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Corporate Corruption & the New Gold Mine

HOW THE DODD-FRANK ACT OVERINCENTIVIZES WHISTLEBLOWING

INTRODUCTION

On September 15, 2008, Lehman Brothers Holdings Inc. filed for relief under Chapter 11 of the Bankruptcy Code.¹ It had debts of \$613 billion against total assets of \$639 billion, and its bankruptcy filing stands as the largest in the United States.² On the following day, the U.S. government seized control of American International Group (AIG), one of the world's largest insurers, in an \$85 billion deal that "signaled the intensity of its concerns about the danger a collapse could pose to the financial system."³ Federal Reserve Vice Chairman Donald Kohn stated that the failure of AIG posed "unacceptably large" risks to "consumers, municipalities, small business . . . as well as the risks to the wider economy," and in essence, provided a "too big to fail" rationale to support the federal government's \$85 billion bailout.⁴ To some, this troubled financial state represented the "worst economy since the Great Depression."⁵

¹ Lehman Brothers Holdings Inc.'s Bankruptcy Information, EPIQ SYS., <http://chapter11.epiqsystems.com/LBH/Project/default.aspx> (last visited Jan. 16, 2011).

² Sam Mamudi, *Lehman Folds with Record \$613 Billion Debt*, MARKET WATCH (Sept. 15, 2008), <http://www.marketwatch.com/story/lehman-folds-with-record-613-billion-debt?siteid=rss>.

³ Matthew Karnitschnig, Deborah Solomon, Liam Plevin & Jon E. Hilsenrath, *U.S. to Take Over AIG in \$85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up*, WALL ST. J., Sept. 17, 2008, at A1.

⁴ Mark Felsenthal, *Fed's Kohn: AIG Too Big to Fail*, REUTERS (Mar. 5, 2009), <http://www.reuters.com/article/idUSTRE52446C20090305>. A bank or financial institution is "too big to fail" when it is so large and interconnected with other financial institutions that its failure could set off a "chain reaction." FIN. CRISIS INQUIRY COMM'N, PRELIMINARY STAFF REPORT: GOVERNMENTAL RESCUES OF "TOO-BIG-TO-FAIL" FINANCIAL INSTITUTIONS 2 (2010), available at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/2010-0831-Governmental-Rescues.pdf.

⁵ See Timothy Geithner, Sec'y, Dep't of Treasury, Address at Congressional Hispanic Caucus Institute Conference (Sept. 13, 2010) (transcript available at <http://www.treasury.gov/press-center/press-releases/Pages/tg849.aspx>); Lori Montgomery, *New Economic Face Is Still Familiar*, WASH. POST, Sept. 11, 2010, at A12; Barack Obama, President, United States, Remarks by the President at a Reception for

This economic crisis led to widespread support for changes in the financial regulatory system.⁶ President Barack Obama, when commenting on twenty-first-century financial regulatory reform, stated, “It is indisputable that one of the most significant contributors to our economic downturn was . . . the lack of adequate regulatory structures to prevent abuse and excess.”⁷ In response to the lack of such regulatory structures, Democratic Representative Barney Frank and Senate Banking Committee Chairman Chris Dodd proposed a financial regulatory overhaul.⁸ President Obama signed the resulting Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) on July 21, 2010.⁹

The Dodd-Frank Act faced fierce resistance and nearly unanimous Republican opposition.¹⁰ Critics of the Dodd-Frank Act claim it is a “radical expansion of the federal government that will hurt small businesses, community banks, and everyday taxpayers”¹¹ and that the “new and expanded regulations . . . will limit the ability of banks . . . to extend credit.”¹² Others argue that the Dodd-Frank Act is not strong

Connecticut Attorney General Richard Blumenthal (Sept. 16, 2010) (transcript available at <http://www.whitehouse.gov/the-press-office/2010/09/16/remarks-president-a-reception-connecticut-attorney-general-richard-blume>) [hereinafter *White House Transcript*].

⁶ Jack Ewing, *Financial Regulatory Reform*, N.Y. TIMES, http://topics.nytimes.com/topics/reference/timestopics/subjects/c/credit_crisis/financial_regulatory_reform/index.html (last updated July 19, 2011).

⁷ Barack Obama, President, United States, Remarks by the President on Regulatory Reform (June 17, 2009) (transcript available at http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform/) [hereinafter *Obama, Remarks*].

⁸ H.R. 4173, 111th Cong. (2010) (enacted).

⁹ See Presidential Statement on Signing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 DAILY COMP. PRES. DOC. 617 (July 21, 2010) (transcript available at <http://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act>).

¹⁰ See Silla Brush, *Dodd to Unveil Financial Legislation on Monday; No GOP Support Expected*, HILL (Mar. 14, 2010, 9:25 PM), <http://thehill.com/homenews/senate/86677-dodd-to-unveil-financial-legislation-monday-no-gop-support-expected> (reporting that Senator Dodd’s financial regulatory proposals are not expected to have Republican support); see also Jim Kuhnhenh, *Historic Financial Overhaul Signed to Law by Obama*, DAILY CALLER (July 21, 2010, 3:08 AM), <http://dailycaller.com/2010/07/21/obama-poised-to-sign-sweeping-financial-overhaul/> (stating that the law passed “despite nearly unanimous Republican opposition”).

¹¹ Don Seymour, *Dodd-Frank: A Radical Expansion of Government That Won’t Prevent Future Bailouts*, FREEDOM PROJECT (July 16, 2010, 3:35 PM), <http://www.freedomproject.org/blog/dodd-frank-radical-expansion-government-wont-prevent-future-bailouts>.

¹² Ryan Grim, *Wall Street Opposes Wall Street Reform*, HUFFINGTON POST (June 28, 2010, 12:42 PM), http://www.huffingtonpost.com/2010/06/28/wall-street-opposes-wall_n_627870.html (quoting Letter from Am. Bankers Ass’n to Members of Congress, June 28, 2010).

enough to revive the nation's economic health.¹³ Proponents, however, praise the Dodd-Frank Act as legislation that “marks the end of more than a generation in which the prevailing posture of Washington toward the financial industry was largely one of hands-off cheering, evidenced by steady deregulation,” and hail the Act as a “clear turning point, highlighting . . . [a] renewed reliance on government to protect the little guy.”¹⁴

Despite the cloud of political controversy surrounding the Dodd-Frank Act, President Obama has firmly held that this overhaul of the financial regulatory system “place[s] rules that will allow our markets to promote innovation while discouraging abuse.”¹⁵ In an effort to help discourage such abuse, the Dodd-Frank Act includes a new whistleblower protection provision and also amends preexisting provisions to provide significant monetary incentives to potential whistleblowers.¹⁶ The new whistleblower provision drastically expands preexisting whistleblower legislation, primarily by expanding the scope of persons *prohibited* from taking retaliatory action and the scope of persons *protected* from retaliatory action. This note will examine two aspects of the Dodd-Frank Act's whistleblower provision: its whistleblower bounty program and its antiretaliation statute. It argues that the Dodd-Frank Act's whistleblower provisions overincentivize whistleblowing by providing excessive and unnecessary bounties, and by granting expansive whistleblower protection to too large a scope of individuals. In effect, the Dodd-Frank Act's whistleblower laws transform corporate corruption into a “gold mine”¹⁷ by giving individuals the opportunity to reap enormous benefits from reporting alleged violations.

¹³ See Gretchen Morgenson, *Strong Enough for Tough Stains?*, N.Y. TIMES, June 26, 2010, at BU1, available at <http://www.nytimes.com/2010/06/27/business/27gret.html> (stating that the Dodd-Frank Act “fails completely” in curbing “dangerous risk taking by institutions and cut[ting] big and interconnected financial entities down to size,” and that “the nation's financial industry will still be dominated by a handful of institutions that are too large, too interconnected and too politically powerful to be allowed to go bankrupt if they make unwise decisions or make huge wrong-way bets”).

¹⁴ Ewing, *supra* note 6.

¹⁵ Obama, *Remarks*, *supra* note 7.

¹⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 748, 922, 124 Stat. 1376 (2010) (codified as amended at 18 U.S.C.A. § 1514A(a) (West 2000 & Supp. 2011)) [hereinafter Dodd-Frank Act].

¹⁷ The “gold mine” metaphor incorporated into this note's title was inspired by Letter from the Association of Corporate Counsel, to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n (Dec. 15, 2010) (on file with author) (stating that as a result of the Dodd-Frank Act's whistleblower provisions, “[f]raudulent misconduct, the bane of good compliance systems, then becomes the gold mine”).

Part I will discuss the preexisting whistleblower protection and bounty provisions. Part II will examine the Dodd-Frank Act's amendments to the preexisting whistleblower laws, as well as its own antiretaliation statute. Part III will discuss the Dodd-Frank Act's whistleblower bounty program and argue that it is likely to be ineffective in furthering the Act's goals of encouraging individuals to report tips of a "higher quality."¹⁸ Part IV will analyze the Dodd-Frank Act's antiretaliation provision in light of judicial interpretation of similar provisions contained in the Sarbanes-Oxley Act, and argue that Dodd-Frank's dramatic expansion of the scope of antiretaliation laws has damaging effects. Finally, Part V will discuss suggestions and recommendations for the future.

I. PREEXISTING WHISTLEBLOWER PROTECTION AND BOUNTY PROVISIONS

Before the Dodd-Frank Act was enacted, several statutes already protected whistleblowers "who report[] illegal or wrongful activities of his employer or fellow employees"¹⁹ and provided for rewarding such informants with bounties. Such provisions include the Sarbanes-Oxley Act of 2002,²⁰ the False Claims Act,²¹ the Internal Revenue Code's whistleblower provision,²² and the Insider Trading and Securities Enforcement Act of 1988.²³ These statutes, however, only protect whistleblowers in narrow circumstances and provide weaker bounty incentives, both of which were imprudently expanded by Dodd-Frank.

A. *The Sarbanes-Oxley Act of 2002*

Under the Sarbanes-Oxley Act of 2002 (SOX), employees who provide information or assist in an investigation regarding conduct that they reasonably believe is a violation of any rule of the Securities Exchange Commission (SEC) or "any provision of federal law relating to fraud against shareholders"²⁴ are

¹⁸ Jessica Holzer & Fawn Johnson, *Larger Bounties Spur Surge in Fraud Tips*, WALL ST. J., Sept. 7, 2010, at C3 (quoting SEC official Stephen Cohen when writing that "[t]he goal is not just to get more tips, we want to get more high-quality tips").

¹⁹ BLACK'S LAW DICTIONARY 1596 (6th ed. 1990).

²⁰ 18 U.S.C. § 1514A (2006).

²¹ 31 U.S.C. § 3730 (2006).

²² 26 U.S.C. § 7623 (2006).

²³ *Id.*

²⁴ 18 U.S.C. § 1514A(a)(1).

protected from discharge, demotion, suspension, harassment, or any other form of discrimination by their employers.²⁵ A whistleblower alleging an injury from a discriminatory or retaliatory act must make a prima facie showing that his whistleblowing behavior was a “contributing factor” to such act.²⁶ If the whistleblower-employee prevails in the action, he is entitled to compensatory relief, including back pay with interest, reinstatement to the same seniority status the employee would have had but for the employee’s act of discrimination, and compensation for any special damages incurred, including reasonable attorneys’ fees.²⁷

Although SOX protects whistleblowers from retaliation, it applies only when the whistleblower provides information to, or the investigation is conducted by, “a federal regulatory enforcement agency or law,” a congressional committee or member, or an individual “with supervisory authority over the employee.”²⁸ SOX is further limited to apply only to publicly traded companies.²⁹

B. *The False Claims Act*

The False Claims Act (FCA) similarly protects whistleblowers from retaliatory action. It prohibits an employer from discharging, demoting, suspending, harassing, or otherwise discriminating against the whistleblowing

²⁵ *Id.* § 1514A(a).

²⁶ 49 U.S.C. § 42121(b)(2)(B)(i) (2006). *See, e.g.,* Ray v. Henderson, 217 F.3d 1234, 1242-43 (9th Cir. 2000) (noting the persuasiveness of the EEOC’s guidance that “any adverse treatment that is based on a retaliatory motive and is reasonably likely to deter the charging party or others from engaging in protected activity” is prohibited (quoting EEOC Compliance Manual Section 8, “Retaliation,” ¶ 8008 (1998))); Collins v. Beazer Homes USA, Inc., 334 F. Supp. 2d 1365, 1379 (N.D. Ga. 2004) (ruling that a two-week span between the whistleblower’s complaints of alleged violations and her termination was sufficient to establish circumstances suggesting that the protected activity “was a contributing factor to the unfavorable personnel action” for summary judgment purposes).

²⁷ 18 U.S.C. § 1514A(c)(2)(A)-(C). Once a party has established its entitlement to an award of attorneys’ fees, the court must determine what is reasonable. Van Asdale v. Int’l Game, Tech., No. 3:04-CV-703-RAM, 2010 U.S. Dist. LEXIS 46725, at *21 (D. Nev. Apr. 13, 2010). Under federal law, reasonable attorneys’ fees are generally calculated using the “lodestar” method based on the number of hours the attorney worked. *Id.*

²⁸ 18 U.S.C. § 1514A(a)(1)(A)-(C).

²⁹ The provision prohibits any company with a class of securities “registered under section 12 of the Securities Exchange Act of 1934, or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company” from retaliating against an employee. *Id.* § 1514A(a).

employee.³⁰ Relief for the injured whistleblower includes reinstatement to the same seniority status that the employee would have had but for the discrimination, double the amount of back pay plus interest, and compensation for any special damages sustained, which also includes reasonable attorneys' fees.³¹

In addition to its antiretaliation provision, the FCA offers a monetary reward to whistleblowers.³² The whistleblower, however, must initiate the action himself.³³ If the government (through the Department of Justice) elects to proceed with the complaint, the whistleblower is entitled to 15 to 25 percent of the action's proceeds or settlement.³⁴ The ultimate amount of the reward depends on the extent to which the whistleblower "substantially contributed to the prosecution of the action."³⁵ If the government declines to pursue an action initiated by the whistleblower, then the whistleblower will have the right to conduct it himself³⁶ and be eligible for a reward the court deems reasonable (between 25 and 30 percent of the proceeds of the action).³⁷ In making this determination, the court must consider the whistleblower's role in advancing the case to litigation, as well as the significance of the information he furnishes.³⁸ Under the FCA, the whistleblower

³⁰ An employee, contractor, or agent is entitled to "all relief to make [him] whole[.]" if he "is discharged, demoted, suspended . . . or in any other manner discriminated against in the terms and conditions of employment . . . because of [his] lawful acts . . . in furtherance of an action under this section . . ." 31 U.S.C. § 3730(h) (2006).

³¹ *Id.*

³² *Id.* § 3730(d).

³³ *Id.* § 3730(b)(1).

³⁴ *Id.* § 3730(d)(1).

³⁵ *Id.*

³⁶ Within 60 days after the whistleblower files his report, the Government will either proceed with the action, in which case the action is to be conducted by the Government, or notify the court that it declines to take over the action, in which case the person bringing the action shall have the right to conduct the action. *Id.* § 3730(b)(4).

³⁷ *Id.* § 3730(d)(2). Some courts have interpreted the False Claims Act's whistleblower bounty provision to provide the minimum amount of recovery for individuals who "substantially and independently contribute to the government's recovery." *See, e.g., United States ex rel. Burr v. Blue Cross & Blue Shield*, 882 F. Supp. 166, 168 (M.D. Fla. 1995). If, however, a whistleblower suffers "considerable personal and professional expense," he is entitled to recover the full thirty percent. *Id.* The courts have further held that the "maximum recovery is reserved for situations where the [whistleblower] actively and uniquely aids the government in the prosecution of the case." *Id.* Other courts believe that an "important factor in determining whether a [whistleblower] has actively and uniquely aided the government is if the matter proceeds all the way through trial." *United States ex rel. Fox v. Nw. Nephrology Assocs.*, 87 F. Supp. 2d 1103, 1112 (E.D. Wash. 2000). Such courts have held that "[i]t should be a rare occurrence that the maximum percentage is awarded in a case that has settled short of trial." *Id.*

³⁸ 31 U.S.C. § 3730(d)(1).

may also be rewarded up to 10 percent of the action's proceeds even if the court determines that the action was based primarily on information that has already been made public.³⁹

C. Internal Revenue Code's Whistleblower Provision

The Internal Revenue Code's whistleblower provision also provides bounties to whistleblowers reporting tax violations. The provision states that a whistleblower who furnishes information regarding an employer's underpayment of taxes or violations of tax laws⁴⁰ may receive an award of 15 to 30 percent of the collected proceeds.⁴¹ The amount of the whistleblower's reward will be determined in light of the extent to which he "substantially contributed to such action."⁴² If the information provided by the whistleblower is based principally on public information,⁴³ the whistleblower may receive an award of up to 10 percent of the collected proceeds or settlement.⁴⁴ This determination must take into account the significance of the whistleblower's role in contributing to the action.⁴⁵ In this respect, the Internal Revenue Code's whistleblower incentive system is similar to that of the False Claims Act.⁴⁶ The Internal Revenue Code's whistleblower provisions, however, are limited in scope and do not apply to illegal actions by individual taxpayers whose gross annual income is not more than \$200,000 or where the amounts in dispute do not exceed \$2 million.⁴⁷ In addition, unlike under the

³⁹ *Id.*

⁴⁰ If the Secretary of the Treasury proceeds with an administrative or judicial action for the underpayment of taxes or a violation of the internal revenue laws based on information brought by a whistleblower, the whistleblower is entitled to receive a monetary reward. 26 U.S.C. § 7623(b)(1) (2006).

⁴¹ The whistleblower shall "receive as an award at least 15 percent but not more than 30 percent of the collected proceeds . . . resulting from the action (including any related actions) or from any settlement in response to such action." *Id.*

⁴² *Id.* There are several factors considered when determining the amount of the whistleblower's reward. For instance, the award is reduced where the whistleblower planned the actions leading to the underpayment of tax. *Id.* § 7623(b)(3).

⁴³ *Id.* § 7623(b)(2)(A).

⁴⁴ *Id.*

⁴⁵ The Whistleblower Office is to take into account the "significance of the individual's information and the role of such individual and any legal representative of such individual in contributing to such action." *Id.*

⁴⁶ Under the False Claims Act, the degree to which the whistleblower contributed to the prosecution of the action is a factor that determines the amount of the reward. 31 U.S.C. § 3730(d)(1) (2006).

⁴⁷ 26 U.S.C. § 7623(b)(5).

False Claims Act, the payment of the whistleblower reward here is discretionary, not mandatory.⁴⁸

D. Insider Trading and Securities Fraud Enforcement Act of 1988

The Insider Trading and Securities Enforcement Act of 1988 (Insider Trading Act) added a whistleblower bounty provision to the Securities Exchange Act of 1934⁴⁹ that applies only to insider trading.⁵⁰ The Insider Trading Act prohibits any person from purchasing or selling a security while in possession of material and nonpublic information⁵¹ and mandates an award to whistleblowers of up to 10 percent of the proceeds of an action brought for any such violation they helped expose.⁵²

These preexisting whistleblower statutes protect whistleblowers from employer retaliation, and even provide monetary rewards to incent whistleblowing. These provisions, however, protect and reward whistleblowers only in limited circumstances. For instance, SOX's whistleblower protection provision applies only to publicly traded companies,⁵³ and the

⁴⁸ Courts have held that the whistleblower reward provision in 26 U.S.C. § 7623(b)(1) is not "money-mandating." *Wilson v. United States*, No. 07-191T, 2007 U.S. Claims LEXIS 268, at *5-6 (Fed. Cl. July 13, 2007). Instead, the provision gives the Internal Revenue Service the "broad discretion to decide whether to make an award or how much to grant." *Merrick v. United States*, 846 F.2d 725, 726 (Fed. Cir. 1988); *see also* *Schmidt v. IRS*, No. 08-10037, 2008 U.S. Dist. LEXIS 39376, at *3-4 (E.D. Mich. May 15, 2008) (concluding that an award under the Internal Revenue Code's whistleblower provision is discretionary unless there have been negotiations with the whistleblower, and the whistleblower entered into an explicit agreement on the amount of the award with the Internal Revenue Service); *Conner v. United States*, No. 06-655C, 2007 U.S. Claims LEXIS 104, at *2 (Fed. Cl. Mar. 28, 2007) (holding that the statute only gives the Internal Revenue Status "broad discretion" to determine whether to make an award); *Destefano v. United States*, 52 Fed. Cl. 291, 293 (2002) (stating that the Internal Revenue Code's whistleblower reward provision is a "discretionary statute" that does "not mandate monetary rewards and consequently do[es] not create a substantive right to money damages"); *Krug v. United States*, 41 Fed. Cl. 96, 97 (1998) (ruling that the Internal Revenue Service is not obligated to reward informants).

⁴⁹ Insider Trading Act and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677.

⁵⁰ *Id.* § 21A, 102 Stat. at 4677-78.

⁵¹ *Id.*

⁵² "[T]here shall be paid from amounts imposed as a penalty . . . such sums, not to exceed 10 percent of such amounts, as the [SEC] deems appropriate, to the person or persons who provide information leading to the imposition of such penalty." *Id.* § 21A(e), 102 Stat. at 4679.

⁵³ The provision prohibits any company with a class of securities "registered under section 12 of the Securities Exchange Act of 1934, or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934" from retaliating against an employee. 18 U.S.C. § 1514A(a) (2006).

Internal Revenue Code's whistleblower bounty program applies to an individual only if the disputed amount exceeds \$2 million.⁵⁴ Further, such rewards are not mandatory.⁵⁵ Although bounties under the False Claims Act are mandated, the whistleblower himself must initiate the action,⁵⁶ thereby saving the government from administrative expenses. The Dodd-Frank Act's whistleblower provisions, however, largely eliminate these limitations and drastically expand the applicability of whistleblower laws.

II. WHISTLEBLOWER INCENTIVES AND PROTECTION UNDER THE DODD-FRANK ACT

The Dodd-Frank Act greatly expands preexisting whistleblower bounty and antiretaliation provisions. It amends the SEC's whistleblower provision by expanding its scope to cases other than those involving insider trading.⁵⁷ The newly amended whistleblower provision now applies to *any* violation of securities laws and prohibits employers from discharging, demoting, suspending, threatening, or otherwise discriminating against a whistleblower.⁵⁸ The provision also expands the definition of a whistleblower, which is now defined as an individual, or two or more individuals acting jointly, who provide information "relating to a violation of the securities laws."⁵⁹

The Dodd-Frank Act also incentivizes whistleblowing by mandating a monetary reward to informants who provide "original information" regarding illegal activity.⁶⁰ The provision

⁵⁴ 26 U.S.C. § 7623(b)(5)(B) (2006).

⁵⁵ See *supra* note 48.

⁵⁶ 31 U.S.C. § 3730(b)(1) (2006).

⁵⁷ See 15 U.S.C.A. § 78u-6 (West 2001 & Supp. 2011).

⁵⁸ *Id.* § 78u-6(h)(1)(A). The provision reads:

No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower (i) in providing information to the [SEC] in accordance with this section; (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the [SEC] based upon or related to such information; or (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), including section 10A(m) of such Act (15 U.S.C. 78f(m)), section 1513(e) of title 18, United States Code, and any other law, rule, or regulation subject to the jurisdiction of the [SEC].

Id.

⁵⁹ *Id.* § 78u-6(a)(6).

⁶⁰ *Id.* § 78u-6(b)(1).

defines “original information” as information that is derived from the

independent knowledge or analysis of a whistleblower; is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit or investigation, or from the news media, unless the whistleblower is a source of the information.⁶¹

Further, the Act expands the type of person that can be a whistleblower. For instance, a whistleblower is not required to be an employee to receive the reward.⁶² In order to be eligible for a reward, however, the information furnished by the whistleblower must result in sanctions exceeding \$1 million.⁶³ Thus, if the whistleblower qualifies for the reward, he is guaranteed to receive a payment of at least 10 percent of \$1 million, or \$100,000. Additionally, the Dodd-Frank Act inserts a nearly identical whistleblower bounty provision into the Commodity Exchange Act.⁶⁴

Section 922 of the Dodd-Frank Act also expands the types of companies these provisions apply to by amending SOX’s whistleblower provision.⁶⁵ Unamended, SOX’s antiretaliation statute applied only to publicly traded companies.⁶⁶ Under the Dodd-Frank Act amendments, however, now any “subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company”⁶⁷ is within the purview of SOX’s whistleblower protection provision.

Although the Dodd-Frank Act makes significant changes in preexisting whistleblower statutes, section 1057 of the Act most notably creates a broad private right of action for employees in the financial services industry who are retaliated

⁶¹ *Id.* § 78u-6(a)(3).

⁶² A “whistleblower” is defined as “any individual who provides . . . information relating to a violation of securities laws to the [SEC].” *Id.* § 78u-6(a)(6) (emphasis added).

⁶³ Under section 21F of the Securities Exchange Act of 1934, a whistleblower is to be rewarded only in a “covered judicial or administrative action.” *Id.* § 78u-6(b)(1). A “covered judicial or administrative action,” in turn, is defined as one that results in monetary sanctions exceeding \$1 million. Dodd-Frank Act, Pub. L. No. 111-203, §§ 748(a)(1), 922(a)(1), 124 Stat. 1376, 1841, 1842 (2010) (codified as amended at 18 U.S.C.A. § 1514A(a) (West 2000 & Supp. 2011)).

⁶⁴ 7 U.S.C. § 1 (2006).

⁶⁵ Dodd-Frank Act § 922, 124 Stat. at 1841.

⁶⁶ 18 U.S.C. § 1514A(a) (2006).

⁶⁷ Dodd-Frank Act § 929A, 124 Stat. at 1852.

against for disclosing information regarding a violation of the Dodd-Frank Act, or any other provision that is subject to the Bureau of Consumer Financial Protection (Bureau).⁶⁸

Under section 1057, “covered employees”⁶⁹ are protected from retaliation if they engage in certain protected activities.⁷⁰ A covered employee is any individual who performs “tasks related to the offering or provision of a consumer financial product or service,”⁷¹ or an authorized representative of such an individual.⁷² An employer (or any affiliate of such employer if the affiliate is a service provider) engaged in the offering or provision of a “consumer financial product or service” cannot discriminate against the whistleblower-employee, or cause the whistleblower-employee to be discriminated against.⁷³ The complainant has the burden of making a prima facie showing that his disclosure of information was a contributing factor to the alleged retaliatory action.⁷⁴ But if the employer demonstrates by clear and convincing evidence that he would have taken the same unfavorable personnel action even in the absence of that behavior, then the complainant is not entitled to any relief.⁷⁵ If it is ultimately determined that the whistleblower was the victim of discrimination in violation of section 1057, he is entitled to reinstatement to his former position, as well as compensatory damages.⁷⁶

⁶⁸ *Id.* § 1057, 124 Stat. at 2031. Section 1011 of the Dodd-Frank Act establishes an independent executive agency called the “Bureau of Consumer Financial Protection.” The Bureau is to “regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws.” *Id.* § 1011(a), 124 Stat. at 1964.

⁶⁹ The Dodd-Frank Act prohibits an employer’s retaliatory action against “any covered employee or any authorized representative of covered employees.” *Id.* § 1057(a), 124 Stat. at 2031.

⁷⁰ A whistleblower’s protected activity includes providing information to the employer or any government authority relating to any violation of any law that is subject to the Bureau’s jurisdiction, as well as “testify[ing] . . . in any proceeding resulting from the . . . enforcement of any . . . law that is subject to the [Bureau’s jurisdiction] . . . or object[ing] to . . . any activity . . . that the employee . . . reasonably believed to be a violation of any law . . . subject to the [Bureau’s jurisdiction].” *Id.* § 1057(a)(1)-(4), 124 Stat. at 2031-32.

⁷¹ *Id.* § 1057(b), 124 Stat. at 2032.

⁷² The Dodd-Frank Act prohibits a covered person or service provider from discriminating against “any covered employee or any authorized representative of covered employees” for reporting a violation. *Id.* § 1057(a), 124 Stat. at 2031.

⁷³ *Id.* §§ 1002(6), 1057(a), 124 Stat. at 1961, 2031.

⁷⁴ *Id.* § 1057(c)(3)(A), 124 Stat. at 2033.

⁷⁵ *Id.* § 1057(c)(3)(C), 124 Stat. at 2033. Note that these standards of proof are essentially identical to those governing whistleblower retaliation claims brought under the Sarbanes-Oxley Act. *See supra* Part I.A.

⁷⁶ Dodd-Frank Act § 1057(c)(4)(B), 124 Stat. at 2033.

Section 1057 of the Dodd-Frank Act as well as the Act's amendments to preexisting whistleblower laws dramatically expands the scope of liability under antiretaliation provisions. The SEC's whistleblower program now extends to cases other than insider trading, and whistleblowers engaged in the consumer financial product or service industries are offered expansive protection from retaliation or discrimination.⁷⁷ The Dodd-Frank Act also creates generous bounty programs offering large monetary rewards to qualifying whistleblowers in efforts to encourage individuals to report violations.⁷⁸ However, the effectiveness of the Dodd-Frank Act's whistleblower provisions is doubtful, and likely overincentivizes whistleblowing.

III. THE INEFFECTIVENESS OF THE DODD-FRANK ACT'S WHISTLEBLOWER BOUNTY PROGRAM

Despite legislators' good intentions, the Dodd-Frank Act's bounty program overincentivizes whistleblowing and will waste administrative resources because it provides what studies show are unnecessarily excessive awards. Although the bounty program was enacted to encourage whistleblowing, the monetary rewards are likely unnecessary in advancing the provision's purported goals. Further, the bounty provisions lack significant threshold considerations and fail to discourage the submission of frivolous claims. As a result, whistleblowers are overincentivized.

A. *Goals of the Dodd-Frank Act's Whistleblower Bounty Program*

The legislative history of the Dodd-Frank Act reveals Congress's intent "to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated securities laws and recover money for victims of financial fraud."⁷⁹ Congress emphasized the importance of bounty programs because whistleblowers "often face the difficult choice between telling the truth and the risk of committing 'career suicide.'"⁸⁰ Harry

⁷⁷ See *infra* Part IV.

⁷⁸ The program "[r]ecogniz[es] that whistleblowers often face the difficult choice between telling the truth and the risk of committing 'career suicide.'" S. REP. NO. 111-176, at 110 (2010).

⁷⁹ *Id.*

⁸⁰ *Id.*

Markopolos, Certified Fraud Examiner and Madoff whistleblower, attested to the efficiency and effectiveness of whistleblower bounty programs. He cited statistics holding that whistleblower tips uncovered 54 percent of fraud schemes in public companies, as opposed to the 4 percent that external auditors—including the SEC—exposed.⁸¹ SEC Chairman Mary L. Schapiro further noted that “[w]histleblowers can be a source of valuable firsthand information that may otherwise not come to light”⁸² and that “[t]hese high-quality leads can be crucial to protecting investors and recovering ill-gotten gains from wrongdoers.”⁸³ Congress has made it abundantly clear that one of the primary purposes of the Dodd-Frank Act’s whistleblower bounty program is to encourage the reporting of “high-quality” tips,⁸⁴ and the \$1 million requirement that whistleblowers must meet in order to qualify for a reward evidences legislators’ efforts to encourage the disclosure of major violations. Although it may seem logical that providing monetary rewards incentivizes whistleblowers to report illegal activity, studies show that this assumption is not entirely true. In fact, in light of recent research, the Dodd-Frank Act’s whistleblower bounty program is counterproductive.

B. Research Indicating the Ineffectiveness of the Dodd-Frank Act’s Whistleblower Bounty Program

A recent study demonstrates the ineffectiveness of the Dodd-Frank Act’s bounty program. The study examined the role incentives play in whistleblowers’ decisions to report illegal activity.⁸⁵ It concluded that in cases where the whistleblower has a “greater ethical stake in the outcome” monetary incentives might be unnecessary and counterproductive because they may offset the whistleblower’s internal ethical motivation.⁸⁶ Conversely, when the perceived severity of the misconduct is

⁸¹ See *Assessing the Madoff Ponzi Scheme and Regulatory Failures: Hearing Before the Subcomm. on Capital Mkts., Ins., & Gov’t Sponsored Enters. of the Comm. on Fin. Servs.*, 111th Cong. (2009) (testimony of Harry Markopolos).

⁸² Press Release, Sec. & Exch. Comm’n, SEC Proposes New Whistleblower Program Under Dodd-Frank Act (Nov. 3, 2010), available at <http://www.sec.gov/news/press/2010/2010-213.htm>.

⁸³ *Id.*

⁸⁴ Holzer & Johnson, *supra* note 18.

⁸⁵ See generally Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151 (2010).

⁸⁶ *Id.* at 1207.

low, “external incentives,” such as monetary rewards, “matter much more” to the whistleblower’s decision to report the illegality.⁸⁷ In other words, in cases where the activity at issue has significant ethical and moral implications, research suggests that the whistleblower does not need monetary incentives to compel him to report the violation. On the other hand, situations involving less severe conduct may require financial rewards to encourage the whistleblower to report the misconduct. These results are “contrary to the basic intuition of the legal policy maker to give higher rewards as the misconduct is more severe.”⁸⁸ Given its legislative intent to encourage the reporting of major violations, the Dodd-Frank Act’s whistleblower bounty program is likely to be counterproductive, as it offers large monetary rewards, which studies indicate are unnecessary for cases involving significant moral implications.⁸⁹ Other studies show that “extrinsic motivators do not alter the attitudes that underlie our behaviors. They do not create an enduring commitment to any value or action.”⁹⁰ Thus, it is unlikely that the Dodd-Frank Act’s whistleblower bounty program will be successful in furthering legislators’ goals. The Dodd-Frank Act also lacks significant thresholds that the whistleblower must overcome, which is likely to result in a surge of reports of trivial claims.

1. The Ineffectiveness of the Dodd-Frank Act’s Large Monetary Rewards

The general perception regarding the relationship between the amount of sanctions imposed and the severity of misconduct is that the greater the amount of sanctions, the more severe the misconduct.⁹¹ Thus, through the Dodd-Frank Act’s imposition of the \$1 million minimum, the legislature appears to intend to reward whistleblowers only in cases where the severity of misconduct and moral offensiveness is high. The study generally found that “[i]n areas where the misconduct is expected to trigger high internal motivation, there is less need

⁸⁷ *Id.* at 1194.

⁸⁸ *Id.* at 1204.

⁸⁹ *See id.*

⁹⁰ Alfie Kohn, *Why Incentive Plans Cannot Work*, HARV. BUS. REV., Sept.-Oct. 1993, at 55.

⁹¹ Feldman & Lobel, *supra* note 85, at 1204 (stating that “legal policy maker[s] give higher rewards as the misconduct is more severe (given its likely correlation with greater harm to society)”).

to invest in incentive mechanisms.”⁹² The Dodd-Frank Act’s bounty program appears to contradict this research, as it guarantees a qualifying whistleblower a minimum reward of \$100,000 for a tip regarding a violation worthy of sanctions of at least \$1 million.⁹³ Consequently, the Dodd-Frank Act’s bounty program is excessive, as it offers monetary incentives that studies show are not necessary.

The large rewards offered to whistleblowers overincentivize whistleblowing, and may ultimately prove to be a waste of limited agency resources. This is not to suggest that all whistleblower bounty programs should be eliminated. Due to its inherent risks,⁹⁴ whistleblowing, to some extent, should be incentivized through regulatory policies that “encourage individuals to break the code of silence in corrupt organizations.”⁹⁵ Eliminating all whistleblower bounty provisions and instead implementing a legal duty to report, along with a fine for a failure to report, is unlikely to be effective in encouraging whistleblowing, as there is a “growing body of studies both in social psychology and in behavioral economics indicating that people respond more strongly to incentives than penalties.”⁹⁶ However, monetary incentives may not be necessary or effective in all situations, and thus it is imperative that legislators accurately assess and determine the optimal level of rewards to ensure the effective application of limited agency resources.⁹⁷ Although the Dodd-Frank Act’s whistleblower bounty program attempts to achieve this ideal level of whistleblower incentives, it fails to do so. By mandating large rewards to whistleblowers, the Dodd-Frank Act’s whistleblower provision invites a flood of whistleblower reports, which may not necessarily be of the “high-quality”

⁹² *Id.*

⁹³ Under section 21F of the Securities Exchange Act, a whistleblower is to receive a minimum of ten percent of the sanctions recovered, which must be at least \$1,000,000, resulting in a minimum recovery of \$100,000. 15 U.S.C.A. § 78u-6(a)-(b)(1) (West 2009 & Supp. 2011). The law further provides that a “covered judicial or administrative action” is an action that “results in monetary sanctions exceeding \$1,000,000.” *Id.* § 78u-6(a)(1).

⁹⁴ See Feldman & Lobel, *supra* note 85, at 1157-58 (“The decision of whether to blow the whistle is a complex one and inevitably involves certain risks. . . . In addition to direct employment retaliation, reporting often entails psychological and societal costs, including fear, guilt and mistreatment by peers and community. . . . One commentator has described whistle-blowing as ‘professional suicide.’” (quoting James Gobert & Maurice Punch, *Whistleblowers, the Public Interest, and the Public Interest Disclosure Act 1998*, 63 MOD. L. REV. 25, 35 (2000))).

⁹⁵ *Id.* at 1159.

⁹⁶ *Id.* at 1181.

⁹⁷ See *id.* at 1182.

legislators intended to encourage.⁹⁸ Although some whistleblowers may be discouraged from bringing such claims forward because of fear of retaliation, in light of the expansive protection granted by the Dodd-Frank Act's whistleblower protection provisions, this ultimately may not prove to be a significant disincentive.⁹⁹

2. The Dodd-Frank Act's Lack of Significant Threshold Considerations

The excessive rewards provided by the Dodd-Frank Act could be justifiable if there were meaningful thresholds the whistleblower had to overcome in order to receive his reward. Threshold considerations involve what the whistleblower must first do and what the result of the disclosures must be in order to qualify for a reward.¹⁰⁰ For example, the FCA contains significant threshold considerations¹⁰¹—namely, the whistleblower must initiate the litigation himself.¹⁰² As a result of this prerequisite, whistleblowers may be discouraged from reporting frivolous claims.¹⁰³ Such meaningful threshold considerations are absent in the Dodd-Frank Act's whistleblower bounty provisions.

For instance, the Dodd-Frank Act does not contain significant threshold considerations with respect to *who* can benefit from its provisions. In fact, the whistleblower does not even need to be an employee of the entity allegedly engaging in the illegal activity.¹⁰⁴ Although the whistleblower must provide information that is not known to the agency from another

⁹⁸ Holzer & Johnson, *supra* note 18.

⁹⁹ See discussion *supra* Part II; see also Marsha J. Ferziger & Daniel G. Currell, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 1999 U. ILL. L. REV. 1141, 1173-74 ("Although an informant's discounted losses can arise in many ways, the 'big ticket' potential harms are harm to her livelihood In this vein, discounted retaliation costs arise from a host of actions a defendant could take against the informant . . ."). However, federal and state antiretaliation statutes protect the whistleblower, and "[a]lthough an informant may not find his former workplace a pleasant post-informing environment, these statutes can ensure that he remains gainfully employed or receives compensation for any harm suffered in the workplace, thus mitigating his discounted retaliation losses." *Id.* at 1174. Such discounted losses may also include "reputational harms and the mental and emotional costs of testifying in litigation." *Id.*

¹⁰⁰ *Id.* at 1150.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.* at 1159.

¹⁰⁴ 15 U.S.C.A. § 78u-6(a)(6) (West 2009 & Supp. 2011).

source,¹⁰⁵ thus overcoming a threshold requirement concerning the type of information covered under the Act, this may not ultimately prove to be a difficult standard to overcome as whistleblowers can race to furnish the agencies with their inside information. Another arguable “threshold” contained in the Dodd-Frank Act is the \$1 million requirement whistleblowers must satisfy in order to be eligible for a reward.¹⁰⁶ Although this million-dollar minimum does provide some limitation on the whistleblower’s eligibility for the bounty, there is no provision preventing the whistleblower from reporting frivolous claims in hopes that the sanctions exceed \$1 million.¹⁰⁷ Additionally, whistleblowers do not need to demonstrate the veracity of their allegations. Under the finalized rules, the whistleblower submits his or her information regarding potential securities law violations under the penalty of perjury.¹⁰⁸ However, “there is little to deter individuals from making unjustified accusations of wrongdoing,”¹⁰⁹ and the possibility that a whistleblower will provide a *knowingly* false statement that could be the basis for prosecution of perjury¹¹⁰ is “remote at best.”¹¹¹

Thus, the Dodd-Frank Act’s whistleblower provisions lack significant threshold considerations and fail to discourage whistleblowers from reporting trivial claims. The Act also offers excessive monetary rewards, and as a result, overincentivizes whistleblowing.

¹⁰⁵ Dodd-Frank Act, Pub. L. No. 111-203, §§ 748(a)(4)(B), 922(a)(3)(B), 124 Stat. 1376, 1740, 1842 (2010) (codified as amended at 18 U.S.C.A. § 1514A(a) (West 2000 & Supp. 2011)).

¹⁰⁶ A whistleblower is rewarded only in a “covered judicial or administrative action,” 15 U.S.C.A. § 78u-6(b)(1), which is defined as an action that results in monetary sanctions exceeding \$1 million. Dodd-Frank Act §§ 748(a)(1), 922(a)(1), 124 Stat. at 1841, 1842.

¹⁰⁷ 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/> (noting that “[t]he millions that whistleblowers might potentially reap could also encourage a lottery mentality, where people file complaints on weak or wholly illegitimate claims ‘just in case.’”). However, there is a provision that penalizes the whistleblower for willfully furnishing false information. Dodd-Frank Act §§ 748(m), 922(i), 124 Stat. at 1746, 1847.

¹⁰⁸ Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act Release No. 34-64545, 76 Fed. Reg. 34,300 (May 25, 2011) [hereinafter *SEC Final Rules*]; see also 15 U.S.C.A. § 78u-6(i).

¹⁰⁹ Letter from Jones Day, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Dec. 17, 2010) (on file with author) [hereinafter *Jones Day Letter*].

¹¹⁰ Under 18 U.S.C. § 1001(a) (2006), any person who “knowingly and willfully (1) falsifies, conceals, or covers up . . . a material fact; (2) makes any materially . . . fraudulent statement or representation; or (3) makes or uses any false writing or document knowing the same to contain any materially . . . fraudulent statement . . . will be fined and imprisoned for not more than 5 years.” *Id.*

¹¹¹ *Jones Day Letter*, *supra* note 109.

C. *Future Implications of the Dodd-Frank Act's Whistleblower Bounty Program*

The excessive rewards provided by the Dodd-Frank Act's whistleblower bounty program, as well as its lack of significant threshold considerations, is likely to have several implications, including an increase in the number of whistleblower claims, a burden on administrative costs, and employees' circumvention of companies' internal compliance systems.

1. Substantial Increase in the Number of Whistleblower Claims

Expected bounty payments are one of the most important factors that influence whistleblowers' decisions to disclose a violation.¹¹² In fact, "[m]uch of the [whistleblower's] uncertainty [is attributed to] the agency's discretion to award a reduced bounty or no bounty at all."¹¹³ Under the Dodd-Frank Act, a whistleblower's uncertainty regarding payment is largely eliminated. Provided that his information results in sanctions exceeding \$1 million, the whistleblower is certain that he will receive a reward of at least \$100,000. But if monetary rewards are high, "every potential informant with a crumb of information might crawl out of the woodwork hoping to hit the bounty jackpot."¹¹⁴ In fact, claims began "trickling in" shortly after the enactment of the Dodd-Frank Act.¹¹⁵ Although "no flood of tips" has occurred yet since the SEC finalized the whistleblower provisions,¹¹⁶ Sean McKessy, head of the Whistleblower Office, is expanding his staff¹¹⁷ and the SEC predicts it will receive approximately thirty-thousand tips per year.¹¹⁸ Further, it is likely that a SEC announcement of a large

¹¹² Ferziger & Currell, *supra* note 99, at 1152.

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ Jean Eaglesham & Ashby Jones, *Whistleblower Bounties Pose Challenges*, WALL ST. J. (Dec. 13, 2010), http://online.wsj.com/article/SB10001424052748704058704576015210866784294.html?mod=WSJ_hp_LEFTWhatsNewsCollection.

¹¹⁶ Andrea Shalal-Esa, *US SEC Says Will Fix Whistleblower Rule if Any Problems*, REUTERS (Aug. 11, 2011, 6:34 PM), <http://www.reuters.com/article/2011/08/11/sec-whistleblowers-idUSN1E77A1YH20110811>.

¹¹⁷ *See id.*

¹¹⁸ Eaglesham & Jones, *supra* note 115.

reward arising from a Dodd-Frank whistleblower initiative will trigger an increased number of claims.¹¹⁹

Due to the Act's lack of significant threshold considerations,¹²⁰ whistleblowers may rush to report alleged violations without confirming that the allegations are valid in order to ensure that they are the original source of information. Ultimately, the unnecessary payments the whistleblower receives is likely to be ineffective in furthering the Dodd-Frank Act's goal of soliciting "high quality" tips. Instead, the Dodd-Frank Act's whistleblower bounty program overincentivizes whistleblowing, and is likely to lead to a surge of reports and a burden on administrative costs.

2. Burden on Administrative Costs

Whistleblower bounty programs may ostensibly lower the cost of obtaining vital information, but the Dodd-Frank Act will not ultimately save administrative resources.¹²¹ A reduction in administrative costs may result if the statute contained meaningful threshold considerations, such as in the False Claims Act, which permits private individuals to bring the suit on behalf of the government.¹²² However, the administration under the Dodd-Frank Act will have to "review—and occasionally litigate—a substantial number of claims that turn out to be grounded on poor information or information the [agency] or the public already possessed."¹²³ Unlike the False Claims Act, where the government does not conduct most of the litigation,¹²⁴ the administration under the Dodd-Frank Act will have to devote further resources to investigate the alleged misconduct. Additionally, given the likelihood that the Dodd-Frank Act will result in a drastically increased amount of whistleblower reports, agencies will expend additional "time and resources when sorting good tips from the bad."¹²⁵ The

¹¹⁹ Doug Clark, *Opening the Floodgates: The Dodd-Frank Whistleblower Provisions' Impact on Corporate America*, BOARDMEMBER.COM, http://www.boardmember.com/Article_Details.aspx?id=5642&page=1 (last visited Sept. 23, 2011).

¹²⁰ See *supra* Part III.B.2.

¹²¹ Ferziger & Currell, *supra* note 99, at 1158-59.

¹²² 31 U.S.C. § 3730(b)(1) (2006).

¹²³ Ferziger & Currell, *supra* note 99, at 1159.

¹²⁴ *Id.* "Of the first four hundred [False Claims Act] cases filed, the Department of Justice . . . joined as a litigant in only seventy; the others proceeded privately." *Id.*

¹²⁵ *Id.* at 1171. Aside from its practical consequences, implementing whistleblower incentive programs also has several ethical implications, and the morality of the practice of rewarding informants has been disputed. *Id.* at 1191. The

administrative cost of processing these voluminous reports may exceed the benefit gained from enticing a few whistleblowers holding excellent information on high-level crimes.¹²⁶ The rules provide that whistleblowers who wish to participate in the whistleblower program must “declare, under penalty of perjury, that their submission is truthful to the best of their knowledge.”¹²⁷ Thus, the SEC argues, the whistleblower rules sufficiently discourage frivolous claims.¹²⁸ It reasons that “[t]his should reduce the costs incurred by the [SEC] from devoting resources to review and evaluate frivolous submissions, and also create efficiency gains by permitting the [SEC] to place greater reliance on the accuracy of information that is received.”¹²⁹ But the rules lack threshold considerations that prevent whistleblowers from reporting claims in hopes that they will result in sanctions exceeding \$1 million.¹³⁰ As a result, while their submissions may not be perjurious, they may not be of the high quality sought by legislators when drafting the Dodd-Frank Act.

Although the Internal Revenue Code’s whistleblower bounty program was profitable before its 2006 amendment,¹³¹ it is important to note that the Internal Revenue Service (IRS) did not pay whistleblowers the maximum reward of 15 percent.¹³² In fact, in 1993, the IRS paid an average reward of 3 percent of resulting sanctions.¹³³ Data further indicate that the IRS “not only pa[id] small percentages and small rewards but also pa[id] them to a small number of claimants.”¹³⁴ Thus, it is

general opinion is that informants should voluntarily come forward with information, rather than being “brib[ed]” to disclose any illegal activity. *Id.* at 1192. One U.S. District Court Judge noted, “I don’t think that turkeys like that ought to receive a dime of my money.” *Id.* at 1191 (quoting Judge Alcee Hastings). Others, however, do not find such whistleblower incentives as immoral. *Id.* at 1192. Some view such programs as “right and honorable,” and hold the viewpoint that whistleblowers are protecting the public. *Id.* Although such moral issues present an interesting debate, it is beyond the scope of this note.

¹²⁶ *Id.* at 1152.

¹²⁷ *SEC Final Rules*, *supra* note 108, at 219.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *See infra* Part V.A.

¹³¹ In 1967, the IRS paid \$723,995 to whistleblowers whose tips led to a \$10 million collection of tax revenue. In 1977, it recovered \$14,602,341 in unpaid tax revenue and paid \$360,304 in whistleblower rewards. In 1993, the Treasury recovered \$173 million and whistleblower rewards totaled over \$5 million. Ferziger & Currell, *supra* note 99, at 1166-67.

¹³² *Id.* at 1167.

¹³³ *Id.*

¹³⁴ *Id.* at 1168. Although data indicates that the unamended version of the SEC’s whistleblower program also turns an annual profit, *id.* at 1167, Ferziger and Currell note that “statistics on the SEC’s bounty provisions are largely meaningless

not unreasonable to posit that the Internal Revenue Code's previous profits are attributable, at least in part, to its small and infrequent payouts. Under the Dodd-Frank Act, however, agencies must reward qualifying whistleblowers at least 10 percent of the resulting sanctions.¹³⁵ As a result, it is questionable whether Dodd-Frank's whistleblower program will turn a similar profit.¹³⁶

Interestingly, the IRS paid its first whistleblower reward in 2011, four years after the enactment of its whistleblower bounty program.¹³⁷ Further, the IRS recently reported that it would delay payments under its pre-amendment program for up to two years.¹³⁸ According to the Treasury Department's Inspector General for Tax Administration, the IRS's whistleblower program suffered from defects in the "control and timely resolution of whistleblower claims."¹³⁹ In light of the shortcomings of preexisting whistleblower bounty programs, it is likely that the Dodd-Frank Act's bounty program will also be ineffective in furthering the Act's purported goals.

3. Eradication of Companies' Internal Compliance Systems

The Dodd-Frank Act's whistleblower program is also likely to undermine companies' established internal compliance systems. Rather than reporting alleged illegal activity to the company itself, potential whistleblowers may opt to forgo internal compliance methods and report the misconduct directly to the SEC. The National Association of Corporate Directors (NACD) recently argued to the SEC that the Dodd-Frank Act's whistleblower provision "encourage[s] employees to bypass their own [company's] compliance departments in their

given the extremely low number of claims and payouts in the ten-year history of SEC bounties." *Id.* at 1170.

¹³⁵ 15 U.S.C.A. § 78u-6(b)(1)(A) (West 2009 & Supp. 2011).

¹³⁶ In fact, the SEC has delayed the opening of its whistleblower office due to budgeting concerns. Eaglesham & Jones, *supra* note 115.

¹³⁷ Ashby Jones, *After Four Years, the IRS (Finally!) Makes a Whistleblower Payment*, WALL ST. J. LAW BLOG (Apr. 8, 2011, 11:44 AM), <http://blogs.wsj.com/law/2011/04/08/after-four-years-the-irs-finally-makes-a-whistleblower-payment>. As of December 15, 2010, the IRS had not paid any whistleblower rewards. Ryan J. Donmoyer, *IRS Paid No Rewards in U.S. Whistleblower Program*, BLOOMBERG (Dec. 15, 2010, 5:29 PM), <http://www.bloomberg.com/news/2010-12-15/irs-paid-no-rewards-to-informants-in-u-s-whistleblower-program.html>.

¹³⁸ Donmoyer, *supra* note 137.

¹³⁹ Eaglesham & Jones, *supra* note 115.

eagerness to inform the SEC of suspected foul play.”¹⁴⁰ It is inappropriate for such SEC investigations to be conducted at taxpayer expense,¹⁴¹ and instead, the company should be afforded an opportunity to remedy the alleged violation. Bypassing internal compliance essentially denies management the opportunity to take remedial action because of the whistleblower’s pursuit of a profit. As a result, the Dodd-Frank Act vitiates companies’ responsible efforts to create and implement effective compliance systems and reporting schemes.¹⁴²

In an attempt to mitigate the subversion of internal compliance programs, the SEC now offers a potentially larger reward if a whistleblower first utilizes the company’s compliance program before reporting the alleged violation to the SEC.¹⁴³ The SEC does this in several ways. For instance, if a whistleblower first reports the alleged misconduct to the company’s internal compliance program and the company later investigates and reports the results of its investigation to the SEC, all the information provided to the SEC by the company will be attributed to the whistleblower,¹⁴⁴ which can lead to an increased reward. Additionally, the rules expressly state that a whistleblower’s participation in his or her company’s internal compliance program is a factor that can increase his or her reward.¹⁴⁵ Thus, this arguably remedies the issue of the eradication of companies’ internal compliance programs.¹⁴⁶

¹⁴⁰ Crossman, *supra* note 17. The NACD also argued that the whistleblower program “provide[s] an incentive for persons having “independent knowledge” of possible corporate wrongdoing to report directly to the SEC,” and that “the legislators who enacted the original provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 did not weigh the consequences the provisions could have on the ethical and compliance-based cultures of corporations.” *Id.* (quoting the NACD).

¹⁴¹ *Id.*

¹⁴² Eaglesham & Jones, *supra* note 115 (quoting Susan Hackett, Senior Vice President of the Association of Corporate Counsel, who stated that “[t]he proposals cut to the very core of what it is that every responsible U.S. company has been trying to do for the last couple of decades, which is to create effective, robust compliance reporting systems”).

¹⁴³ Memorandum from Cleary Gottlieb Steen & Hamilton LLP 3 (May 26, 2011), available at <http://www.cgsh.com/files/News/af83e39a-f0df-442e-8e78-1f05c1bc4a54/Presentation/NewsAttachment/b281f060-f24c-42b6-8248-23990d2aca9a/CGSH%20Alert%20-%20SEC%20Approves%20New%20Whistleblower%20Program.pdf> (“Despite controversy and numerous comments from the business community, the final rules do not require whistleblowers to avail themselves of internal compliance programs before reporting to the SEC. Instead, the [SEC] made several changes to its proposal to add incentives for whistleblowers to use internal compliance programs before or when going to the [SEC].”).

¹⁴⁴ 17 C.F.R. § 240.21F-4(c) (2010).

¹⁴⁵ *Id.* § 240.21F-6(a)(4).

¹⁴⁶ The SEC states that although it did not require whistleblowers to report violations internally, it has “made additional changes to the rules to further incentivize

However, it is unclear whether increased monetary rewards will be effective in encouraging whistleblowers to first report alleged violations internally. First, as noted above,¹⁴⁷ studies indicate that large monetary rewards offset internal motivations, and may prove to be unnecessary and counterproductive.¹⁴⁸ Further, in light of the court's interpretation in *Egan v. Tradingscreen, Inc.*,¹⁴⁹ whistleblowers are likely to bypass the internal compliance system despite the increased reward.

Egan is the first reported decision under the Dodd-Frank Act's whistleblower protection provision,¹⁵⁰ and concerns a "major issue addressed as part of the Dodd-Frank whistleblower rulemaking proceedings: the integrity of corporate internal compliance and reporting programs."¹⁵¹ In *Egan*, the whistleblower-employee reported suspected fraudulent activity to the company's internal compliance system.¹⁵² Despite assurances that he would not be fired, he was later terminated and thus filed suit, alleging a violation of the Dodd-Frank Act's antiretaliation provision.¹⁵³ The employer argued that the antiretaliation provisions did not apply because the whistleblower-employee did not directly report the alleged violation to the SEC.¹⁵⁴ The court interpreted the whistleblower protection provisions as follows:

Plaintiff must either allege that his information was reported to the [SEC], or that his disclosures fell under the four categories of disclosure delineated by 15 U.S.C. § 78u-6(h)(1)(A)(iii) that do not require such reporting: those under the Sarbanes-Oxley Act, the Securities Exchange Act, 18 U.S.C. § 1513(e), or other laws and regulations subject to the jurisdiction of the [SEC].¹⁵⁵

The *Egan* Court reasoned that the legislature could have easily provided broader protection for whistleblowers

whistleblowers to utilize their companies' internal compliance and reporting systems when appropriate." *SEC Final Rules*, *supra* note 108, at 5.

¹⁴⁷ See *supra* Part III.B.

¹⁴⁸ See Feldman & Lobel, *supra* note 85, at 1154-55.

¹⁴⁹ No. 10 Civ. 8202 (LBS), 2011 U.S. Dist. LEXIS 47713, at *1-2 (S.D.N.Y. May 4, 2011).

¹⁵⁰ Letter from Stephen M. Kohn, Exec. Dir., Nat'l Whistleblowers Ctr., to Elizabeth Murphy, Sec'y, Sec. & Exch. Comm'n, and David A. Stawick, Sec'y, Commodity Futures Trading Comm'n, at 1 (May 17, 2011) (on file with author) [hereinafter *National Whistleblowers Center Letter*].

¹⁵¹ *Id.*

¹⁵² *Egan v. Tradingscreen, Inc.*, No. 10 Civ. 8202 (LBS), 2011 U.S. Dist. LEXIS 47713, at *5 (S.D.N.Y. May 4, 2011).

¹⁵³ *Id.* at *5-6.

¹⁵⁴ *Id.* at *9.

¹⁵⁵ *Id.* at *13-14.

alleging securities laws and thus the “absence of similarly broad protections . . . indicates that Congress intended to encourage whistleblowers reporting such violations to report to the SEC.”¹⁵⁶ As such, the court’s interpretation can be read to mean that “employees have no choice but to bypass internal reporting systems and directly raise concerns regarding violations of securities laws with federal regulatory agencies and the Justice Department.”¹⁵⁷ In light of the court’s interpretation, the possibility of an increased monetary reward for using internal compliance systems does not outweigh whistleblowers’ concern of retaliation, and thus they are likely to report directly to the SEC. In fact, some organizations assert that they “will do everything in their power to ensure that employees bypass such channels [as i]t would be the height of irresponsibility for whistleblower advocates to urge employees to use internal reporting programs.”¹⁵⁸ As a result, the important policy objectives identified by the SEC would be “seriously undermined.”¹⁵⁹ The *Egan* Court further noted that “[o]bviously, a whistleblower must directly report to the SEC to receive a bounty award from the SEC.”¹⁶⁰ Consequently, the requirement that a whistleblower must report the alleged violation to the SEC in order to receive the reward, along with the confusion about whether whistleblowers must report to the SEC in order to receive protection under the Dodd-Frank Act’s antiretaliation provisions, is likely to lead to the eradication of internal compliance programs. Thus, the SEC’s attempt to encourage whistleblowers to first use companies’ internal compliance systems by offering larger rewards is ineffective.

The Dodd-Frank Act’s excessive bounties and lack of significant threshold considerations invite a flood of whistleblower reports. Supporters may argue that such monetary incentives are necessary, as whistleblowers are unwilling to report violations for fear of retaliation or discrimination by their employer. But the Dodd-Frank Act also offers expansive protection under its antiretaliation statute, largely reducing such fears. As a result, the Dodd-Frank Act’s unnecessary and excessive bounty program, coupled with its expansive antiretaliation protection,

¹⁵⁶ *Id.* at *12.

¹⁵⁷ *National Whistleblowers Center Letter*, *supra* note 150, at 3.

¹⁵⁸ *Id.* at 4.

¹⁵⁹ *Id.* at 2.

¹⁶⁰ *Egan*, 2011 U.S. Dist. LEXIS 47713, at *24.

overincentivizes whistleblowing and is likely to lead to the waste of administrative resources.

IV. THE DODD-FRANK ACT'S EXPANSION OF PREEXISTING WHISTLEBLOWER PROTECTION PROVISIONS

The Dodd-Frank Act's antiretaliation provisions drastically expand preexisting laws in two respects: first, by expanding the scope of persons *prohibited* from taking retaliatory action, and second, by enlarging the scope of persons *protected* from retaliatory action.

A. *The Expansion of the Class of Persons Prohibited from Taking Retaliatory Action*

Unamended, SOX's whistleblower protection provision applies only to certain publicly traded companies.¹⁶¹ In applying the statute's plain meaning, courts have held that a narrow reading—applying the provisions only to public companies—is “necessary” to limit the scope of SOX's antiretaliation protection.¹⁶² Here courts have argued that a contrary holding might have the effect of extending the statute “far beyond” what Congress envisioned.¹⁶³ Additionally, courts have held that to subject nonpublic subsidiaries of publicly traded parent companies to SOX's whistleblower statute would “widen the scope of the whistleblower protection provisions beyond what Congress appears to have intended.”¹⁶⁴ Congress, however, has effectuated such intent through the Dodd-Frank Act. The Dodd-Frank Act amended SOX's antiretaliation provision, which now provides that “*any* subsidiary or affiliate whose financial information is included in the consolidated financial

¹⁶¹ 18 U.S.C. § 1514A(a) (2006); *see also* Brady v. Calyon Sec. (USA), 406 F. Supp. 2d 307, 317 (S.D.N.Y. 2005) (holding that an employee of nonpublicly traded companies was not covered by SOX and that a “specific requirement . . . is that defendant be a publicly traded company”); Flake v. New World Pasta Co., 03-126, Final Decision and Order (Dep't of Labor Feb. 25, 2004) (concluding that pursuant to the plain language of the Sarbanes-Oxley Act, even when an employer is a publicly traded company, it is not covered if it is not registered under section 12 or required to file reports under section 15(d) of the Securities and Exchange Act of 1934).

¹⁶² Lawson v. FMR LLC, 724 F. Supp. 2d 141, 155 (D. Mass. 2010) (citing Goodman v. Decisive Analytics Corp., 2006 SOX 11 (Dep't of Labor Jan. 10, 2006)).

¹⁶³ *Id.* (quoting Goodman v. Decisive Analytics Corp., 2006 SOX 11 (Dep't of Labor Jan. 10, 2006)).

¹⁶⁴ Malin v. Siemens Med. Solutions Health Servs., 638 F. Supp. 2d 492, 500-01 (D. Md. 2008).

statements”¹⁶⁵ of a publicly traded company is prohibited from taking discriminatory or retaliatory action against a whistleblower-employee.¹⁶⁶ Under this amendment, the scope of SOX’s antiretaliation provision has been significantly expanded, and now prohibits non-publicly traded subsidiaries or affiliates of publicly traded companies from taking discriminatory action against whistleblowers. Arguably, the scope of persons prohibited from taking retaliatory action under SOX is still restricted, as the statute applies only to allegations of violations of securities regulations.¹⁶⁷ In this respect, the scope of SOX’s whistleblower provision may remain limited. It is unlikely, however, that this “limitation” will ease employers’ concerns, since individuals hoping to blow the whistle on violations of regulations other than securities laws can claim protection under a new antiretaliation statute provided in section 1057 of the Dodd-Frank Act, which implements a very broad antiretaliation provision.

The amended antiretaliation provision protects whistleblowers from retaliation against “any person that engages in offering or providing a consumer financial product or service,”¹⁶⁸ rather than to a narrow band of certain publicly traded companies. The provision also broadly defines “financial products or services” and includes appraisers, check cashers, and lenders.¹⁶⁹ Affiliates of financial service providers¹⁷⁰ are also subject

¹⁶⁵ Dodd-Frank Act, Pub. L. No. 111-203, § 929A, 124 Stat. 1376, 1852 (2010) (codified as amended at 18 U.S.C.A. § 1514A(a) (West 2000 & Supp. 2011)) (emphasis added).

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* In *Egan v. Tradingscreen, Inc.*, the whistleblower-employee argued that his employer, a privately held company, violated the antiretaliation provision. No. 10 Civ. 8202 (LBS), 2011 U.S. Dist. LEXIS 47713, at *5-6 (S.D.N.Y. May 4, 2011). The court, however, stated that “a specific requirement . . . is that defendant be a publicly traded company.” *Id.* at *14 (quoting *Brady v. Calyon Sec. (USA)*, 406 F. Supp. 2d 307, 317 (S.D.N.Y. 2005)). The plaintiff attempted to argue that the company was selling securities and sought an initial public offering. *Id.* at *14-15. However, the court found that the plaintiff “fail[ed] to identify the securities covered by the Exchange Act which he claims [the defendant] sold. A mere allegation of an intention to sell securities, without more, is not enough to turn a privately held company into a publicly traded one.” *Id.* at *15.

¹⁶⁸ 12 U.S.C.A. § 5481(6)(A) (West 2001 & Supp. 2011).

¹⁶⁹ The term “financial product or service,” in turn, includes extending credit; appraising real and personal property, providing credit counseling, check cashing, and real estate settlement services; and collecting or analyzing information “used in connection with any decision regarding the offering or provision of a consumer financial product or service” *Id.* § 5481(15)(A). The term “financial product or service” also includes acting as a “custodian of funds or any financial instrument for use by or on behalf of a consumer . . . providing financial advisory services . . . to consumers on individual financial matters . . . [and] providing services to assist a consumer with debt management or debt settlement . . . or avoiding foreclosure.” *Id.*

to SOX's expanded laws, provided that the affiliate acts as a "service provider,"¹⁷¹ or someone who furnishes a "material service" to the financial service provider in connection with the offering of a financial product or service. As a result, under the Dodd-Frank Act's amendment to SOX's preexisting whistleblower provisions, persons who provide or offer financial products or services, and even those who may indirectly offer or provide financial services, are subject to antiretaliation provisions.

This expansion of liability under the Dodd-Frank Act is startling. Application of the preexisting statutes was limited to cases of insider trading, tax evasion, fraudulent transactions with the government, and those involving publicly traded companies. Under section 1057, however, persons offering or providing financial products or services to consumers, and even those who provide a "material" service to such providers of financial products or services, are subject to antiretaliation provisions.

The Bureau's ability to insert additional examples and definitions of "financial product or service" further evidences the broad scope of the individuals and entities subject to section 1057.¹⁷² If the Bureau concludes that a financial product or service is executed with the purpose of evading any federal consumer financial law, or is one that a bank or financial holding company is permitted to offer and is likely to have a material impact on consumers, the Bureau is explicitly authorized to insert that product or service into the Dodd-Frank Act's definition of "financial product or service."¹⁷³ The scope of persons subject to section 1057's prohibition against retaliatory action is noninclusive and can be amended to include other persons in the future, further expanding its scope. The expanded protection that is now provided to whistleblowers leads to increased employer liability, which can have numerous negative effects like increased costs.¹⁷⁴

¹⁷⁰ *Id.* An affiliate is a person that "controls, is controlled by, or is under common control with another person" of a person engaged in the offering or provision of a consumer financial product or service. *Id.* § 5481(1), (6)(A).

¹⁷¹ *Id.* § 5481(26). The Dodd-Frank Act explicitly provides that the term "service provider" is not to include a person who offers or provides to a covered person a support service that is generally provided to businesses or a "similar ministerial service," *id.* § 5481(26)(B)(i), nor a person who provides "time or space for an advertisement for a consumer financial product or service through print, newspaper, or electronic media." *Id.* § 5481(26)(B)(ii). Note that if the service provider offers or profits from its own consumer financial product or service, it is deemed to be a covered person. *Id.* § 5481(26)(C).

¹⁷² *Id.* § 5481(15)(A)(xi).

¹⁷³ *Id.*

¹⁷⁴ *See infra* Part IV.C.

B. The Expansion of the Class of Persons Protected from Retaliatory Action

The Dodd-Frank Act imprudently expands the class of whistleblowers from the previously narrowly defined constraints of the preexisting antiretaliation provisions to the current definition protecting any whistleblower who performs tasks “related” to “the offering or provision of a consumer financial product or service.”¹⁷⁵ The use of the broad, undefined term “related” greatly increases the scope of antiretaliation protection beyond what is appropriate to achieve congressional goals.

In addition, unlike SOX’s antiretaliation provision, section 1057 is not limited to whistleblowers alleging certain types of violations.¹⁷⁶ Instead, legislators set section 1057’s parameters broadly, and the statute explicitly applies to whistleblowers who allege violations of any law subject to the jurisdiction of the Bureau.¹⁷⁷ The Bureau’s jurisdiction extends to the regulation of the offering and provision of consumer financial products or services under the federal consumer financial laws, as well as all federal laws concerning public or federal contracts, property, works, employees, budgets, or funds.¹⁷⁸ Protection from retaliation is no longer limited to whistleblowers claiming violations of securities laws, tax codes, or cases of insider trading. Rather, section 1057 significantly expands the class of individuals protected under antiretaliation laws.¹⁷⁹ Due to the greater protection afforded to them, whistleblowers now have additional incentives to blow the whistle. The Dodd-Frank Act also increases employers’ liability

¹⁷⁵ 12 U.S.C.A. § 5567(b).

¹⁷⁶ Section 1057 also protects authorized representatives of covered employees. *Id.* § 5567(a). This is similar to SOX’s whistleblower provision, which protects “employees” from retaliation. 18 U.S.C.A. § 1514A(a) (2006). Accordingly, an “employee” includes a “company representative,” which is defined as “any officer, employee, contractor, subcontractor, or agent of a company.” 29 C.F.R. § 1980.101 (2010).

¹⁷⁷ Dodd-Frank Act, Pub. L. No. 111-203, § 1057(a)(1), 124 Stat. 1376, 2031 (2010) (codified as amended at 12 U.S.C. § 5567(a)(1) (West 2001 & Supp. 2011)).

¹⁷⁸ *Id.* § 1011(a), 124 Stat. at 1964.

¹⁷⁹ Sections 748 and 922 of the Dodd-Frank Act amend the Commodity Exchange Act and Securities and Exchange Act of 1934, respectively. The provisions provide that no employer may discriminate or retaliate against an employee because of the employee’s furnishing of information to either the Commodity Futures Trading Commission or the SEC regarding the employer’s misconduct. *Id.* §§ 748(h)(1)(A), 922(h)(1)(A), 124 Stat. at 1744, 1845. These provisions include additional classes of individuals who are protected from retaliatory and discriminatory action, further expanding the scope of whistleblower protection laws. *See* 15 U.S.C.A. § 78u-6(h) (West 2009 & Supp. 2011).

to such provisions. This expansion of liability, however, is likely to have damaging effects.

C. *The Negative Effects of Employers' Expanded Liability Under Dodd-Frank's Whistleblower Protection Statutes*

It is undeniable that antiretaliation laws justly protect whistleblowers who report legitimate claims of employers' violations. The positive effects of whistleblower protection laws, however, do not justify the Dodd-Frank Act's dramatic expansion of liability under such provisions. Employers' increased liability under the Dodd-Frank Act is likely to lead to several damaging consequences. For instance, given the direct costs associated with expanded corporate liability, such as indemnity and defense costs,¹⁸⁰ an increase in liability may "affect the economy by influencing the behavior of individual corporations."¹⁸¹ It is likely that such expenses will increase as a result of employers' greater exposure to liability, thereby impacting management decisions, including the cost-benefit analyses associated with such decisions.¹⁸²

Another cost that may result from the Dodd-Frank Act's whistleblower provisions is the "negative effect on organizational culture."¹⁸³ Management shapes the ethical nature of an organization, and by undermining management's internal compliance efforts, the whistleblower provisions are "harming the organizational culture."¹⁸⁴ Further, "as organizational culture affects organizational performance, Dodd-Frank is harming the bottom line."¹⁸⁵ Other costs include the damage to organizational reputation and a decrease in shareholder wealth caused by SEC actions.¹⁸⁶ Additionally, employers may implement more stringent employment policies in response to their increased liability.¹⁸⁷ Although employers may refrain from unjustly terminating competent employees as

¹⁸⁰ PETER REUTER, *THE ECONOMIC CONSEQUENCES OF EXPANDED CORPORATE LIABILITY: AN EXPLORATORY STUDY* v (1988) (examining the effects of expanded liability in the context of wrongful termination).

¹⁸¹ *Id.* at vi.

¹⁸² *Id.* at v.

¹⁸³ David Ebersole, *Blowing the Whistle on the Dodd-Frank Whistleblower Provisions*, 6 *ENTREPREN. BUS. L.J.* 123, 139 (2011).

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 139-40.

¹⁸⁷ REUTER, *supra* note 180, at vi.

a result of the employment policies,¹⁸⁸ they may be hesitant to terminate incompetent employees for fear of accusations of violating antiretaliation laws.¹⁸⁹ Consequently, there may be an increase in the number of employees retained who in fact should be terminated,¹⁹⁰ and employers are likely to become “hampered in their ability to adjust their employment levels expeditiously.”¹⁹¹ Moreover, each new employee represents a potential liability in the event of their termination,¹⁹² and thus employers may incur greater expenditures for recruitment efforts.¹⁹³ The fear of wrongful termination actions can prevent managers from “being as flexible in their response to changing market conditions, risky investment opportunities, or technology advances.”¹⁹⁴ In effect, expanded exposure to liability may prevent firms from making short-run adjustments in light of business fluctuations.¹⁹⁵ As a result, companies may increasingly rely on overtime contractors or temporary agencies during transition periods rather than permanent employees.¹⁹⁶

The expanded protection granted to whistleblowers in itself is arguably sufficient to encourage employees to report violations, as it eliminates potential whistleblowers’ fears of retaliation. But coupled with the excessive bounties offered to whistleblowers under the Dodd-Frank Act, whistleblowers are overincentivized, leading to more whistleblower reports¹⁹⁷ and burdening both employers and administrative agencies.

V. SUGGESTED APPROACH FOR THE FUTURE

The ideal whistleblower provision is one that “maximize[s] a potential informant’s discounted reward and minimize[s] his discounted losses without making the mix so attractive as to induce the disclosure of large amounts of bad information.”¹⁹⁸ The Dodd-Frank Act’s whistleblower provisions,

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.* at 22.

¹⁹² *Id.* at vii.

¹⁹³ *Id.*

¹⁹⁴ JAMES N. DERTOUZOS, ELAINE HOLLAND & PATRICIA EBENER, *THE LEGAL AND ECONOMIC CONSEQUENCES OF WRONGFUL TERMINATION 1* (1988).

¹⁹⁵ *Id.*

¹⁹⁶ *Id.* at 1-2.

¹⁹⁷ The SEC has already reported a “surge in tips” since the passage of the Dodd-Frank Act. *See* Holzer & Johnson, *supra* note 18.

¹⁹⁸ Ferziger & Currell, *supra* note 99, at 1172. A whistleblower’s “discounted gain” is the “amount [he] legitimately expects to receive, discounted by the likelihood

however, fail to achieve this ideal balance. These provisions overincentivize whistleblowing through their exorbitant bounty payouts¹⁹⁹ and expansive protection against retaliation.²⁰⁰ Whistleblowers need not overcome significant threshold considerations to be eligible for the rewards, and these employees are protected by the liberal interpretation of antiretaliation provisions. Thus, risk is comparably low for whistleblowers, but the potential reward is high. In such circumstances, “most informants will come forward with even a low level of certainty”²⁰¹ and inundate government agencies with trivial reports. In order to provide a more efficient and effective means of policing employers through the use of whistleblowers, Congress should ensure that the Dodd-Frank Act’s whistleblower provision includes meaningful thresholds that the whistleblower must overcome, lower rewards for the whistleblower to recover, and appropriate penalties if the whistleblower intentionally delays reporting a violation in order to increase the amount of his reward.

A. *Implement Significant Threshold Considerations*

In efforts to discourage whistleblowers from reporting trivial claims, the Dodd-Frank Act should encourage whistleblowers to report only those violations involving a substantial amount of money.²⁰² Although the Dodd-Frank Act attempts to achieve this by requiring that the whistleblower’s information lead to sanctions resulting in at least \$1 million,²⁰³ this requirement alone is unlikely to prevent whistleblowers from bringing forth insignificant claims. First, the rules now provide that, “for the purposes of making an award, [the SEC] will aggregate two or more smaller actions that arise from the same nucleus of operative facts.”²⁰⁴ This is likely to lead to a “just in case” mentality because a whistleblower may think

that the amount will be reduced or not awarded at all.” *Id.* at 1171. A whistleblower’s “discounted losses” are the “potential losses discounted by the likelihood they will occur at all.” *Id.*

¹⁹⁹ See *supra* Part III.

²⁰⁰ See *supra* Part IV.

²⁰¹ Ferziger & Currell, *supra* note 99, at 1180.

²⁰² “[I]f a bounty program is to avoid” incentivizing citizens to “snitch on their neighbors for insignificant transgressions and . . . the administrative costs attendant to sifting through such bogus claims, it should encourage . . . informants to come forward with information only when (1) the violation is factually and legally clear, and (2) it involves a substantial quantity of money.” *Id.* at 1198.

²⁰³ See *supra* note 63.

²⁰⁴ SEC *Final Rules*, *supra* note 108, at 6-7.

that another person is also reporting a violation that arises out of the “same nucleus of operative facts.” Instead, the Dodd-Frank Act should impose additional threshold requirements.

One meaningful threshold is a requirement that whistleblowers demonstrate the reasonable likelihood that the alleged violation will result in sanctions of at least \$1 million. This requirement is not likely to be particularly cumbersome to the potential whistleblower, as an informant is

able to cheaply discover the maximum and minimum awards for which he is potentially eligible, and, unlike an agency, he may know approximately how much is at stake in the potential litigation. Based on this nonpublic information, an informant should be able to estimate with some accuracy whether the government is likely to recover a penalty from the defendant.²⁰⁵

This requirement would discourage whistleblowers from reporting trivial claims “just in case” they lead to sanctions of over \$1 million, thereby reducing administrative costs.²⁰⁶ One might argue that there is a threshold consideration in the Dodd-Frank Act. The final rules define a whistleblower as one who “possess[es] a reasonable belief that the information [he or she is] providing relates to a possible securities law violation . . . that has occurred, is ongoing, or is about to occur.”²⁰⁷ Thus, although there is no standard that the whistleblower must meet regarding whether or not the claim will meet the \$1 million minimum, there is arguably a threshold consideration as the alleged violation must be a “possible” violation. However, in its letter to the SEC, Jones Day provided an example of where a “*literally true* statement might relate to a *potential* violation but not to an *actual*

²⁰⁵ Ferziger & Currell, *supra* note 99, at 1183-84.

²⁰⁶ Commentators advocated for including a standard of reasonableness in the definition of a “whistleblower.” Some recommended that an individual have a “reasonable” or “good faith belief” that the information he or she possesses relates to a securities law violation. See *Jones Day Letter*, *supra* note 109, at 2-3; Letter from Morgan, Lewis & Bockius LLP, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n, at 3 (Dec. 17, 2010) (on file with author) (suggesting a requirement for both a subjective and objectively reasonable belief of a violation); Letter from Ronald C. Long, Dir. Regulatory Affairs, Wells Fargo, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n, at 3 (Dec. 17, 2010) (noting that defining whistleblowers as individuals who provide information regarding “potential violations’ without any threshold defining criteria or good faith standard would only serve to frustrate the effective and efficient administration of genuine whistleblower claims”). The SEC, however, commented that “a higher standard requiring a ‘probable’ or ‘likely’ violation is unnecessary, and would make it difficult for the staff to promptly assess whether to accord whistleblower status to a submission.” *SEC Final Rules*, *supra* note 108, at 13.

²⁰⁷ 17 C.F.R. § 240.21F-2 (2010).

*violation.*²⁰⁸ For instance, Jones Day presents a scenario where a company's Chief Financial Officer makes optimistic statements about the company's prospects. At the end of the financial quarter, however, the company reports disappointing results and the company's stock falls. An employee of the company then blows the whistle and alleges that prior to making the optimistic statements, the Chief Financial Officer made statements during an internal meeting suggesting the company faced "significant challenges."²⁰⁹ Jones Day notes that the contrast between the negative internal statements and the more optimistic statements may suggest a potential violation of section 10(b) of the Securities Exchange Act of 1934.²¹⁰ The whistleblower-employee, however, knows the full context of the internal statements and in what respects the company faced such challenges. Thus, the full context of the internal statements makes it apparent that the Chief Financial Officer has not engaged in any misrepresentation. In this scenario, the whistleblower-employee's allegation is "literally true, and it relates to a *possible* violation of the securities laws; but even if [the whistleblower-employee] acted in bad faith, she is absolutely protected in her employment due to the [SEC's] expansion of the definition of a 'whistleblower' to include information relating to 'potential' violations."²¹¹ In this respect, the fact that the SEC requires whistleblowers to bring claims regarding "possible" violations will not likely serve as a meaningful threshold consideration.

An additional threshold that legislators should implement is a requirement that whistleblowers first report the alleged discrepancy to employers' internal compliance systems. Only if the issue is not resolved may the whistleblower resort to government assistance. For instance, a

²⁰⁸ *Jones Day Letter, supra* note 109, at 3.

²⁰⁹ *Id.*

²¹⁰ *Id.* Section 10(b) of the Securities Exchange Act of 1934 provides that it is unlawful

for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange [t]o effect a short sale . . . [and] [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (2006).

²¹¹ *Jones Day Letter, supra* note 109, at 3.

provision similar to section 10A of the Securities Exchange Act would provide a more “logical whistleblowing framework.”²¹² Under section 10A, auditors who believe they have discovered an illegal act at a company are required to report it first to company management and the audit committee.²¹³ If the company fails to take remedial action, only then is the auditor required to report the violation to the SEC.²¹⁴ As it stands now, the Dodd-Frank Act’s whistleblower provision is likely to “reverse a decade of effort promoting integrity, self-remediation, and corporate self-reporting.”²¹⁵ Requiring whistleblowers to report first through companies’ internal compliance systems would provide senior management with the opportunity to remedy the alleged violation, and avoid employees’ circumvention of internal compliance programs.²¹⁶ The finalized rules provide that a whistleblower’s reward may be increased if he or she utilizes the internal compliance system.²¹⁷ However, as displayed in *Egan v. Tradingscreen, Inc.*, this might not always be the most effective means of encouraging whistleblowers to use internal compliance programs.²¹⁸ Under the *Egan* Court’s interpretation, the Dodd-Frank Act’s whistleblower provision requires whistleblowers to report to the SEC in order to receive both protection against retaliation²¹⁹ and their monetary reward.²²⁰ As a result, it is

²¹² Carton, *supra* note 107 (quoting former SEC enforcement attorney, Jacob Frenkel, and providing that “absent egregious misconduct condoned (or even conducted) by senior management, employees have a responsibility to attempt to correct errors and misconduct through existing corporate compliance systems”).

²¹³ 15 U.S.C. § 78j-1(b)(1) (“If, in the course of conducting an audit . . . the registered public accounting firm detects . . . an illegal act . . . the firm shall . . . inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer . . . is adequately informed with respect to illegal acts that have been detected.”).

²¹⁴ *Id.* § 78j-1(b)(2). “If . . . the registered public accounting firm concludes that . . . the senior management has not taken . . . timely and appropriate remedial actions with respect to the illegal act . . . the registered public accounting firm shall, as soon as practicable, directly report its conclusions to the board of directors.” *Id.* Once the issuer’s board of directors receives the report, it must “inform the [SEC] by notice not later than 1 business day after the receipt of such report and shall furnish the registered public accounting firm making such report with a copy of the notice furnished to the [SEC].” *Id.* § 78j-1(b)(3).

²¹⁵ Carton, *supra* note 107 (quoting former SEC enforcement attorney, Jacob Frenkel).

²¹⁶ See *supra* Part III.C.3.

²¹⁷ See 17 C.F.R. §§ 240.21F-4(c), 240.21F-6(a)(4) (2010).

²¹⁸ See *supra* Part III.C.

²¹⁹ *Egan v. Tradingscreen, Inc.*, No. 10 Civ. 8202 (LBS), 2011 U.S. Dist. LEXIS 47713, at *19 (S.D.N.Y. May 4, 2011).

²²⁰ *Id.* at *24 (“Obviously, a whistleblower must directly report to the SEC to receive a bounty award from the SEC . . .”).

likely that whistleblowers will bypass internal compliance programs. The SEC states that “internal investigations can be an important component of corporate compliance . . . [but] providing information to persons conducting an internal investigation, or simply being contacted by them, may not, without more, achieve the statutory purpose of getting high-quality, original information about securities violations directly into the hands of [SEC] staff.”²²¹ However, Congress should implement a program that replicates the auditing system where the whistleblower first reports the violation internally, and receives protection from retaliation, and then reports it to the SEC if a certain period of time passes and no remedial action has been taken. Such a reporting system would avoid the eradication of companies’ internal compliance programs and mitigate the issue of threshold considerations,²²² thereby encouraging only those who have nontrivial claims to come forward.

B. Reduce the Amount of the Mandated Bounties Awarded to Eligible Whistleblowers

Legislators should also reduce the amount of the mandated reward given to eligible whistleblowers. The imposition of high monetary rewards for violations involving high levels of moral outrage is unnecessary and overincentivizes whistleblowing.²²³ Instead, a low, fixed-percentage award provides the best route.²²⁴ Although a low bounty may affect potential whistleblowers’ decisions to report alleged violations, a lower reward is not likely to affect whistleblowers’ decisions to report cases of serious infractions.²²⁵ Instead, a low bounty’s most profound effect will likely be limited to whistleblowers’ decisions to expose cases involving “insignificant” fraud.²²⁶ Even if the bounties offered under the Dodd-Frank Act were limited to 5

²²¹ *SEC Final Rules*, *supra* note 108, at 34.

²²² Orly Lobel, *Citizenship, Organizational Citizenship, and the Laws of Overlapping Obligations*, 97 CALIF. L. REV. 433, 463 (2009).

²²³ *See supra* Part III.B.

²²⁴ Ferziger & Currell, *supra* note 99, at 1197. The authors also propose that the ideal whistleblower bounty provision “guarantee[s] that (1) the maximum allowable bounty will *always* be paid where an agency recovers a penalty based on an informant’s tip, and (2) the agency will make all possible efforts to maintain an informant’s anonymity within the constraints of the litigation process.” *Id.*

²²⁵ *Id.* at 1198.

²²⁶ *Id.*

percent of sanctions exceeding \$1 million, this would guarantee a minimum payment of \$50,000—hardly an insignificant amount.

C. Penalize Whistleblowers Who Intentionally Delay Reporting the Alleged Violation

Another concern implicated by the Dodd-Frank Act's whistleblower provision is the fear that whistleblowers may intentionally delay reporting violations to increase the amount of the resulting sanctions, thereby increasing the amount of their reward. To discourage such behavior, lawmakers should penalize whistleblowers who unreasonably delay reporting the illegality. Research has indicated that penalties are not always effective in inducing action.²²⁷ Thus, if such a penalty were imposed, it should be implemented only in limited circumstances where the employer demonstrates that the whistleblower unreasonably delayed reporting the violation with the clear intent to increase the amount of his reward or to increase his chances of satisfying the Dodd-Frank Act's \$1 million minimum. The use of a penalty in limited circumstances may prevent whistleblowers' fraudulent behavior while minimizing the negative sociological effects of penalties.

Arguably, whistleblowers are penalized under Dodd-Frank if they attempt to undermine the integrity of internal compliance systems. The SEC provides that a whistleblower's attempts to undermine the company's internal compliance program can decrease the amount of an award.²²⁸ However, the mere diminution of an award will not be sufficient to deter people from acting in this manner. The Dodd-Frank Act whistleblower provisions were implemented in hopes to "promote effective enforcement of federal securities laws by providing incentives for persons with knowledge of misconduct to come forward and share their information with the [SEC]."²²⁹ If, however, a whistleblower takes "any steps to undermine the integrity of . . . [employers' internal compliance] systems or processes,"²³⁰ his or her reward is merely *reduced* rather than eliminated, and this contradicts the goals of the provisions. Instead, elimination of the reward is a better option.

²²⁷ Feldman & Lobel, *supra* note 85, at 1181.

²²⁸ *SEC Final Rules*, *supra* note 108, at 5; 17 C.F.R. § 240.21F-6(b)(3) (2010).

²²⁹ *SEC Final Rules*, *supra* note 108, at 34.

²³⁰ *Id.*

CONCLUSION

Drafters of the Dodd-Frank Act attempted to cure the defects that many alleged were the contributing factors to the 2008 financial crisis, including regulatory failure.²³¹ Commentators, however, have noted that “reform is premature when the exact nature and causes of the financial crisis are yet to be determined.”²³² Legislators, without fully knowing the extent and precise causes of the financial crisis, implemented provisions calling for comprehensive regulatory reform²³³ and created a broad whistleblower provision within the Dodd-Frank Act. As a result, the Dodd-Frank Act fails to provide an effective whistleblower program, and instead overincentivizes whistleblowing through its expansive whistleblower protection and excessive bounties. Instead, legislators should carefully examine the incentives and consequences of whistleblowing and draft a provision that reflects those findings accordingly.

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²³¹ Heidi Mandanis Schooner, *Private Enforcement of Systemic Risk Regulation*, 43 CREIGHTON L. REV. 993, 993-94 (2010).

²³² *Id.* at 994.

²³³ *Id.*

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