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Rewarding Whistle-blowers For Greater Compliance

In the wake of some spectacular instances of corporate evildoing, the SEC is wondering about offering serious cash to entice people who want to come forward.

By Emily Badger

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The financial reform bill passed by Congress last year contained a provocative idea: Perhaps the government could entice more corporate whistle-blowers to speak up about the type of abuse that's become synonymous with Enron, or WorldCom, or Fannie Mae, if it offered a serious bounty. Specifically, Congress had in mind as much as 30 percent of any settlement money the Securities and Exchange Commission recovers from companies in a fraud case.

Business groups and whistle-blower advocates have been sparring over exactly how the SEC should implement the program for the last year. This week, the SEC voted to finalize the rules in a contentious 3-2 decision praised by whistle-blower groups but derided by the U.S. Chamber of Commerce.

At the heart of the dispute was whether whistle-blowers should first have to alert their companies of allegations before taking them to the feds. Business groups argued that, without such a rule, the government's initiative would undermine corporate compliance programs. Opponents countered that such a requirement would discourage whistle-blowers from speaking out by forcing them to, in essence, alert corporate criminals before going to the authorities.

<http://www.uschamber.com/press/releases/2011/may/us-chamber-warns-new-sec-whistleblower-rule-will-undermine-corporate-complia>

The SEC sided with the latter logic, and the new program will now reward whistle-blowers who voluntarily provide "original information" that leads to a penalty of at least \$1 million with 10 to 30 percent of the settlement.

If the agency properly administers its whistle-blower office, responded Stephen Kohn, executive director of the National Whistleblowers Center, the program could detect fraud and "create the enforcement hammer needed to make real change in the culture of corruption that fostered fraudsters like Bernie Madoff and led to countless Wall Street debacles, costing innocent investors trillions of dollars."

In its statement, the Chamber of Commerce offered a different analogy.

"Not informing the company of a potential fraud and waiting for the SEC to act is the equivalent of not calling the firefighters down the street to put out a raging fire and instead calling the lawyers from the next town to sue over the fire instead," Chamber officials said in a statement.

"The company is in the best position to immediately investigate and mitigate any violations, not the SEC, who will be inundated with thousands of tips it won't be able to handle."

The National Whistle-blowers Center last year produced a study suggesting cash rewards would make whistle-blowers no more likely to turn to the government than their own corporate compliance offices and would do little to harm internal compliance. In assessing cases filed under the False Claims Act since 2007, the study found that nearly 90 percent of employees still reported their concerns internally before going to the government (although sometimes the government benefits by setting a rogue to catch a rogue).

A *New England Journal of Medicine* study published last year reached similar conclusions in analyzing the experiences of whistle-blowers against pharmaceutical companies. Not one of the 26 whistle-blowers involved in litigation who were interviewed for the study said he or she was



Recent corporate debacles have the SEC wondering if offering serious cash rewards to entice whistle-blowers will be the panacea they're looking for. Business groups disagree. (Thomas Lammeyer / istockphoto.com)

motivated by a financial bounty. In fact, “The prevailing sentiment was that the payoff had not been worth the personal cost,” the researchers concluded. Generally, the whistle-blowers interviewed also tried to address their concerns internally and only became litigants either accidentally or “as a last resort.”

Such results suggest businesses may be overreacting to the fear that a flood of employees will run to the government in secret to profit off tattling bonuses. But they also suggest something else: If money hasn’t been shown to dramatically motivate whistle-blowers, will the SEC’s program even have its intended effect?

“Almost certainly the quantity of whistleblowing disclosures will increase thanks to this program,” said Tom Devine, the legal director with the Government Accountability Project. But that’s not because whistleblowers are motivated by financial personal gain. “First, the government is putting its money where its mouth is, and that’s a good antidote for the primary reason why whistleblowers remain silent, which is cynicism. With good cause, they think the government’s not really interested in going beyond public relation invitations to provide evidence.”

And the second reason? Devine said the money helps to neutralize the chilling effect from the fear of bankruptcy that can come with lost employment and mounting legal fees.

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