgewater Associates.²⁸⁵

279. Celarier, *Dark Money*, *supra* note 75.

280. Daniel Strauss, *Famed Madoff Whistleblower Harry Markopolos Could Make Millions from His Claims General Electric Is Committing Fraud*, BUS. INSIDER IND. (Aug. 16, 2019), <https://www.businessinsider.in/famed-madoff-whistleblower-harry-markopolos-could-make-millions-from-his-claims-general-electric-is-committing-fraud/articleshow/70702958.cms> [<https://perma.cc/C2HS-L7VB>].

281. *See id.*

282. *Id.*; *see also* Paul R. La Monica, *Madoff Whistleblower Says GE Is ‘One Recession Away from Chapter 11,’* CNN (Aug. 16, 2019), <https://www.cnn.com/2019/08/16/investing/ge-harry-markopolos-interview/index.html> [<https://perma.cc/5D6P-DK9E>] (“Markopolos added that he’s had ‘ongoing discussions’ with the Securities and Exchange Commission and the Department of Justice about their investigations into GE’s accounting”).

283. Press Release, SEC, General Electric Agrees to Pay \$200 Million Penalty for Disclosure Violations (Dec. 9, 2020), <https://www.sec.gov/newsroom/press-releases/2020-312> (last visited Aug. 3, 2024).

284. *Compare* Letter from Joshua Mitts & John C. Coffee, to Vanessa Countryman, Secretary, SEC, Re: Petition for Rulemaking on Short and Distort, at 2 (Feb. 12, 2020) (using Markopolos’s GE report as the lead example of the dangers of activist short selling and “short and distort” and stating that “[m]ost analysts, investment banks and reporters came to the conclusion that the Markopolos report was unfounded”) with Ryan Beene, *GE Warns of Likely SEC Action in Probe of Insurance Reserves*, BLOOMBERG (Oct. 6, 2020, 3:15 PM), <https://www.bloomberg.com/news/articles/2020-10-06/ge-warns-of-likely-sec-accusations-tied-to-insurance-portfolio> (last visited Sept. 8, 2024) (quoting Coffee, one of the primary authors of the short-and-distort petition, responding to news of the SEC investigation of GE: “GE probably thought it had defeated Markopolos when GE’s price went back to its prior level, but apparently the issue still lives”); *see also* Celarier, *Dark Money*, *supra* note 75 (stating that Markopolos “appears to have been vindicated” by the SEC investigation); Allison Bell, *SEC Adds to General Electric’s Long-Term Care Insurance Headaches*, THINKADVISOR (Oct. 7, 2020, 3:26 PM), <https://www.thinkadvisor.com/2020/10/07/sec-adds-to-general-electrics-long-term-care-insurance-headaches/> [<https://perma.cc/CB45-UHAJ>] (connecting SEC investigation to Markopolos’ allegations); Michelle Celarier, *Triam Dumped GE Stock, but Druckenmiller Stood Pat in Q3 as SEC Probe Heated Up*, INSTITUTIONAL INV. (Nov. 17, 2020), <https://www.institutionalinvestor.com/article/2bsx8t52hwxtm91nsljwg/premium/triam-dumped-ge-stock-but-druckenmiller-stood-pat-in-q3-as-sec-probe-heated-up> (last visited Sept. 8, 2024) (same).

285. Rob Copeland, *How Does the World’s Largest Hedge Fund Really Make Its Money?*, N.Y. TIMES (Nov. 2, 2023), <https://www.nytimes.com/2023/11/01/business/how-does-the-worlds-largest-hedge-fund-really-make-its-money.html> (last visited Sept. 8, 2024).

As of 2019, Markopolos had submitted at least nine other tips through the WBP on insurance companies.²⁸⁶ And as of 2020, Markopolos had received at least one bounty payment from the SEC.²⁸⁷

Similarly, the SEC awarded a \$2.5 million bounty to a pair of professional stock analysts who flagged financial reporting fraud by Orthofix, a medical device maker.²⁸⁸ Jordan Thomas (a premier whistleblower lawyer discussed above) represented the analysts, supplementing their outside information with insider knowledge. Thomas' investigators reportedly "scouted industry message boards looking for former Orthofix employees" and found at least one such former employee who provided additional information that Thomas provided to the SEC.²⁸⁹ The extent to which the analysts or their clients also privately profited from this information is unknown.

The SEC also awarded \$110 million to a tipster who "utilized publicly available information" derived from "multiple sources that were not readily identified and accessed by members of the public without specialized knowledge, unusual effort, or substantial cost."²⁹⁰ The SEC's order granting the award highlighted the fact that the tipster provided "a detailed suggested witness list" and other "supporting documents" that "saved the Commission significant time and resources."²⁹¹ But it is not known whether the tipster privately profited from the information in addition to receiving the bounty.

In another case, the SEC awarded \$1.2 million to an outsider tipster who shared a "complex algorithm" with the agency that, when applied to

286. Bill Alpert, *Whistleblower Harry Markopolos Says the SEC Hasn't Paid Him for His Work*, BARRON'S (Aug. 19, 2019), <https://www.barrons.com/articles/harry-markopolos-whistleblower-sec-51566229876> (last visited Sept. 8, 2024); cf. Mengqi Sun, *Whistleblowers Worry SEC's Interpretation of 'Independent Analysis' Could Discourage Tipsters*, WALL ST. J. (Dec. 7, 2020), <https://www.wsj.com/articles/whistleblowers-worry-secs-interpretation-of-independent-analysis-could-discourage-tipsters-11607337001> (last visited Sept. 8, 2024) (stating that Markopolos had submitted "at least five tips").

287. Sun, *Whistleblowers Worry*, *supra* note 286.

288. Katanga Johnson, *U.S. SEC Awards \$2.5 million to Orthofix Medical's External Whistleblowers*, REUTERS (Sept. 1, 2020), <https://www.reuters.com/article/idUSKBN25S65K/> (last visited Sept. 15, 2024); Sarah N. Lynch, *Not an Inside Job: How Two Analysts Became SEC Whistleblowers*, REUTERS (Apr. 25, 2017, 12:54 PM), <https://www.reuters.com/article/legal/not-an-inside-job-how-two-analysts-became-sec-whistleblowers-idUSL1N1HX1WK/> (last visited Sept. 8, 2024).

289. Lynch, *supra* note 288.

290. Order Determining Whistleblower Award Claims, Exchange Act Release No. 92985, 2021 WL 4242573, at *2 n.8 (Sept 15, 2021).

291. *Id.*

publicly available data, helped the SEC in the underlying case.²⁹² Again, it is unclear whether the tipster who provided this “algorithm” also privately profited from it—either by using it himself to trade, by licensing it to others, or otherwise.

More recently, the SEC awarded a bounty to “an outsider” who undertook “unusual effort and intensive research over the course of many weeks, and developed . . . a detailed analysis of publicly-available information,” including “public filings, research reports, [and] earnings call transcripts,” and then “distilled” those materials “into allegations” of securities fraud.²⁹³ Again, there is no mention of whether the tipster also privately profited from this extensive research—by trading on it or sharing it with others.

Numerous other WBP awards have been given to outsider tipsters providing analysis of publicly available information, but the published versions of the SEC’s awards are heavily redacted and do not provide any details about the type of outsider or the extent to which the tipster had also privately profited from the information.²⁹⁴

IV. INTERPRETATION: THE NEW PRIVATIZATION OF PUBLIC ENFORCEMENT

Conventional accounts of the WBP tend to emphasize its role in eliciting information from well-placed *insiders* at target firms. Insider tipsters have received exclusive mention in prominent discussions of the

292. Order Determining Whistleblower Award Claim, Exchange Act Release No. 92777, 2021 WL 3860244 (Aug. 27, 2021), <https://www.sec.gov/files/rules/other/2021/34-92777.pdf> [<https://perma.cc/573Z-95AZ>].

293. Order Determining Whistleblower Award Claims, Exchange Act Release No. 94860, 2022 WL 1467832 (May 6, 2022), <https://www.sec.gov/files/rules/other/2022/34-94860.pdf> [<https://perma.cc/4YGD-T3UP>].

294. *E.g.*, Order Determining Whistleblower Award Claims, Exchange Act Release No. 97295, 2023 WL 2950981 (Apr. 13, 2023), <https://www.sec.gov/files/rules/other/2023/34-97295.pdf> [<https://perma.cc/E8WU-7HN2>] (awarding \$1.9 million to an individual who used their “specialized access and knowledge to evaluate the facts in a [redacted] case against the Company and its executives to identify potential violations of the U.S. securities laws”); Order Determining Whistleblower Award Claim, Exchange Act Release No. 90412, 2020 WL 6742763 (Nov. 13, 2020), <https://www.sec.gov/files/rules/other/2020/34-90412.pdf> [<https://perma.cc/B8QV-9TSR>] (awarding \$1.1 million to an individual who “examined and evaluated publicly available materials that provided important insight into possible securities violations that were not apparent from the face of the public materials themselves”); Order Determining Whistleblower Award Claims, Exchange Act Release No. 93685, 2021 WL 5741427 (Dec. 1, 2021), <https://www.sec.gov/files/rules/other/2021/34-93685.pdf> [<https://perma.cc/YF3K-PZFE>] (awarding \$175,000 to individual whose “analysis of information from public sources revealed possible violations that were not apparent from the face of the publicly available materials”).

WBP by SEC Chairs and Commissioners,²⁹⁵ elected officials,²⁹⁶ advocacy groups,²⁹⁷ whistleblower lawyers,²⁹⁸ academics,²⁹⁹ and journalists.³⁰⁰

295. See, e.g., Caroline A. Crenshaw, SEC Comm’r, Statement on Whistleblower Program Rule Amends. (Sept. 23, 2020), <https://www.sec.gov/news/public-statement/crenshaw-whistleblower-2020-09-23> (last visited June 23, 2024) (“To date, we have paid more than \$523 million to whistleblowers who *risks their livelihoods* to do the right thing.” (emphasis added)); Jay Clayton, SEC Chairman, Statement: Strengthening our Whistleblower Program (Sept. 23, 2020), <https://www.sec.gov/news/public-statement/clayton-whistleblower-2020-09-23> (last visited Sept. 8, 2024) (“I want to note our appreciation to whistleblowers who, sometimes at *great risk to their livelihood*, report suspected securities laws violations to the SEC. Our whistleblower program has been a success because of their efforts.” (emphasis added)); Hester M. Pierce, SEC Comm’r, Statement on Amends. to the Comm’n’s Whistleblower Program Rules (Sept. 23, 2020), <https://www.sec.gov/newsroom/speeches-statements/peirce-whistleblower-2020-09-23> (last visited Sept. 8, 2024) (“An award may encourage an individual to make the difficult choice to tell the truth by *replacing the income she loses if she is fired from her job* and by providing some offset for the reputational, personal, and even physical threats that whistleblowers can endure as a result of alerting us to wrongdoing.” (emphasis added)); Allison Herren Lee, SEC Comm’r, June Bug vs. Hurricane: Whistleblowers Fight Tremendous Odds and Deserve Better (Sept. 23, 2020), <https://www.sec.gov/newsroom/speeches-statements/lee-whistleblower-2020-09-23> (last visited Sept. 8, 2024) (“Whistleblowers . . . take great risks to help law enforcement, never knowing when they make their decision to speak up what will happen to them. *Will they lose their jobs?* Will their physical safety be threatened? Will anyone care? Will there be enough proof to bring a case? If an action is brought, will it result in a recovery for victims? Will they ever be compensated in any way for these risks? Each of these questions creates well-grounded fear, uncertainty, and risk.” (emphasis added)); Robert Jackson, SEC Comm’r, Statement on Proposed Rules Regarding SEC Whistleblower Program (June 28, 2018), <https://www.sec.gov/news/public-statement/jackson-statement-whistleblowers-062818> (last visited Sept. 8, 2024) (“Let’s start from the perspective of an employee who is witnessing a significant corporate fraud. Especially if she is a high-ranking insider at a large public company—the whistleblowers who are most valuable to us in protecting our markets—*there are major risks for the employee if she comes forward*. She may lose her job and her salary, but worse, she faces the very real prospect of never working in a senior position in her field again.” (emphasis added)).

296. Letter from Sen. Charles E. Grassley, U.S. Senate Judiciary Comm. Chairman, to Hon. Jay Clayton, SEC Chairman, Re: File No. S7-16-18, Amends. to SEC’s Whistleblower Program Rules (Sep. 18, 2018), <https://www.sec.gov/comments/s7-16-18/s71618-4373264-175545.pdf> [<https://perma.cc/6TX9-8D2W>] (emphasizing that, because of the SEC WBP, would-be law-breakers “know their *colleagues* are watching them” and that the “most well-informed whistleblowers . . . are usually the most highly placed in a company” and failing to note that outsiders may also qualify for whistleblower awards (emphasis added)).

297. See, e.g., Press Release, Better Markets, The SEC’s Whistleblower Rule Helps Protect Main Street Consumers, Investors, and Families Against Securities Crooks, Fraudsters & Rip-Off Artists, (Aug. 26, 2022), <https://bettermarkets.org/newsroom/the-secs-whistleblower-rule-helps-protects-main-street-consumers-investors-and-families-against-securities-crooks-fraudsters-rip-off-artists/> [<https://perma.cc/4WBG-GRP6>] (“The SEC’s whistleblower program . . . has *encouraged and protected insiders* who blow the whistle on often complex and hard-to-uncover corporate schemes, and that has helped the SEC catch the lawbreakers.” (emphasis added)); Letter from Ira D. Hammerman, Exec. Vice Pres. & Gen. Couns., Sec. Indus. & Fin. Mkts. Ass’n (SIFMA), to Brent Fields, Sec’y, SEC, Re: Whistleblower Program Rules, Exch. Act Release No. 83557, File No. S7-16-18 (Sept. 18, 2018), <https://www.sifma.org/wp-content/uploads/2018/09/Whistleblower-Program-Rules.pdf> [<https://perma.cc/KAB5-CNLZ>] (noting that whistleblowers may take “substantial career and personal risks” and not noting that non-insiders may also qualify for awards).

This emphasis on insiders is understandable. Courageous individuals who risk their livelihoods to stop corporate misdeeds make for highly appealing program mascots. The policy logic of rewarding these insiders is rock solid: for many frauds, the lure of a financial bounty for a prospective whistleblower plausibly represents the best and *only* way to bring the truth to light. Finally, for insiders (who are barred from trading on material non-public information about their own firms), the prospect of a public bounty is their only way of profiting on the information.

The significant role played by outsider tipsters in the WBP disrupts this conventional thinking. Outsiders are a far less politically appealing group. At least some outsiders are well-heeled market professionals already being generously compensated for the work of researching and identifying overvalued companies. Indeed, the SEC has been downright *hostile* to

298. *SEC Whistleblower Rules & Changes*, KOHN, KOHN & COLAPINTO, <https://kkc.com/sec-whistleblower-rule-changes-resource-center/> [<https://perma.cc/3NKF-2XGJ>].

299. See, e.g., O’Sullivan, *supra* note 43, at 84 (“[T]he SEC WBP [is] explicitly designed to elicit *inside* information about public harms.” (emphasis added)); Casey & Niblett, *supra* note 43, at 1189 (“Whistleblowing laws are enacted with the express purpose of inducing parties with *private* information about socially costly dishonest or illegal behavior to come forward to the poorly informed government.” (emphasis added)); Baer, *Reconceptualizing*, *supra* note 43 (analysis of the WBP focusing exclusively on insiders); Rodrigues, *supra* note 43, at 299–303 (same); Pacella, *supra* note 43 (same); Skinner, *supra* note 43 (same); Rapp, *supra* note 43 (same). *But see* Rose, *Better Bounty Hunting*, *supra* note 43, at 1238, 1287 (analysis of the WBP program that recognizes that outsiders can also recover bounties); Yehonatan Givati, *Of Snitches and Riches: Optimal IRS and SEC Whistleblower Awards*, 55 HARV. J. ON LEGIS. 105, 119 (2018) (same).

300. See, e.g., Kara Scannell, *SEC Turns Whistleblower Tips into Cases*, FIN. TIMES (Mar. 12, 2012), <https://www.ft.com/content/15e5a89c-6a27-11e1-b54f-00144feabdc0> (last visited Sept. 16, 2024) (“The whistleblowers range from former employees, insiders who may have some involvement in the alleged wrongdoing, and those who observe it but aren’t involved, lawyers familiar with the tips say.”); Edward Wyatt, *Overcoming Dissenters, S.E.C. Adopts Revised Whistle-Blower Rules*, N.Y. TIMES (May 26, 2011, 7:52 PM), <https://archive.nytimes.com/query.nytimes.com/gst/fullpage-9E00E0DC133AF935A15756C0A9679D8B63.html> [<https://perma.cc/Q2R4-Z9PU>] (quoting SEC Chair explaining that the whistleblower program allows agency “to leverage the resources of people who may have first-hand information about potential violations” and providing no clarification that second-hand information may also qualify for a bounty). *But see* Sun, *Whistleblowers Worry*, *supra* note 287 (“The cash-for-tips program has attracted tips from company insiders as well as outside experts who scrutinize corporate filings, such as forensic accountants and Wall Street analysts.”); Andrew Tangel, *SEC Whistle-Blower Program Paying Off for Agency, Tipsters*, L.A. TIMES (Aug. 22, 2012), <https://www.latimes.com/archives/la-xpm-2012-aug-22-la-fi-sec-whistleblower-20120822-story.html> [<https://perma.cc/U6JJ-A5EQ>] (“And it’s not just insiders who are eligible—short-sellers, who bet against stocks, or other outsiders using publicly available information in their analyses can profit, too.”); Dave Michaels, *SEC Ramps Up Whistleblower Awards*, WALL ST. J. (May 4, 2020), <https://www.wsj.com/articles/sec-ramps-up-whistleblower-awards-11588614514> (last visited Sept. 8, 2024) (recognizing that the SEC has paid bounties to “people who aren’t traditional whistleblowers, such as investors who lost money to illegal schemes and later provided what the SEC said was important investigative information”); Ameet Sachdev, *SEC Whetting Incentives for Whistle-Blowers*, CHI. TRIB., Aug. 28, 2011, at 2.4 (“The tips don’t have to come from employees. Financial analysts, academics and traders who research companies for a living could provide analysis that helps uncover fraud.”).

activist shorts, partnering with the DOJ in a sweeping investigation of the entire industry³⁰¹ and enacting restrictive new rules.³⁰²

301. See Jody Godoy, Svea Herbst-Bayliss & Chris Prentice, *Carson Block's Muddy Waters Among Short Sellers Being Probed by U.S. Justice Dept.*, REUTERS (Feb. 16, 2022, 10:26 AM), <https://www.reuters.com/business/finance/federal-prosecutors-probing-short-sellers-wsj-2022-02-16/> (last visited Sept. 8, 2024); Katia Porzecanski & Tom Schoenberg, *Vast DOJ Probe Looks at Almost 30 Short-Selling Firms and Allies*, BLOOMBERG (Feb. 4, 2022), <https://news.bloomberglaw.com/securities-law/vast-doj-probe-looks-at-almost-30-short-selling-firms-and-allies> (last visited Sept. 8, 2024); Liz Hoffman & Justin Baer, *Justice Department Targets 'Spoofing' and 'Scalping' in Short Seller Investigation*, WALL ST. J., <https://www.wsj.com/articles/justice-department-is-pursuing-wide-ranging-investigation-of-short-sellers-sources-say-11645019122> (last updated Feb. 16, 2022, 2:24 PM) (last visited Sept. 8, 2024). The investigation is ongoing, with one official telling reporters in May 2023 to expect more “activity” in the next few months. Chris Prentice, *US Action on Short-Sellers Likely in 'Next Few Months,'* REUTERS (May 24, 2023, 5:52 PM), <https://www.reuters.com/markets/us/us-action-short-sellers-likely-next-few-months-doj-official-2023-05-24/> (last visited Sept. 8, 2024); see also Tom Schoenberg, *Short Seller Andrew Left Lives in Fear of the Feds at His Door*, BLOOMBERG (July 11, 2023), <https://news.bloomberglaw.com/banking-law/short-seller-andrew-left-lives-in-fear-of-the-feds-at-his-door> (last visited Sept. 16, 2024). According to *Bloomberg*, targets of the investigation include Carson Block (Muddy Waters), Nate Anderson (Hindenburg), and Fraser Perring (Viceroy). Porzecanski & Schoenberg, *supra*. But see Hughes, *supra* note 148 (reporting in February 2023 that Anderson “hasn’t received a subpoena or a warrant and is not a current focus of the investigation”). In the summer of 2024, the well-known activist short-seller, Andrew Left was indicted by the Department of Justice and sued by the SEC for alleged market manipulation in connection with short-selling activities. *Pending Criminal Division Cases: United States v. Andrew Left*, CRIM. DIV.: U.S. DEP’T OF JUST., <https://www.justice.gov/criminal/criminal-vns/case/united-states-v-andrew-left> [<https://perma.cc/7PYG-4XEF>]. Press Release, SEC, SEC Charges Andrew Left and Citron Capital for \$20 Million Fraud Scheme (July 29, 2024), <https://www.sec.gov/newsroom/press-releases/2024-89> (last visited Sept. 7, 2024).

302. See Short Position and Short Activity Reporting by Institutional Investment Managers, 88 Fed. Reg. 75100 (Nov. 1, 2023) (to be codified at 17 C.F.R. pts. 240, 249); see also Hester M. Peirce, SEC Comm’r, Statement on Short Sale Disclosure (Oct. 13, 2023), <https://www.sec.gov/newsroom/speeches-statements/peirce-statement-short-sale-101323> (last visited Sept. 16, 2024) (warning that the rule may deter short sellers and “could be bad for the markets: unhedged risks, *more fraud*, and less liquidity” (emphasis added)); Mark T. Uyeda, SEC Comm’r, Statement on Short Position and Short Activity Reporting by Institutional Investment Managers (Oct. 13, 2023), <https://www.sec.gov/newsroom/speeches-statements/uyeda-statement-short-sale-101323> (last visited Sept. 16, 2024) (warning that the rule could “discourage short selling” including by short sellers who “identify[] companies with potential fraudulent disclosures; short sellers were among the earliest persons to identify potential problems at Enron”).

This creates some whiplash-inducing reversals. Just few months after Carson Block received a search warrant, he was awarded a fourteen million dollar bounty arising from one of his short selling campaigns. See Matthew Goldstein & Emily Flitter, *Regulators Are Looking into Whether Short Sellers Improperly Influenced Stock Prices*, N.Y. TIMES (Feb. 16, 2022), <https://www.nytimes.com/2022/02/16/business/short-selling-stock-prices.htm> (last visited Sept. 8, 2024); *supra* section II.B.1; see also Real Vision Daily Briefing: Finance & Investing, *My Life in 4 Trades – Carson Block on Why Activist Short Sellers Are Misunderstood*, REAL VISION, at 31:00–33:00 (May 14, 2022), <https://www.realvision.com/podcast/realvision/episode/d25b165a-d1fb-11ec-88f1-d72be6895810> (last visited Sept. 16, 2024) (Block highlighting this apparent contradiction); Lead-Lag Live, *Lessons on Shorting Stocks With Carson Block*, EVERAND, at 41:00–42:15 (Aug. 15, 2022), <https://www.everand.com/podcast/654396254/Lessons-On-Shorting-Stocks-With-Carson->

But, more importantly, the significant role of outsiders in the WBP reveals a policy choice that has until now been obscure: whatever the original intentions for the program, the WBP has become a covert outsourcing program for SEC enforcement.

Unlike insiders, outsiders are being rewarded for discovering *precisely* the sort of information that could have been and often is discovered by the SEC's own staff.³⁰³ When an outsider scrutinizes public filings, interviews customers and suppliers, and looks for unusual market patterns and behaviors, they are doing the same work that thousands of civil servants are hired, trained, and paid to do. Similarly, when outsiders draft and share legal analyses, witness lists, and other litigation documents with the SEC to aid in public enforcement, they are doing precisely the same work that can be, and often is, done by public employees. In this way, the SEC's increasing reliance on outsider tipsters has partially transformed the WBP into a program to privatize public investigation and enforcement.

To make the point concrete, consider the following: From FY 2020–2022, the SEC allocated \$215 million to pay private actors to perform the same kind of investigatory and enforcement work that might have otherwise been done by its own staff. That amount is equal to about twelve

Block (last visited Sept. 8, 2024) (same). After one short attack, the SEC investigated David Einhorn for possible market manipulation; after another, they paid him a bounty. *See* Lindgren, *The Confidence Man*, *supra* note 181; *supra* section III.B.4. After Kyle Bass accused United Development Funding of operating a Ponzi Scheme, the SEC's first response was to open an investigation into Bass for market manipulation; now the agency seems poised to issue a bounty to Bass for his work on the very same case. *See* Dave Michaels & Aruna Viswanatha, *Investor's Attack on Texas Real-Estate Lender Boomerangs*, WALL ST. J. (June 14, 2020), <https://www.wsj.com/articles/investors-attack-on-texas-real-estate-lender-boomerangs-11592157950> (last visited Sept. 8, 2024); *supra* section III.B.3. Indeed, virtually all of the activist shorts listed above have been subject to investigations by the SEC and/or other securities regulators. Porzecanski & Schoenberg, *supra* note 301 (listing Block, Anderson, and Perring as subjects of the DOJ/SEC crackdown on activist shorts). *But see* Hughes, *supra* note 148 (reporting in February 2023 that Anderson "hasn't received a subpoena or a warrant and is not a current focus of the investigation"); Celarier, *Master of Destruction*, *supra* note 194 (discussing FBI investigation of Cohodes); John O'Donnell, *Germany's Long, Lonely Campaign: Battling Wirecard's Short Sellers*, REUTERS, <https://www.reuters.com/article/idUSKCN24H0JL/> (last updated July 15, 2020, 10:22 PM) (last visited Sept. 8, 2024) (discussing German securities regulator's investigation of Perring); Steinberg, *supra* note 231 (discussing SEC prosecution of Cuban for insider trading); Baer, *Short Sellers*, *supra* note 241 (discussing SEC investigation of Mathews); Jonathan Marino, *Bill Ackman Has Little to Fear from the Herbalife Stock-Manipulation Investigation, Experts Say—At Least for Now*, BUS. INSIDER (Mar. 19, 2015), <https://www.businessinsider.com/bill-ackman-herbalife-stock-manipulation-investigation-2015-3> (last visited Sept. 16, 2024) (discussing government investigation of Ackman for manipulation related to Herbalife); Livesey, *supra* note 222 (discussing British Columbia securities regulator investigation of Jon Carnes).

303. John Foley, *Uncle Sam Cleverly Goes Long on Short Sellers*, REUTERS (Nov. 15, 2023, 2:52 PM), <https://www.reuters.com/breakingviews/uncle-sam-cleverly-goes-long-short-sellers-2023-11-15/> (last visited Sept. 8, 2024).

percent of the agency's enforcement budget during that same period.³⁰⁴ This points to a policy question that has yet to be asked, much less answered: Would we have been better off if the SEC spent that same money to expand its own enforcement resources rather than to pay private professionals to do the work?

Section A evaluates the impact on efficiency, asking whether the SEC has likely deterred more (or less) fraud by allocating public resources towards *private* fraud detection. Section B evaluates the impact on program accountability. I find reasons for concern across both.

A. *Efficiency Deficits*

A core objective of SEC enforcement is to deter securities law violations.³⁰⁵ The level of deterrence is a function (among other things) of the probabilities of (1) detection and (2) conviction.³⁰⁶ All else equal, privatization in this context should be pursued if and only if the government can “buy” more deterrence on the private market than it could get by spending the same money on public government employees.

This Section argues that the SEC's payment of outsider tipsters may not “buy” more detection or a higher probability of conviction than the SEC could receive by allocating those funds internally to hire, train, and supervise more SEC enforcement staff to do this work.

304. I divide \$215 million by the sum of the actual enforcement budgets disclosed in annual congressional budget justifications for fiscal years 2020, 2021, and 2022. *See* FY 2024 SEC CONG. BUDGET JUSTIFICATION & FY 2022 ANN. PERFORMANCE REP. 14 (2024) (stating FY 2022 actual enforcement budget of \$644,719,000); FY 2023 SEC CONG. BUDGET JUSTIFICATION & FY 2021 ANN. PERFORMANCE REP. 18 (2023) (stating FY 2021 actual enforcement budget of \$627,556,000); FY 2022 SEC CONG. BUDGET JUSTIFICATION & FY 2020 ANN. PERFORMANCE REP. 16 (2022) (stating FY 2020 actual enforcement budget of \$588,530,000).

305. *E.g.*, Gary Gensler, Chair, SEC, Prepared Remarks at the Securities Enforcement Forum (Nov. 4, 2021), <https://www.sec.gov/newsroom/speeches-statements/gensler-securities-enforcement-forum-20211104> (last visited Sept. 8, 2024) (“It is critical that our enforcement program have tremendous breadth, be nimble, and penalize bad actors so we discourage misconduct before it happens.”); Press Release, SEC, SEC Announces Enforcement Results for FY22 (Nov. 15, 2022) (quoting Gurbir S. Grewal, Director of the Division of Enforcement), <https://www.sec.gov/newsroom/press-releases/2022-206> (last visited Sept. 7, 2024) (“[T]he Enforcement Division is working with a sense of urgency to protect investors, hold wrongdoers accountable and deter future misconduct in our financial markets.”). *But see* Rose, *Better Bounty*, *supra* note 43, at 1275 (noting that “detering securities fraud is desirable only insofar as it operates to enhance overall social welfare—that is, only to the extent that the benefits of increased deterrence exceed the costs of the legal regime”).

306. *Cf.* Alex Raskolnikov, *Deterrence Theory: Key Findings and Challenges*, in THE CAMBRIDGE HANDBOOK OF COMPLIANCE 182 (Benjamin van Rooij & D. Daniel Sokol eds., 2021) (“The standard response to the problem of imperfect detection is to increase the nominal (that is, statutory) sanction by the so-called multiplier, making sure that the expected sanction equals the act's external harm.”).

1. *Paying Outsiders May Not Increase The Probability of Detection*

Both activist short selling and the WBP are understood to increase the probability of detection through the same channel: Each provides financial incentives for actors to bring forward information about misconduct that might otherwise have remained hidden.³⁰⁷ But, when the two institutions cross over, problems arise. It seems questionable whether the prospect of an SEC financial bounty causes activist shorts (or other types of outsider tipsters) to bring forward new information beyond what the prospect of trading profits already induces. This is in contrast with insiders, for whom the prospect of a whistleblower bounty provides a key incentive to bring the information forward. These tipsters likely do not have another lawful way to profit from sharing such information because insider trading rules prohibit them from trading on the information or selling it to others.

Outsiders, by contrast, are not bound by those restrictions and may already be well-incentivized to bring the information to the market. For instance, they may be able to sell or short the stock and earn trading profits from the information. They may be able to sell the information to others. By comparison, the prospect of a whistleblower bounty may simply be too remote to move the needle. Although some whistleblower bounties have been large,³⁰⁸ the probability of actually getting one remains extremely remote³⁰⁹ and is shaped by factors outside the tipster's control or knowledge.³¹⁰ In many cases, market profits may be far more reliable.³¹¹

Many outsider tipsters have confirmed as much. One prominent activist short recently told an interviewer that, because of the low probability, lengthy delays, and uncertainties associated with the WBP, "it's not a

307. See Rose, *Better Bounty*, *supra* note 43, at 1275–76 ("The assumption underlying the WBP is that the lure of financial reward, as well as the promise of confidentiality and strong retaliation protection, will alter the internal cost-benefit calculation a potential whistleblower engages in when deciding whether to report wrongdoing or remain silent.").

308. *E.g.*, *Whistleblower Awards*, SEC, <https://www.sec.gov/page/whistleblower-100million> (last visited Aug. 4, 2024) (listing the largest ten awards in program history, which include three awards larger than fifty million dollars).

309. See, *e.g.*, Barron's Live, *supra* note 132, at 44:08–20 (discussing the WBP: "It's still like buying a lottery ticket. Ok. It's better than buying a lottery ticket in terms of your odds. But it's still really stacked against you in terms of the odds that you'll get an award").

310. *Id.* at 45:12–38 ("If you've identified a good company, and you've laid the case out the right way, then you depend on the SEC actually doing something and being able to get a sizable enough settlement from the company such that you can get paid on your claim. And it's years. It's always going to be years at best before you get paid.").

311. *Supra* section I.B (collecting studies showing that activist short seller strategy can produce financial returns over the short, medium, and long terms).

viable business.”³¹² Activist shorts confirmed that they often will “throw in” a tip just before running a report because of the very low marginal costs of doing so, but that the prospect of a bounty is too remote to shape their behavior.³¹³ The same is true for analysts: Harry Markopolos—the outsider tipster whose work uncovering the Madoff fraud helped inspire the WBP—has expressed frustration with the WBP and told a reporter that “his failure to collect from the SEC is the reason he teamed up with a hedge fund in his GE critique.”³¹⁴ Thus, for outsiders, the incentive provided by the trading profits may plausibly be doing all of the work in many cases.³¹⁵

Issuing bounties to an outsider tipster who would have brought the information forward to the public even without the prospect of an SEC bounty does nothing to improve deterrence. The SEC would have had access to the same information, just like everyone else. The “bounty” in this situation is merely a windfall for the recipient.

Some may object that supra-compensatory bounties are warranted here because a professional outsider tipster likely has to invest many hours and resources investigating a whole array of potential leads, and may also need to file multiple tips, in order to get a single bounty. The argument is that, to induce private professionals to do this work, the SEC has to provide a sufficient incentive, given the low probability of a bounty award.

But this argument fails for the reason already given. Issuing a bounty—large or small—to an outsider tipster who was already sufficiently incentivized to bring the information forward in a short seller report does not serve the deterrent goals of the SEC enforcement program.

To be clear: Nothing here questions the social value of the work outsiders do to detect fraud. I do not doubt the benefits of activist short selling, deny that activist short selling is costly and risky,³¹⁶ or reject the

312. Barron’s Live, *supra* note 132, at 45:30–40 (stating that, “as a short seller” you “might as well do it”).

313. Interviews of anonymous activist short sellers by author (interview notes on file with author).

314. Alpert, *supra* note 286.

315. The point is general and is not intended to describe any of the specific cases I discuss above. Working with the SEC may also be something activist shorts do for non-pecuniary reasons—including both improving their reputations and doing the right thing. *E.g.*, Weinstein, *supra* note 45 (“For some short sellers, tipping the SEC fits into their self-image of the good-guy role they play in the markets: you can stop fraud and make money at the same time. ‘Your job is to convince people,’ [Carson] Block said. ‘When you succeed in doing that, and ultimately when there’s is some sort of judicial resolution that ratifies it, yeah, it’s really satisfying.’”). But this is only further reason to doubt that a financial bounty is useful to induce this kind of cooperation.

316. See Bliss, Molk, & Partnoy, *supra* note 44, at 1376–78; Real Vision Daily Briefing, *supra* note 302, at 29:00–30:00; see also, *e.g.*, Yun Li, *Bill Ackman Is Done with Activist Short-Selling, will Focus On Quieter, Long-Term Approach*, CNBC (Mar. 29, 2022),

idea of some public subsidy for activist shorts' activities.³¹⁷ Similarly, I agree that actions by the SEC or other government agencies to curtail the activities of activist shorts should be viewed with skepticism. Nor is the argument here that there is inherently something wrong with “double dipping”—if the availability of a prospective second “dip” provided a meaningful incentive that led to more significant information being brought forward, there would be no reason to stop it.³¹⁸ Rather, the concern is that the longshot of receiving a WBP bounty may not provide any marginal incentive to bring information forward and therefore that money could be better spent elsewhere—either on staffing up the SEC or paying more to insider tipsters.

But there are exceptions to this logic. This argument only holds in cases where private profits are readily available. Outsiders who identify frauds by entities other than public companies (e.g., Madoff-style Ponzi schemes, private company frauds, etc.) may lack reasonable opportunities to trade on or sell this information for a profit. Further, some outsiders who identify public company frauds may lack the resources or ability to take advantage of market incentives to bring that information forward. In these cases, the prospect of an SEC bounty *does* likely provide an important incentive and reasonably may be thought to bring information forward that might otherwise have remained hidden.

Still, even for this subset of cases, the key question is not just whether the SEC is buying *any* deterrence (it clearly is) but whether it is buying *more* deterrence than it could get from spending the money on public enforcers or insider tipsters. Instead of paying bounties to the private outsiders who identify Ponzi schemes, the SEC could use the money to hire, train, and pay a team of Ponzi scheme specialists to staff the SEC. Instead of paying bounties to outsiders who identify un-shortable private company frauds, the agency could establish a unit devoted to the investigation of private companies. As noted above, in recent years, the SEC has spent an amount equal to about twelve percent of the agency's total enforcement budget on compensating private bounty hunters for their work. It is not obvious that the SEC is getting more deterrent “bang” for

<https://www.cnbc.com/2022/03/29/bill-ackman-is-done-with-activist-short-selling-will-focus-on-quieter-long-term-approach.html> [<https://perma.cc/R8UY-F44H>]; The Wolf Den, *Episode 3*, *supra* note 130 (interview with Jon Carnes, explaining why he has given up activist short selling); *cf. supra* section III.B.14 (discussing Ackman's catastrophic failed short against Herbalife).

317. *Cf.* Bliss, Molk, & Partnoy, *supra* note 44, at 1341, 1385 (calling on the SEC to “subsidize” activist short selling); Barron's Live, *supra* note 132, at 42:57–43:03 (arguing that the SEC should be more “open” to paying whistleblower awards to activist shorts because “short sellers often lose money on our shorts”).

318. *Cf.* Hornblower, *supra* note 45, at 318–19 (encouraging the SEC to allow such “double-dipping”).

its buck by allocating this money to outsiders than it might have gotten by hiring, training, and supervising a team of expert government enforcers and investigators.

There is one more key exception: Outsiders can play a valuable role in the WBP by drawing *more* insiders to participate in the program. Outsiders can eliminate a roadblock that has plagued the WBP since its inception—the lengthy delays and uncertainty that may discourage some of the best insider tipsters from coming forward. For insiders, whistleblowing can bring enormous professional and personal risk. The WBP is meant to offset that risk and motivate these individuals to come forward with actionable information about securities fraud. But tipsters’ prospects of winning a bounty in any case are very low—through September 2021, the SEC issued awards to just one out of every 242 tips it received.³¹⁹ And, even those who win awards have to wait for the investigation and enforcement process, and then an additional period for the SEC to solicit, consider, and rule on applications for whistleblower awards—a process that typically takes many years. The low probability of a payout and the long delay may discourage some insider tipsters from participating. The ability to partner with outsiders can mitigate those delays and uncertainties. Such partnerships potentially enable a whistleblower to obtain some kind of compensation immediately (such as a share of the trading profits, indemnification against retaliation by their employer, legal fees, or otherwise), while still providing cooperation and information to the SEC.

For instance, in the Nikola case discussed above, the whistleblowers with direct knowledge of the fraud partnered with an activist short and thus “were able to participate with some of the profits that were made.”³²⁰ This gave them “some profit *right at the beginning*.”³²¹ According to the whistleblower lawyer involved in that case, this was “important” because “being a whistleblower is extremely hard,” “takes a long time,” and is “a very slow, long, frustrating process.”³²² As such, “a benefit . . . is that being able to participate with [activist short] Hindenberg enabled my guys to get a little bit of income in the front end . . . enough to kind of pay their bills and . . . [avoid any] difficult situations financially.”³²³ Thus, by

319. Platt, *WBIC*, *supra* note 43, at 691.

320. FRAUD IN AMERICA, *supra* note 165, at 32:25–35.

321. *Id.* at 32:25–45.

322. *Id.* at 32:45–33:38.

323. *Id.* at 33:44–34:10.

partnering with insiders, activist shorts may overcome the delay and uncertainty that has impaired the WBP to date.³²⁴

The key limit for such insider-outsider partnerships comes from the insider trading rules, which sharply limit insiders' ability to share information about fraud with outsiders in exchange for any kind of personal benefit, as well as the ability of outsiders to trade on that information.³²⁵

2. *Paying Outsiders May Not Increase the Probability of Conviction*

Outsiders might also enhance deterrence by supporting the SEC's efforts to effectively prosecute targets after they have been identified.³²⁶ The evidence above suggests that these outsider tipsters represent a well-resourced, sophisticated, and effective new ally for SEC enforcement.³²⁷ They supply the SEC with detailed legal and financial analysis of potential claims (prepared by expert researchers and outside counsel, with whom the activist shorts often have a repeat-player relationship); finance the preparation of reports by independent experts that the government can use in building its case; and finance the preparation of litigation documents for the SEC to adapt into its own legal filings.³²⁸

Although this amounts to an unquestionable efficiency gain to the SEC's efforts to hold targets accountable, there is reason to worry that the SEC is *overpaying* for these services. Performing legal analysis and drafting litigation documents are core competencies of the SEC's own staff. Is it possible that the SEC could have bought *more* deterrence by spending \$271 million to hire, train, and supervise more in-house attorneys and experts to work in the public interest?

Further, as the SEC comes to depend on these highly polished tips that present a relatively complete case on a silver platter,³²⁹ insider tipsters may be crowded out of the program. Outsiders are likely in a better

324. As discussed above, however, the limit here is insider trading rules, which prevent at least some types of insiders from receiving at least some kinds of benefits in exchange for their information. See *supra* section II.B; cf. Macey, *supra* note 124, at 1915.

325. See *supra* section II.B.2.

326. Cf. Rose, *Better Bounty*, *supra* note 43, at 1280 ("Apart from its impact on the probability and timing of detection, the WBP might also increase deterrence by raising the expected costs a fraudster faces if detected . . . The WBP now gives tipsters (and their contingency-fee lawyers) a strong financial stake in monitoring and encouraging SEC follow-through.")

327. See *supra* Part III.

328. One anonymous short seller stated that he had financed the research, drafting, and direct submission of a legal brief responding in detail to the legal points made in a Wells submission from the target of an SEC investigation and that the SEC welcomed this legal assistance. Interviews of anonymous activist short sellers by author (interview notes on file with author).

329. See Platt, *WBIC*, *supra* note 43, at 715.

position to finance the production of these tips because they are well-resourced, repeat players, often with useful connections.³³⁰ They can afford to hire experts, investigators, and other intermediaries to validate the information they submit. They may have repeat relationships with top-performing well-connected whistleblower lawyers—or even inside the SEC directly. For a busy SEC enforcement attorney, a highly polished and well-packaged tip from an activist short is likely to be very attractive.³³¹ But this may create a kind of “arms race” in the amount of resources invested in preparing tips *ex ante* that puts insider tipsters at a systematic disadvantage in the competition to win attention from SEC enforcers. Even sophisticated well-counseled insiders may not be able to compete with the kind of deep financing that activist shorts can afford to invest in preparation of their submissions. Less sophisticated, less well-counseled, one-off insider tipsters cannot hope to do so. The net result may be that activist short participation may crowd out the less polished, but no less intrinsically valuable, insider tips.³³² Chilling participation in the WBP by insiders may undermine deterrence.

The preceding analysis has implicitly assumed that the SEC *could* reallocate the money it currently spends on private outside whistleblowers to bolster its own SEC enforcement staff. This assumption is useful to cast in sharp relief the policy choice the SEC has made over the preceding years to privatize the administration of the WBP.

But the assumption is unrealistic. The SEC is not legally permitted to reallocate funds from the whistleblower bounty fund to hire more enforcement staff.³³³ Although Congress could relax these constraints and

330. *Cf. id.* at 720–32 (documenting apparent outperformance of tips submitted by well-connected, repeat-player whistleblower lawyers).

331. Barron’s Live, *supra* note 132, at 44:50–45:18 (statement of Carson Block) (“You have to be able to hand a case to the SEC where they can follow the roadmap, because, god knows, I mean these are government attorneys. . . . They’re not going to do the equivalent of, you know, 2,500 billable hours a year that private sector attorneys do And they don’t have a lot of money at their disposal to investigate. So, you have to really hand them these things with a clear roadmap—and basically on a silver platter.”).

332. There is currently no way to directly test this hypothesis unfortunately, because SEC has recently curtailed the (already meager) information it releases each year regarding the participation by outsiders and insiders. *See infra* section V.A.2.

Further, since insiders face legal and practical restrictions in making such profits that outsiders do not, paying bounties to activist shorts means those actors receive significantly greater potential total compensation from any tip than insiders do. Thus, the WBP may be over-incentivizing outsiders and under-incentivizing insiders.

333. Although both whistleblower bounties and the SEC’s enforcement staff are paid out of the U.S. Treasury, the funds come through distinct appropriations. *Compare* 15 U.S.C. § 78u-6(g) (establishing “in the Treasury of the United States” a fund for the SEC to use to pay whistleblower

change the law to allow the SEC to spend funds currently earmarked exclusively for whistleblower bounties on expanding the capabilities of its own enforcement staff, it seems practically unlikely that Congress would do this given the aforementioned deep entrenchment of privatization.³³⁴

In this more realistic light, the efficiency effects of professional outsider involvement in the WBP may seem far more benign. It may still be true that the SEC is making some number of windfall payments that provide no added incentive effect to professional outsiders who would have brought the information forward regardless of such payments. It may also be true that the SEC is still vastly overpaying some of these actors for basic legal services that could have been performed far more cheaply by government employees. But so what? A hundred million misspent is hardly worth mentioning on the scale of the federal budget of over six trillion dollars. And given that at least *some* of the bounty money going to professional outsiders *is* well spent, that may well provide all the justification needed to leave the status quo alone.

But, even so, there is still reason to worry that professional outsiders' rise in the WBP undermines the core value of democratic accountability that is embedded in SEC enforcement.

B. *Accountability Deficits*

Efficiency is not the only value implicated by privatization programs. A core value embedded in the SEC's enforcement program is democratic accountability. The division's priorities are shaped by agency leaders who are ultimately held accountable by the President, Congress, the press, and the public. This accountability is enabled by a host of transparency and disclosure obligations and norms: annual reports,³³⁵ FOIA requests,³³⁶ a publicly available enforcement manual describing the agency's practices

bounties, providing for the SEC to deposit into the fund monetary sanctions it collects in enforcement actions until the fund's balance reaches \$300 million), *with* Consolidated Appropriations Act, 2023, Pub. L. No. 117-328, § 2, 136 Stat. 4459, 4692–93 (2022) (appropriating \$2.1 billion for FY 2023 SEC operations).

334. *See supra* note 30.

335. *E.g.*, Press Release, SEC, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234> (last visited Sept. 7, 2024); *see also* Urksa Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901 (2016).

336. *E.g.*, Platt, *WBIC*, *supra* note 43.

and procedures,³³⁷ regular public speeches by agency leaders setting enforcement priorities,³³⁸ and congressional oversight.³³⁹

Accountability for SEC enforcement is also ensured by a host of special, heightened procedural restrictions and limits that apply to SEC enforcers' investigatory and enforcement activities. Targets of such actions ordinarily enjoy a variety of legal protections such as a right to receive (and legally contest) subpoenas for documents,³⁴⁰ a right to receive (and legally contest) subpoenas compelling testimony before having testimony taken,³⁴¹ a right to be notified before certain conversations are recorded,³⁴² a right against self-incrimination,³⁴³ a right to counsel,³⁴⁴ and a right to receive exculpatory information in the government's possession.³⁴⁵ Further, investigators may be required to adhere to various procedures and standards of conduct as articulated in agency statutes and regulations, ethics rules,³⁴⁶ enforcement manuals,³⁴⁷ and other internal guidance documents. A failure to adhere to these rights, procedures, and standards may result in problems for the investigation, discipline for the government investigators, or other consequences.

Accountability is further enhanced by the civil service system. The system operates to protect and promote the quality and independence of the people who wield the power and discretion of the federal government. It helps ensure, for instance, that these civil servants do not exploit their positions to further personal private interests at the expense of the public whom they are serving.³⁴⁸

337. DIV. OF ENF'T, SEC, ENFORCEMENT MANUAL (2017); *see also* JORDAN LEE PERKINS, REGULATORY ENFORCEMENT MANUALS: REPORT FOR THE ADMINISTRATIVE CONFERENCE OF THE UNITED STATES (2022).

338. *See, e.g.*, Speeches and Statements of Gurbir Grewal, Dir., Div. of Enf't, SEC, <https://www.sec.gov/news/speeches-statements> (search "Speakers" field for "Gurbir S. Grewal") (last visited Aug. 5, 2024).

339. *See* Gurbir S. Grewal, Dir., Div. of Enf't, SEC, Testimony on "Oversight of the SEC's Division of Enforcement" Before the House Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets (July 21, 2022), <https://www.sec.gov/newsroom/speeches-statements/grewal-statement-house-testimony-071922> (last visited Sept. 16, 2024).

340. *See, e.g.*, 17 C.F.R. §§ 201.150(b)–(d), 201.232(c), (e), 203.8 (2024).

341. *Id.*

342. *See, e.g.*, DIV. OF ENF'T, SEC, *supra* note 337, at 61 (Voluntary Telephone Interviews).

343. *See, e.g., id.* at 73 (The Fifth Amendment Privilege Against Self-Incrimination).

344. *See, e.g., id.* at 64 (Witness Right to Counsel); 17 C.F.R. § 203.7(b) (2024).

345. *See, e.g.*, Brady v. Maryland, 373 U.S. 83, 87 (1963) (holding that "suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment").

346. *See* DIV. OF ENF'T, SEC, *supra* note 337, at 2.

347. *E.g.*, SEC ENFORCEMENT MANUAL, *supra* note 337.

348. Jon D. Michaels, *The American Deep State*, 93 NOTRE DAME L. REV. 1653 (2018).

Unfortunately, all of these mechanisms and dimensions of public accountability have been compromised by the SEC's outsourcing of investigation and enforcement functions through the WBP. Scholars of privatization have often warned that replacing public officials with private actors performing public functions can weaken various institutions of democratic accountability,³⁴⁹ and at least some of those concerns seems to be borne out in this context.³⁵⁰

1. *Transparency Deficit*

Scholars have repeatedly warned about the transparency deficits that arise in the context of privatization programs.³⁵¹ Those concerns seem to be warranted here. The WBP has always been secretive, but has become even more so recently.³⁵² Strikingly, the SEC does not disclose *anything* about the outsider tipsters it pays—even ones who have been publicly identified with outing the underlying fraudsters.³⁵³ Indeed, as of FY 2022, the SEC even stopped disclosing the proportion of awards going to insider and outsider tipsters.³⁵⁴ The resulting secrecy impedes the ordinary forces of accountability that keep the SEC's enforcement program in check.

2. *Circumventing Legal Guardrails*

Scholars also warn that privatization programs often circumvent or otherwise challenge established constitutional and legal guardrails.³⁵⁵ Again, this concern seems borne out in the WBP. The investigations

349. See PAUL R. VERKUIL, *OUTSOURCING SOVEREIGNTY: WHY PRIVATIZATION OF GOVERNMENT FUNCTIONS THREATENS DEMOCRACY AND WHAT WE CAN DO ABOUT IT* 4 (2007); Jack M. Beermann, *Privatization and Political Accountability*, 28 *FORDHAM URB. L.J.* 1507, 1525–26 (2001).

350. The focus here is on how activist short participation tends to undercut the existing accountability guardrails for SEC enforcement. The suggestion is not that activist shorts operate without sufficient forms of accountability in general.

351. See Alfred C. Aman, Jr. & Landyn Wm. Rookard, *Private Government and the Transparency Deficit*, 71 *ADMIN. L. REV.* 437 (2019).

352. E.g., Riann Winget, *Is the SEC Hiding in Plain Sight?*, *REGUL. REV.* (Nov. 28, 2023), <https://www.theregview.org/2023/11/28/winget-is-the-sec-hiding-in-plain-sight/> [<https://perma.cc/7NJB-UHSM>].

353. On the other hand, it is possible that some activist shorts would prefer *not* to be publicly identified as cooperating with the government to preserve their reputation as outsider outlaw cowboys. *Supra* sections III.B.1, 3–4.

354. Platt, *Going Dark(er)*, *supra* note 64, at 67.

355. See Huq, *supra* note 47; Michaels & Noll, *supra* note 47; Gillian E. Metzger, *Privatization as Delegation*, 103 *COLUM. L. REV.* 1367 (2003); David S. Rubenstein, *Supremacy, Inc.*, 67 *UCLA L. REV.* 1130 (2020); Alfred C. Aman, Jr., *Privatization and Democracy: Resources in Administrative Law*, in *GOVERNMENT BY CONTRACT* 261 (Jody Freeman & Martha Minow eds., 2009); Nina A. Mendelson, *Six Simple Steps to Increase Contractor Accountability*, in *GOVERNMENT BY CONTRACT*, *supra*, at 241.

conducted by outsiders are exempted from the constitutional, legal, and procedural restrictions and limits that keep public enforcers in check. Outsiders can and do conduct extensive on the ground investigations of their targets, go undercover, pay off or deceive insiders, record conversations, obtain confidential documents and more—all without adhering to the constitutional and legal restrictions that apply to government investigators.³⁵⁶ One might wonder whether some of these legal protections ought to apply, notwithstanding the nominal “private” status of the individuals conducting the investigation.³⁵⁷

3. *Regulatory Capture*

Finally, scholars have repeatedly warned that privatization may facilitate “regulatory capture”—in which the regulator becomes dependent on and subservient to the interests of the individuals it is supposed to regulate.³⁵⁸ Those concerns seem to be worth worrying about here, too. Although the SEC still retains the sole authority to set priorities and select *which* tips to pursue, outsourcing opens a new channel for sophisticated investors to influence this priority-setting. As SEC enforcers come to depend on the many polished tips from highly resourced, repeat-player outsiders, the agency’s enforcement priorities may gravitate towards the particular kind of cases that outsiders have an interest in bringing.³⁵⁹

Replacing civil servants with private bounty hunters also invites the prospect that the public enforcement process will be abused for the private benefits of those outside actors. For instance, outsiders may find ways to turn the SEC enforcement process into one or more tradable events. In other words, outsiders may “triple dip” by potentially benefiting from the same information three times: (1) trading around the disclosure of the

356. *Supra* note 63

357. See Platt, *WBIC*, *supra* note 43, at 738–41; Christopher A. Brown, Note, *Why Whistleblowing Walter May Be Helping the SEC Violate the Fourth Amendment*, 49 J. CORP. L. 167 (2023). On the other hand, one might also wonder whether this phenomenon (SEC outsourcing investigations to sophisticated private outsiders) provides an indication that large corporations facing administrative investigations have *too much* procedural protection under current law.

358. *E.g.*, Beermann, *supra* note 349, at 1529, 1537; PAUL C. LIGHT, *THE GOVERNMENT-INDUSTRIAL COMPLEX: THE TRUE SIZE OF THE FEDERAL GOVERNMENT, 1984–2018* 117–18 (2019).

359. *Cf.* Rose, *Better Bounty*, *supra* note 43, at 1283 (raising the possibility that SEC enforcement priorities may be distorted by a desire to create large bounties: “If culpable individuals cannot pay sufficiently high fines to sustain attractive bounty payments, the SEC may be tempted to impose sanctions on their more deep-pocketed corporate employers”); Urska Velikonja, *How Fair Funds Changed Public Compensation and Strengthened SEC Enforcement*, 78 BUS. LAW. 667 (2023) (describing fundamental changes to orientation of the SEC enforcement program caused by 2002 legislation giving SEC authority to compensate injured investors).

fraud; (2) receiving a public bounty; and (3) trading around the disclosure of the government investigation.

V. RECOMMENDATIONS

Even if it wanted to, the SEC cannot currently reallocate funds away from the WBP to expand the capabilities of its own professional staff.³⁶⁰ Accepting this reality, this Part offers some moderate reforms to the status quo, aiming to ensure that the SEC pays private professional outsider tipsters in a manner that more effectively mitigates the efficiency and accountability concerns detailed above.

A. *Reforming the SEC Whistleblower Program*

1. *The SEC Should Account for Trading Profits When Determining Whistleblower Bounties*

Ideally, the SEC would issue awards only to tipsters who were actually motivated to bring forward the information by the prospect of such an award. Rewarding individuals who would have brought the information forward even without the prospect of a bounty constitutes a windfall and does not enhance deterrence. But the counterfactual is not observable; it is not possible to directly see what an individual would have done in the absence of the WBP.

As a second-best approximation, the SEC may consider adopting a new rule for whistleblower claims with two requirements. First, this rule would require the claimant (whether insider or outsider) to disclose in their submission any private profits they have actually earned on the subject information. Second, this rule would require the SEC to account for those trading profits when determining the award.³⁶¹ As noted above, program rules already carefully limit bounty-eligibility for tipsters who receive (or seek) bounties from other whistleblower programs but are silent on the topic of private trading profits.³⁶² The idea is that, if a tipster *did* earn private profits on the information, it is likely that the prospect of those private profits played an important role in eliciting the information in the first place.

In cases where a tipster has already earned substantial trading profits, the rule could establish a presumption that the tipster receive no bounty (or a bounty at the lower end of the ten to thirty percent range) unless the

360. *Supra* note 58 (discussing specific appropriation of investor protection fund).

361. For a specific regulatory reform proposal, *see infra* Appx. A.

362. 17 C.F.R. § 240.21F-3(b)(3) (2024).

tipster can demonstrate that they provided significant additional information to the SEC beyond what was disclosed in the public activist report. Under this rule, an activist short who merely sends a copy of their public activist report to the SEC and earns trading profits on that report should earn either no bounty or a low bounty. However, an activist short who earned trading profits but also provided significant additional information to the SEC should still be entitled to the maximum award (thirty percent).

This rule would ensure that the scarce government resources allocated to the WBP are used to maximum effect—to elicit new information in support of policing and enforcing securities fraud, rather than merely giving windfalls for information that would have been produced even without payment.

To be clear, the proposal is not to “discriminate” against short sellers, or to categorically bar anyone who has engaged in short selling from participation in the program.³⁶³ Rather, the proposal is merely to incorporate information about the extent the tipster has already privately profited from the information through other channels into the SEC’s award determination.³⁶⁴

It seems likely that the SEC has legal authority to implement this proposal via rulemaking. Congress emphasized that “the determination of the amount of the award . . . shall be in the discretion of the Commission” and expressly authorized the SEC to consider any “relevant factors as the Commission may establish by rule or regulation.”³⁶⁵ As noted above, the SEC has already adopted closely related rules that require it to consider both whether the whistleblower has already won a whistleblower award from another program, as well as consider certain *costs* incurred by the whistleblower. Although an important policy change, this proposal would not constitute any categorical legal departure from the kinds of criteria that the SEC has adopted in past rulemakings.

2. *Congress Should Increase the Transparency of the Whistleblower Program*

To restore accountability to the WBP, Congress should consider modifying the statute’s strict anonymity protections to be inapplicable in

363. Cf. Weinstein, *supra* note 45 (statement of Carson Block) (“If you want the whistleblower program to be open to external whistleblowers, you have to be open to short sellers and can’t discriminate against them.”).

364. This proposal is a previously unrecognized corollary of calls for the SEC to account for the particular costs incurred by a whistleblower before setting awards. Cf. Rose, *Calculating SEC Whistleblower Awards*, *supra* note 43, at 2072–74; Givati, *supra* note 299, at 132.

365. 15 U.S.C. § 78u-6(c)(1)(A)–(c)(1)(B)(i)(IV).

cases of successful whistleblowers who have already publicly alleged wrongdoing against the subject company. In such cases, there is nothing to be gained from maintaining anonymity. On the other side, there is a public right to know how public funds are spent.

The SEC could and should go further to promote transparency in the WBP. Each year the SEC is required to issue a report to Congress on the WBP. Prior to the FY 2022 report, these reports routinely included information about the proportion of “insider” and “outsider” tipsters who received awards during the preceding year. However, this information was omitted without explanation from the most recent reports.³⁶⁶ To promote transparency, accountability, and oversight, the SEC might collect, aggregate, and annually publish data regarding the following: (a) the number and value of awards issued to insiders and outsiders; (b) the number and value of awards issued to tipsters who had either previously earned some kind of trading profits on the information or who had partnered with actors who had earned such trading profits; and (c) the extent to which the SEC reduced any awards to account for prior trading profits.³⁶⁷ This information would enable agency leaders, Congress, and the public to continue to monitor this critical intersection between two important anti-fraud institutions.³⁶⁸

Enhanced transparency could also have a beneficial secondary effect on deterrence. As noted above, sending a clear signal about which activist shorts the SEC has deemed credible may enhance deterrence. Others in the marketplace may be more inclined to listen to those activists going forward. Such activists can more easily separate themselves from the bad actors in the activist short selling space. Currently, this signal is very obscure. The SEC does not disclose the identities of even successful activist short seller whistleblowers. When an activist short receives a bounty after having already publicly attacked the target (as both Carson Block and David Einhorn did in the cases above), the cat is already out of the bag regarding the activist’s efforts to attack the target.³⁶⁹ And yet, the

366. Platt, *Going Dark(er)*, *supra* note 64; Holland, *Bass, Block*, *supra* note 155.

367. For some language Congress could add to the U.S. Code to force the SEC to do this, see *infra* Appx. B.

368. In April 2024, Senator Chuck Grassley, perhaps the single most important legislative supporter of the whistleblower program, wrote a letter to the SEC raising concerns about the program’s secrecy and asking the agency to release information regarding staffing, tips, and claims processing. Letter from Sen. Charles E. Grassley, Ranking Member, Sen. Comm. on the Budget, to Hon. Gary Gensler, Chairman, SEC (Apr. 4, 2024), https://www.grassley.senate.gov/imo/media/doc/grassley_to_sec_-_whistleblower_program.pdf [<https://perma.cc/UY4X-63G3>].

369. On the other hand, it is possible that some activist shorts would prefer *not* to be publicly identified as cooperating with the government for some reason.

public only learned about the Block and Einhorn bounties by happenstance. In Block's case, we only learned about the bounty because he was sued (unsuccessfully) for half of the bounty payment by a co-venturer; in Einhorn's case, he happened to write about the bounty in an investor letter.³⁷⁰

More transparency surrounding the participation of activist shorts would have other potentially positive effects. Classifying some activist shorts as "SEC whistleblowers" may also raise their public status and lend some additional legitimacy to this subset of controversial actors who have proven their social value in this way. Activist shorts who won whistleblower awards may be able to more easily convince investors of their theses by reminding them that the SEC previously recognized their contribution to an investigation with a sizable bounty payment. It may also help insulate activist shorts from regulatory and legal attacks going forward. One activist short focused on Chinese companies explained: "One thing that's very helpful for us in protecting ourselves is if these Chinese companies think the SEC is listening to us."³⁷¹

B. *Reforming Insider Trading Rules*

While outsiders may enhance the deterrent power of SEC enforcement by partnering with insiders to elicit new information about securities fraud,³⁷² insider trading law stands as an obstacle to that beneficial effect. Scholars have long argued that a prohibition on insider trading chills socially valuable disclosures,³⁷³ including disclosures of corporate wrongdoing.³⁷⁴ But insider trading also generates costs,³⁷⁵ and broadly licensing insider trading remains a political nonstarter.³⁷⁶

A limited compromise solution may be workable. The SEC might consider adopting a regulatory safe harbor that would define "personal

370. See *supra* section III.B.1 (Block); Complaint, *Barnes v. Block*, *supra* note 3; *supra* section III.B.4; see also Greenlight Investor Letter, *supra* note 22.

371. Donville & Lawrence, *supra* note 228.

372. See *supra* section II.B.

373. E.g., HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966); see also STEPHEN M. BAINBRIDGE, *INSIDER TRADING LAW AND POLICY* 176–89 (2014) (reviewing the case for deregulation).

374. E.g., Macey, *supra* note 124; Jerry Ellig & Hester Peirce, *SEC Regulatory Analysis: "A Long Way to Go and A Short Time to Get There,"* 8 *BROOK. J. CORP. FIN. & COM. L.* 361, 394 (2014).

375. BAINBRIDGE, *supra* note 373, at 190–206 (reviewing the case for regulation); Michael D. Guttentag, *What Inside Information is Worth and Why it Matters 1* (Loyola L. Sch. L.A., Legal Studies Paper No. 2023-26, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4588097 (last visited Sept. 16, 2024).

376. BAINBRIDGE, *supra* note 373, at 6 ("[V]irtually no one seriously believes that the federal insider trading prohibition is likely to be repealed any time soon.").

benefit” (for purposes of tipper/tippee liability) to exclude anything related to the tipper’s efforts to submit the information to the WBP or other similar authority.³⁷⁷ This would make it clear that an individual who exchanges information about corporate wrongdoing to an activist short in exchange for assistance or coordination in a WBP submission does not thereby trigger any risk of insider trading liability for either them or the activist short.

The safe harbor could also be expanded. For instance, it might exclude from the definition of “personal benefit” any indemnification or legal assistance associated with legal actions the tipper may face for disclosing the information. Insiders would still be prohibited from directly profiting on information about corporate wrongdoing—to the extent they are under current law—but they would be encouraged to bring that information to light by partnering with activist shorts in WBP submissions.

CONCLUSION

Since the global financial crisis of 2008, the WBP and activist shorts have each redefined the way corporate fraud is detected and deterred in the United States. Considered separately, these two institutions are widely regarded as socially valuable innovations. We are better off because of them. Nothing here is intended to dispute that view.

However, these two institutions are not entirely separate. Instead, activist shorts and other professional outsider tipsters have been participating effectively in the WBP. This intersection has transformed the WBP into a kind of covert privatization program wherein the SEC outsources a chunk of its investigatory and enforcement work to private professionals. If done well, with the right safeguards and best practices, privatization can improve the performance of government without compromising core values. Unfortunately, the WBP’s reliance on private professional outsiders seems to be the worst of both worlds—sacrificing both the efficiency and accountability of SEC enforcement.

The concerns raised in this paper deserve further scrutiny and transparency. Although I have attempted to pull together evidence from FOIA data, private conversations, and myriad public sources, there is still a great deal that remains hidden. A fuller accounting of activist short and outsider participation in the whistleblower program is needed.

Unfortunately, as noted above, the SEC has made this all but impossible. The WBP is extremely secretive and becoming more so. Prior to FY 2022, every annual report from the WBP included some basic

377. For a specific regulatory reform proposal, see *infra* Appx. C.

information regarding the proportion of awards issued to insiders and outsiders.³⁷⁸ Although this information was hardly sufficient to meaningfully assess the role of activist shorts and other professional outsiders, it was at least a starting place to track what the program was up to. But, in November 2022, the agency's FY 2022 report conspicuously omitted even this basic information without providing any explanation.³⁷⁹ In FY 2023, the agency once again failed to include this information.³⁸⁰ When questioned by journalists about this important omission, the agency stated that it no longer even *tracks* this information.³⁸¹

Privatization is here to stay. In all likelihood, the SEC will continue to rely on private professional outsiders to do investigation and enforcement work that might have been performed by government employees. But accepting this reality does not require giving up on demanding the privatization program adhere to basic standards of governance. A good starting place would be for the agency to resume tracking and disclosing basic information.

378. Platt, *Going Dark(er)*, *supra* note 64, at 67.

379. *Id.*

380. Holland, *SEC Payouts*, *supra* note 62.

381. *Id.* ("The agency told Bloomberg Law it doesn't track how many analysts who are not company insiders, such as short-sellers, received awards . . .").

APPENDIX A

Amend 17 C.F.R. § 240.21F-6(b) (“Factors that may decrease the amount of a whistleblower’s award”) to add the following at the end of the subsection:

(4) ***Profits from information.*** The Commission will assess whether the whistleblower already received any financial benefit from use of the same original information they provided to the SEC.

APPENDIX B

Amend 15 U.S.C. § 78u-6(g)(5) (“Reports to Congress”) as follows:

Not later than October 30 of each fiscal year beginning after July 21, 2010, the Commission shall submit to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives a report on—

(A) the whistleblower award program, established under this section, including—

- (i) a description of the number of awards granted; **and**
- (ii) the types of cases in which awards were granted during the preceding fiscal year;
- (iii) the number and value of awards issued to insiders and outsiders, respectively;**
- (iv) the number and value of awards issued to tipsters who had previously received any financial reward from use of the original information or who had partnered with actors who had earned such trading profits; and**
- (v) the extent to which the SEC reduced any whistleblower awards to account for such private profits.**

APPENDIX C

Amend 17 C.F.R § 240.10b5 to add new subsection (3):

“Safe Harbor for Whistleblowers”

Support in aid of submitting a tip to the SEC Whistleblower program shall not be considered a “personal benefit” under *Dirks v. SEC*.³⁸²

382. 463 U.S. 646 (1983).

