SECURITIES WHISTLEBLOWING UNDER DODD-FRANK: NEGLECTING THE POWER OF "ENTERPRISING PRIVATEERS" IN FAVOR OF THE "SLOW-GOING PUBLIC VESSEL"

by
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This Note analyzes the SEC whistleblower program, as modified by the Dodd-Frank Act of 2010. It reviews the history of whistleblowing-like statutes in the United States and analyzes the successes and failures of prior whistleblowers after dividing them into two mutually exclusive groups: Insiders, those who are employed by the company against whom they report; and Outsiders, non-employees. The Note concludes that the new SEC whistleblower program is deficient in two ways. First, it does not create an affirmative duty for Insiders to internally report when their employer has a functioning compliance department; and second, Outsiders lack an offensive private cause of action granting them standing to sue on behalf of the SEC. The Note recommends changes to the program that resolve these deficiencies and better align the SEC's required functions with its resources. The Note concludes that, as enacted, the SEC whistleblower program encourages the avoidance of internal corporate compliance systems, externalizes corporate compliance to a regulatory body already struggling to provide adequate oversight, weakens the partnership between the regulator and the regulated, and has the potential of reversing the positive progression in corporate cultures developed over the past decade.

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I. INTRODUCTION

In the aftermath of the late-2000s recession and Bernie Madoff's Ponzi scheme, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[1] One part of this voluminous act requires the Securities and Exchange Commission (SEC) to reward whistleblowers with up to 30% of its fines and sanctions for the delivery of original information that assists in exposing securities fraud.[2]

As currently implemented the program fails to achieve its goals. Instead of helping the SEC fulfill its responsibilities, the program encourages the avoidance of internal corporate systems, externalizes corporate compliance to a regulatory body already struggling to provide adequate oversight, weakens the partnership between regulators and corporations, and reverses the positive developments in corporate culture developed over the past decade.

For companies with functioning compliance departments, the SEC's whistleblower program has a negative effect because it allows almost anyone to qualify for a reward[3] and has no requirement that an employee (an "Insider") report suspected violations through internal channels.[4] In

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

[2] *Id.* § 922(b)(1)(B), 124 Stat. at 1842.

[3] While the rules limit qualifying information to exclude any information obtained as the result of a compliance inquiry or other similar process, *see* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34363, 34364 (June 13, 2011) (to be codified at 17 C.F.R. § 240.21F-4(b)(1)(iii)), the exceptions to this limitation grant the whistleblower the right to make a reasonableness decision that could re-qualify the information as compliant, *id.* at 34365 (to be codified at 17 C.F.R. § 240.21F-4(b)(4)(v)). This puts the employee in the position of evaluating whether companies have self-reported or have acted in bad faith. The existence of large monetary incentives will undoubtedly motivate the employee to report to the SEC, effectively putting the SEC in the difficult position of weighing whether self-reporting was necessary.

[4] Although the rules allow an informant to report elsewhere, including to an internal corporate compliance department, it is not required and is likely to be

practice, the effectiveness of corporate compliance departments, which have shouldered a significant portion of compliance obligations over the past decade, will diminish as they spend valuable audit time fending off securities ambushes set by its own employees. In some cases monetary rewards have proven successful at motivating private parties to discover and prosecute fraud, but it is not the only motivator for whistleblowers. Moreover, any reward program should be carefully constructed to ensure that conflicts of interest are not encouraged, particularly for inside whistleblowers. Research shows that within a corporation, monetary incentives for whistleblowers actually result in fewer whistleblowing tips and that a duty to report, coupled with fines for not doing so, is a better motivator.[5]

Furthermore, the new SEC whistleblower program is a congressional solution that does not fix the widespread financial fraud that prompted its creation. In the Bernie Madoff situation, despite repeated attempts, a zealous and unaffiliated whistleblower (an "Outsider") was unable to raise government attention to the largest Ponzi scheme in U.S. history. In that case, a reward was not the solution because the informant was already sufficiently motivated. What was lacking, however, was better processes within the SEC to handle incoming tips, or the existence of another forum through which a whistleblower could act to disrupt the fraud. Dodd-Frank does call for the creation of a Whistleblower office, which is a helpful step, but the primary thrust of the legislation is to encourage inside whistleblowers to come forward. The Whistleblower office will be hard-pressed to effectively manage the now super-motivated whistleblowers when the SEC, as an agency, is already incapable of sufficiently managing the tips, informants, and resulting investigations.

This Note analyzes these two distinct problem areas of the SEC whistleblower program. The first explains how it fails to address the primary problem for whistleblowers who are not employed by the company against whom they report (Outsiders) and concludes that granting a private cause of action to these whistleblowers increases the chance that the next Bernie Madoff can be stopped sooner. The second reveals the negative effect the program has for corporations that have functioning corporate security and accounting compliance departments. Specifically, the Note discusses the effect that bounties, and the rules supporting these bounties, may have on employees or agents (Insiders) of those corporations who are motivated to report suspected securities violations directly to the SEC, bypassing the very corporate compliance tools designed to capture and address such violations.

Part II provides a contextual framework by reviewing the United States' history of informant programs and showing what has and has not worked. Part III discusses the motivations and successes of several outside

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avoided by a whistleblower attempting to maximize the reward. *Id.* at 34365 (to be codified at 17 C.F.R. § 240.21F-4(b)(7)).

[5] *See* discussion *infra* Part III.B.2.

and inside whistleblowers, and Part IV brings these together to identify suggested changes that remedy the Act's shortcomings. Part V is a summary and conclusion.

II. U.S. INFORMANT PROGRAMS

A. *Stealing from the Government—The False Claims Act*

The government's appetite for war supplies increased dramatically during the Civil War, which in turn created opportunities for unscrupulous government suppliers.

> Through haste, carelessness, or criminal collusion, the state and federal officers accepted almost every offer and paid almost any price for the commodities, regardless of character, quality, or quantity . . . . For sugar [the government] often got sand; for coffee, rye; for leather, something no better than brown paper; for sound horses and mules, spavined beasts and dying donkeys . . . .[6]

As a result Congress passed the False Claims Act (FCA), also known as "The Lincoln Law," on March 2, 1863.[7] The FCA's focus is the "world's second oldest profession . . . stealing"[8] and was the primary mechanism through which the government prosecuted civil fraud.[9]

The FCA grants private persons the right to bring a civil action, called a *qui tam* suit,[10] against those who commit fraud on the government, provided they do so in the name of the government.[11] This formalized an exception to the legal rule of standing, whereby a private and unaffiliated citizen (a "relator") is partially assigned a portion of the government's injury[12] and can therefore sue on the government's behalf and receive a portion of the recovery.[13] One senator explained that

[6] CLAIRE M. SYLVIA, THE FALSE CLAIMS ACT: FRAUD AGAINST THE GOVERNMENT § 2:6, at 42–43 (2010) (alteration in original) (quoting 1 FRED ALBERT SHANNON, THE ORGANIZATION AND ADMINISTRATION OF THE UNION ARMY 1861-1865, at 55–56, 58 (1928)).

[7] False Claims Act, ch. 67, 12 Stat. 696, 696 (1863) (current version at 31 U.S.C. §§ 3729–3733 (2006)); United States *ex rel.* Graber v. City of New York, 8 F. Supp. 2d 343, 352 (S.D.N.Y. 1998).

[8] Pamela H. Bucy, *Growing Pains: Using the False Claims Act to Combat Health Care Fraud*, 51 ALA. L. REV. 57, 57 (1999) (quoting 132 CONG. REC. 22,339 (1986) (statement of Rep. Bedell)).

[9] *Id.*

[10] *See* 3 WILLIAM BLACKSTONE, COMMENTARIES *160 ("*qui tam pro domino rege . . . quam pro se ipso in hac parte sequitur*" or "who prosecutes this suit as well for the king . . . as for himself").

[11] 31 U.S.C. § 3730(b) (2006).

[12] *See* Nathan D. Sturycz, Comment, *The King* and *I?: An Examination of the Interest* Qui Tam *Relators Represent and the Implications for Future False Claims Act Litigation*, 28 ST. LOUIS PUB. L. REV. 459, 466–67 (2009) (discussing the history and significant court cases establishing the constitutionality of the doctrine of partially assigning standing).

[13] *See, e.g.*, Marvin v. Trout, 199 U.S. 212, 225 (1905) ("Statutes providing for actions by a common informer, who himself had no interest whatever in the

relator rewards were available even to those in complicity with the accused.[14]

To encourage and reward relators for exposing and prosecuting the fraud on behalf of the government, the original FCA awarded up to 50% of the recovery in *qui tam* suits.[15] This doctrine, however, was not without its detractors who argued that relators added no value to the pursuit of the fraud. In 1855 Judge Deady supported *qui tam* relators, arguing that *qui tam* cases and relator rewards were not against public policy. He wrote:

> The statute is a remedial one. It is intended to protect the treasury against the hungry and unscrupulous host that encompasses it on every side, and should be construed accordingly. It was passed upon the theory, based on experience as old as modern civilization, that one of the least expensive and most effective means of preventing frauds on the treasury is to make the perpetrators of them *liable to actions by private persons* acting, if you please, under the strong stimulus of personal ill will or the hope of gain. Prosecutions conducted by such means compare with the ordinary methods as the *enterprising privateer does to the slow-going public vessel*.[16]

Few relators took advantage of the FCA in the law's first eighty years, which was likely due to the smaller role of the federal government during these years. This changed with the advent of the Second World War. As government spending ballooned and a slew of war profiteering charges were brought by the government, opportunistic relators filed *qui tam* suits against the already accused. The Justice Department argued that these relator suits were simply copied from the government pleadings and offered nothing new to the government's case.[17]

The relators found theoretical support for their suits in Chief Justice Marshall's opinion in *Adams v. Woods*, decided in 1805, almost sixty years before the passage of the original FCA.[18] Marshall observed that "[a]lmost every fine or forfeiture under a penal statute, may be recovered by an action of debt," that is, through a *qui tam* proceeding initiated by a

controversy other than that given by statute, have been in existence for hundreds of years in England, and in this country ever since the foundation of our Government. The right to recover the penalty or forfeiture granted by statute is frequently given to the first common informer who brings the action, although he has no interest in the matter whatever except as such informer.").

[14] SYLVIA, *supra* note 6, § 2:6, at 44 (quoting CONG. GLOBE, 37TH CONG., 3D SESS. 955–56 (1863) (statement of Sen. Howard)) ("The [FCA] offers . . . a reward to the informer who comes into court and betrays his coconspirator . . . . In short, sir, I have based the [qui tam provisions] upon the old-fashioned idea of holding out a temptation and 'setting a rogue to catch a rogue,' which is the safest and most expeditious way I have ever discovered of bringing rogues to justice.").

[15] False Claims Act, ch. 67, § 6, 12 Stat. 696, 698 (1863).

[16] United States v. Griswold, 24 F. 361, 366 (D. Or. 1885) (emphasis added).

[17] SYLVIA, *supra* note 6, § 2:8, at 50 (citing S. REP. NO. 78-291 (1943)).

[18] Adams v. Woods, 6 U.S. (2 Cranch) 336 (1805).

private informer, "as well as by information" from the Government.[19] Lower courts also expressed their opinions that a statute that provides for the award of a penalty automatically authorizes a *qui tam* suit.[20]

The Department of Justice unsuccessfully requested that the Supreme Court construe limitations into the FCA in order to stop these parasitic and non-meritorious relator claims.[21] The Supreme Court indicated that a relator claim is not barred by the fact the complainant may have obtained his information from the indictment, or even if the "petitioner has contributed nothing to the discovery of this crime."[22] In response, Congress passed the 1943 amendments to the FCA which significantly reduced its reach and the chance of reward for the relator.[23] Unsurprisingly, *qui tam* suits diminished.[24]

In the four decades following the 1943 amendments, the size and scope of the U.S. government dramatically increased and with it the potential for fraud and waste. To battle this trend, in 1982, Ronald Reagan created the Private Sector Survey on Cost Control (commonly referred to as the Grace Commission). President Reagan instructed the executive committee of this to commission to "[b]e bold. We want your team to work like tireless bloodhounds. Don't leave any stone unturned in your search to root out inefficiency."[25] The Grace Commission delivered its report to Congress in 1984 and reported that a third of all taxes were lost to federal government waste and inefficiency.[26] Presumably, a significant component of this waste was under-reported and under-prosecuted fraud by government vendors. In 1986, Congress passed another round of FCA amendments.[27] The changes dramatically

[19] *Id.* at 341.

[20] *See, e.g.*, United States v. Laescki, 29 F. 699, 701 (N.D. Ill. 1887) (statute providing that penalty is "recoverable, one-half to the use of the informer" authorizes a suit by an informer); United States v. Payne, 22 F. 426, 427 (D. Kan. 1884) (interpreting statute that precluded penalty to informer when United States "first instituted" the prosecution as providing "[t]he prosecution may be instituted by an informer, and thus become a *qui tam* action."); Sims v. Alderson, 35 Va. (8 Leigh) 479, 479, 486–88 (1836) (statute providing that a penalty may be recovered "by bill, plaint or information . . . one moiety to the use of the informer, and the other to the use of the commonwealth" authorizes a *qui tam* action).

[21] United States *ex rel.* Marcus v. Hess, 317 U.S. 537, 545 (1943).

[22] *Id.*

[23] For example, the 1943 amendments eliminated jurisdiction over *qui tam* suits based on information already in government possession, permitted intervention by the Department of Justice in relator cases, and reduced the maximum recovery to 10%. SYLVIA, *supra* note 6, § 2:8, at 51–52.

[24] *Id.* at 53.

[25] Remarks at a White House Luncheon for the Chairman and Executive Committee of the Private Sector Survey on Cost Control in the Federal Government, 1 PUB. PAPERS 275 (Mar. 10, 1982).

[26] PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, WAR ON WASTE, at vii (1984).

[27] *See* False Claims Amendments Act of 1986, Pub. L. No. 99-562, 100 Stat. 3153 (codified as amended at 31 U.S.C. §§ 3729–3733 (2006)).

improved conditions for future relators by increasing rewards to a maximum of 30% of recovered funds,[28] allowing reimbursement of expenses and attorney's fees,[29] and improving employment protection for Insiders.[30] In addition, the burden of proof standard for all elements of the relator's claim dropped to a preponderance of the evidence,[31] and defendants are potentially exposed to treble damages.[32]

From a process standpoint, the FCA requires a relator to file a copy of the complaint and a written disclosure containing all the material evidence to the government.[33] The government then chooses whether to prosecute, dismiss, or settle the claim(s).[34] If the government does not intervene, the relator is free to pursue the complaint privately provided it is served on the defendant in the name of the government.[35]

Since 1986, total recoveries under the FCA have totaled nearly $24 billion, the majority resulting from *qui tam* actions.[36] While the catalyst for the original FCA was fraud within the defense industry,[37] today it applies to nearly every situation where federal government expenditures are involved.[38] As an indicator of the changing financial landscape of the U.S. government and a broadened application of the FCA, the majority of pending *qui tam* cases in 1998 (61%) involved medical fraud.[39]

Despite concerns about excessive or non-meritorious relator claims, today the FCA deters those who would defraud the government by subjecting them to the threat of repaying significantly more than their ill-gotten gain, coupled with the notion that every citizen can become an enforcer of the law. As a result, the FCA continues to be America's most successful reward program today.

[28] *Id.* § 3, 100 Stat. at 3156–57.

[29] *Id.* § 3, 100 Stat. at 3156.

[30] *Id.* § 4, 100 Stat. at 3157–58.

[31] 10A FEDERAL PROCEDURAL FORMS: GOVERNMENT CONTRACTS § 34:574, at 531 (Lisa Kless et al. eds., lawyer's ed. 2005).

[32] 31 U.S.C. § 3729(a). Even prior to the 1986 Amendments, the Supreme Court held in *United States v. Bornstein*, 423 U.S. 303, 315 (1976), that multiple damages are "necessary to compensate the Government completely for the costs, delays, and inconveniences occasioned by fraudulent claims."

[33] 31 U.S.C. § 3730(b)(2) (2006).

[34] *Id.* § 3730(c)(1)–(2)

[35] *Id.* § 3730(b)(1), (c)(3).

[36] SYLVIA, *supra* note 6, § 2:13, at 64–65.

[37] *Id.* § 2:14, at 65.

[38] *Id.* § 2:13, at 65.

[39] Bucy, *supra* note 8, at 58.

B. *The IRS Informant Program—"The Reward for Rats"*[40]

The False Claims Act by its express language excludes the payment of rewards for Internal Revenue Service claims, leaving the government exposed to taxpayer fraud.[41] Only four years after the False Claims Act was passed in 1863, Congress passed another law allowing the Internal Revenue Service to compensate informants for "detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, or conniving at the same."[42]

In striking similarity to the FCA's failure after the restrictive amendments of World-War II, the IRS whistleblower program was shockingly unsuccessful. Granting the Service broad discretion to determine whether an applicant qualified for a reward—and how much was to be rewarded—significantly undermined the program's success.[43] For example, in the ten-year span between 1989 and 1998, IRS informants made over 95,000 applications for reward with a success rate of less than 7%.[44] During this time, the Service paid just over $29 million to informers out of the approximately $1.5 billion that was recovered by the government—an abysmally low rate of just over 2%.[45] During these same years, recoveries under the FCA totaled over $2.3 billion with a payout to private informants of over $360 million, or 15.7%.[46] Further complicating the situation of the IRS informants, the Service's program was largely discretionary. The regulations supporting § 7623 of the Internal Revenue Code explain that "[t]he amount of a reward will represent what the district or service center director deems to be adequate compensation in the particular case."[47] While the regulations

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[40] This unflattering title was given by Senator Harry Reid (D-Nev.) when he described the IRS informant program in support of his bid to abolish the program. Reid complained that the Service was paying "snitches to act against associates, employers, relatives, and others—whether motivated by greed or revenge—in order to collect taxes." 144 CONG. REC. 8193 (1998). He thought it was "unseemly, distasteful, and just wrong," as well as "a powerful incentive to anyone interested in becoming rich at the expense of a neighbor, former business associates or business associate, former wife, former husband." *Id.*

[41] 31 U.S.C. § 3729(e) (2006).

[42] Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473. A similar provision, currently codified at 26 U.S.C. § 7623 (2006), was enacted in 1954. *See* Internal Revenue Code of 1954, ch. 736, § 7623, 68A Stat. 3, 904.

[43] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., DEP'T OF THE TREASURY, REFERENCE NO. 2006-30-092, THE INFORMANTS' REWARDS PROGRAM NEEDS MORE CENTRALIZED MANAGEMENT OVERSIGHT 2 (2006) [hereinafter REWARDS PROGRAM REPORT].

[44] Dennis J. Ventry, Jr., *Whistleblowers and* Qui Tam *for Tax*, 61 TAX LAW. 357, 364 (2008).

[45] *Id.*

[46] *Id.* (calculated from CIVIL DIV., U.S. DEP'T OF JUSTICE, FRAUD STATISTICS—OVERVIEW (Oct. 1, 1986–Sept. 30, 2006)).

[47] Treas. Reg. § 301.7623-1(c) (as amended in 1998).

and the statute provided certain parameters for the reward,[48] the IRS decisions were not subject to judicial appeal.[49] From 1941 through 1998 (a 58 year span) a total of nineteen cases by whistleblowers challenged their informant reward determination.[50] The Service won 100% of these cases, partially because the review was based on an "abuse of discretion" standard.[51]

In June 2006, the Treasury Inspector General for Tax Administration performed an IRS audit and issued a report titled *The Informants' Rewards Program Needs More Centralized Management Oversight*.[52] The report summarized that the IRS informant program suffered from "decentralized management, poor oversight, lack of standardization with respect to informant tips and Service payments, and inefficient processing of claims, examinations, and rewards."[53] It stated that the program had "paltry bounties, stingy administrators, inadequate protection for whistleblowers, and unreceptive courts."[54]

Congress modified the Service's program in 2006 to enhance the position of IRS whistleblowers by removing some of the more discretionary components of the program.[55] For example, the reward is considered mandatory because the statute reads that a whistleblower "shall . . . receive as an award at least 15 percent but not more than 30 percent of the collected proceeds."[56] The amendment also requires the

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[48] *See* Michelle M. Kwon, *Whistling Dixie About the IRS Whistleblower Program Thanks to the IRC Confidentiality Restrictions*, 29 VA. TAX REV. 447, 452–53 (2010).

[49] *Id.* at 453.

[50] Terri Gutierrez, *IRS Informants Reward Program: Is It Fair?*, 84 TAX NOTES 1203, 1205 (1999).

[51] *See id.* at 1205–07. *See also* Krug v. United States, 41 Fed. Cl. 96, 97–99 (Fed. Cl. 1998), *aff'd*, 168 F.3d 1307 (Fed. Cir. 1999). *Krug* shows just how difficult the plight of the informant really was. The Service had sent to Krug, an informant seeking a reward, a form letter denying any award stating that the amount was too small to warrant an award, that the Service already had the information or that the information was already publically available, and that the information furnished did not cause an investigation. *Id.* at 97. The court decision exposed the IRS position, stating that "[g]overnment counsel ultimately acknowledged that the IRS used the information plaintiff provided to make cases against the taxpayers, that it did not have the information available otherwise, and that it recovered 'millions and millions' of dollars in taxes and penalties as a result of plaintiff's information." *Id.* at 99. Despite this clear evidence in favor of the plaintiffs, the Federal Claims court determined that the Service had not abused its discretion by refusing to pay a reward to Krug. *Id.*

[52] *See* REWARDS PROGRAM REPORT, *supra* note 43.

[53] Ventry, *supra* note 44, at 363.

[54] *Id.* at 364.

[55] *See* Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406(a)(1)(D), 120 Stat. 2922, 2958–59.

[56] 26 U.S.C. § 7623(b)(1) (2006). The changes did not remove the discretionary authority from the IRS entirely. For example, the Service retains the discretion to initiate "administrative or judicial actions," and to determine the percentage of

IRS to create a whistleblower office that reports to the Commissioner to implement the law.[57] In 2007, the director of this office, Mr. Stephen Whitlock, explained that the effect of these amendments

> increased the percentage for awards and removed the policy caps in place under the old statute. The basic idea here is to create a substantial financial incentive for people to come forward with information that will help the Service make cases that we might not be able to make without them.[58]

He indicated that the program was starting to see success: "In some cases, they're talking about tens and hundreds of millions of dollars. That's not what the program was getting very often in the preamendment days."[59]

Recent numbers confirm this success. From 2005 through 2008, the amount of awards paid to informants increased to an average of 9.8% of Service recoveries,[60] a significant improvement from the 2% average reported in earlier years.[61]

C. *The SEC Informant Program*

1. *Background and History*

Congress passed the first securities whistleblower reward program in the Insider Trading and Securities Fraud Enforcement Act of 1988.[62] In the two decades that followed, however, only seven payments were paid to a total of five informants for a meager $159,537.[63] In discussing the failure of this program the SEC Chairman at the time commented that "right now, the main reward for being a whistleblower is the good feeling you get of having done something important, because [the SEC does

reward based on the value of the information and the "extent to which the individual substantially contributed to such action." *Id.*

[57] Tax Relief and Health Care Act of 2006, § 406(b), 120 Stat. at 2959–60.

[58] Jeremiah Coder, *Tax Analysts Exclusive: Conversations: Stephen Whitlock*, 116 TAX NOTES 98, 98 (2007).

[59] *Id.*

[60] *See* WHISTLEBLOWER OFFICE, I.R.S., FY 2009 ANNUAL REPORT TO CONGRESS ON THE USE OF SECTION 7623, at 8 (2010), *available at* http://www.irs.gov/pub/irs-utl/whistleblowerfy09rtc.pdf.

[61] Ventry, *supra* note 44, at 364. In 2009, the Service changed how it calculated the timing of informant payments which resulted in a significant drop in the amount of awards paid such that the percentage of payouts relative to collections returned to 2.8%. *See* WHISTLEBLOWER OFFICE, *supra* note 60, at 8. The IRS determined that the payout on awards should be delayed until two years have passed after the last payment by the taxpayer because until then the case is still "subject to the possibility of appeal." *Id.* at 7. Theoretically this change is strictly one of timing and the total number of claims and their amounts will be paid in future years.

[62] Pub. L. No. 100-704, § 3(a)(2), 102 Stat. 4677, 4677–80 (codified as amended at 15 U.S.C. § 78u-1 (2006)).

[63] OFFICE OF INSPECTOR GEN., U.S. SEC. & EXCH. COMM'N, REPORT NO. 474, ASSESSMENT OF THE SEC'S BOUNTY PROGRAM 5 (2010).

not] have the authority to pay except where the whistleblowing relates to insider trading."[64]

Some commentators have argued that to study the first version of the SEC bounty program was "to reveal the unsuccessful and unappealing features of would-be reward systems."[65] If the IRS's early bounty program was stingy, the SEC's first attempt was excessively so. The SEC's 10% bounty compensation cap fell considerably below the IRS's 15–30% cap.[66] In addition, the program only rewarded those who provided information on insider trading,[67] and the bounty determinations were final because the informant lacked the right to judicial review.[68] The IRS rules had similar language, but it appears that the SEC was more aggressive about the anti-informant use of this policy.[69]

Partially due to the Bernie Madoff scheme and other timely financial challenges,[70] Congress passed Dodd-Frank on July 21, 2010.[71] Section 922 of Dodd-Frank amends the Securities Exchange Act of 1934 to significantly improve the SEC's whistleblower program,[72] including provisions to:

- Increase the possible reward to whistleblowers to between 10% and 30% of collected monetary sanctions[73] that exceed $1,000,000 imposed by actions resulting from "original information" by the whistleblower.[74]

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[64] *Id.* at 2.

[65] Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151, 1170 (2010).

[66] *Compare* 15 U.S.C. § 78u-l(e) (2006) ("[T]here shall be paid from amounts imposed as a penalty under this section and recovered by the Commission or the Attorney General, such sums, not to exceed 10 percent of such amounts . . . to the person or persons who provide information leading to the imposition of such penalty."), *with* 26 U.S.C. § 7623(b)(1) (2006) ("If the Secretary proceeds with any administrative or judicial action . . . based on information brought to the Secretary's attention by an individual, such individual shall . . . receive as an award at least 15 percent but not more than 30 percent of the collected proceeds . . . .").

[67] Insider Trading and Securities Fraud Enforcement Act of 1988, § 3(a)(2), 102 Stat. at 4679.

[68] 15 U.S.C § 78u-1(e).

[69] *See* Feldman & Lobel, *supra* note 65, at 1171 n.134 (detailing some of the differences between the IRS and SEC bounty programs and illustrating reasons that the SEC informant was less confident).

[70] *See* S. REP. NO. 111-176, at 139–40 (2010) (showing that the Dodd-Frank was partially motivated by Madoff).

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

[72] *Id.* § 922, 124 Stat. at 1841–49.

[73] *Id.* § 922(a), 124 Stat. at 1842.

[74] *Id.* § 922(a), 124 Stat. at 1841–42 (defining "original information" to include information "derived from the independent knowledge or analysis of the whistleblower" that is not otherwise known to the Commission).

- Allow the whistleblower to appeal the award determination through the appropriate court of appeals.[75]
- Provide enhanced anti-retaliation whistleblower protection, including a private cause of action against retaliators.[76]
- Create a Whistleblower Office to administer and enforce the provisions of the new SEC whistleblower program.[77]

Dodd-Frank required that the SEC promulgate regulations for the new whistleblower program no later than April 21, 2011 (nine months from enactment).[78] On June 13, 2011, two months behind schedule, the final rules of the SEC whistleblower provisions were promulgated.[79] These rules are deficient in two critical ways: first, there is no duty that Insiders[80] utilize internal compliance procedures; second, they provide no relief or tools to the Outside whistleblower.

2. Insiders Have No Duty to Report Suspected Violations Internally

The rules for the SEC whistleblower reward program have no requirement that inside whistleblowers utilize existing internal compliance and reporting systems. The SEC acknowledged the important role companies play when it indicated during the comment process for the Proposed Rules that "[c]ompliance with the Federal securities laws is promoted when companies have effective programs for identifying, correcting, and self-reporting unlawful conduct by company officers or employees."[81] However, the policy interest in fostering robust corporate compliance programs was outweighed by the concern that not all companies have sufficient procedures and protections for the whistleblower.[82] This logic suggests that our securities laws are a one-size-fits-all set of rules established for the least effective corporate compliance program. The SEC does permit a whistleblower to report through an internal compliance department, but eligibility for a reward hinges on the SEC report occurring within 120 days of any other report.[83]

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[75] *Id.* § 922(a), 124 Stat. at 1844.

[76] *Id.* § 922(a), 124 Stat. at 1845–47 (increases the statute of limitations for whistleblower protection actions to six years and authorizes private causes of action by whistleblowers against wrongful retaliation).

[77] *Id.* § 924(d), 124 Stat. at 1850.

[78] *See id.* § 924(a), 124 Stat. at 1850.

[79] *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34363 (June 13, 2011).

[80] The distinction between an inside ("Insider") and outside ("Outsider") whistleblower is whether the whistleblower is employed by the company against which the report is lodged.

[81] Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 75 Fed. Reg. 70488, 70496 (proposed November 17, 2010) (to be codified at 17 C.F.R. pts. 240 and 249).

[82] *See id.*

[83] Securities Whistleblower Incentives and Protections, 76 Fed. Reg at 34,365 (to be codified at 17 C.F.R. § 240.21F-4(b)(7)).

Providing generous rewards for external reporting without any requirements for internal reporting is likely to cause employees to ignore internal compliance programs. The FCA's history proved that monetary incentives, if reasonably attainable, produce the intended result. This avoidance of internal compliance mechanisms will damage securities regulation as a whole.

3. Dodd-Frank Does Not Provide a Private Cause of Action (like the FCA Qui Tam *Suit)*

Dodd-Frank's anti-retaliation provision bars an employer from discharging, demoting, or harassing a whistleblower in any way because of the whistleblower's disclosures[84] and grants whistleblowers a private right of action to enforce these provisions.[85] Anti-retaliation provisions are designed exclusively as a defensive measure for Insiders. However, these same Insiders are endowed with the right to a significant bounty—up to 30%.[86]

Dodd-Frank does not authorize an offensive cause of action against perpetrators of securities fraud. In contrast, the more successful FCA program does allow a private party to sue on the government's behalf. Corporate law also allows private shareholders to sue a company's board of directors on behalf of the company through a derivative suit.[87] In these cases, the private party is "standing in" on behalf of the injured party (the government or the corporation). However, from a whistleblower's perspective, securities enforcement is left entirely to the government and its regulatory bodies, like the SEC. Inside and outside whistleblowers can only inform and assist, but have no active role in the prosecution of the fraud. And yet the need for private action in the securities markets is arguably greater than in other areas. Securities fraud operates at speeds far in excess of government purchases or corporate actions where private offensive actions are allowed. Securities enforcement is an area where the slow-moving wheels of government cannot possibly keep pace. Acquiring information from private citizens is not enough; encouraging their actions and enlisting their support, through proper incentives, should be a priority.

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[84] Dodd-Frank, Pub. L. No. 111-203, § 922(a), 124 Stat. 1376, 1845 (2010).

[85] *See id.* § 922(a), 124 Stat. at 1846.

[86] When considering the two solutions together, they seem to address opposing problems. Bounties motivate a whistleblower to inform the SEC despite any negative effect, while anti-retaliation addresses the weak and under-represented who want to remain employed and harassment-free with no prospect of such a windfall. Under Dodd-Frank, Insiders are entitled to both rich rewards and freedom from harassment by their employers. It is not difficult to imagine situations where perverse incentives are created for Insiders who both profit from a corporate fraud and are simultaneously protected from its causal effect.

[87] PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS pt. VII, introductory note (1994) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE].

The next Part tells the story of four whistleblowers and their relative successes. Two useful questions to ask are: "Which of these whistleblowers could have been more effective with an offensive cause of action?" and "Would the private right to sue on behalf of the regulatory body advance the cause of justice more quickly than waiting for a regulatory body to act?"

III. THE WHISTLEBLOWER

A. *Review of Four Securities Whistleblowers*

This Part reviews the motives and results of four prominent whistleblowers. Because the SEC's new whistleblower program is in its infant stages, we can only look backward to see what motivated prior corporate whistleblowers and compare their relative successes to ensure that new programs maximize those conditions.

The first two whistleblowers are Harry Markopolos, who repeatedly attempted to notify the SEC about the Bernie Madoff scheme, and Ty Schlobohm, who was instrumental in investigating another more recent Ponzi scheme. They were both Outsiders—unaffiliated with their targets. The second set includes Insiders Sherron Watkins and Cynthia Cooper, the famed whistleblowers of Enron and WorldCom, respectively. In contrast to the first two examples, these women were both high-level employees in the firms against whom they blew the whistle.

1. *Mr. Harry Markopolos—Outsider*

In 1960, Bernie Madoff started Bernard L. Madoff Investment Securities. The firm began trading penny stocks with $5,000 that Madoff had earned working as a lifeguard and sprinkler system installer.[88] Madoff became highly influential in the securities industry and even served as the Chairman of the Board of Directors and on the Board of Governors of the NASDAQ.[89] Madoff's financial returns were wildly successful, and he was closely connected to many of the powerful and influential players throughout the securities industry. In 1999, a competitor firm charged its employee, Harry Markopolos, to study Madoff to learn how to match his consistent and impressive double-digit returns. Markopolos would later testify to Congress that in five minutes he suspected fraud.[90] He analogized that Madoff's success would be "equivalent to a major league

[88] Stephen Foley, *The Madoff Files: Bernie's Billions*, INDEPENDENT, Jan. 29, 2009, http://www.independent.co.uk/news/business/analysis-and-features/the-madoff-files-bernies-billions-1518939.html.

[89] *Id.*

[90] *Assessing the Madoff Ponzi Scheme and Regulatory Failures: Hearing Before the Subcomm. on Capital Mkts., Ins., & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 111th Cong. 12 (2009) [hereinafter *Assessing the Madoff Ponzi Scheme*].

baseball player batting .966,"[91] and that within four hours he had mathematically proven Madoff's fraud.[92]

In 2000, when Madoff's firm managed a relatively small $300 million,[93] Markopolos delivered to the SEC a gift-wrapped whistleblower case. He was ignored. He tried again in 2001, 2005, 2007, and for the last time in 2008.[94] The 2005 tip was the most expansive. He produced a 21-page report that he delivered to the SEC's New York office detailing how Madoff was paying off old investors with money from fresh recruits (a Ponzi scheme).[95] He also delivered information to journalists at the Wall Street Journal and to Eliot Spitzer (former New York Attorney General). In all cases, no actions were pursued and no investigations of any substance materialized.[96]

In late 2008, Madoff finally confessed to his two sons, both of whom worked at a sister firm, that he was running a giant Ponzi scheme.[97] The sons promptly informed the police. Madoff was arrested on December 11, 2008, and subsequently sentenced to a prison term of 150 years, the maximum amount allowed by law, for running what is generally considered to be one of the largest Ponzi schemes in history.[98]

Some estimates put the total amount of investor losses at over $64 billion,[99] but in reality, a sizeable chunk of that amount included falsely reported profits from the scheme. David Sheehan, chief counsel to Irving Picard (the court-appointed trustee for Madoff's business) said that about $36 billion was invested into the scam, of which $18 billion had been returned to investors before the collapse, leaving approximately $18 billion missing.[100]

As a result of his unsuccessful attempts to inform the SEC of the Madoff scheme, Markopolos became an overnight sensation for both media and government inquiries. He testified before the United States Congress's Financial Services Committee in February 2009, where he was direct and harsh in his criticisms against the SEC for having ignored not

[91] *Id.* at app. 111 (written testimony of Harry Markopolos).

[92] *Id.* at 13.

[93] Michael J. de la Merced, *Effort Under Way to Sell Madoff Unit*, N.Y. TIMES, Dec. 25, 2008, at B1.

[94] *Assessing the Madoff Ponzi Scheme*, *supra* note 90, at 5.

[95] *See id.* app. at 116.

[96] *See id.* at 25, 32.

[97] Diana B. Henriques, *New Timing on Madoff's Confession*, N.Y. TIMES, Jan. 10, 2009, at B1. *See also* Foley, *supra* note 88 (suggesting that Madoff's sons grew suspicious and "demanded the truth").

[98] Diana B. Henriques, *Madoff, Apologizing, Is Given 150 Years*, N.Y. TIMES, June 29, 2009, at A1.

[99] *See, e.g.*, *The Madoff Scam: Meet the Liquidator*, CBS NEWS (June 20, 2010), http://www.cbsnews.com/2102-18560_162-5339719.html.

[100] *Id.*

only his own warnings but also those that should have been readily apparent.[101]

In prepared testimony, he indicated that "nothing was done. . . . There was an abject failure by the regulatory agencies we entrust as our watchdog."[102] The bulk of his testimony is an unforgiving and scathing review of the SEC's failures and is coupled with his suggestions of how the situation can be repaired. As for what motivated Markopolos and his support team, he testified to Congress:

> [We] did our best to do our duty as private citizens and industry experts to stop what we knew to be the most complex and sinister fraud in American history. We were probably a lot more foolish than brave to keep up our pursuit in the face of such long odds. What troubles us is that hundreds of highly knowledgeable men and women also knew that [Bernie Madoff] was a fraud and walked away silently, saying nothing and doing nothing. They avoided investing time, energy and money to disclose what they also felt was certain fraud. How can we go forward without assurance that others will not shirk their civic duty? We can ask ourselves would the result have been different if those others had raised their voices and what does that say about self-regulated markets?[103]

Despite his efforts, Markopolos was wholly ineffective as a whistleblower. His notoriety came in a post-Madoff era when he effectively wagged his finger at the SEC, saying "I told you so!" His many reports over the course of almost a decade proved unable to stop the Madoff scheme, which finally imploded under its own weight. This, of course, is not his fault. He was an Outsider to the Madoff scheme, and while he provided intelligible information to the proper regulatory authorities in a timely fashion, the "slow-going public vessel" was simply incapable of adapting and responding with the speed of such an "enterprising privateer."[104] Had Madoff's fraud occurred against the government, rather than private investors, the FCA would have entitled Markopolos to sue Madoff as a relator on behalf of the government. Markopolos would have been entitled to a portion of the proceeds, and it is highly likely that Madoff's scheme would have been stopped in its early years. Unfortunately for the many swindled investors, securities laws allow no such offensive cause of action, leaving it to an overwhelmed and understaffed government regulator to handle all offensive actions.

2. *Mr. Ty Schlobohm—Outsider*

Another Outsider whistleblowing case occurred in 2009 when Ty Schlobohm left his "unremarkable financial career . . . [to] do something

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[101] *See generally Assessing the Madoff Ponzi Scheme*, *supra* note 90.

[102] *Id.* app. at 102.

[103] *Id.* app. at 126.

[104] United States v. Griswold, 24 F. 361, 366 (D. Or. 1885) (describing the effectiveness of *qui tam* suits because the "enterprising privateer" is able to move faster than the "slow-going public vessel").

good."[105] Earlier that year he had learned about an investment strategy being offered by Trevor Cook. Like Markopolos, Schlobohm became suspicious that Cook's operation was a fraud and contacted the FBI. He eventually became an active part of the government's investigation into Cook's business, carrying up to two wires and a hidden camera while attending Cook's sales seminars. His effort grew to be so time-intensive that he voluntarily left his job to focus on the investigation full time. Thanks in large part to Schlobohm's efforts, Cook was eventually arrested and pleaded guilty to mail and tax fraud. When describing what drove him to such extremes, Schlobohm said, "I was doing this, and continued to do it, for moral reasons . . . . I was finally in the position to maybe not make a bunch of people money but maybe to save some people their life savings."[106] Like Markopolos, despite his remarkable efforts, Schlobohm's work preceded Dodd-Frank, and thus he is not eligible for an SEC whistleblower reward. There is a possibility of a reward under the IRS bounty program, and Schlobohm said, "If I were to receive some reward, I think that would be great . . . . But that's not why I did it."[107]

Securities regulators had credible information that Cook was running a Ponzi scheme in December 2008, and yet, as in the Bernie Madoff situation, they did nothing.[108] In the end, it was a private lawsuit that shut down Cook's operation when the injured investors obtained a court order to freeze his assets.[109] The securities regulators did not file their civil suits against Cook until November 2009.[110] The U.S. Attorney's office provided that "[c]ategorically at no time did [the government's criminal investigation] ever interfere with a regulatory agency's ability to move."[111]

From the date that the regulatory agencies had credible information about the illegitimacy of Cook's enterprise through the date of its closure, an additional $35 million flowed into Cook's scheme.[112] While Schlobohm's efforts were instrumental in the arrest and conviction of Cook, they did not stop the illicit flow of money and the perpetuation of the fraud. That success belongs instead to private citizens in a civil suit.

Reflecting on this lack of success, Schlobohm lamented, "If I could have just leaned over and whispered in someone's ear, 'Don't invest in this! Just trust me!,' there would be a family out there now with kids that could go to college."[113] However, as a government informant, Schlobohm's primary goal was not to warn and protect current investors,

[105] Edward Wyatt, *Whistle. Then Worry and Wait.*, N.Y. TIMES, Oct. 10, 2010, at BU1.
[106] *Id.*
[107] *Id.*
[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] *Id.*

but rather to gather incriminating evidence so the fraudster could be punished. It could be argued that successful prosecution eventually protects a greater number of investors over a greater period of time, but this provides little solace to the victims defrauded out of their life savings in the meantime.

3. Enron's Ms. Sherron Watkins—Insider

Enron filed bankruptcy in 2001, as the largest bankruptcy reorganization in American history.[114] Only one year earlier it was America's seventh-largest firm by market capitalization and was "hailed . . . as America's most innovative firm for five years running."[115] The drama surrounding the exposure of its financial misdeeds shocked the financial world, changed corporate management in this country forever and was one of the primary drivers behind the Sarbanes-Oxley Act of 2002 (SOX).[116] Sherron Watkins, an Enron vice president,[117] is heralded as Enron's corporate whistleblower. Today, Watkins, among other things, speaks publically about her experience with Enron. Her biographical summary from one such speaking program reads:

> Sherron Watkins sounded the alarm that marked the beginning of the end for the corporate giant. In one of the most courageous decisions of her life, she tapped into her own value system, helping topple one of the largest corporations in the world.
>
> . . . She gave no thought to the personal repercussions she would face and the incredible impact of her actions.[118]

On August 15, 2001, almost four months prior to Enron's bankruptcy filing, Watkins wrote a letter to Ken Lay, the company's Chairman, outlining the financial transactions that concerned her. Watkins' letter was released by the House of Representatives' Energy and Commerce Committee.[119]

Reviewing Watkins's letter, however, reveals a story in stark contrast to the biography mentioned above. While she had all the information and the ability to blow the whistle, the letter seems more focused on repairing the problems than on exposing the fraudulent corporate

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[114] William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1276 (2002); *see also* Christopher Tkaczyk, *The 10 Largest U.S. Bankruptcies*, CNN MONEY (Nov. 1, 2009), http://money.cnn.com/galleries/2009/fortune/0905/gallery.largest_bankruptcies.fortune/index.html (listing the ten largest Chapter 11 bankruptcy cases in U.S. history).

[115] Bratton, *supra* note 114, at 1276.

[116] *See* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 917 (2003).

[117] *Sherron Watkins*, THE AMERICAN PROGRAM BUREAU, http://www.apbspeakers.com/speaker/sherron-watkins (last visited Nov. 22, 2011).

[118] *Id.*

[119] *See* Letter from Sherron Watkins to Kenneth Lay, Chairman & C.E.O., Enron, *available at* http://energycommerce.house.gov/107/news/layletter.pdf.

conduct. She wrote, "Has Enron become a risky place to work?"[120] She continued, "The spotlight will be on us . . . . I think that the valuation issues can be fixed and reported with other goodwill write-downs to occur in 2002."[121] She continues, "My [eight] years of Enron work history will be worth nothing on my resume."[122] Later in the letter, when attempting to put the accounting treatment in perspective, she indicated, "Technically, we can wait and face the music in 2002–2004."[123]

Watkins's motivation was to save the company out of self-preservation and concern for her future, rather than from an altruistic or moral compulsion to bring the guilty to a well-deserved punishment. This prompted a very "softly pitched" whistleblowing letter. Instead of threats, Watkins's letter is focused on repair and mitigation. Nevertheless, the effect of the letter was almost immediate. Although the resulting investigation by Enron's law firm was equally soft-pitched, it started a process that would prove to be the beginning of the end for Enron. In a comparatively short four months, Enron filed for bankruptcy and the corporate fraud was exposed for what it was. In recognition, Watkins became one of Time Magazine's three Persons of the Year in 2002.[124]

4. WorldCom's Ms. Cynthia Cooper—Insider

On June 25, 2002, WorldCom shocked investors and the government alike when it voluntarily announced that it had fraudulently inflated its profits by $3.8 billion over the previous four years.[125] One month later, it filed for bankruptcy—the largest bankruptcy in U.S. history up to that date.[126] WorldCom's fraud was accomplished primarily by capitalizing certain operating costs that should have been expensed, thus spreading the actual negative effect of the cost over multiple years, and by inflating revenues.[127] Four months earlier, Cynthia Cooper, WorldCom's vice president of internal audit, and her team became concerned about accounting irregularities and began working, often at night and in secret,

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[120] *Id.*

[121] *Id.*

[122] *Id.*

[123] *Id.*

[124] Richard Lacayo & Amanda Ripley, *Persons of The Year*, TIME, Dec. 30, 2002–Jan. 6, 2003, at 30, 30–33. (Watkins shared the Time cover and Persons of the Year award with two additional whistleblowers, Cynthia Cooper of WorldCom and Coleen Rowley of the FBI).

[125] DENNIS R. BERESFORD ET AL., SPECIAL INVESTIGATIVE COMM. OF THE BD. OF DIRS. OF WORLDCOM, INC., REPORT OF INVESTIGATION 2 (2003), *available at* http://www.sec.gov/Archives/edgar/data/723527/000093176303001862/dex991.htm.

[126] *See* Tkaczyk, *supra* note 114. WorldCom's $103.9 billion bankruptcy surpassed Enron's $65.5 billion from only six months earlier by roughly 60%. Both have since been exceeded by Washington Mutual's $327.9 billion and Lehman Brother's $639 billion bankruptcies. *Id.*

[127] *See* BERESFORD ET AL., *supra* note 125, at 9.

to unearth the massive fraud.[128] Only days before the June announcement of fraud, Cooper communicated her concerns to the audit committee member on the company's board of directors.[129] Resignations, terminations, and the public announcement followed within days.[130] Cooper became a sensation. She received a call from a WorldCom representative who said, "The press is calling, and they want to make you a hero."[131] To which she replied, "I'm not a hero. I'm just doing my job," and that "[t]here was nothing to celebrate." She went on to say that "[t]here really is a corporate-governance revolution across the country. Internal-audit departments are going to be taken more seriously."[132]

From the day Cooper's team discovered the improper accounting to the time of its public exposure, less than four months passed. Despite fears and misgivings about the negative effect her revelations would have, Cooper tenaciously strove to uncover wrongdoings in her company. She remarked that "doing the right thing doesn't mean there will be no cost to others, your family, or yourself."[133]

The speed with which Cooper's hunch about corporate fraud led to her revelation to WorldCom's board and their subsequent action is simply staggering. No government that respects its constituents can operate on that timeline without seriously infringing on the rights of its citizens. As painful as the WorldCom fraud has been to U.S. markets and investor confidence, it likely would have been many times worse had Cooper not communicated her findings internally, and had instead reported to the SEC and waited for them to act. The counter-factual "what if" question is: Considering the SEC's lack of attention to the Madoff fraud, if Cooper *had* gone to the SEC, how long would WorldCom's fraud have been allowed to continue? Further, given the reactive nature of the legislature, without the dramatic announcements, back-stories, and resulting bankruptcy, would the Sarbanes–Oxley Act ever have become law? It's a stretch—but not impossible.

B. Motivating Whistleblowers

When comparing these two sets of whistleblowers (Outsiders v. Insiders), striking similarities and differences quickly become obvious. Each incident occurred prior to a relevant whistleblower reward system, so the conduct can be analyzed without external influences, such as the promise of a reward. In the case of the Outsiders, Markopolos and Schlobohm both went to great lengths to see justice served despite the

[128] Susan Pulliam & Deborah Solomon, *Uncooking the Books: How Three Unlikely Sleuths Discovered Fraud at WorldCom*, WALL ST. J., Oct. 30, 2002, at A1.

[129] *Id.*

[130] *Id.*

[131] Amanda Ripley, *The Night Detective*, TIME, Dec. 30, 2002–Jan. 6, 2003, at 45, 49.

[132] *Id.* at 49–50.

[133] CYNTHIA COOPER, EXTRAORDINARY CIRCUMSTANCES: THE JOURNEY OF A CORPORATE WHISTLEBLOWER, at ix (2008).

lack of a promise of financial reward, and their heroism should not be understated. However, for reasons out of their control, their success as whistleblowers was dismal. Neither was instrumental in putting a stop to the fraud.

In contrast, the Insiders (Watkins and Cooper) were financially motivated, but in a negative way. Their jobs and careers were at great risk as a consequence of their decisions, yet they chose to move forward in revealing the fraud. They both reported their findings internally and, in both cases, the fraud ceased and was exposed in rapid succession. If either or both of these women had communicated their concerns to the SEC instead of reporting internally, it is fair to wonder how different the outcomes and timelines might have been. How much longer would the Enron fraud have lasted? How long could WorldCom have survived and continued its ledger-shifting strategy? How much more damage could have been sustained had those whistleblowers—motivated by the alluring promise of a rich reward through a government bounty program—decided to not report internally but rather to file with the SEC and wait for its historically time-intensive response?

Recognizing the differences between "Outsiders" and "Insiders" is critical in the quest to determine the primary motivating factors, and thereby build the most successful whistleblower program. The two groups are distinct in almost every way. They have access to different information and people, experience wildly distinct social and peer pressures and, as can be seen in the examples above, are driven by often contradictory motivations.

Deciding to blow the whistle is a difficult and complex decision with potentially devastating personal consequences. A recent behavioral report by Yuval Feldman and Orly Lobel, titled *The Incentives Matrix*, provides great insights on the comparative effectiveness of rewards, liabilities, duties, and protections for reporting illegality.[134] It indicates that "[a]n important implication of the study is that no one-size-fits-all policy design exists, but rather, policy makers must evaluate the full scope of psychological and situational factors in order to design the most efficient incentive structures."[135]

A key factor leading to whistleblowing is the moral outrage of those who witness the wrongdoing.[136] Another study, however, argues that many are motivated by the idea of "legitimacy," which is a "feeling of obligation to obey the law and to defer to the decisions made by legal authorities. Legitimacy, therefore, reflects an important social value, *distinct from self-interest*, to which social authorities can appeal to gain public deference

[134] *See generally* Feldman & Lobel, *supra* note 65.
[135] *Id.* at 1207.
[136] *See id.* at 1173–74.

and cooperation."[137] Another news article asserts that it was religion or faith, not money or self-interest, that drove the whistleblowers they analyzed.[138] And finally, one author suggests that other non-altruistic factors such as revenge play a significant role.[139]

Is it self-interest, moral outrage, revenge, the desire for legitimacy, improved social standing, religion, vigilantism, or ill-will, as Judge Deady suggested,[140] that emboldens those with knowledge of fraud to step up and cry foul? The short answer is "Yes"—but not all motivators carry equal weight.

1. Motivating the Outsider

Reviewing the two outside whistleblowers in the previous Part, a common thread in how they describe themselves is evident: righteously indignant. Whistleblower laws make this form of vigilantism not only acceptable, but in some circumstances, implicitly encouraged.

Outsiders are not exposed to the kind of co-worker harassment that Insiders face. Thus, the private right of action provided in Dodd-Frank, which focuses on Insiders and grants the whistleblower "who alleges discharge or other discrimination" to bring an action for the relief of reinstatement, back pay, and litigation costs,[141] is wholly irrelevant. But even for Outsiders, the decision to blow the whistle on frauds is nonetheless a significant and potentially painful one. Mr. Schlobohm became unemployed and Mr. Markopolos feared for his own life enough to consider that murdering Madoff was not only a legitimate option but a self-protecting requirement.[142]

Feldman and Lobel's study found the existence of a "holier-than-thou" feeling among whistleblowers.[143] It showed that "[o]verwhelmingly, the respondents in the study perceived their own reporting behavior as being more motivated by intrinsic ethical concerns than the actions of others."[144] In the case of both Markopolos and Schlobohm, the absence of an applicable reward program during their respective whistleblowing attempts certainly confirms that ethical and moral concerns are primary drivers.

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[137] Tom R. Tyler & Jeffrey Fagan, *Legitimacy and Cooperation: Why Do People Help the Police Fight Crime in Their Communities?*, 6 OHIO ST. J. CRIM. L. 231, 235 (2008) (emphasis added).

[138] *See* Eamon Javers, *Religion, Not Money, Often Motivates Corporate Whistleblowers*, CNBC (Feb. 12, 2011), http://www.cnbc.com/id/41494697.

[139] *See* Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899, 1907 (2007).

[140] United States v. Griswold, 24 F. 361, 366 (D. Or. 1885).

[141] Dodd-Frank, Pub. L. No. 111-203, § 922(a), 124 Stat. 1376, 1846 (2010).

[142] *See* HARRY MARKOPOLOS, NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER 145 (2010) ("The government would have forced me into it by failing to do its job, and failing to protect me. In that situation I felt I had no other options. I was going to kill him.").

[143] Feldman & Lobel, *supra* note 65, at 1156.

[144] *Id.*

A successful Outsider reward program needs to accomplish two primary goals. First, it must put into place a mechanism whereby the whistleblower who is already sufficiently motivated can actually succeed and, second, encourage the otherwise non-motivated but "highly knowledgeable" people to come forward.

The goal cannot be simply to compensate those already motivated by morality. It must have a goal of augmenting that group, of giving courage and heart to those who have information but are either too complacent or too scared to use it. Markopolos argued for an expansion of the SEC whistleblower program.[145] He indicated that "the treatment accorded whistleblowers ranges from dismissive to outright unwelcome yet whistleblowers are the best, and cheapest source of . . . [whistleblower] cases."[146]

Monetary rewards are positive for this group. While Markopolos and Schlobohm both acted without it, it is fair to believe that the knowledge of an impending windfall would have only intensified their efforts. And, such a reward is likely to encourage future Outsiders in similar situations who might be otherwise under-motivated to take action. However, a reward alone is insufficient to improve the odds of success for this most-likely-to-fail whistleblowing group.

The new whistleblower office may help the SEC better manage the tips it receives and communicate with reward applicants. However, the program will still be hampered by the intentionally slow-moving wheels inherent in bureaucratic government agencies. There are few other areas in the world that can operate at faster speeds than the securities markets. Quite simply, the government can only hope to be in the position to figure out what happened afterwards, rather than to do something about it in real time. Thus, the SEC whistleblower program should be adapted to create a private offensive right of action. This action would focus on enforcement rather than the anti-retaliation right of action that exists for Insiders and could either be similar to the right enjoyed by relators under the FCA or a novel approach unique to the securities industry.

The Dodd-Frank SEC whistleblowing provisions have already had the effect of creating an industry of outside whistleblowers.[147] These are determined bounty-hunters who take the time to sniff out and hunt down corporate fraud. It is unclear from the legislative history whether this was the intent of the law, but it is certainly the result. While controls and limits should be explored to prevent overzealous outside-fraud bounty-hunters from causing unnecessary damage, these Outsiders should be allowed to succeed at the speed of an enterprising privateer, not limited by the government's ponderous plodding.

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[145] *Assessing the Madoff Ponzi Scheme*, *supra* note 90, app. at 159.

[146] *Id.* app. at 158.

[147] *See* Eamon Javers, CNBC, *Using Greed, and Lots of Cash to Fight Greed*, YAHOO! FINANCE (Feb. 8, 2011), http://finance.yahoo.com/news/Using-Greed-and-Lots-of-Cash-cnbc-738616733.html?x=0&.v=2.

2. *Motivating the Insider*

One scholar commented that

> [t]he unstated rule is that 'dirty linen is not to be washed in public'. Those who violate this rule can expect to incur the wrath of both co-workers and the organisation for which they work. Whistleblowing is often regarded as akin to betrayal, a decision to bring the organisation into disrepute.[148]

And there is a significant motive to suffer in silence out of the fear of termination and harassment.[149] Another scholar commented that whistleblowing was "professional suicide."[150] The WorldCom story reflected this internal social pressure. Notwithstanding the knowledge that the WorldCom house of cards would eventually collapse, some employees told auditors that they wished they had left the accounting issues alone.[151] Evidently blissful ignorance, albeit temporary, is superior to unemployment. Whistleblowers are not normally lauded as social or corporate heroes.[152]

For inside whistleblowers, there are concerns other than the promise of financial reward that influence the decision to turn on their employers. Feldman and Lobel confirmed this, stating that for "laws that are likely to trigger strong internal ethical motivation, offering monetary rewards may be unnecessary or, worse yet, counterproductive."[153] Therefore, reward programs, such as the new SEC program promulgated under Dodd-Frank, could have unintended counterproductive effects by offering rewards in lieu of creating internal affirmative duties to report.

This "crowding-out" effect creates competing incentives for Insiders. For inherently offensive conduct, like securities fraud, regulations should take advantage of the moral dimension by appealing to the employee's sense of duty. For Insiders, financial incentives are both "unnecessary [and] counterproductive" because they offset internal motivations to report.[154] A successful program identifies these crowding-out effects in order to save public dollars and to maximize high quality reporting.[155] Social praise and stigmas can add an unanticipated effect to the informants' actions. Another author indicated that "overly legalistic

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[148] James Gobert & Maurice Punch, *Whistleblowers, the Public Interest, and the Public Interest Disclosure Act 1998*, 63 MOD. L. REV. 25, 27 (2000).

[149] *See* Feldman & Lobel, *supra* note 65, at 1158.

[150] Gobert & Punch, *supra* note 148, at 35.

[151] Pulliam & Solomon, *supra* note 128.

[152] TERANCE D. MIETHE, WHISTLEBLOWING AT WORK: TOUGH CHOICES IN EXPOSING FRAUD, WASTE, AND ABUSE ON THE JOB 12 (1999) (claiming that a whistleblower is normally considered a "lowlife who betrays a sacred trust largely for personal gain"); *but see* Lacayo & Ripley, *supra* note 124 (Time magazine article portraying whistleblowers as heroes).

[153] Feldman & Lobel, *supra* note 65, at 1155.

[154] *Id.* at 1207.

[155] *Id.*

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regulation can be ineffective because its very legalism dissipates voluntary responsibility."[156]

The best way to motivate Insiders is to impose affirmative duties on the employees, supported by fines for non-compliance. Doing so enhances the social position of whistleblowers and reduces the negative stigma associated with rewards and legal protections.[157] However, Dodd-Frank ignores the reality that rewards may actually be counterproductive. Inside whistleblowers today are eligible to earn a bounty on SEC fines assessed against their employers. At this point the best that can be done is to maximize the positive effect of the new program and implement the law in such a way as to preserve the other, more powerful motivations and minimize the negative effects of a reward-based system for Insiders.

For example, improving the social position of inside whistleblowers from tattle-tales and malcontents to responsible corporate citizens—or maybe even heroes—should be a primary objective. Another objective should be to promote the concept of corporate fraud as an "inherently offensive" type of misconduct in order to maximize the moral dimension of the situation. Both require a stronger outreach and education program by the SEC. Finally, imposing an affirmative duty for Insiders to report through internal compliance departments supported either through fines or by removing eligibility for rewards is critical to preserve the highest levels of motivation for Insiders.

The issue of reporting internally in lieu of externally also reduces the effect of the negative social stigma attached to whistleblowing.[158] Communicating internally to compliance and auditing groups reduces the likelihood that the whistleblower is seen as airing the company's "dirty linen" in public.

To improve the motivation for inside whistleblowers, a successful program should first improve the social stigma and reputation of those who report bad corporate conduct by creating a corporate culture that both expects and rewards such reporting from all its stakeholders. And second, the program should create an affirmative duty to report fraud or

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[156] CHRISTINE PARKER, THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY 9 (2002).

[157] *See* Feldman & Lobel, *supra* note 65, at 1200.

[158] If the social stigma of whistleblowers is not improved, then a "lose–lose" situation is created. A whistleblower reports externally and applies for a reward that her co-workers view as an unfair and treacherously derived windfall at their expense—a betrayal of corporate and inside loyalty. In addition, despite the monetary windfall, the turncoat receives anti-retaliation protections not extended to her co-workers. Some could argue that anti-retaliation laws coupled with a 30% bounty are conflicting solutions designed to address concerns at opposing ends of the problem. Rewards motivate a whistleblower to report despite the potential negative effects, while anti-retaliation concerns itself with the weak and under-represented who want to remain employed. With the very minimum SEC whistleblowing reward at $150,000 and the possibility of quickly crossing into the millions or even tens of millions of dollars, anti-retaliation seems less relevant.

compliance questions internally before an Insider becomes eligible for an external reward.

IV. SUGGESTED CHANGES TO THE SEC WHISTLEBLOWER PROGRAM

A. *Create an Affirmative Duty to Report Internally for Insiders*

The ideal corporate culture is one where the business recognizes its place as a citizen in the community; has a strong internal mechanism to find, improve, and correct issues; and has the intrinsic ability to accomplish these goals. Supporting this means a general acceptance that corporate compliance and audit departments are "mission-critical" to the company, and anyone supporting or promoting their agenda, like internal whistleblowers, are displaying the highest form of corporate loyalty and heroism. In contrast, the current implementation of the SEC whistleblowing rules externalizes corporate compliance, has the potential for creating an inefficient system, and damages the recent positive developments in corporate culture.

After the Enron and WorldCom scandals, Congress passed SOX.[159] This act includes a variety of whistleblowing provisions, including two sections intended to motivate and protect whistleblowers for corporations covered by SOX.[160] Section 301 requires that audit committees "shall establish procedures for . . . the confidential, anonymous submission by employees . . . regarding questionable accounting or auditing matters."[161] Section 806 provides anti-retaliation protection for anyone who reports certain information to members of Congress, a federal regulatory agency (like the SEC) or to someone within the organization who "has the authority to investigate, discover, or terminate misconduct."[162]

It is clear that Congress, through SOX, intended internal whistleblowing to be a significant mechanism to uncover and deter corporate fraud. Further, it is clear that SOX was intended to improve corporate responsibility and transparency from within the corporation.[163] One author indicated that, "[i]n this regard, SOX follows common

[159] Sarbanes-Oxley Act of 2002 (SOX), Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 and 29 U.S.C).

[160] Those with securities registered under Section 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78*l* (2006), or one that is required to file reports under Section 15(d) of that Act, 15 U.S.C. § 78*o*(d) (2006). SOX § 302(a), 116 Stat. at 777 (codified at 15 U.S.C. § 7241 (2006)).

[161] SOX § 301, 116 Stat. at 776 (codified at 15 U.S.C. § 78j-1(m)(4) (2006)).

[162] SOX § 806(a), 116 Stat. at 802–04 (codified as amended at 18 U.S.C. § 1514A (2006)).

[163] Title I through Title VIII and Title X of SOX are directed at improving corporate transparency and operations such as the requirement of an accounting oversight board, the independence of corporate auditors, improved transparency of financial disclosures and more. Titles IX and XI add penalties for any resulting fraud.

whistleblower practice since internal reporting is the most common type of initial whistleblowing."[164] He continued:

> Benefits of internal whistleblowing include facilitating the prompt investigation and correction of wrongful conduct and minimizing the organizational costs of whistleblowing by permitting employers to rectify misconduct confidentially, with little disruption to the employer-employee relationship. Internal whistleblowing also enables the correction of misunderstanding, which reduces the likelihood that the organization and its employees will unfairly suffer harm.[165]

Another author phrased the issue by introducing the concept that businesses should be good citizens. She indicated that it is

> not reasonable, practical or efficient for external legislatures and regulators to be solely responsible for determining how organizations should manage social issues. The design and enforcement of regulation to govern every potential social dilemma facing business is simply not achievable. And even if it were, it would not make businesses better citizens, since citizenship implies *an internal capacity to respond with integrity* to external values.[166]

Moreover, even if it was desirable, no regulatory body can be expected to manage or review all corporate conduct. The SEC has neither the manpower nor the capacity to perform real-time reviews or audits to ensure compliance in every situation. In an oral presentation at the Northwest Securities Institute, Marc Fagel, a Regional Director for the SEC, commented that among hundreds of thousands of tips and claims of fraud that the SEC receives each year, it is only able to bring an average of between 600 to 800 enforcement cases per year.[167] He reported that in 2010 only 18% of the SEC enforcement caseload was for public companies, down from a high of 50%.[168] He credited this drop to improved internal auditing and compliance departments and much more vigorous corporate board and internal management systems—all of which were created or enhanced by SOX.[169]

A partnership between the regulator and the regulated entity must exist in order to ensure the most efficient operation of the securities markets and the corporations that operate in them. While SOX has not

[164] Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 MICH. L. REV. 1757, 1760 (2007).

[165] *Id.*

[166] PARKER, *supra* note 156, at 29 (emphasis added).

[167] Marc J. Fagel, Reg'l Dir., S.F. Reg'l Office, U.S. Sec. and Exch. Comm'n, SEC and Judicial Enforcement Update at the Northwest Securities Institute (Feb. 4, 2011) (notes on file with author).

[168] *Id.*

[169] *Id.*

been without its detractors,[170] its effect has been to greatly expand and improve corporate self-regulation and transparency.

Large monetary incentives without any internal reporting duty have the potential of destroying this corporation–regulator partnership while creating the possibility of reducing actual whistleblower tips.[171] Allowing inside whistleblowers to report directly to the SEC, and incentivizing them to do so, intentionally circumvents the internal protections designed by SOX and shifts the oversight responsibility away from corporations to the SEC. The message to employees with knowledge of bad corporate conduct is to avoid internal reporting in favor of anonymous external reporting. Despite any rules that might be implemented requiring a potential whistleblower to report internally, the natural motivation is to comply with those rules at an absolute minimum in an effort to minimize any negative potential effect on an eventual whistleblower reward. Without creating affirmative duties to report internally, enforced by the possibility of fines and penalties for lack of compliance, the significant improvement in corporate compliance and audit departments is at risk.

Common law and many decades of corporate law support SOX's idea that employees should have a duty to report internally. The Restatement of Agency indicates that employees, as agents of their employers, have a duty to provide their employer with any information that the employer would "wish to have."[172] Corporate shareholders are similarly situated. When they identify corporate misconduct, they have a private right of action against the corporation in the form of a derivative lawsuit.[173] However, many states require that, prior to instituting a derivative action, the affected shareholders must first exhaust internal remedies by making a demand on the board of directors to "take suitable corrective measures."[174] Further, a court should dismiss a derivative action if it was commenced prior to either the aggrieved shareholders' demand or the response of the board to that demand.[175] This follows the commonsense approach that all parties are best situated when a person with knowledge or a belief of misconduct first communicates internally before rushing to the courthouse. The court system or an external governance body is generally not as efficient as an internal resolution.

The easiest way to implement a duty to report internally is by amending Rule 21F-8(c) of the SEC's whistleblower program in a single location. The rule should be amended to create a condition precedent to reward eligibility based upon a timely internal report. Rule 21F-8(c) might be amended to add an eighth reason for ineligibility that reads

170 *See* Cunningham, *supra* note 116, at 917–18.

171 *See supra* Part III.B.2.

172 RESTATEMENT (THIRD) OF AGENCY § 8.11 (2006).

173 *See generally* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 87, § 7.03(a).

174 *Id.*

175 *Id.* at § 7.03(d).

that a whistleblower is not eligible for a reward if: "(8) You are or were, at the time you acquired the original information, an employee of the entity on which the original information is based and did not timely report that information through your employer's compliance reporting procedure, unless you can prove that your employer's compliance reporting procedure was inadequate or insufficient to protect you from retaliation or it would result in a furtherance of the fraud."

Amending this one eligibility rule reduces the need to amend other rules elsewhere. The supporting notes to the rule would also need to explain a few key points: first, that a corporation's compliance, or lack thereof, with SOX's section 301, which requires that covered companies establish anonymous internal reporting procedures, creates a rebuttable presumption on the adequacy of the company's compliance reporting procedures; and second, that use of the word "timely" is intended to reduce the likelihood that an employee could become aware of a situation but would delay reporting until the size and scope of the problem increased in an effort to maximize his potential reward. Finally, the exception that allows an employee not to internally report when he believes that doing so will result "in a furtherance of the fraud" requires an employee to make a showing that he had a reasonable belief that an internal report would likely have resulted in the destruction of documents or the disappearance of funds or people of interest in a subsequent investigation.

Additional rules or regulations governing corporations could be created to facilitate operational workings between the SEC's whistleblower office and corporations that have received internal reports of improper conduct. For example, corporations should have a time period, 90 days for example, within which to conduct an internal investigation, and if necessary self-report to the SEC's whistleblower office. This puts the whistleblower office in the position of passively reviewing incoming whistleblower tips for a certain time period while corporations, who are in the best position to address and resolve these issues most quickly, are on notice to respond promptly.

Imposing duties and fines on employees to report internally enhances the social position of whistleblowers and results in the highest level of reporting. The lack of fines for not internally reporting is partially overcome by making the whistleblower ineligible for a reward if the whistleblower skips internal compliance procedures.

B. Create an FCA-like Private Cause of Action for Whistleblowers

Because private parties are in the best position to most swiftly and efficiently expose current fraud, whistleblowers should be armed with an offensive right of action against those perpetuating the fraud. Dodd-Frank currently gives whistleblowers a private cause of action focused on anti-retaliation. It is a defensive tool used by whistleblowers after they have reported the suspected conduct to preserve their employment rights and work environment.

The False Claims Act allows private citizens to sue on the government's behalf for fraud. The success of the FCA is equally attributable to the promise of reward and the right of private action by the whistleblower. An FCA relator sues privately, standing in for the government, which puts the control of the litigation in the relator's hands, rather than waiting on the slow wheels of government. This is a significant reason that the FCA has been far more successful than other government-sponsored bounty programs. And the government's ability to intercede in the relator's suit reigns in the relator's potentially overzealous enthusiasm. Both outside and inside whistleblowers could be afforded a similar right, although Insiders should be required to take internal reporting steps and should be more highly scrutinized to ensure they are not effectively perpetuating a new fraud through the inappropriate use of their information.

The SEC's bounty program, however, operates in a manner similar to the IRS's informant program. The IRS whistleblowers must report a tax fraud directly and only to the IRS, and then wait for that agency to take action. Success or failure is entirely dependent upon the actions and the timing of the government, which too often results in the loss of speed offered by private parties.

Allowing securities whistleblowers to directly sue their targets puts the SEC in the position of a regulator in a self-regulated industry rather than a proactive enforcement body like the Department of Justice. In implementing this offensive cause of action, the SEC could require the private parties to provide notice to both the SEC and the target corporation's board of directors consistent with the successful practice employed in corporate derivative suits. Further, the SEC could retain the power to quash, intercede, or otherwise influence the litigation based upon its understanding of the merits. This power, however, should be passive. The advantage of a private cause of action would be lost if the SEC acts as a gate-keeper to the litigation rather than as a passive monitor with a certain time period within which it must exercise its power or allow the private action to proceed independently.

Providing an offensive cause of action to whistleblowers, especially to Outsiders, is more effective and efficient at exposing fraud than relying on a government entity. This in turn puts future fraudsters on notice that they are likely to be stopped and caught much sooner than under the current system.

V. CONCLUSION

The Dodd-Frank improvements to the SEC whistleblower program, as implemented by the SEC, are likely to generate increased whistleblowing reports. However, in terms of the higher goals of identifying and quickly stopping fraud and deterring future malfeasance, its chance of success is questionable. Outsiders, who prompted the changes in the whistleblowing program in the first place, have been largely ignored. Other than the existence of a small whistleblower office, they have been given no additional tools to combat their targets. In contrast, the situation for inside whistleblowers has dramatically changed. Insiders are now incentivized to avoid the very internal compliance departments that prior legislation enhanced, and which are responsible for the improvement in corporate governance over the past decade. Regulation in the fast-paced securities market depends on a government-corporate partnership that takes advantage of the strengths of each party.

Most of the recommendations below can be made at the SEC level and do not require congressional amendments.

(1) *Whistleblower Reward Eligibility*. Amend the rules supporting the program to include a requirement of internal reporting unless a sufficient corporate compliance program does not exist or the informant can make a showing that an internal report would result in a furtherance of the fraud.

(2) *Private Offensive Cause of Action*. Grant a private offensive cause of action to a whistleblower similar to how an FCA *qui tam* suit works.

(3) *Whistleblower Office*. Modify the SEC Whistleblower Office's current objectives to include:

(a) Manage and evaluate incoming whistleblower reports and compare them to corporate responses to those reports. Act proactively only when corporate response to a report is insufficient, the tip relates to a firm without a satisfactory internal compliance program, or the tip provides information sufficiently egregious to suggest a fraud that necessitates immediate action.

(b) Determine when further investigation or discussion about whistleblower reports is warranted.

(c) Evaluate and determine the SEC response to the private legal actions of whistleblower relators.

(d) Develop a marketing program that sufficiently improves whistleblower social status both internal to the SEC and external to all stakeholders within the securities markets.

It is clear as one reviews the history of whistleblowing laws and their varied success that offering financial rewards has a direct correlation with the motivations of whistleblowers. But the desire to profit is not always the driving motive, and if implemented improperly, monetary rewards can have a negative effect on whistleblowers. Creating affirmative duties for Insiders to report to corporate compliance departments improves the social position of whistleblowers, puts corporate compliance departments in control of their obligations, and builds a strong partnership between the regulator and the regulated. Additionally, granting a private cause of action similar to the one granted to relators in FCA *qui tam* suits is the most efficient and speedy way to expose current and deter future fraud, which should be the foremost goals of a whistleblower program.