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Whistling Rogues: A Comparative Analysis of the Dodd–Frank Whistleblower Bounty Program

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* Candidate for J.D., Washington and Lee University School of Law, May 2012; B.A., University of Florida, May 2009. I would like to give immeasurable thanks to my wife, Katie Barthle, for her enduring love and support not only throughout this writing process, but also throughout all of law school. I would also like to thank my good friend Aaron Wells and my dog Ollie for keeping me company and keeping me sane during the myriad late nights that went into this project. Special thanks also to Professor Doug Rendleman for providing the idea for this Note and for serving as my advisor.

> I have based [the False Claims Act] 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.[1]

I. Introduction

In describing the concept upon which the forerunner to the False Claims Act[2] was based, Senator Howard, perhaps unknowingly, pointed out one of the intrinsic issues of all whistleblower bounty programs: the innate conflict of using a "rogue" to catch a rogue. There is a necessary threshold assumption that these programs use informants they perhaps should not trust to catch cheats they do not trust. And therein lies the conflict. Whistleblowers provide an invaluable service, ferreting out fraud where the government simply does not have the access or ability to do so.[3] However, in utilizing such "rogues" to accomplish this laudable goal, one must also realize the inherent need to check the possibly roguish nature of whistleblowers that are incentivized by bounties.

"Imagine getting 10% for blowing the whistle on Madoff's $50 billion scam. 'It's a simple thing that will stop a lot of fraud fast.'"[4] Under the new Dodd–Frank[5] whistleblower bounty program, that is exactly what Harry Markopolos, the whistleblower in the Bernie

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1. CONG. GLOBE, 37TH CONG., 3D SESS. 956 (Feb. 14, 1863) (statement of Senator Howard).

2. *See* 31 U.S.C. §§ 3729–3733 (2006) (establishing a private right to bring "a civil action" on behalf of "the person and for the United States Government" against parties who make fraudulent claims for payment by the government).

3. *See* Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes–Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 109 (2007) ("Overcoming an internal conspiracy can only succeed if insiders bring information about ongoing . . . fraud to the attention of regulators . . . .").

4. Robert Chew, *Calling All Whistleblowers! The SEC Wants You*, TIME, Feb. 24, 2009, *available at* http://www.time.com/time/business/article/0,8599,1881318,00.html (quoting Laura Goldman, a whistleblower who has alerted the SEC to fraud over thirty times).

5. Dodd–Frank Wall Street Reform and Consumer Protections Act, Pub. Law No. 111-203, 124 Stat. 1376 (2010) (establishing comprehensive financial industry reform).

Madoff scandal,[6] would have been entitled to. In fact, under the new program, 10% would be the minimum he might collect, with a possible reward of up to 30%.[7] With hundreds of millions, or even billions of dollars in awards to whistleblowers at play, the importance of this program is apparent.

This Note's argument rests on the proposition that in any whistleblower bounty program three competing interests must be balanced: (1) those of the employee in reporting wrongdoing, (2) those of the employer in maximizing efficiency, and (3) those of society in encouraging the rule of law and accountability.[8] This Note contends that the Dodd–Frank program unfairly misbalances these interests in a way that gives too little weight to the interests of the employer.

"Whistleblower" is defined as "[a]n employee who reports employer wrongdoing to a governmental or law-enforcement agency."[9] The virtues of whistleblower programs cannot be understated. In 2009, whistleblower lawsuits led to the recovery of nearly $2 billion in frauds against the government.[10] Whistleblowers provide inside information about fraud and corruption that government authorities could otherwise not reach.[11] As such, whistleblowers are an invaluable resource in any effective fraud-detection scheme.

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6. *See id.* ("[W]histleblowers like Harry Markopolos, the private securities fraud investigator who dogged Madoff for years and whistled loudly . . . to others, both inside and outside the agency.").

7. *See infra* Part II (explaining the new Dodd–Frank program).

8. Terry Dworkin & Elletta Callahan, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society*, 29 AM. BUS. L.J. 267, 268 (1991) ("Principled policymaking regarding whistleblowing outlets requires the balancing of competing interests: the employee's interest in reporting wrongdoing without penalty, the organization's interest in maximizing control and efficiency, and society's interest in encouraging lawful behavior and public accountability.").

9. BLACK'S LAW DICTIONARY 1734 (9th ed. 2009).

10. *See* Press Release, Dept. of Justice, Justice Department Recovers $2.4 Billion in False Claims Cases in Fiscal Year 2009; More Than $24 Billion Since 1986 (Nov. 19, 2009), *available at* http://www.justice.gov/opa/pr/2009/November/09-civ-1253.html ("Of the $2.4 billion in settlements and judgments obtained in fiscal year 2009, nearly $2 billion was recovered in lawsuits filed under the False Claims Act's [whistleblower] provisions.").

11. *See* Pamela H. Bucy, *Private Justice*, 76 S. CAL. L. REV. 1, 4–5 (2002) [hereinafter Bucy, *Private Justice*] ("No matter how talented or dedicated our public law enforcement personnel may be nor how many resources our society

However, whistleblowing, and in particular whistleblower bounty provisions, are subject to abuse and criticism.[12] A whistleblower "bounty" provision offers the whistleblower an award for reporting wrongdoing. Often the amount of the award is set as a percentage of the total recovery that results from the information.[13] This gives whistleblowers an enormous economic incentive to report violations.[14] While this incentive can often serve to overcome the myriad of negative effects that result from reporting misconduct (such as retaliation, ostracism, and career stagnation), it can also lead to severe abuse (such as meritless reporting in the hopes of a huge payday).[15] To combat these competing issues, any whistleblower bounty program needs to have certain restrictive policies in place. Essentially, the extreme economic incentive of the bounty must be tempered by certain principles of confinement in order to restrict meritless or otherwise unnecessarily harmful reporting.

To best discover what some of these principles are, this Note analyzes the Dodd–Frank program in a comparative light with several other whistleblower bounty programs and predicts how it will affect businesses. Part II is an overview of the Dodd–Frank program. It provides an internal view of exactly what the Dodd–Frank program is and how it will operate.

Part III delves into various other bounty programs. Part III.A looks at the Internal Revenue Service's (IRS) bounty program. Dodd–Frank was modeled after the IRS program.[16] The experience with that program, therefore, enlightens what the expectations

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commits to regulatory efforts, a public regulatory system will always lack the one resource that is indispensable to effective detection and deterrence of complex economic wrongdoing: inside information.").

12. *See infra* Part III (describing abuse and criticisms in multiple arenas).

13. *See infra* Part II (stating Dodd–Frank's bounty as 10%–30% of the total recovered amount).

14. *Cf.* Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protection for Reporting Illegality*, 88 TEX. L. REV. 1151, 1202–03 (2010) (describing a survey and experiment on whistleblowers and stating "the level of monetary compensation offered through the regulatory system is decisive" and "high rewards were highly influential at the experimental stage").

15. *See infra* Part III.B (describing abuses seen under the Federal False Claims Act).

16. *See infra* note 60 and accompanying text (reporting that the Dodd–Frank provision is based on the IRS program).

under Dodd–Frank should be. Part III.B examines the Federal False Claims Act. This examination highlights several issues that are certain to arise under Dodd–Frank, including meritless reporting, nurturing unlawful conduct, and high transaction costs. Part III.C explores some state False Claims Acts and discovers some useful provisions applicable to the Dodd–Frank program. Part III.D discusses the Sarbanes–Oxley Act[17] and its whistleblower-related provisions along with other state internal reporting requirements. Although Sarbanes–Oxley does not create a bounty program, the systems it establishes for internal reporting of wrongdoing are not only applicable but are absolutely vital to the proper functioning of the Dodd–Frank program. Finally, Part IV presents some recommendations that should be included in the Dodd–Frank program; these are needed to better ensure that *all* the "rogues" involved are properly policed and not just the rogues being chased.

II. The Dodd–Frank Program

On July 21, 2010, President Obama signed into law the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank).[18] Sections 922–24 of Title IX of Dodd–Frank implement a substantial whistleblower protection and bounty program.[19] This Part details the contours of this new program and draws some comparisons to the former bounty program it replaces.

Section 922 of Dodd–Frank amends the Securities Exchange Act of 1934 (Exchange Act)[20] by adding section 21F.[21] This new whistleblower bounty program only applies to "covered judicial or administrative actions," defined as "any judicial or administrative

17. *See* Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (establishing increased disclosure and accounting requirements for publically held companies).

18. Dodd–Frank Wall Street Reform and Consumer Protections Act, Pub. Law No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd–Frank].

19. Dodd–Frank § 922–24.

20. *See* Securities Exchange Act of 1934, 15. U.S.C. 78a *et seq*. (2006) (establishing the Securities and Exchange Commission and providing for the regulation of secondary trading of securities and the regulation of financial markets and their participants).

21. *See* Dodd–Frank § 922(a).

action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000."[22] The Securities and Exchange Commission (Commission or SEC) defines "action" as "a single captioned judicial or administrative proceeding."[23]

This approach has two specific implications. First, "action" includes "all defendants or respondents, and all claims, that are brought within that proceeding without regard to which specific defendants or respondents, or which specific claims, were included in the action as a result of the information that the whistleblower provided."[24] This means if a whistleblower provided information about insider trading by a single individual, and the investigation leads to an action against multiple defendants, all "the sanctions collected from all the defendants in the action would be added up to determine whether the $1,000,000 threshold has been met."[25]

Second, "action" also means that the "Commission [will] not aggregate sanctions that are imposed in separate judicial or administrative actions for purposes of determining whether the $1,000,000 threshold is satisfied, even if the actions arise out of a single investigation."[26] Therefore, if a whistleblower provided information that lead to two separate judicial or administrative actions, one leading to a $500,000 sanction, and the other leading to an $800,000 sanction, these amounts would not be aggregated, and "no whistleblower award would be authorized because no single action will have obtained sanctions exceeding $1,000,000."[27]

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22. *Id.* § 922(a)(1).

23. Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 75 Fed. Reg. 70488, 70521 (proposed Nov. 17, 2010) (to be codified at 40 C.F.R. pts. 240, 249) [hereinafter SEC, *Proposed Rules*]; 17 C.F.R. § 240.21F–4(d) (2011). At the time of writing, only the Proposed Rules were available. Some limited citations to, and comments regarding, the final rules have been made where necessary and appropriate. In the final rule, the definition of "action" also includes "two or more administrative or judicial proceedings brought by the Commission if these proceedings arise out of the same nucleus of operative facts." 17 C.F.R. § 240.21F–4(d)(1) (2011).

24. SEC, *Proposed Rules*, *supra* note 23, at 70498.

25. *Id.* Although the final rule does not mention this analysis, given its adoption of the "same nucleus of operative facts" test, this analysis should remain correct.

26. *Id.*

27. *Id.* The final rule does give the Commission added discretion in this

Once the $1,000,000 threshold has been met, the whistleblower bounty program is triggered. In such an event, the Commission

> shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to—
>
> (A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and
>
> (B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions.[28]

This portion of the legislation represents what is known as the "bounty" provision.[29] There are several major points of departure here from the old SEC bounty program worth noting. The previous bounty provision under the Exchange Act called for "such sums, not to exceed 10 percent of such amounts, as the Commission deems appropriate."[30] First, this § 78u program left the payment of bounties totally at the discretion of the Commission, whereas the Dodd–Frank program directs that the Commission "shall" pay such awards.[31] Second, the old provision capped all possible bounties at 10%, whereas the Dodd–Frank program imposes a 10% mandatory floor, with a possible reward up to a ceiling of 30%.[32]

Another important difference from the § 78u program is a right of judicial review. Section 78u states, "Any determinations under this subsection, including whether, to whom, or in what

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regard, allowing aggregation where the proceedings arise out of the "same nucleus of operative facts." However, the final rule still states that "[a]n action generally means a single captioned judicial or administrative proceeding." 17 C.F.R. § 240.21F–4(d) (2011).

28. Dodd–Frank § 922(b)(1).

29. *See* U.S. *ex rel.* Taxpayers Against Fraud v. General Elec. Co., 41 F.3d 1032, 1035 (6th Cir. 1994) (discussing bounties in the False Claims Act and stating, "If . . . a sum of money is collected from the defendant as a result of the ensuing action or settlement, the relator is to receive a bounty between 15–25% of the collected sum ('the bounty').").

30. Securities Exchange Act of 1934, 15 U.S.C. § 78u-1(e) (2006).

31. Dodd–Frank § 922(b)(1).

32. *Id.*

amount to make payments, shall be in the sole discretion of the Commission . . . . Any such determination shall be final and not subject to judicial review."[33] Dodd–Frank, however, provides that, "Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States. . . ."[34] Therefore, the only non-appealable determination under Dodd–Frank is a granted award that lies within the 10%–30% range.[35] However, determinations of "whether, [and] to whom," to make an award, or awards outside of the 10%–30% range, are amenable to judicial review under Dodd–Frank.[36]

The next important substantive change from the § 78u program is that the Dodd–Frank provision also applies to sanctions and settlements from "related action[s]."[37] This is defined by the statute as meaning "any judicial or administrative action brought"[38] by "the Attorney General of the United States, an appropriate regulatory authority, a self-regulatory organization, or a State attorney general in connection with any criminal investigation,"[39] which is "based upon the [same] original information provided by [the] whistle-blower"[40] that initially led the Commission to obtain monetary sanctions totaling more than $1,000,000.[41] The § 78u program only

33. 15 U.S.C. § 78u-1(e) (2006).

34. Dodd–Frank § 922(f).

35. Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 76 Fed. Reg. 34300, 34347 (June 13, 2011) [hereinafter SEC, *Final Rules*] ("[W]hen the Commission makes an award between 10 and 30 percent . . . our final order regarding the amount of an award (including the award allocation among multiple whistleblowers) is not appealable.").

36. Dodd–Frank § 922(f) ("Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Commission. Any such determination . . . may be appealed to the appropriate court of appeals of the United States . . . .").

37. *Id.* § 922(a)(5).

38. *Id.*

39. *Id.* § 922(h)(2)(D)(i)(I)–(IV).

40. *Id.* § 922(a)(5).

41. *See* 17 C.F.R. § 240.21F–3(b)(1) (2011) ("A related action is a judicial or administrative action that is . . . based on the same original information that the whistleblower voluntarily provided to the Commission, and that led the Commission to obtain monetary sanctions totaling more than $1,000,000.").

applied to sanctions recovered by "the Commission or the Attorney General."[42]

The next logical question is what are appropriate regulatory authorities or self-regulatory organizations? These have further been defined through the SEC rulemaking process.[43] The SEC has defined an appropriate regulatory authority as "the Commission, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and any other agencies that may be defined as appropriate regulatory agencies under Section 3(a)(34) of the Exchange Act (15 U.S.C. 78c(a)(34))."[44] Self-regulatory organizations include "any national securities exchange, registered securities association, registered clearing agency, the Municipal Securities Rulemaking Board, and any other organizations that may be defined as self-regulatory organizations under Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))."[45]

Clearly, the "related action" provision of the Dodd–Frank program greatly expands the scope of this whistleblower bounty program. Once the initial $1,000,000 covered action hurdle is crossed, a putative whistleblower is eligible to receive 10%–30% of all sanctions recovered from any of the above listed entities.[46] This provision highlights the major expansion that the Dodd–Frank whistleblower program is over its predecessor.

Aside from the elements that expand upon the old § 78u program, other statutory language also requires parsing before the full scope of the new program becomes clear. First of all, Dodd–Frank section 922(b)(1) states that the bounty will only be paid to

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42. 15 U.S.C. § 78u-1(e) (2006).

43. *See generally* SEC, *Final Rules*, *supra* note 35 (defining terms associated with the Dodd–Frank whistleblower program); SEC, *Proposed Rules*, *supra* note 23 (same).

44. 17 C.F.R. § 240.21F–4(f) (2011).

45. *Id.* § 240.21F–4(h).

46. *See id.* § 240.21F–3(b) ("The Commission will also pay an award based on amounts collected in certain related actions . . . A related action is a judicial or administrative action that is . . . based on the same original information . . . that led the Commission to obtain monetary sanctions totaling more than $1,000,000.").

a "whistleblower."[47] But what is a whistleblower? The Commission states:

> 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 the Federal securities laws . . . that has occurred, is ongoing, or is about to occur. A whistleblower must be an individual. A company or another entity is not eligible to be a whistleblower.[48]

Next, section 922(b)(1) states that the whistleblower must have "voluntarily provided original information."[49] The Commission has defined these two terms in a very restrictive way. The Commission will deem a submission to be "voluntary" if the whistleblower "provide[s] the Commission with the information before [the whistleblower] or anyone representing [the whistleblower] (such as an attorney) receives any request, inquiry, or demand . . . about a matter to which the information in [the] submission is relevant."[50] The Commission also states that a submission will not be considered voluntary if the whistleblower is "under a pre-existing legal or contractual duty to report the securities violations that are the subject" of the submission.[51]

"Original Information" is even more restrictively defined. The statute states:

> The term "original information" means information that—
>
> (A) is derived from the independent knowledge or analysis of a whistleblower;
>
> (B) is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and
>
> (C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report,

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47. Dodd–Frank § 922(b)(1).

48. 17 C.F.R. § 240.21F–2(a)(1) (2011).

49. Dodd–Frank § 922(b)(1).

50. SEC, *Proposed Rules*, *supra* note 23, at 70520. The final rule's language on this point remained almost unchanged from the proposed rules. 17 C.F.R. § 240.21F–4(a) (2011).

51. SEC, *Proposed Rules*, *supra* note 23, at 70520. This language also was nearly unchanged. 17 C.F.R. § 240.21F–4(a)(3) (2011).

> hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information.[52]

The Commission goes even further by additionally refining what "independent knowledge or analysis" entails. The Commission will not consider information to be derived from the whistleblower's individual knowledge or analysis:

> (i) If you obtained the information through a communication that was subject to the attorney-client privilege. . . .
>
> (ii) If you obtained the information in connection with the legal representation of a client on whose behalf you or your employer or firm are providing services, and you seek to use the information to make a whistleblower submission for your own benefit. . . .
>
> (iii) In circumstances not covered by paragraphs [](i) or [](ii) of this section, if you obtained the information because you were:
>
>> (A) An officer, director, trustee, or partner of an entity and another person informed you of allegations of misconduct, or you learned the information in connection with the entity's processes for identifying, reporting, and addressing possible violations of law;
>>
>> (B) An employee whose principal duties involve compliance or internal audit responsibilities, or you were employed by or otherwise associated with a firm retained to perform compliance or internal audit functions for an entity;
>>
>> (C) Employed by or otherwise associated with a firm retained to conduct an inquiry or investigation into possible violations of law; or
>>
>> (D) An employee of, or other person associated with, a public accounting firm, if you obtained the information through the performance of an engagement required of an independent public accountant under the Federal securities laws . . . .
>
> (iv) If you obtained the information by a means or in a manner that is determined by a United States court to violate applicable Federal or state criminal law . . . .
>
> (vi) If you obtained the information from a person who is subject to this section . . . .[53]

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52. Dodd–Frank § 922(a)(3).

53. 17 C.F.R. § 240.21F–4(b)(4) (2011). There are some limited exceptions to the exclusions in (iii). *See generally id.* § 240.21F–4(b)(4)(v).

This restrictive definition of "independent knowledge" and by proxy "original information" will likely serve to reduce the number of successful whistleblower bounty claims by limiting the number of eligible participants.[54]

The final requirement of section 922(b)(1) is that the information must have "led to the successful enforcement" of the covered action.[55] The Commission will consider original information to have "led to" a successful enforcement if the whistleblower's submission "was sufficiently specific, credible, and timely to cause the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation, and the Commission brought a successful judicial or administrative action based in whole or in part on conduct that was the subject of your original information."[56]

The Commission will also consider the whistleblower's submission to have passed the "led to" requirement if the whistleblower "gave the Commission original information about conduct that was already under examination or investigation . . . and [the information] significantly contributed to the success of the action."[57] The Commission has implied that it intends to interpret this second prong strictly, so that bounty rewards under it will be rare.[58]

III. Other Whistleblower Bounty Programs

To determine the likely effects of the Dodd–Frank program, it is relevant to look at other whistleblower bounty programs and

54. *See* SEC, *Proposed Rules*, *supra* note 23, at 70516 ("[T]he restrictions in this definition would limit the pool of eligible whistleblowers and thereby reduce the number of potentially useful informants . . . .").

55. Dodd–Frank § 922(b)(1).

56. 17 C.F.R. § 240.21F–4(c)(1) (2011).

57. *Id.* § 240.21F–4(c)(2).

58. *See* SEC, *Final Rules*, *supra* note 35, at 34325 ("In applying this standard, among other things, we will look at factors such as whether the information allowed us to bring: (1) Our successful action in significantly less time or with significantly fewer resources; (2) additional successful claims; or (3) successful claims against additional individuals or entities.").

perform a comparative analysis. From these we can determine likely bounty amounts, determine the likely level of reporting, and identify relevant changes that should be implemented into the Dodd–Frank program. Several similar bounty programs exist both on the federal and state levels.[59] From this analysis we can ascertain important implementation and administrative policies that should be incorporated into the Dodd–Frank program.

A. The IRS Bounty Program

The most appropriate starting point for this comparative analysis is the program upon which the Dodd–Frank program is based, the Internal Revenue Service's bounty program.[60] The IRS program was established pursuant to the Tax Relief and Healthcare Act of 2006.[61] Similar to Dodd–Frank and the old § 78u program for the SEC, the IRS program was established to strengthen a bounty program that had been in place since 1867,[62] but was mostly ineffective.[63] The new program was established by adding subsection (b) to the 140-year-old § 7623 of the Internal Revenue Code.[64] Section 7623(a), similar to the § 78u program,

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59. *See generally* M. Thomas Arnold, *"It's Déjà Vu All Over Again" Using Bounty Hunters to Leverage Gatekeeper Duties*, 45 TULSA L. REV. 419 (2010); Pamela Bucy et al., *States, Statutes, and Fraud: A Study of Emerging State Efforts to Combat White Collar Crime*, 31 CARDOZO L. REV. 1523 (2010) [hereinafter Bucy, *States*].

60. *See* S. REP. NO. 111-176, at 111 (2010) ("The [Dodd–Frank] program is modeled after a successful IRS Whistleblower Program enacted into law in 2006.").

61. *See* Pub. L. No. 109-432, 120 Stat. 2922, 2958 (2006) (codified at 26 U.S.C. § 7623(b)) (establishing an expanded IRS whistleblower bounty program).

62. *See* Act of Mar. 2, 1867, ch. 169, § 7, 14 Stat. 471, 473 (codified at I.R.C. § 7623(a)) (providing the commissioner of the IRS with the power to "pay such sums" as he deems "necessary for detecting and bringing to trial and punishment" those who violate the internal revenue laws).

63. *See* Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 364 (2008) (concluding that the old IRS Informant Reward Program failed due to "paltry bounties, stingy administrators, inadequate protection for whistleblowers, and unreceptive courts").

64. *See* Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, Div. A, Title IV, § 406(d), 120 Stat. 2922 (2006) (amending 26 U.S.C. § 7623 by adding new subsection 7623(b)).

leaves reward amounts to the total discretion of the Commissioner.[65] The § 7623(a) program is still in effect today for those whistleblower claims that do not qualify for subsection (b) treatment.[66]

The Dodd–Frank program is extremely similar to the IRS § 7623(b) program.[67] Section 7623(b)(1) provides that whistleblowers shall receive a 15%–30% bounty of the collected revenues if the Secretary of the IRS proceeds with any administrative or judicial action based on the information brought to the Secretary's attention by the whistleblower.[68] Such information must relate to either the underpayment of taxes or the bringing to justice of those who have violated the tax laws.[69] The § 7623(b) program is limited, however. It applies to both

65. *See* I.R.C. § 7623(a) (2006) ("The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums as he deems necessary for—(1) detecting underpayments of tax . . . ."); *see also* John R. Dorocak, *State Tax Informants: Rewards and Liabilities Implementation in California and Guidance From the New and Old Federal Program—Should They be Paid?*, 38 CUMB. L. REV. 279, 282–84 (2008) (stating that the §7623(b) program takes away IRS discretion "through the 'shall receive' language" but that the §7623(a) arm of the program "leaves the amount of the reward to the discretion" of the IRS).

66. *See* I.R.C. § 7623(b)(5) (2006) ("This subsection shall apply with respect to any action—(A) against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds $200,000 . . . and (B) if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000."); *see also* Dorocak, *supra* note 65, at 282 ("Section 7623(b)(5) indicates that 7623(b) does not apply . . . unless such individual's gross income in any involved year exceeds $200,000 and the amounts in dispute exceed $2 million. . . . Thus, many IRS informants . . . will continue to suffer the problems of the existing IRS reward [§7623(a)] program.").

67. *See* S. REP. NO. 111-176, at 112 (2010) (using the IRS's program as a model, the Senate Banking Committee "determined that enforceability and relatively predictable level of payout will go a long way to motivate potential whistleblowers to come forward").

68. *See* I.R.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, subject to paragraph (2), receive as an award at least 15 percent but not more than 30 percent of the collected proceeds . . . .").

69. *See id.* § 7623(a) ("The Secretary, under regulations prescribed by the Secretary, is authorized to pay such sums as he deems necessary for—(1) detecting underpayments of tax, or (2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same. . . ."); *Id.* § 7623(b)(1) ("If the Secretary proceeds with any administrative or judicial action described in subsection (a) . . . .").

corporations and individuals, but in the case of an action against an individual, such individual's gross income must exceed $200,000 for one of the taxable years in dispute.[70] Also, for the program to trigger in any case, the amount in dispute must exceed $2 million.[71] If these requirements are not met the whistleblower may revert to the § 7623(a) program.[72]

Whistleblowers who file under § 7623(b) also have a right to judicial review by the Tax Court of their claims and awards under this program.[73] The appeal, however, must occur within thirty days of the award determination.[74]

Because the two programs are so similar, the success of the § 7623(b) program is particularly relevant to any inquiry into the likely effect of the Dodd–Frank program. Since the § 7623(b) program's passage in 2006, the IRS has seen a marked increase in reporting: from 2,751 cases received in Fiscal Year (FY) 2007, to 5,678 cases received in FY 2009, an over 100% increase in reporting over just three years.[75] From FY 2007 through FY 2009, $41,822,569 in whistleblower awards were paid,[76] and

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70. *See id.* § 7623(b)(5) ("This subsection shall apply with respect to any action—(A) against any taxpayer, but in the case of any individual, only if such individual's gross income exceeds $200,000 for any taxable year subject to such action . . . .").

71. *See id.* ("This subsection shall apply with respect to any action . . . if the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000.").

72. *See* Michelle M. Kwon, *Whistling Dixie About the IRS Whistleblower Program Thanks to the IRC Confidentiality Restrictions*, 29 VA. TAX REV. 447, 456 (2010) ("The Service whistleblower law as it was before the 2006 amendments continues to exist in section 7623(a). Section 7623(a) applies to claims that do not meet the section 7623(b) thresholds and to information submitted before the new law became effective." (internal citations omitted)).

73. *See* I.R.C. § 7623(b)(4) (2006) ("Any determination regarding an award under paragraph (1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).").

74. *Id.*

75. IRS, FY 2009 ANNUAL REPORT TO CONGRESS ON THE USE OF SECTION 7623 7–8 (2010) [hereinafter IRS, 2009 REPORT], *available at* www.irs.gov/pub/irs-utl/whistleblowerfy09rtc.pdf. This report discusses program activities for the fiscal year 2009, which ended September 30, 2009. *Id.* at 1. It represents the most current information available at the time of this writing.

76. *Id.* at 8.

$543,802,993 of unpaid taxes were collected.[77] The Treasury Inspector General for Tax Administration found that in 2008 whistleblower reports alleged $65 billion in underreported income,[78] up from alleged underreporting of $8 billion in 2007, an increase by a factor of eight.[79] It is also worth noting that from 2003 through 2006, there were zero IRS collections of over $2 million through the whistleblower program.[80] But in 2007, the first full year in which the new § 7623(b) program was in effect, there were twelve collections of over $2 million,[81] and there were a total of thirteen collections over $2 million in 2008 and 2009.[82]

This data reveals that the § 7623(b) program has led to increased reporting. However, no awards have been paid out under it yet due to an IRS policy of waiting until the period for filing an appeal has lapsed before paying any awards.[83] Therefore, the § 7623(b) program has not affected the total percentage dollar amount of the bounties that have been paid to date.[84]

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77. *Id.*

78. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, DEFICIENCIES EXIST IN THE CONTROL AND TIMELY RESOLUTION OF WHISTLEBLOWER CLAIMS 1 (2009), *available at* www.treasury.gov/tigta/auditreports/2009reports/00930114fr.pdf.

79. *Id.* at 6.

80. *See* IRS, FY 2007 ANNUAL REPORT TO CONGRESS ON THE USE OF SECTION 7623 6 (2008), *available at* www.irs.gov/pub/whistleblower/whistleblower_annual_report.pdf (reporting whistleblower data from fiscal year 2003 through 2007).

81. *Id.*

82. IRS, 2009 REPORT, *supra* note 75, at 9.

83. *See id.* at 7 ("[T]he Whistleblower Office determined that in cases where the taxpayer has not filed an appeal, the IRS should not pay the claim until the period for filing an appeal has lapsed. . . . [U]ntil two years have passed after the last payment, the case is still subject to . . . appeal.").

84. *See id.* ("To date, all awards the IRS has paid have been based on information received before December 20, 2006, the date of the enactment of section [7623(b)]. Therefore, all of the awards, including those paid in FY 2009, were governed by . . . what is now section 7623(a)."). The report goes on to state, "Thus, the applicable award percentages were those established in prior IRS policy, not the higher percentages set by the new law." *Id.* The most infamous reporting under the new § 7623(b) program is that of Bradley Birkenfeld, a former employee of UBS, Switzerland's largest bank. *See* Janet Novak & William P. Barrett, *Tax Informants Are On the Loose*, FORBES, Dec. 14, 2009, at 104 (reporting the story of Birkenfeld's whistleblowing). His information about tax evasion techniques led to a $780 million dollar payment by UBS to the U.S. government, but also resulted in forty months of jail time for Birkenfeld. *See*

Despite the possible pitfalls and slow payments, the § 7623(b) program has led to increased reporting and will eventually lead to increased bounty payments. Given the similarity of the § 7623(b) and Dodd–Frank programs, a similar marked increase in reporting and payments should be expected under Dodd–Frank.[85]

B. The Federal False Claims Act[86]

The IRS program, and therefore implicitly the Dodd–Frank program, is in many ways modeled after the False Claims Act (FCA).[87] The FCA is an example of a "*qui tam*" provision, a Latin term short for, "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," which translates to "who as well for the king as for himself sues in this matter."[88] In a *qui tam* action, private citizens (known as "relators"[89]) with personal knowledge of wrongdoing (here, fraud perpetrated against the government) can bring a suit on behalf of the United States, and in return he or she gets to share in a significant "cut of the judgment proceeds should they prevail."[90] *Qui tam* provisions were quite popular in England at

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David S. Hilzenrath, *A Swiss Banker's Saga Offers a Cautionary Tale: For Spilling Secrets to the Government, You Could be Richly Rewarded or Sent to Prison. Or Both.*, WASH. POST, May 16, 2010, at G1 (reporting on Birkenfeld's criminal case and imprisonment).

85. *See* Yin Wilczek, *SEC to Take Advantage of New Powers to File Aiding, Abetting Charges, Official Says*, 8 CORP. ACCOUNTABILITY REP. (BNA) 1224 (Nov. 12, 2010) (quoting David Rosenfeld, associate director of the SEC's New York Regional Office as stating that his office has been "inundated" with tips under the Dodd–Frank program, and that he "expect[s] tons of these whistleblower complaints").

86. *See* 31 U.S.C. §§ 3729–3733 (2006) (establishing a private right to bring "a civil action" on behalf of "the person and for the United States Government" against parties who make fraudulent claims for payment by the government).

87. *See* Kwon, *supra* note 72, at 457 ("The 2006 amendments to the IRS Whistleblower Act in many respects model the 1986 amendments to the federal False Claims Act.").

88. BLACK'S LAW DICTIONARY 1368 (9th ed. 2009).

89. *See, e.g.*, MASS. GEN. LAWS ch. 12, § 5C (2010) ("An individual, hereafter referred to as relator, may bring a civil action in superior court for a violation of said sections . . . on behalf of the relator and the commonwealth or any political subdivision thereof.").

90. U.S. *ex rel.* Lamers v. Green Bay, 998 F. Supp. 971, 977 (E.D. Wis. 1998), *aff'd*, 168 F.3d 1013 (7th Cir. 1999).

the time of our nation's founding, and early American Congresses likewise enacted multiple *qui tam* statutes.[91] Most of these provisions, however, no longer exist.[92]

The FCA was originally passed in 1863 in response to fraud perpetrated on the government during the Civil War.[93] It was commonly referred to as the "Lincoln Law," and it responded to reports that, amongst other frauds, the U.S. government was being sold the same horses multiple times or supplies that were nothing but boxes of sawdust.[94] The essence of a FCA claim is that the defendant has "knowingly" presented or caused to be presented a false or fraudulent claim for payment.[95]

The FCA remained relatively dormant after the Civil War until the 1930s and 1940s when increased government spending on New Deal programs and the build up to World War II "opened up numerous opportunities for unscrupulous government contractors to defraud the government."[96] Unfortunately, the large cash

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91. *See* J. Randy Beck, *The False Claims Act and the English Eradication of Qui Tam Legislation*, 78 N.C. L. REV. 539, 553 (2002) ("Qui tam enforcement has never been as widespread in this country as it once was in England. Early American Congresses continued the English practice by enacting a few qui tam statutes."); *Id.* at 553 n.54 (noting early American *qui tam* statutes relating to the collection of duties, regulation of the slave trade, and the employment of seamen without a contract, amongst others).

92. *See id.* at 554 ("Most of these passed out of existence long ago, and only a smattering of qui tam provisions still linger in the United States Code.").

93. *See* STEPHEN M. KOHN, CONCEPTS AND PROCEDURES IN WHISTLEBLOWER LAW 203 (2001) ("The False Claims Act . . . is the major law utilized to 'feret out fraud against the federal government.' It was enacted during the Civil War at the 'behest' of President Abraham Lincoln to 'control fraud in defense contracts' . . . ." (internal citations omitted)).

94. *See* Todd J. Canni, *Who's Making False Claims, The Qui Tam Plaintiff or the Government Contractor? A Proposal to Amend the FCA to Require that All Qui Tam Plaintiffs Possess Direct Knowledge*, 37 PUB. CONT. L.J. 1, 4 (2007) ("[T]he FCA was commonly referred to as 'the Lincoln Law' because President Abraham Lincoln advocated in favor of its passage. . . [S]ome war profiteers had engaged in . . . shipping boxes of sawdust in place of supplies or by tricking the Government into purchasing the same horses more than once." (internal citations omitted)).

95. 31 U.S.C. § 3729(a)(1)(A) (2006). "Knowingly" is further defined as, "[H]as actual knowledge of the information; (ii) acts in deliberate ignorance of the truth or falsity of the information; or (iii) acts in reckless disregard of the truth or falsity of the information; and (B) require no proof of specific intent to defraud." *Id.* § 3729(b)(1)(A), (B).

96. U.S. *ex rel.* Findley v. FPC-Boran Employees' Club, 105 F.3d 675, 679 (D.C. Cir. 1997).

bounties offered by the FCA also provided great incentive for relators to file "parasitic" suits, actions not based on any personal knowledge of the relator, but rather consisting solely of information already known to the government.[97] The relator simply needed to file the action before the government could.[98]

This abuse led to reform in 1943, when Congress amended the FCA to deprive courts of jurisdiction when the suit was based on evidence or information already "in the possession of the United States, or any agency."[99] The change, however, lead to absurd results; in one case the state of Wisconsin was unable to pursue a doctor who had submitted 912 fraudulent claims for reimbursement from Medicare because, as required by statute, the State had already disclosed the fraud to the federal government before filing the suit.[100] To make matters worse, the Attorney General failed to intervene, "leaving no proper plaintiff to pursue patently fraudulent conduct."[101] Due to this "government knowledge bar," the number of *qui tam* claims brought under the FCA decreased significantly.[102]

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97. *See* Beverly Cohen, *Trouble at the Source: The Debates Over the Public Disclosure Provisions of the False Claims Act's Original Source Rule*, 60 MERCER L. REV. 701, 704 (2009) ("[T]he Act did not require the relators to allege undiscovered frauds in their qui tam complaints; instead, relators were able to commence a qui tam lawsuit based completely on information already uncovered by government investigators. [The Act was] [w]ithout any statutory restrictions on these 'parasitic' lawsuits . . . ." (citations omitted)).

98. *See* KOHN, *supra* note 93, at 205 ("In fact, the language of the law permitted 'piggy-back law suits' in which the relator could merely copy a criminal fraud indictment and rush to the courthouse to beat the government in filing the FCA claim.").

99. Act of Dec. 23, 1943, ch. 377, 57 Stat. 608, 609 (1943).

100. *See* U.S. *ex rel.* Wisconsin v. Dean, 729 F.2d 1100, 1102, 1104 (7th Cir. 1984) (finding that the State could not pursue the claim because the information had already been revealed to the federal government).

101. U.S. *ex rel.* Lamers v. Green Bay, 998 F. Supp. 971, 977 (E.D. Wis. 1998), *aff'd*, 168 F.3d 1013 (7th Cir. 1999).

102. *See* U.S. *ex rel.* Findley v. FPC-Boron Employees' Club, 105 F.3d 675, 680 (D.C. Cir. 1997) ("The use of qui tam suits as a weapon for fighting fraud against the government dramatically declined."); Cohen, *supra* note 97, at 706 ("[T]he 'government knowledge' standard ultimately frustrated the efforts of legitimate relators who had acquired knowledge of the fraud on their own but were required by law to report the fraud. As a result, use of qui tam lawsuits declined." (internal citations omitted)).

With this checkered past in mind, Congress amended the FCA in 1986 to its current version.[103] The 1986 amendments repealed the government knowledge bar, and courts are only deprived of jurisdiction if the complaint is based upon allegations or transactions that were publically disclosed, unless the relator was the source of the public disclosure.[104] Public disclosures include: federal criminal, civil, or administrative hearings in which the government is a party; congressional reports, audits, and investigations; and disclosures "from the news media."[105] To avoid this "public disclosure bar," the relator must show that he is an "original source," defined as an individual who prior to the public disclosure "voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based," or "who has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions, and who has voluntarily provided the information to the Government before filing [the *qui tam* complaint]."[106] Most commentators state that the relator must have "direct and independent knowledge" of the allegations on which the claim is based.[107]

We see this history, and the incremental changes to the FCA to remedy it, reflected in Dodd–Frank's definition of "original information."[108] Dodd–Frank and the Commission's rules define "original information" to exclude information that was "exclusively derived" from a judicial or administrative hearing, in a governmental report, or from "the news media,"[109] unless "the

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

104. *See* 31 U.S.C. § 3730(e)(4) (2006) ("The court shall dismiss an action or claim under this section . . . if substantially the same allegations or transactions as alleged in the action or claim were publicly disclosed . . . unless . . . the person bringing the action is an original source of the information.").

105. *Id.*

106. *Id.* § 3730(e)(4)(B).

107. *See, e.g.*, KOHN, *supra* note 93, at 208 (citing 31 U.S.C. § 3730(e)(4)(B)); Cohen, *supra* note 97, at 709.

108. *See supra* note 52 and accompanying text (quoting the full definition of "original information").

109. Dodd–Frank § 922(a)(3)(C); 17 C.F.R. § 240.21F–4(b) (2011).

whistleblower is a source of the information."[110] This is nearly a direct parroting of the FCA's "public disclosure bar" discussed above[111] and illustrates Dodd–Frank's parallels to and awareness of issues faced by the FCA in the past.

Although private citizens bring these *qui tam* FCA claims, a claim must be filed "in the name of the [United States] Government."[112] A copy of the complaint along with a "disclosure of substantially all material evidence" must then be served on the government.[113] The complaint is filed *in camera* and under seal for sixty days.[114] The complaint is not served on the defendant "until the court so orders."[115] During those sixty days, the Department of Justice (DOJ) "may elect" to intervene in the suit.[116] However, the DOJ may "for good cause" move for an extension of the sixty-day intervention period, and this may be done an indefinite number of times.[117] Most importantly, even if the DOJ decides not to intervene, the relator can still go forward with the suit.[118]

If the DOJ does intervene, its primacy is indisputable.[119] In fact, the DOJ can dismiss the case over the objection of the relator.[120] This power, however, is rarely used.[121] Further, the

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110. Dodd–Frank § 922(a)(3)(B).

111. *See supra* notes 104–07 and accompanying text (discussing the FCA's "public disclosure bar").

112. 31 U.S.C. § 3730(b)(1) (2006).

113. *Id.* § 3730(b)(2).

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.* § 3730(b)(3); Dayna Bowen Matthew, *The Moral Hazard Problem with Privatization of Public Enforcement: The Case of Pharmaceutical Fraud*, 40 U. MICH. J.L. REFORM 281, 287 (2007) ("The Government may request an indefinite number of continuances while it considers and reviews the case at issue.").

118. *See* 31 U.S.C. § 3730(b)(4) (2006) ("Before the expiration of the 60-day period . . . the Government shall—(A) proceed with the action . . . or (B) notify the court that it declines to take over the action, in which case the person bringing the action shall have the right to conduct the action.").

119. *See id.* § 3730(c)(1) ("If the Government proceeds with the action, it shall have the primary responsibility for prosecuting the action, and shall not be bound by an act of the person bringing the action.").

120. *See id.* § 3730(c)(2)(A) ("The Government may dismiss the action notwithstanding the objections of the person initiating the action.").

121. *See* Michael Rich, *Prosecutorial Indiscretion: Encouraging the Department of Justice to Rein In Out-of-Control Qui Tam Litigation Under the*

Attorney General may also settle the claim over the objection of the relator if the settlement is "fair, adequate, and reasonable."[122] A relator's participation in the case can also be greatly restricted if the DOJ shows that the relator's involvement would "interfere with or unduly delay the Government's prosecution of the case."[123] Even where the DOJ decides not to intervene, the FCA gives the DOJ substantial supervisory powers such as the right to be served with all pleadings, transcripts of all depositions,[124] and the ability to stay discovery.[125] The DOJ can also preempt the relator's claim by pursuing it through alternative means.[126] Finally, upon a

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Civil False Claims Act, 76 U. CIN. L. REV. 1233, 1236 (2008) ("However, the Department of Justice (DOJ) exercises its check only occasionally, intervening in less than a quarter of the qui tam actions filed and moving to dismiss sparingly.").

122. *See* 31 U.S.C. § 3730(c)(2)(B) (2006) ("The Government may settle the action with the defendant notwithstanding the objections of the person initiating the action if the court determines, after a hearing, that the proposed settlement is fair, adequate, and reasonable under all the circumstances.").

123. *See id.* § 3730(c)(2)(C), (D) (stating certain limitations that may be imposed). The statute states:

> Upon a showing by the Government that unrestricted participation during the course of the litigation by the person initiating the action would interfere with or unduly delay the Government's prosecution of the case, or would be repetitious, irrelevant, or for purposes of harassment, the court may, in its discretion, impose limitations on the person's participation, such as–
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> (i) limiting the number of witnesses the person may call;
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> (ii) limiting the length of the testimony of such witnesses;
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> (iii) limiting the person's cross-examination of witnesses; or
>
> (iv) otherwise limiting the participation by the person in the litigation.
>
> (D) Upon a showing by the defendant that unrestricted participation during the course of the litigation by the person initiating the action would be for purposes of harassment or would cause the defendant undue burden or unnecessary expense, the court may limit the participation by the person in the litigation.

Id.

124. *See id.* § 3730(c)(3) ("If the Government so requests, it shall be served with copies of all pleadings filed in the action and shall be supplied with copies of all deposition transcripts (at the Government's expense).").

125. *See id.* § 3730(c)(4) ("[U]pon a showing by the Government . . . the court may stay such discovery for a period of not more than 60 days.").

126. *See id.* § 3730(c)(5) ("Notwithstanding subsection (b), the Government may elect to pursue its claim through any alternate remedy available to the Government, including any administrative proceeding to determine a civil

showing of good cause, the DOJ may choose to intervene at a later date.[127]

The 1986 FCA amendments also increased the penalties under the Act to between $5,500–$11,000 per false claim, plus three times the amount of damages sustained by the government due to the defendant's fraudulent act.[128] The FCA defines "claim" as "any request or demand . . . for money or property."[129] This means, for example, that each false request for payment submitted by a doctor will be considered a separate claim, amenable to separate $5,500–$11,000 penalties.[130] Then, any monetary damages resulting from the fraudulent claims that are inflicted on the government are trebled.[131] Therefore, potential recoveries, especially in the medical arena, can quickly escalate into the "tens or hundreds of millions of dollars."[132]

Assuming that the public disclosure bar and all other hurdles are passed, the relator then takes his or her share of the

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money penalty.").

127. *See id.* § 3730(c)(3) ("When a person proceeds with the action, the court, without limiting the status and rights of the person initiating the action, may nevertheless permit the Government to intervene at a later date upon a showing of good cause.").

128. *See id.* § 3729(a)(1)(G) ("[A] civil penalty of not less than $5,000 and not more than $10,000 . . . plus 3 times the amount of damages which the Government sustains because of the act of that person."); 28 C.F.R. § 85.3(a)(9) (2012) (raising the mandatory FCA penalty "minimum from $5,000 to $5,500; maximum from $10,000 to $11,000").

129. 31 U.S.C. § 3729(b)(2)(A) (2006).

130. *See* S. REP. NO. 99-345, at 9 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5266, 5274 ("Each separate bill, voucher or other 'false payment demand' constitutes a separate claim for which a forfeiture shall be imposed, . . . and this is true although many such claims may be submitted to the Government at one time." (internal citations omitted)). The report continues, "For example, a doctor who completes separate Medicare claims for each patient treated will be liable for a forfeiture for each such form that contains false entries even though several such forms may be submitted to the fiscal intermediary at one time." *Id.*

131. *See* 31 U.S.C. § 3729(a)(1)(G) (2006) ("[A] civil penalty of not less than $5,000 and not more than $10,000 . . . plus 3 times the amount of damages which the Government sustains because of the act of that person.").

132. Rich, *supra* note 121, at 1248; *see also* U.S. *ex rel.* Tyson v. Amerigroup Ill., Inc., 488 F. Supp. 2d. 719, 740–42 (N.D. Ill. 2007) (assessing separate FCA penalties for each false enrollment form completed by defendant for each of 18,130 patients, even though the intermediary submitted only twenty-four claims to the government resulting from the forms, for a total FCA penalty of nearly $100 million).

damages.[133] The relator is entitled to not less than 15% and not more than 25% of the proceeds from any settlement or judgment in which the DOJ intervenes.[134] Where the DOJ fails to intervene, the relator is entitled to "not less than 25[%] and not more than 30[%] of the proceeds of the action or settlement."[135] In either event, the relator is also entitled to recover "an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs."[136]

There are some compensation limitations in the statute as well. If the court finds that the relator "planned and initiated" the violation on which the action is brought, the court may "to the extent [it] considers appropriate" reduce the relator's share below the 15% or 25% minimums.[137] Further, if the relator is convicted of criminal conduct arising from the underlying violation, the relator is dismissed from the case and is entitled to receive no compensation.[138]

Finally, the FCA also has one seemingly strong provision that should disincentivize meritless suits: if the relator's claim is not

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133. *See supra* notes 104–07 and accompanying text (describing the public disclosure bar).

134. *See* 31 U.S.C. § 3730(d)(1) (2006) ("If the Government proceeds with an action brought by a person under subsection (b), such person shall . . . receive at least 15[%] but not more than 25[%] of the proceeds of the action or settlement of the claim . . . ."). The award can be reduced below the 15% minimum in certain public disclosure situations. *Id.* The statute states:

> Where the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) relating to allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, the court may award such sums as it considers appropriate, but in no case more than 10 percent of the proceeds, taking into account the significance of the information and the role of the person bringing the action in advancing the case to litigation.

Id.

135. *Id.* § 3730(d)(2).

136. *Id.* § 3730(d)(1), (d)(2).

137. *Id.* § 3730(d)(3).

138. *See. id.* ("If the person bringing the action is convicted of criminal conduct arising from his or her role in the violation of section 3729, that person shall be dismissed from the civil action and shall not receive any share of the proceeds of the action.").

joined by the DOJ and the defendant is successful in defending against the suit, the court "may award to the defendant its reasonable attorneys' fees and expenses" if it finds that the suit was "clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."[139] Despite this clear indication from Congress, reverse-attorney's fees awards are rarely granted under this provision.[140]

From one point of view, the FCA, with its *qui tam* element, has been a resounding success.[141] Since 1987, the year after its reinvigoration, claims under the FCA have resulted in the recovery of over $27 billion.[142] Over that period, the relators' share of the recoveries has been nearly $3 billion.[143]

Recent examples of the FCA's efficacy include the story of Cheryl Eckard.[144] She blew the whistle on GlaxoSmithKline (GSK) over faulty drug manufacturing in the company's Puerto Rico

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139. *Id.* § 3730(d)(4); *see also* S. REP. NO. 99-345, at 29 (1986) *reprinted in* 1986 U.S.C.C.A.N. 5266, 5294 ("The Committee added this language in order to create a strong disincentive and send a clear message to those who might consider using the private enforcement provision of this Act for illegitimate purposes."). The report continues, "The Committee encourages courts to strictly apply this provision in frivolous or harassment suits as well as any applicable sanctions available under the Federal Rules of Civil Procedure." *Id.*

140. *See, e.g.*, Pfingston v. Ronan Eng'g Co., 284 F.3d 999, 1006–07 (9th Cir. 2002) ("The award of fees under the False Claims Act is reserved for rare and special circumstances.").

141. *See* Bucy, *Private Justice*, *supra* note 11, at 58 ("The qui tam private justice model, by comparison, has proven to be highly effective in recruiting legal talent . . . . Because of the large recoveries available to private plaintiffs under the FCA[,] . . . plaintiffs' counsel can receive large fees . . . ." (citation omitted)). The article continues, "These large fees are a significant incentive for top legal talent to undertake qui tam plaintiffs' work." *Id.* In addition, "the qui tam FCA 'common good' private justice action is extremely successful in bringing forth helpful inside information." *Id.* at 61.

142. *See* CIVIL DIV., U.S. DEP'T OF JUSTICE, FRAUD STATISTICS—OVERVIEW 2 (Nov. 23, 2010) [hereinafter FRAUD STATISTICS, 2010], *available at* www.taf.org/FCA-stats-2010.pdf (reporting $27,195,570,308 in total settlements and judgments for both *qui tam* and non-*qui tam* actions under the FCA).

143. *See id.* (reporting $2,877,694,871 as the relator share of awards).

144. *See* Lisa Flam, *Ex-Worker Wins $96M for Blowing Whistle on Drug Giant*, AOLNEWS.COM (Oct. 27, 2010, 12:50 PM), http://www.aolnews.com/2010/10/27/ex-worker-wins-96m-for-blowing-whistle-on-drug-giant/ (last visited Apr. 10, 2012) (reporting on a recent whistleblower who reported under the False Claims Act against GlaxoSmithKine) (on file with the Washington and Lee Law Review).

plant.[145] The claim resulted in a $750 million penalty against GSK and a $96 million award for Eckard, believed to be the single-biggest whistleblower bounty ever in the United States.[146] Further, is the story of John Kophinski, a former sales representative for Pfizer, whose reporting lead to a $50 million dollar bounty for himself and $2.3 billion in payments by Pfizer for illegal drug marketing.[147]

Despite these examples of the extreme good that can come from FCA *qui tam* litigation, the academic and statistical record is replete with examples of its utter misuse through expanded liability, meritless claims, and increased transaction costs.[148]

1. Non-Meritorious Claims

The key issue here, as it relates to Dodd–Frank, is the amount of non-meritorious claims filed by *qui tam* plaintiffs under the FCA, as this will likely reflect a similar amount of meritless reporting to be expected under the Dodd–Frank program. This

145. *See id.* ("She found that the . . . facility had a contaminated water system, an air system that allowed products to be cross-contaminated and pills of different strengths mixed in the same bottles . . . .").

146. *See id.* ("Her lawyers, Neil Getnick and Leslie Ann Skillen, believe her share is the single-biggest whistle-blower award in the U.S. . . ."); *see also* Press Release, Getnick & Getnick, GlaxoSmithKiline Pays $750 Million For Fraud On Medicaid (Oct. 26, 2010), *available at* http://www.taf.org/Eckard-Getick&Getnick-PR.pdf (stating that GSK was required to pay $600 million to settle the civil claims and a $150 million criminal penalty).

147. *See* Gardiner Harris, *Pfizer to Pay $2.3 Billion to Settle Inquiry Over Marketing*, N.Y. TIMES, Sept. 3, 2009, at B4 (stating that Kopchinski received more than $50 million for his role in the case and that a total of $102 million in bounties was paid to informants).

148. *See, e.g.*, Bucy, *States*, *supra* note 59, at 1533 ("In short, despite its enormous success as a regulatory tool, the federal False Claims Act, because of its unique private-public partnership, creates tensions and costs for law enforcement, the courts, and businesses."); Rich, *supra* note 121, at 1234 ("94% of qui tam FCA suits that the DOJ has allowed to proceed (totaling more than 3,000 actions) have been dismissed without recovering any funds. These non-meritorious suits have exacted a heavy toll on defendants, the judicial system, and the public as a whole."). *See generally* Canni, *supra* note 94; Christina Broderick, Note, *Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 COLUM. L. REV. 949 (2007); Justin P. Tschoepe, Comment, *A Fraud Against One Is Apparently a Fraud Against All: The Fraud Enforcement and Recovery Act's Unprecedented Expansion of Liability Under the False Claims Act*, 47 HOUS. L. REV. 741 (2010).

follows because both programs function as whistleblower bounty provisions, and both have a similar percentage of recovery incentive structure.[149] It seems reasonable to conclude, then, that meritless claims filed under the FCA are a reasonable guidepost to expected non-meritorious reporting under the Dodd–Frank program.

The DOJ breaks down *qui tam* statistics into three categories: "active," "settlement or judgment," and "dismissed."[150] This Note takes the position that dismissed cases were non-meritorious claims. That position is based on the premise that meritorious claims would have been settled or proceeded to judgment, even if the judgment went against the relator. Although many argue that a significant amount of cases that settle also lack substantial merit,[151] this Note views settlements in the light most favorable to relators. Dismissed cases, however, either were meritless and therefore did not warrant adjudication on the merits, or were somehow technically deficient.[152] The former explanation seems

149. *See supra* notes 134–36 and accompanying text (stating that FCA relators are entitled to between 15%–30% of recovered proceeds); *supra* note 28 and accompanying text (stating that whistleblowers under the Dodd–Frank program are entitled to between 10%–30% of recovered funds).

150. FRAUD STATISTICS, 2010, *supra* note 142, at 9.

151. *See* Beck, *supra* note 91, at 624–25 ("[I]t may be rational for an informer to pursue a claim, even if it seems unlikely to yield a victory on the merits. For instance, the case could prove to have a nuisance value, causing the defendant to settle to avoid the higher costs of defending a fraud claim."). *Cf.* Denise N. Martin et al., *Recent Trends IV: What Explains Filings and Settlements in Shareholder Class Actions*, 5 STAN. J.L. BUS. & FIN. 121, 125 (1999) ("The merits of most of these lawsuits . . . seem to be of relatively little, if any, importance in determining the amount of settlement.").

152. *See* Broderick, *supra* note 148, at 972 ("[T]here are two primary reasons for dismissing a suit: Either it lacks merit or it is deficient on some technical ground."). Another possible explanation for both dismissals, and the high dismissal rates in these *qui tam* actions, is voluntary dismissal after the government declines to intervene. Professor Bucy notes, "Historically, relators who proceed on their own after the DOJ has declined to intervene as a plaintiff have enjoyed little success. . . . The litigational advantages to private plaintiffs of obtaining DOJ intervention are so substantial that the acknowledged goal of any experienced relators' attorney is to obtain the government's intervention." Bucy, *Private Justice*, *supra* note 11, at 51. Because the Government intervenes in only 22% of *qui tam* actions, this is a plausible explanation. FRAUD STATISTICS, 2010, *supra* note 142, at 9. *But see* Rich, *supra* note 121, at 1264 ("[A] senior DOJ official acknowledged in remarks to a conference of health care lawyers that the merit of many non-intervened cases 'has been questionable at best.'" (quoting Robert D. McCallum, Jr., Assistant Attorney Gen., Remarks to

more likely in the FCA context for a host of reasons. First, the FCA statute mandates that the relators' complaint and all material information be filed with the Attorney General before it is served on the defendant.[153] This gives the DOJ an opportunity to review the complaint for any technical noncompliance, and rectify any errors.[154] Second, since the 1986 amendments, a considerable "*qui tam* bar" has developed.[155] These lawyers specialize in FCA litigation and devote considerable resources towards FCA claims;

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the American Health Lawyers Association Meeting (Sept. 30, 2002))). It is the opinion of this author that although some of these cases are being voluntarily dismissed, the extreme financial incentives provided by the Act lead the vast majority of cases to be dismissed non-voluntarily, and therefore the dismissal rates do reflect their non-meritorious nature. *See* Matthew, *supra* note 117, at 293 ("Awards to plaintiffs of between $1 million and $10 million are announced regularly."). Further, although the Government may dismiss any claim in which it has intervened over the objection of the relator per § 3730(c)(2)(A), that power is rarely used, despite a flood of articles calling for such action. *See, e.g.*, Rich, *supra* note 121, at 1264–65 ("The result is that the government does not dismiss, and relators are permitted to proceed with, thousands of non-meritorious qui tam suits."); Matthew, *supra* note 117, at 285 ("The Government's abdication of authority under the FCA results in over-prosecution and a harmful reduction in the Government's exercise of caution in the selection and pursuit of these cases."). Finally, as discussed *supra*, the reverse attorney's fees provided for under the statute are rarely granted; therefore, there is little incentive to voluntarily dismiss a possibly lucrative case. *See supra* note 140 and accompanying text (discussing the rarity with which reverse attorney's fees are awarded).

153. *See* 31 U.S.C. § 3730(b)(2) (2006) ("A copy of the complaint and written disclosure of substantially all material evidence and information the person possesses shall be served on the Government[,] . . . shall remain under seal for at least 60 days, and shall not be served on the defendant until the court so orders.").

154. *See* Broderick, *supra* note 148, at 973 ("During this review, the Attorney General has the opportunity to correct any technical errors in the complaint. According to Michael Bassham, Tennessee Assistant Attorney General, it is common for state attorneys general to correct such errors at this stage."); *supra* note 117 and accompanying text (discussing the Government's ability to move for an indefinite number of continuances when deciding whether to intervene); *see also* Canni, *supra* note 94, at 2 ("[I]t is not uncommon for courts to grant plaintiffs leave to amend their complaints multiple times . . . .").

155. The term "*qui tam* bar" refers to a set of attorneys or law firms that work predominantly on *qui tam* cases, it is a subset of the "plaintiff's bar." *See, e.g.*, A. Craig Eddy, *The Effect of the Health Insurance Profitability and Accountability Act of 1996 (HIPAA) on Health Care Fraud in Montana*, 61 MONT. L. REV. 175, 203 (2000) ("[T]he predominant target of qui tam actions recently shifted from defense contractors to health care providers and the plaintiff's qui tam bar is growing rapidly.").

their presence further undermines the idea that a substantial number of these claims are being dismissed due to technical defects.[156] Finally, there is a general public policy in the law that cases be decided on the merits.[157] Because of these reasons, dismissed *qui tam* claims are treated herein as presumptively meritless.

As of 2010, the DOJ's Fraud Statistics show that 74.4% of all *qui tam* actions filed under the FCA were dismissed without a settlement or judgment.[158] Even more concerning, 94% of cases in which the Government did not intervene were dismissed.[159] It is

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156. *See* Beck, *supra* note 91, at 624 n.441 ("The FCA has spurred the growth of a 'qui tam bar' consisting of law firms that devote substantial resources to FCA litigation."); ALICE G. GOSFIELD, MEDICARE AND MEDICAID FRAUD AND ABUSE § 6:12 (2011) ("The so-called 'Qui Tam' bar has attracted former federal and state prosecutors, employment lawyers, class action lawyers and other lawyers skilled in complex, multi-district, high stakes civil litigation. . . . The sophistication and training of the bar has led to bigger and larger cases being brought, litigated and ultimately settled.").

157. *See* Quinonez v. Nat'l Ass'n of Sec. Dealers, Inc., 540 F.2d 824, 826–27 (5th Cir. 1976) (restating the "universal rule" that motions to dismiss should rarely be granted (citing Conley v. Gibson, 355 U.S. 41, 45–46 (1957)); Muncaster v. Baptist, 367 F. Supp. 1120, 1124 (N.D. Ala. 1973) ("[T]he granting of motions to dismiss . . . is not favored."); Carss v. Outboard Marine Corp., 252 F.2d 690, 691 (5th Cir. 1958) ("'[C]ases are generally to be tried on the proofs rather than the pleadings.'" (quoting Des Isles v. Evans, 200 F.2d 614, 616 (5th Cir. 1952))). *Contra* Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 570 (2007) (overturning *Conley's* "no set of facts" standard and announcing a "plausibility" pleading standard); Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009) (applying the *Twombly* "plausibility" pleading standard). *But see* Patricia W. Hatamyar, *The Toa of Pleading: Do* Twombly *and* Iqbal *Matter Empirically?*, 59 AM. U. L. REV. 553, 587 n.209 (2010) ("In addition, claims other than common law fraud that allege some sort of underlying deception, such as securities fraud, RICO, and qui tam actions under the False Claims Act, must also be pled with particularity. Such cases are not governed by *Twombly* and *Iqbal* . . . ."); William M. Janssen, Iqbal *"Plausibility" in Pharmaceutical and Medical Device Litigation*, 71 LA. L. REV. 541, 543, 587 (2011) (finding that *Iqbal* "plausibility" pleading was not a factor in 80% of the pharmaceutical and medical device dismissals studied, some of which involved False Claims Act claims). In any event, the underlying effect of the *Twombly–Iqbal* line of cases is likely marginal as those were not decided until 2007 and 2009 respectively, and the FCA dismissal data covers from 1987 to the present. *See* FRAUD STATISTICS, 2010, *supra* note 142, at 9 (covering 1987–2010).

158. *See* FRAUD STATISTICS, 2010, *supra* note 142, at 9 (reporting that of the 5,404 total *qui tam* actions which had been resolved (i.e., those cases not "under investigation" or "active") 4,022 of them were dismissed).

159. *See id.* (reporting that 3,962 of the 4,628 non-intervened cases were dismissed, with 412 cases still active). I arrived at this statistic by subtracting

important to note that although in the late 1980s and early 1990s *qui tam* claims were significantly outpaced by government instituted (non-*qui tam*) claims,[160] since the year 2000 *qui tam* claims account for 78.5% of all claims instituted under the FCA.[161] To summarize, nearly 75% of all *qui tam* actions are dismissed without an award, and *qui tam* claims account for nearly 80% of the FCA actions brought since the year 2000.[162]

These are truly startling statistics. Further, one must keep in mind that in FCA *qui tam* actions the relator is charged with doing much more than simply reporting on wrongdoing; these whistleblowers are required to file a complaint with a court[163] and hire a lawyer.[164] This is a much higher burden than Dodd–Frank will require, where all the potential whistleblower is required to do is simply submit the information to an online collection system or fill out a form and mail or fax it to the SEC Whistleblower Office.[165]

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the number of active cases from the total, then dividing the number of non-intervened dismissed actions by that total, which resulted in a statistic of 93.975%. This approach appears to be the same as that used by Professor Rich in his Article cited *supra* note 121.

160. *See* FRAUD STATISTICS, 2010, *supra* note 142, at 1 (reporting that from 1987–1994 non-*qui tam* claims accounted for 73% of all FCA claims).

161. *Id.* at 2.

162. Over the entire span since 1987, *qui tam* claims account for 63.4% of all FCA claims. *Id.* Unfortunately the DOJ does not break down dismissal rates by year, but rather only provide statistics relating to all *qui tam* actions since 1987. *Id.* at 9. This is why dismissal rates over the relevant periods discussed above are not provided.

163. *See* 31 U.S.C. § 3730(b), (b)(2) (2006) (stating that the complaint shall be filed with the court *in camera*).

164. *See, e.g.*, U.S. *ex rel.* Mergent Sers. v. Flaherty, 540 F.3d 89, 93 (2d Cir. 2008) ("Because relators lack a personal interest in False Claims Act *qui tam* actions, we conclude that they are not entitled to proceed *pro se*."); Timson v. Sampson, 518 F.3d 870, 874 (11th Cir. 2008) ("[T]he district court did not err in dismissing Timson's complaint because Timson could not maintain a *qui tam* suit under the FCA as a *pro se* relator."); U.S. *ex rel.* Brooks v. Lockheed Martin Corp., 237 F. App'x 802, 803 (4th Cir. 2007) ("A lay person may not bring a qui tam action under the False Claims Act. Although a qui tam relator is entitled by statute to a share of the recovery if his action is successful, the United States is the real party in interest . . . ." (internal citations omitted)).

165. 17 C.F.R. § 240.21F–9(a) (2011) ("[Y]ou must submit your information about a possible securities law violation by either of these methods: (1) Online, through the Commission's Web site located at http://www.sec.gov; or (2) By mailing or faxing a Form TCR . . . to the SEC Office of the Whistleblower . . . .").

It does not, therefore, take a substantial leap of logic to infer that, as reflected in the *qui tam* dismissal data, somewhere between 75%–94% of reports submitted under the Dodd–Frank program will be non-meritorious. In fact, because simple submission of a report of wrongdoing is more akin to those *qui tam* claims in which the government does not intervene, the 94% figure may be the more likely result.[166]

2. Inherent Issues

Although many of the problems that commentators typically lament about the FCA will not be present under the Dodd–Frank program because it is not a *qui tam* program,[167] some problems remain quite important, as they likely will apply in the Dodd–Frank arena as well.

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166. This conclusion is based on the idea that in non-intervened cases the relator is functioning independently of the government. *See* 31 U.S.C. § 3730(c)(3) (2006) ("If the Government elects not to proceed with the action, the person who initiated the action shall have the right to conduct the action."). This is similar to what Dodd–Frank whistleblowers will be doing when submitting their initial information.

167. There are several consistently decried FCA issues unlikely to apply in the Dodd–Frank context: First, broad piecemeal expansion of liability driven by relator's novel legal theories. *See* Rich, *supra* note 121, at 1236–37 ("[N]on-intervened qui tam suits that do result in recovery present a different problem: the haphazard expansion of FCA liability without any guarantee that new theories of liability will work to the public's benefit."). Second, the prevention of companies from contracting with the government. *See* William E. Kovacic, *The Civil False Claims Act as a Deterrent to Participation in Government Procurement Markets*, 6. SUP. CT. ECON. REV. 201, 223–35 (1998) (discussing a survey of forty government contractors, which found that increased compliance costs and huge potential liability were threats to continued operation in government contracting). Lastly, because FCA liability can be predicated on "technical" violations of government regulations, and relators can still recover the minimum $5,500 per "false" claim plus treble any damages, some commentators claim relators' interests are at odds with the Government's. *See id.* at 223 ("Where relators challenge behavior that involves no injury to the public, and where the fact of a challenge itself may be counterproductive, the 'relator's interests and the Government's do not necessarily coincide.'" (citing Hughes Aircraft Co. v. U.S. *ex rel.* Schumer, 520 U.S. 939, 949 n.5 (1997))); Beck, *supra* note 91, at 630–31 ("Any failure to comply with the vast array of federal regulations governing procurement might be the basis of a qui tam complaint.").

The most notable of these inherent issues is the intrinsic conflict of interest between the relator's (or whistleblower's) interests and those of the government or public.[168] This phenomenon can be termed "nurturing unlawful conduct,"[169] and it results from the fact that in whistleblower bounty situations, such as the FCA, IRS, and Dodd–Frank programs, the whistleblower's compensation is tied directly to the amount of damages or unlawful conduct present.[170] Therefore, putative whistleblowers have an incentive to allow damages to build up, thereby increasing the total amount of damages from which their compensation percentage will be based.[171] The Sixth Circuit faced just such a situation in a case where the FCA relator first contacted his attorneys in 1987 when damages were at $13.1 million but delayed filing suit until the damages against the government had more than tripled to $41.6 million, meaning the relator's bounty had more than tripled as well.[172]

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168. *See* Beck, *supra* note 91, at 633 ("The public adopts a regulatory command because it wants the proscribed behavior to decrease. On the other hand, the informer makes a living from the illegal conduct, and, therefore, the informer's interests are advanced by an increase in the number and severity of statutory violations." (internal citations omitted)).

169. *Id.*

170. *See* 31 U.S.C. § 3730(d)(1), (d)(2) (2006) (stating a bounty of 15%–30% under the FCA); I.R.C. § 7623(b)(1) (2006) (establishing a 15%–30% bounty for IRS collections over $2 million); Dodd–Frank § 922(b)(1) (establishing a 10%–30% bounty for all SEC collections over $1 million).

171. *See* Beck, *supra* note 91, at 633 ("[T]he informer makes a living from the illegal conduct, and, therefore, the informer's interests are advanced by an increase in the number and severity of statutory violations."); *Id.* at 635 ("The informer, however, is paid based on the amount of fraud he proves. Thus . . . it is in the informer's financial interest for the government to be damaged to the greatest extent possible before the scheme is brought to light."). *Cf.* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 661 (7th ed. 2007) ("The incentive for waiting would be to obtain greater compensation, since the penalty for the completed crime would be heavier than the penalty for the attempt."). Judge Posner also notes a possible "supply" conflict of interest in private enforcement situations, he notes, "The private enforcer would presumably be paid per offender convicted . . . . There are several ways in which the enforcer could increase his 'catch,' and hence his income . . . . He could fabricate an offense . . . or encourage an individual to commit an offense that he would not have committed without encouragement . . . ." *Id.*

172. *See* U.S. *ex rel.* Taxpayers Against Fraud v. General Elec. Co., 41 F.3d 1032, 1037–39 (6th Cir. 1994) (stating that the relator contacted his attorneys in mid-1987 but did not file suit until 1990, after substantial damages had compiled). The court remanded the case to determine whether the relator was

The rules promulgated by the SEC for the Dodd–Frank program only obliquely reference this inherent issue of unnecessary delay. The only mention of it is in the comments to the rule defining "independent knowledge," and it simply relates to allowing certain persons with oversight and governance responsibilities (who would be excluded from the definition of independent knowledge) to make a claim if the company acted in bad faith in not reporting or remedying the violation.[173] This is a major oversight; the SEC should promulgate rules substantially reducing the whistleblower's share if purposeful delay is found. This recommendation is explained further *infra* Part IV.B.

The next inherent issue is the increased transaction costs for both regulated entities and the government. The experience with the FCA is illustrative of this issue. A senior DOJ official testified before a Congressional committee that between 1987 and 1992 the Civil Division spent "20,000 hours investigating . . . 150 *qui tam* cases that were [later] dismissed by the courts or not pursued after we declined to intervene."[174] And this figure does not account for additional time expended by Assistant U.S. Attorneys or other government officials such as the Defense Contract Audit Agency and the Air Force Office of Special Investigations.[175] While the relator or whistleblower that submits such a meritless claim loses little, the government and the public must foot the bill.[176]

"running up costs." *Id.* at 1044.

173. *See* SEC, *Proposed Rules*, *supra* note 23, at 70494 ("[I]f the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith, these exclusions would no longer apply, thereby making an individual who knows this undisclosed information eligible to become a whistleblower by providing 'independent knowledge' of the violations."); 17 C.F.R. § 240.21F–4(b)(v) (2011) (listing exceptions to the exclusions from "independent knowledge").

174. *False Claims Act Technical Amendments of 1992: Hearing on H.R. 4563 Before the Subcomm. on Admin. Law and Governmental Relations of the H. Comm. on the Judiciary*, 102d Cong. 25 (1992) (Sup. Docs. No. Y4.J89/1:102/49) (statement of Stuart M. Gerson, Assistant Attorney General, Civil Division, Department of Justice) [hereinafter Gerson Testimony].

175. *See id.* at 25–26 ("Assistant U.S. Attorneys spent additional, unrecorded time on these matters."); Beck, *supra* note 91, at 627 ("[T]his total did not include time spent by other government investigators, such as employees of the Defense Contract Audit Agency and the Air Force Office of Special Investigations.").

176. *See* Beck, *supra* note 91, at 627 ("If the government finds evidence of fraud, the informer can claim a share of the recovery. If not, the investigation

This inherent issue highlights the need for the SEC to further disincentivize meritless reporting under the Dodd–Frank program.[177] This is especially true with Dodd–Frank where the SEC is likely to receive thousands of reports,[178] whereas here the DOJ was only dealing with 150 meritless claims and still resulted in significant labor outlays by the Department.[179] Because the Dodd–Frank program's incentives are likely to cause the SEC to be overrun with claims,[180] limiting the amount of meritless claims is in the SEC's own interest.[181]

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has cost the informer little. The costs of a government investigation matter a great deal to the public, however, because tax dollars pay the salaries of law enforcement personnel.").

177. *See* Jayne W. Barnard, *Evolutionary Enforcement at the Securities and Exchange Commission*, 71 U. PITT. L. REV. 403, 413 (2010) ("Bounties may also increase demands on regulatory staff, who not only have to sift through informants' tips, but also may have to determine just how much a piece of information is worth . . . ."); *infra* Part IV (proposing new rules to disincentivize meritless reporting).

178. *See supra* Part III.A (discussing the IRS bounty program and prognosticating a similar, if not increased, amount of reporting under Dodd–Frank); *see also* Sue Reisinger, *Firms Face a Sudden Rush of Whistleblower Claims*, CORPORATE COUNSEL, Sept. 9, 2010, *available at* http://www.law.com/jsp/article.jsp?id=1202471768561 ("The new federal whistleblower law is proving a hot item for many plaintiff law firms. Attorneys say that tipsters with visions of becoming millionaires are flooding their offices with calls.").

179. Although the Attorney General is required by statute to "diligently . . . investigate" all claims under the FCA, 31 U.S.C. § 3730(a), and no similar duty is required of the SEC by Dodd–Frank, it seems quite likely that significant effort will have to be expended in investigating claims submitted to the SEC Whistleblower Office. Therefore, these statistics, while not perfectly analogous, do provide some baseline expectations.

180. *See, e.g.*, Jessica Holzer & Fawn Johnson, *Larger Bounties Spur Surge in Fraud Tips*, WALL ST. J., Sept. 7, 2010, at C3 ("[T]he guaranteed minimum payout for whistle-blowers who qualify, [is] encouraging insiders to step forward, said Erika Kelton of Phillips & Cohen LLP. 'We're seeing a flood of inquiries,' . . . .").

181. *See* Barnard, *supra* note 177, at 412 ("The biggest objection to adoption of an SEC bounty program, as was the case in 1988, will be that the Enforcement Division already receives more tips than it can reasonably handle." (citations omitted)). *Cf.* Bruce Carton, *Pitfalls Emerge in Dodd–Frank Whistleblower Bounty Provision*, SECURITIES DOCKET, Sept. 9, 2010, *available at* http://www.securitiesdocket.com/2010/09/09/pitfalls-emerge-in-dodd-frank-whistleblower-bounty-provision/ ("Contending with a barrage of borderline (or worse) claims will prove quite costly to the SEC, which will still be required to review each matter submitted to it.").

Further, increased transaction and compliance costs are sure to inure to regulated entities, just as they have to companies to which the FCA applies.[182] One 1998 survey of government contractors showed that in defending thirty-eight *qui tam* FCA claims, the respondents expended over $53 million on outside legal costs, whereas total recoveries only amounted to just over $3.5 million.[183] Internal and other costs of defending such matters are estimated to equal, if not exceed, those expended on legal fees.[184] This data clearly indicates that the costs associated with responding to such suits are substantial.

Although Dodd–Frank has no *qui tam* provision, and therefore the number of actual cases instituted against regulated entities should be lower, similar financial incentives for the whistleblower are at play, and therefore a significant amount of non-meritorious reporting is likely.[185] While not all of these reports will lead to trials, the costs of responding to any investigation launched by the SEC is sure to be considerable.[186] Due to this, non-meritorious

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182. *See* Bucy, *States*, *supra* note 59, at 1532–33 ("FCA actions can also hurt legitimate businesses. It is extremely costly for a company to respond to an FCA action. . . . When a fraud investigation becomes public, business expansions, corporate borrowing, and mergers and acquisitions may be put on hold or lost as opportunities."); Canni, *supra* note 94, at 12 ("These huge costs may ultimately put the contractor out of business and result in a loss in jobs, cause the contractor to raise his prices, or discourage future involvement with the Government."); Kovacic, *supra* note 167, at 225 ("[T]he survey data suggest that contractors incur out-of-pocket legal costs of at least $250,000 to $500,000 whenever the firm is informed that the government has commenced an inquiry into alleged []FCA violations or a qui tam relator has filed a suit.").

183. *See* Kovacic, *supra* note 167, at 226 ("To defend themselves in these 38 completed matters, the survey respondents spent approximately $53,403,000 on external legal costs. The total amount of CFCA recoveries obtained in these matters was $3,694,484. The average expenditure in outside legal fees . . . was $1,431,660, and the average CFCA recovery was $97,223." (citations omitted)).

184. *See id.* at 225 (stating that "amounts paid to external professional advisors quickly exceed $1 million and, in a number of cases, reach $10 million or more" and that "the internal economic costs to the firm match or surpass the costs associated with retaining external professional advisors such as law firms").

185. *See supra* notes 158–66 and accompanying text (referencing dismissal rates of the FCA and predicting similar amounts of meritless reporting under Dodd–Frank).

186. *Cf.* Bucy, *States*, *supra* note 59, at 1533 (reporting in the FCA context, "When an investigation or lawsuit is nonmeritorious, the tangible and intangible costs to the targeted company are not only substantial but also unnecessary"). The article continues, "The threat of nonmeritorious actions,

reporting should be disincentivized through an SEC rule holding the whistleblower and government jointly liable to the regulated entity for its reasonable attorney's fees that are incurred in the successful defense of any "related action" (as defined by the SEC rules)[187] that is found to be frivolous.[188] This recommendation is defined further *infra* Part IV.A.

C. State False Claims Acts

As Justice Brandeis so poignantly stated, "It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory."[189] Currently twenty-seven states, the District of Columbia, and the cities of Chicago and New York, all have their own versions of the False Claims Act.[190] Many of these were passed in the wake of federal legislation[191] that provided states with an additional 10% of federal Medicaid fraud recoveries.[192] Each state's version varies in

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brought by any of thousands of potential relators, creates uncertainty for businesses and often causes businesses to engage in unnecessarily extensive and expensive preventative programs." *Id.*

187. *See* 17 C.F.R. § 240.21F–3(b)(1) (2011) ("A related action is a judicial or administrative action that is brought by: (i) The Attorney General of the United States; (ii) An appropriate regulatory authority; (iii) A self-regulatory organization; or (iv) A state attorney general in a criminal case. . . .").

188. *See infra* Part IV (describing further the proposed rule and definition of "frivolous").

189. New State Ice Co. v. Liebmann, 285 U.S. 262, 386–87 (1932) (Brandeis, J., dissenting).

190. *See* Taxpayers Against Fraud, *State False Claims Acts*, http://www.taf.org/statefca.htm (last visited Apr. 10, 2012) (listing California, Colorado Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Oklahoma, Rhode Island, Tennessee, Texas, Virginia, and Wisconsin; some of these are Medicaid only) (on file with the Washington and Lee Law Review).

191. Deficit Reduction Act of 2005, Pub. L. No. 109-171, 120 Stat 4 (2006).

192. *See* 42 U.S.C. § 1396h(a) (2006) ("[I]f a State has in effect a law relating to false or fraudulent claims . . . the Federal medical assistance percentage with respect to any amounts recovered under a State action brought under such law, shall be decreased by 10 percentage points."); Bucy, *States*, *supra* note 59, at 1546 ("[H]aving a state qui tam statute will result in the federal government's decreasing the FMAP from fifty to forty percent for a Medicaid fraud settlement, thereby increasing the state's portion of the recovery to sixty percent of the settlement or judgment . . . ."); *Id.* at 1535 ("Many of the state false claims

different ways from the federal FCA;[193] however, some of these differences are of particular note here, as they reflect positive evolutions applicable not only to the federal FCA, but also to the Dodd–Frank whistleblower bounty program. Some of the systemic changes not applicable to Dodd–Frank include changes such as either removing private *qui tam* actions altogether[194] or greatly restricting them.[195] Because Dodd–Frank does not provide a private cause of action, the value, or lack thereof, of a *qui tam* provision is of little moment here.

The most notable difference in many state FCAs is the existence of an internal reporting requirement.[196] These requirements almost exclusively apply only to current or former government employees who discovered the fraud during the course of their employment.[197] Typically these provisions require good-

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statutes, however, are of very recent vintage. States have passed or significantly amended ten of the twenty-four since 2005 when Congress provided a financial incentive for states to pass FCAs that mirror the federal FCA.").

193. *See, e.g.*, MINN. STAT. § 15C.02(e) (2010) ("An employer is not liable for an act committed by a nonmanagerial employee that violates this section, unless the employer had knowledge of the act, ratified the act, or was reckless in the hiring or supervision of the employee."). No such similar exclusion exists under the Federal FCA. *See also* Bucy, *States*, *supra* note 59, at 1536 ("Of the twenty-four states with qui tam statutes, fifteen statutes apply to any type of false claim against the state, but the remaining nine statutes limit claims to health care or Medicaid fraud.").

194. *See, e.g.*, KAN. STAT. ANN. § 75-7504(b) (2011) ("[N]othing in this act shall be construed to create a private cause of action.").

195. *See, e.g.*, Scachitti v. UBS Fin. Servs., 831 N.E.2d 544, 554 (Ill. 2005) (interpreting the Illinois FCA and finding that only "the Attorney General has the exclusive constitutional authority to represent the state," thereby eliminating standing for *qui tam* plaintiffs to bring claims on their own).

196. *See, e.g.*, D.C. CODE § 2-381.03 (2011) ("No present or former employee of the District . . . may bring an action pursuant to subsection (b) of this section . . . unless that employee first in good faith exhausted internal procedures for reporting and seeking recovery of such falsely claimed sums . . . ."); HAW. REV. STAT. § 661-27(e)(2) (2011) ("In no event may a person bring an action under section 661-25: When the person is a present or former employee of the State . . . unless the employee first, in good faith, exhausted any existing internal procedures for reporting and seeking recovery of the falsely claimed sums . . . ."); NEV. REV. STAT. § 357.090 (2010) ("No action may be maintained pursuant to NRS 357.080 that is based upon information discovered by a present or former employee of the State . . . unless he or she first in good faith exhausted internal procedures for reporting and seeking recovery of the proceeds of the fraudulent activity . . . .").

197. *See, e.g.*, CAL. GOV'T CODE 12652(d)(4) (West 2011) ("No court shall have

faith exhaustion of all internal reporting procedures before the government employee can file the *qui tam* suit.[198] This type of internal reporting requirement should be included in the Dodd–Frank program. It would further reduce non-meritorious claims and put the regulated entity on notice of possible securities violations.[199] Because an underlying value of Dodd–Frank is the protection of whistleblower anonymity,[200] having the whistleblower's attorney file the internal report on behalf of the unnamed whistleblower could fulfill this internal reporting requirement.[201]

A total exhaustion of internal channels is, in this author's opinion, too high a burden on putative whistleblowers. Simply requiring that some sort of internal reporting has occurred, however, would not be a substantial hurdle and would further the larger public policy concerns of receiving the best quality, meritorious tips from informants,[202] while discouraging informants with only specious information.[203]

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jurisdiction over an action brought under subdivision (c) based upon information discovered by a present or former employee of the state or a political subdivision during the course of his or her employment . . . .").

198. *See e.g.*, HAW. REV. STAT. § 661-27(e)(2) (2011) ("In no event may a person bring an action under section 661-25 . . . unless the employee first, in good faith, exhausted any existing internal procedures for reporting and seeking recovery of the falsely claimed sums . . . .").

199. *See infra* Part III.D.3 (explaining how internal reporting would reduce meritless claims by allowing employers to respond to them first).

200. *See* Dodd–Frank § 922(d)(1)(A) ("Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower anonymously submits the information upon which the claim is based."); *Id.* § 922(h)(2)(A) ("[T]he Commission and any officer or employee of the Commission 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 . . . .").

201. *See also infra* Part III.D (discussing the internal reporting requirement in the context of the Sarbanes–Oxley Act).

202. *See* SEC, *Proposed Rules*, *supra* note 23, at 70496 ("The Commission's primary goal, consistent with the congressional intent behind [Dodd–Frank], is to encourage the submission of high-quality information to facilitate the effectiveness and efficiency of the Commission's enforcement program.").

203. The internal reporting requirement is examined further *infra* Part III.D and Part IV.C.

Another extremely important recommendation from a state FCA is drawn from the pre-2009 version of the Florida FCA.[204] Under that version of the Act, if the government did not intervene and the defendant was successful in defending against the suit, then the "court shall award the defendant reasonable attorney's fees and costs against the person bringing the action."[205] This provision would be an extreme deterrent to specious tips and would greatly disincentivize non-meritorious reporting; an analogous provision should be included in the Dodd–Frank program. This recommendation is explored in further detail *infra* Part IV.A.

The Minnesota FCA[206] has a "right to cure"[207] provision.[208] This allows defendants to escape liability if they repay the amount of actual damages within forty-five days of being informed of the

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204. FLA. STAT. §§ 68.081–68.092 (2011) (establishing the Florida False Claims Act).

205. FLA. STAT. § 68.086(3) (2008). This provision appears to have been changed not because it was too effective or improperly administered, but rather solely in order for the Florida FCA to become DRA compliant and therefore qualify for the incentives noted *supra* note 192. *See* Bucy, *States*, *supra* note 59, at 1531 ("Congress passed legislation in 2006 that offers financial rewards to states that enact statutes patterned after the federal FCA."). The article continues:

> If a state passes a false claim act that is 'at least as effective in rewarding and facilitating qui tam actions' as the federal FCA, the state receives a ten percent reduction in the amount it owes to the federal government for the federal portion of any Medicaid fraud recovery the state obtains. This provision went into effect on January 1, 2007.

Id. (citations omitted). Florida's responses to Professor Bucy's FCA questionnaire note that the Florida FCA has been amended several times to comply with the Federal FCA. *See id.* at 1565–66 (stating that the Florida FCA provisions relating to the statute of limitations, penalty levels, and "[t]he time a new filing is initially under seal," were all "amended to conform with the Federal Act," and that the reason for the changes was "to comply with DRA").

206. *See* MINN. STAT. §§ 15C.01–15C.16 (2011) (establishing the Minnesota False Claims Act).

207. Marc Raspanti & Pamela Brecht, *The Minnesota False Claims Act: Is It Minnesota Nice?*, 67 BENCH & B. MINN. 20, 21 (2010) ("Another significant provision, which is not contained within the federal False Claims Act, is Minnesota's 'Right to Cure' provision.").

208. *See* MINN. STAT. § 15C.02(f)(2) (2010) ("[A] person is not liable under this section if . . . the person repays the amount of actual damages to the state or the political subdivision within 45 days after being so informed.").

underlying violation.[209] Although there is some logical appeal to this kind of provision for Dodd–Frank, it is unlikely to work for securities violations where the underlying damages would likely inure to shareholders,[210] thereby making expedient repayment very difficult. Additionally, measuring the amount of "actual damages" to those shareholders would be much more difficult than is seen in the FCA context.[211]

Some municipalities have also adopted FCAs.[212] One county in Florida has certain "escape provisions"[213] that allow defendants to escape liability if they meet specified criteria, such as: "reasonably

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209. *Id.*

210. *See* Complaint at 8, United States v. Madoff, 2009 WL 596981 (S.D.N.Y. 2009) (NO. 09CR213) (alleging violations of "Title 17, Code of Federal Regulations, Section 240.10b-5, by: (a) employing devices, schemes, and artifices to defraud; (b) making untrue statements of material facts . . . ."). A 10b-5 action makes it illegal to use "any means or instrumentality of interstate commerce, or of the mails" to defraud investors in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (2012). This section has been interpreted to provide a private right of action and is often used by shareholders to initiate shareholder derivative suits. *See* J.I. Case Co. v. Borak, 377 U.S. 426, 430–31 (1964), *abrogated on other grounds by* Corr. Servs. Corp. v. Malesko, 534 U.S. 61 (2001) ("It appears clear that private parties have a right under s 27 to bring suit for violation of s 14(a) of the Act. . . [W]e believe that a right of action exists as to both derivative and direct causes."); *see also e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 228 (1988) ("Respondents are former Basic shareholders . . . . Respondents brought a class action against Basic and its directors, asserting that the defendants issued three false or misleading public statements and thereby were in violation of § 10(b) of the 1934 Act and of Rule 10b-5."). *See generally* Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10B-5*, 108 COLUM. L. REV. 1301 (2008) (providing an overview of 10b-5 litigation).

211. *See, e.g.*, Kevin McCoy, *Few Madoff Victims Reimbursed as Many Await Ruling on Claims*, USA TODAY, Dec. 10, 2009, at 1B ("Court trustee Irving Picard is seeking Madoff assets to repay victims. He's collected $1.4 billion so far, and has filed lawsuits seeking nearly $15 billion. But there are $19.4 billion in *estimated* losses." (emphasis added)).

212. *See, e.g.*, *supra* note 190 and accompanying text (stating that Chicago and New York City have False Claims Acts); MIAMI DADE COUNTY, FLA, ORDINANCE, ch. 21, art. XV, §§ 21-255–21-266 (2012), *available at* http://library.municode.com/index.aspx?clientId=10620&stateId=9&stateName=Florida (establishing a FCA for Miami-Dade County).

213. *See* Edward J. Kinberg, *The Impact of Federal, State, and Local False Claims Acts on the Construction Industry*, 84 FLA. B. J. 48, 52 (Oct. 2010) ("However, these 'escape' provisions also give MDC a very strong hammer to use to discourage contractors from pursuing a claim.").

believing that such claim was free of any material misstatements," "no reasonable basis to doubt the truth, veracity, or accuracy of such claim," or the "claimant diligently investigated the facts underlying such claim and prepared the claim in a reasonable manner."[214] Defendants, however, only have five days to cure the claim under any of these exceptions.[215] These exceptions seem to be addressing a common complaint amongst FCA critics regarding over-enforcement, especially of technical violations.[216] While this issue could become a problem in the Dodd–Frank context, until the program produces some empirical data, it is impossible to prognosticate whether over-enforcement will be an issue. Therefore, while some version of an "escape" provision may be warranted in the future, it is not necessary at this point.[217]

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214. MIAMI DADE COUNTY, FLA, ORDINANCE, ch. 21, art. XV, § 21-266(1)–(3) (2012), *available at* http://library.municode.com/index.aspx?clientId=10620&stateId=9&stateName=Florida.

215. *See id.* § 21-266(4) ("When information indicating that any element . . . in the claim was false or misleading first became available, such claimant, within five (5) business days of discovering the falsity of the claim, took immediate steps to modify, correct, or withdraw such claim and provided . . . immediate notice thereof.").

216. *See* Hughes Aircraft Co. v. U.S. *ex rel.* Schumer, 520 U.S. 939, 949 (1997) ("*Qui tam* relators are thus less likely than is the Government to forgo an action arguably based on a mere technical noncompliance with reporting requirements that involved no harm to the public fisc."); Beck, *supra* note 91, at 630 ("From the informer's perspective, however, it makes little difference whether a particular case is a wise application of the False Claims Act. Any reckless misstatement in a document submitted to the government might generate a bounty, whether or not the defendant meant to defraud the public." (citations omitted)).

217. The over-enforcement/technical-violation critique seems to arise chiefly in the *qui tam* context. *See* Kovacic, *supra* note 167, at 223 ("These passages from *Schumer* implicitly recognize that qui tam oversight can elicit excessively aggressive enforcement of certain legal commands. There may be numerous instances in which compliance with a nominal legal command . . . may undermine rather than enhance the public interest."). Because Dodd–Frank contains no *qui tam* provision, and enforcement will be left to the SEC, a good faith "escape" provision may not ever be necessary. The lack of oversight by the government that is consistently condemned in the FCA context should not be an issue under Dodd–Frank because the SEC and other government actors are completely responsible for litigating all actions under the program. *See* Rich, *supra* note 121, at 1278 ("Much of the blame for these problems is put on relators . . . . The problem instead lies with the DOJ, which is failing to counterbalance the financial motivations of the relator with its own considerations of how FCA actions can best serve the public interest."); *supra* notes 22–27, 37–45 and accompanying text (defining "covered actions" and

D. The Sarbanes–Oxley Act and Internal Reporting Requirements

1. Sarbanes–Oxley

The Sarbanes–Oxley Act[218] (SOX) was passed in the wake of the Enron and WorldCom scandals.[219] It set out various provisions requiring publically held companies to have independent directors, audit committees, and numerous other changes to corporate governance.[220] Of particular relevance to this Note, one section also addresses the whistleblower context.

Section 301(4) requires the "audit committees"[221] of all companies subject to SOX to establish procedures for "the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters" and for the "confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters."[222] This provision was included to decrease fraud through employee reporting or whistleblowing.[223]

"related actions" as used in Dodd–Frank).

218. *See* Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) [hereinafter Sarbanes–Oxley] (establishing increased disclosure and accounting requirements for publically held companies).

219. *See* Roberta Romano, *The* Sarbanes–Oxley Act *and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523 (2005) ("SOX was enacted in a flurry of congressional activity in the runup to the midterm 2002 congressional elections after the spectacular failures of the once highly regarded firms Enron and WorldCom.").

220. *See, e.g.*, *id.* at 1529, 1538 (stating, for example, "[s]ection 301 of SOX requires all listed companies to have audit committees composed entirely of independent directors, as defined by Congress" and "[s]ection 402(a) of SOX prohibits corporations from arranging or extending credit to executive officers or directors").

221. The "audit committee" is defined by the statute as "a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer . . . ." Sarbanes–Oxley § 2(a)(3) (codified at 15 U.S.C. § 7201(3)(A) (2006)).

222. Sarbanes–Oxley § 301(4) (codified as amended at 15 U.S.C. § 78j-1 (2006)).

223. *See* Miriam A. Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes–Oxley Act for Employment Law*, 79 WASH. L. REV. 1029, 1056 (2004) ("One of the major purposes of Sarbanes–Oxley is to promote the flow of accurate information to investors so that they can make informed decisions about how to allocate their resources.

The provision has led to the establishment of "whistleblower hotlines," where employees who become aware of fraud can report it.[224] The Act also provides substantial retaliation protections for employees who report corporate malfeasance either internally to the company or externally to government officials[225] and makes it a federal crime to retaliate against whistleblowers that report to law enforcement.[226]

The requirement to institute such internal reporting mechanisms is not phrased in discretionary terms; all companies subject to SOX must institute them.[227] In reaction to this federal mandate and in order to avoid any possible liability and delisting, companies instituted internal reporting mechanisms.[228] The cost of

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The whistleblowing provisions advance this purpose in that, if effective, they will reduce the amount of fraudulent financial information." (citations omitted)).

224. *See* Donald C. Dowling, Jr., *Sarbanes–Oxley Whistleblower Hotlines Across Europe: Directions Through the Maze*, 42 INT'L LAW. 1, 1 (2008) ("One discrete, and seemingly-straightforward**,** aspect of SOX and its Section 301 mandate [is] that audit committees offer 'confidential, anonymous employee complaint procedures,' colloquially called whistleblower hotlines.").

225. *See* Sarbanes–Oxley § 806(a) (codified at 18 U.S.C. § 1514A (2006)) (stating that no company shall "discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee" for providing information about violations of the securities laws to "a Federal regulatory or law enforcement agency," "any Member of Congress," or "a person with supervisory authority over the employee"); *see also* Cherry, *supra* note 223, at 1064 ("Under § 806 of Sarbanes–Oxley, whistleblowers who report instances of fraud internally or to governmental agencies are statutorily protected from retaliation if they work at publicly traded companies."); *id.* at 1065 ("[T]he Act protects whistleblowers who make internal reports of violations, as long as those reports are made to a supervisor or another individual within the organization. . . . Externally, the law covers reports to government agencies, such as the SEC.").

226. *See* Sarbanes–Oxley § 1107(a) (codified at 18 U.S.C. § 1513(e) (2006)) (stating that "[w]hoever knowingly, with the intent to retaliate" takes any action harmful to any person, including interference with employment, "for providing to a law enforcement officer any truthful information relating to the commission" of any "Federal offense, shall be fined" or "imprisoned not more than 10 years, or both").

227. *See* Sarbanes–Oxley § 301(4) (codified as amended at 15 U.S.C. § 78j-1 (2006)) ("Each audit committee *shall* establish procedures for—(A) the receipt, retention, and treatment of complaints . . . ." (emphasis added)); Cherry, *supra* note 223 at 1069 ("This is not phrased in discretionary terms—every publicly traded company must have a system in place for receiving anonymous complaints.").

228. *See* Richard Moberly, *Sarbanes–Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 B.Y.U. L. REV. 1107, 1139 ("The Act instructs

complying with SOX is significant.[229] In 2009, an SEC report found that the average compliance cost for companies with a "public float"[230] of more than $75 million was $2.33 million per year.[231] For companies with a public float of less than $75 million, the average was $690,000 per year.[232] Granted, only a portion of these costs are associated with the implementation and operation of the internal reporting systems; however, it does represent some portion of those totals, and the potential liability and other "soft" costs are considerable as well.[233] One observer noted that despite the possible implications of Dodd–Frank on this SOX provision, "companies will still have to keep compliance programs in place, often at a significant cost."[234]

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the Securities and Exchange Commission to direct the national securities exchanges and national securities associations (e.g., the New York Stock Exchange . . .) to prohibit the listing of any security of a company that is not in compliance with th[e] [§ 301] requirement."). It follows that because companies remain listed on the New York Stock Exchange they must have complied with section 301.

229. *See* OFFICE OF ECON. ANALYSIS, SEC. AND EXCH. COMM'N, STUDY OF THE SARBANES–OXLEY ACT OF 2002 SECTION 404 INTERNAL CONTROL OVER FINANCIAL REPORTING REQUIREMENTS 4–5 (2009) [hereinafter SEC, REPORT], *available at* www.sec.gov/news/studies/2009/sox-404_study.pdf (stating the mean compliance costs for companies with a "public float" above $75 million was $2.33 million per year).

230. *See In re* DVI Inc., Sec. Litig., 249 F.R.D. 196, 212 (E.D. Pa. 2008) ("[P]ublic float, [is] defined as the percentage of a security held by the public as opposed to company insiders . . . ."). Investorwords.com defines this term as, "The portion of a company's outstanding shares that is in the hands of public investors, as opposed to company officers, directors, or controlling-interest investors." *Public Float*, INVESTORWORDS.COM, http://www.investorwords.com/3936/public_float.html (last visited Apr. 10, 2012) (on file with the Washington and Lee Law Review).

231. SEC, REPORT, *supra* note 229, at 4–5.

232. *Id.* at 5.

233. *See* Kathy Gurchiek, *Sarbanes–Oxley Compliance Costs Rising*, HR MAGAZINE, Jan. 2005, *available at* http://findarticles.com/p/articles/mi_m3495/is_1_50/ai_n8699080/ ("Dealing with whistle-blowers might not be the most expensive element of complying with Sarbanes–Oxley. But it must be taken seriously or the consequences could be costly . . . ."). The article continues, "There also . . . are soft costs to the organization, such as potential loss of business momentum and focus. The chief financial officer, for example, may be less available for normal work duties because he or she is dealing with whistle-blower-related activities." *Id.*

234. Peter J. Henning, *The S.E.C., Whistle-Blowers and Sarbanes–Oxley*, DEALBOOK.NYTIMES.COM (Nov. 9, 2010, 1:35 PM) http://dealbook.nytimes.com/2010/11/09/the-s-e-c-whistleblowers-and-sarbanes-oxley/ (last visited Apr. 10,

With these facts in mind, the SEC should promulgate a rule for the Dodd–Frank program requiring all whistleblowers to first file an internal report with their company before becoming eligible for an award.[235] It seems patently illogical to require all publically held companies to institute internal reporting systems, at great cost to the company, and then disincenitivize actual use of those same systems through the Dodd–Frank program.[236] Even the SEC has stated that it wanted "to implement [Dodd–Frank] in a way that encourages strong company compliance programs."[237] An internal reporting requirement would effectuate that policy.[238]

Additionally, an internal reporting requirement would not be inconsistent with other SEC programs. Under Section 10A of the Exchange Act,[239] when a registered public accounting firm, performing an audit of a public company's financial statements, becomes aware of information that an illegal act "has or may have occurred," the accounting firm must first inform the company's audit committee.[240] If the audit committee fails to take adequate action, the accounting firm must then inform the board of directors.[241] Only if the board of directors then fails to report the

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2012) (on file with the Washington and Lee Law Review).

235. This recommendation is explored more fully *infra* Part IV.C.

236. Several of the comments received by the SEC to the proposed rules advocated similar rules. *See, e.g.*, BUSINESS ROUNDTABLE, COMMENTS ON PROPOSED RULES FOR IMPLEMENTING THE WHISTLEBLOWER PROVISIONS OF SECTION 21F OF THE SECURITIES EXCHANGE ACT OF 1934 6 (2010) [hereinafter BUSINESS ROUNDTABLE, COMMENTS], *available at* http://www.sec.gov/comments/s7-33-10/s73310-142.pdf (recommending an "internal reporting [requirement] where a company has a SOX-compliant procedure"). Business Roundtable consists of "an association of chief executive officers of leading corporations with a combined workforce of more than 12 million employees" and "nearly $6 trillion in annual revenues." *Id.* at 1. Several other comments made similar recommendations.

237. SEC, *Proposed Rules*, *supra* note 23, at 70496.

238. *See infra* Part III.D.3 (explaining the policies underlying internal reporting requirements and explaining why the existence of such a requirement would lead to better company compliance).

239. *See* Securities and Exchange Act of 1934 § 10A, 15 U.S.C. § 78j-1 (2006) (establishing an internal reporting requirement for registered public accounting firms performing audits on publically held companies).

240. 15 U.S.C. § 78j-1(b)(1)(B).

241. *See id.* § 78j-1(b)(2) ("If, after determining that the audit committee . . . is adequately informed . . . the registered public accounting firm concludes that . . . the senior management has not taken . . . timely and appropriate remedial actions . . . the registered public accounting firm shall, as soon as

violation to the SEC may the accounting firm report directly to the SEC.[242] Shareholder derivative suits echo a similar pattern of internal reporting. In that context, the shareholder must first make a demand of the board of directors that it pursue the claim or justify why such a demand is excused before the shareholder can pursue the action on his own.[243]

2. State Internal Reporting Requirements

Internal reporting requirements are also seen in a variety of other state contexts, apart from those seen in the state FCAs.[244] Ohio, for example, requires internal reporting to one's employer of violations of state or federal law as a prerequisite to reporting to government officials and for successfully litigating a retaliation claim.[245] Similarly, Florida law requires the employee to first "in writing, [bring] the activity, policy, or practice to the attention of a supervisor" and afford "the employer a reasonable opportunity to

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practicable, directly report its conclusions to the board of directors.").

242. *See id.* § 78j-1(b)(3) ("An issuer whose board of directors receives a report under paragraph (2) shall inform the Commission . . . . If the registered public accounting firm fails to receive a copy of the notice [informing the Commission] . . . the registered public accounting firm shall . . . furnish to the Commission a copy of its report . . . .").

243. *See* Grimes v. Donald, 673 A.2d 1207, 1216 (Del. 1996), *abrogated on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) ("A stockholder filing a derivative suit must allege either that the board rejected his pre-suit demand that the board assert the corporation's claim or allege with particularity why the stockholder was justified in not having made the effort to obtain board action."). For an overview of pre-suit demands, see generally Robert K. Wise, *Demand Futility in Shareholder-Derivative Litigation Under Texas Law*, 28 TEX. TECH L. REV. 59 (1997). Although shareholder derivative suits typically arise under state law and therefore are not governed by the SEC, these suits often relate to securities fraud or breaches of fiduciary duties by company directors and therefore are applicable to the Dodd–Frank program.

244. *See supra* notes 196–99 and accompanying text (describing State FCAs with internal reporting/exhaustion requirements).

245. *See* OHIO REV. CODE ANN. § 4113.52(A)(1)(A) (West 2011) ("[T]he employee orally shall notify the employee's supervisor or other responsible officer of the employee's employer of the violation and subsequently shall file with that supervisor or officer a written report that provides sufficient detail to identify and describe the violation."); *id.* § 4113.52(D) ("If an employer takes any disciplinary or retaliatory action against an employee as a result of the employee's having filed a report under division (A) of this section, the employee may bring a civil action . . . .").

correct" the violation before retaliation protection attaches.[246] New York has a nearly identical law to Florida's.[247]

Other states, in requiring internal reporting, carve out exceptions that are applicable in the Dodd–Frank context. Maine also withholds retaliation protection from reporting employees who do not first bring the violation to the attention of their employer.[248] Maine waives this exclusion, however, if "the employee has specific reason to believe that reports to the employer will not result in promptly correcting the violation."[249] New Jersey also has an exclusion to its mandatory reporting law where "the employee is reasonably certain that the activity, policy or practice is known to one or more supervisors of the employer or where the employee reasonably fears physical harm as a result of the disclosure provided, however, that the situation is emergency in nature."[250] Alaska also requires internal reporting, but it is waived in four situations: where the employee reasonably believes (1) reports to the employer will not result in prompt action to remedy the matter; (2) the activity, policy, or practice is already known to one or more supervisors; (3) an emergency is involved; or (4) fears reprisal or discrimination as a result of disclosure.[251]

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246. FLA. STAT. § 448.102 (2011).

247. N.Y. LABOR LAW § 740(3) (McKinney 2011) ("The protection against retaliatory personnel action . . . shall not apply to an employee who makes such disclosure . . . unless the employee has brought the activity, policy or practice . . . to the attention of a supervisor of the employer and has afforded such employer a reasonable opportunity to correct . . . ."); *see also* DANIEL P. WESTMAN & NANCY M. MODESITT, WHISTLEBLOWING: THE LAW OF RETALIATORY DISCHARGE 69–70 (2d ed. 2004) (listing, in addition to the above, Arkansas, Idaho, Louisiana, Massachusetts, Wyoming, Colorado, and North Carolina as all requiring either prior internal reporting or notice to the employer before external reporting is permitted).

248. *See* ME. REV. STAT. tit. 26, § 833(2) (2011) ("Subsection 1 does not apply to an employee who has reported . . . unless the employee has first brought the alleged violation, condition or practice to the attention of a person having supervisory authority . . . and has allowed the employer a reasonable opportunity to correct that violation . . . .").

249. *Id.*

250. N.J. STAT. ANN. § 34:19-4 (2011) ("The protection against retaliatory action provided by this act pertaining to disclosure to a public body shall not apply to an employee who makes a disclosure . . . unless the employee has brought the activity . . . to the attention of a supervisor . . . .").

251. ALASKA STAT. § 39.90.110(c) (2011).

Clearly the experience of the states supports prior internal reporting. These provisions are even harsher than would be applicable in Dodd–Frank, as they prevent employees from qualifying for retaliation protections,[252] whereas the internal reporting requirement advocated here would simply prevent the whistleblower from collecting a bounty.[253]

3. Public Policies Supporting Internal Reporting

Chiefly, an internal reporting requirement would support the main public policies which underlie any whistleblowing system on the macro level. First and foremost, the primary goal of any whistleblower provision should not be the punishment or harassment of employers by whistleblowers with intrinsic conflicts of interest,[254] but rather it should be the fast and effective correction of any wrongdoing.[255] This sentiment is reflected in a host of scholarship. One pair of scholars noted: "[T]he primary goal of whistleblowing is reduc[ing] wrongdoing rather than the prosecution of wrongdoers, and the speed with which problems are addressed is significant."[256]

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252. *See supra* notes 245–51 and accompanying text (describing state laws).

253. *See infra* Part IV.C (describing further the internal reporting requirement).

254. *See supra* notes 168–72 and accompanying text (discussing the whistleblowers' inherent conflicts of interest).

255. *See* Terry Dworkin & Elletta Callahan, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society*, 29 AM. BUS. L.J. 267, 285 (1991) ("Although prosecution may be a legitimate secondary goal of public whistleblower protection, it should not be permitted to hamper the primary objective of most whistleblowing statutes, which is to correct the wrongdoing as quickly and efficiently as possible.").

256. *Id.* at 306. *Cf.* Larry DiMatteo & Don Wiesner, *Academic Honor Codes: A Legal and Ethical Analysis*, 19 S. ILL. U. L.J. 49, 83 (1994) ("[T]he primary goal of whistleblowing [or reporting honor code violations] is reduction of wrongdoing rather than the prosecution of wrongdoers . . . . Thus, if the violation can be prevented or the violator immediately confronted, then it is more likely that the harm to the individuals and to the institution will be minimized." (citations omitted) (citing Dworkin & Callahan, *supra* note 255, at 306)); Raxak Mahat, *A Carrot for the Lawyer: Providing Economic Incentives for In-House Lawyers in a* Sarbanes–Oxley *Regime*, 21 GEO. J. LEGAL ETHICS 913, 932–33 (2008) ("The primary goal should be to get the information out at the earliest possible time so that transaction costs and shareholder losses are minimized and market confidence is not unnecessarily undermined."); Sarah Baum, Note, Callahan v.

An internal reporting requirement would support this goal in a variety of ways. Internal reporting would allow the company to respond quickly to allegations that are the result of simple negligence, oversight, "some other easily corrected inadvertence,"[257] or situations of legal nuance.[258] In many cases upper management may not even be aware of the issues being reported.[259] Internal reporting would allow companies to correct their own mistakes and avoid the need for significant, extended, and costly government intervention.[260] In the Dodd–Frank context,

Edgewater Care & Rehabilitation Center*: The Illinois Whistleblower Act Does Not Preempt the Common Law Tort of Retaliatory Discharge*, 57 DEPAUL L. REV. 161, 186–87 (2007) ("The primary goal of state whistleblower statutes is to correct wrongdoing."); Trystan Phifer O'Leary, Note, *Silencing the Whistleblower: The Gap Between Federal and State Retaliatory Discharge Laws*, 85 IOWA L. REV. 663, 663–64 (2000) ("The primary goal of many federal statutes, therefore, is not protection of the whistleblower. Rather, provisions protective of whistleblowers were included primarily as tools by which to advance the objectives of the legislation." (citations omitted)).

257. *See* WESTMAN & MODESITT, *supra* note 247, at 39–40 ("[E]mployees should consider . . . whether improprieties simply were the result of negligence, oversight, mistake, or some other easily corrected inadvertence.").

258. *See* Moberly, *supra* note 228, at 1156 ("[R]eporting errors could occur simply because an employee does not fully understand an ambiguous and complex situation in which it might be difficult to discern legal from illegal conduct."); *see also* Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 MICH. L. REV. 1757, 1760 (2007) ("Internal whistleblowing also enables the correction of misunderstanding, which reduces the likelihood that the organization and its employees will unfairly suffer harm."); Kevin Runinstein, Note, *Internal Whistleblowing and Sarbanes–Oxley Section 806: Balancing the Interests of Employee and Employer*, 52 N.Y.L. SCH. L. REV. 637, 650 (2008) ("In a case where no actual wrongdoing occurred, internal whistleblowing would allow the employer to clarify the misunderstanding before negative information becomes public.").

259. *See* WESTMAN & MODESITT, *supra* note 247, at 40 ("Attempts to informally resolve alleged violations may lead to correction of problems, and may prevent criminal prosecution of honest but ill-informed managers who would immediately correct problems if they knew about them."); Terry Dworkin & Janet Near, *Whistleblowing Statutes: Are They Working?*, 25 AM. BUS. L.J. 241, 243 (1987) ("[T]op executives may actually be unaware of wrongdoing committed by subordinates; internal complaints give them a chance to stop the wrongdoing before it is made public.").

260. *See* Passaic Valley Sewerage Comm'rs v. U.S. Dep't of Labor, 992 F.2d 474, 478–79 (3d Cir. 1993) ("Employees should not be discouraged from the normal route of pursuing internal remedies before going public . . . . [I]t is most appropriate, both in terms of efficiency and economics . . . that employees notify management of their observations as to the corporation's failures before formal investigations and litigation are initiated . . . ."); David Culp, *Whistleblowers:*

this benefit would actually inure to the public, as immediate public disclosure would likely lead to significant negative press, thereby harming public shareholders through lowered share values.[261] Further, the requirement would also incentivize companies to create effective reporting and compliance mechanisms, as only where responsive and efficient systems are in place would the requirement preclude full public disclosure of the possible violation.[262]

Corporate Anarchists or Heroes? Towards a Judicial Perspective, 13 HOFSTRA LAB. L.J. 109, 133 (1995) ("This would 'give employers the initial opportunity to correct their own violations,' and encourage resolution within the company." (quoting Martin H. Malin, *Protecting the Whistleblower from Retaliatory Discharge*, 16 MICH. J. OF L. REFORM 277, 305 (1982))).

261. For a detailed discussion of how all publically available information integrates into stock price, see generally Ronald Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 554 (1984) ("The common definition of market efficiency, that 'prices at any time 'fully reflect' all available information' . . . ." (quoting Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383, 383 (1970))); *see also* Schleicher v. Wendt, 618 F.3d 679, 684–85 (7th Cir. 2010) ("There are three versions of the efficient capital market hypothesis: weak, semi-strong, and strong.") The court continues:

> The weak version is that prices incorporate information in a way that prevents the historical pattern of prices from being used to predict changes in price. In other words, it is not possible to identify any trading rule that beats the market. Everyone can observe historical prices; if information were there, sophisticated traders would use it, prices would adjust, and the past prices would cease to be informative. This implies that only someone with new information can make a trading profit. The semi-strong version adds that the value of new information is itself reflected in prices quickly after release, so that only the *first* recipient of this information (or someone with inside information) makes a profit; everyone else might as well ignore the information and rely on the prices. The strong version adds a claim that the price set in this way is *right*, in the sense that it accurately reflects the firm's value.

Id. at 685.

262. *See* Runinstein, *supra* note 258, at 652 ("Requiring internal disclosure as a first resort would also encourage organizations to develop effective reporting and compliance mechanisms to ensure that problems are corrected within the organization in order to avoid external disclosure."); *cf.* Dworkin & Near, *supra* note 259, at 251 ("[T]he provisions encourage organizations to set up grievance procedures or other constructive ways of dealing with internal problems, for the bar to suit by employees exists only for those who do not make reasonable efforts to take advantage of what is available.").

Reducing costs for all parties involved should also underlie any good whistleblower program.[263] As explained above, the internal reporting requirement would screen out spurious claims, saving both the government (in the form of reduced investigative expenditures) and companies money. Whistleblowers may also use external reporting for bad-faith purposes, such as gaining an advantage in promotions or retaliating against the employer for some perceived slight.[264] An internal reporting requirement would channel these complaints inward where they could be vetted more cheaply than by government investigation and avoid possible litigation and opportunity costs.[265]

The SEC has expressed reticence in promulgating an internal reporting requirement, stating, "[W]hile many employers have compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances of confidentiality, others lack such established procedures and protections."[266] An internal reporting requirement, however, would actually incentivize the establishment and use of such robust and thorough procedures.[267] Companies subject to SOX are already mandated to have in place substantial internal reporting mechanisms,[268] and any lack of internal systems would in no way

263. *See* Moberly, *supra* note 228, at 1153 (describing the costs associated with any whistleblower system, and finding that the SOX model of internal reporting "minimizes those costs and, where appropriate, reduces the costs of whistleblowing").

264. *See id.* at 1156 ("Whistleblowers could use the system opportunistically to gain some sort of job security by disclosing imaginary misconduct, to achieve an advantage in promotion or salary by wrongly reporting a co-employee, or simply to hurt the employer in retaliation for some perceived slight." (citations omitted)).

265. *See id.* ("[T]he costs of such erroneous claims include costs associated with internal investigations, litigation expenses, opportunity costs, potential penalties, and costs related to becoming a possible target for government regulators."). The article continues, "The [SOX] Model can reduce the costs of whistleblowing errors, whether made maliciously or in good faith, because the Model channels whistleblower disclosures internally rather than externally. . . . [A] corporation that receives erroneous disclosures internally at least has the possibility of providing feedback and correct information to a whistleblowing employee." *Id.* at 1156–57 (citations omitted).

266. SEC, *Proposed Rules*, *supra* note 23, at 70496.

267. *See supra* note 262 and accompanying text (describing how the requirement would lead to effective internal reporting systems).

268. *See* Sarbanes–Oxley § 301(4) (codified as amended at 15 U.S.C. § 78j-1

preclude subsequent external reporting to the SEC by the whistleblower if the company fails to do so. Finally, the SEC's concern about confidentiality could easily be remedied by having the whistleblower's attorney file the internal report. Dodd–Frank itself requires anonymous whistleblowers to be represented by counsel.[269]

While the SEC notes that it "does not intend for its rules to undermine effective company processes for receiving reports on potential violations,"[270] the tremendous economic incentives provided for under the Dodd–Frank program do just that.[271] The best way to ensure "thorough and robust"[272] internal reporting systems is by not just allowing internal reporting but by requiring it.

With all this in mind, a uniform rule would include a requirement that, for any whistleblower to become eligible for an award under Dodd–Frank, the whistleblower must first have filed an internal report and given the company a reasonable time to respond.[273] The whistleblower's counsel can fulfill this requirement if adequate confidential reporting systems are not in place. The

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(2006)) ("Each audit committee *shall* establish procedures for—(A) the receipt, retention, and treatment of complaints . . . ." (emphasis added)); Cherry, *supra* note 223, at 1069 ("This is not phrased in discretionary terms—every publicly traded company must have a system in place for receiving anonymous complaints.").

269. *See* Dodd–Frank § 922(d)(2) ("Any whistleblower who anonymously makes a claim for an award under subsection (b) shall be represented by counsel if the whistleblower anonymously submits the information upon which the claims is based.").

270. SEC, *Proposed Rules*, *supra* note 23, at 70496.

271. *See* BUSINESS ROUNDTABLE, COMMENTS, *supra* note 236, at 2 ("[D]espite the Commission's best intentions, its 'Securities Whistleblower Incentives and Protection' program is likely to significantly undermine established corporate compliance programs by giving employees a substantial financial incentive and no meaningful disincentive to bypass internal reporting mechanisms in pursuit of bounty payments from the SEC.").

272. *Id.*

273. Nothing in this requirement should be interpreted as removing retaliation protection under Dodd–Frank from the putative whistleblower. *See* Dodd–Frank § 922(h)(1)(A) ("No employer may discharge, demote, suspend, threaten, [or] harass . . . a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—(i) in providing information to the Commission . . . ."). This suggestion only relates to removing the bounty incentive from whistleblowers that fail to file an internal report.

internal reporting requirement would be waived if the employee: (1) is reasonably certain that the employer will not make a good faith effort at remedying the violation, such as where the conduct implicates high-level supervisors (such as directors), or (2) reasonably believes an emergency is involved.[274]

This recommendation would both further the policy goals underlying whistleblower provisions and reduce meritless reporting to the SEC by having the companies themselves screen spurious or ill-informed claims.[275] In addition, this recommendation balances the interests of both whistleblowers and companies by requiring a presumptive duty to file an internal report but also recognizing that in certain circumstances such a barrier may be too high.[276]

IV. Recommendations

A synthesis of all this information leads to a few logical conclusions. Experience under the IRS whistleblower bounty

274. These exceptions are fairly similar to those seen above, *supra* note 250, in the New Jersey statute, about which one commentator stated, "The requirement gives employees the opportunity to voice any concerns they may have with their employers candidly and in good faith. It also gives employers the opportunity to inform employees about any potential misperception the employee has made about the relevant law or actual practice." David Aron, *"Internal" Business Practices?: The Limits of Whistleblower Protection for Employees Who Oppose or Expose Fraud in the Private Sector*, 25 ABA J. LAB. & EMP. L. 277, 295–96 (2010).

275. *See supra* note 257 and accompanying text (describing how internal reporting would lead to internal resolution of many disputes).

276. Some comments to the proposed rules made similar suggestions, including the exceptions to the duty. *See, e.g.*, HUNTSMAN CORPORATION, COMMENTS ON PROPOSED RULES FOR IMPLEMENTING THE WHISTLEBLOWER PROVISIONS OF SECTION 21F OF THE SECURITIES EXCHANGE ACT OF 1934 5 (2010), *available at* http://www.sec.gov/comments/df-title-ix/whistleblower/whistleblower-74.pdf ("We strongly urge that the SEC impose upon a whistleblower a presumptive duty to report a potential violation to the company . . . ."). The comment continues:

> We recognize that there may be instances in which a whistleblower may not want to report to the company because of a concern that there will be retaliation or that senior management is . . . involved in the wrongdoing . . . . Thus, we suggest that the SEC . . . leave open the possibility that a whistleblower may be allowed to circumvent the company's compliance process if there is a substantial, reasonable and legitimate reason to do so.

Id. at n.1.

provision shows that reporting under Dodd–Frank is likely to increase markedly from that seen under the old § 78u program and is also likely to increase over time.[277] In fact, David Rosenfeld, associate director of the SEC's New York Regional Office, stated that his office has been "inundated" with tips and complaints under the newly enacted program.[278] He expects "tons of these whistleblower complaints" and that "considerable resources and time" will be needed to sort out viable tips.[279] This only reinforces the inference drawn from the IRS program's reporting data that a major amount of reporting under Dodd–Frank should be expected.[280] The IRS data also show that a major increase in collected penalties and payouts of bounties is imminent as well.[281]

A. Reverse Attorney's Fees

Federal experience with the FCA illustrates that an extreme amount of meritless reporting should be expected.[282] To combat this problem the SEC should promulgate rules disincentivizing meritless reporting under Dodd–Frank. Drawing on both federal and state FCA provisions,[283] such a rule should state: Where the defendant is successful in defending a suit brought against it pursuant to information provided by a Dodd–Frank whistleblower, the government and the whistleblower shall be jointly and

277. *See supra* Part III.A (describing the IRS program and data).

278. Yin Wilczek, *SEC to Take Advantage of New Powers to File Aiding, Abetting Charges, Official Says*, 8 CORP. ACCOUNTABILITY REP. (BNA) 1224 (Nov. 12, 2010).

279. *Id.*

280. *See supra* notes 75–85 and accompanying text (predicting significant reporting under Dodd–Frank).

281. *See supra* notes 75–85 and accompanying text (describing collection and payment data).

282. *See supra* notes 149–66 and accompanying text (describing meritless claims data).

283. *See* 31 U.S.C. § 3730(d)(4) (2006) ("[T]he court may award to the defendant its reasonable attorneys' fees and expenses if the defendant prevails in the action and the court finds that the claim of the person bringing the action was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment."); FLA. STAT. § 68.086(3) (2008) ("If the department does not proceed with an action under this act and the defendant is the prevailing party, the court shall award the defendant reasonable attorney's fees and costs against the person bringing the action.").

severally liable to the defendant for the costs of its reasonable attorney's fees, if the suit is shown to have been frivolous.

As noted in Part III.B, the "clearly frivolous" language of the federal FCA has been interpreted too narrowly in this context,[284] and thus this recommendation refers to the definition of "frivolous" in the Federal Rules of Civil Procedure Rule 11.[285] Using the Rule 11 definition of "frivolous" provides a prepackaged standard with which lawyers and judges are both well aware and familiar.[286]

B. Nurturing Unlawful Conduct

Experience with the federal FCA also cautions that "nurturing unlawful conduct" will be an issue in the Dodd–Frank context as well.[287] This phenomenon involves the incentive that whistleblowers in the bounty context have to delay reporting until

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284. *See, e.g.*, Pfingston v. Ronan Eng'g Co., 284 F.3d 999, 1006–07 (9th Cir. 2002) ("The award of fees under the False Claims Act is reserved for rare and special circumstances.").

285. FED. R. CIV. P. 11 (establishing the effect of an attorney or unrepresented party's signing of pleadings, motions, other papers, and representations to the court, and providing sanctions for frivolous assertions contained therein). The Rule states:

> [A]n attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation; (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law; (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

Id.

286. *See, e.g.*, William W. Schwarzer, *Rule 11 Revisited*, 101 HARV. L. REV. 1013, 1013 (1988) ("Rule 11 has become a significant factor in civil litigation . . . ."). "[T]he majority of the lawyers practicing in federal courts must be aware by now of the requirements of rule 11. This awareness has certainly deterred some frivolous, wasteful, or abusive litigation." *Id.* at 1014–15.

287. *See supra* notes 168–72 and accompanying text (describing the concept of "nurturing unlawful conduct" in the FCA context).

damages have increased to the maximum amount.[288] Because the whistleblowers' compensation is tied directly to the amount of damages, the higher the damages, the greater their award.[289]

To combat this, the SEC should promulgate a rule that reduces the whistleblowers award to the minimum percentage allowed by law if it is found that the whistleblower unreasonably delayed reporting the violation. Under the FCA, Congress has found it fit to cap the relator's award at 10% if their claim was based on certain publically available information.[290] The only award amounts that are appealable under Dodd–Frank, however, are those outside the 10%–30% range.[291] Therefore, it seems unlikely that the SEC has the statutory authority to reduce the award below 10% for this kind of conduct. A congressional amendment to the program authorizing an award below the 10% minimum for unreasonably delaying whistleblowers should occur as well.

C. Internal Reporting Requirement

Finally, and perhaps most importantly, the realities of SOX and the experience of the states in the FCA and employment

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288. *Supra* notes 168–72 and accompanying text.

289. *Supra* notes 168–72 and accompanying text.

290. 31 U.S.C. § 3730(d)(1) (2006) (reducing the award to maximum of 10%). The text of the statute states:

> Where the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) relating to allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, the court may award such sums as it considers appropriate, but in no case more than 10 percent of the proceeds . . . .

Id.

291. *See* SEC, *Final Rules*, *supra* note 35, at 34347 ("[W]hen the Commission makes an award between 10 and 30 percent . . . our final order regarding the amount of an award (including the award allocation among multiple whistleblowers) is not appealable."); Dodd–Frank § 922(f) ("Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States. . . ."); *supra* notes 34–36 and accompanying text (describing the right of appeal).

retaliation contexts demonstrate that the SEC should promulgate an internal reporting requirement.[292] This rule would require a presumptive duty for the whistleblower to report internally first and then allow a reasonable amount of time for the company to respond. The whistleblower's counsel can fulfill this requirement if the company does not have adequate, confidential systems in place. The internal reporting presumption can be overcome in two situations, if the employee: (1) is reasonably certain that the employer will not make a good-faith effort at remedying the violation, such as where the conduct implicates high-level supervisors (such as directors), or (2) reasonably believes an emergency is involved.

V. Conclusion

By recognizing the inherent conflict in using a "rogue to catch a rogue," this Note concludes that certain changes to the Dodd–Frank whistleblower bounty program are necessary. Data compiled from the IRS and the Federal False Claims Act illustrate that a significant amount of meritless reporting is expected. To combat this, a reverse attorney's fees rule is needed. Experience with the Federal FCA also illustrates that a major reduction in awards should occur for all whistleblowers that unreasonably delay reporting. Drawing on State False Claims Acts and the Sarbanes–Oxley Act, an internal reporting rule is necessary to reduce further the transaction costs associated with meritless or otherwise unnecessary reporting. In sum, when using rogues to catch rogues, it is both necessary and appropriate to confine these whistleblowers somewhat so as to provide a check against the enormous economic incentive provided by whistleblower bounty programs.

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292. *See supra* notes 218–76 and accompanying text (describing the requirements of SOX); *supra* notes 196–201 and accompanying text (discussing state FCA provisions with internal reporting requirements); *supra* notes 245–52 (describing internal reporting requirements in state employment retaliation law).