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New Financial Regulations Will Make Whistleblowing Lucrative

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A "whistleblower" provision in the sweeping new financial regulations President Barack Obama is expected to sign into law on Wednesday creates a potentially lucrative incentive for employees to drop a dime on their employers.

Very lucrative.

Whistleblowers who provide what the statute describes as "original information" related to an alleged securities fraud will be eligible to collect a reward of between 10% and 30% of any fines or other restitution paid by the guilty party in excess of $1 million.

Let's consider a couple of hypothetical scenarios helpfully provided by the Washington D.C. law firm Miller Chevalier.

In 2008, global engineering giant Siemens (SI: 95.04, -0.17, -0.18%) agreed to shell out a total of $1.6 billion in combined fines to settle bribery allegations. Had there been a whistleblower in the Siemens case -- and using the high end of the new reward range -- he or she would have been eligible for a $496 million payout under the provisions included in the Dodd-Frank bill.

The lawyers at Miller Chevalier also cited a 2009 bribery case against defense company Kellogg Brown & Root in which the former Halliburton (HAL: 30.25, 1.07, 3.67%) unit agreed to pay $579 million in fines. A whistleblower in that case would have been eligible for a $173 million reward.

While few would argue that whistleblowing isn't a necessary component in helping government regulators uncover corporate fraud, some lawyers believe the Dodd-Frank bill pushes the reward element too far.

"It skews the incentives the wrong way," said George Clarke, a lawyer at Miller Chevalier. "It makes people find problems that aren't there."

Clarke said a view currently prevalent among law enforcement and Congress is that "the best way to get people to rat other people out, to be blunt about it," is to reward them financially.

"We don't have enough enforcement resources so we'll deputize people on the inside and have them be our eyes and ears," he said, describing the thought process that apparently led to the Dodd-Frank provision.

Clarke is dubious.

"It's not a good idea. Real wrongdoing should be brought forward without a financial incentive, and that's happening all the time. This provokes a lottery mentality," he said.

A related concern, according to Clarke, is that the huge financial incentives offered under the new provisions will encourage the expansion of "a whole cottage industry of whistleblower lawyers who represent on a contingent fee and gin up problems that may not be there.

"It might help some, but what I worry about is all the junk that it may bring -- stuff that's ginned up to try and make some money," he added.

The provisions cover a lot of new ground, and all of it strengthen the hand of the whistleblower.

Whistleblowers have often been portrayed -- not inaccurately in many cases -- as lonely figures fighting against the tide of corporate power and profits. Typically in these portrayals, they are ostracized and persecuted for their efforts.

And, in fact, there are any number of well-documented cases of whistleblowers who have been fired from their jobs or harassed by their bosses after reporting wrongdoing by their employers.

Consequently, the new laws make it tougher for companies to retaliate against whistleblowers. Specifically, the law shifts the burden of proof away from the whistleblower, a move that will make it harder for companies to deny retaliation in court. The new laws also give whistleblowers more time (three years) to file claims against retaliation.

The law disqualifies from receiving any reward whistleblowers who are convicted for being involved in the fraud they reported.

Walter Olson, a senior fellow at the Cato Institute and editor of the blog Overlawyered.com, said some of the biggest opponents to the new provisions are corporate oversight managers paid by big companies to keep the firms in line and out of trouble. The concern among these managers is that lower level compliance employees who might otherwise have reported a potential infraction to a supervisor will now wait until the infraction is big enough for them to collect a big reward.

“The fear is that employees will wait while it grows, then when it’s really valuable report it to Washington instead,” said Olson.

Olson said two prevailing trends contributed to the dramatic strengthening of the laws. First, he said, there’s a “political cachet” to strengthening these types of laws. Second is the motivation provided by the powerful lobby “that makes money on the whistle blower business.”

But Olson said there’s a larger concern: The growth of an “informer society that civil libertarians are concerned with and which encourages people to be disloyal to their friends and co-workers.”

You might catch a few corporate scam artists, he conceded, but “you lose something about the trusting and cooperative nature of society that we might miss when it’s gone.”