

Denver SPEE Ethics Presentation: Reserves, Insider Trading & Whistleblowers

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Holland & Knight

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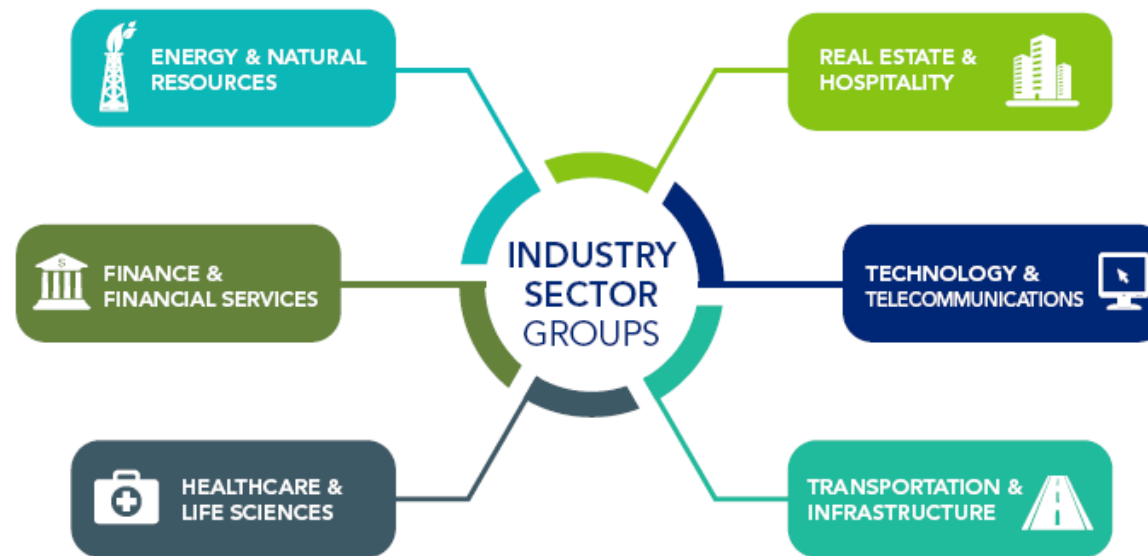
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Seth Belzley advises clients on a wide range of transactional and regulatory issues with a focus on mergers and acquisitions, joint ventures, finance, project development, and commercial transactions. Mr. Belzley's practice emphasizes the development of close, long-term, value-added relationships. His clients often turn to him first for advice relating to a wide range of issues and ask him to coordinate a team of specialists to handle their most complex matters.

Mr. Belzley has significant experience in the energy industry that includes representing clients in the pipeline, midstream, oil and gas, renewable fuels, refining, and solar industries. He has served as lead counsel on the development of several significant pipeline, processing and terminal projects in the most important energy hubs in the country. He also regularly advises buyers and sellers of energy infrastructure assets on the sale of those assets or the formation of joint ventures to develop and operate those assets.

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Shawn M. Turner is a partner in Holland & Knight's Denver office and is a member of the firm's Financial Service Practice Group. He serves as executive partner for Holland & Knight's Denver office.

Mr. Turner advises public and private companies on corporate governance matters, mergers, acquisitions, strategic transactions and investment strategies, public and private equity and debt financings, anti-takeover defenses, executive compensation and Securities and Exchange Commission compliance matters. He has represented operating companies, regulated financial institutions, family offices and one of the world's largest institutional private equity investors in a variety transactions and investment structures throughout North America, South America, Europe and Asia.

What is Material Non-public Information?

- Generally most relevant for those involved with publicly-traded companies, but also important for anyone who may learn MNPI to understand how to identify it.
- Information is “material” if there is a substantial likelihood that a reasonable investor would consider the information important in making his or her investment decisions, or information that is reasonably certain to have a substantial effect on the price of an issuer’s securities. Material information can be positive or negative and can relate to virtually any aspect of a company’s business.
- Information is “non-public” until it has been effectively communicated to the marketplace.
- Examples of MNPI?

Reserve Reporting Is Often Material

- El Paso Corp.
 - In 2004, El Paso restated financial statements to reduce proved reserves by more than 35%, which led to a decline in equity value of over \$1.7B
 - SEC charged the company and five executives with intentionally inflating reserve estimates
 - Company and executives settled with the SEC
 - Five executives, including the president of E&P group, paid substantial fines
- Miller Energy Resources
 - Company bought properties in Alaska for \$2.25M
 - Reevaluated reserves and determined properties were worth \$400M
 - Stock went from a penny stock to \$9 per share
 - SEC alleged intentional over-valuing of properties and failure of auditors to properly confirm company numbers
 - Company and executives settled; company paid fines of \$5M; executives paid fines of \$125k

Two Paths Diverge.....



Insider Trading

A Hypothetical

- Publicly-traded oil & gas company needs cash infusion.
- Share price reflects liquidity needs.
- Company negotiates with a private equity firm for PIPE transaction that will provide much-needed funds for the company.
- Before the Company publicly discloses the investment, the CEO boasts to a few friends about the great new deal that he's closing.
- Friends make trades in the company stock.

Not so Hypothetical

Denver investment firm owner settles with SEC in Delta Petroleum insider trading case

Apr 15, 2013, 5:48pm MDT Updated: Apr 16, 2013, 1:33pm MDT

Scott Reiman, 48, founder of investment firm Hexagon Inc., has agreed to pay nearly \$900,000 to settle a Securities and Exchange Commission civil case against him alleging that he made illegal trades based on insider information regarding Delta Petroleum Corp., according to an SEC filing.

To settle the SEC's charges, Reiman agreed to pay \$900,000 and be barred from the securities industry and from serving as an officer or director of a public company for at least five years, the SEC said Monday.

Reiman's attorney, Cliff Stricklin — a partner at Bryan Cave HRO who led the government's insider-trading case against former Qwest CEO Joe Nacchio when Stricklin was a federal prosecutor— said Reiman neither admitted nor denied the facts of the case in his settlement agreement.

Delta's former CEO, Roger Parker, was charged on Nov. 28, 2012, with providing insider information to at least two people about an impending \$684 million investment in Delta by Beverly Hills-based private investment firm Tracinda Corp., owned by Kirk Kerkorian.

The SEC alleged that in late 2007, Parker "conveyed material nonpublic information to Michael Van Gilder and Friend A about the impending investment." The SEC complaint didn't name "Friend A."

The SEC filed a civil complaint against Van Gilder, the former CEO of Denver-based Van Gilder Insurance Corp., on Oct. 26, 2012. In addition to the SEC's civil complaint against Van Gilder, a federal grand jury indicted him Oct. 26 on five counts of insider trading. He has pleaded not guilty to the criminal charges.



Insider Trading

- Prohibition derives from securities laws (Rule 10b-5 and Sarbanes Oxley), but there is no explicit law prohibiting insider trading.
- “Classic” insider trading involves a corporate “insider” who trades in the securities without properly disclosing MNPI – disclose or abstain.
- Misappropriation theory of insider trading extends application beyond “insiders” to those who receive information from an insider, had a duty to the insider or the corporation, and “misappropriated” the information.
- Tipper/Tippee liability extends insider trading even further to “outsiders” even if they do not have a duty to the insider or the corporation.
- Boil it all down: insider trading liability can extend to anyone who trades on the basis of MNPI.

Chiarella v. U.S., 445 U.S. 222 (1980)

- Declines to adopt an “equal access to information” standard in trading and instead, requires that a duty have been breached in connection with the trade.
- Establishes the classic theory of insider trading, which prohibits a corporate insider from trading the securities of the corporation on the basis of MNPI.
- Prohibition requires a duty arising from a “relationship of trust and confidence between shareholders ...and insiders who have obtained confidential information due to their position with [the company.]”
- When an insider trades based on MNPI that constitutes deception because the insider is using information for personal benefit in breach of duty to shareholders
- Insider must “disclose or abstain” from using MNPI.

Other Theories of Insider Trading Liability

- Misappropriation Theory: Non-insiders can also be liable for insider trading if they owed a duty to the corporation in respect of the information and misappropriated it. For example, an attorney.
- Tipper / Tippee Liability (*Dirks v. SEC*, 463 U.S. 646 (1983)):
 - Tipper obtains MNPI and passes to Tippee in breach of duty (requires benefit to the insider)
 - Tippee knew that the Tipper breached a duty (highly litigated – both knew that the disclosure was improper, and that the Tipper received a benefit)
 - Tippee trades on the basis of the MNPI
 - Tippee provides MNPI to another Tippee who trades on the information
- Penalties for insider trading are severe:
 - Fines up to three times amount gained or loss avoided
 - Imprisonment for up to 20 years and fines up to \$5 million for willful violation
 - Violations by high-level employees can lead to fines of up to \$25 million and civil lawsuits

Whistleblower

Whistleblower Rewards



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Date	Title	Release No.
NOVEMBER 2020		
Nov. 19, 2020	SEC Awards Whistleblower Over \$900,000	2020-288
Nov. 13, 2020	SEC Awards Over \$1.1 Million to Whistleblower for Independent Analysis	2020-283
Nov. 5, 2020	SEC Awards More Than \$3.6 Million and \$750,000 in Separate Whistleblower Awards	2020-278
Nov. 3, 2020	SEC Awards Over \$28 Million to Whistleblower	2020-275
OCTOBER 2020		
Oct. 29, 2020	SEC Awards Over \$10 Million to Whistleblower	2020-270
Oct. 22, 2020	SEC Issues Record \$114 Million Whistleblower Award	2020-266
Oct. 15, 2020	SEC Awards \$800,000 to Whistleblower	2020-255
SEPTEMBER 2020		
Sept. 30, 2020	SEC Whistleblower Program Ends Record-Setting Fiscal Year With Four Additional Awards	2020-240
Sept. 30, 2020	SEC Awards Almost \$30 Million to Two Insider Whistleblowers	2020-239
Sept. 28, 2020	SEC Issues \$1.8 Million Whistleblower Award to a Company Outsider	2020-231
Sept. 25, 2020	SEC Issues Two Whistleblower Awards for High-Quality Information Regarding Overseas Conduct	2020-225

Whistleblowers

- Employee raised concerns about methods being used by SandRidge Energy to determine reserves.
- SandRidge commenced but did not complete an internal audit relating to the issue, then after offering the employee a promotion, which was declined, separated the employee.
- As part of separation, SandRidge required the employee to sign an agreement prohibiting the employee from participating in any government investigation or disclosing information potentially harmful or embarrassing to the company.
- SEC charged with violating whistleblower protections
- Without admitting or denying guilt, SandRidge agreed to pay a penalty of \$1.4 million.
- This was the first time a company was charged for retaliating against an internal whistleblower, according to the Chief of the SEC's Office of the Whistleblower.

What is the SEC Whistleblower Program?

- Under the Program, eligible whistleblowers are entitled to an award of between 10% and 30% of the monetary sanctions collected in actions brought by the SEC and related actions brought by certain other regulatory and law enforcement authorities.
- Pursuant to the 2020 Amendments; however, a new rule creates a presumption that for awards where the statutory maximum of 30% is \$5 million or less, a claimant shall be entitled to the maximum award if:
 - none of the negative factors is present,
 - the claimant did not unreasonably delay in bringing the information to the SEC, and
 - the SEC does not determine within its discretion that the enhanced award is inappropriate because the claimant's contribution was limited, or it is inconsistent with the public interest, investor protection, or program objectives.
- The Program also prohibits retaliation by employers against employees who provide us with information about possible securities violations.

Who is an eligible Whistleblower?

- An “**eligible whistleblower**” is a person who voluntarily provides the SEC with original information about a possible violation of the federal securities laws that has occurred, is ongoing, or is about to occur.
- The information provided must lead to a successful SEC action resulting in an order of monetary sanctions exceeding \$1 million.
- One or more people are allowed to act as a whistleblower, but **companies or organizations cannot qualify as whistleblowers.**
- You are not required to be an employee of the company to submit information about any certain company.

What type of information must be submitted to the SEC?

- Because the SEC conducts investigations into possible violations of the federal securities laws, in general, the more specific, credible, and timely a whistleblower tip, the more likely it is that the tip will be forwarded to investigative staff for further follow-up or investigation. For instance, the tip is more likely to be assigned to Enforcement staff for investigation if:
 - the tip identifies individuals involved in the scheme,
 - provides examples of particular fraudulent transactions, or
 - points to non-public materials evidencing the fraud.

What type of information must be submitted to the SEC?

- Some examples of the kind of conduct the SEC is interested in:
 1. Ponzi scheme, Pyramid Scheme, or a High-Yield Investment Program,
 2. Theft or misappropriation of funds or securities,
 3. Manipulation of a security's price or volume,
 4. *Insider trading*,
 5. Fraudulent or unregistered securities offering,
 6. False or misleading statements about a company (including false or misleading SEC reports or financial statements),
 7. Abusive naked short selling,
 8. Bribery of, or improper payments to, foreign officials,
 9. Fraudulent conduct associated with municipal securities transactions or public pension plans, and
 10. Other fraudulent conduct involving securities.

SEC Whistleblower Process.



SEC Whistleblowing Considerations.

- The SEC provides a strict format as to how to effectively blow the whistle. Among other requirements, below is a non-exhaustive list of elements the SEC takes into consideration when assessing whether a whistleblower's claim will be successful:
 - Was the information provided in writing?
 - Is the information original?
 - Did the information lead to a successful enforcement action (as defined by the SEC).
 - What were the consequences of the action?
 - Was a non-prosecution agreement or settlement agreement entered into?
 - Were there monetary sanctions?

SEC Whistleblower Protections.

- To be afforded anti-retaliation protections, an individual must first qualify as a whistleblower.
- To be protected as a whistleblower, individuals must report wrongdoing to the SEC before the retaliatory conduct occurs.
- Retaliation by an employer is prohibited by an employer because of any lawful act taken by a whistleblower in:
 - providing information to the SEC in any “covered judicial or administrative action,” defined as: any judicial or administrative action brought by the SEC under the securities laws; and resulting monetary sanction exceeding \$1 million;
 - initiating, testifying in, or assisting in any investigation or covered judicial or administrative action of the SEC based on information provided to the SEC pursuant to certain rules; or
 - making disclosures that are required under or protected under a law, rule, or regulation under the jurisdiction of the SEC.

Questions?