BLOWING THE WHISTLE ON THE DODD-FRANK WHISTLEBLOWER PROVISIONS

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I. INTRODUCTION

"Imagine getting 10% for blowing the whistle on Madoff's $50 billion scam. 'It's a simple thing that will stop a lot of fraud fast.'"[1] At first blush this logic may be very convincing, but whistleblowers are driven by more than just monetary incentives.[2] The emotions of Harry Markopolos, the whistleblower who tried to expose Bernie Madoff's infamous Ponzi scheme, are telling:[3]

> If [Madoff] contacted me and threatened me, I was going to drive down to New York and take him out. At that point it would have come down to him or me; it was as simple as that. The government would have forced me into it by failing to do its job, and failing to protect me. In that situation I felt I had no other options. *I was going to kill him.*[4]

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[1] Robert Chew, *Calling All Whistleblowers! The SEC Wants You*, TIME, Feb. 24, 2009, http://www.time.com/time/business/article/0,8599,1881318,00.html (quoting Laura Goldman, a whistleblower who has alerted the SEC to twenty-five cases leading to SEC fraud charges).

[2] Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151, 1155 (2010) (noting that monetary incentives can sometimes be counterproductive). *See, e.g.*, *id.* at 1181–82.

[3] *Assessing the Madoff Ponzi Scheme and Regulatory Failures: Hearing Before the H. Comm. on Financial Services*, 111th Cong. 102 (2009) [hereinafter *Assessing the Madoff Scheme*] (statement of Harry Markopolus) (stating that "as early as May 2000, I provided evidence to the SEC's Boston Regional Office that should have caused an investigation of Madoff. I re-submitted this evidence with additional support several times between 2000–2008, a period of nine years. Yet nothing was done."); *see also* Ross Kerber, *The Whistleblower: Dogged Pursuer of Madoff Way of Fame*, BOSTON GLOBE, Jan. 8, 2009, http://www.boston.com/business/articles/2009/01/08/the_whistleblower/.

[4] HARRY MARKOPOLOS, NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER 145 (2010). *See also Madoff Whistleblower Slams SEC in New Book*, DEALBOOK (Feb. 26, 2010), http://dealbook.blogs.nytimes.com/2010/02/26/madoff-whistle-blower-slams-s-e-c-in-new-book/.

Are these the words of a man motivated by money? Recent research shows that many factors incentivize whistleblowers to expose fraud,[5] and may vary depending on context.[6]

In the wake of Bernie Madoff's[7] and Sir Allen Stanford's[8] widely-publicized Ponzi schemes, the Dodd-Frank Wall Street Reform and Consumer Protection Act[9] ("Dodd-Frank") significantly expands upon existing whistleblower law.[10] By expanding anti-retaliation protection and monetary incentives, Dodd-Frank is designed to incentivize whistleblowers to expose securities fraud.[11] One such monetary incentive, a new bounty program providing a ten to thirty percent bounty to whistleblowers exposing securities fraud,[12] may be a misguided monetary incentive.[13] According to former Securities and Exchange Commission ("SEC") Enforcement Division Director Linda Thomsen, assertions that the new bounty program will lead to more reliable tips are "unfounded."[14] Dodd-Frank's implications bring to light plausible alternatives to whistleblower reporting for enforcing securities fraud and highlight the importance of thoughtful business practices.[15]

This Note analyzes the Dodd-Frank whistleblower provisions and provides recommendations moving forward. Part II briefly outlines relevant whistleblower laws to provide context. Part III examines the costs and benefits of the provisions as they affect government, businesses and individuals. Part IV assesses prospects for legislative amendment and Part V analyzes agency implementation issues regarding the SEC's Proposed Rules. Next, Part VI provides practical guidance for business compliance. Finally, Part VII offers concluding remarks.

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[5] Feldman & Lobel, *supra* note 2, at 1178–79.

[6] *Id.* at 1155 (stating that "[o]ur findings suggest that a systematic approach to regulation must include an understanding of the fit between the adopted law, the misconduct it addresses, and the individual it aims to incentivize").

[7] United States v. Madoff, 586 F. Supp. 2d 240, 244–46 (S.D.N.Y. Jan. 12, 2009).

[8] Julie Creswell, *U.S. Agents Scrutinize Texas Firm*, N.Y. TIMES, Feb. 12, 2009, http://www.nytimes.com/2009/02/13/business/13stanford.html?_r=2&ref=business. *See also* Laurel Brubaker Calkins & Andrew M. Harris, *Stanford Committed No Crimes: Securities Expert Says,* BLOOMBERG BUSINESSWEEK, Aug. 27, 2010, http://www.businessweek.com/news/2010-10-04/stanford-asks-u-s-judge-to-dismiss-fraud-charges.html.

[9] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[10] S. REP. NO. 111-176, at 110 (2009).

[11] *Id.* at 112.

[12] Dodd-Frank Wall Street Reform and Consumer Protection Act § 922(a).

[13] Feldman & Lobel, *supra* note 2, at 1178–79.

[14] Edward Wyatt, *For Whistle-Blowers, Expanded Incentives*, N.Y. TIMES, Nov. 14, 2010, http://www.nytimes.com/2010/11/15/business/15whistle.html.

[15] *See infra* Pts.III–VI.

II. RELEVANT WHISTLEBLOWER LAWS

A. *Existing Whistleblower Laws*[16]

A relatively recent area of law, whistleblower law has evolved partly in response to financial scandals.[17] In 1978, the Civil Service Reform Act ("CSRA") established the first statutory cause of action protecting whistleblowers from employer retaliation.[18] While the CSRA set the foundation for future whistleblower legislation, its provisions were limited to protecting federal employees[19] and had little impact.[20]

Accordingly, Congress enacted the Whistleblower Protection Act of 1989 ("WPA"), which greatly expanded whistleblower protection.[21] Among other provisions, the WPA created a separate agency to litigate claims,[22] permitted individuals to file whistleblower claims without government support in some cases,[23] and permitted courts to shift attorneys' fees from whistleblower plaintiffs to defendants.[24] A contemporary act, the Insider Trading and Securities Enforcement Act of 1988, mandated an SEC whistleblower bounty program for tips reporting insider trading.[25] However, the bounty program has proven to be largely ineffective, making only seven payments totaling $159,537 since its inception.[26]

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[16] For an objective and thorough discussion of the policy and efficiency of encouraging whistleblowers to report bad conduct, presented in the context of the False Claims Act, see William Kovacic, *Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting*, 29 LOY. L.A. L. Rev. 1799, 1821–41 (1996).

[17] The Insider Trading and Securities Fraud Enforcement Act was enacted, in part, to respond to insider trading scandals, including a scandal at Drexel Burnham Lambert, Inc. H.R. REP. NO. 100-910, at 12 (1988). The Sarbanes-Oxley Act ("SOX") was passed, in part, to respond to corporate scandals at Enron and Worldcom. STEPHEN M. KOHN ET AL., WHISTLEBLOWER LAW: A GUIDE TO LEGAL PROTECTIONS FOR CORPORATE EMPLOYEES xi (2004).

[18] S. REP. NO. 100-413, at 2 (1988).

[19] *Id.*

[20] *Id.* at 5. Surveys show that the percentage of federal employees reporting known fraud remained fairly constant in 1980 and 1983. *Id.* Moreover, the number of employees failing to report illegal activity due to fear of reprisal had risen. *Id.*

[21] *See Bill Summary & Status, 101st Congress, S.20*, CRS SUMMARY (Mar. 16, 1989), http://thomas.loc.gov/cgi-bin/bdquery/z?d101:SN00020:@@@D&summ2=m&; *see also* S. REP. NO. 100-413, at 2 (1988).

[22] Whistleblower Protection Act, Pub. L. No. 101-12, § 1221, 103 Stat. 16 (1989).

[23] *Id.* § 1221(a).

[24] *Id.* § 1221(g)(1).

[25] 15 U.S.C. § 78u-1 (1988).

[26] SEC. & EXCH. COMM'N, OFFICE OF INSPECTOR GEN., ASSESSMENT OF THE SEC'S BOUNTY PROGRAM: REP. NO. 474, 5 (Mar. 29, 2010).

In 2002, the Sarbanes-Oxley Act ("SOX") tremendously expanded the scope of whistleblower protection and also required business controls to deter and detect fraud.[27] Following corporate scandals at Enron and Worldcom,[28] SOX extended whistleblower protection beyond federal employees to employees of publicly held companies.[29] Notably, whistleblower protection for non-government employees effectively adopted public policy to regulate the public risk associated with private firm failure.[30] In addition, SOX granted whistleblowers the right to file a claim in federal court if an administrative procedure did not result in a final order within a statute of limitations.[31] SOX also set a low standard for whistleblowers to acquire statutory protection, requiring only that the whistleblower have a reasonable belief of fraud.[32] Thus, whistleblowers enjoyed a broad array of federal protection to incentivize securities fraud reporting prior to Dodd-Frank.[33]

B. *Dodd-Frank Whistleblower Reform*[34]

Dodd-Frank expands whistleblower protection and monetary incentives even further than SOX, partially in response to the Madoff and Stanford Ponzi schemes.[35] Specifically, the Dodd-Frank whistleblower provisions:

- Provide *a ten to thirty percent bounty for all tips resulting in SEC*[36] *or CFTC*[37] *enforcement actions with monetary sanctions greater than $1,000,000*, which expands upon the SEC's existing insider trading bounty program.

[27] 18 U.S.C. § 1514A (2006); *see also* CRS Summary, Pub. L. No. 107-204, 116 Stat. 745 (2003); KOHN ET AL., *supra* note 17.
[28] KOHN ET AL., *supra* note 17, at xii.
[29] 18 U.S.C. § 1514A. *See also* KOHN ET AL., *supra* note 17, at xiii.
[30] KOHN ET AL., *supra* note 17, at xiv.
[31] 18 U.S.C. § 1514A(b)(1)(B). *See also* KOHN ET AL., *supra* note 17, at 5.
[32] 18 U.S.C. § 1514A(b)(2)(C) (citing 49 U.S.C. § 42121(b)(2)(A), stating that "[i]f the Secretary of Labor concludes that there is a reasonable cause to believe that a violation of subsection (a) has occurred, the Secretary shall accompany the Secretary's findings with a preliminary order providing the relief prescribed by paragraph (3)(B)); *see also* KOHN ET AL., *supra* note 17, at 6.
[33] *See* KOHN ET AL., *supra* note 17, at 6.
[34] For a more thorough discussion of the Dodd-Frank whistleblower provisions, see Drew Harker et al., *Whistleblower Incentives and Protections in the Financial Reform Act*, 127 BANKING L.J. 779 (2010).
[35] S. REP. NO. 111-176, at 139–40 (2009).
[36] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(b)(1), 124 Stat. 1376 (2010).
[37] *Id.* at sec. 748, § 23(b)(1).

- Provide *protection to employees of all subsidiaries and affiliates of public companies*[38] and "any individual performing tasks related to the offering or provision of a consumer financial product or service."[39]
- Provide a *private right of action in federal court* for whistleblowers regardless of administrative delay.[40]
- *Increase the statute of limitations* for whistleblower protection actions to six years following the alleged violation.[41]

Perhaps as a result of being lost in long legislation, which totals over 2000 pages,[42] the Dodd-Frank whistleblower provisions received relatively little media attention during Dodd-Frank's deliberation.[43] Nonetheless, media attention has since recognized that Dodd-Frank's whistleblower provisions will undoubtedly affect fraud reporting and impose costs on businesses and government agencies.[44]

III. COST/BENEFIT ANALYSIS

Ideally, additional whistleblower reporting will increase fraud detection and build public confidence in U.S. capital markets, which in turn will stimulate investment and economic growth.[45] However, it is not certain that the new whistleblower provisions, especially the bounty program, will increase the quality of whistleblower reporting and subsequently detect fraud as intended.[46] Early reports do indicate that whistleblower tips have

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[38] *Id.* § 929A.
[39] *Id.* § 1057(b). Whistleblowers protected under § 1057 may not waive their statutory rights through arbitration agreements. *Id.* § 1057(d)(1).
[40] *Id.* at sec. 922(a), § 21F(h)(1)(B)(i). Under SOX, whistleblowers could only proceed to federal court if they could not obtain a final order from an administrative hearing within 180 days. 18 U.S.C. § 1514A(b)(1)(B).
[41] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(h)(1)(B)(iii), 124 Stat. 1376 (2010).
[42] *Id.* In contrast, SOX is only sixty-six pages long. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.
[43] Richard Renner, *CNBC notices whistleblower provisions of Dodd-Frank Act*, WHISTLEBLOWERS PROTECTION BLOG (July 27, 2010), http://www.whistleblowersblog.org/2010/07/articles/whistleblowers-tax-fraud/cnbc-notices-whistleblower-provisions-of-doddfrank-act/.
[44] *See* Jessica Holzer & Fawn Johnson, *Larger Bounties Spur Surge in Fraud Tips*, WALL ST. J., Sep. 7, 2010, http://online.wsj.com/article/SB10001424052748704855104575470080998966388.html. *See also* Sue Reisinger, *Firms Face a Sudden Rush of Whistleblower Claims*, LAW.COM (Sept. 9, 2010), http://www.law.com/jsp/article.jsp?id=1202471808839&rss=newswire&slreturn=1&hbxlogin=1.
[45] S. REP. NO. 111-176, at 2–4 (2009).
[46] *See infra* Pt. III.A.1.

significantly increased since Dodd-Frank's enactment,[47] but time is needed to assess the quality of these tips.[48] This section discusses Dodd-Frank's likely impact on whistleblower reporting and associated costs.

A. *Dodd-Frank's Benefits: A Closer Look at Reporting Securities Fraud*

Dodd-Frank provides both anti-retaliation protection (e.g. direct access to federal court) and monetary incentives (e.g. the bounty program) designed to increase whistleblower reporting.[49] Unfortunately, Dodd-Frank does not adequately address existing administrative issues with managing whistleblower tips. Also, monetary incentives may encourage unreliable tips if outrage over morally culpable behavior already incentivizes whistleblowers to voluntarily report actual securities fraud.

1. *The Problem: Managing Whistleblower Tips*

Better administrative tip management, rather than increased monetary incentives, is needed to efficiently improve securities law compliance.[50] A 2010 Inspector General Report implicitly recognized as much by offering many managerial recommendations for improving the SEC's existing insider trading bounty program.[51] Taken in this light, it is not whistleblower incentives of any type, but rather administrative management that should be reformed to enforce securities laws.

A recently exposed Ponzi scheme is a prime example of the need for better administrative tip management and the potential ineffectiveness of monetary incentives.[52] In the case, a trader named Ty Schlobohm obtained

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[47] Yin Wilczek, *SEC Already Receiving Whistleblower Claims; More Coming in Near Future, Law Firms Say, in* BNA CORPORATE ACCOUNTABILITY REPORT (Sept. 10, 2010). *See also* Holzer &d Johnson, *supra* note 44.

[48] Holzer & Johnson, *supra* note 44.

[49] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(b)(1), 124 Stat. 1376 (2010). Generally, there are three distinct types of whistleblower incentives: anti-retaliation laws, affirmative duties to report and monetary incentives. Feldman & Lobel, *supra* note 2, at 1160.

[50] *See* SEC. & EXCH. COMM'N, OFFICE OF INSPECTOR GEN., *supra* note 26.

[51] *Id.*

[52] There is plentiful anecdotal evidence of the SEC and CFTC mishandling valid tips about fraud. In the context of the SEC, the SEC mishandled Harry Markopolos's repeated tips about the Madoff Ponzi scheme. An earlier response to the Markopolos tips would have limited the degree of Madoff's fraud. Moreover, Markopolos's motive for attempting to expose Madoff's fraud was not a whistleblower bounty, but rather to create fair competition among hedge funds competing for business. MARKOPOLOS, *supra* note 4, at 54. Thus, while better handling of the Markopolos tip would have been effective, monetary whistleblower incentives would not have exposed the Madoff scheme because Markopolos voluntarily provided the tip. *Assessing the Madoff Scheme*, *supra* note 3, at 2 (Rep.

information exposing a hedge fund's Ponzi scheme.[53] Mr. Schlobohm's initial report, however, was ignored by the Commodities and Futures Trading Commission ("CFTC"), which incorrectly concluded that it did not have jurisdiction over the case.[54] It was not until Mr. Schlobohm reported the tip to the Department of Justice ("DOJ") that the government began to act.[55] The FBI eventually took the lead in the criminal investigation, and the DOJ action resulted in guilty pleas of mail fraud and tax evasion.[56]

By contrast, the SEC and CFTC's civil investigation began after the criminal investigation and is still pending as of October 2010, ironically, despite a less extensive civil burden of proof than in the criminal context.[57] Furthermore, the DOJ investigator stated that "[c]ategorically, at no time did we interfere with the [SEC/CFTC's] ability to move."[58] Also, it is doubtful that monetary incentives such as the Dodd-Frank bounty program[59] would have affected Mr. Schlobohm's behavior.[60] In fact, Mr. Schlobohm stated that he did not report the fraud to earn a reward and has even suggested that he might reject any award or give it to the victims of the fraud.[61]

The successful result of the criminal investigation in Mr. Schlobohm's case considered in tandem with the slow pace and uncertain results of the SEC/CFTC civil investigation demonstrates the need for improved SEC and CFTC administrative efficiency.[62] Had the SEC or CFTC been as

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Kanjorski stating that "Mr. Markopolos was justifiably relentless in ringing alarm bells. Unfortunately, our regulators failed to follow his roadmap and heed his warnings. As a result, thousands of investors were hurt."). A third example of mishandling tips, this time in the CFTC context, regards tips about manipulating silver commodity prices. Susan Pulliam & Carolyn Cui, *Act Now, CFTC is Urged*, WALL ST. J., Oct. 27, 2010, http://online.wsj.com/article/SB10001424052702303341904575576203310056046.html.

[53] Edward Wyatt, *Whistle. Then Worry and Wait.* N.Y. TIMES, Oct. 9, 2010, http://www.nytimes.com/2010/10/10/business/10whistle.html?pagewanted=1&_r=3&emc=eta1.

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.*

[58] *Id.*

[59] It is not clear in this case whether the Dodd-Frank whistleblower provisions are applicable to this situation because the investigation began prior to Dodd-Frank's enactment. *Id. But see* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 924(b), 124 Stat. 1376 (2010).

[60] Wyatt, *supra* note 53.

[61] *Id.*

[62] One lawyer representing the victims noted "it is inexcusable that the authorities did not move in more quickly to stop people from investing more money." *Id.*

responsive initially as the DOJ and FBI were, the fraud could have been detected in a timely manner and investors may have saved significant amounts of money.[63] As demonstrated by Mr. Schlobohm's case, it is apparent that whistleblower incentives cannot be successfully implemented without the ability to adequately manage whistleblower tips.

2. *The Congressional Solution: A Bounty Program*

Even if administrative management is sufficient to benefit from whistleblower incentives, Dodd-Frank's bounty program is an unnecessary and misguided securities fraud deterrent. In recognizing that legal incentives are limited by social norms and corporate cultures,[64] regulation should implement "a fit between the adopted law, the misconduct it addresses and the individual it aims to incentivize."[65] Specifically, individuals are more likely to report illegal activity if they are particularly outraged by morally reprehensible conduct.[66] As such, monetary incentives are most effective in the context of conduct that is not viewed as morally reprehensible.[67] In other contexts, monetary incentives can be ineffective or even counterproductive and decrease reporting of illegal activity.[68]

Against this background, Congressional arguments analogizing the new SEC bounty program to the IRS's recently reformed bounty program may be faulty. The two bounty programs may not be analogous because securities fraud reporting is not necessarily analogous to tax fraud reporting.[69] Tax fraud may not be viewed as morally reprehensible[70]

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[63] *Id.* The criminal investigation in this case allowed fraud to persist in order to build enough evidence to bring a successful criminal case. *Id.* A civil investigation may not have required as much evidence, brought a civil action sooner and effectively concluded the investor fraud sooner.
[64] Yuval Feldman & Orly Lobel, *Behavioral versus Institutional Antecedents of Decentralized Enforcement in Organizations: An Experimental Approach*, 2 REG & GOVERNANCE 165, 201 (2008).
[65] Feldman & Lobel, *supra* note 2, at 1155.
[66] *Id.* at 1192.
[67] *Id.* at 1193–94.
[68] Monetary incentives can result in a "crowding out effect," whereby informants are discouraged from reporting illegal activity because the presence of external rewards discounts moral incentives and intrinsic motivation to report. *Id.* at 1178–81. In the presence of monetary incentives, reporting of illegal activity can be viewed as a "transaction rather than a charitable act." *Id.* at 1179.
[69] *Id.* at 1171 (making a positive analogy between the new SEC bounty program and the recently reformed IRS bounty program). *See also* Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. 2922, 2958 (legislation creating the IRS whistleblower bounty program).
[70] Feldman & Lobel, *supra* note 2, at 1204 (stating that tax fraud is generally not viewed as morally culpable).

because it harms diffuse victims indirectly through the government.[71] In contrast, securities fraud may be viewed as morally reprehensible[72] insomuch as it involves morally culpable conduct directly harming individual investors who have difficulty collectively defending themselves against fraud.[73] If securities fraud is more likely than tax fraud to involve morally culpable conduct and enrage potential whistleblowers, potential whistleblowers are more likely to report securities fraud voluntarily regardless of any monetary incentive.[74]

Two prominent cases epitomize the divergent nature of reporting tax and securities fraud. Bradley Birkenfeld, the whistleblower who exposed extensive tax fraud at UBS AG, was motivated to report by monetary incentives.[75] Originally outraged over a dispute with management, Mr. Birkenfeld decided to report fraud externally, rather than walk away with a fortune in ill-gotten gains, due to the prospect of a fifteen to thirty percent bounty under the IRS bounty program.[76] Ironically, Mr. Birkenfeld is now serving a prison sentence for tax fraud and still seeking a bounty from the IRS for the amounts recovered as a result of his tip.[77] By contrast, Sherron Watkins exposed the accounting scandal (i.e., securities fraud) at Enron

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[71] Dan Markel, *Executing Retributivism: Panetti and the Future of the Eighth Amendment*, 103 NW. U. L. REV. 1163, 1204 n.161 (2009).

[72] S. Michael Sirkin, *The Deterrence Paradox: How Making Securities Fraud Class Actions More Difficult for Plaintiffs Will More Strongly Deter Corporate Fraud*, 82 TEMP. L. REV. 307, 307–08 (2009) (stating that strong cases of securities fraud involve morally culpable conduct). *See, e.g.*, Brent Horton, *How Corporate Lawyers Escape Sarbanes-Oxley: Disparate Treatment in the Legislative Process*, 60 S.C. L. REV. 149, 162 (2008) (stating that Enron's security fraud was morally reprehensible).

[73] David A. Wilson, *Outsider Trading—Morality and the Law of Securities Fraud*, 77 GEO. L.J. 181, 215 (1988). *See also* KOHN, *supra* note 17, at xv (citing congressional intent to enact "U.S. laws [that] encourage and protect those who report fraudulent activity that can damage innocent investors in publicly traded companies."). Additionally, Kohn notes that pre-SOX securities fraud "caused investors and pensioners to lose billions of dollars in scandal-plagued companies. *Id.* at xii. By citing such congressional intent and noting the effect on individuals, Kohn recognizes that securities fraud can have a direct effect on individuals. It should be noted that individual investors sometimes invest through institutional investors, who presumably provide sophistication and defense against fraud.

[74] *See* Feldman & Lobel, *supra* note 2, at 1193–95.

[75] Michael Bronner, *Telling Swiss Secrets: A Banker's Betrayal*, GLOBALPOST, at pt. 4, Aug. 5, 2010, *available at* http://www.globalpost.com/dispatch/europe/100724/globalpost-investigation-telling-swiss-secrets-part-4?page=0,0. *See also* Ken Stier, *Why is the UBS Whistle-Blower Headed to Prison?*, TIME, Oct. 6, 2009, http://www.time.com/time/business/article/0,8599,1928897,00.html.

[76] Bronner, *supra* note 75, at pt. 4.

[77] *Id.*

Corp., not due to monetary incentives, but rather because she was concerned about the consequences of Enron's collapse on the lives of its employees.[78] Ms. Watkins has vividly noted that "she was just trying to save the ship or at least get the captain of the ship to man the lifeboats."[79]

In addition to voluntary disclosure by individuals due to moral outrage, corporate management may self-report securities fraud in return for leniency in sentencing.[80] However, as many tips incentivized by Dodd-Frank are expected to report Foreign Corrupt Practices Act ("FCPA") violations,[81] Dodd-Frank arguably decreases corporate self-reporting. That is, increased monetary incentives may encourage whistleblowers to report externally to the SEC,[82] whereas internal reporting could result in voluntary corporate disclosure but for the prior external reporting.[83] Critics argue that voluntary FCPA self-reporting will increase because companies will have little choice but to self-report due to the threat of reporting by Dodd-Frank whistleblowers.[84] Implicit in this reasoning, however, is the assumption that there are a significant amount of undetected FCPA claims.[85] Thus, at

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[78] MIMI SWARTZ & SHERRON WATKINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON 275 (2003). In a memo to Enron CEO Kenneth Lay, Ms. Watkins stated, "[f]or those of us who didn't get rich over the last few years, can we afford to stay?," which demonstrates concern for Enron employees who, like her, depended on Enron for their livelihood. *Id.*

[79] *Id.* at 281.

[80] Bruce Hinchey, *Punishing the Penitent: Disproportionate Fines in Recent FCPA Enforcements and Suggested Improvements*, 40 PUB. CONT. L.J. 393, 420–22 (2011).

[81] Harker et al., *supra* note 34, at 2. *See also* Holzer & Johnson, *supra* note 44. The FCPA prohibits bribery and requires that issuers within the scope of the Securities Act maintain records, books, and accounts to a reasonable level of detail. 15 U.S.C. § 78dd-1 (2006).

[82] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70514 (Nov. 17, 2010). *See also* Bruce Carton, *Pitfalls Emerge in Dodd-Frank Whistleblower Bounty Provision*, SEC. DOCKET (Sept. 9, 2010), http://www.securitiesdocket.com/2010/09/09/pitfalls-emerge-in-dodd-frank-whistleblower-bounty-provision.

[83] Daniel J. Grimm, *The Foreign Corrupt Practices Act in Merger and Acquisition Transactions: Successor Liability and its Consequences*, 7 N.Y.U. J.L. & BUS. 247, 273–74 (2010) (stating that "fifty of eighty-five FCPA investigations made publicly available between 2005 and the fall of 2008 'were voluntarily disclosed to the SEC or the DOJ following internal investigations by the companies.'").

[84] Yin Wilczek, *Panel: Self-Reporting of FCPA Violations Only Real Option in Era of Whistleblowers*, *in* BNA CORPORATE ACCOUNTABILITY REPORT (Dec 10, 2010).

[85] *See infra* Pt.III.B.1 (arguing that Dodd-Frank will result in frivolous whistleblower tips). *But see* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70514 (noting a proposed SEC mechanism whereby whistleblowers can seek guidance from corporate compliance

least in the case of FCPA tips, monetary incentives may not be as effective as intended or as in the tax fraud setting.

Also, the IRS analogy is not very persuasive because there is conflicting evidence as to the success of the IRS bounty program. Under the IRS program, whistleblower bounties take years to be issued,[86] and are so uncertain that hedge funds invest in prospective awards.[87] As of January 2010, the IRS had not yet paid a bounty under the program reformed in 2006.[88] The Chief Counsel of the IRS has even stated that the bounty program "was forced on us," a "disaster waiting to happen"[89] and a "ticking time-bomb"[90] because the whistleblower program could result in complaints about overzealous auditors.[91] Nonetheless, advocates of the IRS bounty program point to the billions of dollars in tax revenue the IRS stands to gain under the program[92] and the reliable information provided by whistleblowers.[93]

A more compelling argument in support of the new SEC bounty program, not cited in a relevant Senate Report,[94] analogizes it to the False Claims Act ("FCA").[95] The FCA analogy is more compelling because *qui*

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staff as to whether certain conduct constitutes securities fraud and still be eligible for a bounty).

[86] David Kocieniewski, *Whistle-Blowers Become Investment Option for Hedge Funds*, N.Y. TIMES, May 19, 2010, http://www.nytimes.com/2010/05/20/business/20whistleblower.html?pagewanted=1&_r=1.

[87] *Id.* (stating that hedge funds "[agree] to buy a percentage of [future payouts to IRS whistleblowers] in exchange for a smaller amount upfront to the whistleblowers). *See also* Bronner, *supra* note 75.

[88] *IRS Whistleblower Office Closer to First Aware Determinations Under New Law*, 2010 TNT 15-8, Jan. 25, 2010.

[89] Kocieniewski, *supra* note 86.

[90] Jeremiah Coder, *Tax Analysts Exclusive: Conversations: Donald Korb,* 2010 TNT 11–7, Jan. 19, 2010.

[91] *Id.*

[92] *Cf.* Feldman & Lobel, *supra* note 2, at 1168 (Feldman and Lobel point out that the IRS has already made billions. There is a logical inference that since the IRS has recovered billions in the past, that they stand to recover billions in the future.).

[93] Erika Kelton, *Letters to the Editor: Korb Wrong about Whistleblower Program, Writer Says*, 2010 TNT 15–20, Jan. 25, 2010.

[94] *See generally* S. REP. NO. 111–176 (2009).

[95] *See* 31 U.S.C. § 3730(d) (2006). As with the SEC bounty program, awards resulting from *qui tam* actions under the FCA may reach up to thirty of the enforcement proceeds. 31 U.S.C. § 3730(d)(2). For a thorough description of relator/whistleblowers and the FCA, see Kovacic, *supra* note 16, at 1818–19.

tam actions brought by private citizens on behalf of the United States[96] have more clearly led to successful enforcement actions.[97] However, the FCA may still be distinct from securities fraud for the same reasons tax fraud is distinct from securities fraud. Expressly, securities fraud is more likely than fraudulently claiming federal funds to involve morally culpable conduct, which may outrage potential whistleblowers, result in voluntary reporting and, in turn, obviate the need for monetary incentives.[98] As with tax fraud, one supporting argument is that FCA violations affect a more diffuse group (i.e., the government) than securities fraud. Thus, a bounty is more appropriate for FCA violations than securities fraud.

Finally, Dodd-Frank's legislative history suggests that Congress may not have been very thoughtful in reforming the SEC's bounty program. First, research cited by the Senate to support the proposition that whistleblowers are instrumental in detecting and reporting fraud does not address securities fraud *per se*, but rather all occupational fraud, which is overinclusive and underinclusive of the Dodd-Frank bounty program's scope.[99] Second, there is little indication that Congress considered the negative ramifications of providing whistleblowers with additional monetary incentives.[100] Rather, Congress appears to have followed a common misconception that monetary incentives always increase reported illegal activity without providing authority.[101] Third, the relevant White House press release does not propose a reformed SEC bounty program, which is a major part of Dodd-Frank whistleblower reform.[102] More thoughtful policy may have garnered initial executive support.

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[96] 31 U.S.C. § 3730(d) (1994). While not a bounty program per se, *qui tam* actions under the FCA encourage relator/whistleblowers to report fraud by bringing actions on behalf of the United States government.

[97] Thomas Harris, *Alternate Remedies & the False Claims Act: Protecting Qui Tam Relators in Light of Government Intervention and Criminal Prosecution Decisions*, 94 CORNELL L. REV. 1293, 1302 (2009). *But see* Kovacic, *supra* note 16, at 1841–42 (stating that there is a lack of empirical evidence to evaluate the effectiveness of FCA *qui tam* actions).

[98] *See* Feldman & Lobel, *supra* note 2, at 1193–94.

[99] S. REP. NO. 111-176, at 110 (2009) (citing *Assessing the Madoff Scheme*, *supra* note 3). Expressly, only some securities fraud occurs in the occupational context and only some occupational fraud is securities fraud.

[100] *But see* S. REP. NO. 111-176, at 244 (2009).

[101] Feldman & Lobel, *supra* note 2, at 1190 (noting empirical research in which survey participants "[revealed] a perception that a stranger's decision to report [illegal activity] is more likely to be externally driven" as opposed to being driven by moral considerations). *See* 156 CONG. REC. S4076 (May 20, 2010) (Senator Shelby stating that "the guaranteed massive minimum payouts and limited SEC flexibility ensures that a line of claimants will form at the SEC's door.").

[102] *See* I.R.S. Press Release TG-205 (July 10, 2009), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg205.aspx.

Accordingly, the SEC bounty program may not significantly increase fraud reporting, detection or enforcement.

B. *Dodd-Frank's Costs*

There are certain to be additional costs from Dodd-Frank's whistleblower provisions simply due to increased whistleblower reporting.[103] As a result, attorneys providing whistleblower representation and business compliance advice will benefit. Three types of laws incentivize whistleblower reporting: anti-retaliation protection, monetary incentives, and affirmative duties to report.[104] As noted, Dodd-Frank adopts anti-retaliation measures (e.g. a private right of action in federal court) and monetary incentives (e.g. the bounty program).[105] Each incentive type will cause businesses and government agencies to incur considerable costs.

1. *Costs Resulting from Monetary Whistleblower Incentives*

The Dodd-Frank bounty program imposes heavy costs on business compliance and agency administration. Specifically, the new bounty program will: (1) cause a flood of poor quality tips; (2) encourage employees to report fraud externally rather than internally; (3) develop an inflexible SEC fraud enforcement strategy; (4) not be cost-effective; and (5) result in excessive and unnecessary litigation.

First, the bounty program is likely to incentivize frivolous, misleading, exaggerated or otherwise unreliable tips.[106] As tip quality is rarely apparent from a whistleblower complaint, frivolous tips impose costs associated with administrative tip investigation and management.[107] Further, unreliable tips provide only a minimal benefit to gather evidence in the event that another whistleblower provides related information indicating that there is actual fraud. One concern is that misunderstanding of the *reporting requirements* under the bounty program may result in employees reporting poor or

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[103] Holzer & Johnson, *supra* note 44. *See also* Reisinger, *supra* note 44.

[104] Feldman & Lobel, *supra* note 2, at 1160.

[105] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 922(a), 124 Stat. 1376, 1842 (2010).

[106] *See id.* It should be noted that poor tips may have the relatively minor benefit of inadvertently assisting with the evidentiary burden even if not meeting the pleading requirement to be eligible for the bounty program.

[107] Amy Kolz, *Serial whistle-blower Joseph Piacentile makes millions helping the government uncover fraud. That's how the False Claims Act is supposed to work. Or is it?*, AM. LAW., June 1, 2010, http://www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202457711736&slreturn=1&hbxlogin=1.

incomplete information "just in case" they have sufficient information.[108] Potentially ambiguous rules implementing Dodd-Frank or insufficient notice of the bounty requirements may contribute to such misunderstanding.[109]

In addition to complicated reporting standards, employees may not understand the complicated *legal standards* for securities fraud.[110] For example, employees may report FCPA violations[111] contributing to the administrative backlog of tips despite, or perhaps because, FCPA violations are not always clear due to ambiguous law.[112] It is expected that many tips under the new bounty program will report potential FCPA fraud,[113] but there is little FCPA case law because enforcement actions usually result in settlement.[114] As a result, FCPA actions are usually pursued under sometimes conflicting agency interpretations that do not have the force of law.[115] Also, many FCPA violations are already voluntarily reported by whistleblowers.[116]

Similarly, complicated legal standards subject whistleblowers to personal risk if Dodd-Frank encourages whistleblowers to report fraud. Although a pre-Dodd-Frank case, Former Lehman Brother's Executive Matthew Lee, for example, was fired as a result of calling attention to Lehman Brother's questionable accounting practices.[117] Even the most knowledgeable commentator cannot state with certainty whether Repo 105 transactions, which Mr. Lee did not cite,[118] and other accounting practices cited by Mr. Lee were legal under the generally accepted accounting principles then in place.[119] Moreover, extensive legal analysis is required to

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[108] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70497 (Nov. 17, 2010).
[109] *See infra* Pt.V.B.3.
[110] *See e.g.*, Kolz, *supra* note 107.
[111] 15 U.S.C. § 78dd-1 (2006).
[112] Mike Koehler, *The Financial Reform Bill's Whistleblower Provisions and the FCPA*, FPCA PROFESSOR (July 20, 2010), http://fcpaprofessor.blogspot.com/2010/07/financial-reform-bills-whistleblower.html.
[113] Holzer & Johnson, *supra* note 44. *See also* Reisinger, *supra* note 44.
[114] Koehler, *supra* note 112.
[115] *Id.*
[116] *See* Hinchey, *supra* note 80. Voluntary reporting may be a result of the outrage that can be associated with securities fraud, in contrast to tax fraud. *See* discussion *supra* Pt. III(A)(2).
[117] Shira Ovide, *Lehman Brothers Whistleblower Matthew Lee Again in Spotlight*, WALL ST. J. DEAL BLOG, Dec. 21, 2010, http://blogs.wsj.com/deals/2010/12/21/lehman-brothers-whistleblower-matthew-lee-again-in-spotlight/.
[118] *Id.*
[119] *See* Steve Eder, *Lehman Auditor May Bear the Brunt*, WALL ST. J., Mar. 14, 2011,

determine whether Ernst & Young LLP, Lehman Brothers, and/or executives in their personal capacity are liable for any fraud.[120] Whistleblowers encouraged to report complicated securities fraud under Dodd-Frank could suffer a similar fate to Mr. Lee. Thus, Dodd-Frank's whistleblower provisions may harm individual whistleblowers and government agencies due to the unclear legal and reporting standards.

Second, Dodd-Frank imposes costs by encouraging employees to report fraud externally to the government rather than internally through corporate compliance systems.[121] Under the bounty program, employees stand to earn a considerable award if they directly report fraud to the SEC, which may not be available if the fraud is handled internally.[122] Critically, external reporting undermines the effectiveness of internal corporate compliance systems, which are often responsive[123] and effective[124] in stemming fraud. Further, internal compliance systems can be more efficient than external reporting in avoiding delay in correcting financial misstatements and increasing the accuracy of management's assessment of internal controls.[125] It is also efficient for internal systems to screen tips to reduce the volume of agency tips, preserve the SEC's limited resources,[126] and ease the SEC's recent difficulty managing tips.

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http://online.wsj.com/article_email/SB1000142405274870402750457619884079365 0766-lMyQjAxMTAxMDEwNDExNDQyWj.html.

[120] *Id.*

[121] Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488 (Nov. 17, 2010). *See also* Carton, *supra* note 82.

[122] *Id. See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922, § 21F(b)(1), 124 Stat. 1376 (2010).
But see Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, 75 Fed. Reg. at 70497 (proposing a mechanism whereby whistleblowers may report internally and still receive a bounty).

[123] *See* 2010 CORPORATE GOVERNANCE AND COMPLIANCE HOTLINE BENCHMARKING REPORT NETWORK 70, http://www.tnwinc.com/downloads/2010benchmarkingreport.pdf?webSyncID=1e367c41-c2ad-59d6-3c58-5448edcb0a5d&sessionGUID=39772723-a599-4ec7-8d64-12c28ca90c9c (last visited Mar. 30, 2011) (stating that companies investigated seventy-three percent of reports, despite the fact that most reports are frivolous).

[124] *See id.* at 22 (stating that forty of internal investigations led to action by the company in 2009).

[125] Public Comments from Joe DiLeo, Deloitte & Touche, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 10–12 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-184.pdf.

[126] *See Implementing the Dodd-Frank Wall Street Reform and Consumer Act–Dates to be Determined*, SEC. & EXCH. COMM'N, Feb. 16, 2011, http://www.sec.gov/spotlight/dodd-frank/dates_to_be_determined.shtml. *See also* Jessica Holzer, *SEC Delays Plans for Whistleblower Office*, WALL ST. J., Dec. 3, 2010,

Ironically, Dodd-Frank's whistleblower provisions also undermine other federal policy. By incentivizing external reporting to the detriment of internal compliance, Dodd-Frank contradicts the policy behind SOX 404 provisions promoting effective internal control systems. Insomuch as external reporting incentivizes small businesses to meet and exceed internal compliance initiatives to avoid external reporting,[127] Dodd-Frank's whistleblower provisions undermine Dodd-Frank's exemption of businesses with market capitalization smaller than $75 million from SOX 404.[128] Put differently, the whistleblower provisions may effectively leave in place the burden of closely scrutinizing internal controls, which is a small business burden similar to SOX 404.[129]

Additional controls to prevent whistleblower retaliation[130] and burdensome explanations to the SEC regarding the outcome of internal investigations[131] may be necessary due to the threat of increased whistleblower reporting. Also, new compliance burdens may be unnecessarily duplicative in light of other fraud detection measures already in place including external audits, internal audits and existing internal

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http://online.wsj.com/article_email/SB10001424052748704377004575651272119701864-lMyQjAxMTAwMDAwMjEwNDIyWj.html.

[127] *See* MICHAEL DELIKAT & RENÉE PHILLIPS, CORPORATE WHISTLEBLOWING IN THE SARBANES-OXLEY ERA § 10:1 (2010) (outlining measures businesses can implement to comply with SOX). Internal controls designed to avoid whistleblower retaliation are increasingly important with an increasing number of whistleblowers likely to result from additional whistleblower incentives. *See* Holzer & Johnson, *supra* note 44. Moreover, Dodd-Frank expands the coverage of whistleblower protection to affiliates and subsidiaries of public companies, which will emphasize the need for compliance among these businesses. *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act § 929(A).

[128] Dodd-Frank Wall Street Reform and Consumer Protection Act § 989G(a). *See* DELIKAT & PHILLIPS, *supra* note 127. As Dodd-Frank increases whistleblower incentives and protection, prudent business practices will maintain internal controls to avoid whistleblower retaliation liability. *See id.*

[129] Tina Chi, *FCPA-Related Whistleblowing Likely to Grow; Companies Must Boost Controls, Expert Says*, *in* BNA CORPORATE ACCOUNTABILITY REPORT (Dec. 22, 2010). *See also Whistleblowing and the New Race to Report*, DELOITTE, at 1 (2010), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FAS_ForensicCenter_us_fas-us_dfc/us_dfc/us_dfc_whistleblowing_120910.pdf. *See also* Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?*, 26 YALE J. REG. 229, 239–43 (noting that business must implement controls and incur costs to comply with SOX).

[130] Dodd-Frank Wall Street Reform and Consumer Protection Act § 989G(b).

[131] Richard J. Morvillo & Jeffrey F. Robertson, *Whistleblowers and the Resurgence of Internal Investigations*, *in* BNA CORPORATE ACCOUNTABILITY REPORT (Jan. 11, 2011).

controls.[132] The SEC has implicitly acknowledged that the whistleblower provisions will require improving internal systems while explaining that the proposed rules do not require internal reporting.[133] To illustrate, subsidiaries of public companies may require management training to avoid whistleblower retaliation, and all businesses may need new policies to encourage internal reporting.[134]

Another cost resulting from the external reporting incentive is the negative effect on organizational culture. The ethical nature of an organization is shaped by management.[135] By undermining management's efforts to internally handle fraud and foster an ethical culture, Dodd-Frank is concurrently harming the organizational culture.[136] Deteriorating organizational culture has a cascading effect on internal compliance because employees are more likely to report fraud internally in organizations with an ethical culture, in which case there is less fear of retaliation.[137] More broadly, as organizational culture affects organizational performance, Dodd-Frank is harming the bottom line.[138] To note other

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[132] Michael K. Shaub & James F. Brown, Jr., *Whistleblowing management accountants: a US view, in* GERALD VINTEN, WHISTLEBLOWING: SUBVERSION OR CORPORATE CITIZENSHIP 107 (1994) (noting accountants' role in maintaining internal controls, internal auditors' role in monitoring managerial accountants and external auditors' role in attesting to fair presentation of financial statements). *See also* Association for Certified Fraud Examiners, *2008 Report to the Nation on Occupational Fraud & Abuse*, ASS'N CERTIFIED FRAUD EXAMINERS (2008), *available at* http://www.intercedeservices.com/downloads/2008-rttn.pdf. Although the ACFE report examines all occupational fraud, securities fraud is a subset of occupational fraud which may be detected by these measures.
[133] *See* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70496 (Nov. 17, 2010).
[134] *See infra* Pt.VI.A.
[135] Linda Sharp Paine, *Managing for Organizational Integrity*, HAR. BUS. R., Mar.-Apr 1994, at 106. *See also Integrity Survey (2008-09)*, KPMG LLP 9 (Jan. 15,2009), http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Press-Releases/Documents/IntegritySuvey08_09.pdf.
[136] *See* Paine, *supra* note 135, at 111 (stating that ethics systems are most effective when imposed implicitly through organizational culture, rather than as an external burden).
[137] Orly Lobel, *Lawyering Loyalties: Speech Rights and Duties Within Twenty-First-Century New Governance*, 77 FORDHAM L. REV. 1245, 1250 (2009).
[138] *See* THOMAS ROLLINS & DARRYL ROBERTS, WORK CULTURE, ORGANIZATIONAL PERFORMANCE, AND BUSINESS SUCCESS 6 (1998) (noting that organizational culture is linked to organizational performance). Rollins and Roberts identify the visibility of high-profile companies attributing success to their culture, and quantitative, empirical evidence to support this conclusion. *Id.* Other commentators have noted that there is likely a positive connection between organizational culture and organizational success/performance, but that empirical research is inconclusive because of difficulties in defining "culture" due to the unique characteristics of

costs, an SEC action may damage organizational reputation and decrease shareholder wealth,[139] give rise to monetary penalties and costs of corporate legal defense,[140] and forgo leniency for corporate self-reporting.

Third, Dodd-Frank implicitly mandates a SEC fraud enforcement strategy rather than deferring to administrative expertise to set the enforcement agenda.[141] Dodd-Frank does so by creating administrative costs that limit resources available to pursue alternative enforcement methods.[142] New costs facing the SEC include costs associated with operating a new whistleblower office,[143] investigating additional whistleblower tips,[144] enforcement actions based upon those tips[145] and paying mandatory whistleblower bounties.[146] Exacerbating the impact of the costs is a budget shortfall, which has caused the SEC to defer some of these mandates, including the creation of the new whistleblower office.[147] It is also possible that the SEC will face moral hazard in relying on

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each organization's culture. MATS ALVESSON, UNDERSTANDING ORGANIZATIONAL CULTURE 67–68 (2002) (noting that managers often believe there is a positive link between culture and performance). *See also* NEAL M. ASHKANASY ET. AL., HANDBOOK OF ORGANIZATIONAL CULTURE & CLIMATE 193–194 (2000) (stating that future empirical research is likely to show a positive link between culture and performance).

[139] *See* Robert M. Bowen et al., *Whistle-Blowing: Target Firm Characteristics and Economic Consequences*, 85 ACCT. REV. 1239, 1260, 1266 (2010).

[140] Paine, *supra* note 135, at 109.

[141] Carton, *supra* note 82 (citing Richard Wallace, Esq.).

[142] Peter J. Henning, *For the S.E.C., Problems of Time and Money*, N.Y. TIMES DEALBOOK (Feb. 22, 2011), http://dealbook.nytimes.com/2011/02/22/for-the-s-e-c-problems-of-time-and-money/

> A budget cutback, or even a budget freeze, while the S.E.C. is in the midst of dealing with its new responsibilities for drafting and enforcing rules governing the securities derivative markets and hedge funds may mean the enforcement division will have to drop investigations, or at least slow some of them down, while it deals with other issues.

Id.

[143] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 924, 124 Stat. 1376 (2010).

[144] Holzer & Johnson, *supra* note 44 (noting that additional whistleblower tips are expected as a result of Dodd-Frank). *See also* Reisinger, *supra* note 44.

[145] Michael K. Lowman, *Leading Lawyers on Working with the SEC, Structuring Effective Compliance Programs, and Evaluating Securities Developments*, SEC COMPLIANCE BEST PRAC., 2010 WL 894704, at *2 (2010).

[146] Dodd-Frank requires that whistleblowers who provide original information leading to successful SEC or CFTC enforcement actions with proceeds greater than 1 million receive, *at a minimum*, ten of the proceeds as an award. Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(b)(1)(A).

[147] *Implementing the Dodd-Frank Wall Street Reform and Consumer Act–Dates to be Determined*, *supra* note 126. *See also* Holzer, *supra* note 126.

informant tips.[148] As a result of the foregoing, the SEC may not set its enforcement strategy at it otherwise might.

One alternative SEC enforcement strategy is using test cases to signal to the market or "draw a line in the sand" stating that their fraud enforcement is focused on deterring a particular fraud type.[149] As part of a markedly distinct strategy, Dodd-Frank mandates a report to assess whether whistleblower tips are handled with administrative efficiency.[150] The SEC is therefore expected to pursue each case reported by a whistleblower, regardless of whether it is part of their strategy of identifying test cases.

The Congressional enforcement directive is especially unfortunate because test cases can be very effective and require many resources. For example, the SEC recently spent hundreds of thousands of dollars pursuing a small insider trading case that only resulted in a $110 client gross profit specifically to deter insider trading involving unregistered broker/dealers.[151] The SEC was willing to incur the high costs because it expects that other cases of insider trading will be deterred by the threat of enforcement.

Another case illustrates the magnitude and importance of test cases. Days prior to Dodd-Frank's enactment, the SEC reached a $550 million settlement with Goldman Sachs as a result of an SEC investigation.[152] The case was designed, at least in part, to signal to the market that the SEC was strengthening enforcement efforts against deceptive collateralized debt obligation sales.[153] Significantly, it is probable that the SEC incurred extremely high out-of-pocket expenses pursuing the settlement.[154] By

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[148] Dayna Bowen Matthew, *The Moral Hazard Problem with Privatization of Public Enforcement: The Case of Pharmaceutical Fraud*, 40 U. MICH. J.L. REFORM 281, 300 (2007).

[149] Lowman, *supra* note 145, at 2 ("If there are certain people they feel are gatekeepers . . . the agency will take marginal dollar value cases if they can advance a message they believe will advance the SEC's enforcement program."). *See also* Carton, *supra* note 82.

[150] Dodd-Frank Wall Street Reform and Consumer Protection Act § 922(d). (It should be noted that the report may not be undertaken if the new whistleblower office is not created).

[151] Lowman, *supra* note 145 at 2.

[152] Andrew Martin, *S.E.C. Puts Wall St. on Notice*, NY TIMES DEALBOOK, Apr. 19, 2010, http://dealbook.blogs.nytimes.com/2010/04/19/s-e-c-puts-wall-st-on-notice.

[153] *Id. See also* Carton, *supra* note 82.

[154] Although SEC enforcement expenses are not publicly available, the SEC unquestionably spends considerable amounts of out-of-pocket expenses and attorney time related to enforcement actions. Lowman, *supra* note 145. Regarding the $550 million Goldman Sachs-SEC settlement, the long duration of the investigation which lasted over a year, the large size of the alleged fraud which resulted in a $550 million settlement and the complexity of the alleged fraud involving sophisticated collateralized debt obligations, all indicate that the SEC incurred significant expenditures during the investigation. Lindsay Fortado &

pursuing this individual case, the SEC was addressing the subprime mortgage crisis that had a devastating effect on the economy. Had Dodd-Frank been in place prior to the Goldman settlement, the SEC may have also been required to pay a large and unnecessary whistleblower bounty ($55–$165 million) or litigate against whistleblowers claiming a bounty.[155] Taken in this light, Dodd-Frank's costs will mandate an SEC enforcement strategy and limit scarce resources available for the SEC to pursue test cases at its discretion.

Fourth, Dodd-Frank's requirement to award whistleblowers *at least* a ten percent bounty is both overreaching and misplaced.[156] The ten percent floor is overreaching because it may not be cost-effective. That is, the marginal utility of providing a whistleblower with, for example $7 million rather than $5 million, may not be a meaningful incentive to report fraud. Further, Dodd-Frank may not be cost effective. There is little evidence in the legislative history of Dodd-Frank that Congress contemplated whether Dodd-Frank's costs might exceed the residual amount of fraud enforcement proceeds deposited in the Investor Protection Fund once bounties are paid from the Fund.[157]

Christine Harper, *Goldman Sachs Fined $27 Million for Not Reporting Probe*, BLOOMBERG NEWS, Sept. 9, 2010, http://www.bloomberg.com/news/2010-09-09/goldman-sachs-fined-27-million-by-u-k-for-failing-to-report-tourre-probe.html (noting that the SEC has been investigating the Goldman Sachs Abacus deal since August 2008). Patricia Hurtado & Christine Harper, *SEC Settlement with Goldman Sachs for $550 Million Approved by U.S. Judge*, BLOOMBERG NEWS, July 21, 2010, http://www.bloomberg.com/news/2010-07-20/goldman-sachs-settlement-with-sec-for-550-million-approved-by-u-s-judge.html.

[155] As an alternative to whistleblower leads, poor investment performance often leads to regulatory investigation of securities fraud. *See* Carrick Mollenkamp et al., *SEC Probes Other Soured Deals*, WALL ST. J, Apr. 19, 2010, http://online.wsj.com/article/SB10001424052748704508904575192294041013802.html (noting that the SEC is investigating securities fraud in underperforming funds). *See also* Gretchen Mortgenson & Landon Thomas, *A Glare on Goldman, From U.S. and Beyond*, N.Y. TIMES DEALBOOK (Apr. 19, 2010), http://dealbook.nytimes.com/2010/04/19/a-glare-on-goldman-from-u-s-and-beyond/ (noting that members of Congress have been requesting that the SEC investigate mortgage securities deals due to government investment in financial institutions like A.I.G.).

[156] S. REP. NO. 111-176, at 111 (2009) (stating that the "critical component of the whistleblower program is the minimum payout that any individual could look towards in determining whether to take the enormous risk of blowing the whistle in calling attention to fraud"). *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(b)(1)(A), 124 Stat. 1376 (2010).

[157] *But see* S. REP. NO. 111-176, at 244 (2009) (stating the "minority view" of the Dodd-Frank bill).

Moreover, the ten percent floor is misplaced because it may not provide certainty as intended.[158] Whistleblower bounties are anything but certain because other whistleblowers may provide information entitling them to a portion of the bounty.[159] As noted above, ambiguity about the reporting standard or securities law can also decrease certainty.[160] Although whistleblower bounties are likely to be unnecessarily high with little marginal utility, they may not provide certainty as intended.

Fifth, the new bounty program is likely to lead to unnecessary litigation. One reason is because Dodd-Frank entitles whistleblowers to appeal the amount of a bounty awarded by the SEC.[161] Under the new bounty program, bounties are determined on an *ad hoc* basis using subjective factors, but must be within ten to thirty percent of the penalty collected as a result of the tip.[162] Subjective criteria make award amounts an easy target to dispute. Further, appeals are incentivized because successful appeals could yield lofty rewards representing a portion of high penalties in SEC fraud actions.[163]

Dodd-Frank also invites litigation to establish the contours of the reporting standard and define key terms including "original information."[164] Without a clear reporting standard, a whistleblower's burden of proof is ambiguous and litigation is needed to specify the level of detail required to obtain a whistleblower bounty.[165] For example, whistleblowers with less conclusive evidence of fraud, or perhaps just a hunch, may file claims seeking an award.[166] Moreover, secondary whistleblowers providing

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[158] *Id.* at 111.

[159] Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(b)(1). *See also* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70499 (Nov. 17, 2010).

[160] Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, 75 Fed. Reg. at 70514 (stating that whistleblowers may be mistaken about securities laws).

[161] Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(f).

[162] *Id.*; *see also* S. REP. NO. 111-176, at 244 (2009). Some have also criticized the Dodd-Frank bounty program for eliminating the SEC's discretion to award bounties in amounts less than ten percent of the fraud penalty.

[163] Dodd-Frank entitles whistleblowers to bounties only if an SEC or CFTC action results in monetary sanctions greater than 1 million. Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922, § 21F(a)(1).

[164] *Id. See also id.* at sec. 922(a), § 21F(a)(3).

[165] *See* Telephone Interview with Dan Sandman, U.S. Steel Vice Chairman and Chief Legal & Administrative Officer and General Counsel (Ret.)(Oct. 15, 2010).

[166] *See, e.g.*, Kolz, *supra* note 107. Kolz describes the case of Joseph Piacentile, a whistleblower who does not report fraud as an employee or business partner, but instead in reliance of potentially unreliable secondhand information resulting from

information about fraud that has already been reported may file a claim seeking a portion of the bounty.[167] While the SEC's proposed rules provide some guidance to limit uncertainty and curb litigation,[168] discretionary standards nonetheless provide potential for considerable litigation.

2. *Costs Resulting from Anti-Retaliation Protection*

Anti-retaliation protection costs are exemplified by existing whistleblower protection that extends to government agencies and publicly traded companies, but not private businesses.[169] Implicit in the absence of whistleblower protection for employees of privately held businesses is the public policy determination that fraud at privately held businesses does not pose a threat to society which warrants imposing the costs associated with federal whistleblower protection.[170]

Perhaps the most significant cost of Dodd-Frank's anti-retaliation protection is the direct access to federal courts provided to whistleblowers, which may lead to expensive litigation. Under existing law, whistleblowers were granted access to federal courts only if there was administrative delay such that a final order was not issued within a 180 day statute of

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his own investigations. *Id.* As there is little or no disincentive to deter unreliable whistleblower tips, one lawyer has noted that "even if [Piacentile] hits a couple, his batting average is terrible." *Id. But see* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70499 (Nov. 17, 2010).

[167] Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, 75 Fed. Reg. at 70499. *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(b)(1), 124 Stat. 1376 (2010). *See, e.g.*, Kolz, supra note 107.

[168] Dodd-Frank Wall Street Reform and Consumer Protection Act § 924(a). Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, 75 Fed. Reg. at 70497.

[169] Frank Cavico, *Private Sector Whistleblowing and the Employment-At-Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis,* 45 S. TEX. L. REV. 545, 546–47 (2004). The exclusion of private company employees from whistleblower protection is contrasts with more encompassing federal anti-discrimination laws. *Id.*

[170] *See* KOHN ET AL., *supra* note 17, at xiv (noting that whistleblower protection for employees of publicly held companies serves the public interest). Harsh results to employees of privately-held companies are avoided through secondary employer liability, which may be the result of state policy decisions to protect private employees from whistleblower retaliation. First, there is secondary liability under state blues sky laws. Cavico, *supra* note 169, at 550. Second, common law tort actions provide secondary liability. *Id.* at 550–52. Specifically, many state statutes allow wrongfully discharged employees to recover damages from their employer in tort. *Id.* at 579.

limitations.[171] Litigation in federal court results in additional costs because it often includes expensive discovery, litigation and appeals processes.[172] In contrast, administrative hearings limit costs because they are not governed by the rules of evidence[173] and may be amended or streamlined to accommodate an executive's budget concerns.[174]

Dodd-Frank also prohibits pre-dispute arbitration agreements and waiver of statutory whistleblower protection.[175] Arbitration and waiver can be effective tools to combat the business burdens resulting from expanded whistleblower protection.[176] By eliminating these cost-cutting options,[177] Dodd-Frank forces parties into expensive litigation in federal court.

Another cost is adverse selection with regard to frivolous tips.[178] Since whistleblower protection applies even if they are providing invalid tips, employees fearing discipline or termination may report false tips solely to obtain whistleblower protection that may prevent an employer from terminating an employee.[179] Broadening whistleblower protection may therefore have the effect of requiring businesses to retain employees they would otherwise terminate. Additionally, agencies incur costs screening frivolous tips. In light of the foregoing, Dodd-Frank's broadening of anti-retaliation protection poses a considerable burden.

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[171] 18 U.S.C. § 1514A(b)(1)(B) (2006). *See also* KOHN ET AL., *supra* note 17, at 5.

[172] Robert Bone, *Improving Rule 1: A Master Rule for the Federal Rules*, 87 DENV. U. L. REV. 287, 296 (2010) (stating that increasing federal litigation expense has given rise to a movement in alternative dispute resolution).

[173] Schuler v. Comm'r of Soc. Sec., No. 03-3734, 2004 WL 2030280, at *102 (6th Cir. 2004) (citing Cline v. Sec. of Health, Educ. & Welfare, 444 F.2d 289, 291 (6th Cir. 1971)).

[174] Andrew Page, *What's the Cost of Living in Oregon These Days? A Fresh Look at the Need for Judicial Protections in the Death with Dignity Act*, 22 REGENT L. REV. 233, 253 (2009).

[175] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(c)(2), § 1514A(e)(2), 124 Stat. 1376, 1848 (2010).

[176] Robert Rhoad et al., *Whistling While They Work: Limiting Exposure in the Face of the PPACA's Invitation to Employee Whistleblower Lawsuits*, 22 A.B.A. HEALTH L. SEC. 19, 19 (2010).

[177] Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(c)(2), § 1514(A)(e)(2).

[178] Feldman & Lobel, *supra* note 2, at 1177 ("Overprotection may encourage bad-faith reporting and exaggerated, or even false, accusations. It can also diminish the positive ties and organizational citizenship behavior of institutional players.").

[179] Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(h)(1). Section 922(a) only requires that an employee report information, not that the employee report accurate information, to obtain whistleblower protection. *See id.*

IV. PROSPECTS FOR LEGISLATIVELY AMENDING DODD-FRANK

Notwithstanding any plausible reform proposals, it is unlikely that Congress will amend or repeal the Dodd-Frank whistleblower provisions. One factor indicating that Congress will not amend Dodd-Frank is the influence of the trial lawyer lobby. Admittedly, it is difficult to measure a particular special interest's influence because it is difficult to know the specific purpose behind political contributions.[180] Exacerbating this difficulty are political contributions made not just by political organizations, but trial lawyers individually, their families and law firms.[181] Despite this difficulty, the American Association for Justice, which is the preeminent trial lawyer lobbying association, is regarded as an influential contributor to Congressional members and the Obama administration during Dodd-Frank's enactment.[182]

If incentives suggest the purpose behind contributions, the trial lawyer lobby is certainly a likely promoter of whistleblower bounties because attorneys stand to gain considerably from whistleblower litigation.[183] The SEC bounty program is expected to be a significant boon to trial lawyers just as *qui tam* actions under the False Claims Act earn trial lawyers

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[180] *See* WILLIAM N. ESKRIDGE, JR. ET AL., CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY 305 (4th ed. 2007) (noting uncertainty, in the context of bribery, regarding situations that "fall somewhere along the spectrum between clearly legitimate arrangements and patently corrupt deals"). Contributions to a candidate or organization may be a result of a donor's wish to support a variety of issues or candidates for past or future behavior. *Id.* at 304. For information about the American Association for Justice Political Action Committee contributions and expenditures, see *American Assn for Justice*, OPENSECRETS.ORG, http://www.opensecrets.org/pacs/lookup2.php?strID=C00024521&cycle=2010.

[181] Chris Rizo, *Group says trial lawyers actually gave $35 Million to political causes*, LEGALNEWSLINE (Mar. 15, 2010), http://www.legalnewsline.com/news/226145-group-says-trial-lawyers-actually-gave-35-million-to-political-causes.

[182] David Ingram, *Trial Lawyers Sticking With Democratic Party*, NAT'L L.J., Oct. 19, 2010, http://www.law.com/jsp/article.jsp?id=1202473540921&Trial_Lawyers_Sticking_With_Democratic_Party. *See also* David Freddoso, *Will Obama administration give trial lawyers a $1.6 billion tax break?*, WASH. EXAMINER, July 14, 2010, http://www.washingtonexaminer.com/opinion/blogs/beltway-confidential/will-obama-administration-give-trial-lawyers-a-16-billion-tax-break-98413014.html. *But see* Kara Rowland, *Trial Lawyer Lobby Sinks $6.2M in Debt*, WASH. TIMES, Sep. 28, 2009, http://www.washingtontimes.com/news/2009/sep/28/trial-lawyers-lobby-is-62-m-in-debt/ (noting that the trial lawyer lobby may have had limited influence on Dodd-Frank if they only have limited financial resources).

[183] Harker et al., *supra* note 34, at 780–81 (noting that trial lawyers may benefit handsomely from the Dodd-Frank whistleblower provisions).

handsome fees.[184] Moreover, trial lawyers benefit not only from legal fees taking a portion of lucrative whistleblower bounties, but also in negotiations with employers on behalf of terminated employees claiming whistleblower protection.[185] Thus, the presence of trial lawyers' interest stands as a potential bar to more thoughtful policy and whistleblower reform.

Another factor indicating that Congress will not amend Dodd-Frank is the prospect that reform will open the door to amending other Dodd-Frank provisions or other legislation enacted by the 111th Congress, including the Patient Protection and Affordable Care Act ("PPACA").[186] To illustrate, consider that Congress recently declined to amend the PPACA to eliminate a new Form 1099 ("1099") reporting requirement designed to close the tax gap and pay for health care reform.[187] The 1099 reporting requirement requires all businesses to prepare 1099s for goods and services purchased from vendors that cumulatively exceed $600 during the course of the taxable year.[188]

However, the 1099 reporting requirement may not have carefully contemplated the considerable compliance burden placed on small business.[189] Also, it is not clear that the 1099 requirement will increase income reporting as intended because businesses may not comply, and even with business compliance, it will be administratively difficult for the IRS to process the information in a useful way.[190] Despite the negative implications, Congress rejected proposals to eliminate or amend the

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[184] Harris, *supra* note 97, at 1302-03.

[185] William Olsen, *Major Whistleblower Provisions in Financial Regulation Bill*, CATO INSTITUTE, July 16. 2010, http://www.cato-at-liberty.org/major-whistleblower-provisions-in-financial-regulation-bill/.

[186] Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119 (2010).

[187] Alexander Bolton, *Senate Defeats Plan to Strip Filing Requirement from Health Care Law*, HILL, Sept. 14, 2010, http://thehill.com/homenews/senate/118637-senate-defeats-effort-to-strip-1099-requirement-from-health-law.

[188] Patient Protection and Affordable Care Act, Pub. L. 111-148, sec. 9006, § 6041, 124 Stat. 119, 855 (2010). "Current law dictates that only services provided in excess of $600 must be reported via Form 1099 and that corporations (with the exception of attorneys) are exempt from receiving 1099s." Amy Mignogna, *Concern over new 1099 reporting requirement gaining momentum*, CPA VOICE, Aug. 2010, at 7. Notably, credit card transactions are exempt from this requirement. *Id.*

[189] Robert Pear, *Many Push for Repeal of Tax Provision in Health Law*, N.Y. TIMES, Sept. 12, 2010, at A25. Democratic support for repealing the requirement suggests that it may not have been carefully contemplated because Democratic votes were the primary source of support to enact the PPACA. *Id.*

[190] Amy Mignogna, *Federal tax proposals heat up over summer months*, CPA VOICE, Sept. 2010, at 11.

requirement, in part due to reluctance to open the door to amend other legislation and in part due to an inability to replace expected tax revenue.[191] As applied to Dodd-Frank, it is unlikely that Congress will amend the new whistleblower provisions because it would open the door to amending other controversial and distantly related Dodd-Frank provisions.

V. AGENCY IMPLEMENTATION & PROPOSED RULE ANALYSIS

Administrative action is a plausible way to remedy the costs of the Dodd-Frank bounty program. The SEC and CFTC may achieve Dodd-Frank's purpose and limit associated costs by: (1) adopting practices to better manage whistleblower tips; (2) amending the SEC's Proposed Rules; and (3) considering two novel rule proposals.

A. Administrative Efficiency: Improving Tip Management

As noted at the outset, whistleblower reform cannot achieve its policy ends if there are not administrative structures in place to properly manage whistleblower tips. That is, no incentive to report fraud, monetary or otherwise, will address the underlying problems if the enforcement agency does not act on fraud reports. With this in mind, administrative reform in the way the SEC manages whistleblower tips and its bounty program should have been implemented and assessed prior to enacting Dodd-Frank's more sweeping and costly changes.[192] Had assessment of administrative reform demonstrated improved fraud enforcement, many of the Dodd-Frank provisions may have proved overreaching or even unnecessary because Dodd-Frank's purpose would have already been achieved. Put simply, it is possible, perhaps even likely, that existing voluntary whistleblower reports are sufficient to achieve Dodd-Frank's purpose of exposing Ponzi schemes

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[191] Pear, *supra* note 189 ("The White House is nervous about a repeal, fearing that it could set a precedent for rolling back other unpopular features of the law."). Repeal of the 1099 requirement was not included in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 or otherwise achieved during the lame duck session of the 111th Congress. American Institute of CPAs, *Congress Resolves Many Tax Issues During Lame-Duck Session*, TAX ADVISOR, Dec. 22, 2010, http://www.aicpa.org/InterestAreas/Tax/NewsAndPublications/taxnews/Pages/20101222.aspx. While the House of Representatives recently passed a bill to repeal the Form 1099 requirement, it is not expected to pass the Senate due to disagreement about how to pay for "lost" revenue. Robert Pear, *House Votes to Help Small Businesses Comply with Health Bill, but Relief Is Held Up*, N.Y. TIMES, Mar. 3, 2011, http://www.nytimes.com/2011/03/04/health/policy/04health.html?partner=rss&emc=rss.

[192] *See* SEC. & EXCH. COMM'N, *supra* note 26, at vi–vii.

and structured finance fraud, but that agencies have not been responsive enough to benefit from the tips.[193]

Indeed, the SEC's proposed rules provide measures that are designed to improve information management, including clear reporting procedures,[194] standardized forms[195] and communication procedures.[196] Specifically, whistleblowers must fill out three forms: a form TCR providing the tip information; a form WB-DEC essentially stating that the information is eligible for an award; and a form WB-APP claiming the award following a SEC covered action.[197] While the SEC has expressed concern that these measures are procedural hurdles that may be overly burdensome and deter whistleblower reporting,[198] the forms should be adopted because the simple presence of any standardized form provides critical procedures to organize tip gathering. Further, separation may avoid paying bounties to whistleblowers who are not motivated by monetary incentives.

Additionally, the proposed rules should adopt pre-Dodd-Frank Inspector General recommendations to reform the SEC's existing bounty program, many of which are applicable to managing whistleblower tips even in the absence of a bounty program.[199] Specifically, a 2010 Inspector General Report reveals that the SEC's insider trading bounty program had basic deficiencies and provides the following corresponding recommendations:[200]

- The SEC's bounty program has made few payments to date and should be *more publicized*.[201]
- Information on the SEC's website about applying for a bounty is misleading.[202] As such, there should be *a standardized form to*

[193] *See* discussion *infra* Pt.III.A.
[194] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70501 (Nov. 17, 2010).
[195] *Id.* at 62.
[196] *Id.* at 84.
[197] *Id.* at 96.
[198] *Id.* at 116.
[199] *See* SEC. & EXCH. COMM'N, *supra* note 26, at vi–vii. Interestingly, Dodd-Frank calls for another Inspector General report to assess the new whistleblower provisions despite the presence of the aforementioned report. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(d), § 1514A, 124 Stat. 1376, 1848 (2010). As the Dodd-Frank whistleblower provisions were enacted prior to the implementation and assessment of existing recommendations, it is questionable whether a new Inspector General Report will garner attention necessary to result in administrative reform and improved enforcement.
[200] SEC. & EXCH. COMM'N, *supra* note 26, at 4–22.
[201] *Id.* at 8.
[202] *Id.*

report illegal activity and policies for following up with whistleblower tips.[203]

- Existing criteria (pre-Dodd-Frank) for awarding bounties is overly vague. There should be *more objective criteria for determining whistleblower award amounts*.[204]
- The SEC does not update whistleblowers with the status of their case and should *communicate with whistleblowers more* to encourage reporting additional information.[205]
- Bounty applications are handled on an *ad hoc* basis and better tracking of applications should result in *more timely review*.[206]
- Bounty applicant's files sometimes contain incomplete information and the SEC should *require a bounty file with specific information*.[207]
- The SEC should *implement best practices from other agencies*.[208]

To strengthen the proposed rules with Inspector General recommendations, the SEC should maintain individualized whistleblower files. With the files, the SEC should notify individual whistleblowers at their last known address, rather than the public at-large, when tips result in a covered action.[209] Unfortunately, it is not clear whether these improvements to tip management are practical due to SEC budget constraints, which have postponed the creation of the new whistleblower office.[210] Regardless, Dodd-Frank's sweeping whistleblower reform may have been unnecessary in light of several basic recommendations to better manage and utilize existing whistleblower reports to enforce fraud.

B. *Proposed Rule Analysis*

Despite potentially heavy costs that may result from the Dodd-Frank bounty program, carefully written SEC rules must "separate the wheat from

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[203] *Id.* at 11.

[204] *Id.* at 12–13. It should be noted that Dodd-Frank provides several factors for determining the amount of whistleblower awards Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(c)(1).

[205] SEC. & EXCH. COMM'N, *supra* note 26, at 13–15.

[206] *Id.* at 15–19.

[207] *Id.* at 19–20.

[208] *Id.* at 20–22.

[209] Public Comment from District of Columbia Bar, to Proposed Rule for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 1–2 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-146.pdf.

[210] Yin Wilczek, *Whistleblower Program Seen Mirroring SEC Proposal, but Depends on Budget Cuts*, *in* BNA CORPORATE ACCOUNTABILITY REPORT (Jan. 11, 2011).

the chaff"[211] to limit costs, encourage reliable tips and maintain the purpose of Dodd-Frank moving forward.[212] It is critical to note that the proposed rules do not bar whistleblowers from reporting externally *per se*, but rather limit their eligibility for a lucrative whistleblower bounty while preserving retaliation protection.[213] Recognizing that it is a windfall gain at stake, rather than protection of one's livelihood, it is more acceptable to have high eligibility standards under the bounty program. Further justifying high standards, monetary incentives may not be a major impetus for reporting securities fraud.[214] The rules should be specifically amended to: (1) require internal reporting; (2) appropriately restrict standing; (3) adopt heightened pleading; (4) expose whistleblowers and attorneys to risk; (5) and further address the anti-retaliation provisions.

1. *Require Internal Reporting & Waiting Period*

The SEC should require whistleblowers seeking a bounty to report securities fraud internally and grant an extended period of time for internal compliance systems to remedy the fraud. Because the proposed rules do not require internal reporting, one issue presented is how to avoid a whistleblower's "race to external reporting" with other whistleblowers and corporate compliance staff.[215] Whistleblowers are incentivized to be the first to report because only "original information" is worthy of a bounty while corporate compliance is incentivized to self-report to obtain leniency in sentencing.[216]

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[211] Yin Wilczek, *SEC Enforcement Director Acknowledges 'Challenges' in Writing Whistleblower Rules*, *in* BNA CORPORATE ACCOUNTABILITY REPORT (Oct. 27, 2010).

[212] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(j), 124 Stat. 1376 (2010). Dodd-Frank gives the SEC 270 days, until April 21, 2011, to write rules implementing the bounty program. *Id.* § 924(a). CHARLES KOCH, JR., 1 ADMIN. L. & PRAC. § 4.1 (3d ed. 2010) (stating that "rulemaking is foremost a policymaking device").

[213] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70489 (Nov. 17, 2010).

[214] Feldman & Lobel, *supra* note 2, at 1178–79.

[215] *See supra* Pt.III.B.1.

[216] Carton, *supra* note 82. Whistleblowers are only entitled to awards under the new bounty program if they provide original information. Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(b)(1). *See also* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70495–99 (defining "original information"). Explicitly, whistleblowers may report externally to the SEC, rather than internally to management, to avoid delay and mitigate the risk of foregoing or sharing an award due to another whistleblower reporting sooner, collecting the award, and rendering the information non-original. *Id.*

The proposed rules address the race to external reporting by providing a mechanism whereby whistleblowers may maintain eligibility and their place in line for a bounty up to ninety days after internal reporting.[217] In addition, the proposed rules incentivize internal reporting by identifying internal reporting as a factor that will lead to a higher bounty.[218] However, these incentives do not guarantee internal reporting and are not attractive to some whistleblowers who: may not want to prolong the potentially emotional whistleblowing process;[219] may be skeptical of corporate interests to detect fraud;[220] and may not be aware of internal reporting incentives any more than they are aware of the specifics of the underlying securities laws.[221] As presented, the proposed rules may be an unsuccessful attempt to toe the line between business and whistleblower interests.

To counteract the external reporting incentive, Congress should adopt a provision requiring that whistleblowers report internally before reporting to the SEC or CFTC.[222] Candidly, whistleblowers usually report internally before reporting externally, even in the case of *qui tam* whistleblowers who are incentivized by a reward.[223] However, whistleblowers may first report internally because they are not aware of incentives or options for external reporting.[224] With uncertainty about when whistleblowers report externally,

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[217] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70516.

[218] *Id.* at 70500. Curiously, the proposed rules also grant the SEC discretion to allow corporate compliance even after a whistleblower externally reports a tip, which is inconsistent with Dodd-Frank's policy to provide certainty to whistleblowers. *Id.* at 70496. Under the rule, reporting would not be certain and even deceive whistleblowers making the emotional decision to report fraud. *Id.* at 70517. If a whistleblower reports fraud and the SEC subsequently allows a business to remedy a securities violation with little penalty, the whistleblower may not receive the bounty that incentivized reporting in the first place. Such a result is especially troublesome when whistleblower anonymity is impracticable because only a select few individuals within an organization are likely to be aware of the reported fraud.

[219] Cavico, *supra* note 169, at 545.

[220] Whistleblowers may decide not to report internally due to the potential conflict of interest between corporate interests and whistleblower interests to detect fraud or collect a whistleblower award.

[221] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70516.

[222] Carton, *supra* note 82.

[223] *The Impact of Qui Tam Laws on Internal Compliance*, NAT'L WHISTLEBLOWER CENTER 5 (2010), *available at* http://sec.gov/comments/s7-33-10/s73310-212.pdf. *See also* Lobel, *supra* note 137, at 1250.

[224] Marcia Parmerlee Miceli & Janet P. Near, *The Relationship among Beliefs, Organizational Position, and Whistle-Blowing Status: A Discriminant Analysis*, 27 ACADEMY MGMT. J. 687, 701 (1984). *See also* Proposed Rules for Implementing the Whistleblower Provisions of Section 21F, 75 Fed. Reg. at 70488.

the mere presence of initial internal reporting will not ensure that internal systems have an opportunity to investigate and remedy the fraud before external reporting. The proposed rules should avoid the harm of unnecessary external reporting by not only allowing whistleblowers to maintain their place in line upon internal reporting, but requiring internal reporting and giving internal compliance an extended period, perhaps 180 days following internal reporting, before fraud may be reported externally.[225]

Public policy often requires internal reporting in analogous situations. Elsewhere in the securities laws, for example, illegal activity must be reported internally before reporting to the SEC. Section 10A of the Exchange Act requires that auditor's report fraud to company management before reporting to the board of directors, who must inform the SEC.[226] In addition, shareholder derivative rights of action echo similar policy rationale by generally requiring either a demand on the board of directors or a determination by a special litigation committee before properly proceeding to court.[227] Moreover, other countries, including Germany and Britain, require internal reporting to qualify for anti-retaliation protection or monetary incentives.[228]

If internal reporting is required, whistleblower awards should be based upon the size of the fraud when the whistleblower initially became aware of the fraud.[229] Otherwise, bounties may have the adverse effect of discouraging potential whistleblowers who would otherwise report fraud.[230] Allowing the fraud to persist will likely increase the size of the fraud, and

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[225] *See* Morvillo & Robertson, *supra* note 131 (stating that ninety days may not give internal compliance systems sufficient time to investigate whistleblower complaints).

[226] 15 U.S.C. § 78j-1(b)(1)(B) (2010).

[227] Grimes v. Donald, 673 A.2d 1207, 1216 (Del. Sup. Ct. 1996) (stating that "[a] stockholder filing a derivative suit must allege either that the board rejected his pre-suit demand that the board assert the corporation's claim or allege with particularity why the stockholder was justified in not having made the effort to obtain board action."). *See also id.* (citing Aronson v. Lewis, 473 A.2d 805, 812 (1984) (The demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of the corporation.")).

[228] Elletta Sangrey Callahan et al., *Whistleblowing: Australian, U.K., and U.S. Approaches to Disclosure in the Public Interest*, 44 VA. J. INT'L L. 879, 890 (2004) (stating that British law requires internal reporting to obtain anti-retaliation protection); Matthias Schmidt, "*Whistle Blowing" Regulation and Accounting Standards Enforcement in Germany and Europe—An Economic Perspective* UNIVERSITÄT MARBURG 21, http://www.wiwi.uni-marburg.de/ZentrEinr/Dekanat/fk_paper_schmidt.pdf (last visited Mar. 30, 2011) (noting the German internal reporting requirement).

[229] Kovacic, *supra* note 16, at 1845–46.

[230] *Id.*

with it, the size of the SEC penalty and bounty.[231] Thus, freezing the bounty in time is necessary to combat this disincentive.

In the likely event that the SEC does not require internal reporting under the final rules,[232] the SEC should maintain the internal reporting incentives in the proposed rules and provide objective criteria for internal control systems as a safe harbor from liability or leniency incentive.[233] Under this proposal, defendant corporations have the burden of proving that internal controls met the objective requirements.[234] In a similar context, antitrust law contains objective business practices companies may follow to obtain sentencing leniency.[235] Regarding FCPA violations, one proposal offers twelve objective criteria that must be met to fall under a safe harbor.[236] The proposal provides certainty to companies by recognizing that internal systems which result in self-reporting provide a significant benefit to law enforcement.[237] For the reasons stated above, the SEC should amend the proposed rules to support internal compliance systems.

2. *Restrictive Standing Requirements*

Ideally, standing requirements will minimize the cost of frivolous tips made by profit-driven persons and make ineligible whistleblowers with pre-existing duties to report (i.e., involuntary parties). Under the proposed rules, such "involuntary" whistleblowers are not eligible for a bounty.[238] More controversial are the listed exclusions to how whistleblowers may obtain "independent knowledge," which essentially define the standing requirements.[239] The listed exclusions affect the whistleblower status of attorneys, accountants, other professionals, compliance officers and any

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[231] *Id.*

[232] Wilczek, *supra* note 210. An internal reporting requirement is not expected to be enacted under the final rules.

[233] Robert W. Tarun & Peter P. Tomczak, *A proposal for a United States Department of Justice Foreign Corrupt Practices Act Leniency Policy*, 47 AM. CRIM. L. REV. 153, 219–20 (2010). *See also* Public Comments from General Electric Co. et al., to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 4–5 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-179.pdf.

[234] Tarun & Tomczak, *supra* note 233, at 220.

[235] *Id.* at 158–59.

[236] *Id.* at 219–20. For business compliance advice similar to the proposal offered by Tarun and Tomczak, see discussion *infra* Pt.VI.

[237] Tarun & Tomczak, *supra* note 233, at 215.

[238] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70490 (Nov. 17, 2010).

[239] *Id.* at 19–20.

culpable party.[240] Rules should be implemented to severely curtail these parties' eligibility for a bounty.

First, the proposed rules properly limit attorney whistleblower standing. Namely, information obtained through legal representation for an attorney's own benefit as well as information subject to attorney-client privilege may not be used to obtain a whistleblower bounty.[241] It is unnecessary to incentivize attorneys to report information obtained through legal representation due to pre-existing professional responsibilities.[242]

More controversial is the use of privileged materials in such actions. To be sure, an in-house attorney whistleblower may use materials protected by the attorney-client privilege to prove a SOX 806 whistleblower *retaliation* claim.[243] In *Jordan v. Sprint Nextel*, an administrative tribunal invoked Fifth Circuit precedent citing ABA Model Rule 1.6(b)(5), which states that "[a] lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary . . . to establish a claim or defense on behalf of the lawyer *in a controversy between the lawyer and the client*."[244]

However, in the context of Dodd-Frank whistleblower bounties, privileged information should not be admissible evidence. Retaliatory discharge claims by an in-house attorney involve situations where the attorney clearly has a controversy with the employer, as referenced in Rule 1.6(b)(5). By contrast, suits claiming a whistleblower bounty do not necessarily involve a controversy between the lawyer and the client if the attorney has been harmed only indirectly as a member of society, rather than individually.

In the case of employees or third parties seeking privileged materials where the corporation is the client, privileged materials should not be admissible to avoid creating a monetary incentive to undermine attorney-client privilege.[245] Also, whistleblowers have a compelling interest to preserve their livelihood in retaliatory discharge claims that may not be present with bounty claims. As such, confidentiality is properly preserved in the retaliatory discharge context, but not the bounty claim context. For these reasons, the rule excluding privileged materials from proving bounty claims should be adopted.

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[240] *Id.* at 19–28.
[241] *Id.* at 20–21.
[242] *Id.* at 21 n.25.
[243] Jordan v. Sprint Nextel Corp., 06-105, Administrative Review Board's Order of Remand, at 2 (Dep't of Labor Sept. 30, 2009).
[244] *Id.* at 9 (emphasis added).
[245] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70490 (Nov. 17, 2010).

Second, the proposed rules limit the eligibility of independent public accountants by prohibiting the use of information obtained through the performance of an engagement required by the securities laws.[246] However, limiting the exclusion to required engagements is too narrow in scope. The accountant exclusion should preclude accountants from earning bounties any time they obtain information in their professional capacity. As noted by major accounting firms, a broader restriction excluding information obtained from non-audit services is needed to preserve confidentiality and foster a culture of trust between accountants and their clients.[247] Similarly, investment advisors echo this reasoning in arguing that they should not be eligible for whistleblower bounties.[248]

Third, the proposed rules limit the eligibility of corporate compliance personnel when they obtain information from persons expecting them to respond to a violation or through an internal compliance system.[249] To incentivize effective internal compliance, these exclusions are not applicable if the entity does not disclose the information to the SEC within a reasonable time or acts in bad faith.[250] These exclusions are appropriately designed to support internal corporate compliance systems by preventing compliance personnel from "front running" internal compliance systems.[251]

However, the rules go too far insomuch as they effectively create a duty to disclose.[252] Expressly, the rules require businesses to disclose

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[246] *Id.* at 22.

[247] Public Comments from PricewaterhouseCooper LLP, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 3 (Dec. 22, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-281.pdf. *See also* Public Comments from KPMG LLP, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 2–3 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-152.pdf; Public Comments from Joe DiLeo, *supra* note 125, at 3. *But see* Public Comments from Laura Montgomery, Ernst & Young LLP, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 4–5 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-176.pdf (stating that there are some instances in which auditors should be eligible for whistleblower bounties).

[248] Public Comments from Jim DeLoach, Protiviti Risk & Business Consulting, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 2 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-178.pdf.

[249] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70493.

[250] *Id.*

[251] *Id.* at 70493–94.

[252] *But see id.* at 70494 n.36 (stating that "This provision does not impose new reporting requirements in addition to those already existing under the federal

information obtained through internal systems to the SEC within a reasonable time.[253] One problem with the reasonable time exception is that not all compliance staff will be aware of the status of all internal investigations (i.e., when they began and whether they have been reported to the SEC). As such, compliance staff will have to make an uninformed decision about whether a reasonable time has passed before reporting externally.[254] It is a significant burden on internal compliance systems to inform all compliance personnel as to the status of all investigations, which is necessary to disable compliance personnel from reporting externally at any time under the bounty program.[255] Other issues arise due to the uncertainty that results from the reasonable time exception. The exception would eliminate issuer discretion to disclose investigations regarding minor or self-remediated violations.[256] In doing so, the rule is subjecting internal investigations to uncertainty because they may be potentially overruled by SEC review.[257] Furthermore, the exception does not preserve confidentiality because SEC review could reveal confidential information gathered during internal investigations.[258] Under these circumstances, employees may not be as candid as they otherwise might and the rule undermines the effectiveness of internal compliance systems.

The reasonable time exception may further harm businesses by rushing internal compliance because it is difficult to know when to close a whistleblower investigation.[259] For example, Renault SA recently experienced an embarrassing public affair by acting too quickly in response to an anonymous corporate espionage tip.[260] In Renault's case, executives accused of leaking secret company information to competitors were fired following a four-month investigation.[261] However, Renault uncovered no evidence against the fired executives and the whistleblower likely sold false

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securities laws."). The SEC's states that there is no additional reporting requirement, but nonetheless requires firms to self-report potential violations.

[253] *Id.* at 70493-94.

[254] Public Comments from General Electric Co. et al., *supra* note 233, at 6.

[255] *Id.* at 7.

[256] *Id.*

[257] *Id.*

[258] *Id. See* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70510 (Nov. 17, 2010).

[259] Ashby Jones & Joann Lublin, *Firms Revisit Whistleblowing*, WALL ST. J., Mar. 14, 2011, http://online.wsj.com/article_email/SB10001424052748703327404576194913231712904-lMyQjAxMTAxMDEwMzExNDMyWj.html. *See also* Sebastian Moffett, *In Renault Spy Case, Deja-Vu*, WALL ST. J., Mar. 12, 2011, http://online.wsj.com/article_email/SB1000142405274870359780457619477411043 8358-lMyQjAxMTAxMDEwNDExNDQyWj.html.

[260] Jones & Lublin *supra* note 259.

[261] *Id.*

information to extort money.[262] The affair concluded with an embarrassing public apology from Renault.[263]

To support internal compliance systems, the proposed rules should eliminate the reasonable time exception for compliance personnel to obtain standing. Alternatively, if not eliminating the reasonable time exception altogether, the certainty issues noted above may be resolved by replacing the language in the rule requiring disclosure with language requiring internal corrective action of the violation.[264]

Fourth, the proposed rules bar culpable parties convicted of a related criminal violation from obtaining whistleblower bounties. While appropriately recognizing that culpable parties should not have standing, the rules should go further to exclude other culpable parties.[265] Parties that are complicit in wrongdoing for failing to follow internal control procedures or reporting known fraud should also be considered culpable and therefore ineligible for whistleblower bounties.[266]

Alternatively, corporations should be permitted to require internal reporting and bring counterclaims against whistleblowers violating such policies.[267] As complicity to fraud can be culpable behavior itself, an important tool for corporations to prevent fraud is ethics codes requiring employees to serve a gatekeeping function and report bad conduct.[268] It could be unnecessarily difficult for corporations to enforce internal compliance systems if they cannot require ethical conduct from employees.[269] Critics argue that culpable parties often have the most significant and relevant information.[270] Nonetheless, the proposed rules

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[262] David Gauthier-Villars, *Police Probe If Renault was Victim in Spy Case,* WALL ST. J., Mar. 14, 2011, http://online.wsj.com/article_email/SB1000142405274870 4027504576198924136741318-lMyQjAxMTAxMDEwNDExNDQyWj.html.

[263] Sebastian Moffett & David Pearson, *Renault Apologizes to Fired Employees,* WALL ST. J. Mar. 15, 2011, http://online.wsj.com/article_email/SB10001424052 748704893604576200320262843698-lMyQjAxMTAxMDEwNDExNDQyWj. html.

[264] Public Comments from Karrie McMillan, Investment Company Institute, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 9 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-139.pdf.

[265] Public Comments from Davis Polk & Wardwell LLP, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 3 (Dec. 17, 2010), *available at* http://sec.gov/comments/ s7-33-10/s73310-200.pdf.

[266] *Id.*

[267] Kovacic, *supra* note 16, at 1843–44.

[268] *Id.* at 1844.

[269] *Id.*

[270] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70517 (Nov. 17, 2010). *See*

should be amended to define culpable parties to include whistleblowers who do not follow internal controls procedures.

Fifth, the proposed rules require that whistleblowers are the "original source" of information in a similar manner to the False Claims Act.[271] More specifically, the rule should require that whistleblowers be the primary source of information. Until 2009, the FCA required that whistleblowers be the primary source of information.[272]

Poor policy results without a primary source requirement because the rule could be construed as going beyond what Dodd-Frank requires and creating an affirmative duty to report. In some cases it may be difficult for employees who do not wish to report to avoid telling third parties. For example, employees may seek advice about reporting from fellow employees (i.e., third parties). As such, some employees with information may need to report the fraud to avoid exploitation from third party whistleblowers. Even well-intentioned third parties may effectively implicate the primary source employee and compromise anonymity when only a select few individuals have access to reported information. Alternatively, employees fearing such exploitation may be deterred from seeking advice about reporting from fellow employees.

Going further to reinforce a primary source requirement, the SEC should limit standing to employees and those in contractual privity with the wrongdoer (e.g. business partners and vendors).[273] Employees and parties in contractual privity with the wrongdoer, in contrast to outsiders, should be eligible for bounties because their relationship to a wrongdoer puts them in a position to obtain inside information and their professional responsibilities do not necessarily compel disclosure.[274]

The story of one professional whistleblower heeds a cautionary tale.[275] Professional whistleblower Joe Piacentile ("Dr. Joe")[276] and his attorneys[277]

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also Bronner, *supra* note 75 (noting that whistleblower Bradley Birkenfeld did not receive an award under the IRS bounty program for reporting UBS AG tax fraud because he was a culpable party).

[271] Bronner, *supra* note 75, at 18 n.21.

[272] *Id.*

[273] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(b)(1), 124 Stat. 1376, 1842–43 (2010). In contrast, the SEC's proposed rules limitstanding by defining the term "independent knowledge," which is required for a bounty, to except information obtained by certain persons or in certain situations. Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70492.

[274] S. REP. NO. 111-176, at 110 (2009).

[275] Kolz, *supra* note 107.

[276] Mr. Piacentile is known as "Dr. Joe" by the *qui tam* bar. *Id.*

[277] *Id.* (noting that many lawyers from the "relatively clubby" *qui tam* bar have represented Dr. Joe).

have amassed a small fortune making FCA claims based on information obtained from private investigations.[278] To obtain information, Dr. Joe often poses as a business partner or employee.[279] While Dr. Joe sometimes obtains and reports information leading to an award, the overwhelming majority of his tips do not lead to enforcement actions.[280] In light of Dr. Joe's often poor but nonetheless frequent tips, he imposes unnecessary costs on businesses unaware of his misrepresentations and on agencies conducting fraud investigations.

Public policy should not support granting professional whistleblowers standing to obtain bounties. Investigations should not be outsourced to professional whistleblowers because agencies are presumably better investigators due to experience, resource availability and reasonable compensation (i.e., do not require whistleblower bounties). Dodd-Frank outsources enforcement to whistleblowers only under the assumption that whistleblowers are in a better position to obtain relevant information.[281] Put simply, professional whistleblowers do not support Dodd-Frank's policy objectives because they are not naturally in a better position to obtain material inside information than existing government agencies.

Another consideration is that professional whistleblowers may cause whistleblower awards to be shared and detract from the awards of more legitimate whistleblowers.[282] One strategy employed by Dr. Joe is to obtain vague information and strive to be the first whistleblower to report fraud. By doing so, Dr. Joe can "piggyback" on information provided by other whistleblowers even if his information, standing alone, would not have been sufficient to lead to an enforcement action. Although Dr. Joe is a rare instance of a professional whistleblower and many of the specifics of his tips are left under seal, his story illustrates the need to narrow whistleblower standing to avoid mischief.

As a corollary to the primary source requirement, the proposed rules properly require that whistleblowers report non-publicly available information to be eligible for a bounty.[283] An exemption for independent analysis of publicly available information strikes an appropriate balance for this requirement.[284] Harry Markopolous' analysis of publicly available information, for example, would still be eligible for an award. Finally, the

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[278] Dr. Joe has made at least $17 million in whistleblower awards. *Id.*
[279] *Id.*
[280] *Id.*
[281] S. REP. NO. 111-176, at 110 (2009).
[282] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(j), 124 Stat. 1376 (2010). *See also* Kolz, *supra* note 107 (stating that the FCA requires relator bounties to be awarded as a group).
[283] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70492 (Nov. 17, 2010).
[284] *Id.*

proposed rules do not grant foreign officials standing to receive a whistleblower bounty in recognition of foreign sovereignty.[285] Accordingly, changes should be made to the standing requirements under the proposed rules.

3. *"Pleading" with Particularity*

A heightened pleading/reporting standard should be incorporated into the definition of original information such that tips providing incomplete information or mere hunches will not lead to an award. Indeed, the SEC's proposed rules provide some guidance to whistleblowers as to what requirements must be met to earn a bounty.[286] The proposed rules require that whistleblowers: cause the SEC to open an investigation; provide information "significantly contributing" to the success of the enforcement action; and provide evidence which will "lead to a successful enforcement action."[287]

However, the proposed rules should be more restrictive. A heightened pleading/reporting standard should require whistleblowers to identify culpable individuals, plead any required level of scienter, explain where the fraud occurred and explain the specific behavior constituting fraud.[288] If not adopting a *per se* standing bar, as suggested above, professional plaintiffs could be deterred by limiting the number of permissible whistleblower complaints. Other restrictions may include staying discovery pending administrative review of pleading/reporting requirements or requiring whistleblowers to provide specific types of reliable evidence.

The Federal Rules of Civil Procedure and analogous laws adopt a heightened pleading standard to prove fraud in federal court and should extend to the whistleblower reporting context.[289] In the securities litigation context, the Private Securities Litigation Reform Act ("PLSRA") is designed to limit frivolous strike suits that place an undue burden on businesses.[290] Specifically, the PSLRA: requires that plaintiff's plead with

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[285] *Id.* at 70502.

[286] *Id.* at 70497.

[287] *Id.* It should be noted that there are circumstances where a whistleblower bounty is available even though the tip did not cause an investigation to begin, but such information is held to a higher standard. *Id.* at 70498.

[288] FED. R. CIV. P. 9(b). *See also* Stradford v. Zurich Ins. Co., No. 02 CIV. 3628(NRB), 2002 WL 31027517, at *4 (S.D.N.Y. Sept. 10, 2002) (noting that "FED. R. CIV. P. 9(b) requires that the time, place, and nature of the [alleged] misrepresentations be disclosed to the party accused of fraud").

[289] FED. R. CIV. P. 9(b).

[290] H.R. REP. NO. 104-50 (1995). Strike suits may emerge in the securities litigation context due to plaintiff's lawyers, more so than angry shareholders, seeking to capitalize on falling stock prices. Corporations are often willing to settle strike suits because they are risk averse and they wish to avoid costs of litigation

particularity that defendants acted with a particular state of mind;[291] limits plaintiffs to five securities class action cases within a three year period; and stays discovery pending motions to dismiss.[292] With strike suits in mind, it is reasonable to extend heightened pleading/reporting as a requirement for whistleblower bounties because pleading with particularity is required to enforce the securities laws in federal court and therefore necessary for the SEC to measurably benefit from tips.[293] Elsewhere, *qui tam* actions brought by whistleblowers under the FCA, a similar context, require heightened pleading.[294] Within Dodd-Frank, heightened pleading is invoked for claims against credit rating agencies.[295]

From a policy standpoint, heightened pleading is efficient to limit many costs of the bounty program. First, frivolous tips based upon hunches or without evidence may be deterred as clearly outside the scope of the bounty program. Second, whistleblowers may be incentivized to gather and provide more complete information before reporting fraud, which will reduce agency investigatory costs. Third, companies accused of fraud will be in a better position to defend against whistleblower claims because they will have a better understanding of the fraud allegations against them.[296] Bounties should therefore be awarded only to those whistleblowers reporting fraud allegations with particularity.

4. Deterring Frivolous Tips with Risk Exposure

Whistleblowers and attorneys should be exposed to risk to deter unreliable tips.[297] Giving attorneys or whistleblowers "skin in the game"[298]

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and associated reputational harm. *Id.* Moreover, courts are often willing to approve settlements to clear complicated cases from their dockets. *Id.* Similar circumstances may arise with whistleblowers reporting securities fraud. Public Comments from Jack Jordan, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 2–8 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-198.pdf.

[291] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, sec. 101(b), § 21D(b)(1)(B)(2), 109 Stat. 737, 747, 15 U.S.C. § 78u-4 (1995).

[292] *Id.* at sec. 101(b), § 27(b).

[293] The SEC uses a similar line of reasoning to justify a whistleblower's evidentiary burden. *See* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70497 (Nov. 17, 2010).

[294] United States v. Eastman Kodak Co., et al., 98 F. Supp. 2d 141 (D. Mass. 2000).

[295] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 933(b)(2)(B), 124 Stat. 1376, 1883–84 (2010).

[296] *Stradford v. Zurich Insurance Company*, 2002 WL 31027517, at *4 (noting that "the 'primary purpose' of Rule 9(b) is to afford a litigant accused of fraud fair notice of the claim and the factual ground upon which it is based.").

[297] Kovacic, *supra* note 16, at 1850.

may deter unreliable tips made by employees reporting mere hunches about fraud, employees defensively seeking statutory whistleblower protection and employees retaliating against supervisors for perceived slights.[299] In turn, exposure to risk will ease the SEC's management burden while preserving the benefits of whistleblower incentives.

Dodd-Frank, as supported by the proposed rules, indirectly places attorneys at risk for frivolous tip submissions under the SEC's Rules of Practice by requiring that anonymous whistleblowers retain an attorney.[300] Attorneys must essentially perform a screening function to avoid representing whistleblowers making frivolous tips, which could subject them to sanctions under the SEC Rules of Practice.[301] The resultant cost on attorneys is appropriate because, as noted above, trial attorneys benefit from the bounty program insomuch as they earn fees representing whistleblowers and advising businesses.[302] In light of this benefit, attorneys gain little sympathy over screening expenses they choose to incur by representing securities law whistleblowers. For similar reasons, the PLSRA subjects attorneys to "sanctions for abusive litigation."[303] In the present context, the SEC should write a rule outlining specific attorney sanctions for abusive whistleblower claims. Moreover, it may be appropriate to cap attorneys' fees for SEC whistleblowers to further discourage unreliable tips.[304]

Whistleblowers, in contrast to attorneys, are currently exposed to little litigation risk as a result of the bounty program. In fact, the only statutory penalty for reporting intentionally unreliable tips is inconsequential

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[298] Telephone Interview with Dan Sandman, *supra* note 165.

[299] *Id. See also e.g.*, Kolz, *supra* note 107.

[300] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70501 (Nov. 17, 2010) (stating that attorneys may face sanction under SEC Rules of Practice for misconduct while practicing before the SEC). *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(d)(2).

[301] *But see* Public Comments from Jack Jordan, *supra* note 290, at 8 (stating that the SEC does not sufficiently scrutinize frivolous statements by whistleblower attorneys). *But see* Public Comments from Eric Dixon, Esq., to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 2 (Dec. 13, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-221.pdf (stating that attorneys must perform a screening function to represent whistleblowers).

[302] *See supra* Pt.IV.

[303] Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 77z-1.

[304] *But see* Public Comments from C. Gibson Vance, President, American Association for Justice, to Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 2–3 (Dec. 17, 2010), *available at* http://sec.gov/comments/s7-33-10/s73310-132.pdf (arguing that access to attorneys is critical for whistleblowers to report fraud).

ineligibility for whistleblower awards.[305] Nonetheless, there may still be some risk as the Department of Justice has indicated that it will prosecute fabricated whistleblower tips.[306]

Fee-shifting may deter frivolous tips. Under the "American bounty hunter" system, plaintiffs are free to bring claims without exposure to the risk they will be responsible for the defendant's attorneys' fees if their action is unsuccessful.[307] By comparison, a rule adopting the English fee-shifting system in which a litigation loser pays the winner's legal fees would subject whistleblowers to risk. With fee-shifting, whistleblowers may be reluctant to make unreliable claims because they face monetary penalties.[308] As a result, the SEC would reduce the burden of handling some unreliable tips.

Candidly, issues arise surrounding a risk-based system. First, whistleblowers concerned that their tips will be characterized as frivolous and result in liability may be reluctant to file valid claims. Nonetheless, creating an objective and high standard for fraud will provide certainty and limit the risk of deterring reliable whistleblowers claims due to a fear of penalties. Second, whistleblowers may already be exposed to sufficient risk due to the career-risk involved with reporting if there is no anonymous method of reporting.[309] However, career risk does not deter whistleblowers who defensively make claims to avoid otherwise justified workplace penalties, which may appear to be retaliatory when applied to a whistleblower.

In a similar context, Congress implemented fee-shifting provisions for *qui tam* actions brought under the False Claims Act.[310] Under the FCA, the defendant's legal fees are shifted to the whistleblower[311] if the suit is "clearly frivolous, clearly vexatious or brought primarily for purposes of

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[305] Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(i).

[306] Yin Wilczek, *DOJ to Prosecute Whistleblowers Who Fabricate Information, Bharara Says, in* BNA CORPORATE ACCOUNTABILITY REPORT (Nov. 15, 2010).

[307] Professor Dale Oesterle, J. Gilbert Reese Chair in Contract Law, The Ohio State University Moritz College of Law, Class Lecture in Law 607.01L: Business Associations, Feb. 22, 2010.

[308] Telephone Interview with Dan Sandman, *supra* note 165. *But see* Kovacic, *supra* note 16, at 1850 n.185 (noting that there is debate over whether fee-shifting deters frivolous suits).

[309] Cavico, *supra* note 169, at 545 ("practical, ethical and legal ramifications [make] blowing the whistle one of the most difficult decisions an employee will have to make").

[310] Kovacic, *supra* note 16 at 1850 (citing 31 U.S.C. § 3730(d)(4) (1994)).

[311] Persons reporting illegal activity are referred to as "relators" rather than "whistleblowers" under the False Claims Act. *See* Kovacic, *supra* note 16.

harassment."[312] Although the high standard has resulted in few defendants successfully shifting fees to whistleblowers,[313] the presence of FCA fee-shifting may still deter frivolous claims and there appear to be few costs associated with the FCA fee-shifting rule. A rule subjecting attorneys or whistleblowers to risk should be adopted due to the considerable benefits of deterring unreliable tips and nominal costs.

5. *Proper Scope of Anti-Retaliation Protection*

The SEC has provided little guidance to implement Dodd-Frank's anti-retaliation provisions. The proposed rules state only that whistleblowers do not need to meet the procedures and conditions for a bounty to have anti-retaliation protection.[314] Although critics argue that whistleblowers should not benefit from anti-relation protection if not eligible for a bounty,[315] separate qualifications for anti-retaliation and bounty program eligibility are appropriate to protect whistleblowers from uncertainty about anti-retaliation protection. Furthermore, separate standards justify higher standards for bounty program eligibility because ineligibility only revokes opportunity for a windfall gain. In sum, Dodd-Frank's anti-retaliation provisions should be independent of bounty program eligibility.

C. *Novel Rule Proposals*

1. *Bounties for Only Certain Types of Securities Fraud*

Dodd-Frank is designed to address problems with U.S. capital markets[316] and its whistleblower provisions are specifically intended to address notorious Ponzi schemes.[317] A broad whistleblower program incentivizing whistleblowers to report all securities fraud therefore goes beyond the scope of Dodd-Frank's policy objectives. By incentivizing tangentially related fraud, some whistleblower reports will have abstract benefits but nonetheless incur heavy costs.[318] For example, whistleblowers reporting violations of the FCPA's anti-bribery provisions will only

[312] *Id.* at 1850 (citing 31 U.S.C. § 3730(d)(4) (1994)).
[313] *Id.*
[314] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70489 (Nov. 17, 2010).
[315] Wilczek, *supra* note 211.
[316] S. REP. NO. 111-176, at 2–4 (2009).
[317] *Id.* at 110.
[318] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, 75 Fed. Reg. at 70516.

indirectly protect U.S. capital markets, but nonetheless impose costs on businesses and the SEC.[319]

To address Dodd-Frank's policy anomaly, the SEC should define "original information" in such a way that reporting only the type of securities fraud that Dodd-Frank was intended to address would warrant a whistleblower award. Past securities legislation has avoided this oddity by tailoring whistleblower bounty programs to the specific fraud they were meant to deter. For example, the Insider Trading and Securities Enforcement Act of 1988 was enacted in response to insider trading scandals and accordingly instituted a bounty program limited to insider trading.[320]

Legislative history clearly shows that original information is intended to mean "new" or "novel."[321] However, in addition to new or novel, rules may be written to interpret original information as also meaning "origin" or "beginning,"[322] as in the origins of the financial crisis Dodd-Frank is intended to address.[323] Applying this interpretation, a rule could limit whistleblower bounties to novel reports of structured finance fraud, Ponzi schemes or financial reporting under the FCPA and SOX 404. Although the SEC has indicated that they have authority to define the scope of Dodd-Frank through rulemaking,[324] a rule adopting this interpretation could be overruled even by courts applying *Chevron* deference on the ground that it is not consistent with legislative intent or against Dodd-Frank's plain meaning.[325]

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[319] *See, e.g.*, Edward Wyatt, *Oil and Gas Bribery Case Settled for $236 Million*, N.Y. TIMES, Nov. 4, 2010, http://www.nytimes.com/2010/11/05/business/global/05bribe.html?ref=business.

[320] The existing SEC insider trading bounty program was enacted in response to scandals at Drexel Burnham Lambert Inc. and other banks. H. REP. NO. 100-910, at 12 (1988).

[321] S. REP. NO. 111-176, at 111 (2009).

[322] Definition of *Original*, FREE MERRIAM-WEBSTER DICTIONARY, *available at* http://www.merriam-webster.com/dictionary/original (last visited Mar. 30, 2011).

[323] S. REP. NO. 111-176, at 2-4. *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 931(5), 124 Stat. 1376, 1872 (2010).

[324] Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70514–15 (Nov. 17, 2010). *But see id.* at 70515–16 ("[M]any of the key elements of the whistleblower program have been established by the statute.").

[325] Chevron U.S.A., Inc. v. Natural Resources Def. Council, Inc., 467 U.S. 837 (1984). Under the *Chevron* doctrine, administrative rules are upheld if they are: (1) consistent with congressional intent; and (2) reasonable. *Id.* at 842–43. As applied to the present case, the interpretation would probably be considered reasonable in light of administrative expertise and political accountability. *Id.* at 834–44. However, there may be an issue as to whether interpreting original information as

Regardless, a rule limiting the type of fraud within the bounty program is a potential way to deter tips about unrelated fraud. Moreover, it is a way for the SEC to pursue an enforcement strategy based upon their independent judgment. If the SEC elects to pursue an independent enforcement strategy by simply ignoring whistleblower tips, they are subject to criticism though Dodd-Frank's mandate for an Inspector General Report.[326] A rule limiting the scope of the bounty program is therefore appropriate.

2. *Dollar Value Bounty Caps/Floors and Non-Pooled Bounties*

Dodd-Frank encompasses policy objectives to provide certainty to whistleblowers and presumably strives to do so in a cost-effective manner as well.[327] However, as noted above, the required 10-30% bounty may not provide certainty as intended or, even if doing so, may not be cost-effective.[328] To remedy these concerns, the SEC should implement a rule guaranteeing bounties within a stated dollar range regardless of whether other whistleblowers earn awards as well.

Addressing the marginal utility of large monetary whistleblower incentives, Senator Kyl proposed a $5-20 million cap on whistleblower bounties on the Senate floor.[329] Sen. Kyl reasoned that bounties above a high dollar amount are not likely to incentivize additional reporting because bounties may be virtually indistinguishable to most whistleblowers.[330] In response to Sen. Kyl, Sen. Leahy noted legislative deference to discretionary judicial approval of whistleblower bounties to refute such a cap.[331] However, the judiciary does not have discretion to impose a cap below ten percent of enforcement proceeds due to statutory restrictions. Moreover, any floor on whistleblower bounties necessarily limits administrative discretion.[332] Thus, the ten percent floor may not be cost-effective if there is little marginal utility and Congress should adopt dollar value caps on whistleblower bounties.

"origin" is against congressional intent. Specifically, the text and legislative history establish that original information means "new" or "novel," but it is not clear whether the "origin" interpretation is inconsistent with the "new" or "novel" interpretation.

[326] Dodd-Frank Wall Street Reform and Consumer Protection Act § 922(d).

[327] S. REP. NO. 111-176, at 110 (2009).

[328] *See supra* Pt.III.B.

[329] CONG. REC. S4611 (Apr. 23, 2009) (statement of Sen. Kyl).

[330] *Id.* It should also be noted that whistleblowers may not be aware of whether their reporting will result in a successful enforcement action and thus do not have an accurate estimation of a potential award. *See e.g.*, Wyatt, *supra* note 53.

[331] CONG. REC. S4517 (Apr. 23, 2009) (statement of Sen. Kyl).

[332] *See id.*

Moreover, the required whistleblower bounty range will only provide whistleblowers with certainty if they know that the award will not be pooled and split among multiple whistleblowers, as Dodd-Frank allows.[333] To provide certainty, a rule should be written foregoing pooled bounties.[334] An obvious criticism to this approach is that bounties may be exorbitant and even exceed penalties collected. However, this result can be curtailed or avoided by adopting high reporting standards through rulemaking, as suggested above. Further, the certainty provided to whistleblowers may justify this counterintuitive result if only occurring in rare instances. In a similar context, test cases pursued by the SEC have justified excessive costs in individual cases to benefit the overall enforcement strategy. Accordingly, rules are necessary to provide whistleblowers with certainty and, in the aggregate, SEC rulemaking can address Dodd-Frank's likely costs moving forward.

VI. BUSINESS COMPLIANCE

Employees uncovering fraud must balance a duty to society with organizational loyalty.[335] Dodd-Frank is designed to tip the scales in favor of a duty to society by offering whistleblowers substantial bounties for reliable tips.[336] In pursuit of this goal, however, Dodd-Frank also encourages employees to promptly report fraud externally to win the race to secure a bounty.[337] As such, the essence of Dodd-Frank's whistleblower provisions complicates business compliance. Notwithstanding any efforts to influence administrative rulemaking through public comment or legislative action through lobbying, businesses can promote compliance by taking steps: (1) to prevent fraud and encourage internal detection; (2) to avoid whistleblower retaliation once fraud has been detected; and (3) to comply specifically with the Foreign Corrupt Practices Act ("FCPA").[338]

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[333] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 922(a), § 21F(b)(1), 124 Stat. 1376 (2010).

[334] *But see* Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488, 70499 (Nov. 17, 2010).

[335] MILTON SNOEYENBOS ET AL., BUSINESS ETHICS 388–89 (3d ed. 2001). *See also* ROBERTA ANN JOHNSON, WHISTLEBLOWING: WHEN IT WORKS AND WHY 27 (2003).

[336] S. REP. NO. 111-176, at 111 (2009). *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, sec. 922(a), § 21F(b)(1)(A).

[337] Carton, *supra* note 82.

[338] This section is designed to be a general overview of steps to comply with internal control requirements and avoid whistleblower retaliation liability, which may be contingent on a particular jurisdiction's law. For a more in-depth discussion and analysis, see DELIKAT & PHILLIPS, *supra* note 127, § 10:1; Donald

A. *Preventative Measures and Internal Detection*

Management systems should be in place to encourage and manage internal fraud reporting in a way that limits potential liability. Training is also necessary to notify employees of wrongful behavior and procedures should be available to report corporate wrongdoing internally.[339] As employees are often reluctant to report fraud due to uncertainty regarding potential retaliation and condemnation by their peers,[340] knowledge of prohibited activity and reporting procedures may encourage employees to report fraud internally.[341]

Prohibited wrongful conduct in a code of conduct should include retaliation against employees reporting fraud.[342] Other prohibited conduct may include: "insider trading, environmental crimes, bribery/payment violations, intellectual property infractions, accounting improprieties, discrimination/harassment and other offenses."[343] With regard to procedure, employees should be permitted to report fraud to particular individuals who can report retaliation complaints.[344] Hotlines may also be implemented for employees to anonymously or confidentially report fraud.[345]

Businesses should review their internal controls to prevent fraud and encourage internal reporting if fraud does occur.[346] Proper internal controls and communication systems can serve as "a corporate safety net" against fraud and render whistleblowing virtually unnecessary.[347] In fact,

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C. Dowling, Jr., *International HR Best Practice Tips: Conducting Internal Employee Investigation Outside the U.S.*, 19 INT'L HR J. 1, 2 (2006).

339 DELIKAT & PHILLIPS, *supra* note 127, § 10.1.

340 Frank Cavico, *Private Sector Whistleblowing and the Employment-At-Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis*, 45 S. TEX. L. REV. 545, 546–47 (2004).

341 Dowling, Jr., *supra* note 338, at 2–3.

342 *Id.*

343 *Id.*

344 DELIKAT & PHILLIPS, *supra* note 127, § 10.1. Such individuals may include "designated managers, in-house counsel and/or human resources personnel." *Id.*

345 Dowling, *supra* note 338, at 2.

346 FREDERICK ELLISTON ET AL., WHISTLEBLOWING 135 (1985) (stating that external fraud reporting can "embarrass the company by washing their dirty laundry in public). *See also Competition, Antitrust & White-Collar Crime and Business Litigation Update: Dodd-Frank Expands Securities Whistleblower Incentives*, THOMPSON HINE LLP (July 30, 2010), http://www.thompsonhine.com/publications/publication2134.html.

347 Marlene Winfield, *Whistleblowing as corporate safety net*, *in* GERALD VINTEN, WHISTLEBLOWING: SUBVERSION OR CORPORATE CITIZENSHIP 25 (1994).

companies have been relatively successful in defending against SOX whistleblower retaliation claims.[348]

In addition, employers should maintain performance records about employees.[349] If an employee is disciplined or terminated after reporting wrongdoing, the employer may be able to successfully defend against employee retaliation claims.[350] With poor performance records prior to fraud reporting, employers may cast doubt on a causal link between disciplinary measures and reporting.[351]

B. *Avoiding Whistleblower Retaliation*

Procedures should be in place and management should be trained to prevent retaliation against employees reporting fraud.[352] Under Dodd-Frank, even employees reporting unauthenticated fraud are protected against retaliation and employers should avoid any appearance of whistleblower retaliation.[353] Procedures should be designed to retain management rights such that a reporting employee is no better or worse off as a result of reporting.[354] Employers must therefore balance retaining management rights and avoiding whistleblower liability.

Once wrongdoing or fraud has been reported, it is critical to swiftly respond. Misconduct must be discontinued[355] and immediate discipline should be implemented if fraud or other misconduct is clear.[356] Moreover, the employee allegedly engaging in fraud should be counseled about proper behavior.[357] If the reporting employee so desires, s/he should be separated from working alongside the employee engaging in alleged misconduct.[358]

Furthermore, every effort must be made to confidentially communicate with all the parties involved, including the reporting employee, the employee engaging in alleged misconduct and any witnesses. Initially, involved employees should be notified of investigation procedures and assured that communication is confidential, where appropriate.[359]

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[348] DELIKAT & PHILLIPS, *supra* note 127, § 10.1.
[349] *Id.*
[350] *Id.*
[351] *Id.*
[352] DELIKAT & PHILLIPS, *supra* note 127, § 10:2.
[353] *Id.*
[354] *Id.*
[355] Dowling, *supra* note 338, at 6.
[356] *Id.* at 2.
[357] DELIKAT & PHILLIPS, *supra* note 127, § 10:2.
[358] *Id.* Measures should be taken to ensure that the employee does not consider any change in working conditions to be retaliatory in nature. *Id.*
[359] *Id.* For each instance of reported fraud, it is important to appoint an investigation team, define the scope of the investigation (i.e., legal and factual

Management should check in periodically with the reporting employee during the investigation to ask about any retaliation concerns.[360] Other witnesses should be notified of the investigation and given *Upjohn* warnings, which explain that the attorney works for the employer corporation and may have corresponding confidentiality obligations.[361]

Yet another safeguard is accumulating and maintaining records after fraud has been reported. To prepare for potential litigation, records about the alleged fraud and the involved employees should be accumulated.[362] Internal and external auditors should be consulted to ensure that financial statements are accurate despite any hidden losses or inappropriate payments.[363] For example, and as addressed in the next section, inaccurate financial reporting may increase the volume of FCPA violations.[364]

C. *Compliance with the Foreign Corrupt Practices Act: Siemens AG*

Compliance with the FCPA, which prohibits bribery[365] and requires maintaining reasonable records,[366] is increasingly important in today's regulatory environment. First, the SEC has adopted an enforcement strategy which prioritizes FCPA enforcement.[367] Second, it is expected that Dodd-Frank will incentivize many tips regarding violations of the FCPA to spur SEC enforcement.[368] Third, companies driven to engage in illegal activity to remain competitive during the recent economic crisis may increase the volume of FCPA violations.[369]

Necessarily, then, businesses must implement internal controls to comply with the FCPA.[370] Of particular importance are policies that

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issues to be investigated) and draft an investigation plan outlining steps to be taken. *Id.* at 3.

[360] *Id.* § 10:2. If the reporting employee has valid retaliation concerns, prompt remedial action should be taken. *Id.*

[361] Dowling, *supra* note 338, at 4 (citing Upjohn v. United States, 449 U.S. 383 (1981)).

[362] *Id.*

[363] *Id.* at 5.

[364] *Id.*

[365] Philip H. Hilder, Hilder & Associates PC, *Foreign Corrupt Practices Act Compliance Issues: Leading Lawyers on Responding to Recent FCPA Enforcement Actions, Maintaining an Effective Compliance Program, and Navigating Risk in Emerging Markets*, 2010 WL 2828307, at *5 (July 2010).

[366] 15 U.S.C. § 78dd-1 (2006). *See also* Hilder, *supra* note 365, at 6.

[367] Chi, *supra* note 129. *See also* Lowman, *supra* note 145, at 4.

[368] Harker et al., *supra* note 34. *See also* Carton, *supra* note 82; Reisinger, *supra* note 44.

[369] Lowman, *supra* note 145, at 5.

[370] Wilczek, *supra* note 84.

specifically forbid acts prohibited by the FCPA[371] and training employees about such prohibited activity.[372] With respect to financial reporting, internal controls should be in place to ensure that transactions are authorized, monitored if deemed to be high risk, properly recorded and in accordance with generally accepted accounting principles.[373] If there is any doubt regarding whether a particular activity complies with the FCPA, the Department of Justice is available to review the proposed conduct and provide an opinion on legality.

Monitoring can be an effective tool to detect illegal activity and avoid or limit FCPA liability.[374] Internal audits involving a team of forensic auditors including outside counsel can be an effective fraud detection strategy.[375] Further, risk assessment should be performed, especially regarding consultants, agents, distributors and subcontractors working in countries with a history of corruption.[376] Similarly, due diligence of third parties should be performed before entering into international mergers, acquisitions or joint ventures.[377] If all else fails and FCPA violations are detected, companies should strongly consider self-reporting violations to potentially curb liability.[378] Self-reporting may produce leniency and prevent the fraud from becoming a larger problem.[379]

Reformed practices at Siemens AG, an international electronics and electrical engineering firm, demonstrate proper FCPA compliance. In 2008, Siemens plead guilty and settled civil charges regarding longstanding criminal violations of the FCPA's internal controls and books/records provisions.[380] With "crisis" looming, Siemens response to these violations

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[371] Lowman, *supra* note 145, at 9 (noting that recent FCPA enforcement actions have resulted in senior management being liable for FCPA violations they did not know were illegal despite the presence of a corporate policy forbidding such conduct). *See also* Hilder, *supra* note 365, at 7. Such activity should clearly outline permissible corporate payments for gifts and entertainment. *Id.* at 8.

[372] Lowman, *supra* note 145, at 9. *See also* Hilder, *supra* note 365, at 7.

[373] Hilder, *supra* note 365, at 6.

[374] *Id.*

[375] Lowman, *supra* note 145, at 9–10.

[376] *Id.*

[377] *Id.* at 8. *See also* Hinchey, *supra* note 80; Rebekah J. Poston et al., *FCPA Due Diligence in Acquisitions*, 43 REV. SEC. & COMMODITIES REG. 13, 14 (Jan. 20, 2010).

[378] Wilczek, *supra* note 84. *But see* Tarun & Tomczak, *supra* note 233, at 183–84 (noting that some companies may rationally choose to resolve issues internally rather than self-report).

[379] Tarun & Tomczak, *supra* note 233, at 183–212.

[380] Press Release No. 08-11-5, U.S. Dep't of Justice, Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay $450 Million in Combined Criminal Fines (Dec. 15, 2010), *available at* http://www.justice.gov/opa/pr/2008/December/08-crm-1105.html. Subsidiaries

has allowed it to maintain a competitive global presence.[381] During the crisis, Siemens spent an estimated $1 billion to conduct an extensive investigation into the violations and comply with law enforcement.[382] Once the violations were resolved, Siemens instituted a world-class compliance system consistent with the recommendations in this section.[383] Specifically, Siemens now has extensive internal controls (e.g. proper approval and reporting of transactions), conducts employee and management training, conducts extensive due diligence of business partners, provides a tip line for employees to report fraud and also a hotline to answer employee compliance questions.[384] Coming full circle, the 2009 Dow Jones Sustainability Index bestowed its top rating upon Siemens in the "Codes of Conduct/Compliance" category.[385] Like Siemens, other businesses should implement practices to properly manage existing fraud and avoid or limit liability resulting from Dodd-Frank's whistleblower provisions.

VII. CONCLUSION

The 2000 page Dodd-Frank Act enacts sweeping changes to our financial regulatory system including provisions that provide whistleblowers with anti-retaliation protection and monetary incentives to report securities fraud.[386] Surprisingly, or perhaps unsurprisingly in light of the sheer length of Dodd-Frank, there is little indication in the legislative history of Dodd-Frank that Congress objectively considered whistleblower motives, incentives and the negative implications which may result.[387] Moving forward, negative implications should be remedied with agency management and rulemaking, legislative amendment and internal business policies and controls.[388]

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also admitted violating the FCPA's anti-bribery provisions. *Id. See also* Press Release No. 2008-294, SEC Charges Siemens AG for Engaging in Worldwide Bribery, Sec. & Exch. Comm'n (Dec. 15, 2010), *available at* http://www.sec.gov/news/press/2008/2008-294.htm.

[381] *See* Jack Ewing, *Siemens Posts $1.9 Billion Quarterly Profit*, N.Y. TIMES, July 29, 2010, http://www.nytimes.com/2010/07/30/business/global/30iht-siemens.html?ref=siemensag. *But see* Altman Granitsas, *Greece Targets Siemens Over Bribe Scandal*, WALL ST. J., Jan. 25, 2011, http://online.wsj.com/article/SB10001424052748704698004576103481318124252.html?mod=WSJ_business_whatsNews (noting that Siemens may still face penalties outside the U.S.).

[382] Tarun & Tomczak, *supra* note 233, at 209.

[383] 2 *Compliance Report*, SIEMENS AG 25 (2009).

[384] *Id.* at 25–27.

[385] *Id.* at 27.

[386] *See infra* Pt.II.B.

[387] *But see* S. REP. NO. 111-176, at 244 (2009).

[388] *See infra* Pt.IV–VI.

Against this background, the Dodd-Frank whistleblower provisions demonstrate a risk inherent in long legislation encompassing broad substantive areas. Expressly, broadly reaching legislation may result in less-than-thoughtful legislation and undesirable policy that is difficult to amend. To be sure, the Dodd-Frank whistleblower provisions will impose costs on businesses and agencies and benefit trial lawyer interests.[389] What are less certain are the benefits to society—namely confidence in the U.S. capital markets.[390] Therefore, while only time will tell whether the Dodd-Frank whistleblower provisions fulfill their policy ends[391], lawmakers should be cognizant of the risks inherent with long and broadly reaching legislation.

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[389] *See supra* Pt. III.B.

[390] *See supra* Pt. III.A. The SEC posits that whistleblower bounty program costs are outweighed by the confidence they create in U.S. capital markets by deterring fraud, which consequently incentives investing. Proposed Rules for Implementing the Whistleblower Provision of Section 21F, Exch. Act Release No. 34-63237, 75 Fed. Reg. 70488 (Nov. 17, 2010).

[391] *See e.g.*, Harker et al., *supra* note 34, at 7779–80 ("[T]he program could be a boon to law enforcement in connection with laws such as the Foreign Corrupt Practices Act"). It is expected that agencies will be heavily lobbied as they write rules and regulations to implement Dodd-Frank. Amanda Becker, *Financial overhaul has been signed, but lawyers' work on law is far from over*, WASH. POST, July 26, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/07/23/AR2010072304359.html; Ronald D. Oral, *Bank lobbyist expects 'mistakes' with new rules*, MARKETWATCH (Oct. 14, 2010), http://www.marketwatch.com/story/bank-lobbyist-expects-mistakes-with-new-rules-2010-10-14, (stating that short time horizons to write the rules implementing Dodd-Frank may result in administrative rulemaking mistakes).