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Beyond Incentives: Making Corporate Whistleblowing Moral in the New Era of Dodd-Frank Act Bounty Hunting

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Beyond Incentives: Making Corporate Whistleblowing Moral in the New Era of Dodd-Frank Act “Bounty Hunting”

MATT A. VEGA

If you can imagine Wall Street as the American Old West and the Securities and Exchange Commission (“SEC”) as the local sheriff, then the SEC’s new bounty program is the equivalent of nailing up reward signs all over town that read: “Wanted: Dead or Alive.” The agency is looking for information regarding publicly traded companies, financial services institutions, and other covered entities who may have violated U.S. securities laws, and it is willing, more than ever, to pay a premium for the information.

On July 21, 2010, President Obama signed into law the Dodd-Frank Act that, among other things, amends the Securities Exchange Act of 1934 by adding Section 21F “Securities Whistleblower Incentives and Protection.” This obscure and little debated section offers whistleblowers multi-million dollar “bounties” for reporting suspected securities law violations directly to the SEC. Under the program, which went into effect last year, the SEC is required to pay as a bounty to whistleblowers who voluntarily provide the agency with “original information” an amount equal to 10% to 30% of any monetary sanctions exceeding \$1 million dollars. When the average SEC settlement is over \$18.3 million dollars, whistleblowers can expect the average bounty to be well in the range of \$2 million to \$5 million dollars.

This new program is fundamentally flawed because it attempts to combat corporate opportunism by encouraging employee opportunism. To solve systemic problems like securities fraud and foreign bribery, the SEC needs to look beyond financial incentives. It needs to take a step back and consider the basic moral principles of mutual self-interest and subsidiarity. These normative arguments were sorely missing in the debates leading up to the final rules implementing the bounty program. These principles make clear that what is missing from Congress’s latest effort is mandatory internal reporting.

This Article endorses the Whistleblower Improvement Act of 2011, H.R. 2483, which was introduced by Congressman Michael Grimm in the first session of the 112th Congress and would require internal reporting as a condition for money benefits under the SEC’s new bounty program. This amendment is needed not just to make corporate compliance programs work in the new era of SEC bounty hunting, but to make whistleblowing morally upright.

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Beyond Incentives: Making Corporate Whistleblowing Moral in the New Era of Dodd-Frank Act “Bounty Hunting”

MATT A. VEGA*

I. INTRODUCTION

The emergence of the whistleblower as an institution is one of the most significant developments in corporate governance in the last fifty years. Despite the importance of this development, the role of the whistleblower in corporate compliance has received relatively little scholarly attention.¹ Most of the existing scholarship concerning whistleblowers has focused on analyzing the unwillingness or incapacity of employees to blow the whistle,² and these arguments are often overstated and lack empirical validation. In addition, these arguments usually gloss over the deep tension in our society’s understanding of whistleblowing by emphasizing that informants have provided some assistance in law enforcement efforts that benefit society and that the end justifies the means. This debate over when or, better yet, how to get employees to blow the whistle should not trump the more fundamental analysis of the whistleblower institution itself as a moral enterprise. Our failure to expand the whistleblower inquiry beyond prudential concerns is shortsighted and is leading to perverse consequences,³ such as the new whistleblower bounty program of the Securities and Exchange Commission (“SEC” or the “Commission”) mandated by the Dodd-Frank Wall Street Reform and Consumer

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¹ Throughout this Article, I use the terms “corporate governance” and “corporate compliance” interchangeably.

² See Jayne W. Barnard, *Evolutionary Enforcement at the Securities and Exchange Commission*, 71 U. PITT. L. REV. 403, 410 (2010) (summarizing arguments that suggest a bounty program is necessary to encourage whistleblowing).

³ See, e.g., *United States v. Gen. Elec.*, 808 F. Supp. 580, 584 (S.D. Ohio 1992) (criticizing the Department of Justice for the perverse way it treats its informants as adversaries rather than allies).

Protection Act (“Dodd-Frank Act”).⁴ The Dodd-Frank Act, among other things, amended the Securities Exchange Act of 1934 (“Exchange Act”) by adding Section 21F entitled “Securities Whistleblower Incentives and Protection” to significantly expand the SEC’s existing whistleblower bounty program.⁵

This Article argues that the most significant problem with the SEC’s new bounty program is that it does not mandate that corporate whistleblowers report violations internally before going to the SEC in order to qualify for the award. Under the bounty program, corporate whistleblowers are confronted with the Hobson’s choice of either reporting directly to the SEC and maximizing their prospects for a financial award, or giving the corporation the opportunity to do the right thing and risk getting nothing. Although the final rules add certain incentives intended to encourage employees to utilize their company’s internal compliance programs, the provisions do not go far enough because whistleblowers are not required to use a company’s internal reporting system. Instead, the SEC assumes the employee is in the best position to decide whether to cooperate with internal compliance efforts. The agency further assumes that the corporation will not do the right thing, even if prompted by internal members.

Part II of this Article explores the changing role and understandings of whistleblowers. It describes the tension between the two competing views of whistleblowers as rats and heroes. Modern regulatory attempts to accommodate both views of whistleblowing have left the whistleblower laws increasingly incoherent. Essentially, regulators have opted to avoid the fundamental moral questions altogether and have chosen instead to treat whistleblowing as a mere instrumentality or tool for prosecutors to

⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of 7, 12, 15, 18, 22, 31, and 41 U.S.C.). Passed by the House on December 11, 2009, and passed with amendments by the Senate on May 20, 2010, the Dodd-Frank Act constitutes “a sweeping overhaul of the financial regulatory system.” Press Release, White House Office of the Press Sec’y, Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009), http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform/. While many of its provisions related primarily to financial institutions, the Act also required the creation of a number of new rules for corporate governance affecting public companies in the United States, such as: “say-on-pay” and “say-on-severance” provisions permitting non-binding shareholder votes on executives’ compensation and golden parachutes every three years; the independence of compensation committees; certain prohibitions and reporting requirements for financial institutions regarding compensation structures; guidance regarding auditing, attestation, and related professional practice standards for brokers and dealers; and clarification that any accounting firm preparing an audit report for an issuer that is a non-accelerated filer will not be required to attest to, and report on, the internal control assessment made by the issuer’s management. *See, e.g.*, Dodd-Frank Act §§ 721, 723, 733, 735, 951–53, 955, 982, 989G, 7 U.S.C. §§ 1a, 2, 7, 7b-3 (2010), 15 U.S.C. §§ 78n, 78n-1, 7201, 7262 (2010) (providing compliance, reporting, and auditing requirements for publicly traded companies promulgated under the Dodd-Frank Act).

⁵ Dodd-Frank Act § 922, 15 U.S.C. § 78u-6 (2010).

gather useful information. This strictly pragmatic view of whistleblowing is particularly evident in the SEC's new whistleblower bounty program, which appeals without apology to an informant's greed and shows little regard for an employee's duty to report potential compliance problems internally before going to the SEC.

Part III of this Article briefly describes the Dodd-Frank Act's new Section 21F whistleblower bounty program and the SEC's final rules implementing the program that went into effect on August 12, 2011.⁶ This program offers whistleblowers more protection from retaliation, as well as monetary bounties for reporting suspected securities law violations directly to the SEC.⁷ Under the program, the SEC is required to pay a bounty to whistleblowers who voluntarily provide the SEC with "original information" about a potential securities law violation that leads to a successful SEC or "related" enforcement action and results in monetary sanctions of sufficient size.⁸

Part IV of this Article explores the consequences of treating whistleblowing as a mere instrumentality. The bounty program turns the very concept of a "whistleblower" on its head and hinders internal efforts to promote a strong culture of ethical corporate compliance. It discourages "real" whistleblowing by encouraging employees to remain silent until a possible violation reaches the optimum point to present to the SEC a worst case scenario and collect their reward. In addition, it may actually increase retaliation against whistleblowers by creating intrafirm adversarialism where none previously existed. In so doing, the bounty program may ultimately undermine the moral legitimacy of the whistleblowing enterprise altogether.

Drawing mostly from perfectionist theories of jurisprudence, Part V articulates a unifying theory of the role of whistleblowers. The whistleblowing institution is a moral enterprise, and it should be treated as such. The moral approach to whistleblowing can also overcome problems that the mere instrumentality approach to whistleblowing—where the whistleblower has a legal right to be uncooperative with his or her employer's compliance efforts—cannot. Making whistleblowing moral reduces transaction costs and enhances performance; therefore, corporations have more incentive to value—rather than merely to tolerate—whistleblowers. To be moral, whistleblowing and the laws and

⁶ The SEC's final rules ("SEC Rules") are currently codified at 17 C.F.R. § 240.21F-1 et seq. and the whistleblower forms are available at 17 C.F.R. §§ 249.1800 and 249.1801. The new rules apply retroactively to tips provided on or after July 21, 2010, the Dodd-Frank Act's enactment date. Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300 (June 13, 2011).

⁷ See *id.* at 34,301 (summarizing the potentially greater rewards and the retaliation protections of the proposed rule).

⁸ *Id.* at 34,305.

organizational rules promoting whistleblowing must, at a minimum, respect two basic ideas: (1) the common good of mutual self-interest and (2) the communitarian principle of subsidiarity.

The common good of mutual self-interest rests on an understanding that corporate laws and regulations shape the corporation as a community, and that community matters, especially when it comes to finding a legitimate role for whistleblowers in corporate compliance. In addition, the principle of subsidiarity demands that whistleblowers try to resolve a potential compliance problem internally at the lower corporate level before reporting it externally to government at a higher level.

Support for these two guiding principles is found in a wide range of legal philosophies and theories, including the work of perfectionist scholars like Joseph Raz,⁹ new natural law theorist John Finnis,¹⁰ and communitarian virtue ethicist Alasdair MacIntyre.¹¹ Additionally, empirical research and theory developed in the field of organizational behavioral management (“OBM”) over the last couple of decades support more consideration of both of these moral factors.¹²

Together, these two ideas contribute to a unifying theory that helps to explain the role of whistleblowers in corporate compliance, and they also provide more substantive criteria of judgment to evaluate and critique the SEC’s regulations implementing the bounty program. Mutual self-interest aligns whistleblowing specifically (and corporate compliance more generally) along a more coherent axis that turns on the common good of community. The principle of subsidiarity has a paradoxical quality that helps balance the tension between the ideals of belonging to a corporate community and affirming an allegiance to the rule of law. It avoids the collapse of corporate compliance into either the unworkable top-down approach of traditional command-and-control measures or the ideological abstraction of “pure” self-regulation.

As a practical matter, this unifying theory highlights the need to make internal whistleblowing mandatory under the SEC’s new bounty program with certain exceptions. This Article supports a bill introduced to the 112th Congress to amend the Dodd-Frank Act to require internal reporting as a condition for money benefits. This legislation offers a reasonable

⁹ See JOSEPH RAZ, *THE MORALITY OF FREEDOM* 206 (1986) (suggesting that being part of a society or institution can be intrinsically good).

¹⁰ See JOHN FINNIS, *NATURAL LAW AND NATURAL RIGHTS* 305 (1980) [hereinafter FINNIS, *NATURAL LAW*] (“[T]he common good *is* the good of individuals, living together and depending upon one another in ways that favour the well-being of each.”).

¹¹ See ALASDAIR MACINTYRE, *AFTER VIRTUE: A STUDY IN MORAL THEORY* 187–88 (2d ed. 1984) (describing goods internal to human practices which result in excellence over that form of activity).

¹² See LYNN STOUT, *CULTIVATING CONSCIENCE* 247–49 (2011) (discussing the effects of economics literature that describes self-interest as rational).

approach for addressing both the prudential and normative questions raised in this Article.

II. THE EVOLVING ROLES OF CORPORATE WHISTLEBLOWERS

This Part describes the evolution of the whistleblower's role in corporate governance. Although most legal scholarship regarding the role of private actors in corporate compliance has focused on lawyers, auditors, and institutional shareholders as gatekeepers, rather than whistleblowers,¹³ over the last several years many fraud and bribery scandals have come to light because of whistleblower tips.¹⁴ Because whistleblowers are now playing an increasingly important role in the actual governance of corporations, they deserve greater consideration in legal scholarship.¹⁵

This Article focuses exclusively on employee whistleblowers. The SEC broadly defines a "whistleblower" as any individual who alone or jointly with others provides the Commission with information relating to a possible violation of the federal securities laws.¹⁶ This definition includes vendors, service providers, consultants, business competitors and other third parties, as well as employees of the offending company.¹⁷ However, when an employee blows the whistle there is tension between his or her duties and responsibilities as both a citizen and a corporate citizen that does not exist for whistleblowers generally.¹⁸ This tension revolves around

¹³ See, e.g., Stephen M. Bainbridge, *Corporate Decisionmaking and the Moral Rights of Employees: Participatory Management and Natural Law*, 43 VILL. L. REV. 741, 742 (1998) (discussing programs in which employees participate in corporate compliance decisions); John W. Cioffi, *Irresistible Forces and Political Obstacles: Securities Litigation Reform and the Structural Regulation of Corporate Governance* (Comparative Research in Law & Political Econ., Research Paper No. 7/2006) (describing reforms as restructuring the private sphere to improve corporate compliance), available at <http://ssrn.com/abstractid=902648>.

¹⁴ Nina Schichor, *Does Sarbanes-Oxley Force Whistleblowers to Sacrifice Their Reputations? An Argument for Granting Whistleblowers Non-Pecuniary Damages*, 8 U.C. DAVIS. BUS. L.J. 272, 292 (2008) ("Our post-Enron society depends on whistleblowers to help regulate private industry." (footnote omitted)).

¹⁵ Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 126 (2007) [hereinafter Rapp, *Beyond Protection*] (suggesting that the merits of internal versus external whistleblowing deserves further consideration).

¹⁶ See Securities Whistleblower Incentives and Protections, 17 C.F.R. § 240.21F-2 (2012) ("You are a whistleblower if, alone or jointly with others, you provide the Commission with information . . . and the information relates to a possible violation of Federal securities laws.")

¹⁷ See *id.* (providing only that a whistleblower must be an individual, and not a company or another entity, and noting that a company or another legal entity is not eligible to be a whistleblower, only individuals); see also Marc S. Raspanti & Bryan S. Neft, *Dodd-Frank Opens Doors on Whistleblower Claims for Securities Law Violations*, LAW. J., May 20, 2011 at 4 (arguing that a requirement for whistleblowers to report a violation internally prior to submitting an official claim will have perverse effects).

¹⁸ For a general discussion of this tension, see Orly Lobel, *Citizenship, Organizational Citizenship, and the Laws of Overlapping Obligations*, 97 CALIF. L. REV. 433, 436-40 (2009).

the question of whether an employee should disclose what he or she believes to be unethical or illegal to management (internal whistleblowing) or to an external authority or the public (external whistleblowing).¹⁹ For purposes of this Article, “corporate whistleblowing” is defined as “the disclosure by organization members (former and current) of illegal, immoral or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect [sic] action.”²⁰

Corporate whistleblowers fall into one of three distinct categories: (1) voluntary whistleblowers; (2) mandatory (or compelled) whistleblowers; and (3) bounty hunters.²¹ Voluntary whistleblowing refers to the classic situation in which an employee chooses to report potential violations of the law internally or, if necessary, externally. On the other hand, compelled whistleblowers are required by various laws to monitor the workplace and to report potential violations to the proper authorities. They are often referred to by the term “gatekeepers.” Finally, bounty hunters are generally defined as professionals who provide information and other services directly to the government for a reward.²²

Over the last several decades, corporate whistleblowing has evolved from strictly voluntary whistleblowing to both voluntary and mandatory whistleblowing. This change is largely traceable to the passage of modern corporate laws and regulations in the late 1970s, and again in the late 1990s, that express a decidedly moral view of whistleblowers as allies in the fight against corporate fraud, bribery, and corruption. For the most part, this development improved the perception of whistleblowing as a legitimate “gatekeeper” function in promoting corporate compliance. Since then, however, legislators and regulators have been sending mixed signals regarding whistleblowing. Most recently, the SEC has recast corporate whistleblowers as “bounty hunters.” This paradigm shift undercuts the moral enterprise of whistleblowing. By becoming a hired gun for the SEC, the whistleblower risks losing his or her seat at the table

¹⁹ See James N. Adler & Mark Daniels, *Managing the Whistleblowing Employee*, 8 LAB. L. 19, 21–22 n.8 (1992) (further dividing whistleblowers into three subcategories: passive, active, and embryonic).

²⁰ Janet P. Near & Marcia P. Miceli, *Organizational Dissidence: The Case of Whistle-Blowing*, 4 J. BUS. ETHICS 1, 4 (1985).

²¹ See Lawrence A. Cunningham, *Beyond Liability: Rewarding Effective Gatekeepers*, 92 MINN. L. REV. 323, 330–31 (2007) (describing the three categories of whistleblowers). *But see* Elizabeth Tippet, *The Promise of Compelled Whistleblowing: What the Corporate Governance Provisions Sarbanes Oxley Mean for Employment Law*, 11 EMP. RTS. & EMP. POL’Y J. 1, 12–13 (2007) (further distinguishing “compelled whistleblowing” from “mandatory whistleblowing”).

²² See James Fisher et al., *Privatizing Regulation: Whistleblowing and Bounty Hunting in the Financial Services Industries*, 19 DICK. J. INT’L L. 117, 143 (2000) (concluding that the professional bounty hunter model may become essential to enforcement of existing regulations in the financial services industry). Technically, the term “bounty hunters” is a bit of a misnomer when applied to corporate whistleblowing since most employees are not professional informants. *Id.* at 136–37.

of corporate compliance generally. If left unchanged, the SEC regulations that implement the Dodd-Frank Act's new bounty program threaten to turn back the clock on whistleblowers by more than half a century by treating whistleblowing as a necessary evil motivated by financial gain rather than by moral responsibility.

A. *Whistleblowers as Rats*

Historically, many policymakers viewed whistleblowers as “rat[s]” and “snitches.”²³ For example, during the 1998 debate in Congress over whether to dismantle the Internal Revenue Service (“IRS”) whistleblower program, Senator Harry Reid of Nevada argued for the end of what he called the “Snitch Program” and the “Reward for Rats Program.”²⁴ Even regulators who were responsible for protecting whistleblowers treated employees who blew the whistle on their employers as morally suspect.²⁵ For example, a former Reagan Administration official in charge of the federal whistleblower program reportedly called them “malcontents.”²⁶

Despite the government's low opinion of whistleblowers, the incidence of whistleblowing has steadily increased.²⁷ Published case law from both federal and state courts confirms that prior to 1977, only three reported federal or state cases dealt directly with whistleblowing.²⁸ During the 1980s, however, over 300 published opinions addressed whistleblowing.²⁹ In the 1990s, 2,207 cases involved whistleblowing, seven times the number from the prior decade.³⁰ For many employment lawyers in the mid-1990s, this increase made whistleblowing cases “the hottest niche of their

²³ Marshal J. Ferziger & Daniel G. Currell, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 1999 U. ILL. L. REV. 1141, 1142 (1999); see also C. Fred Alford, *Whistle-Blower Narratives: The Experience of Choiceless Choice*, 74 SOC. RES. 223, 244 (2007) (“[T]hose who raise ethical issues are treated as disturbed or morally suspect.”).

²⁴ 144 Cong. Rec. S4397–98 (daily ed. May 6, 1998) (statement of Sen. Harry Reid).

²⁵ See Gene A. Brewer & Sally Coleman Selden, *Whistle Blowers in the Federal Civil Service: New Evidence of the Public Service Ethic*, 8 J. PUB. ADMIN. RES. & THEORY 413, 419 (1998) (describing negative stereotypes sometimes associated with whistleblowers).

²⁶ *Id.*

²⁷ See Eve Tahmincioglu, *More Workers Willing to Blow the Whistle on Their Employer*, NBCNEWS.COM (Sept. 15, 2012, 4:15 PM), http://www.msnbc.msn.com/id/44524270/ns/business-careers/t/more-workers-willing-blow-whistle-their-employer/#.UFTf_o42d8t (noting the increase in whistleblower claims and analyzing possible causes).

²⁸ *E.g.*, *Odell v. Humble Oil & Refining Co.*, 201 F.2d 123, 125 (10th Cir. 1953) (affirming the district court's dismissal of a wrongful discharge claim); *Percival v. General Motor Corp.*, 400 F. Supp. 1322, 1324 (E.D. Mo. 1975) (“[D]ischarge did not involve a breach of public policy sufficient to state a cause of action for wrongful or retaliatory discharge.”); *Reagan v. Bichsel*, 284 S.W.2d 935, 936–38 (Tex. Civ. App. 1955) (holding that a police officer's suspension for conduct prejudicial to good order was supported by substantial evidence).

²⁹ The list of cases as of October 31, 2012 is on file with the author [hereinafter Whistleblower Cases].

³⁰ *Id.*

practice.”³¹ Finally, the number of whistleblower suits has tripled over the last decade, with over 7,700 published cases mentioning whistleblowing since January 2000.³²

This increase may be due to an increased willingness to confront corporate wrongdoing, or it could be because of an overall increase in the level of corporate corruption generally. Regardless, this dramatic increase in litigation has prompted fears that whistleblowers are unduly disruptive and harassing.³³ Several states have responded by modifying their whistleblower laws to make it clear that whistleblowers can be held liable for bringing frivolous claims.³⁴ While a degree of skepticism about the merits of a complaint is justifiable, the legislative history behind these provisions confirms that a deep distrust of whistleblowers remains a part of American policymakers’ psyche.³⁵

B. Whistleblowers as Heroes

Ironically, the failure of public enforcement efforts to regulate

³¹ Gary Taylor, *Blowing Whistles: Spilling Beans in the Private Sector Is Now a Big Legal Business*, NAT’L L.J., Sept. 20, 1993, at 37.

³² Whistleblower Cases, *supra* note 29. This figure includes 6,118 reported cases between January 2000 and January 2011, with the remaining 1,582 cases being brought within the last eighteen months. *Id.* At this rate, more than seventy-three published judicial decisions impact whistleblowers every month.

³³ See *Oklahoma to Stem Frivolous Whistleblower Claims*, 7 INDIVIDUAL EMPL. RTS. LAB. REL. REP. (BNA) 2 (June 2, 1992); David Culp, *Whistleblowers: Corporate Anarchists or Heroes? Towards a Judicial Perspective*, 13 HOFSTRA LAB. L.J. 109, 131 (1995) (suggesting that implicit in judicial and legislative policies is the belief that employers ought to remain free to choose which employees to keep).

³⁴ See, e.g., TENN. CODE ANN. §§ 50-1-304(e)(1)–(f)(2) (2008) (providing that a statutory cause-of-action for retaliatory discharge is not to be used for frivolous lawsuits or other “improper purpose[s],” and any employee who files a frivolous lawsuit is subject to sanctions, including attorneys’ fees). Some states require good faith in bringing claims. See, e.g., CAL. GOV’T CODE § 8547.2(e) (2012) (stating that a “[p]rotected disclosure” is a “good faith communication”); FLA. STAT. ANN. § 112.3187(9)(d) (West 2008) (requiring an employee who filed a “frivolous action in bad faith” to pay reasonable costs to the prevailing party); LA. REV. STAT. ANN. § 23:967(D) (2010) (stating that if a “complaint is brought in bad faith” or if court determines that the employer’s act is not in violation of law, then the employer may be entitled to compensation for attorney fees and court costs); MASS. GEN. LAWS ANN. ch. 149, § 185(e)(1) (2004) (providing that the “court may award reasonable attorneys’ fees and court costs to the employer” for any action that is brought “without basis in law or fact”); N.J. STAT. ANN. § 34:19-12 (2012) (stating that employers are prohibited from retaliating against any employee who “makes a good faith report . . . of a violation”). At least one state requires both reasonableness and good faith. E.g., OHIO REV. CODE ANN. § 4113.52(A)(1)(a) (West 2007). Idaho discourages whistleblowers from bringing suit without any basis in law or fact since a court may order reasonable attorneys’ fees and court costs for such actions unless the employee dismisses the action within a reasonable time after discovering that the employer is not liable for damages. IDAHO CODE § 6-2107 (2010). Finally, a few states including Connecticut, Hawaii, and Michigan require that the employee’s report not be knowingly false. CONN. GEN. STAT. § 31-51m(b) (2011); HAW. REV. STAT. § 378-62(1) (1993); MICH. COMP. LAWS SERV. § 15.362 (2009).

³⁵ See Adler & Daniels, *supra* note 19, at 19, 29 (discussing requirements in state statutes that aim to prevent employees from making bad faith or frivolous claims).

corporations effectively using traditional command-and-control mechanisms has catapulted whistleblowers to the forefront of corporate governance. Since 1934, the SEC, in conjunction with the Department of Justice (“DOJ”), has been the principal enforcer of securities laws.³⁶ However, major public scandals involving large corporations in the late 1970s, and again in the late 1990s, made it evident to policymakers that effective corporate regulation depended not only on public enforcement by government agencies, but also on the participation of private citizens willing to bring compliance problems to light.³⁷

1. *Watergate’s Mark Felt*

The first transformative moment for whistleblowers in corporate governance was the Watergate scandal in the late 1970s.³⁸ A whistleblower named Mark Felt (a.k.a. “Deep Throat”) helped Bob Woodward break the story that led to President Nixon’s resignation in 1974.³⁹ The revelation that President Nixon’s reelection campaign had used illegally acquired corporate funds to finance the break-in of the Democratic National Committee Headquarters eroded the trust of Americans in their government. Subsequent investigations by the Senate and the Watergate Special Prosecutor Archibald Cox, however, led to an even more startling revelation: hundreds of publicly traded U.S. companies had made corrupt foreign payments involving hundreds of millions of dollars.⁴⁰ In fact, between 400 and 500 publicly traded companies, including Exxon and Lockheed Martin, admitted to having made questionable payments or outright bribes amounting to over \$300 million to obtain contracts from foreign governments.⁴¹

³⁶ See *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC, <http://www.sec.gov/about/whatwedo.shtml> (last visited Sept. 24, 2012) (describing the SEC’s roles and responsibilities as an enforcement authority of the securities laws). But see James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 739 (2003) (noting that Congress, in the 1934 Securities Exchange Act, created a few express private causes of action).

³⁷ See Howard Rockness & Joanne Rockness, *Legislated Ethics: From Enron to Sarbanes-Oxley, the Impact on Corporate America*, 57 J. BUS. ETHICS 31, 31 (2005) (describing the role of the Enron scandal on regulatory policy); Alexander W. Sierck & Keith S. Watson, *Post-Watergate Business Conduct: What Role for the SEC*, 31 BUS. LAW. 721 (1976) (describing the role of Watergate on regulatory policy).

³⁸ See Sierck & Watson, *supra* note 37, at 724–26 (describing the expanded role the SEC has taken in determining what information a company must disclose).

³⁹ Todd S. Purdum, *‘Deep Throat’ Unmasks Himself: Ex-No. 2 at F.B.I.*, N.Y. TIMES, June 1, 2005, at A1; see also Schichor, *supra* note 14, at 273.

⁴⁰ Frederick M. Lawrence, *In Memoriam, Archibald Cox*, 85 B.U. L. REV. 355, 356 (2005); Matt A. Vega, *Balancing Judicial Cognizance and Caution: Whether Transnational Corporations Are Liable for Foreign Bribery Under the Alien Tort Statute*, 31 MICH. J. INT’L L. 385, 404–05 (2010) (arguing that the prohibition against foreign bribery has become customary international law).

⁴¹ Vega, *supra* note 40, at 405.

In response, Congress passed the Foreign Corrupt Practices Act of 1977 (“FCPA”).⁴² The FCPA made bribery of foreign government officials a crime.⁴³ It also required companies registered with the SEC to maintain accurate books and records and to develop a system of internal accounting controls.⁴⁴ These internal controls included, among other things, establishing internal whistleblowing procedures.⁴⁵

More than a decade passed, however, before either the SEC or the DOJ began to take FCPA enforcement seriously. Eventually, however, the SEC and the DOJ began more aggressive enforcement efforts, and many of the enforcement actions were made possible by tips from corporate whistleblowers.⁴⁶ While some continued to see whistleblowers as “traitorous violators of organizational loyalty norms,” others began to see them as “heroic defenders of values considered to be more important than company loyalty.”⁴⁷

2. *Enron’s Sherron Watkins*

The second transformative moment was the Enron and MCI/WorldCom financial scandals.⁴⁸ The highlight of congressional hearings on Enron and MCI/WorldCom was testimony regarding the actions of two key whistleblowers, Sherron Watkins and Cynthia Cooper.⁴⁹ In her testimony, “Sherron Watkins revealed crucial details regarding Enron’s fraudulent activities.”⁵⁰ Similarly, the CEO of MCI/WorldCom

⁴² Securities Exchange Act of 1934 §§ 13(b)(2), 30A, 32, 15 U.S.C. §§ 78m(b)(2), 78dd-1 to -2, 78ff, (2006), added by Pub. L. No. 95-213, 91 Stat. 1494 (1977) (requiring accurate accounting and internal controls for all transactions and rendering bribes to foreign officials by company officers illegal with penalties such as fines and imprisonment).

⁴³ 15 U.S.C. § 78dd-1 to -2 (2006).

⁴⁴ Securities Exchange Act of 1934 § 13(b)(2), 15 U.S.C. § 78m(b)(2) (2006).

⁴⁵ *See id.*

⁴⁶ Schichor, *supra* note 14, at 292 (arguing that greater compensation for whistleblowers will encourage more to step forward and mitigate the personal impact whistleblowers endure).

⁴⁷ Joyce Rothschild & Terance D. Miethe, *Whistle-Blower Disclosures and Management Retaliation*, 26 WORK & OCCUPATIONS 107, 125 (1999).

⁴⁸ *See* Rockness & Rockness, *supra* note 37, at 31 (discussing how scandals such as Enron and WorldCom prompted Congress to respond with the Sarbanes-Oxley Act to legislate ethical behavior for certain firms); J. Gregory Sidak, *The Failure of Good Intentions: The WorldCom Fraud and the Collapse of American Telecommunications After Deregulation*, 20 YALE J. REG. 207, 259 (2003) (discussing how WorldCom’s deception “harmed the telecommunications industry,” and as a result led the Federal Communications Commission to respond).

⁴⁹ Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 WM. & MARY L. REV. 65, 74–75 (2007) (suggesting improvements to the Sarbanes-Oxley Act based on analysis showing whistleblowers generally have been unsuccessful in winning compensation for their actions).

⁵⁰ *Id.*; *see also* The Financial Collapse of Enron-Part 3: Hearing Before the Subcomm. on Oversight & Investigations of the H. Comm. on Energy & Commerce, 107th Cong. 14–15 (2002) (testimony of Sherron Watkins, Vice President of Corporate Development, Enron Corp.) (discussing the deceptive information that Sherron Watkins was aware of in her position at Enron).

testified about how an internal auditor named Cynthia Cooper had discovered the massive fraud orchestrated by the company's CFO and reported it to the board of directors.⁵¹ These testimonies convinced legislators to do more to convince potential whistleblowers to come forward in future cases and to protect them from retaliation.⁵²

Accordingly, Congress passed the Sarbanes-Oxley Act of 2002 ("SOX"),⁵³ which included, among other things, the first set of comprehensive federal whistleblower provisions protecting employees who raise concerns about a violation of any federal criminal statute.⁵⁴ Section 301 of SOX requires that audit committees establish internal whistleblower procedures allowing employees to report anonymously concerns about questionable accounting or auditing.⁵⁵ In addition, Section 1107 of SOX gives the DOJ discretionary authority to impose criminal penalties on companies or individuals that retaliate against whistleblowers who participate in an official proceeding or tender information directly to a law enforcement officer.⁵⁶ Finally, Section 806 of SOX grants corporate whistleblowers the right to bring a private civil action if they were subject to retaliation for reporting a violation of any securities laws or SEC regulations.⁵⁷

However, SOX went beyond merely protecting voluntary whistleblowers; it also mandated whistleblowing. It required several key insiders, including corporate in-house lawyers and CEOs, to function as

⁵¹ Wrong Numbers: The Accounting Problems at WorldCom: Hearing Before the H. Comm. on Fin. Servs., 107th Cong. 129 (2002) (statement of John W. Sidgmore, President & CEO, WorldCom, Inc.).

⁵² See S. REP. NO. 107-146, at 4-5 (2002) (discussing the need to break the "code of silence" keeping potential whistleblowers from coming forward).

⁵³ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18 U.S.C.).

⁵⁴ Sarbanes-Oxley Act of 2002 § 1107, 18 U.S.C. § 1513(e) (providing that covered employees who raise concerns about a violation of any federal criminal statute, not simply laws limited to financial fraud, cannot be retaliated against); see also Mary L. Schapiro, Chairman, U.S. SEC, Opening Statement at SEC Open Meeting: Item 2 Whistleblower Program (May 25, 2011), available at <http://www.sec.gov/news/speech/2011/spch052511mls-item2.htm> [hereinafter SEC Opening Statement] (acknowledging that SOX "made great strides in creating whistleblower protections and requiring internal reporting systems at public companies").

⁵⁵ Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(m)(4)(B) (2006).

⁵⁶ Sarbanes-Oxley Act of 2002 § 1107, 18 U.S.C. § 1513(e) (2006). The SEC has seldom, if ever, brought any criminal prosecutions under Section 1107 of SOX. See Daniel P. Westman, *The Significance of the Sarbanes-Oxley Whistleblower Provision*, 21 LAB. LAW. 141, 147 (2005) (establishing that there is no apparent record of any criminal prosecutions brought under Section 1107 to date).

⁵⁷ Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (2006); see also 29 C.F.R. § 1980.101 (2011) (interpreting Section 806 to hold not only corporations, but also individuals liable for retaliating against a whistleblower).

both gatekeepers and whistleblowers.⁵⁸ SOX required that in-house attorneys, for example, report suspected violations up the ladder in the corporation and then report those violations to the SEC if the internal reports do not resolve the violations.⁵⁹ SOX also imposed direct responsibility on executive officers.⁶⁰ In addition to certifying the accuracy of the company's SEC filings, the principal executive and financial officers must certify that they designed and evaluated the internal controls to ensure that any material information was made known to them.⁶¹

After the Enron and MCI/WorldCom hearings and the passage of SOX, whistleblowers were seen in a different light. In particular, corporate whistleblowers were viewed as heroes serving a critical "gatekeeping" role.⁶² A broader conception of whistleblowing as a moral enterprise began to emerge, as the media described whistleblowers as unsung saviors and the new "saints of secular culture."⁶³ In 2002, for example, *TIME* magazine named Sherron Watkins and Cynthia Cooper as "Persons of the Year."⁶⁴ Even policymakers spoke more favorably of whistleblowers. For example, Senator Charles Grassley, speaking of the IRS bounty program, called informants "patriotic and described them as protectors" of taxpayer dollars.⁶⁵

⁵⁸ See JOHN C. COFFEE, JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* 2–3 (2006) (discussing the history, roles, and capabilities of gatekeepers); John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1294 (2003) (arguing that securities attorneys do play a gatekeeping role that does not conflict with representing their clients and that the SEC should adopt standards that enhance this role); Caroline Harrington, *Attorney Gatekeeper Duties in an Increasingly Complex World: Revisiting the "Noisy Withdrawal" Proposal of SEC Rule 205*, 22 GEO. J. LEGAL ETHICS 893, 896 (2009) (discussing the attorney's role as a gatekeeper under SOX).

⁵⁹ 17 C.F.R. §§ 205.3(b)(1), (b)(9) (2011).

⁶⁰ Sarbanes-Oxley Act of 2002 § 302(a), 15 U.S.C. § 7241(a) (2006).

⁶¹ *Id.* These provisions have been implemented by Securities and Exchange Act of 1934 Rules 13a-14 and 13a-15. 17 C.F.R. §§ 240.13a-14, 240.13a-15 (2011). See also Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,276, 57,280 (Sept. 9, 2002) (explaining that the new Exchange Act Rules 13a-15 require issuers to file reports to maintain disclosure controls and procedures as defined in the new Exchange Act Rule 13a-14(c)).

⁶² See Rapp, *Beyond Protection*, *supra* note 15, at 95 (implying that a bounty model to compensate whistleblowers is preferred because SOX fails to increase incentives for insiders with knowledge of fraud); Schichor, *supra* note 14, at 273 (explaining how a WorldCom whistleblower, Cynthia Cooper, "won applause from the media, Congress, and the general public" for playing a significant role in uncovering fraud).

⁶³ Colin Grant, *Whistle Blowers: Saints of Secular Culture*, 39 J. BUS. ETHICS 391, 398 (2002) (characterizing whistleblowers as achieving new, high moral ground in society); Richard Lacayo & Amanda Ripley, *Persons of the Year 2002: The Whistleblowers*, *TIME*, Dec. 30, 2002, <http://www.time.com/time/magazine/article/0,9171,1003998,00.html> (naming whistleblowers as "Persons of the Year").

⁶⁴ Schichor, *supra* note 14, at 292; Lacayo & Ripley, *supra* note 63.

⁶⁵ Lobel, *supra* note 18, at 488 (internal quotation marks omitted).

C. Whistleblowers as Bounty Hunters

The current global financial crisis has proven to be a third transformative moment for whistleblowers in corporate governance.⁶⁶ Despite increased enforcement efforts, securities fraud, foreign bribery, and other forms of corporate corruption are at an all-time high.⁶⁷ The crisis began here in the United States with reports of a multi-million dollar Ponzi scheme on Wall Street,⁶⁸ but the Bernie Madoff story was just the tip of the iceberg.⁶⁹ From Bear Stearns and Lehman Brothers to Fannie Mae and Freddie Mac, “the events of the last decade demonstrate that securities fraud is repeatedly perpetrated against unsuspecting investors.”⁷⁰

Many legal scholars have blamed this financial crisis on, of all things, the lack of financial incentives for corporate whistleblowers.⁷¹ They have argued that SOX did not go far enough.⁷² What is needed, according to

⁶⁶ See Thomas J. Schoenbaum, *The Global Financial Crisis and Its Impact on World Trade and the World Economy—An Overview*, 41 UCC L.J. 375, 377–78 (2009) (discussing the historical significance and global impact of the ongoing financial crisis and the landmark structural changes that have resulted to prevent it from happening again).

⁶⁷ See, e.g., ETHICS RESEARCH CTR., NATIONAL BUSINESS ETHICS SURVEY: AN INSIDE VIEW OF PRIVATE SECTOR ETHICS v (2007) (concluding that “[e]thical misconduct in general is very high and back at pre-Enron levels” within the national firms surveyed); KROLL, GLOBAL FRAUD REPORT: ANNUAL EDITION 2008/2009 6–7 (2008) (noting increases in overall incidence of corporate fraud and weakening internal controls among firms surveyed globally).

⁶⁸ See U.S. SEC, OFFICE OF INVESTIGATIONS, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF’S PONZI SCHEME 1–2 (2009), available at <http://www.sec.gov/news/studies/2009/oig-509.pdf> (detailing the SEC’s failures to detect the Madoff fraud).

⁶⁹ See Miriam H. Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 950 (2009) (arguing the meltdown of the mortgage security market came about because “numerous people in varying positions of public and private power ignored internal company policies, twisted regulatory requirements, or perpetrated outright violations of the law”).

⁷⁰ Elizabeth Cosenza, *Is the Third Time the Charm? Janus and the Proper Balance Between Primary and Secondary Actor Liability Under Section 10(b)*, 33 CARDOZO L. REV. 1019, 1022 (2012) (arguing for amendment to the Exchange Act to overcome court imposed restrictions on private lawsuits against secondary actors).

⁷¹ See Pamela H. Bucy, “*Carrots and Sticks*”: *Post-Enron Regulatory Initiatives*, 8 BUFF. CRIM. L. REV. 277, 318–22 (2004) [hereinafter Bucy, “*Carrots and Sticks*”] (arguing for a carrot approach to encourage provision of inside information to regulators); Cunningham, *supra* note 21, at 325 (“The prevailing regime’s overwhelming emphasis on sticks offers limited assurance of success. That system failed during the late 1990s and early 2000s.”); Richard E. Moberly, *Sarbanes-Oxley’s Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. REV. 1107, 1133–38 (2006) [hereinafter Moberly, *Sarbanes-Oxley’s Structural Model*] (stating that the “pre-scandal versions of the Structural Model, like the Anti-retaliation Model, failed to encourage effective whistleblowing”); Rapp, *Beyond Protection*, *supra* note 15, at 93 (discussing the recent corporate scandals and suggesting financial incentives should be strengthened for whistleblowers). *But see* Baer, *supra* note 69, at 950 (“[T]he meltdown of the mortgage security market . . . came about because numerous people in varying positions of public and private power ignored internal company policies, twisted regulatory requirements, or perpetrated outright violations of the law.”).

⁷² See Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 MICH. L. REV. 1757, 1769 (2007) (arguing that SOX fails to provide effective whistleblower protections); Mary Kreiner Ramirez,

these scholars, is a new government program to radically increase the economic incentives for whistleblowers to do the right thing.⁷³ Professor Rapp, for example, in his influential article lamented the fact that SOX was just “defensive” and failed to “radically increase” financial incentives for whistleblowers.⁷⁴ In fact, there was nearly universal support among legal scholars for a new bounty program.⁷⁵

A bounty program was not a completely new idea for the SEC. In 1988, Congress passed Section 21A(e) of the Exchange Act authorizing the SEC to award a bounty of up to 10% of the civil penalty recovered in insider trading cases.⁷⁶ However, this insider trading bounty program had several shortcomings: first, the program only awarded whistleblowers for tips concerning insider trading that are, by their very nature, particularly secretive; second, the grant of any reward was within the sole discretion of the SEC; and third, it was seldom used.⁷⁷ Not surprisingly, there were only seven payouts to five whistleblowers under the former program for a meager total of \$159,537.⁷⁸ Aware of these shortcomings, Professor Bucy (now Pierson) of the University of Alabama School of Law advocated for the significant ramping up of the SEC insider trading bounty program in a seminal article published less than two years after the insider trading bounty program was first established.⁷⁹

The Obama Administration quickly embraced the idea of a more

Blowing the Whistle on Whistleblower Protection, 76 U. CIN. L. REV. 183, 187–88 (2007) (“SOX does little to change the hazardous path whistleblowers must tread.”).

⁷³ See Geoffrey Christopher Rapp, *False Claims, Not Securities Fraud: Towards Corporate Governance by Whistleblowers*, 15 NEXUS: CHAP. J.L. & POL’Y 55, 61 (2009) [hereinafter Rapp, *False Claims*] (suggesting SOX’s anti-retaliation measures “may do little to alter the cost-benefit analysis engaged in by a potential whistleblower”).

⁷⁴ Rapp, *Beyond Protection*, *supra* note 15, at 95.

⁷⁵ See, e.g., M. Thomas Arnold, “*It’s Déjà Vu All over Again*”: *Using Bounty Hunters to Leverage Gatekeeper Duties*, 45 TULSA L. REV. 419, 459 (2010) (proposing the establishment of a bounty system); Barnard, *supra* note 2, at 409 (calling for the creation of an SEC bounty program for informants); Bucy, “*Carrots and Sticks*,” *supra* note 71, at 318–22 (recommending a system utilizing the carrot approach of the False Claims Act (“FCA”) private justice model); Cunningham, *supra* note 21, at 327 (“Positive incentives can induce gatekeepers to perform vital functions that the current regime discourages them from performing.”); Rapp, *Beyond Protection*, *supra* note 15, at 92 (calling for the adoption of a bounty model).

⁷⁶ 15 U.S.C. § 78u-1(e) (1988).

⁷⁷ See U.S. SEC, OFFICE OF INSPECTOR GENERAL, ASSESSMENT OF THE SEC’S BOUNTY PROGRAM 2, 4, 12–13, 31 (2010) (providing an in-depth review of the bounty program and recommendations to improve functioning); Bruce Carton, *SEC IG’s Report Details Insider Trading Bounties*, COMPLIANCE WEEK (Apr. 2, 2010), <http://www.complianceweek.com/sec-igs-report-details-insider-trading-bounties/printarticle/188244/> (discussing the rarity of payments under the bounty program).

⁷⁸ S. REP. NO. 111-176, at 111 (2010).

⁷⁹ Pamela H. Bucy, *Private Justice*, 76 S. CALIF. L. REV. 1, 60–62 (2002). This article was one of the first, if not the first, to propose using FCA-like *qui tam* enforcement to help police securities laws generally.

robust whistleblower bounty program as advocated by Professors Bucy and Rapp. In 2009, the Administration floated a proposal to amend Section 21F to expand the existing SEC program beyond insider trading and establish a fund to pay whistleblowers “significant financial awards” for tips.⁸⁰ The proposal was made a part of the Investor Protection Act of 2009, but the bill was never passed by the 111th Congress.⁸¹ Eventually, however, the 112th Congress authorized a new bounty program as part of the Dodd-Frank Act.⁸²

The new bounty program has led, almost overnight, to a whole new cottage industry of lawyers specializing in corporate whistleblowing.⁸³ Encouraged by several early signs, one major firm has declared 2012 to be the “Year of the Whistleblower.”⁸⁴

The downside of making whistleblowing highly profitable is that it may cause whistleblowers to lose some of their legitimizing status as corporate gatekeepers. As bounty hunters, they become just the latest example of employee greed. The bounty program assumes that corporate whistleblowers are selfish and greedy, and the agency appears to believe that it must appeal to their “self-interest” with insanely large incentives to get them to cooperate with external enforcement efforts.⁸⁵ The entire premise of the bounty program is that only a large bounty will motivate a

⁸⁰ U.S. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 70–73, available at http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

⁸¹ Investor Protection Act of 2009, H.R. 3817, 111th Cong. § 203 (2009); Rapp, *False Claims*, *supra* note 73, at 58. Professor Rapp proposes an even more radical idea that whistleblowers be permitted to bring *qui tam* actions on behalf of the federal government—as the shareholder-in-chief of several bailed-out American companies—against those who perpetrated what is traditionally thought of as only securities fraud. *Id.* at 59–60.

⁸² See *infra* Part III (discussing the details of the final program under Dodd-Frank Act).

⁸³ See, e.g., KLINE & SPECTER, <http://www.attorneysforwhistleblowers.com> (last visited Aug. 24, 2012) (calling themselves “National Whistleblower Attorneys”).

⁸⁴ Phillips & Cohen, *2012: Year of the Whistleblower* (Dec. 28, 2011), <http://www.phillipsandcohen.com/P-C-News/2012-Year-of-the-Whistleblower.shtml>. The first signal came two days after the SEC announced its new bounty program, when the SEC dramatically increased the reward under its old insider-trading program. See, e.g., Press Release, U.S. SEC, SEC Awards \$1 Million for Information Provided in Insider Trading Case (July 23, 2010), available at www.sec.gov/litigation/litreleases/2010/lr21601.htm (announcing that the SEC paid its “the largest award . . . for information provided in connection with an insider trading case”). Other telltale signs included increased activity pertaining to the bounty programs of other federal agencies. For example, the DOJ announced a \$750 million settlement of criminal and civil actions stemming from a whistleblower suit against the pharmaceutical manufacturer GlaxoSmithKline brought under the FCA. Press Release, Dep’t of Justice Office of Public Affairs, Justice Department Recovers \$3 Billion in False Claims Act Cases in Fiscal Year 2011 (Dec. 19, 2011), available at <http://www.justice.gov/opa/pr/2011/December/11-civ-1665.html>. The IRS has enhanced its bounty program and recently paid out a \$104 million whistleblower award. Jackson Lewis, IRS Awards Unprecedented \$104 Million to Whistleblower (Sept. 12, 2012), available at <http://www.jacksonlewis.com/resources.php?NewsID=4195>.

⁸⁵ See Rapp, *Beyond Protection*, *supra* note 15, at 111–13 (arguing that the decisions of potential whistleblowers are based on an analysis of the costs and benefits of coming forward).

sizable percentage of whistleblowers.⁸⁶ Thus, the SEC's program targets self-interested "bounty hunters," rather than "real" (unselfish) whistleblowers, who cooperate because they believe it is the right thing to do or because they expect their cooperation to benefit others.

III. THE BASICS OF THE NEW BOUNTY PROGRAM

The SEC's new whistleblower bounty program requires that eligible persons who report potential securities law violations to the SEC be paid between 10% and 30% of the monetary sanctions imposed on any publicly traded company, financial services institution or other covered entity in any SEC action, in which the final judgment or order for monetary sanctions exceeds \$1 million.⁸⁷

The SEC expects to receive 30,000 tips each year as a result of this new program.⁸⁸ The SEC has said it will pay the highest awards to those individuals who provide specific, credible and timely information that saves the SEC weeks of investigation time.⁸⁹ Therefore, the SEC has made providing tips as easy as possible. The final rules set out a simplified procedure for a corporate whistleblower to submit information to the SEC without the need to alert his or her company,⁹⁰ and this information is then shared throughout the agency.⁹¹ If the SEC eventually brings a covered action that is eligible for an award, a Notice of Covered Action is posted on the Office of the Whistleblower website.⁹² To date, a total of 320 cases have been listed on this website as potentially eligible for an award because in each case a court order was entered granting monetary sanctions

⁸⁶ See *id.* at 113 ("[B]ecause potential whistleblowers will discount their expected recovery from whistleblowing by the chance that they will not receive such a recovery, and to account for the time value of money, a potential financial benefit may need to be quite large in order to stimulate a risk-averse employee to blow the whistle." (footnote omitted)).

⁸⁷ Dodd-Frank Act § 922(a), 15 U.S.C. § 78u-6 (2010). Within this mandatory range, the SEC maintains discretion over the actual percentage using criteria provided in the Dodd-Frank Act such as the significance of the whistleblower's information. *Id.* The \$1 million threshold amount can be reached by aggregating multiple cases brought to the agency by the same whistleblower. *Id.*

⁸⁸ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,354 (June 13, 2011).

⁸⁹ SEC Opening Statement, *supra* note 54.

⁹⁰ See *Tips, Complaints and Referrals Portal*, U.S. SEC, <https://denebleo.sec.gov/TCRExternal/index.xhtml> (last visited Aug. 24, 2012). Whistleblowers are instructed to complete a six-page form and mail or fax it to the SEC Office of the Whistleblower, or to submit it online through the SEC's Tip, Complaint or Referral ("TCR") Portal. *Id.*

⁹¹ See BOS. CONSULTING GRP., U.S. SEC ORGANIZATIONAL STUDY AND REFORM 44 (2011), available at <http://www.sec.gov/news/studies/2011/967study.pdf> (discussing the cross-divisional TCR project).

⁹² *Claim an Award*, U.S. SEC, OFFICE OF THE WHISTLEBLOWER, <http://www.sec.gov/about/office/sowb/owb-awards.shtml> (last visited Oct. 31, 2012).

exceeding \$1 million.⁹³ Individuals who submitted original information related to the covered action then have ninety calendar days from the date of the posting to apply for an award from the SEC Whistleblower Office.⁹⁴

When the SEC first released for comment the proposed rules implementing the Section 21F whistleblower bounty program, they received more than 240 comments and approximately 1,300 letters regarding the proposed rules.⁹⁵ Some commenters suggested they had gone too far,⁹⁶ while others insisted they did not go far enough.⁹⁷ In response, the SEC revised its final rules to address many of these concerns. However, despite these efforts, even the SEC Commissioners remained divided three-to-two on whether to adopt the final rules.⁹⁸

The specific rules that most impact corporate whistleblowers and their relationship with their employers include provisions: (1) providing incentives for whistleblowers to report internally; (2) excluding certain categories of employees from being eligible for whistleblower payments altogether; and (3) broadening the definitions of the types of information which may be reported directly to the SEC for a bounty.⁹⁹ The specifics of the rule choices in each of these areas are summarized below.

A. Internal Whistleblowing Incentives

The SEC declined to require corporate whistleblowers to report violations internally to their employer first to be eligible for a bounty.¹⁰⁰

⁹³ *Id.* In 2011, 217 cases were listed as eligible for an award. *Id.* An additional 103 cases have been posted on the SEC's "Claim an Award" webpage so far in 2012. *Id.*

⁹⁴ *FAQs*, U.S. SEC, OFFICE OF THE WHISTLEBLOWER, <http://www.sec.gov/about/offices/owb/owb-faq.shtml> (last visited Aug. 24, 2012). The application does not mean that a whistleblower will automatically receive an award, but if the whistleblower does not submit an application he or she will have no chance of receiving an award. *Id.*

⁹⁵ SEC Opening Statement, *supra* note 54.

⁹⁶ *See, e.g.*, Comment from Cynthia M. Fornelli, Exec. Dir., Ctr. for Audit Quality 4 (Dec. 23, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-242.pdf> (suggesting that whistleblowers should not be eligible for an award without at a minimum concurrently reporting the violation internally).

⁹⁷ *See, e.g.*, Comment from Eric Dixon 2 (Dec. 19, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-221.pdf> (arguing that the confidentiality provisions are not sufficient to provide assurance to whistleblowers).

⁹⁸ Josef Rashty, *The Dodd-Frank Act Addresses Corporate Governance*, CPA J., Apr. 2012, at 40. The new rules will take effect sixty days after their publication in the Federal Register. *See also* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,300 (June 13, 2011).

⁹⁹ *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,301, 34,303 (June 13, 2011) (discussing the proposed rules, comments received, and final rules). The final rules also include anti-retaliation provisions, which I hope to argue in a later article provides unequal protection for victims of retaliation; namely, it protects external but not internal whistleblowers. In addition, it does not adequately remedy SOX's lack of extraterritorial application. *Id.* at 34,303-04.

¹⁰⁰ *Id.* at 34,301. The final rules do impose an exhaustion requirement similar to the one advocated in this Article, but only for individuals that have causal or assignment responsibility for the securities violation. *Id.* at 34,316-19.

This prompted an outpouring of vigorous objections from the corporate community.¹⁰¹ They argued that the financial incentives would divert whistleblowers from internal reporting,¹⁰² and “[t]hese commenters further argued that companies and other entities would experience significant costs as a result.”¹⁰³ On the other hand, whistleblower advocates argued that mandating internal whistleblowing is inconsistent with the statute and would dissuade whistleblowers from coming forward.¹⁰⁴ In response, the SEC incorporated in its final rules several provisions that were intended to strengthen incentives for employees to report internally but that “ultimately . . . leave that decision to the whistleblower.”¹⁰⁵ According to SEC Chairperson Mary Schapiro, “[o]ffering financial incentives for whistleblowers to report appropriate concerns to internal compliance is unprecedented . . . [but] incentivizing—rather than requiring—internal reporting is more likely to encourage a strong internal compliance culture.”¹⁰⁶

1. 120-Day “Look-Back” Period

Under the final rules, a whistleblower is deemed to have reported information to the SEC on the date that he or she makes an internal report

¹⁰¹ See SEC Opening Statement, *supra* note 54 (“[M]any commenters vigorously asserted that these programs would only survive if the Commission required whistleblowers to first report internally before coming to us.”).

¹⁰² See, e.g., Comment from David Hirschman, President and CEO, Ctr. for Capital Markets Competitiveness, U.S. Chamber of Commerce 12 (Dec. 17, 2010), *available at* <http://www.sec.gov/comments/s7-33-10/s73310-194.pdf> (“In the absence of an affirmative restriction on external reporting when effective internal compliance channels are available, or provision of a significant incentive for using those internal channels, employees will face an irresistible temptation to go to the SEC with their report.”); see also Comment from Cynthia M. Fornelli, Exec. Dir., Ctr. for Audit Quality 2 (Dec. 23, 2010), *available at* <http://www.sec.gov/comments/s7-33-10/s73310-242.pdf> (arguing that the credit offered for first reporting to an employer is not sufficient to encourage employees to utilize internal reporting processes); Comment from Richard F. McMahon, Exec. Dir., Edison Elec. Inst. 1 (Dec. 17, 2010), *available at* <http://www.sec.gov/comments/s7-33-10/s73310-177.pdf> (arguing that employees should be required to first use employer-sponsored recording procedures in order to be eligible for any bounty); Comment from Gen. Elec. Co. 3 (Dec. 17, 2010), *available at* <http://www.sec.gov/comments/s7-33-10/s73310-179.pdf> (“[W]e believe that the balance reflected in the Proposed Rules favors too heavily the promotion of whistleblower bounties at the expense of effective and efficient corporate compliance programs.”).

¹⁰³ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,359 (June 13, 2011).

¹⁰⁴ See Douglas W. Baruch & Nancy N. Barr, *The SEC’s Whistleblower Program: What the SEC Has Learned from the False Claims Act About Avoiding Whistleblower Abuses*, 2 HARV. BUS. L. REV. ONLINE 28, 41 (July 25, 2011), <http://www.hblr.org/wp-content/uploads/2011/07/Baruch-Barr-Whistleblower.pdf> (discussing the voluntary nature of internal reporting and highlighting the incentives available to those who choose to first report internally).

¹⁰⁵ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,362 (June 13, 2011).

¹⁰⁶ SEC Opening Statement, *supra* note 54.

to the company, so long as the whistleblower or the company subsequently reports the information to the SEC within 120 days of the initial internal report.¹⁰⁷ If the company does not report back to the employee within the 120-day period, the employee is then free to report the matter to the SEC and still be eligible for a bounty.¹⁰⁸ Although the 120-day “look-back” period was not intended to be a deadline for companies to self-report to the SEC, it effectively limits the window of time that companies have to complete a thorough investigation because the company must beat the whistleblower to the Commission to avoid stiffer penalties.¹⁰⁹

2. Internal Reporting as a Plus-Factor

“[P]articipation by the whistleblower in internal compliance systems” is a plus-factor under the final rules that can increase the amount of the award.¹¹⁰ The Dodd-Frank Act set forth three general criteria the SEC must consider when determining the percentage of the whistleblower award within the range of ten and thirty percent.¹¹¹ The SEC has added four additional criteria by which a whistleblower’s award percentage may be increased, including “the extent to which, a whistleblower reported the possible violation through effective internal whistleblower, legal, or compliance procedures before reporting the violations to the

¹⁰⁷ SEC Securities Whistleblower Incentives and Protections Rule, 17 C.F.R. § 240.21F-4(c)(3) (2012). Originally, the SEC proposed a ninety-day “look-back” period but the Business Roundtable effectively argued companies needed more time to complete an internal investigation of potential violations, particularly allegations that raise complex issues or occur overseas. Comment from Alexander M. Cutler, Chair, Bus. Roundtable Corp. Leadership Initiative 8 (Dec. 17, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-142.pdf> [hereinafter Comment from Cutler]. Partially conceding this point, the SEC added thirty days to the period of time in which an internal whistleblower can wait before coming to the SEC. 17 C.F.R. § 240.21F-4(c)(3).

¹⁰⁸ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,319 (June 13, 2011).

¹⁰⁹ See Baruch & Barr, *supra* note 104, at 41 (describing the incentives for a whistleblower by internally reporting).

¹¹⁰ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,329, 34,360 (June 13, 2011).

¹¹¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act specified three general criteria the SEC must consider:

(I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action; (II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower . . . [.] (III) [law enforcement’s] programmatic interest . . . in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws.

Dodd-Frank Act § 922, 15 U.S.C. 78u-6(c)(1)(b)(i) (2010). The statute also authorizes “such additional relevant factors as the Commission may establish by rule or regulation.” *Id.*

Commission.”¹¹²

In addition, the SEC added three criteria to the final rules which may decrease the amount of an award, including: (1) the culpability of the whistleblower; (2) an unreasonable reporting delay by the whistleblower; and (3) any interference with internal compliance and reporting systems by the whistleblower.¹¹³ According to the SEC, the threat of decreasing the amount of an award is intended to “minimize any incentive for whistleblowers to conceal misconduct or to delay reporting it” and “to increase the potential for a larger award.”¹¹⁴ However, the SEC readily admits “a whistleblower has the greatest likelihood of receiving an award if he reports misconduct to [the SEC] first.”¹¹⁵ Even the third criterion, which addresses interference with internal reporting systems, applies only in “cases where the whistleblower, while [voluntarily] interacting with his entity’s internal compliance or reporting system, interferes with or otherwise undermines the system’s integrity.”¹¹⁶ Therefore, these negative factors are not designed to encourage internal reporting. At best, any reduction penalty is meant to encourage prompt external reporting, not to mandate internal reporting.

Unfortunately, the SEC has provided very little guidance on how it will weigh either the positive or negative factors. It appears the SEC has adopted a subjective effects-based approach to maximize prosecutorial discretion “[d]epending upon the facts and circumstances of each case.”¹¹⁷ In fact, the SEC specifically states that a whistleblower who was especially helpful to the SEC “could receive the maximum award [of 30%] regardless of whether the whistleblower satisfied other factors such as participating in internal compliance programs.”¹¹⁸ To further cement the SEC’s ultimate discretion, the final rules make non-appealable both the final order regarding the amount of an award as well as “any factual findings, legal conclusions, policy judgments, or discretionary assessments” that the SEC

¹¹² Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,330 (June 13, 2011).

¹¹³ SEC Securities Whistleblower Incentives and Protections Rule, 17 C.F.R. §§ 240.21F-6(b)(1)–(3) (2012); *see also* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,308 (June 13, 2011) (“If a whistleblower took any steps to undermine the integrity of [the employer’s internal compliance and reporting] systems or processes, we will consider that conduct as a factor that may decrease the amount of any award.”).

¹¹⁴ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,350, 34,351 n.391 (June 13, 2011).

¹¹⁵ *Id.* at 34,351 n.391.

¹¹⁶ *Id.* at 34,358 n.443.

¹¹⁷ *Id.* at 34,331; *see also id.* (“[N]o attempt has been made to list the factors in order of importance, weigh the relative importance of each factor, or suggest how much any factor should increase or decrease the award percentage.”).

¹¹⁸ *Id.*

makes in considering the Rule 21F factors.¹¹⁹

3. Full-Credit Provision

Under the final rules, a whistleblower reporting original information to the company internally will also get credit for all information that is ultimately provided by the company to the SEC, regardless of whether the information was included in the whistleblower's report to the company or obtained from an independent source.¹²⁰ According to the SEC, "This could create an opportunity for a whistleblower to obtain an award through internal reporting where the whistleblower might not otherwise have qualified for an award because the information was not sufficiently specific and credible."¹²¹ If more than one whistleblower contributes to a company's investigation and report, all the whistleblowers will have to share the bounty because the aggregate amount of all whistleblower awards for the same or related SEC action cannot exceed thirty percent of the amount the SEC collects.¹²² This rule may actually exacerbate the number of vague and meritless complaints that are filed internally while simultaneously diverting the most serious reports of wrongdoing that may merit the maximum bounty to the SEC.

B. Eligibility Exclusions

Under the final rules, employees with causal responsibility are ineligible for a whistleblower award.¹²³ A person can be said to be causally responsible for a securities violation if his or her action or inaction contributes to the violation. For example, if an employee bribes a foreign government official to secure a substantial government contract then he or she is causally responsible for the subsequent books and records violation. The SEC's final rules attempt to account for this sort of responsibility by excluding from eligibility anyone who is convicted of a criminal violation that is related to the SEC action that resulted from the tip.¹²⁴

In addition, some employees with assignment responsibilities are not eligible for whistleblower payments.¹²⁵ A person is understood to have assignment responsibility for some matter if it is part of his or her job duties. The SEC partially accommodated this notion by excluding from the bounty program certain individuals whose job function is to detect or

¹¹⁹ Securities Whistleblower Incentives and Protections Rule, 17 C.F.R. § 240.21F-13(a) (2012).

¹²⁰ 17 C.F.R. §§ 240.21F-4(c)(1)–(3) (2012).

¹²¹ SEC Opening Statement, *supra* note 54.

¹²² Securities Whistleblower Incentives and Protections Rule, 17 C.F.R. § 240.21F-5(c) (2012).

¹²³ 17 C.F.R. § 240.21F-8(c)(3) (2012).

¹²⁴ *Id.*

¹²⁵ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,306 n.61 (June 13, 2011).

investigate securities violations such as legal counsel, auditors, and internal compliance personnel.¹²⁶ These exclusions reflect the SEC's determination that at least some employees should not be permitted to "improperly use their positions to claim a reward."¹²⁷ However, the SEC failed to provide any accommodation for those companies that consider monitoring the workplace for illegalities in the job of every employee.¹²⁸

These eligibility exclusions, as promulgated in the final rules, are considerably weaker than the exclusions originally proposed by the SEC. For example, attorneys now qualify as whistleblowers where disclosures of information learned in connection with the legal representation of a client is otherwise waived or if disclosure is permissible pursuant to the SEC's attorney conduct rules, applicable state statutes, or local bar rules.¹²⁹ Similarly, auditors and internal compliance personnel now qualify as whistleblowers when they have a "reasonable basis to believe" that the company is engaging in conduct that: (1) is "likely to cause substantial injury to the financial interest or property" of the company or investors; or (2) "will impede an investigation of the misconduct," and at least 120 days have elapsed since the whistleblower reported the information internally to the company or became aware of information that was already known to the company.¹³⁰

C. *Qualifying Information Definitions*

The final rules also broaden the criteria for "information" that may be reported directly to the SEC for a bounty to include: (1) information regarding "possible" securities law violation that "has occurred, is ongoing, or is about to occur";¹³¹ (2) information that causes the SEC to reopen an investigation or pursue a new line of inquiry in existing investigations;¹³² and (3) information that is provided even after the government begins an investigation if the information is deemed to have

¹²⁶ *Id.*

¹²⁷ SEC Opening Statement, *supra* note 54.

¹²⁸ *See, e.g.*, Comment from Susan Hackett, Senior Vice President and Gen. Counsel, Ass'n of Corporate Counsel 2 (Dec. 15, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-126.pdf> (insisting that "all employees are responsible for ensuring that the company operates within the bounds of the law and ethics").

¹²⁹ *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,306 (June 13, 2011) (outlining comments that called for the exclusion of persons with employment duties to perform from acting as a whistleblower).

¹³⁰ Securities Whistleblower Incentives and Protections Rule, 17 C.F.R. § 240.21F-4(b)(4)(v) (2012).

¹³¹ 17 C.F.R. § 240.21F-2(a)(1) (2012).

¹³² Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,323-24 (June 13, 2011).

“substantially contributed” to the success of the ongoing investigation.¹³³ Critics argue these broad definitions of qualifying information will likely open the SEC floodgates to complaints based on sheer conjecture and speculation.¹³⁴ Early reports from the SEC, however, suggest that the quality of tips has not diminished.¹³⁵ Regardless, the SEC needs to provide whistleblowers with clearer guidance on what constitutes qualifying information regarding possible violations.

IV. THE CONSEQUENCES OF THE NEW BOUNTY PROGRAM

The primary problem with the new SEC whistleblower bounty program that this Article seeks to address is that it relies too much on financial incentives. The stated goal of the SEC’s new bounty program is to “incentivize those close to a fraud [or other securities violation] to come forward and provide information to the Commission” so that the SEC can bring more targeted public enforcement actions.¹³⁶ Thus, the SEC’s primary focus is on how best to increase tips leading to successful prosecutions.¹³⁷

During the rulemaking process, the SEC considered a mandatory internal pre-reporting requirement where a whistleblower’s award eligibility would be conditioned on his first making a report internally and providing the company’s internal compliance function a reasonable period of time to respond.¹³⁸ However, the SEC rejected mandatory internal

¹³³ *Id.* Only if the government requests information directly from the whistleblower (or anyone representing the whistleblower) will the whistleblower be deemed ineligible for a bounty. 17 C.F.R. § 240.21F-4(a)(2) (2012). In addition, while a request from any state authority would have automatically disqualified an individual from collecting a bounty under the rules as originally proposed, the final rules provide that only a request from a state attorney general or securities regulator made in connection with an investigation, inspection, or examination would serve as a disqualification. 17 C.F.R. § 240.21F-4(b)(5) (2012).

¹³⁴ See Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,338 (June 13, 2011) (outlining the comments made regarding the procedures that attorneys should follow when receiving tips that may not be based on fact).

¹³⁵ See *SEC Issues First Whistleblower Program Award*, U.S. SEC (Aug. 21, 2012), <http://www.sec.gov/news/digest/2012/dig082112.htm> (explaining that the early successes of the whistleblower program is due to the quality of tips received).

¹³⁶ SEC Opening Statement, *supra* note 54; see also Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,359 (June 13, 2011) (stating that “the principle purpose of the statute . . . is ensuring that the [SEC] receives quality tips” for their money); S. REP. NO. 111-176 at 110 (2010) (“The Whistleblower Program aims to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated the securities laws.”).

¹³⁷ SEC Opening Statement, *supra* note 54; see also Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,359 (June 13, 2011) (“[T]he principal purpose of the statute, which is ensuring that the Commission receives quality tips as a result of the financial incentive[s].”).

¹³⁸ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,361 (June 13, 2011). The SEC also considered mandatory simultaneous reporting, under which the whistleblower’s eligibility is conditioned upon a simultaneous report to internal compliance and the SEC. *Id.*

whistleblowing, believing it could result in less external whistleblowing to the SEC.¹³⁹ Effectively, this relegates corporate whistleblowers to being a mere instrumentality of the SEC. In fact, the SEC's only concern since the program was enacted, at least publicly, has been to alleviate concerns about the quality of tips being diminished.¹⁴⁰

Most of the legal scholarship on bounty programs has also tended to focus on whether informants will “bring[] information about . . . fraud [and other securities violations] to light.”¹⁴¹ The flow of information is one of the “classic objective[s] of corporate governance”;¹⁴² however, it is not the only objective. By focusing exclusively on the utilitarian function of whistleblowing, even on something as valuable as whistleblowing's contribution to corporate transparency, we avoid the moral questions surrounding whistleblowing altogether. Is it really the case that “[s]o long as the information is sound, its recipient should be indifferent to the informant's motivations?”¹⁴³ What if the informant is only coming forward out of a desire to avoid punishment for himself? What if selfish or evil motives tempt an informant to falsify or embellish the information?¹⁴⁴ Doesn't the difficulty of testing either the informant's motives or the information's reliability make it all the more important to insist that he or she demonstrate some good faith attempt to cooperate with the employer's compliance efforts before passing the information on to the SEC?

In this Part, I argue we must go beyond incentives and consider the moral implications of whistleblowing. I am not arguing against using financial incentives; rather, I am arguing against only using financial incentives. Emphasizing only the power of large monetary rewards and ignoring morality not only hampers a corporation's ability to address compliance problems, it can make those compliance problems worse. The SEC should reject its “mere instrumentality” approach to whistleblowing for at least three reasons: (1) it suppresses “real” whistleblowing; (2) it increases retaliation against whistleblowers; and (3) it undermines corporate compliance generally.

Additionally, the SEC considered “mandating that a whistleblower report internally within a specified period of time *after* reporting to [the SEC], *unless* upon reviewing the submission [the SEC] direct[s] the whistleblower not to report internally.” *Id.*

¹³⁹ *See id.* (describing an approach based on avoiding implementation of a mandatory pre-reporting or a simultaneous reporting requirement because it would not provide any cost-benefit advantage).

¹⁴⁰ Press Release, U.S. SEC, SEC Adopts Rules to Establish Whistleblower Program (May 25, 2011), available at <http://www.sec.gov/news/press/2011/2011-116.htm>.

¹⁴¹ Rapp, *False Claims*, *supra* note 73, at 57.

¹⁴² *Id.* at 62 (internal quotation marks omitted).

¹⁴³ Fisher et al., *supra* note 22, at 128.

¹⁴⁴ *See id.* (outlining the possibility that some whistleblowers' information may be unreliable due to self-interested motives).

A. *Suppression of “Real” Whistleblowing*

The first consequence of overemphasizing financial incentives is that it suppresses “real” whistleblowing.¹⁴⁵ It does so in at least two distinct ways: (1) by discouraging internal whistleblowing; and (2) by over incentivizing external whistleblowing.

1. *Discouragement of Internal Whistleblowing*

The subtle message of the new bounty program is that whistleblowers are selfish and respond only to radical financial incentives. This implies that selfish opportunistic behavior is the norm and, moreover, that it is legally permissible. OBM research indicates that these sort of social cues encourage employee opportunism—especially when they come from a governmental authority—and become a sort of self-fulfilling prophecy.¹⁴⁶ The SEC final rules repeat the same message that “greed is good” by not mandating internal whistleblowing.¹⁴⁷ This discourages internal whistleblowing because it disconnects whistleblowing from any moral obligation to first work internally with the company to see if there really is a problem, or if it can be solved. In settling on this rule, the SEC is signaling that most whistleblowers are motivated by monetary reward. Empirical studies have shown that a person’s behavior is heavily influenced by his or her expectation of how others will act in similar circumstances.¹⁴⁸ Thus, to the extent that a whistleblower thinks others are not willing to risk retaliation by internally reporting a potential violation, the whistleblower will be less willing to take the risk himself or herself.

The SEC should, instead, make internal whistleblowing the default rule. This would promote the idea that whistleblowing can and should be done for reasons other than financial gain. Despite the potential for incurring costs in terms of time, money, social stigma, and a possible job

¹⁴⁵ Comment from Allstate Ins. Co. et al. (Dec. 17, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-189.pdf> (“If personnel charged with responding to internal reports of wrongdoing were in a position to benefit financially from disclosing such information to the SEC, corporate compliance functions could soon grind to a halt. The very people charged with orchestrating a company’s response could choose financial self-interest over corporate responsibility.”); Comment from U.S. Chamber of Commerce Ctr. for Capital Mkts. Competitiveness & U.S. Chamber Inst. for Legal Reform 2 (May 23, 2011), available at <http://www.sec.gov/comments/s7-33-10/s73310-316.pdf> (“By making . . . individuals eligible to serve as whistleblowers and receive a substantial bounty, the Proposed Rules [which overemphasize financial incentives] would put these professionals in the position of potentially deciding between self-interest and the interest of their employer.”).

¹⁴⁶ See STOUT, *supra* note 12, at 247–48 (2011) (arguing that unselfish behavior is encouraged by the social cues of authoritative figures).

¹⁴⁷ The quote, “greed is good” is from the fictional character Gordon Gekko in Oliver Stone’s movie. WALL STREET (Twentieth Century Fox Film Corp. 1987).

¹⁴⁸ See STOUT, *supra* note 12, at 248 (arguing that people who believe others are acting selfishly will act selfishly themselves).

loss, many employees are motivated to blow the whistle out of a sense of justice, guilt, or simply because it is the right thing to do.¹⁴⁹ A recent study suggested whistleblowers are often emboldened (or at least sustained) by personal religious beliefs, and are more credible as a result.¹⁵⁰ The SEC has argued, unconvincingly, that whistleblowers who are predisposed to report internally will do so irrespective of the rule.¹⁵¹ However, researchers in organizational behavior have found that the vast majority of whistleblowers are, in fact, more likely to selfishly act like bounty hunters when the proper authorities say such selfishness is appropriate or when they believe others would act selfishly.¹⁵² In other words, corporate compliance programs work in large part because a consensus arises that bypassing hotlines violates the internal norm of cooperating.¹⁵³ Therefore, SEC rules are needed to define specific behavior that complies with the cooperation norm.

2. *Overincentivization of External Whistleblowing*

Second, the bounty program also suppresses “real” whistleblowing by over incentivizing external whistleblowing. The most significant difference between bounty hunters and “real” whistleblowers is not what they are saying or even what they are seeking. It is what they are willing to ignore; namely, bounty hunters will ignore opportunities to take proactive measures to prevent or remedy compliance problems. The SEC

¹⁴⁹ See Anthony Heyes & Sandeep Kapur, *An Economic Model of Whistle-Blower Policy*, 25 J.L. ECON. & ORG. 157, 159 (2009) (providing a short review of academic literature on sociology and psychology and listing non-monetary motives for whistleblowing); Aaron S. Kesselheim et al., *Whistle-Blowers' Experience in Fraud Litigation Against Pharmaceutical Companies*, 362 NEW ENG. J. MED. 1832, 1834 (2010) (listing the following as primary motivations for *qui tam* lawsuits: self-preservation, justice, integrity, altruism, and public safety); see also NAT'L WHISTLEBLOWER CTR., IMPACT OF *QUI TAM* LAWS ON INTERNAL COMPLIANCE: A REPORT TO THE SECURITIES EXCHANGE COMMISSION 1, 6 (2010) [hereinafter NAT'L WHISTLEBLOWERS CTR. REPORT], available at www.sec.gov/comments/s7-33-10/s73310.shtml (arguing that whistleblowers are not motivated by monetary gain such as whistleblower rewards).

¹⁵⁰ Daniel Martin, *Whistle Blowing, Religiosity, Spirituality and Integrity: Understanding the Impact of Social Dominance Orientation and Environmental Context*, J. MORAL OCCUPATIONAL PSYCHOL. at 10 (forthcoming Dec. 11, 2011) (citing several studies regarding the link between whistleblowing and religiosity), available at <http://ssrn.com/abstract=1970970>; see also Eamon Javers, *Religion, Not Money, Often Motivates Corporate Whistleblowers*, CNBC Special Series “Bounty Hunters,” Special Report (Feb. 12, 2011), available at http://www.cnbc.com/id/41494697/Religion_Not_Money_Often_Motivates_Corporate_Whistleblowers (reporting that experts say religion is a common trait among whistleblowers).

¹⁵¹ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,325, 34,361 (June 13, 2011).

¹⁵² See STOUT, *supra* note 12, at 119 (“[T]he vast majority will act selfishly when . . . [the] authority says selfishness is appropriate, you believe others would act selfishly, and you believe unselfish cooperation would provide only small benefits to other.”).

¹⁵³ See Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1253 (1999) (arguing that corporate actors are motivated by social norms and financial gain).

assumes that the employee will always make the right choice regarding whether to collaborate with his or her employer or not.¹⁵⁴ So long as the employee does not actively interfere with an internal investigation, SEC Chairperson Mary Schapiro stated it is the SEC's judgment that the whistleblower "is in the best position to know which route is best to pursue."¹⁵⁵ This, she argues, "strikes the correct balance . . . between encouraging whistleblowers to pursue the route of internal compliance when appropriate—while providing them the option of heading directly to the SEC."¹⁵⁶

The SEC, however, grossly underestimates how much large bounties will incentivize bounty hunters to ignore the norm of internal reporting and to adopt a "wait-and-see" attitude. In 2010, according to NERA Economic Consulting, the average SEC settlement was \$18.3 million.¹⁵⁷ In 2011, as the SEC began implementing the Dodd-Frank Act, all median settlement values increased except for the largest settlements against company defendants.¹⁵⁸ In the first half of 2012, the median settlement with companies again rose.¹⁵⁹ For example, the average settlement for a FCPA violation rose significantly from \$11.9 million in 2011 to \$20.8 million in 2012.¹⁶⁰ If this amount continues to climb, then whistleblowers can reasonably expect the average bounty to be well within the range of \$2 million to \$5 million.¹⁶¹ While the SEC's first whistleblower program

¹⁵⁴ See Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,331 n.274 (June 13, 2011) (stating that the effectiveness of the final rule relies on whistleblowers to determine whether reporting internally would be appropriate or not).

¹⁵⁵ SEC Opening Statement, *supra* note 54.

¹⁵⁶ *Id.*

¹⁵⁷ NERA Economic Consulting Releases 2010 SEC Settlement Trends Report, NERA ECON. CONSULTING (Dec. 7, 2010), http://www.nera.com/83_7105.htm. The average SEC settlement amount increased from \$10.9 million in 2009 and from \$4.6 million in 2008. *Id.* However, the median company settlement in 2010 fell to \$799,000 as compared to \$1 million in 2009. *Id.*

¹⁵⁸ See ELAINE BUCKBERG, JAMES OVERDAHL & MAX GULKER, SEC SETTLEMENT TRENDS: 2H11 UPDATE 1 (2012), available at http://www.nera.com/67_7591.htm (finding that the median settlement value increased for both companies and individuals, high-value settlements with individuals "reached post-SOX highs," but high-value settlements with companies declined); *id.* at 8 ("The average settlement value for companies decreased from \$18.5 million in [2010] to \$7.4 million in [2011], although more than half of this decrease is due to the \$550 million settlement with Goldman Sachs, which is the third-largest settlement since SOX. Excluding the Goldman settlement, the average company settlement in 2010 was \$12.3 million.").

¹⁵⁹ See JAMES A. OVERDAHL & ELAINE BUCKBERG, SEC SETTLEMENT TRENDS: 1H12 UPDATE 1 (2012), available at http://www.nera.com/67_7764.htm (finding that the median settlement value for individuals "continued to follow the upward path observed since [2010]" but the median settlement value for companies "declined after reaching a record value in [2011]"); see also *id.* at 7 (finding that the the only notable exception to the upward trend for average values of settlements with companies was for Ponzi schemes, where the average decreased from \$4.8 million to \$1.1 million).

¹⁶⁰ *Id.* at 7.

¹⁶¹ This is just an estimate. The SEC's final rules implementing the Section 21F whistleblower bounty program did not go into effect until August 12, 2011, and the SEC's fiscal year ended September 30, 2011. U.S. SEC, ANNUAL REPORT ON THE DODD-FRANK WHISTLEBLOWER PROGRAM

award was only \$50,000,¹⁶² more awards are expected in the near future.¹⁶³ When the bounty hunter and his or her attorney stand to gain such a sizable amount of money, some of them will inevitably choose to lie, remain silent, or at a minimum, drag their feet, if it will mean the difference between a payout and no payout.¹⁶⁴ This was a key concern for AT&T in their comments to the proposed rules.¹⁶⁵ The telecommunications giant, which employs over 266,000 employees, convincingly argued that plaintiff attorneys stand to gain considerable profit from encouraging their clients to keep silent longer.¹⁶⁶

The SEC claims that its final rules “should mitigate any diversion effect” by providing that an internal report “can increase both the probability and the magnitude of a potential recovery.”¹⁶⁷ According to the SEC, reporting internally increases the *probability* of an award because it creates “two paths to a recovery—[an SEC] investigation, or an internal corporate investigation.”¹⁶⁸ The SEC further maintains reporting internally increases the *magnitude* of a potential award because the award criteria include a “plus-factor for participation in an entity’s internal compliance procedures.”¹⁶⁹

However, both of the SEC’s arguments fail to account for the likelihood that a company that first receives an internal report will take

3, 5 (2011) [hereinafter SEC ANNUAL REPORT], available at www.sec.gov/about/offices/owb/whistleblower-annual-report-2011.pdf. The SEC did not have sufficient time to process any applications during fiscal year 2011. *Id.* at 8. Therefore, it is still too early to know for sure.

¹⁶² See *SEC Issues First Whistleblower Program Award*, U.S. SEC (Aug. 21, 2012), <http://www.sec.gov/news/digest/2012/2012-162.htm> (explaining that the award represents the full thirty percent of the \$150,000 collected so by on a court order of more than \$1 million in sanctions).

¹⁶³ See *SEC Whistleblowers Waiting for Big Payouts as Rumors of First Award Mount*, HUFFINGTON POST, http://www.huffingtonpost.com/2012/05/31/sec-whistleblower-reward-payout_n_1560044.html (May 31, 2012, 5:41 PM) (“Rumors are running wild that the first payout will come any day now.”). *But see* Paul Tharp, *SEC Set to Hand out up to \$452 Million to Whistleblowers*, N.Y. POST, http://www.nypost.com/p/news/business/whistleblower_gold_EgZdzyFPP8vZ8IraUSMvxO (July 10, 2012, 4:37 PM) (“SEC officials would not say when the first awards under the program would be made.”).

¹⁶⁴ See Stefan Rützel, *Snitching for the Common Good: In Search of a Response to the Legal Problems Posed by Environmental Whistleblowing*, 14 TEMP. ENVTL. L. & TECH. J. 1, 44 (1995) (arguing that financial rewards are inappropriate because they increase the danger of frivolous complaints, the costs offset any potential savings, and they may have been unnecessary).

¹⁶⁵ Comment from Wayne Watts, Senior Exec. Vice President & Gen. Counsel, AT&T 1 (Dec. 10, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-102.pdf> [hereinafter Comment from Watts] (emphasizing that whistleblowers should not be rewarded who “engage in, perpetuate, or fail to take action to stop *internal wrongdoing*”).

¹⁶⁶ *Id.*; *Global 500 Rankings*, CNNMONEY.COM, <http://money.cnn.com/magazines/fortune/global500/2011/snapshots/2756.html> (last visited Sept. 3, 2012).

¹⁶⁷ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,360 (June 13, 2011).

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

lawful steps to reduce or avoid the monetary sanctions.¹⁷⁰ Under current SEC guidelines, a monetary penalty will be lower if a company thoroughly investigates, takes remedial action and then promptly self-reports than if the SEC initiates the contact with the company.¹⁷¹ Therefore, internal whistleblowers stand to gain less than external whistleblowers who go directly to the SEC without affording the company the opportunity to mitigate the damage. The SEC can use a “plus-factor” to adjust the award upward where the internal reporting potentially resulted in a lower monetary sanction; however, the SEC makes no guarantee that the higher percentage given to internal whistleblowers will be enough to make up the difference. Moreover, in cases where a company’s prompt remedial action avoids sanctions altogether or keeps the sanctions under the million-dollar threshold, there would be no bounty awards because a greater percentage of zero is still zero. Therefore, it seems certain that no matter how you calculate it, there will be fewer and less timely internal whistleblowings once bounty hunters and their attorneys do the math.¹⁷²

In the end, the message that the SEC is sending is that there is nothing wrong with bypassing the internal reporting system—that whistleblowing is valued not for its own sake, but only as an instrumentality. Such a message will significantly diminish the force of the corporate norm of internal reporting. Just as the FCPA and SOX supported strong corporate compliance cultures by throwing the force of law behind the norm, the Dodd-Frank Act reduces the moral force of whistleblowing by withdrawing support for one of its principal norms.

B. Increase of Retaliation

The second major consequence of the bounty program is it will likely increase retaliation against corporate whistleblowers. One of the primary justifications given for implementing the bounty program was that radical financial incentives are needed to help employees overcome their fear of retaliation, but this is a red herring. It is certainly true that retaliation, as

¹⁷⁰ Comment from Palmina L. Fava, Paul, Hasting, Janofsky & Walker LLP 1 (Dec. 16, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-137.pdf> (arguing that the financial incentives offered in the whistleblower program can create “a conflict of interest between the company’s desire to cooperate with the government in an effort to earn preferred treatment and a possible reduction in penalties, and the whistleblower’s possible incentive to maximize the company’s exposure and thus extract a larger personal pay-day”).

¹⁷¹ *SEC Whistleblower Rules Encourage Internal Investigations*, MILBANK LITIG. (June 3, 2011), <http://www.milbank.com/images/content/5/4/5447.pdf> (asserting that companies that self-report violations will be rewarded by the SEC for their cooperation).

¹⁷² The SEC’s 2012 Annual Whistleblower Report, which will provide the first actual data on payouts, is not expected to be released until late 2012. See SEC ANNUAL REPORT, *supra* note 161, at 1–2 (stating that the Commission’s Office of the Whistleblower is required to report annually at the end of the fiscal year, which ends in September).

well as other social and psychological factors, can have a chilling effect on certain whistleblowers.¹⁷³ However, this is best remedied by increasing legal protection from retaliation, not by increasing non-mutual financial interests. In fact, if anything, allowing employees to blindsides their employers by externally reporting potential securities law violations will increase, rather than decrease, retaliation by increasing intrafirm adversarialism.

The term “adversarialism” is generally used to describe a preexisting case or controversy between opposing parties.¹⁷⁴ In the context of corporate whistleblowing, adversarialism has come to have a double meaning. First, it refers to the adversarialism between corporations and the SEC. The SEC assumes that modern corporations are profit driven and equates this with greed.¹⁷⁵ Greed is now thought to be, in the words of Judge Easterbrook, “the engine that propels a market economy.”¹⁷⁶ When

¹⁷³ See, e.g., Comment from Julie Grohovsky, Wu, Grohovsky & Whipple et al. 4 (Dec. 16, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310.shtml> (arguing that if whistleblowers were required to report internally they would likely remain silent); see also Pamela H. Bucy, *Information as a Commodity in the Regulatory World*, 39 HOUS. L. REV. 905, 950 (2002) (summarizing statistics about the retaliation and effects of whistleblowing on whistleblowers); Kesselheim et al., *supra* note 149, at 1834 (stating that whistleblowers who complained internally had their complaints dismissed, and that the whistleblowers feared losing their jobs); Rapp, *Beyond Protection*, *supra* note 15, at 95–96 (stating that whistleblowing imposes psychological burdens on the potential whistleblower, including the fear of being blacklisted from future employers and social ostracism); Luigi Zingales, *Want to Stop Corporate Fraud? Pay Off Those Whistle-Blowers*, WASH. POST (January 18, 2004), at B2 (arguing that whistleblowers are considered spies and ostracized by their employers); Comment from Eric Dixon, Eric Dixon LLC 2 (Dec. 19, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-221.pdf> (“The identification of whistleblowers exposes them to serious risk, including physical harm to them and their families, professional or career reprisals and community ostracization. Whistleblowers may also face retaliation from alleged wrongdoers or their associates, including civil suits.”).

¹⁷⁴ MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 19 (11th ed. 2005) (defining “adversarial” as “relating to, or characteristic of an adversary or adversary procedures,” and “adversary” as “having or involving antagonistic parties or opposing interests”).

¹⁷⁵ See Lawrence E. Mitchell, *Relevance of Corporate Theory to Corporate and Economic Development: Comment on the Transplantation of the Legal Discourse on Corporate Personality Theories*, 63 WASH. & LEE L. REV. 1489, 1491, 1494 (2006) (asserting that corporations historically existed to further the common good while corporate charters focused more on the protection of the public interest than on the financial interests of its corporate shareholders, but that this so-called “grant theory” died out after the Civil War because of the enactment of general incorporation laws first in New Jersey and later in Delaware, which eventually lead to a widespread race to the bottom among all of the states).

¹⁷⁶ *Wilkow v. Forbes, Inc.*, 241 F.3d 552, 557 (7th Cir. 2001). Judge Easterbrook believes that corporations are, by design, solely profit driven and incapable of assuming moral responsibilities; this view is also known as contractarianism. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 4 (1991). Contractarians argue against any corporate law rules that mandate or inhibit particular governance relationships—except perhaps to counteract market failure. See *id.* at 1 (stating that corporate managers use their control to exploit investors and consumers); see also JOEL BAKAN, *THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER* 69 (2004) (arguing that corporations are programmed to exploit others for profit); David K. Millon, *New Directions in Corporate Law: Communitarians, Contractarians and the Crisis in*

it comes to compliance, the SEC further assumes this profit motive is incompatible with the legal compliance goals of a regulator like the SEC. Instead, companies are said to be driven by the “invisible hand” of self-interest.¹⁷⁷ According to the SEC, when a corporation receives an internal report of wrongdoing, it will most likely retaliate against the whistleblower, cover-up the illegality, or both.¹⁷⁸

Second, the SEC has introduced adversarialism into the relationship between corporations and their employees.¹⁷⁹ The agency assumes that whistleblowers are less protected when they are reporting internally than when reporting externally; therefore, the final rules permit whistleblowers to bypass the internal reporting system altogether. This fosters intrafirm adversarialism between the company and its employees where none previously existed, which, in turn, only increases retaliation.¹⁸⁰

To try to reduce the risk of increased retaliation, the SEC has reserved the right not to take any action that might reveal the whistleblower’s identity until it actually files the enforcement action.¹⁸¹ The SEC may, “upon receiving a whistleblower complaint, contact a company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back,” but not disclose the informant’s identity.¹⁸² In determining what information, if any, to give to a company, the SEC “may consider a number of factors, including, but not limited to . . . the nature of the alleged conduct, the level at which the conduct allegedly occurred, and the company’s existing culture related to corporate governance.”¹⁸³ Keeping the whistleblower’s identity confidential,

Corporate Law, 50 WASH. & LEE. L. REV. 1373, 1377–78 n.19 (1993) (asserting that Judge Easterbrook is a leading proponent of contractarianism and he would advocate a substantial body of rules designed to counteract market failure).

¹⁷⁷ See 1 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 456 (R. H. Campbell et al. eds., Liberty Press 1981) (1976) (concluding that “[b]y pursuing his own interest [Economic Man] frequently promotes that of the society more effectually than when he really intends to promote it”).

¹⁷⁸ See Securities Whistleblower Incentives and Protection, 76 Fed. Reg. 34,300, 34,361 (June 13, 2011) (citing retaliation and cover-ups as reasons for not mandating internal reporting); see also Cynthia Estlund, *Rebuilding the Law of the Workplace in an Era of Self-Regulation*, 105 COLUM. L. REV. 319, 374 (2005) (stating that potential whistleblowers are often financially dependent on the corporation and subject to their reprisals).

¹⁷⁹ Securities Whistleblower Incentives and Protection, 76 Fed. Reg. 34,300, 34,300–01 (June 13, 2011) (stating that the final rule does not require a whistleblower to report internally first).

¹⁸⁰ See Janet P. Near & Marcia P. Miceli, *Whistle-Blowing: Myth and Reality*, 22 J. MGMT. 507, 509 (1996) (citing two 1995 studies concluding that external whistleblowers may be more likely to suffer retaliation than internal whistleblowers).

¹⁸¹ Securities Exchange Act of 1934 § 21F(h)(2), 15 U.S.C. § 78u-6(h)(2) (2010) (providing that the SEC “shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower”).

¹⁸² Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,323 (June 13, 2011).

¹⁸³ *Id.* at 34,323 n.197.

however, will hamper the corporation's ability to fully respond to the allegations. Furthermore, anonymous complaints are less reliable than reports from known informants.¹⁸⁴

The solutions to whistleblower retaliation are more comprehensive protections and legal remedies, not simply more financial incentives on the front end. There are several gaps in the existing anti-retaliation laws that Congress should immediately address if it is serious about achieving justice for corporate whistleblowers.¹⁸⁵ While the private enforcement efforts of whistleblowers clearly have a role to play in corporate governance, the key is timing. Introducing adversarialism too early in the compliance process will supplant internal corporate compliance efforts with conventional command-and-control regulations that, as discussed next, have proven ineffective and only lead to more corporate opportunism.

C. *Undermining of Corporate Compliance*

The third consequence of the bounty program is it undermines a corporation's ability to create an effective compliance culture from the inside out. Over the last decade, the SEC has repeatedly acknowledged that internal compliance programs are vital to the prevention and detection of securities violations.¹⁸⁶ After the Enron scandal, then SEC Chairman, William Donaldson, contended that a company's single most important asset is its "moral DNA."¹⁸⁷ He strongly advocated establishing "a culture that puts ethics and accountability first" and that avoids the "common trap of mere compliance."¹⁸⁸ As recently as last year, the SEC affirmed that "internal reporting to effective compliance programs can provide valuable assistance to [the SEC's] own enforcement efforts."¹⁸⁹ The new bounty

¹⁸⁴ See, e.g., *Florida v. J.L.*, 529 U.S. 266, 269 (2000) (affirming that "anonymous tips . . . are generally less reliable than tips from known informants and can form the basis for reasonable suspicion only if accompanied by specific indicia of reliability" in the appeal of a criminal case).

¹⁸⁵ In another article, I plan to discuss the implications of the principle of restorative justice for whistleblowers. At a minimum, restorative justice requires applying the whistleblower laws extraterritorially, granting whistleblowers a broader private right of action, and creating a comprehensive whistleblower compensation fund to cover non-pecuniary damages suffered as a result of more subtle forms of retaliation. See *Lawson v. FMR LLC*, 670 F.3d 61, 71 (1st Cir. 2012) (holding that provisions of Sarbanes-Oxley do not extend to private company employees); *William Villanueva v. Core Labs. NV*, No. 09-108, 2011 WL 6981989, at *6-8 (DOL Adm. Rev. Bd. Dec. 22, 2011) (discussing the lack of statutory language governing extraterritorial disclosures); Schichor, *supra* note 14, at 292-95 (arguing that non-pecuniary damages are necessary to protect against employer retaliation).

¹⁸⁶ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,323 (June 13, 2011).

¹⁸⁷ William H. Donaldson, Chairman, U.S. SEC, Remarks Before the Economic Club of New York (May 8, 2003), available at <http://www.sec.gov/news/speech/spch050803whd.htm>.

¹⁸⁸ *Id.*

¹⁸⁹ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,360 (June 13, 2011).

program, however, threatens to undermine a corporation's efforts to regulate itself.

1. *Ignoring of Regulatory Standards*

The SEC's new bounty program ignores pre-existing regulatory standards that mandate internal reporting systems. The legal requirement that corporations have adequate systems of internal controls dates back to 1977, when Congress amended the federal securities laws with the enactment of the FCPA, and 2002, when Congress passed SOX and ushered in the modern self-regulation approach to corporate regulation.¹⁹⁰ For example, SOX requires that a company's annual report must include a statement of the management's responsibility over internal controls and reporting; a statement on the framework used to evaluate those controls over the past year; management's assessments of the effectiveness of these controls over the past year, with an identification of any material weaknesses; and a statement that the issuer's auditors have attested to management's assessment of internal controls.¹⁹¹ SOX also required the SEC to issue rules to require issuers to disclose whether they have codes of ethics applicable to senior financial officers.¹⁹² Accordingly, the SEC passed implementing rules requiring issuers to disclose in their annual reports whether the company has adopted a code of ethics and to file a copy with the SEC.¹⁹³ Although the SEC rules do not specify the exact details that must be included in a code of ethics, one of the matters which is most often addressed in a code of ethics is the prompt internal reporting of code violations.

The SEC has also promoted internal compliance programs through the threat of increased liability. Shortly before the enactment of SOX, for example, the SEC issued the so-called Seaboard Report that announced

¹⁹⁰ See Carl Pacini, *The Foreign Corrupt Practices Act: Taking a Bite out of Bribery in International Business Transactions*, 17 FORDHAM J. CORP. & FIN. L. 545, 576 (2012) (explaining that the FCPA requires internal controls, though it does not define them); SEC Opening Statement, *supra* note 54 (acknowledging that SOX "made great strides in creating whistleblower protections and requiring internal reporting systems at public companies"). State law also now emphasizes the need for directors of publicly traded companies to be concerned about internal control systems in fulfilling their duty of care responsibilities. See also *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967–70 (Del. Ch. 1996) (explaining company's duties to act in good faith, monitor its own business decisions, and keep their company compliant with all laws).

¹⁹¹ Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Report Periodic Reports, 68 Fed. Reg. 36,636, 36,642 (June 8, 2003).

¹⁹² Sarbanes-Oxley Act of 2002 § 406, 15 U.S.C. § 7264 (2006).

¹⁹³ 17 C.F.R. § 229.406 (2012); see also Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, 68 Fed. Reg. 5,110, 5,117–20 (Jan. 31, 2003) (explaining the disclosures required and how they are to be made).

thirteen factors the SEC considers when bringing enforcement actions.¹⁹⁴ The second factor in the Seaboard Report asks whether the company had an internal compliance program.¹⁹⁵ Other factors ask about the corporate culture and the tone at the top,¹⁹⁶ how the company monitors compliance, investigates reports of misconduct and corrects any misconduct discovered,¹⁹⁷ and whether the organization learned from the misconduct by modifying its compliance program to better deter and prevent similar misconduct in the future.¹⁹⁸

Since then, the Federal Sentencing Guidelines were revised to reflect the need for more effective and robust internal compliance systems.¹⁹⁹ A corporation may generally be held criminally liable for securities law violations that are (1) connected to and committed in the course of employment, (2) for the benefit of the corporation, and (3) with the authorization or acquiescence of the corporation.²⁰⁰ However, mitigating factors under the Federal Sentencing Guidelines include the presence of “an effective program to prevent and detect violations of law” by corporate agents.²⁰¹ Thus, while corporations are required by law to establish an

¹⁹⁴ Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44,969, 2001 WL 1301408 (Oct. 23, 2001) [hereinafter Seaboard Report], available at www.sec.gov/litigation/investreport/34-44969.htm. The report is referred to as the “Seaboard Report” because the report summarizes why the SEC would not take enforcement action against a parent company—Seaboard Corporation—for accounting misconduct at one of its divisions after the parent company took prompt remedial action and fully cooperated with the SEC. *Compliance 101—The Seaboard Report*, CORP. COMPLIANCE PROF. BLOG (July 11, 2005), http://lawprofessors.typepad.com/compliance_prof/2005/07/compliance_101__1.htm.

¹⁹⁵ Seaboard Report, *supra* note 194 (“What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?”). The Seaboard Report does not, however, discuss how to evaluate the effectiveness of a compliance program.

¹⁹⁶ *Id.* (asking, under Factor 1, whether the misconduct “result[ed] from inadvertence, honest, mistake, simple negligence, reckless or deliberate indifference to indicia or wrongful conduct, willful misconduct or unadorned venality” and whether the company’s auditors were misled, and asking, under Factor 3, where the misconduct occurred in the organization and whether senior management turned a blind eye to the misconduct).

¹⁹⁷ *Id.* (providing, in Factors 4–10, the questions to ask regarding the length of the misconduct, the harm caused by the misconduct, how the misconduct was discovered and by whom, the effective response time, the steps taken by the company to stop the misconduct, the company’s cooperation, and its commitment to finding the truth).

¹⁹⁸ *Id.* (“What assurances are there that the conduct is unlikely to recur? Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct? Did the company provide our staff with sufficient information for it to evaluate the company’s measures to correct the situation and ensure that the conduct does not recur?”).

¹⁹⁹ U.S. SENTENCING COMM’N, GUIDELINES MANUAL § 8B2.1 (2011) (requiring due diligence for the prevention of misconduct, and promotion of a culture of compliance).

²⁰⁰ 10 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 4942 (rev. vol. 2010).

²⁰¹ See Jennifer Moore, *Corporate Culpability Under the Federal Sentencing Guidelines*, 34 ARIZ. L. REV. 743, 784 (1992). The other potential mitigating factor is the extent of the corporation’s

internal reporting system, the new bounty program allows and even incentivizes employees to disregard these internal compliance systems. Without employee participation, however, these corporate systems cannot be expected to effectively prevent or detect violations of the law.²⁰²

2. Ignoring Best Practices

The SEC's new bounty program also ignores accepted "best practices" established by experts in the field of corporate compliance. Most public companies have spent considerable time and effort over the last couple of decades building state-of-the-art internal reporting and compliance programs. In most cases, these compliance efforts are more than just cosmetic.²⁰³ The keystone of these programs is the employees in the field that have access to first-hand information and are in the best position to detect and prevent potential securities violations. They are supported by a wide range of personnel tasked with following up on employee complaints, including internal auditors, human resources directors, in-house counsel specializing in regulatory affairs and compliance officers.²⁰⁴

Most public companies have implemented several alternative internal reporting mechanisms including: (1) an open door policy which allows reporting potential violations or complaints to a supervisor, or when the supervisor is implicated in the alleged misconduct, allows bypassing the chain-of-command and reporting suspected violations or complaints directly to senior management or the compliance office;²⁰⁵ (2) a toll-free whistleblower tip hotline;²⁰⁶ and, in many cases, (3) an ombudsmen

cooperation with law enforcement officials. *Id.* Aggravating factors considered in assessing a corporation's culpability include: "(1) the involvement in or tolerance of criminal activity by 'high level' or 'substantial authority' personnel; (2) a recent history of similar misconduct [by the corporation]; (3) violation of a judicial order or condition of probation; and (4) [corporation's] obstruction of justice." *Id.*

²⁰² See *SEC Whistleblower Rules Encourage Internal Investigations*, MILBANK LITIG. (June 3, 2011), <http://www.millbank.com/images/content/5/4/5447.pdf> (examining the role of the employee whistleblower and the new rules surrounding reporting).

²⁰³ *But see* Kimberly Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491 (2003) (arguing that "a growing body of evidence indicates that internal compliance structures do not deter prohibited conduct within firms, and may largely serve a window-dressing function that provides both market legitimacy and reduced legal liability").

²⁰⁴ Robert Lupone, *Corporate Compliance: The Role of Company Counsel*, 21 GEO. J. LEGAL ETHICS 491, 526 (2008).

²⁰⁵ Nat'l Council of Nonprofit Ass'n, *Whistleblower Policy-Sample*, ASHP.ORG, http://www.ashp.org/s_ashp/docs/files/about/Affiliate_Whistleblower_Sample.pdf (last visited Sept. 25, 2012).

²⁰⁶ See ORG. FOR ECON. COOP. & DEV., UNITED STATES: PHASE 3 REPORT ON THE APPLICATION OF THE CONVENTION ON COMBATING BRIBERY OF FOREIGN PUBLIC OFFICIALS IN INTERNATIONAL BUSINESS TRANSACTIONS AND THE 2009 REVISED RECOMMENDATION ON COMBATING BRIBERY IN INTERNATIONAL BUSINESS TRANSACTIONS 18 (2010) [hereinafter ORG. FOR ECON. COOP. & DEV.], available at <http://www.oecd.org/investment/briberyininternationalbusiness/anti->

program.²⁰⁷ Along with other best practices,²⁰⁸ these internal reporting mechanisms encourage a culture of compliance transparency that takes compliance seriously and often spurs companies to achieve norms that are actually better than what the law requires.²⁰⁹ By allowing employees to bypass these mechanisms altogether, the new bounty program will not only render these internal reporting mechanisms useless, but it will promote the very culture of opportunism that these compliance systems are intended to combat.

As currently implemented, the bounty program jeopardizes the ability of corporations to maintain a strong compliance culture. As discussed earlier, the SEC leaves it up to the employee to decide whether the company has an effective internal reporting system or not.²¹⁰ If in the employee's opinion, the employer's reporting system does not pass muster, then the employee is free to ignore it and proceed directly to the SEC.²¹¹

briberyconvention/46213841.pdf (highlighting the use of U.S. companies' whistleblower tip hotlines); see also Comment from Cutler, *supra* note 107, at 4 (explaining the "value of the hotline for reporting unethical activities and as a means for reducing corporate culpability").

²⁰⁷ See Lobel, *supra* note 18, at 497 ("Employees are more likely to use internal procedures when the procedures are formally established and the corporation asserts its commitment to a fair process. Thus, many companies have created an ombudsman position within the firm" (footnotes omitted)). An ombudsman is a quasi-independent person within the corporation who specializes in hearing complaints, managing conflicts, and monitoring legal compliance. *Id.*; see also Martin Lipton, *SEC Adopts New Rules to Encourage Whistleblowers*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 30, 2011, 9:50 AM), <http://blogs.law.harvard.edu/corpgov/2011/06/30/sec-adopts-new-rules-to-encourage-whistleblowers/> (explaining the measures used by public companies to "enhance the effectiveness of their internal compliance systems" and acknowledging the integral nature of such measures).

²⁰⁸ For a list of other related best practices such as cultivating a tone at the top with communications from the CEO emphasizing the importance of legal compliance and ethics, adopting codes of conduct, conducting ongoing ethics and compliance training and education for employees, investigation reports of misconduct promptly and thoroughly, and taking appropriate remedial action, see ORG. FOR ECON. COOP. & DEV., *supra* note 206, at 46–47. See also Comment from Cutler, *supra* note 107, at 4 (describing procedures of compliance in place to prevent securities law violations); Comment from Susan Hackett, Senior Vice President & Gen. Counsel, Ass'n of Corp. Counsel 3 (Dec. 17, 2010), available at <http://sec.gov/comments/s7-33-10/s73310-144.pdf> (suggesting further provisions, such as barring short sellers from "obtaining a second bite at the apple through the whistleblower process," and ensuring that prospective whistleblowers make timely reports of misconduct, to prevent securities fraud stemming from the new whistleblower policies).

²⁰⁹ See Lori A. Richards, Dir., Office of Compliance Inspections and Examinations U.S. SEC, Speech by SEC Staff: The Culture of Compliance at Spring Compliance Conference: National Regulatory Services (Apr. 23, 2003), available at <http://www.sec.gov/news/speech/spch042303lar.htm> ("[I]t's not enough to have policies. It's not enough to have procedures. It's not enough to have good intentions. All of these can help. But to be successful, compliance must be an embedded part of your firm's culture.").

²¹⁰ See SEC Opening Statement, *supra* note 54 (discussing the balance reached between encouraging internal compliance and allowing the whistleblower to bypass that option if necessary because "it is the whistleblower who is in the best position to know which route is best to pursue").

²¹¹ See *id.* (stating that the whistleblower has the option of reporting internally or going directly to the SEC).

The SEC's final rules effectively prevent corporations from requiring their employees to follow their own internal policies and procedures. A recent report by Littler Mendelson found that 96% of executives surveyed were either moderately or very concerned about potential whistleblower claims against their companies in light of the new program.²¹²

Admittedly, most companies have not yet noticed much of an impact on their internal compliance programs.²¹³ This may be because whistleblowers and their attorneys are still learning how to run the gantlet. In addition, many corporations have taken counter measures to increase employee training on how to report wrongdoing and to increase management training on how to respond to such reports.²¹⁴ In a recent survey conducted by the Society of Corporate Compliance and Ethics and its affiliated Health Care Compliance Association, three-quarters of respondents reported increasing communication to employees on reporting wrongdoing since the passage of the Dodd-Frank Act.²¹⁵ In addition, 66% of survey respondents (72% of respondents from publicly traded companies) reported an expected increase in management communication about handling allegations of wrongdoing.²¹⁶ This significant increase in in-house compliance training may help to buoy internal whistleblowing for the time being.²¹⁷ If so, we are not likely to see the negative effects of the bounty program on corporate culture until a critical mass or tipping point is reached; however, at that point it may be too late to do anything about it.

The SEC insists that the quality of tips has not been diminished, and therefore, any attempt now by Congress to fix it would be premature. However, this pragmatic approach to policy making ignores how law shapes culture, and culture shapes behavior.²¹⁸ Presently, no substantial

²¹² LITTLER MENDELSON, WHISTLEBLOWER SURVEY 1 (2011), available at <http://www.littler.com/files/press/related-files/Littler-Whistleblower-Survey-Nov-2011.pdf>.

²¹³ See NAT'L WHISTLEBLOWERS CTR. REPORT, *supra* note 149, at 5 ("The existence of a . . . whistleblower reward program has no impact on the willingness of employees to internally report potential violations of law, or to work with their employer to resolve compliance issues.").

²¹⁴ Allan Dinkoff, *Corporate Compliance Programs After Dodd-Frank*, WEIL.COM 13–16 (Oct. 2011), http://weil.com/files/upload/Corporate_Compliance_Post_Dodd_Frank_AELC_Oct.11.pdf (discussing the different new initiatives that companies can take to ensure effective compliance).

²¹⁵ HEALTH CARE COMPLIANCE ASS'N & SOC'Y OF CORP. COMPLIANCE & ETHICS, DODD-FRANK: BIG HEADLINES, NOT-SO-BIG IMPACT 4 (2011), available at <http://www.hcca-info.org/Resources/View/ArticleId/195/Survey-by-SCCE-and-HCCA-Reveals-Little-Impact-of-Dodd-Frank-Act.aspx>.

²¹⁶ *Id.* at 5.

²¹⁷ Moberly, *Sarbanes-Oxley's Structural Model*, *supra* note 71, at 1142–43 ("A disclosure channel also harmonizes with a whistleblower's tendency to report misconduct internally . . . by this sense of loyalty. . . . [Internal reporting] fits well with the psyche of the American employee, whose sense of loyalty to the organization keeps her from reporting misconduct externally, but who may report internally if encouraged by the organization." (footnotes omitted)).

²¹⁸ For example, at one time bribery was considered business as usual in many parts of the world. However, the FCPA led to similar anti-bribery laws being established around the world. Today, nearly

bounties have been paid out.²¹⁹ But even one or two sizable awards to the wrong people may be able to radically change the compliance culture in many corporations by successfully allaying fears of any consequences for departing from the norm of internal reporting.

Ironically, “evil” corporations will welcome employees bypassing internal reporting because it will lower their compliance costs. Fewer complaints mean fewer investigations. Moreover, the SEC can target only a small fraction of the over 15,000 public companies; therefore, there is little increased risk of public enforcement. In anticipation of this, the SEC indicated early on that it plans on forwarding whistleblower tips to the employer for an early response.²²⁰ In that case, the only difference will be that the SEC will introduce adversarialism into the process prematurely. This will cause internal investigators to go into defense mode. In doing so, the SEC will discourage in-house compliance personnel and lawyers from sharing information with employees, learning from employees, or otherwise involving employees in mutually beneficial problemsolving efforts.

3. Ignoring Public Enforcement Limitations

Despite corporations’ best efforts, most scholars recognize the need for some threat of prosecution. A growing body of research confirms the need to maintain a significant background threat of external enforcement.²²¹ In general, the law promotes self-regulation by presupposing adversarialism, and then rewarding individual companies who demonstrate exceptional cooperation with a less adversarial or less punitive regime. This is generally known as the “carrot and stick” approach.²²² Relying heavily on this traditional approach, the SEC has taken the position that internal compliance programs cannot serve as complete substitutes for the

every country prohibits bribery of government officials. Over a dozen international anti-bribery conventions have been signed and/or ratified by over 200 countries. The result is bribery is no longer generally acceptable in international business. See Vega, *supra* note 40, at 391 (arguing that the prohibition against foreign bribery has become customary international law).

²¹⁹ But see *S.E.C. Makes First Bounty Award to Dodd-Frank Act Whistleblower*, JACKSON LEWIS LLP (Aug. 22, 2012), <http://www.jacksonlewis.com/resources.php?NewsID=4178> (announcing that the first and only bounty paid out to date was \$50,000).

²²⁰ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,323 (June 13, 2011).

²²¹ See generally IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE (Donald R. Harris et al. eds., 1992) (discussing how regulators influence not only through actual prosecution but public threat of prosecution). See also John W. Maxwell, *Self-Regulation and Social Welfare: The Political Economy of Corporate Environmentalism*, 43 J. L. & ECON. 583, 603 (2000) (positing that “firms engage in more self-regulation when they perceive a greater threat of government regulation”).

²²² Kara Blanco & Rebecca E. Whitacre, *The Carrot and Stick Approach: In Terrorem Clauses in Texas Jurisprudence*, 43 TEX. TECH L. REV. 1127, 1128–29 (noting that the “stick” in this type of approach is “a threatened punishment, which will be used if the carrot [or potential reward] is not sufficient” to elicit compliance).

government's obligation to identify and remedy securities law violations.²²³ In addition to implementing the new bounty program, the SEC has recently undergone a major revamping and is now doubling down on its enforcement efforts.²²⁴

While the SEC must do everything it can to ensure compliance with corporate laws, it must also recognize that external whistleblowing will not be enough. Increasing the number of tips reported to the SEC will not by itself reduce securities law violations for several reasons. First, the SEC does not have the resources to engage in the kind of large-scale, ongoing interventions needed to create a permanent solution using the traditional command-and-control approach.²²⁵ Although the Dodd-Frank Act reflects a broad congressional mandate, the agency did not receive any additional funding. Given its limited resources, it is critical that the SEC find a way to give whistleblowers a role in the compliance process without abandoning the modern experiment in self-regulation.

Second, the SEC also has a checkered history when it comes to taking prompt corrective action. For example, several members of Congress criticized the SEC for failing to promptly act against firms involved in the financial crisis despite being put on notice by several early indicators.²²⁶ Others also fault the SEC, which ignored a 1999 letter accusing Bernard Madoff of conducting a massive Ponzi scheme, for the resulting debacle on Wall Street.²²⁷

Finally, there is little evidence that civil and criminal penalties and settlements can address the more systemic problems in corporate

²²³ Securities Whistleblowers Incentives and Protections, 76 Fed. Reg. 34,000, 34,324 (June 13, 2011) (noting that although the SEC “believe[s] that internal compliance programs play an important role” in the identification of securities law violations, such programs “are not substitutes for rigorous law enforcement”).

²²⁴ See *The Securities and Exchange Commission Post-Madoff Reforms*, U.S. SEC, <http://www.sec.gov/spotlight/secpostmadoffreforms.htm> (last visited Oct. 31, 2012) (describing the SEC's revamping of its policies and procedures and systems for handling whistleblower complaints and tips).

²²⁵ David Hess & Cristie L. Ford, *Corporate Corruption and Reform Undertakings: A New Approach to an Old Problem*, 41 CORNELL INT'L L.J. 307, 310–11 (2008). The traditional approach gives corporations substantive rules and then relies on top-down enforcement by agencies. *Id.* at 311 (noting the deficiencies in such an approach, as it can lead to “cosmetic compliance programs or calculated cooperation with the government”).

²²⁶ Edward Wyatt, *SEC Is Pursuing More Inquiries Tied to the Financial Crisis*, *Chairwoman Says*, N.Y. TIMES, July 21, 2010, at B2 (stating that the SEC drew criticism from Congress, as well as investor groups, for “a lack of prominent enforcement cases against firms that played a major role in the financial crisis, which cost individual and institutional investors billions of dollars in losses”).

²²⁷ See Binyamin Appelbaum & David S. Hilzenrath, *SEC Didn't Act on Madoff Tips*, WASH. POST, Dec. 16, 2008, at D1 (“The SEC had the authority to investigate Madoff's investment business, which managed billions of dollars Financial analysts raised concerns about Madoff's practices repeatedly over the past decade, including a 1999 letter to the SEC that accused Madoff of running a Ponzi scheme. But the agency did not conduct even a routine examination of the investment business until [December 2008].”).

governance.²²⁸ The SEC has dramatically increased the number of civil and criminal public enforcement actions against corporations for the last several years, resulting in record fines and onerous settlement agreements. And despite these aggressive enforcement efforts, the level of white-collar crime and fraud is still increasing.²²⁹ If compliance were based solely on the threat of liability, we would expect the level of compliance to have gone up, but in fact it has gone down significantly over this time period.²³⁰ Thus, even if the SEC's new whistleblower bounty program results in significantly more enforcement actions, monetary fines are unlikely to effect the desired change in corporate compliance.²³¹

Given the inherent limitations of public enforcement efforts, there are two important questions. First, what are the long-term negative effects of the bounty program on corporate compliance? Second, what is its likely effect on the moral legitimacy of corporate whistleblowers? Common sense tells us the solution to corporate opportunism cannot be a program that encourages employee opportunism. What is needed is a coherent regulatory philosophy to guide regulators as to when to require internal whistleblowing and when to encourage external whistleblowing to maximize corporate self-regulation without sacrificing the whistleblower's morality.

V. THE FUNDAMENTALS OF MORAL WHISTLEBLOWING

Corporate whistleblowing must be shaped. Moral principles, not just economic interests, should inform this reshaping. Cultivating a strong moral basis for whistleblowing can overcome transactional costs and other purely economic obstacles that a "mere instrumentality" approach to whistleblowing cannot;²³² however, corporate whistleblowing is first and

²²⁸ See Hess & Ford, *supra* note 225, at 310–11 (discussing how prosecutors and enforcers do not have adequate resources nor a mandate to engage in effective corporate governance).

²²⁹ See, e.g., ETHICS RESEARCH CTR., NATIONAL BUSINESS ETHICS SURVEY: AN INSIDE VIEW OF PRIVATE SECTOR ETHICS v (2007), available at http://www.ethics.org/files/u5/The_2007_National_Business_Ethics_Survey.pdf (concluding that "[e]thical misconduct in general is very high and back at pre-Enron levels" within national firms surveyed); KROLL, *supra* note 67, at 6–7 (noting increases in overall incidence of corporate fraud and weakening internal controls among firms surveyed globally).

²³⁰ ETHICS RESEARCH CTR., NATIONAL BUSINESS ETHICS SURVEY: AN INSIDE VIEW OF PRIVATE SECTOR ETHICS v (2007), available at http://www.ethics.org/files/u5/The_2007_National_Business_Ethics_Survey.pdf.

²³¹ See Cristie L. Ford, *Toward a New Model for Securities Law Enforcement*, 57 ADMIN. L. REV. 757, 766–72 (2005) (discussing the limitations of monetary fines as a tool to effect large-scale reform of organizational culture).

²³² See MARK CASSON, THE ECONOMICS OF BUSINESS CULTURE: GAME THEORY, TRANSACTION COSTS, AND ECONOMIC PERFORMANCE 255 (1991) (noting that third party organizations such as the state can reduce transaction costs by punishing cheaters, and thus allowing actors to trust each other); see also Eisenberg, *supra* note 153, at 1274 (observing that moral whistleblowing reduces transactional costs and enhances performance in ways incentive-based SEC rules and regulations alone cannot).

foremost a moral enterprise. Therefore, the SEC should treat whistleblowing not just as the profitable thing to do, but also as the right thing to do.

The place to start is with the distinction between internal and external whistleblowing. This distinction can be most clearly seen by viewing the whistleblowing enterprise through the lens of (1) the common good of mutual self-interest and (2) the principle of subsidiarity. Internal whistleblowing is mandated, according to the first guiding principle, by the basic good of community within corporations and the norm of cooperation. The second principle affirms the primacy of internal whistleblowing over external whistleblowing. Together, these two principles support the claim that whistleblowers have a moral duty to make a good faith effort to work internally with the company to solve compliance problems before resorting to external whistleblowing.

The remainder of this Part explores how these two guiding principles can help reshape the SEC's new whistleblower bounty program to ensure it is properly oriented with the moral considerations underlying whistleblowing.

A. *The Principle of Mutual Self-Interest*

One of the primary questions that the SEC should ask is what role does the employer's and the employee's mutual self-interest play in corporate compliance? By not requiring employees to make a good faith effort to report potential violations internally before attempting to collect a bounty, the SEC program unnecessarily risks destroying the basic good of community within corporations. A proper normative framework would recognize the importance of the employer and the employee's shared interest in cooperating to solve compliance issues. Although a full framework is beyond the scope of this Article, a good start would be to recognize what many perfectionist legal scholars call "the common good" of mutual self-interest.²³³ Mutual self-interest is an aspect or instantiation of the basic human good of community.²³⁴ This simple but profound idea

²³³ FINNIS, *NATURAL LAW*, *supra* note 10, at 305. The term "common good" refers to "the good of individuals, living together and depending upon on another in ways that favour [sic] the well-being of each." *Id.* It includes factors which "make sense of or give reason for [an employee's] collaboration with [an employer] and would likewise, from their point of view, give reason for [an employer's] collaboration . . . with him." *Id.* at 154; *see also* ROBERT P. GEORGE, *MAKING MEN MORAL: CIVIL LIBERTIES AND PUBLIC MORALITY* 162–63 (1993) (describing the moral perfectionism of Joseph Raz, which includes the idea that governments may advance individual autonomy by "protecting morally valuable options for choice" through social policies).

²³⁴ In his various writings, Finnis identifies seven basic goods, the intrinsic value of which is self-evident to all rational human beings. These include: knowledge; life; work and play; friendship and association (or sociability); aesthetic experience; practical reasonableness; and religion. It is from these

is essential to implementing the SEC's new bounty program without undermining preexisting and future internal compliance and reporting systems.

The SEC generally assumes that self-interest will stymie most, if not all, legitimate compliance efforts. This adversarial (or contractarian) approach to corporate regulation is what led the SEC to conclude that if corporations are driven by profit to avoid costly regulatory compliance, then conversely, a lucrative bounty program is needed to counter that urge by financially incentivizing employees to report a corporation's noncompliance. Self-interest, however, does not alone lead to corporate fraud and corruption.²³⁵ Although the employer and the employee are both driven by self-interest, this shared self-interest does not make the corporate enterprise immoral or evil.²³⁶ On the contrary, this arrangement not only permits both parties to make money, but it also provides a forum in which people can exercise their talents, find fulfillment, and realize their values. It is only when they are acting pursuant to non-mutual interests (i.e., perverse ulterior motives) that self-interest is a real issue. Just like bribery, kickbacks, and financial fraud, laws and regulations that undermine *mutual* self-interest are bad for business.²³⁷ These corrupting influences are not just illegal or damaging to a company's reputation; they destroy the cooperative relationships intrinsic in all corporations that are necessary for the company to be profitable. They transform cooperative relationships into "relationships of mistrust, antagonism and exploitation."²³⁸ Therefore, the most successful corporate compliance regulations will promote the common good of *mutual* self-interest in minimizing the costs of

basic goods that natural law theorists argue all other human goods derive their value. FINNIS, *NATURAL LAW*, *supra* note 10, at 85–90.

²³⁵ See JIM COLLINS, *GOOD TO GREAT: WHY SOME COMPANIES MAKE THE LEAP . . . AND OTHERS DON'T* 41 (2001) (observing the importance to an organization's success of having the right individuals within that organization, which can be extended from for-profit purposes to ones of social responsibility); Elletta Sangrey Callahan & Terry Morehead Dworkin, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization and Society*, 29 AM. BUS. L.J. 267, 299–301 (arguing that the actions of internal whistleblowers and their employers serve the interests of these parties by avoiding adverse publicity and legal consequences, while also reforming their organization from within).

²³⁶ Callahan & Dworkin, *supra* note 235, at 299–303 (arguing that self-interest is not inherently wrong).

²³⁷ See Stefan Rützel, *Snitching for the Common Good: In Search of a Response to the Legal Problems Posed by Environmental Whistleblowing*, 14 TEMP. ENVTL. L. & TECH. J. 1, 44 (1995) (arguing that while "monetary incentives may encourage whistleblowing, and while self-interest as a motive for reporting is not inherently wrong, financial rewards are seemingly inappropriate" because they "increase[] the danger of frivolous complaints," their costs offset any potential savings, and they may have been unnecessary).

²³⁸ Sean Kelsey & Thomas R. Krause, *Leading with Ethics: The Cooperative Model and the Example of Workplace Safety*, in *RETHINKING BUSINESS MANAGEMENT: EXAMINING THE FOUNDATIONS OF BUSINESS EDUCATION* 118, 119 (Samuel Gregg & James R. Stoner, Jr. eds., 2008).

noncompliance for both the company and its employees.

Unfortunately, the SEC's new bounty program actually undermines the collaborative or cooperative relationship between the employer-company and the employees by promoting employee non-mutual interest in a bounty. The prospect of a multi-million dollar bounty may overcome certain self-interests and transaction costs preventing corporate whistleblowers from collaborating with the government, but only at considerable cost to efforts promoting cooperation, coordination, and mutual responsibility between these same whistleblowers and their respective companies. In addition, legally excusing an employee's failure to report potential violations to his or her employer effectively severs the employee's preexisting financial interest in a paycheck from the success of the company's internal compliance and reporting systems and converts this to a non-mutual self-interest.

The SEC insists mandatory internal pre-reporting would not make any difference with respect to those whistleblowers who are already predisposed to report internally.²³⁹ In addition, the SEC claims the bounty program will induce some individuals who, absent any financial incentive, would never have reported either internally or externally to the SEC in the first place.²⁴⁰ However, the SEC leaves the single, largest category of employees completely out of their analysis: those who report internally because it is in their mutual self-interest. The SEC bounty program does much more than simply create a financial incentive to report potential violations to the SEC; it essentially changes the terms and conditions of employment. It effectively prohibits employers from requiring that employees immediately report potential violations to the company as a condition of employment. Employers are now legally forced to leave to the whistleblower the decision whether to report allegations internally. The SEC claims this as an additional "advantage" to its approach:

[I]t allows whistleblowers to select the proper reporting procedures under the specific circumstances. Whistleblowers can balance the potential increase in the probability and magnitude of an award by participating in an effective internal compliance mechanism, against the particular risks that may result from doing so, which could include retaliation, loss of anonymity (for those companies that may not have effective anonymous reporting procedures), delay due to an ineffective or questionable internal compliance

²³⁹ See Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,360 (June 13, 2011) (specifying that whistleblowers who report internally would receive a whistleblower award from the SEC with participation in an internal report framework counting as a "plus-factor").

²⁴⁰ *Id.*

mechanism, and destruction of evidence based on the nature of the allegations or the corporate environment. On balance, we believe that, from a law-enforcement perspective, overall efficiency is better promoted by allowing whistleblowers to make this assessment on a case-by-case basis.²⁴¹

The SEC's conclusion, however, assumes all financial incentives are equal, when they are not. Some financial awards may promote cooperation between the employer and employee, while other incentives can hinder such cooperation. Yet, despite the obvious benefits of employer-employee collaboration, the SEC was unwilling to take on the responsibility (and inherent political risks) of assessing whether a whistleblower should be required to cooperate with an employer's internal reporting system.²⁴² The SEC excused this willful neglect by claiming fact-intensive assessments would "divert limited resources from the [SEC's] primary objective of investigating allegations of wrongdoing."²⁴³

Such an assessment, however, does not depend on fact-intensive empirical research; instead, it rests on the proper understanding of the basic good of community within corporations. The true nature of corporations as communities is obscured by the fact that they are sometimes spoken of as a legal fiction or "system" and at other times referred to as persons with interests and rights.²⁴⁴ According to the legal philosopher John Finnis, however, a corporation is best understood as a "community of joint action" formed between, among others, an employer and its employees.²⁴⁵ Finnis uses a variety of synonyms to describe this "joint action," including "collaboration, co-operation, and co-ordination."²⁴⁶ He also includes in that same grouping what he calls "negative co-ordination," by which he means "mutual non-interference," such as abstaining from harming the other.²⁴⁷

This coordination serves at least two of the most basic human goods. This is true even if the only reason an employee collaborates or cooperates with his or her employer is the business relationship. Beyond the value of what he or she can get paid, for example, there is the value of "skillful

²⁴¹ *Id.* at 34,361–62 & n.462.

²⁴² *Id.* at 34,361 (noting that the inability of the SEC to promptly respond to the necessity of individual whistleblowers to report internally would lead to the program being less cost-effective, and possibly less successful, given that it might reduce overall whistleblowing).

²⁴³ *Id.* at 34,362.

²⁴⁴ See FINNIS, *NATURAL LAW*, *supra* note 10, at 135 (arguing that since all groups are a matter of relationship and interaction, they should be defined as an ongoing state of affairs, or in the broadest sense, as a form of unifying relationship between human beings).

²⁴⁵ *Id.* at 138.

²⁴⁶ *Id.*

²⁴⁷ *Id.*

performance, in work and play,” which Finnis identifies as a basic good.²⁴⁸ An employee also values being a part of an “association between persons,” which Finnis refers to as the basic good of sociability or “community.”²⁴⁹ The intrinsic value of these basic goods is self-evident and therefore, according to natural law scholars, known to all.²⁵⁰ Other scholars, in fact, who do not necessarily consider themselves a part of the recent revitalization of the natural law tradition, agree that community is a basic good.²⁵¹ For example, the perfectionist liberal philosopher Joseph Raz holds that “living in a society” is intrinsically good.²⁵² Even contemporary liberal theorists like Ronald Dworkin recognize the need to balance individual rights with individual responsibilities to the community because “[i]t is part of any proper conception of personal responsibility that people should make . . . choices . . . with an eye to the opportunity costs to others of the choices that they make.”²⁵³

In addition, these perfectionist philosophers are not alone in defending the corporation as a community. Like Finnis, a group of organizational management and corporate law scholars known as “corporate communitarians” also views the employer-employee relationship as one of collaboration.²⁵⁴ These corporate communitarians must be distinguished from political philosophy communitarians like Alasdair MacIntyre,²⁵⁵

²⁴⁸ John Finnis, *Liberalism and Natural Law Theory*, 45 *MERCER L. REV.* 687, 691–92 (1994).

²⁴⁹ *Id.* at 691. He also refers to the basic good of association between persons as “friendship.” *Id.*

²⁵⁰ Adam J. MacLeod, *Identifying Values in Land Use Regulation*, 101 *KY. L.J.* (forthcoming 2012) (explaining that intrinsic means “it is not contingent upon anything more basic than itself”).

²⁵¹ *See, e.g.*, RAZ, *MORALITY*, *supra* note 9, at 199 (observing that living within a tolerant and educated society is beneficial to individuals); Ronald Dworkin, *Justice for Hedgehogs*, 90 *B.U. L. REV.* 469, 470 (2010) [hereinafter Dworkin, *Justice*] (arguing that through government people can collectively ensure their individual right to self-determination).

²⁵² RAZ, *MORALITY*, *supra* note 9, at 206.

²⁵³ Dworkin, *Justice*, *supra* note 251, at 470; *see also id.* (“[P]eople should make such choices with a sense of the consequences.”).

²⁵⁴ *See* Michael E. DeBow & Dwight R. Lee, *Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation*, 18 *DEL. J. CORP. L.* 393, 395–96 (1993) (observing that the corporate communitarianism “seeks to undermine the law’s distinction between ‘public’ and ‘private’ spheres of activity”); *see also* Jeffrey Bone, *Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?*, 24 *CAN. J. L. & JURIS.* 277, 278 (2011) (noting that “communitarians emphasize cooperation, justice, and civic responsibility”); Thomas C. Kohler, *Individualism and Communitarianism at Work*, 1993 *BYU L. REV.* 727, 728 (1993) (arguing against the individualism that leads us to “reject our character as social beings”); Millon, *supra* note 176, at 1378–79 (observing that communitarians emphasize the broad social effects of corporate activity on non-shareholders over the narrow range of monetizable interests of those within the corporation).

²⁵⁵ *See* ALASDAIR MACINTYRE, *AFTER VIRTUE* 5 (2d ed. 1984) (arguing that “the integral substance of morality has to a large degree been fragmented and then in part destroyed,” which has resulted in a lack of rational ways for our society to deal with moral problems). Other leading political philosophy communitarians, such as Richard Rorty, Charles Taylor, and Michael Sandel, share MacIntyre’s anti-corporate views. *See, e.g.*, MICHAEL SANDEL, *PUBLIC PHILOSOPHY: ESSAYS ON MORALITY IN POLITICS* 43 (2005) (arguing against large corporations because they are unaccountable to the communities they serve).

because the latter group reaches very different normative conclusions regarding corporations.²⁵⁶ Nevertheless, several legal and business scholars have used MacIntyre's concepts of "practices" and "communities of purpose" for the basis of a framework of business ethics.²⁵⁷ In particular, corporate communitarians agree with perfectionist philosophers that the concept of the corporation as a community is essential to mitigating the errors of both individualism and collectivism inherent in many corporation laws and regulations.²⁵⁸ They see the corporation as more than simply a contractual arrangement between individuals.²⁵⁹ They seek to inject a sense of mutual responsibility into the discussion that seems too often defined by individual rights.²⁶⁰

The primary difference between communitarians and perfectionists is their respective starting points for deliberations about the common good. As we have already noted, new natural law theorists, like Finnis, begin with a set of basic goods, which are deemed self-evident, from which they

²⁵⁶ Alasdair MacIntyre, *Corporate Modernity and Moral Judgment: Are They Mutually Exclusive?*, in *ETHICS AND PROBLEMS OF THE 21ST CENTURY* 122, 124 (K.E. Goodpaster & K.M. Sayre eds., 1979) (rejecting the idea of the corporation as a community, and asserting that the "modern corporation is an agency which by its moralizing splinters morality into dissociated parts"); see also Ron Beadle, *The Misappropriation of MacIntyre*, 2 *REASON IN PRACTICE* 45, 52–53 (2002) (reversing his position in an earlier work and concluding businesses are "neither practices nor communities of purpose").

²⁵⁷ See Kathryn Balstad Brewer, *Management as a Practice: A Response to Alasdair MacIntyre*, 16 *J. BUS. ETHICS* 825, 829 (1997) (arguing that "management can be construed as a practice under MacIntyre's definition" where "the manager operates within a socially established field"); Geoff Moore, *On the Implications of the Practice Institution Distinction: MacIntyre and the Application of Modern Virtue Ethics to Business*, 12 *BUS. ETHICS Q.* 19, 22–23 (2002) (arguing that a business is a practice); Richard Warren, *The Empty Company: Morality and Job Security*, 25 *PERSONNEL REV.*, Apr. 1996 (arguing corporations are a kind of incubator in which individuals can learn the worth of virtue); Ron Beadle, *Virtue Ethics and Employment or the Case of the Cancelled Holiday 9–11* (Jan. 7, 1998) (unpublished paper, Kingston Bus. Sch.), available at http://northumbria.academia.edu/RonBeadle/Papers/291898/Virtue_Ethics_and_Employment_or_The_Case_of_the_Cancelled_Holiday (arguing that "employment is itself a practice").

²⁵⁸ See Daniel J. Ott, *Process Communitarianism*, 10 *CONSCRESCENCE: AUSTRALASIAN J. PROCESS THOUGHT* 67, 67 (2009), available at conscrescence.org/index.php/ajpt/article/download/75/39 (discussing "[t]he core conviction of [communitarianism]" which advocates the "the renewal and/or creation of human community" to "mitigate the errors of both individualism and collectivism" and "to correct ideologies that have led to destructive practices" (alteration in original)).

²⁵⁹ Communitarianism is generally associated with themes of single constituency, Catholic social thought, and corporate citizenship.

²⁶⁰ In the corporate context, communitarianism generally promotes the idea of corporate social responsibility. It also tends to support unions and other self-organized mediating structures in the workplace. See Kohler, *supra* note 254, at 740 (arguing mediating structures like unions help counter "formal individualism" in which individuals have become increasingly dependent on their employers and the state to regulate the order of the employment relationship); Alia McMullen, *New Streams of Responsibility: A Company's Social Work Should be Aligned with Its Business*, *FIN. POST*, Mar. 23, 2010, at FP8 (discussing some approaches of corporate social responsibility, such as cutting water use and promoting sustainable practices in the office).

can deduce and apply other common goods.²⁶¹ Communitarians, on the other hand, begin by asking, “What is the common good?” They maintain that “society should articulate what is good,” and they see their job as interpreting and refining those immanent values.²⁶² Thus, communitarianism is best understood as the process by which the community deliberates about the common good rather than as a defined set of moral principles to be applied.²⁶³

Under either theoretical construct, however, the whistleblower’s moral responsibility to cooperate in his or her corporate community is more than just a contractual obligation between an employee and an employer. We each have the responsibility, as Finnis puts it, to “do as one would be done by.”²⁶⁴ Corporate whistleblowers incur this responsibility by virtue of the employment relationship. This relationship creates a “special frame of reference or vantage point” that gives each party a “special *locus standi*,” or “right to claim performance.”²⁶⁵ Even if a whistleblower is not working under a written employment contract, certain promises or responsibilities are derived from the employment relationship itself as an instrument of cooperation. According to Finnis, the content of those responsibilities depends on: (1) the employee’s “own voluntary commitment[.]” to being employed; (2) the employee’s “present receipt of benefits” from the employer; and (3) the dependence of others in the workplace on the employee as a result of “actual or potential interdependencies” existing between employees of a corporation.²⁶⁶ The responsibility to adhere to this tacit promise should be respected for the whistleblower’s own good, which is in turn overlapped by the common good.²⁶⁷

All corporations and employees, including corporate whistleblowers, are motivated by the common good of mutual self-interest.²⁶⁸

²⁶¹ See *supra* note 247.

²⁶² Amitai Etzioni, *A Communitarian Approach: A Viewpoint on the Study of the Legal, Ethical and Policy Considerations Raised by DNA Tests and Databases*, 34 J.L. MED. & ETHICS 214, 214 (2006) (“Hence communitarians are interested in communities (and moral dialogues within them), historically transmitted values and mores, and the societal units that transmit and enforce group values . . . which are all parts of communities.”).

²⁶³ See Michele Estrin Gilman, *Poverty and Communitarianism: Toward a Community-Based Welfare System*, 66 U. PITT. L. REV. 721, 733–34 (2005) (explaining communitarians view the community as the primary value in society and contend it is a mistake to strive for universal principles of justice).

²⁶⁴ FINNIS, *NATURAL LAW*, *supra* note 10, at 304.

²⁶⁵ *Id.*

²⁶⁶ *Id.* at 175.

²⁶⁷ See *id.* at 305 (discussing how “[t]he good of an individual party to . . . the promise . . . is part of the common good” because “[t]he common good is the good of individuals, living together and depending upon one another in ways that favour the well-being of each”).

²⁶⁸ See *id.* (“[I]t is a truth of wide application that an individual acts most appropriately for the common good, not by trying to estimate the needs of the common good at large, but by performing his

Fundamentally, a company engages in any business activity, including legal compliance efforts, because it wants to make a profit and its employees participate in or support that activity because they want to earn a living.²⁶⁹ Over the last decade, researchers in the field of organizational behavior management have studied numerous samples of whistleblowers, using sound descriptive and empirical research methods. Their findings provide an emerging picture of whistleblowers that is remarkably consistent with this fundamental idea. For example, research has shown that most whistleblowers are not disgruntled employees; on the contrary, they identify with the company and are committed to its goals.²⁷⁰ Other research confirms that people are motivated to do what they believe benefits others, not just themselves.²⁷¹

This notion of a common interest or common pursuit between a company and its employees is critical to corporate compliance efforts generally.²⁷² With a shared objective, both the employer and the employee will often look for best practices for solving their coordination problems and will recognize the authority of the person designated to select among available solutions.²⁷³ Although the particulars of a corporate compliance program can vary depending on the business of the organization, an integral part of any effective program is a consistent internal process for internally reporting potential violations. The corporate system operates most efficiently where corporate employees act cooperatively—and are perceived as doing so. For example, most companies require as a condition of employment that their employees commit to helping monitor and report potential securities violations internally.²⁷⁴ In one recent survey, 90% of respondents, including 99% of respondents from publicly traded

contractual undertakings, and fulfilling his other responsibilities, to ascertained individuals . . . to those who have particular rights correlative to his duties.”)

²⁶⁹ See *id.* (discussing how “[f]ulfilling one’s particular obligations . . . is necessary if one is to respect and favour [sic] the common good”).

²⁷⁰ Brewer & Selden, *supra* note 25, at 419; see also *id.* at 420 (concluding that “[o]ur review of the literature did not uncover a single study published during the last decade that refutes the findings . . . outlined above”).

²⁷¹ STOUT, *supra* note 12, at 114–18.

²⁷² See, e.g., Comment from Watts, *supra* note 165, at 1 (“AT&T maintains mandatory ethical and Code of Conduct training programs for all employees, offers anonymous hotlines for the reporting of complaints or violations, and repeatedly emphasizes to its employees the need to foster an ethical and compliant business environment at all times.”).

²⁷³ In most companies the internal audit or legal department is responsible for the internal compliance and reporting systems.

²⁷⁴ See, e.g., Comment from Watts, *supra* note 165, at 2 (“AT&T believes that it is critical to any compliance program that an employee who is aware of potential misconduct, but who stands by silently, be barred from any aware or bounty [E]ach [employee] is also responsible for voice any compliance or ethical concerns. Every company must rely on its employees not only to develop and implement new ideas but to do so ethically and in compliance with the company’s code of conduct.”).

companies, reported having employee hotlines in place.²⁷⁵ Those activities must be coordinated, either for the sake of the coordinated interaction itself or for some other shared objective. A legal regime that promotes the views that the moral norm of cooperation is only instrumental, and thereby diminishes both the force of the norm and its internalization, would reduce the efficiency of the corporate compliance system.²⁷⁶

Leading treatises on business ethics have also concluded that using internal before external channels is the only moral choice for a whistleblower, unless he or she reasonably expects that using the internal channel will result in retaliation against him or her.²⁷⁷ For example, Professor Bowie's treatise, *Business Ethics*, warns the whistleblower to use internal channels first, if possible, and to act in accordance with his or her responsibilities for "avoiding and/or exposing moral violations."²⁷⁸ It also includes the now famous dictum that the act of whistleblowing must stem from appropriate moral motives of preventing unnecessary harm to others.²⁷⁹ Yet, the SEC's new bounty program actually incentivizes moral harm to employees by prompting them to act for merely instrumental reasons, at the unnecessary expense of mutual self-interest and cooperation.

Since the passage of the Dodd-Frank Act, several commentators have suggested that one way for corporations to still achieve cooperation, without the SEC mandating internal reporting, is by the corporation creating counterincentives.²⁸⁰ However, the more effective it would be in

²⁷⁵ *Impact of Dodd-Frank Whistleblower Provisions: What Companies Are Doing!*, SOC'Y CORP. COMPLIANCE & ETHICS (Sept. 15, 2011, 11:42 AM), <http://www.corporatecompliance.org/Resources/View/smId/940/ArticleID/329.aspx>.

²⁷⁶ See Eisenberg, *supra* note 153, at 1266, 1291 (arguing that "the social norm of loyalty that the legal rules support and define is critical to the efficient operation of the duty of loyalty" thus "[i]n the loyalty area, social norms increase efficiency").

²⁷⁷ See NORMAN E. BOWIE, *BUSINESS ETHICS* 144 (1982) ("Since the whistle blower does have an obligation of loyalty to his or her employer, he or she should—at least in normal circumstances—use the institutional mechanisms that have been created for the purpose of registering dissent with the policies or actions of the corporation."); R.T. DE GEORGE, *BUSINESS ETHICS* 232–33 (2d. ed. 1986) (arguing that whistle blowing is only morally justifiable if the employee "exhaust[s] the internal procedures and possibilities within the firm" because "whistle blowing does harm to the firm, [and] harm in general is minimized if the firm is informed of the problem and allowed to correct it").

²⁷⁸ BOWIE, *supra* note 277, at 143; see Janet P. Near & Marcia P. Miceli, *Whistle-Blowing: Myth and Reality*, 22 J. MGMT. 507, 509 (1996) ("[O]rganizations being accused of wrongdoing would prefer that whistle-blowers use internal channels to report the wrongdoing rather than external Bowie . . . and other ethicists . . . have implied that this is the only moral action, unless the whistle-blower expects that this channel will result in retaliation against him or her.").

²⁷⁹ See BOWIE, *supra* note 277, at 143 ("The moral aim of whistle blowing is deemed so central that it is made part of the definition, namely, whistle blowing aims at exposing unnecessary harm, violation of human rights, or conduct counter to the defined purpose of the corporation.").

²⁸⁰ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,326 (June 13, 2011); see also *supra* note 213 and accompanying text (discussing how some corporations have already created countermeasures to increase the effectiveness of internal reporting of fraud).

countering a multi-million dollar bounty reward, the more expensive it would need to be. In contrast, using the law itself to facilitate a corporate culture of cooperation by mandating internal reporting is relatively inexpensive.

Despite all of the foregoing reasons to conclude otherwise, the SEC's final rules reflect a much narrower conception of an employee's reciprocal responsibilities to a corporation. The SEC rules address some but not all aspects of the mutual responsibility between a whistleblower and his or her employer. As discussed earlier, the SEC rules attempt to address causal responsibility.²⁸¹ The rules also address what could be called supervisory or assignment responsibility.²⁸² However, the current SEC rules do not address mutual responsibility. As a consequence, the SEC's new bounty program fails to recognize the importance of an employer and employee's shared intention to cooperate via internal compliance and reporting systems.²⁸³

If the only reason for not bypassing internal reporting is the prospect of a slight reduction in the bounty, then whistleblowers can be expected to regularly violate that duty. If the violation is undetected, the whistleblower comes out ahead. If it is detected, the whistleblower is still statistically better off with the slight deduction than he or she would have been if he or she had cooperated internally. While it is possible that the SEC might reduce the bounty to zero, these sanctions are not typical, and thus the prospect of such sanctions, discounted by the likelihood that they will be imposed, will be unlikely to change the picture that much.

This not only undermines the usefulness of internal reporting systems, but it also undermines the common good of "individuals, living together and depending upon one another in ways that favour [sic] the well being of each . . . derived from basic requirements of practicable reasonableness."²⁸⁴ The corporate whistleblower who knows about a potential securities violation has a moral obligation to immediately report it to the company. This responsibility stems "from the sheer fact of ability to co-ordinate action for the common good."²⁸⁵ This ability (or what Finnis elsewhere calls authority) "accrues . . . for the sake of the standing needs of the good of persons in community—from the sheer fact of power, of *opportunity to affect*, for good, the common life,"²⁸⁶ and the internal reporting system

²⁸¹ See *supra* Part III.B. (discussing the eligibility exclusions for a whistleblower award).

²⁸² See *id.* (discussing the eligibility exclusions, as promulgated in the final rules).

²⁸³ Internal compliance programs presuppose that employers and employees have a shared interest to cooperate with each other. Thus, self-interest is not necessarily immoral. I argue it is only non-mutual self-interest that is wrong.

²⁸⁴ FINNIS, NATURAL LAW, *supra* note 10, at 305. Practicable reasonableness is the basic good that structures our pursuit of all the other basic human goods. *Id.* at 100.

²⁸⁵ *Id.* at 252.

²⁸⁶ *Id.* at 275 (emphasis added).

represents just such a missed opportunity to affect. In other words, by failing to respect the authority of his employer, a whistleblower who fails to report internally privileges his private gain over the common life of the corporation's members, and all who depend on them.

The SEC's final rules leave it up to the employee to decide whether to take seriously this responsibility to report internally first. Whether that duty exists, however, cannot turn on the internal attitude of the employee. Individual motivations will vary. In addition, employees are not in the best position to decide whether to utilize an internal reporting system because they will be preoccupied with trying to convince the SEC to bring the enforcement action to worry about "the general needs of the common good which justify authority."²⁸⁷

The bounty program treats the corporate whistleblower like he or she was just some random third party who chooses to blow the whistle on a particular company. The difference between a corporate whistleblower and other whistleblowers, however, is that a corporate whistleblower is an employee of the company, and his or her purpose for being there is to work for the company: to increase its profits, or to earn his or her wages, or both. Therefore, the corporate whistleblower must be willing to change his or her conduct to meet the shared business goals of his or her employer. In contrast, an independent whistleblower's purposes may or may not be coordinated with the company's, but they are not shared. At best, they are what Finnis calls "tangential or coincidental aims."²⁸⁸ If a corporate whistleblower conspires with a third party to harm the corporation, then he or she has undermined the employer-employee relationship, even if only temporarily. Likewise, a corporate whistleblower can work as an informant with the SEC without undermining his or her relationship with their company only if the corporate whistleblower exhausts internal report channels first, where possible.²⁸⁹

Ultimately, a corporate whistleblower who bypasses a company's internal compliance system is acting irresponsibly with regard to his or her corporate community despite the fact that the SEC's final rules declare it to be legal.²⁹⁰ A whistleblower-employee who uses legally recognized authority to "promote [selfish] schemes thoroughly opposed to practical reasonableness cannot then reasonably claim to have discharged his own

²⁸⁷ *Id.* at 249.

²⁸⁸ *Id.* at 152.

²⁸⁹ Under the principle of double effect, any harm that the employee's action causes to the corporate community is not morally culpable as long as the harm was an unintended, secondary consequence of the employee's action.

²⁹⁰ See FINNIS, NATURAL LAW, *supra* note 10, at 246 ("The fact that the say-so of a particular person or body or configuration of persons will in fact be, by and large, complied with and acted upon, has normative consequences of practical reasonableness; it affects the responsibilities of both ruler and ruled by creating certain exclusionary reasons for action.").

responsibilities in reason.”²⁹¹ Bypassing an internal complaint process to maximize the potential for a large bounty denies the corporate community the opportunity to correct wrongful conduct in its midst, and is thus inconsistent with the common good of mutual self-interest.²⁹²

B. *The Communitarian Principle of Subsidiarity*

A second, equally important structural principle for making whistleblowing moral is the notion of subsidiarity. This principle creates a presumption in favor of solving compliance problems at the corporate level, or even sub-corporate level, rather than immediately escalating the problem to the higher level of a federal government agency. Even assuming the basic good of community, and the importance of cooperation, a corporate whistleblower must still sometimes choose between cooperating with the company and cooperating with the SEC. As demonstrated below, the principle of subsidiarity can help whistleblowers mediate between these two conflicting roles in a way that maintains the morality of whistleblowing.

The bounty program, as currently implemented, attempts to reduce the issue of sequencing to a strictly rational economic analysis. By not mandating any particular sequence, the SEC leaves the decision entirely up to the individual whistleblower; the SEC’s only apparent expectation is that the whistleblower will choose the path that best maximizes the amount of any monetary reward.

However, the sequence itself has far-reaching moral implications. Historically, the conflict between a whistleblower’s citizenship duties and his or her corporate citizenship duties has proven to be a significant source of moral tension.²⁹³ According to the SEC, the issue received more focus during the notice of proposed rulemaking for the new bounty program process than the role of internal compliance programs.²⁹⁴ Many of those comments implicitly raise not only prudential, but also normative concerns about permitting whistleblowers to bypass internal reporting channels in direct contravention to the principal of subsidiarity.²⁹⁵

The subsidiarity principle states that “each social and political group should help smaller or more local [forms of human association] accomplish their respective ends without, however, arrogating those tasks to itself.”²⁹⁶ In the corporate compliance context, it means looking first to employees to

²⁹¹ *Id.*

²⁹² *Id.*

²⁹³ Lobel, *supra* note 18, at 438.

²⁹⁴ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300 (June 13, 2011).

²⁹⁵ *Id.* at 34,361.

²⁹⁶ Paolo G. Carozza, *Subsidiarity as a Structural Principle of International Human Rights Law*, 97 AM. J. INT’L L. 38, 38 n.1 (2003).

police themselves, then to companies, and only then to state and federal agencies.²⁹⁷ The idea is that a society is “more just and more functional if the work that can be done by the parts is done by the parts, rather than being taken over by the whole.”²⁹⁸

Like the principle of mutual self-interest, subsidiarity is rooted in a natural law understanding of the common good as a totality of the conditions necessary for a full and flourishing human life.²⁹⁹ Proponents of subsidiarity maintain that the ultimate purpose of the government, the corporation and all other mega structures is to serve human flourishing.³⁰⁰ They further maintain this goal is best achieved by the organization that is closest to the individual because of the reflexive strategy inherent in the modern regulatory approach to corporate compliance known as “enforced self-regulation.”³⁰¹ The goal of enforced self-regulation should be to structure corporations to make them “sensitive to the outside effects of their attempts to maximize internal rationality.”³⁰² Consequently, they tend to favor smaller and more local forms of human associations, like the family, churches, and corporations, which presumably can act more efficaciously in individual lives than the federal government.³⁰³

Historically, the idea of subsidiarity can be traced back to classical Greece and was later embraced by Aquinas.³⁰⁴ It can also be found in the writings of Montesquieu, Locke, Tocqueville³⁰⁵ and others who helped shaped the Founding Fathers’ understanding of federalism here in the United States.³⁰⁶ The Republican G.O.P. has often portrayed its

²⁹⁷ Robert K. Vischer, *Subsidiarity as a Principle of Governance: Beyond Devolution*, 35 IND. L. REV. 103, 104 (2001). In the social context that means always look first to families to help their own, then to churches, neighborhood associations, civic groups, and other community organizations. *Id.*

²⁹⁸ Fred Crosson, *Catholic Social Teaching and American Society*, in PRINCIPLES OF CATHOLIC SOCIAL TEACHING 165, 170–71 (David A. Boileau ed., 1998).

²⁹⁹ Carozza, *supra* note 296, at 43.

³⁰⁰ *Id.*

³⁰¹ IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE 106 (1992) (proposing institutional changes in regulatory structures based on reflexivity); *see also* Carozza, *supra* note 296, at 43 (explaining the liner and organic structure of various human associations and that larger groups are understood to serve the individual).

³⁰² Gunther Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 LAW & SOC’Y REV. 239, 278 (1983).

³⁰³ Several scholars have noted that some corporations, depending on their size and hierarchy, can be just as problematic as governments. *See* Vischer, *supra* note 297, at 129 (stating “the corporation is a money-generating enterprise, not a means for furthering subsidiarity’s objectives”).

³⁰⁴ Carozza, *supra* note 296, at 40–41.

³⁰⁵ *See, e.g.*, ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 513 (J.P. Mayer ed., George Lawrence trans., 1988) (“[A]t the head of any new undertaking, where in France you would find the government or in England some territorial magnate, in the United States you are sure to find an association.”).

³⁰⁶ David P. Currie, *Subsidiarity*, 1 GREEN BAG 2D 359, 363 (1998). *But see* George A. Bermann, *Taking Subsidiarity Seriously*, 94 COLUM. L. REV. 332, 404 (1994) (“[A]lthough federalism conveys a general sense of a vertical distribution, or balance, of power, it is not generally understood as

compassionate conservatism as synonymous with subsidiarity.³⁰⁷ More recently, the term subsidiarity reemerged as one of the central constitutional principles (organizing principles) of the European Union.³⁰⁸

As a political theory, critics have claimed “that subsidiarity is ‘weak, subjective, and open-ended.’”³⁰⁹ The fact that advocates at both ends of the political spectrum have employed the principle seemingly supports that claim. However, subsidiarity is not simply an abstract principle of governance, rather it is a practical framework for solving real problems. In the workplace, subsidiarity has proven particularly useful in imposing both limitations and affirmative duties on employers and employees. For example, Pope Leo XIII, and later Pope Pius XI, used the principle to help forge a middle ground between the extremes of laissez-faire capitalism and Marxist socialism in order to advocate better working conditions and collective bargaining rights for workers in the nineteenth century.³¹⁰

In the context of corporate whistleblowing, subsidiarity is best understood as occupying a middle ground between the traditional command-and-control model, on the one hand, and the pure self-regulation model on the other. Under the traditional command-and-control model, reliance on corporate codes of conduct, internal reporting systems and other forms of self-regulation is a weakness to be overcome by substantially increasing the size and capacity of the SEC. Under a pure self-regulation model, however, recent efforts to bolster public enforcement efforts are further proof that a top-down regulatory approach will not and cannot reduce the level of corporate fraud and corruption. Subsidiarity, on the other hand, makes complete sense of both aspects of enforced self-regulation. Subsidiarity accounts for the discretion afforded to prosecutors and corporations as well as the relationship between internal and external whistleblowing. It does so by recognizing the capacity and responsibility of corporations with respect to compliance issues, and treating regulatory enforcement as properly supplemental or “subsidiary.”

expressing a preference for any particular distribution of that power. . . . [F]ederalism and subsidiarity, though of course closely related, are quite different.”)

³⁰⁷ See Rick Santorum, *A Compassionate Conservative Agenda: Addressing Poverty for the Next Millennium*, 26 J. LEGIS. 93, 94 (2000) (explaining that the “‘compassionate conservative’ approach recognizes that government must work as a ‘silent partner,’ enabling communities, organizations and individuals to be innovative in rescuing those for whom American prosperity is so elusive”); see also MICHAEL NOVAK, *ON CULTIVATING LIBERTY* 97 (Brian C. Anderson ed., 1999) (concluding that the modern administrative state exists because “the principle of subsidiarity is continually violated”).

³⁰⁸ See Charter of Fundamental Rights of the European Union, 2000 O.J. (C 364) 1 (formally recognizing in the preamble subsidiarity as one of the principles governing fundamental rights); Vischer, *supra* note 297, at 121. Although it appeared in debates on EC reform as early as 1975, the use of subsidiarity “‘culminated with the 1992 Treaty of Maastricht, in which ‘the subsidiarity principle was proclaimed a guideline for further European integration.’” *Id.*

³⁰⁹ Vischer, *supra* note 297, at 121.

³¹⁰ Carozza, *supra* note 296, at 41–42.

Subsidiarity creates somewhat of a paradox as applied to whistleblowers. It is able to simultaneously explain the need for internal reporting systems and the dangers of mandatory internal reporting. Subsidiarity suggests both a positive and a negative vision of the role of the whistleblower with respect to government and the corporation.³¹¹ As demonstrated below, this duality mandates that whistleblowers avail themselves of effective internal reporting procedures. Where the corporation fails to establish or follow an internal compliance program, however, the whistleblower is equally justified by subsidiarity in cooperating directly with the regulatory authorities. These two complimentary dimensions are generally referred to as “negative subsidiarity” and “positive subsidiarity.”

1. *Negative Subsidiarity*

Negative subsidiarity generally emphasizes the limits of government intervention in business.³¹² As such, it expresses “a principle of non-interference of the state in the rights of the individual or . . . in the smaller communities, namely where the individual or the small community is capable to fulfill its tasks itself.”³¹³ This limitation is derived, in turn, from the proposition that the government, as one of the largest groupings in a democratic society, does not exist for its own sake. Instead, government exists to provide individuals and smaller communities like corporations with the conditions enabling them to realize their own dignity or worth by freely choosing good ends, and instantiating them by just and proper means. To this end, negative subsidiarity denies the false dichotomy between individualism and collectivism. It requires respect for both individual rights and corporate rights because both are understood to be incorporated into a broader common good. Respect for corporate rights does not become counterproductive or unnecessary, but it is placed in an integral relationship with individual rights to establish an internal compliance culture for the benefit of the whistleblower.

To achieve this integration of corporate and individual rights, negative subsidiarity first recognizes the inherent dignity and value of every whistleblower.³¹⁴ As an individual human being, the whistleblower “is ontologically and morally prior” to the SEC or any other agency of the government.³¹⁵ Therefore, the SEC ought to be understood as serving the

³¹¹ Ken Endo, *The Principle of Subsidiarity: From Johannes Althusius to Jacques Delors*, 44 HOKKAIDO L. REV. 2064, 2054 (1994).

³¹² See J. Verstraeten, *Solidarity and Subsidiarity*, in PRINCIPLES OF CATHOLIC SOCIAL TEACHING, *supra* note 298, at 135.

³¹³ *Id.*

³¹⁴ Endo, *supra* note 311, at 2029.

³¹⁵ Carozza, *supra* note 296, at 42.

whistleblower, not vice versa. Under this approach, the value of the individual whistleblower is not derived from a purely utilitarian concern for regulatory efficiency. A whistleblower is more than just a potential informant; a whistleblower is an employee who seeks to better him or her self through work and other forms of cooperative activity. Work, as part of the basic human good of “excellence in play and work,” enables an individual to flourish as a human being.³¹⁶ If a whistleblower’s human dignity is served through work and not just by the act of whistleblowing itself, then external whistleblowing must be done in such a way that satisfies the conditions necessary to accomplish human dignity and not just the successful prosecution of a corrupt corporation.

Of course, the SEC would likely argue that they uphold the human dignity of whistleblowers by respecting individual autonomy and encouraging but not requiring internal reporting. In reality, however, the bounty program abandons individuals to themselves (or to the arbitrary power of selfish greed and opportunism). Under the bounty program, whistleblowers are not empowered to do the right thing; it makes no moral demands on whistleblowers at all. Instead, it judges their worth solely by the quality of their tips that, in turn, are judged by whether or not the information they provide leads to an increase in the number of successful prosecutions. Ultimately, there is nothing about this mere instrumentality approach that suggests it is reasonably calculated to serve human flourishing. Instead it seems more likely to reduce whistleblowers to being mere agents of the SEC.

At the same time, respect for the dignity and value of whistleblowers cannot be separated from respect for the corporate community, which includes first and foremost respect for the employer-employee relationship. In the case of the bounty program, this means respecting the autonomy and self-sufficiency of the corporation in carrying out its own internal compliance programs. This is not simply because a good corporate compliance program depends for its success on the corporation and its employees working together. Rather, it is because subsidiarity presupposes a substantive purpose and function for all corporations, “a common good” that is not inconsistent with making a profit and “that is ultimately directed toward the dignity of socially oriented human beings.”³¹⁷ Although many have attempted to do so, it is no answer to argue that the modern corporation no longer has the common good as its purpose or end. The dignity and value of whistleblowers, like any individual, “requires relationship with others” in a community and

³¹⁶ MARK C. MURPHY, *NATURAL LAW AND PRACTICAL RATIONALITY* 96 (2001).

³¹⁷ Carozza, *supra* note 296, at 68.

corporations are inevitably members of those communities.³¹⁸ As such, corporations contribute to the conditions necessary for individual dignity and human flourishing whether that is their stated purpose or not.³¹⁹

Moreover, it is through their involvement in the internal compliance process that whistleblowers can take part in applying law and morality to their daily lives. Internal reporting systems contribute to that end in ways which the SEC's bounty program is ill suited; namely, internal reporting simultaneously facilitates an individual's pursuit of work and association.³²⁰ Employees realize their value as human beings in part by cooperating with their employers as members of that corporate community, rather than just cooperating with a government agency.³²¹

If corporations have value in providing individual employees with the conditions to flourish, then negative subsidiarity obligates whistleblowers to act at the lower level of the corporation first, and to work with the SEC to do only what the corporation is unable or unwilling to do with the whistleblower on its own. Since each level of society is responsible for helping the "lower" one freely to accomplish its aims, it would undermine the principle of subsidiarity for a whistleblower to opt to work with the "higher" public authorities if he or she could have effectively worked with some internal corporate group that is closer to the individual. According to Professor Moberly, this harmonizes well with an employee's sense of loyalty to his or her employer.³²²

Therefore, the SEC should amend the rules to mandate internal whistleblowing as a condition of being eligible for a bounty. Clearly, any whistleblower program that seeks to divert every complaint or report to the

³¹⁸ *Id.* at 42–43. Some scholars are reluctant to recognize corporations, especially large corporations, as mediating structures. See, e.g., Timothy L. Fort & James J. Noone, *Banded Contracts, Mediating Institutions, and Corporate Governance: A Naturalist Analysis of Contractual Theories of the Firm*, 62 LAW & CONTEMP. PROBS. 163, 197 (1999) (expressing a belief that corporations currently lack and need to embrace mediating institutions). This is a subject I want to more fully explore in a future article about corporate personhood.

³¹⁹ That said, this social dimension to corporations does arguably obligate shareholders, directors and even employees to consider the common good in the use of corporate resources; however, this obligation is beyond the scope of this Article. See Oliver F. Williams, *Catholic Social Teaching: A Communitarian Democratic Capitalism for the New World Order*, in CATHOLIC SOCIAL THOUGHT AND THE NEW WORLD ORDER 5, 11 (Oliver F. Williams & John W. Houck eds., 1993) (stating this social dimension requires consideration of the common good in which Williams describes throughout the article as including respect for person and the social well-being of the group itself, which requires food, clothes, health, work, education, culture, knowledge, family, etc., as well as peace and order).

³²⁰ Cynthia Estlund argues that the workplace is a crucial site for the boring of personal ties across lines that often divide people through mediating between individual citizens and the broader diverse citizenry. See Estlund, *supra* note 178, at 324 (arguing that changes in employment law and greater self-enforcement is an opportunity to revive employees' voices inside firms and reassert self-monitoring).

³²¹ This is why negative subsidiarity generally favors the free market over centralized government.

³²² Moberly, *Sarbanes-Oxley's Structural Model*, *supra* note 71, at 1142–43.

“higher” level of the government is incompatible with the basic presumptions of subsidiarity. Such regulatory overreaching seriously undermines the corporation as a lower form of voluntary association. To put it in classical subsidiarity terms, mandatory internal whistleblowing (with certain narrow exceptions) is the minimum that is necessary to ensure that whistleblowers operate within the boundaries of subsidiarity and that the SEC does not absorb the whistleblowers or “destroy” whistleblowing as a moral institution.³²³

The SEC’s new bounty program borrowed heavily from the whistleblower provisions of the False Claims Act (“FCA”),³²⁴ and the SEC points to empirical studies of the FCA as evidence that whistleblowers will not be diverted from reporting internally by their new bounty program.³²⁵ One empirical study found that “the overwhelming majority of employees voluntarily utilized internal reporting processes, despite the fact that they were potentially eligible for a large reward under the FCA.”³²⁶ The FCA, however, actually supports the counter argument because, until recently, several courts read the FCA to require “employer notice” of a *qui tam* suit in order to be eligible for an award.³²⁷ Prior to the 2009 amendments to the FCA, the statute did not clearly include within the term “protected activity” any activity conducted prior to filing the *qui tam* suit; therefore, some courts relied on the common law understanding of the fiduciary nature of the employer-employee relationship to infer a duty under the FCA to tell the whistleblower’s employer that he or she planned to file a *qui tam* action.³²⁸ Although Congress amended the FCA in 2009 to broaden the

³²³ Carozza, *supra* note 296, at 44. Equally irreconcilable, however, is a system that would mandate internal reporting at the “lower” corporate level even in the absence of any effective internal compliance program or where the complaint would be otherwise futile. This would inevitably do violence to the dignity of the individual whistleblower. This point is made clear in the discussion of positive subsidiarity.

³²⁴ See Baruch & Barr, *supra* note 104, at 28–29.

³²⁵ Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,359 n.452 (June 13, 2011).

³²⁶ See Comment from Steven Kohn, Nat’l Whistleblowers Ctr. 4 (Dec. 18, 2010), available at <http://www.sec.gov/comments/s7-33-10/s73310-212.pdf>. This study claims that “89.7% of employees who would eventually file a *qui tam* case initially reported their concerns internally, either to supervisors or compliance departments.” *Id.* Another study of *qui tam* cases involving pharmaceutical companies showed “[n]early all (18 of 22) insiders first tried to fix matters internally by talking to their superiors, filing an internal complaint, or both” despite the fact that the ultimate monetary awards from external reporting were large, ranging from \$100,000 to \$42 million, with a median of \$3 million. Kesselheim et al., *supra* note 149, at 1834.

³²⁷ See *Robertson v. Bell Helicopter Textron, Inc.*, 32 F.3d 948, 952 (5th Cir. 1994), *cert denied*, 513 U.S. 1154 (1995); *United States ex rel. McKenzie v. BellSouth Telecomms., Inc.*, 123 F.3d 935, 944 (6th Cir. 1997), *cert denied*, 522 U.S. 1077 (1998) (treating the notice element as giving the employer “reason to believe that the employee was contemplating a *qui tam* action” (quoting *Mikes v. Strauss*, 889 F. Supp. 746, 753 (S.D.N.Y. 1995), *aff’d sub nom.* *United States ex rel. Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001)).

³²⁸ See *Robertson*, 32 F.3d at 951–52.

language in question,³²⁹ and thereby eliminate any remaining statutory ambiguity, this does not disprove the logic of the courts' common sense reasoning for filling in the gaps prior to the amendment with an internal reporting requirement.

Currently, there is legislation pending before the 112th Congress that would impose a similar requirement on the SEC's new bounty program. On July 11, 2011, Congressman Michael Grimm (R-NY) introduced the Whistleblower Improvement Act of 2011, which would, among other things, require internal reporting as a condition for money benefits.³³⁰ The bill exempts a whistleblower from this requirement if internal reporting is not a "viable option" as evidenced by either (1) upper management committing or being involved in the alleged misconduct, or (2) "other evidence of bad faith on the part of the employer."³³¹ In December 2011, the bill passed through the House Subcommittee on Capital Markets and Government Sponsored Enterprises and could be considered at any time by the full House Financial Services Committee.³³² While it faces stiff opposition by whistleblower advocacy groups, the U.S. Chamber of Commerce is partnering with corporations like AT&T and UPS to lend their full support for the bill.³³³

2. Positive Subsidiarity

The second component of subsidiarity answers the question, "What are the 'narrow exceptions,' if any, to the rule against external whistleblowing?" Positive subsidiarity "involves the state intervening . . . to secure the goods of the partial community, but only so long as the partial community is incapable of achieving its ends."³³⁴ It also includes "the help which the individual or the small community may expect from the larger community, but only when it is no longer capable of fulfilling its tasks itself."³³⁵ In other words, subsidiarity does not automatically lead to the

³²⁹ Peter B. Hutt et al., *2009 Amendments to False Claims Act Pose New Challenges to Health Care Industry*, AKIN GUMP STRAUSS HAUER & FELD LLP (June 2, 2009), <http://www.akingump.com/communicationcenter/newsalertdetail.aspx?pub=2163>.

³³⁰ The Whistleblower Improvement Act of 2011, H.R. 2483, 112th Cong. § 3 (2011).

³³¹ *Id.* § 2. The bill is modeled after the United Kingdom's whistleblower law, which requires internal reporting to obtain anti-retaliation protection. Elletta Sangrey Callahan et al., *Whistleblowing: Australian, U.K., and U.S. Approaches to Disclosure in the Public Interest*, 44 VA. J. INT'L L. 879, 890 (2004).

³³² Dana Liebelson, *New Bill to Weaken Protections, Incentives for Whistleblowers Sneak Through Committee*, TRUTHOUT (Feb. 16, 2012 8:04 AM), http://truthout.org/index.php?option=com_k2&view=item&id=6721:new-bill-to-weaken-protections-incentives-for-whistleblowers-sneaks-through-committee.

³³³ Andrew Joseph, *Whistleblower Bill Draws Lobbying*, GOV'T EXEC. (Jan. 10, 2012), <http://www.govexec.com/oversight/2012/01/whistleblower-bill-draws-lobbying/35798/>.

³³⁴ Crosson, *supra* note 298, at 170–71.

³³⁵ Verstraeten, *supra* note 312, at 135.

devolution of functions from the federal government to the corporation, as some have suggested.³³⁶ On the contrary, the positive dimension of subsidiarity implies that the government has both the responsibility and authority to promote human flourishing and the common good; therefore, it has the right and duty to intervene in the economic sphere to foster justice.

For the whistleblower, this means there are legitimate situations in which a whistleblower may cooperate with the SEC to realize subsidiarity's ultimate objectives. Namely, the corporate whistleblower is justified in escalating his or her concerns to the SEC in situations where the corporation cannot, or will not, take appropriate action by themselves. If the corporation has failed to protect the human dignity and value of the whistleblower, for example, then positive subsidiarity supports regulatory intervention. The most obvious examples of this includes a corrupt company that retaliates against an employee for refusing to cooperate with unlawful activity, or that responds to an internal report by covering up the violation. Such conduct, when ratified by the company, inevitably compromises human dignity. A whistleblower certainly has the moral authority or duty in such instances, to escalate the problem to a "higher" level—such as the federal government—"to promote and protect the human dignity."³³⁷

In fact, positive subsidiarity insists not only that the whistleblower may cooperate with prosecutors in such situations, but that the whistleblower has a duty to exercise his or her "inherent right" to concern itself with the common good.³³⁸ This suggests whistleblowers ought to be increasingly treated as "gatekeepers." Although unheard of thirty years ago, the value of gatekeepers is now widely accepted.³³⁹ Still, only a few categories of employees are compelled to blow the whistle on corporate malfeasance under existing law.³⁴⁰ Positive subsidiarity suggests, however, that every

³³⁶ *But see* Marshall J. Breger, *Government Accountability in the Twenty-First Century*, 57 U. PITT. L. REV. 423, 430 (1996) ("The principle of devolution, often called *subsidiarity* in the European Union context, is based on the notion that decisions made closest to those affected are likely to be the best informed and certainly the most democratically based." (footnote omitted)); A. Michael Froomkin, *Of Governments and Governance*, 14 BERKELEY TECH. L.J. 617, 621 n.8 (1999) ("Subsidiarity is the devolution of responsibility to smaller political units in the context of a federal system.").

³³⁷ Vischer, *supra* note 297, at 115; *see also* Damon Linker, *John Paul II, Intellectual*, 103 POL'Y REV. 12, 12 (Oct. 2000), *available at* <http://www.hoover.org/publications/policy-review/article/6912>.

³³⁸ *See* Carozza, *supra* note 296, at 44.

³³⁹ Today the Business Roundtable issues statements on corporate governance supporting the role of gatekeepers. Companies that do not have robust internal reporting systems are subjected to severe criticisms by institutional investors and publicly derided. *See* Letter from Alexander Cutler, CEO of Business Roundtable, to Reps. Scott Garret & Maxine Waters, U.S. Congress (Dec. 23, 2011), *available at* <http://http://businessroundtable.org/news-center/brt-letter-to-chairman-garrett-and-representative-waters-on-whistleblo/> (endorsing the Whistleblower Improvement Act and noting that internal compliance systems remain a defense against unethical behavior).

³⁴⁰ For example, SOX requires principal executive and financial officers to personally certify financial statements, including significant deficiencies and material weaknesses in controls and

employee should be mandated to report potential securities violations.

That said, mandatory whistleblowing would be problematic under the current bounty program because mandatory whistleblowers are not currently eligible for a bounty. One solution would be to permit all categories of employees to be eligible for a bounty. If internal reporting were mandatory for all employees, it would no longer make sense to disqualify one employee but not another. Instead, all employees would be subject to the bounty program's existing exhaustion requirement, or a modified version of it, consistent with the principle of subsidiarity.

Positive subsidiarity also suggests certain definite responsibilities for corporations. First of all, corporations must have good, effective compliance programs. Much of the opposition to mandating internal reporting was based on the fear that internal reporting systems were ineffectual or, worse yet, a sham.³⁴¹ If corporations are not held to their responsibility to the community, this will inevitably foster a corporate culture of lax enforcement and increasing insensitivity to human dignity.³⁴²

H.R. 2483 seeks to accomplish this goal as well. The bill would require an employer to have a policy prohibiting retaliation.³⁴³ In addition, the employer's internal reporting system must allow for anonymous reporting.³⁴⁴ Both of these institutional design conditions on employers would help drive collaborative processes and overcome non-mutual self-interest on the part of either the employer or the employee. Alternatively, Congress could create an affirmative defense, but only for certain types of securities law violations, such as securities fraud or foreign bribery.³⁴⁵ Sen. Christopher Coons (D-DE) has publicly endorsed the idea of amending the FCPA, for example, to create a compliance defense for violations of that Act.³⁴⁶

Finally, positive subsidiarity means corporations should take a more multi-layered approach to corporate compliance, recognizing there are a

procedures. Sarbanes-Oxley Act of 2002 § 302, 116 Stat. 745 (codified at 15 U.S.C. § 7241 (2006)). In addition to establishing a robust oversight role for independent auditors and the board's audit committee, SOX also contains an "up-the-ladder" reporting requirement which encourages corporate counsel to disclose under certain circumstances information related to material violations of securities law to the SEC. Sarbanes-Oxley Act of 2002 § 307, 116 Stat. 784 (codified at 15 U.S.C. § 7245); 17 C.F.R. § 205.3(d)(2) (2011).

³⁴¹ Rapp, *Beyond Protection*, *supra* note 15, at 109.

³⁴² Williams, *supra* note 319, at 18.

³⁴³ The Whistleblower Improvement Act of 2011, H.R. 2483, 112th Cong. § 2(a)(2)(D) (2011).

³⁴⁴ *Id.*

³⁴⁵ At least one firm, however, is advising clients that information regarding foreign bribery is not eligible for whistleblower bounty in the first place. See Larry P. Ellsworth, *No Whistleblower Bounties for FCPA Tips on Private Companies*, JENNER & BLOCK (Sept. 28, 2011), http://jenner.com/system/assets/publications/2962/original/No_Whistleblower_Bounties_for_FCPA_Tips_on_Private_Companies.pdf?1319642124.

³⁴⁶ Mike Koehler, *Big, Bold, and Bizarre: The Foreign Corrupt Practices Act Enters a New Era*, 43 U. TOL. L. REV. 99, 140 (2011).

variety of mediating structures between the whistleblower and the corporation.³⁴⁷ Since no compliance program is perfect, it is essential that companies construct a safety net of overlapping monitoring and reporting systems.³⁴⁸ This is true both at the sub-corporate level, where individual departments, ombudsmen and third-party hotlines play a critical role in compliance, and at the supra corporate level, where industry/trade associations, self-regulating organizations and the cooperation of various stakeholders in the proposed rulemaking process help the SEC to realize universal compliance norms and best practices.

VI. CONCLUSION

A good corporate compliance program depends for its success on the corporation and its employees working together for their mutual benefit. However, the SEC's new bounty program undermines this collaborative or cooperative arrangement by promoting the employee's non-mutual interest in a bounty. In addition, the SEC's "employee knows best" approach undermines the supremacy of internal over external whistleblowing as a problem-solving mechanism. Instead, the SEC should extend the mandatory internal reporting requirement to all corporate whistleblowers rather than just a few select categories of employees. This approach could be developed by the courts through litigation or independently by the SEC through further rulemaking. Alternatively, Congress could pass H.R. 2483, which was referred to the Committee on Financial Services on December 14, 2011, to bring the Dodd-Frank Act more in line with this approach.

This across-the-board approach to mandating internal whistleblowing would have three primary benefits. First, it would address the problem of bad companies that are not compliant with the laws by making the internal reporting requirement contingent on the employer having an effective complaint process in the first instance. Second, it would reduce over-reporting due to the inherent indeterminacy of badly drafted securities laws and regulations, especially anti-corruption and anti-fraud laws. Finally, it would address the growing integrity problem of bad employees

³⁴⁷ Although beyond the scope of this Article, subsidiarity also suggests there are multiple layers of collaboration between the corporation and the government. This subject is more fully explored in the field of New Governance. Scholars in this field such as Professors Cindy L. Estlund and Orly Lobel advocate more dynamic, adaptive policy techniques to structure cooperative interactions between agencies, industries and other stakeholders to increase both the efficiency and legitimacy of regulations in areas such as occupational safety, environmental protection and, of course, securities law. Estlund, *supra* note 178, at 325; Lobel, *supra* note 18, at 434.

³⁴⁸ See Barbara Black, How to Improve Retail Investor Protection After the Dodd-Frank Wall Street Reform and Consumer Protection Act 40 (Aug. 2, 2010) (unpublished manuscript), available at http://works.bepress.com/barbara_black/2/ ("An SEC rule that would impose a monitoring duty on both broker-dealers and investment advisers would be a significant improvement in investor protection and consistent with the modern reality.").

by providing the corporate whistleblower with the added benefit of knowing that he or she did everything reasonably possible internally before escalating the matter to the SEC.

In many ways, whistleblowers are the consciences of the corporations they serve. The failure of the SEC's new whistleblower bounty program to promote the common good of community within corporations risks returning corporate America to the days when employees who ratted on their employers were considered morally repugnant and disloyal due to their insider status. After all, a rich rat is still a rat. Instead, the efforts of "real" whistleblowers, who do what they do because they expect their cooperation to benefit others, ought to be protected, and when they are retaliated against, they ought to be fully restored to their rightful positions, rather than supplanting them with the devious stratagems of bounty hunters. What corporate whistleblowers really need in order to do the right thing is not more radical incentives, but radical justice. Providing a comprehensive whistleblower compensation fund, a topic I hope to explore more fully in my next article, may be the final missing piece to the solution for making corporate whistleblowing moral.