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Abstract

The European Commission has recently released a Proposal for a Regulation on market abuse, to increase investor confidence and market integrity in European capital markets law. One of its most innovative elements involves allowing Member States to provide financial incentives to whistleblowers who report cases of market abuse. In this, the Commission has apparently taken inspiration from the US legislation which with the Dodd Frank Act of 2010, significantly expanded its whistleblower reward program. This article examines both the US and the European regulations, and evaluates the advantages and disadvantages of offering financial incentives to encourage informants to blow the whistle. Finally, it looks at the potential structure of a reward program, examining the balance required between external rewards and internal company compliance processes.

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Financial Incentives for Whistleblowers in European Capital Markets Law?
– Legal Policy Considerations on the Reform of the Market Abuse Regime –

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The European Commission has recently released a Proposal for a Regulation on market abuse, to increase investor confidence and market integrity in European capital markets law. One of its most innovative elements involves allowing Member States to provide financial incentives to whistleblowers who report cases of market abuse. In this, the Commission has apparently taken inspiration from the US legislation which with the Dodd Frank Act of 2010, significantly expanded its whistleblower reward program. This article examines both the US and the European regulations, and evaluates the advantages and disadvantages of offering financial incentives to encourage informants to blow the whistle. Finally, it looks at the potential structure of a reward program, examining the balance required between external rewards and internal company compliance processes.

I. Introduction

Capital markets law is increasingly relying on whistleblowers in the battle against investment fraud, accounting scandals and market abuse.[1] Ideally, employees of a company who become aware of such offences should raise the alarm as swiftly as possible, both to help increase the clear up rate for capital market crimes and to shore up dwindling investor confidence. However, potential informants are often reluctant to notify relevant bodies within the company ("internal" whistleblowing) or to a regulatory authority ("external"

[1] Cf. A. Heyes and S. Kapur, 'An Economic Model of Whistle-Blower Policy', The Journal of Law, Economics, & Organisation (JLEO) 25 (2008) p. 157: '"Whistle-blowing" is an increasingly common element of regulatory enforcement programs and one that is encouraged by recent legislation in the United States and elsewhere'; for a global overview D.B. Lewis (ed.), *A Global Approach to Public Interest Disclosure* (Cheltenham, Edward Elgar Pub. 2010); as to the US setting M. Delikat and R. Phillips, *Corporate Whistleblowing in the Sarbanes-Oxley/Dodd-Frank Era*, (New York, Practising Law Institute 2nd ed. 2011) § 1:1 (p. 1-1): 'Employers need to understand the sea change that has occured since the passage of Sarbanes-Oxley: Employees who 'blow the whistle' are less likely to be viewed as troublemakers than as courageours individuals who are often the last check on corporate wrongdoing.'; L.M. Hartmann,'Whistle While You Work: The Fairytale-Like Whistleblower Provisions of the Dodd-Frank Act and the Emergence of "Greedy," the Eighth Dwarf', 62 Mercer L. Rev. 1279 (2011); from an Australian angle cf. N. Mavrakis and M. Legg, 'The Dodd-Frank Act whistleblower reforms put bounty on corporate non-compliance: Ramifications and lessons for Australia', (2012) 40 ABLR p. 26; from a UK perspective see J. Gobert and M. Punch, 'Whistleblowers, the Public Interest, and the Public Interest Disclosure Act 1998', (2000) 63 *Modern Law Review* (MLR) p. 25, at p. 26: 'In Britain, Parliament, by enacting PIDA, has now climbed aboard the bandwagon.'

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whistleblowing)[2], as they fear for their own future professional advancement. Powerful accounts from home and abroad telling of ostracism in the workplace, dismissal, demotion, suspension and industry wide blacklisting[3], certainly appear to support this concern.[4]

Against this reality, legislators and the courts must provide a legal environment more conducive to reporting illegal activities in order to foster willingness to blow the whistle. The current regulatory toolbox provides a range of measures for consideration, summarised in a newly released article as "Protect - Command - Fine - Pay"[5], i.e.: (1) an effective protection against retaliation for informants, (2) a statutory obligation to report illegal behaviour, (3) the imposition of fines for a failure to report illegal behaviour, and (4) financial incentives for informants.

[2] On the distinction between internal and external Whistleblowing see T.M. Dworkin and M.S. Baucus, 'Internal vs. External Whistleblowers: A Comparison of Whistleblowing Processes', *Journal of Business Ethics* (J. Bus. Ethics) 17 (1998) p. 1281; M. Casper, 'Whistleblowing zwischen Denuntiantentum und integralem Bestandteil von Compliance-Systemen', in M. Hoffmann-Becking, U. Hüffer and J. Reichert, eds., *Liber Amicorum M. Winter* (Köln, Otto Schmidt 2011) p. 77 at pp. 78-79; M. Kort, 'Individualarbeitsrechtliche Fragen des Whistleblowing', in G. Hoenn, H. Oetker and T. Raab, eds., *Festschrift für Peter Kreutz* (Köln, Luchterhand 2010) p. 247 at pp. 247-248; K.U. Schmolke, 'Whistleblowing-Systeme als Corporate Governance-Instrument transnationaler Unternehmen', *Recht der Internationalen Wirtschaft (RIW) (2012)* Issue 4 (forthcoming); R. Sethe, 'Compliance, Whistleblowing und Critical Incident Reporting', in R. Sethe, A. Heinemann, R. M. Hilty, P. Nobel and R. Zäch, eds., *Kommunikation, Festschrift für R.H. Weber zum 60. Geburtstag* (Bern, Stämpfli 2011) p. 189, at p. 195; for an empirical study of German enterprises see E. Pittroff, *Whistle-Blowing-Systeme in deutschen Unternehmen* (Wiesbaden, Gabler Verlag 2011) p. 146.

[3] See from a US perspective C.F. Alford, 'Whistleblowers: Broken Lives and Organizational Power, (New York, Cornell University Press 2001) pp. 52 et seq.; G.C. Rapp, 'Beyond Protection: Invigorating Incentives for Securities Fraud Whistleblowers', 87 Boston University Law Review (2007) p. 91, at p. 95: 'Potential whistleblowers face tremendous obstacles beyond direct employer retaliation. … Moreover, whistleblowers may fear blacklisting from future employers who suspect disloyalty, as well as social ostracism from their co-workers. Additionally, the psychological burdens associated with whistleblowing, including the effects of public criticism and a lengthy stay in litigation's limelight, cannot be ignored.'; see recently from German literature R. Groneberg, 'Whistleblowing – eine rechtsvergleichende Untersuchung des US-amerikanischen, englischen und deutschen Rechts unter besonderer Berücksichtugung des Entwurfs eines neuen § 612a BGB' (Berlin, Duncker & Humblot 2011) at pp. 31 et seq.

[4] As laconically remarked in I.J.A. Dyck, A. Morse and L. Zingales, 'Who Blows the Whistle on Corporate Fraud?', 65 *Journal of Finance* (2010) p. 2213, at p. 2245: 'Given these costs, it is not surprising that most employees do not talk, but that some talk at all.'; Senate Committee on Banking, Housing, and Urban Affairs, *Report on the Restoring American Financial Stability Act of 2010*, S. Rep. 111-176 (30 April 2010), at p. 111: 'career suicide'; similarly from the British perspective Gobert and Punch, *supra* n. 1, at p. 35: 'professional suicide'.

[5] Y. Feldman and O. Lobel, 'The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality' 88 *Texas Law Review* (2010) p. 1151, at p. 1157; similarly D. Ebersole, 'Blowing the Whistle on the Dodd-Frank Whistleblower Provisions', 6 *Entrepreneurial Business Law Journal* (2011) p. 123, at p. 135: 'Three types of laws incentivize whistleblower reporting: anti-retaliation protection, monetary incentives, and affirmative duties to report.'

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Of these four measures, financial incentives for whistleblowers are at the forefront of current legal policy approaches[6]: As part of the Dodd-Frank Act of 2010[7], the US legislator significantly expanded its program of financial incentives for reporting capital market offences[8], and renowned economists are similarly recommending improved financial incentives for whistleblowers.[9] In its recently presented Proposal for a Market Abuse Regulation[10], the European Commission has joined the call, opening up the opportunity to Member States to grant a reward to whistleblowers who submit salient information on market abuse.[11] This article introduces this regulatory innovation in more detail, and evaluates the advantages and disadvantages of financial rewards and financial reward programs for whistleblowers in capital markets law. It also goes into potential structures for reward programs and examines the interaction between external "bounty programs" and internal company compliance processes.

II. Reward Programs in European and US Capital Markets Law

1. Financial Incentives for Informants in European Capital Markets Law

[6] For a US perspective see Feldman and Lobel, *supra* n. 5, at p. 1153: 'Questions about social enforcement and the role of individual reporting in preventing corporate and governmental misconduct are at the forefront of current debates and reforms.'; see also recently J.R. Blount and S. Markel, 'The End of the Internal Compliance World as We Know It, or an Enhancement of the Effectiveness of Securities Law Enforcement? Bounty Hunting Under the Dodd-Frank Act's Whistleblower Provisions', 17 *Fordham Journal of Corporate and Financial Law* (2012) (Issue 1, forthcoming); from a German perspective, see H. Fleischer, 'Zukunftsfragen der Corporate Governance in Deutschland und Europa: Aufsichtsräte, institutionelle Investoren, Proxy Advisors und Whistleblowers', 40 *Zeitschrift für Unternehmens- und Gesellschaftsrecht (ZGR)* (2011) p. 155, at pp. 174-175.

[7] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. 111-203.

[8] See sec. 21F of the Securities Exchange Act 1934; in detail D.A. Harker, M.D. Keiser and S.C. Rosenfeld, 'Whistleblower Incentives and Protections in the Financial Reform Act', 127 *The Banking Law Journal* (2010) p. 779; Delikat and Phillips, *supra* n. 1, § 16; also Hartmann, *supra* n. 1; from an Australian perspective Mavrakis and Legg, *supra* n. 1, at pp. 30-33; from German literature see Fleischer, *supra* n. 6, at p.174 et seq.; T. Schürrle, ''Whistleblowing Unlimited' – Der U.S. Dodd-Frank Act und die neuen Regeln der SEC zum Whistleblowing', 4 *Corporate Compliance Zeitschrift (CCZ)* p. 218, at pp. 218-219.

[9] See Dyck, Morse and Zingales, *supra* n. 4, at p. 2251: 'A natural implication of our findings is that the role of monetary incentives should be expanded. We find that the use of monetary rewards provides positive incentives for whistleblowing.'

[10] See Art. 29 sec. 2 of the Proposal for a Regulation on market abuse.

[11] European Commission, Proposal for a Regulation of the European Parliament and of the Council on insider sealing and market manipulation (market abuse) of 20 October 2011, COM(2011) 651 final; on this proposal R. Veil and P. Koch, 'Auf dem Weg zu einem Europäischen Kapitalmarktrecht: die Vorschläge der Kommission zur Neuregelung des Marktmissbrauchs', *Zeitschrift für Wirtschafts- und Bankrecht* (2011) p. 2297.

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The legal framework for combating insider trading and market manipulation in European capital markets law was set in 2003 by the Market Abuse Directive.[12] However, the sanctioning regime established under this Directive has recently attracted strong criticism[13], which has led the Commission to consider fundamental reforms.

a) Greater Deterrence by Stronger Sanctions

The proposed European market abuse regime aims to introduce a more effective supervisory and sanctioning regime to increase investor confidence and market integrity, thus improving the stability of financial markets[14]. As one of its core elements, the regime puts forward a Directive that requires all Member States to provide criminal law provisions for serious cases of insider trading and market manipulation.[15] The Commission expects this to provide greater deterrence[16], knowing however that the deterrence effect of criminal sanctions depends not only on the level of the sanctions imposed on capital market offences, but also on their likelihood of detection. For this reason, the Commission is seeking to grant greater investigative powers to supervisory bodies and prescribe more effective procedures for reporting of market abuses.[17]

b) Better Protection against Reprisals and Potential Rewards for Whistleblowers

At this point the protection of whistleblowers comes into play: According to the explanatory memorandum for the proposed Regulation, whistleblower reports can serve as a useful source of first-hand information to bring suspected market abuses to the attention of the relevant

[12] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJL 96 of 12 April 2003; on this directive N. Moloney, *EC Securities Regulation* (Oxford, Oxford University Press 2nd ed. 2008), at pp. 913 et seqq.

[13] See the Report of the High-Level Group on Financial Supervision in the EU ('de Larosière-Report') of 25 February 2009, at p. 23.

[14] See the Explanatory Memorandum of the Proposal for a Regulation on Market Abuse, at p. 2; see also Art. 1 of the Proposal for identical content: 'This Regulation establishes a common regulatory framework on market abuse to ensure the integrity of financial markets in the Union and to enhance investor protection and confidence in those markets.'

[15] European Commission, Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation of 20 October 2011, COM(2011) 654 final; critically as to the question of legislative competence of the European Union the Bundesrat (German upper house of parliament), BR-Drucksache 646/1/11.

[16] See Recital 7 of the Proposal for a Directive on market abuse.

[17] See Art. 29 sec. 1 of the Proposal for a Regulation on market abuse.

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government authorities.[18] However, according to the Commission, informants may refrain from coming forward due to a fear of reprisals or a lack of incentives.[19] The proposed regulation therefore aims to provide appropriate safeguards for whistleblower protection and potential financial incentives. Under the heading "Reporting of Violations", Article 29 of the draft Regulation states:

> "1. Member States shall put in place effective mechanisms to encourage reporting of breaches of this Regulation to competent authorities, including at least:
> (a) specific procedures for the receipt of reports of breaches and their follow-up;
> (b) appropriate protection for persons who report potential or actual breaches;
> (c) protection of personal data concerning both the person who reports the potential or actual breaches and the accused person in compliance with the principles laid down in Directive 95/46/EC;
> (d) appropriate procedures to ensure the right of the accused person of defence and to be heard before the adoption of a decision concerning him [...]
> 2. Financial incentives to persons who offer salient information about potential breaches of this Regulation may be granted in conformity with national law where such persons do not have a pre-existing legal or contractual duty to report such information, that the information is new, and it results in the imposition of an administrative sanction or measure or a criminal sanction for a breach of this Regulation.
> 3. […]."

c) Rationale behind the Introduction of Reward Programs

One may search in vain through the various documents released by the Commission for a detailed explanation of the reasons behind the introduction of reward programs into European capital markets law. Apart from cursory remarks about improved access to information, the preliminary impact assessment contains only brief references to potential deterrence effects.[20] It does however rate stronger whistleblower protection and financial incentives as a highly efficient regulatory strategy, as they involve lower costs. [21]

2. Financial Incentives for Whistleblowers in US Capital Markets Law

Article 29 (2) of the regulation constitutes the European Commission's tacit but unmistakable adoption of the reward program put forward in the US Dodd-Frank Act.

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[18] See the Explanatory Memorandum of the Proposal for a Regulation on market abuse, at p. 15.

[19] See recital 36 of the Proposal for a Directive on market abuse.

[20] See the Commission Staff Working Paper, Impact Assessment, SEC(2011) 1217 final, 20 October 2011, at pp. 25 and 49.

[21] See the Commission Staff Working Paper, *supra* n. 20, at p. 49.

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a) Rewards for Whistleblowers under Section 21 F of the Securities Exchange Act 1934

Monetary rewards for whistleblowers have a long tradition in the United States, dating back to the False Claims Act of 1863. Under this legislation, a whistleblower may, even today, file a civil suit against a company that knowingly submits false claims for payment against the US government on the government's behalf ("qui tam" litigation).[22] Where the suit results in an award or settlement payable to the government, the whistleblower stands to receive between 10 and 30% of that amount. Similar instruments have since been introduced into US capital markets law: Under the Insider Trading and Securities Enforcement Act of 1988, the Securities and Exchange Commission (SEC) became authorised to pay premiums for information on insider market abuses[23]. The Dodd-Frank Act expanded on the existing awards system provided by the False Claims Act[24]: By adding section 21 F to the Securities Exchange Act (SEA), whistleblowers became entitled to a reward of between 10 and 30% for volunteering new information that leads to the SEC imposing a fine of at least one million US dollars. According to the legislative records, this provision (also) constitutes a reaction to the enormous securities fraud carried out by *Bernard Madoff*[25], who, undiscovered for many years, ran a Ponzi scheme style investment fund.

b) SEC Rules Implementing Section 21F SEA

In approving the new rules under 21 F-1 to 21 F-17 in May 2011, the SEC also enacted comprehensive regulations for their implementation.[26] The SEC itself stated that these rules should strike a balance between achieving the most effective incentives for whistleblowing and preventing frivolous or false submissions.[27] This is to be achieved by: (1) encouraging high quality submissions and discouraging frivolous submissions, (2) encouraging

[22] See, for example, J.T. Boese, *Civil False Claims and Qui Tam Actions* (New York, Aspen Publishers 4th ed. 2011); T.L. Harris, 'Alternate Remedies & The False Claims Act: Protecting Qui Tam Relators in Light of Government Intervention and Criminal Prosecution Decisions', 94 *Cornell Law Review* (2009) p. 1293; Rapp, *supra* n. 3, at. pp. 126-134.

[23] This law has only yielded limited results, see Ebersole, *supra* n. 5, at 125: 'However, the bounty program has proven to be largely ineffective, making only seven payments totaling $ 159.537 since its inception.'

[24] For a brief comparison of both regimes see Hartmann, *supra* n. 1, at pp. 1301-1302.

[25] See Rep. No. 111-176, at 139-40 (2009); from an academic perspective see also Ebersole, *supra* n. 5, at p. 126: 'Dodd-Frank expands whistleblower protection and monetary incentives even further than SOX, partially in response to the Madoff and Stanford Ponzi schemes.'

[26] SEC, Securities Whistleblower Incentives and Protections, Federal Register, Vol. 76, No. 113, p. 34300.

[27] SEC, *supra* n. 26, at p. 34356.

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whistleblowers to notify of corporate offences swiftly, (3) minimising procedural burdens for whistleblowers, and (4) promoting initial reporting to internal compliance systems where appropriate.[28] In addition, the SEC specified the preconditions required for a reward[29] and stipulated guidelines for determining the amount to be awarded: the amount would increase according to the significance of the information provided, the value of that information in securing successful enforcement, and whether the information had been previously provided through internal company compliance systems. Potential rewards would be reduced where the whistleblower had contributed to the abuse, where there had been an unnecessary delay, or where the whistleblower had failed to first utilise or interfered with internal reporting or compliance systems.[30] To further encourage the flow of information, the SEC also created an "Office of the Whistleblower" to process submissions.

III. Potential Advantages and Disadvantages of an Reward Program for Whistleblowers

An informed assessment of reward programs in European capital markets law can only be made following a fundamental assessment of their advantages and disadvantages.[31]

1. Potential Advantages

Those in favour of reward programs lay the emphasis on the comparative advantages of using company insiders as whistleblowers: While many capital market abuses may be difficult to detect from the outside[32], employees of a company may come across evidence of undetected misdemeanours by management or subordinate staff as part of their daily activities,[33] making

[28] See explicitly SEC, *supra* n. 26, at p. 34356.

[29] Rule 21F-3(a): '[…] The Commission will pay an award or awards to one or more whistleblowers who (1) voluntarily provide the Commission (2) with original information (3) that leads to the successful enforcement by the Commission of a Federal court or administrative action (4) in which the Commission obtains monetary sanctions totalling more than $ 1,000,000.'

[30] Rule 21F-6.

[31] For first attempts see Fleischer, *supra* n. 6, at pp. 177 et seq.

[32] See generally J.H. Arlen, 'The Potentially Perverse Effects of Corporate Criminal Liability', 23 *Journal of Legal Studies* (1994) p. 833, at p. 835: 'Many corporate crimes – such as securities fraud, government procurement fraud, and some environmental crimes – cannot be readily detected by government.'

[33] See Dyck, Morse and Zingales, *supra* n. 4, at p. 2214: 'Employees, industry regulators, and analysts gather a lot of relevant information as a byproduct of their normal work […] and are in a much better position to identify fraud than short sellers, security sellers, or lawyers, for whom detecting fraud is like looking for a needle in the haystack.'; see also R. Howse and R.J. Daniels, 'Rewarding Whistleblowers: The Costs and Benefits of an Incentive-Based Compliance Strategy', in R.J. Daniels and R. Morck, eds., *Corporate Decision-Making in Canada* (Calgary, University of Calgary Press 1995) p. 525, at p. 529: 'First, in contrast to external public monitors, private actors within the corporation can gain access to real-time, on-the-spot information with fewer additional sources.'

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them particularly cost effective and well-informed gatherers of information.[34] As rational actors however, they would only sound the alarm if the individual benefits of notification outweigh the anticipated negatives (threatened dismissal, social ostracism, etc[35]). For those in favour of this approach, financial incentives in the form of an attractive reward could tip the cost/benefit balance in favour of making a submission. Proponents of financial incentives also argue that a higher rate of notifications will result in a higher clear up rate for capital markets crime, thereby increasing investor confidence and social welfare.[36]

2. Objections Raised

Critics of a rewards program in capital markets law place these premises in doubt, arguing that financial incentives bring far fewer benefits to society than the costs this approach may incur.[37]

a) In their opinion, it is far from clear whether financial incentives will increase the number of whistleblowers: Abuses are often reported even without the prospect of a reward, either due to a sense of duty or a desire for revenge.[38] Financial incentives would only succeed in encouraging whistleblowers who would have made their submissions via *internal* reporting processes, to report *externally* to the SEC instead.[39] Worse still, it may lead to a reduction in

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[34] See R. Beller, 'Whistleblower Protection Legislation of the East and West: Can It Really Reduce Corporate Fraud and Improve Corporate Governance - A Study of the Successes and Failures of Whistleblower Protection Legislation in the US and China', 7 *New York University Journal of Law & Business* (2011), p. 873, at p. 880; R.E. Moberly, 'Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers', *Brigham Young University Law Review* (2006) p. 1107, at pp. 1113-1118; also Winter, Circuit Judge, in *United States v. Marino*, 654 F.3d 310, at 322 (2d Cir. 2011): '[W]histleblower tips are among the most effective means of revealing financial frauds and accounting scandals.'

[35] See *supra* n. 3.

[36] See SEC, *supra* n. 26, at p. 34356 and p. 34362; from a critic's view see Ebersole, *supra* n. 5, at p. 127: 'Ideally, additional whistleblower reporting will increase fraud detection and build public confidence in U.S. capital markets, which in turn will stimulate investment and economic growth.'; also Hartmann, *supra* n. 1, at pp. 1303-1305.

[37] See, for example, Ebersole, *supra* n. 5, at p. 174: 'To be sure, the Dodd-Frank whistleblower provisions will impose costs on businesses and agencies and benefit trial lawyer interests. What are less certain are the benefits to society – namely confidence in the U.S. capital markets.'

[38] See, for example, J. Macey, 'Getting the Word out about Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading', 105 *Michigan Law Review* (2007) p. 1899, at p. 1907: 'Disgruntled employees are more likely to engage in whistleblowing than other employees, and revenge is often a common feature in whistleblower cases.'

[39] See Ebersole, *supra* n. 5, at p. 132 referring to D.J. Grimm, 'The Foreign Corrupt Practices Act in merger and acquisition transactions: successor liability and its consequences', 7 *NYU Journal of Law & Business* (2010) p. 247, at pp. 273-274, according to whom 50 out of 85 Foreign Corrupt Practices Act (FCPA) offenses in the

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submissions, as the use of financial incentives could destroy the intrinsic motivation of company employees to report abusive practices.[40] In behavioural economics literature, this is known as the "crowding out" effect.[41]

b) A further objection is based on the assumption that the promise of a reward may also increase the number of unreliable submissions[42], as company employees and other informants adopt a "lottery mentality"[43]. The risk of abuse by opportunist informants also increases[44], as it stands to reason that an environment that creates a predatory shareholder, would also give rise to a predatory whistleblower.[45] Additionally, the supervisory authority must first separate the wheat from the chaff, with the result that the implementation of a reward system would require significant levels of administrative resources, and place unnecessary burdens on the justice system as disappointed whistleblowers appeal unsatisfactory decisions.[46]

c) The argument has also been made that financial incentives for external whistleblowing may weaken the effectiveness of internal compliance programs[47]: Employees may be inclined to contact SEC bodies directly rather than going through the internal whistleblower hotline.[48]

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research period between 2005 and 2008 had been reported by the companies themselves after conducting their own internal investigations. During that period the FCPA did not yet have a whistleblower bounty regime.

[40] See Ebersole, *supra* n. 5, at p. 130: '[M]onetary incentives can be ineffective or even counterproductive and decrease reporting of illegal activity.'; see also the detailed empirical study by Feldman and Lobel, *supra* n. 5.

[41] See the pioneering contribution by B.S. Frey, *Not Just for the Money: An Economic Theory of Personal Motivation* (Elgar, Cheltenham 1997), at p. 4: 'A group of social psychologists have identified that under particular conditions monetary (external) rewards undermine intrinsic motivation.'; further E. Fehr and A. Falk, 'Psychological Foundations of Incentives', 46 *European Economic Revue* (2002) p. 687.

[42] See Ebersole, *supra* n. 5, at p. 135 et seq.

[43] M. Diaz et al., *Whistle-Blowers, Dodd-Frank and the FCPA : the perfect "anti-competitive" storm for U.S. businesses* (2011), available at http://documents.jdsupra.com/7062c02d-ac97-49a4-a7b7-b8ed185e82d2.pdf, p. 8: "lottery mentality"; in detail, Hartmann, *supra* n. 1, at pp. 1305 et seqq.

[44] See Howse and Daniels, *supra* n. 33, at pp. 526-527.

[45] In reference to the German situation Fleischer, *supra* n. 6, p. 155, at p. 177.

[46] See Ebersole, *supra* n. 5, at pp. 143-144 with regard to vague legal terms and subjective assessment criteria of the SEC rules on sec. 21F SEA.

[47] See also SEC, *supra* n. 26 , 34327: '[W]e understand that the financial incentives established by Section 21F could have the potential to divert other whistleblowers away from reporting internally. If this diversion were significant, it might impair the usefulness of internal compliance programs, which can play an important role in achieving compliance with the securities laws.'

[48] See Howse and Daniels, *supra* n. 33, at pp. 526-527; also Hartmann, *supra* n. 1, at p. 1311.

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This would be counterproductive not only from a company perspective, but for society as a whole, as internal compliance systems contribute significantly to limiting breaches of (capital markets) law.[49] Quite apart from this, there is the argument that other regulatory instruments are better suited to ensuring appropriate whistleblower protection than government driven rewards programs. These include a more effective protection against dismissal, and an improved investigation process for authorities to evaluate submissions: Allegedly in the *Madoff* case, information had been submitted indicating the existence of a Ponzi scheme; however the SEC did not pursue the matter sufficiently and the scheme continued to operate.[50]

d) Finally, there are many voices calling attention to cultural differences in the treatment of whistleblowing on both sides of the Atlantic[51]: While lawful action on the part of a company is at the forefront of the US approach, in Germany - as in France - greater emphasis is placed on harmonious relationships between employees and their employer.[52] Whistleblowing also may give rise to strong feelings of aversion in Germany, bringing up dark national memories of denunciation as practiced under the Nazi regime and later under the Ministry for State Security (Stasi) in the former socialist East Germany[53]. In stark contrast, in the USA, Time Magazine named three whistleblowers as "Persons of the Year" in 2002.[54] There are, however, also critics on both sides of the Atlantic who view bounties as morally reprehensible, and speak disparagingly of "rewards for rats"[55]. In their opinion, there are

[49] See Ebersole, *supra* n. 5, at p. 137; also Beller, *supra* n. 34, at p. 915.

[50] In detail Ebersole, *supra* n. 5, at p. 128 et. seq. pointing to numerous anecdotal evidence of insufficient handling of whistleblowing complaints by the SEC.

[51] See the in-depth analysis by Schmolke, *supra* n. 2 with comprehensive references; from a US perspective T.M. Dworkin, 'SOX and Whistleblowing', 105 *Michigan Law Review* (2007) p. 1757, at p. 1774: 'There is a potential drawback, though, to any scheme that rewards whistleblowing: it would be inconsistent with most foreign whistleblowing legislation. Other countries do not approve of large monetary awards for whistleblowing.'; also O. Lobel, 'Citizenship, organizational citizenship and the laws of overlapping obligations', 97 *California Law Review* (2009) p. 433, at pp. 489-491.

[52] See T. Berndt and I. Hoppler, 'Whistleblowing - ein integraler Bestandteil effektiver Corporate Governance', *Betriebs-Berater (BB)* (2005) p. 2623; Kort, *supra* n. 2, at p. 250.

[53] See T. Mahnhold, '„Global Whistle" oder „deutsche Pfeife" – Whistleblowing-Systeme im Jurisdiktionskonflikt', *Neue Zeitschrift für Arbeitsrecht* (2008), p. 737; G. Wisskirchen and A. Körber and A. Bissels, '"Whistleblowing" und "Ethikhotlines"', *BB* (2006), p. 1567, at pp. 1569-1570.

[54] See the Cover of *Time Magazine*, December 2002, with pictures of Cynthia Cooper (WorldCom), Coleen Rowley (FBI) and Sharren Watkins (Enron).

[55] Senator H. Reid (Nevada), 144 Cong. Rec. S4397 (1998).

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limits to the investigative role informants may play, as trust and confidence are viewed as central values in interpersonal relationships.[56]

3. Potential Counter-Arguments

Many of the objections brought forward thus far have been the subject of some dispute and many can be resolved or ameliorated by using an appropriate reward program structure:

a) With regard to the danger of "crowding out" intrinsically motivated informants, it must be considered that this risk is comparatively small, as pure economic crime and simple pecuniary losses in anonymous markets rarely incur a high level of moral outrage.[57] This applies particularly to cases of insider trading, which is often labelled a "victimless crime".[58] Additionally, research indicates that the "crowding out" effect disappears almost completely in the face of sufficiently high financial rewards.[59]

b) Well written regulation may also reduce the potential of that oft touted precautionary claim – the danger of abuse: The SEC, for example, requires that all informants provide an affidavit guaranteeing the veracity of their information.[60] Further precautions could include restricting reward eligibility to direct employees of the company, with the goal of allowing only very limited opportunity for external informants, who presumably have less valuable information.

c) Requiring initial reporting to internal compliance programs before then turning to external authorities could ensure the effectiveness of internal corporate compliance programs. This would require whistleblowers to first submit information through internal compliance systems in order to be eligible for a reward. The same approach has been used in current labour law

[56] See U. H. Schneider and C. Nowak, 'Sind die Einrichtung einer Whistleblowing-Stelle und der Schutz des Whistleblowers Teil guter Corporate Compliance?' in G. Hoenn et al., eds., *Festschrift für Peter Kreutz zum 70. Geburtstag* (München/Unterschleißheim, Luchterhand 2010) p. 855, at p. 863.

[57] Generally Feldman and Lobel, *supra* n. 5, at p. 1207: 'Where levels of moral outrage are expected to be low, financial rewards will likely be a decisive factor, and the inquiry may shift to discovering the true price tag of the reporting behavior.'; in this particular regard Blount and Markel, *supra* n. 6; critical Ebersole, *supra* n. 5, at p. 134.

[58] See, for example, H.C. Manne, 'Insider Trading and Property Rights in New Information', 4 *Cato Journal* (1985) p. 933, at p. 937: 'After all, everyone understands today that insider trading is in the nature of a 'victimless crime'.'

[59] See Feldman and Lobel, *supra* n. 5, at p. 1202: 'At the same time, the findings demonstrate that the crowding-out effect largely disappears with the introduction of sufficiently high monetary rewards.'

[60] See *infra* V. 4. for details.

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disputes over wrongful dismissal and is generally accepted.[61] Submitting information to external supervisory bodies would only be permitted where internal bodies had failed to react. This potential for escalation is also favourable from a compliance point of view, when one considers that an effective compliance system has to be accompanied by a credible external enforcement mechanism.[62] It is anticipated that companies will offer their employees premiums for reporting misdemeanours to internal compliance first[63]. Advocates of a reward program challenge those critics who maintain that the interests of whistleblowers are best served by protection against dismissal, with the counterargument that the two instruments are not mutually exclusive, but rather, complement and add to each other.[64]

d) Legislators could deal with a less than enthusiastic cultural reception of whistleblowers by adopting a broad campaign of reshaping social attitudes.[65] This approach seems to have worked in the United Kingdom, where the introduction of the Public Interest Disclosure Act of 1998 has vastly altered social awareness and attitudes towards whistleblowing.[66] In some respects, this is similar to the anti-trust leniency program used in Germany and Europe: following some initial concerns regarding the legal conscience of the population and some isolated ranting against encouraging denunciation[67] it would appear that the general

[61] For a recent summary of the relevant German case law see G. Forst, 'Strafanzeige gegen den Arbeitgeber- Grund zur Kündigung des Arbeitsvertrags?' *Neue Juristische Wochenschrift* (2011) p. 3477, at pp. 3478-3479; O. Simon and J.M. Schilling, 'Kündigung wegen Whistleblowing?' *BB* (2011) p. 2421, at pp. 2423-2424.

[62] In this sense Blount and Markel, supra n. 6, under the subheading 'Answering the Criticisms: The Threat of External Whistleblowing is a Necessary Companion to Effective Internal Compliance Programs'.

[63] See M. Valencia, 'Year of the Bounty Hunter', *The Economist*, November 17, 2011: 'Big companies will begin to offer what Gregory Keating of Littler Mendelson, an employment-law firm, calls 'mini Dodd-Franks': extra bounties for employees who report their concerns internally before approaching regulators.'; see also Feldman and Lobel, *supra* n. 5, at p. 1159; Lobel, *supra* n. 51, at pp. 443-444; sceptically, Hartmann, *supra* n. 1, at p. 1311: '[A] company is unlikely to provide any sort of incentive equivalent to the monetary incentives that the employees stand to gain.'

[64] See - in spite of certain reservations - Beller, *supra* n. 34, at p. 911 et seq.

[65] From a US perspective with regard to the invigorating role of the media, Feldman and Lobel, *supra* n. 5, at p. 1159: 'In recent years, however, the act of whistle-blowing has been reshaped in the media as a heroic act that can bring deeply corrupt practices to a halt.'

[66] As predicted by Gobert and Punch, supra n. 1, at p. 54: '[T]he greater significance of PIDA is likely to lie in its long-term effect in changing the culture fo the workplace and society. PIDA signifies the government's recognition that whistleblowers can perform a public service. The idea ist to transform the image of the good faith whistleblower from industrial troublemaker to the embodiment of what it means to be a concerned citizen.'; see for more detail Groneberg, *supra* n. 3, at p. 72 et seq. and at pp. 89-90; for the US setting see also the quote of Delikat and Phillips, *supra* n. 1, cited there.

[67] From the early stages of the discussion U. Soltész, 'Bußgeldreduzierung bei Zusammenarbeit mit der Kommission in Kartellsachen – Kronzeugenmitteilung', *Europäisches Wirtschafts- & Steuerrecht* (2000) p. 240, at p. 241 with additional references; later G. Steinberg, 'Schuldgrundsatz versus kartellrechtliche

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population has come to terms with this – highly successful – instrument. Ultimately, the anticipated (likely) success of a reward program in capital markets law shapes the willingness to suspend moral judgement[68] – if perceived to be effective, blowing the whistle is seen not as merely a breach of trust, but rather as evidence of a higher loyalty to the company as a whole.[69]

IV. Empirical Observations and Legal Policy Consequences

1. Empirical Findings

Any theoretical argument stands to gain in credibility when supported by empirical research. In the present case, there are some indications that financial rewards for informants do actually result in a higher clear up rate for capital markets offences. The US Congress justified its passing of the Dodd-Frank Act by arguing that 51.4% of all detected capital markets offences could be attributed to information from whistleblowers, while investigations conducted by external auditors and the SEC only amounted to 4.1%.[70] Similarly, an economic study that examined 216 cases of corporate fraud carried out between 1996 and 2004 discovered a positive relationship between financial incentives and whistleblower submissions, coming predominantly from employees of the company.[71] There are also initial signs that the number of whistleblower submissions has increased significantly since the Dodd-Frank Act entered into force[72], without any reduction in information quality.[73] In

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Kronzeugenregelungen?', *Wirtschaft und Wettbewerb (WuW)* (2006) p. 720, at p. 721 with additional references; recently F. J. Säcker, 'Gesellschafts- und dienstvertragsrechtliche Fragen bei Inanspruchnahme der Kronzeugenregelung', *WuW* (2009) p. 2.

[68] See M.J. Ferziger and D.G. Currell, 'Snitching for Dollars: The economics and public policy of federal civil bounty programs', 1999 University of Illinois Law Review (1999) p. 1141, at p. 1143; also approving Blount and Markel, *supra* n. 6: '[D]espite the potential moral hazards of bounty schemes, they survive for one reason – they work. The bounty model is a win-win-model.'

[69] From the perspective of institutional economics T. Briegel, *Einrichtung und Ausgestaltung unternehmensinterner Whistleblowing-Systeme* (Wiesbaden, Gabler Verlag 2009) at p. 201 et seq. and passim.

[70] See S. Rep. No. 111-176, 110-11 (2010).

[71] See Dyck, Morse and Zingales, *supra* n. 4, at p. 2246.

[72] See the data presented by SEC, *Annual Report on th Dodd-Frank Whistleblower Program: Fiscal Year 2011* (November 2011), at pp. 5-6 and Appendices A to C.

[73] See Valencia, *supra* n. 63: 'Some corporate executives squeal that the new rules will produce waves of frivolous claims by gold-diggers. But the evidence so far suggests that the quality of tips has gone up, not down.'; in the same sense Blount and Markel, *supra* n. 6; urging caution Ebersole, *supra* n. 5, at pp. 127-128: 'time is needed to assess the quality of these tips.'; in the same direction SEC, supra n. 72, at p. 6: 'As a result of the relatively recent launch of the program and the small sample size, it is too early to identify any specific trends or conclusions from the data collected to date.'

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contrast, a comprehensive experimental study found that for many, the decision to blow the whistle depended on a variety of motivations. These were made up of personal, context and situational factors[74], elements which have received only limited attention from researchers so far.[75] However, we have yet to see empirical results that provide a reliable conclusion on the success or undesired side-effects of whistleblower programs in capital markets law, with the research that has been done thus far being limited to the United States.

2. Implications for Legal Policy

Against this mixed backdrop it is not easy to provide a conclusive evaluation of the policy implications of Article 29 (2) of the proposed Market Abuse Directive. In theory, the arguments in favour of a well designed reward program are quite plausible. Even though real life potential informants are not the 'cost-benefit machines' theory makes them out to be[76], there is still reason to assume that the promise of a large financial reward would motivate many to report capital markets offences.[77] Therefore, there is some justification for using the opportunity provided by the proposed EU Market Abuse Directive to introduce this innovative regulatory instrument, despite the weak empirical basis. It would allow every Member State to decide, based on the arguments here, whether it will make use of this additional instrument[78], reject it outright, or wait and see what happens in the United States

[74] See Feldman and Lobel, *supra* n. 5, at p. 1207: 'An important implication of the study is that no one-size-fits-all policy design exists, but rather, policy makers must evaluate the full scope of psychological and situational factors in order to design the most efficient incentive structures.'

[75] See also Blount and Markel, *supra* n. 6: 'The motivations and behavior of whistleblowers have been relatively under-researched.'

[76] To the point and well balanced, L.M. Friedman, 'Coming of Age: Law and Society Enters an Exclusive Club', 1 *Annual Review of Law & Social Science* (2005) p. 1, at p. 14: 'There is no question that human beings do react to the carrot and the stick. However, people are not blindly mechanical cost-benefit machines […].'; similarly, Feldman and Lobel, *supra* n. 5, at p. 1184: 'Instead, people appear to evaluate legal compliance under a more nuanced cost-benefit scale that includes elements that are foreign to pure economic analysis: duty and legitimacy.'

[77] Similarly, SEC, Office of Inspector General, Assessment of the SEC's Bounty Program, Report No. 474, March 29, 2010, at p. 1: 'There is evidence that bounty programs are an effective tool to encourage whistleblowers to come forward and to provide incentives for outside entities to bring complaints about possible illegal activity.'; generally with regard to accounting and capital markets fraud see Rapp, *supra* n. 3, at p. 113: 'Presumably, a large enough financial benefit in favour of blowing the whistle could outweigh any social or psychological factors favoring silence.'

[78] For a recent discussion of the details concerning an optional European private law, see H. Fleischer, 'Optionales Europäisches Privatrecht ("28. Modell")' , 76 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* (2012), Issue 2; J. Smits, 'Optimal Law, A Plea for Multiple Choice in Private Law', Maastricht J. Eur. Comp. L. 17 (2010).

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with their capital markets law "Bounty Program"[79]. In determining their approach[80], Member States need to choose between giving primacy to issues of acceptance within their legal culture, or whether to focus on reshaping their social norms using the expressive function of law [81]. They may also take into account - given the estimated extent of market abuse and its negative effects at the national level - whether improving protection against dismissal for whistleblowers is sufficient to combat the problem of insider trading and market manipulation[82], or whether a combination of measures is required. A comprehensive program of whistleblower protection can then also be used to give a deliberate signal to capital markets.

There are some indications that the United Kingdom would be the most suitable European jurisdiction to first trail a "bounty program": Firstly, the Public Interest Disclosure Act has reshaped the public perception of whistleblowing into a positive one[83]; secondly, market abuse in the City of London seemingly appears somewhat entrenched and difficult to eradicate[84]; thirdly, the Office of Fair Trading (OFT) is already empowered to pay rewards up to £100 000 for information leading to the detection of illegal cartels.[85] Pointing to the OFT model, some legal practitioners argue that the introduction of a capital markets law reward

[79] Cf. for the Australian setting Mavrakis and Legg, *supra* n. 1, at p. 41: 'The United States experience with the *Dodd-Frank Act* is too nascent to allow for many lessons to be drawn. However, it will be worthwhile to monitor how the bounty provisions work.'

[80] In respect of different national preferences and their impacts on the optimal regulation of whistleblowers, see also Heyes and Kapur, *supra* n. 1, at p. 179: 'The cross-cultural variation in attitudes should lead us to suspect some diversity in optimal whistle-blower-policy.'

[81] Generally, see E. Anderson and R.H. Pildes, 'Expressive Theories of Law: A General Restatement', 148 *University of Pennsylvania Law Review* (2000) p. 1503; C.R. Sunstein, 'On the Expressive Function of Law', 144 *University of Pennsylvania Law Review* (1996) p. 2021; in the aforementioned context see Feldman and Lobel, *supra* n. 5, at p. 1184: 'Even in the absence of sanctions and protections, the mere existence of the law helps to shape and define our world views. Expressivists argue that moral and legal evaluation and conduct depend on normative expressions embedded in the law.'

[82] In this vein for the Australian setting Australian Government, The Treasury, *Improving Protections for Corporate Whistleblowers: Options Paper* (October 2009).

[83] With a closer look, see Groneberg, *supra* n. 3, at p. 72 et seq. and pp. 89-90.

[84] Recently, see M.K. Philipps, *Financial News*, 13 February 2012: "FSA gets tough on market abuse".

[85] See OFT, Rewards for information about cartels, http://www.oft.gov.uk/OFTwork/competition-act-and-cartels/cartels/rewards; in detail N. Kar, D. Isaacs, J. Masterson and J. Rickards, 'OFT Payments to Whistle-blowers – A step too far?', 2 *Concurrences* (2008) p. 192, at p. 192; S. Holmes, P. Girardet and A. Butler, 'United Kingdom: Cartels', *The European Antitrust Review* (2011) p. 220, at p. 227.

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program is worth trialling.[86] Britain's Serious Fraud Office (SFO) has also recently set up a telephone hotline for potential whistleblowers, but rejects claims that it is looking to extend this further. "The whistleblower provision in Dodd-Frank, and in particular monetary incentivisation, is not something the SFO has got a view on and it's not something we do", explained one speaker, adding: "We are certainly interested in the debate and in principle it's not totally alien to the UK because of the OFT's scheme."[87]

V. Reward Program Structure

As Article 29 (2) of the proposed Market Abuse Directive does not provide a detailed structure for a reward program, those seeking further inspiration may look to the SEC Rules for section 21F of the SEA.[88]

1. Personal Scope of the Directive

Article 29 (2) Market Abuse Directive only specifically disqualifies a person who is legally obliged to report a capital market offence to a competent authority from receiving a reward. There are, however, good reasons to significantly narrow the scope of application to include only true "company insiders" (company employees and contract partners of the company).[89] This would prevent the emergence of a market for professional whistleblowers, a market that would involve a high cost risk, but promise limited social benefit. It should also exclude persons who in obtaining information, or by the act of reporting have themselves committed an offence.[90] This also applies to potential informants who have hindered the work of supervisory bodies by deliberate deception.[91] It is a delicate question whether an informant who was involved in reported offence should also be entitled to a reward: Although the SEC rules do permit the granting of a reward in this instance, the amount granted decreases in proportion to the whistleblower's own involvement in the offence, and the rules do not

[86] See J. Meek, 'Legal experts have called for Dodd-Frank-style bounty provisions for whistleblowers in the UK', *Operational Risk & Regulation*, November 16, 2011.

[87] Ibid.

[88] See *supra* II 2 b.

[89] Also in favour of such a rule Ebersole, *supra* n. 5, at pp. 159-160.

[90] Rules 21F-4(b)(4)(iv), 21F-4(b)(4)(i) and (ii) as well as 21F-8(c)(4).

[91] Rule 21F-8(c)7.

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guarantee immunity from prosecution.[92] The advantages and disadvantages of this particular approach require greater attention than can be given here.

2. Material Scope

There are four requirements with regards to the material scope of Article 29 (2) of the proposed Regulation: The information submitted must be (a) new and (b) salient, (c) should deal with potential breaches of the Market Abuse Regulation and (d) should lead to the successful enforcement of administrative measures or sanctions under administrative or criminal law for breaches of the Market Abuse Regulation. The '*new information' requirement* not only ensures that rewards are limited to previously undisclosed information, but embeds a principle of priority, emphasising the importance of swift action on the part of the whistleblower. The *'salience' requirement* appears to refer to the significance of the information in securing a conviction. This demands urgent reconsideration, as for a potential whistleblower, it sets a capricious, yet overly stringent requirement. For this reason, the SEC has retreated from its original wording requiring that information "*significantly contributed* to a successful enforcement action", and is now satisfied instead with information that has "*led* to a successful enforcement action".[93] The limits imposed by the Regulation's scope is behind the *requirements for a 'breach of the Market Abuse Regulation'*, although investment and accounting fraud are equally in urgent need of whistleblower assistance and should also be included; Section 21F SEA quite simply requires a "violation of securities law". The imposition of an *administrative or criminal law sanction requirement*, in contrast to the US regulatory model, does not require the imposition of a *monetary* sanction to qualify for a reward. This limitation would, however, come with the benefit of providing the ability to curb excessive and negative impacts on social welfare by introducing a reward determined as a proportion of the sanction imposed.[94]

3. External Rewards and Internal Compliance

As discussed above, a government based reward program may not undermine the internal compliance efforts made within a company. In the USA, many authors have called for a legislative requirement for whistleblowers to first turn to internal compliance processes before

[92] See SEC, *supra* n. 26, at p. 34331: '[W]e do not believe that a *per se* exclusion for culpable whistleblowers is consistent with Section 21F of the Exchange Act.'; see also Rules 21F-15 and 21F-16.

[93] See SEC, *supra* n. 26, at pp. 34324-34325.

[94] In detail see *infra* V 5.

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submitting information directly to external authorities.[95] In support of this stance they point to the comparable duties to report placed on external auditors by Section 10A SEA and case law on derivative actions (demand requirement in derivative action). In so doing, the SEC does not commit to a general principle of subsidiarity , as it does not generally fully trust the adequacy of internal compliance systems.[96] Instead, it provides a range of incentives designed to encourage whistleblowers to consider first reporting through internal channels, for example, by offering a potential increase in the reward granted.[97] The SEC will also treat any information subsequently passed on by the company as *original information* provided by the whistleblower for the purposes of reward calculation, and extend this to also apply to information discovered after the initiation of the internal investigation.[98] Additionally, where internal compliance does not take action, and the whistleblower then submits information to the SEC, that information will be considered received on the date it was submitted internally, provided this interval does not exceed the 120 day 'lookback period'.[99]

4. Process Requirements and Responsibilities for False Information

Standardised forms and procedures can assist supervisory bodies to more effectively process information submissions. However, although these procedures should not set the administrative requirements too high so as to avoid creating barriers for potential informants, [100] they must also hold informants responsible for deliberately false submissions.[101] To this end, the SEC requires that all informants provide a sworn affidavit ensuring the veracity of their information. [102] Informants initially wishing to remain anonymous must engage the services of an attorney, and provide a completed report and signed affidavit. It is the responsibility of the attorney to ensure the veracity of the informant's identity, and of the information provided in the report. The attorney then submits the report to the SEC on the whistleblower's behalf, whilst retaining the affidavit. The

[95] See Ebersole, *supra* n. 5, at p. 151 and p. 158.

[96] Explicitly, SEC, *supra* n. 26, at p. 34323.

[97] See *supra* the text for n. 30.

[98] Rule 21F(4)(b)(5) and (6) as well as 21F-4(c)(3).

[99] See Rule 21F-4(b)(7).

[100] Emphatically, SEC, supra n. 26, at pp. 34338-39 and more.

[101] Forcefully, Ebersole, *supra* n. 5, at pp. 162-163.

[102] With regard to the following, see Rule 21F-9(b).

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informant must also sign an irrevocable consent that allows the original signed submission form to be given to the SEC on request in case of concerns regarding deliberate provision of false information.[103] Anonymous informants must reveal their identity to the SEC in order to receive their reward once the enforcement process has been completed.[104]

5. Nature and Form of the Reward

Article 29 (2) of the proposed Market Abuse Regulation does not specify the nature or form of the reward. It must try to balance private incentives for potential informants with the public's interest in a swift provision of information.[105] The provision in Section 21F(b)(1) SEA which grants informants between 10 and 30% of the final settlement or fine does strike this balance in two ways: Firstly, *proportionate awards* are a simple but effective mechanism for linking the incentive to report with society's general desire "to see justice done" that is reflected in the amount of the fine imposed.[106] Secondly, the minimum of 10% sets a calculable *guaranteed minimum reward* that - together with the potential for judicial review of the final reward amount - provides sufficient assurance of financial gain to stir potential informants into action.[107] Finally, the establishment of a reward *range*, instead of a fixed amount, allows for individual circumstances to be taken into account, while the use of specific criteria for determining the amount of the reward protects the whistleblower from arbitrary bureaucratic decisions.

6. No False Incentives for Deliberate Delays in Notification

Ultimately, a well informed legislator should strive to prevent whistleblowers from unduly delaying a submission of information due to a desire to collect further evidence and thereby

[103] Rule 21F-9(c).

[104] Rule 21F-10(c).

[105] See also SEC, supra n. 26, at p. 34358 with note 444 under reference to B. Depoorter and J. de Mot, 'Whistleblowing: An Economic Analysis of the False Claims Act', 14 Supreme Court Economic Review (2006) p. 135, at p. 158: '[A]wards should be structured to align whistleblowers private incentives with the public interest in timely reporting.'

[106] See in another context K.U. Schmolke, 'Die Aktionärsklage nach § 148 AktG - Anreizwirkungen de lege lata und Reformanregungen de lege ferenda', *ZGR* (2011) p. 398, at p. 435. Given the diminishing marginal utility of money, one could admittedly consider an absolute cap of the reward.

[107] See, very clearly, S. Rep. No. 111-176, 111 (2010): 'The Committee feels the critical component of the Whistleblower Program is the minimum payout that any individual could look towards in determining whether to take the enormous risk of blowing the whistle in calling attention to fraud.'

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increase the reward amount.[108] The fear of being pipped at the post already provides some motivation for swift notification, however, a disproportionate delay in submitting information should also serve as a reason for reducing the amount of any reward granted.[109] It is also conceivable that the reward could be calculated based on the extent of the damages at the time the whistleblower became aware of it.[110] Additionally, any intentional delay resulting in increased damage or costs to the company may render the whistleblower culpable of breaching contractual or fiduciary duties to the company.[111]

VI. Findings

1. There are a range of mechanisms to encourage informants to 'blow the whistle': (a) effective protection against retaliation, (b) a statutory obligation to report, (c) the imposition of fines for a failure to notify, and (d) financial incentives for informants ("Protect - Command - Fine - Pay"). Of these four measures, financial rewards are the current focus of legal policy discussion.

2. In the Dodd-Frank Act 2010, the US introduced a reward program for whistleblowers. The European Commission has followed suit with the recent proposed Regulation on Market Abuse, providing Member States with the opportunity to reward informants for salient information on cases of market abuse.

3. The introduction of reward programs in capital markets law carries a range of advantages and disadvantages that have been examined individually here. In theory, the arguments in favour of a well considered reward program appear convincing: There is reason to assume that a large reward would motivate a sufficiently large number of informants to report instances of market abuse. Despite a modest empirical foundation, the opportunity provided by the proposed Market Abuse Regulation does appear reasonable. Member States may decide for themselves whether to make use of this approach immediately, to reject it outright, or to wait and see what results a "bounty program" yields in other jurisdictions. In making this decision, they may also choose to either focus on potential acceptance problems stemming

[108] With regard to this risk, for example see Depoorter and de Mot, *supra* n. 105, at p. 160.

[109] See, for example Rule 21F-6(b)(2).

[110] In favour of this proposition Ebersole, *supra* n. 5, at p. 153; prior to this W. Kovacic, 'Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting, 29 *Loyola of Los Angeles Law Review* (1996) p. 1799, at pp. 1845-1846.

[111] From a US perspective see Ebersole, *supra* n. 5, at p. 158.

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from their own legal culture, or to implement an "expressive law" approach to reshape social attitudes to whistleblowing.

4. The specific structure of a reward program requires a balance between implementing the incentives that will be the most effective in encouraging informants to blow the whistle, while also preventing frivolous claims. This structure must also ensure that financial incentives provided for external whistleblowing do not undermine the efficiency of internal company compliance programs.

5. "Do good and get rich"[112] – is a catchy line that describes the way reward programs work to expose illegal activities. It remains to be seen whether they are to become an established instrument in the toolbox of European capital markets law.

[112] See the title of the essay of E.S. Callahan and T.M. Dworkin, 'Do Good and Get Rich: Financial Incentives for Whistleblowing and the False Claims Act', 37 *Villanova Law Review* (1992) p. 273.

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