



SEC Files First Whistleblower Retaliation Enforcement Action

BY THE PAUL HASTINGS INVESTIGATIONS AND WHITE COLLAR DEFENSE GROUP

On June 16, 2014, the Securities and Exchange Commission filed the first-ever enforcement action charging whistleblower retaliation. The SEC was granted the power to bring enforcement actions to punish retaliation pursuant to a Commission rule adopted in 2011 under the Dodd-Frank Act. In this first exercise of that power, the SEC filed an enforcement action against Paradigm Capital Management, Inc., an Albany, New York-based investment adviser, and its owner, Candace King Weir.

According to the SEC's order, from 2009 to 2011, as part of a trading strategy designed to reduce tax liability for its hedge fund clients, Weir directed Paradigm's traders to sell certain securities from the fund to a proprietary trading account that she controlled at her affiliated broker-dealer, C.L. King & Associates, Inc. The sales were executed to realize trading losses for the purpose of tax deductions. The head of trading at Paradigm reported the activity to the SEC in March 2012. When it learned he was a whistleblower, Paradigm demoted him, required him to work offsite, and stripped him of supervisory responsibilities. As a result, the SEC found that Paradigm engaged in unlawful retaliation against the whistleblower.

The SEC also found that because Weir controlled both Paradigm and C.L. King, the sales were principal transactions that posed potential conflicts of interest between the adviser and the fund and, therefore, required Paradigm to make written disclosure to, and obtain consent from, the fund. The SEC further found that Paradigm's conflicts committee, which reviewed and approved principal transactions, was conflicted and could not provide effective consent to the principal transactions, and that Paradigm's Form ADV failed to disclose this conflict.

Paradigm and Weir consented to entry of the order and agreed to pay \$1.7 million in disgorgement, \$181,771 in prejudgment interest, and \$300,000 in penalties to settle the charges. Paradigm also agreed to retain an independent compliance consultant.

"Paradigm retaliated against an employee who reported potentially illegal activity to the SEC," said Enforcement Director Andrew Ceresney. Ceresney also noted that the whistleblower may be eligible for a whistleblower award under the Dodd Frank Act.

"For whistleblowers to come forward, they must feel assured that they're protected from retaliation and the law is on their side should it occur," said Sean McKessy, chief of the SEC's Office of the Whistleblower. "We will continue to exercise our anti-retaliation authority in these and other types of situations where a whistleblower is wrongfully targeted for doing the right thing and reporting a possible securities law violation."

The SEC has long warned that it would bring whistleblower retaliation claims in appropriate enforcement cases. As rewards paid by the SEC to whistleblowers have increased over the last

eighteen months, so have the number of whistleblowers. Unfortunately, the line between legitimate personnel action (particularly with poor-performing employees) and retaliation is not always a clear one, but employers who are deemed to cross that line will find themselves subject not only to employment-related retaliation claims, but to SEC charges as well. As a result, employers who become aware that their employees have made whistleblowing complaints to the SEC must be extremely careful not to allow those employees to be subject to adverse employment actions that could be construed to be retaliation because of their whistleblowing activity.



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