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Rewarding Whistleblowers: The Costs and Benefits of an Incentive-Based Compliance Strategy

INTRODUCTION

CANADIANS TODAY ARE VERY MUCH CONCERNED about corporate crime and about corporations that do not comply with regulatory requirements, especially those related to the environment, securities law and occupational health and safety regulations. This increased concern has led to proposals to extend liability for illegal corporate conduct[1] (by making directors *personally* liable for the actions of their companies, for example); it has also led to arguments in favour of greatly increasing the sanctions on corporations (and individual wrongdoers within those corporations) for wrongful conduct. The recent academic literature reflects a lively debate as to the effectiveness of such proposals in reducing illegal behaviour in corporations and their consequences for the functioning of the corporation as an economic institution.[2]

With some notable exceptions,[3] the focus of the debate on sanctions and liability rules has resulted in the relative neglect of an essential ingredient in effective deterrence; the capacity to monitor and detect wrongdoing within the corporation. The lack of attention to the potential for increased compliance through improved monitoring and detection is surprising for several reasons. First, as Jennifer Arlen notes, "[m]any corporate crimes – such as securities fraud, government procurement fraud, and some environmental crimes – cannot be readily detected by government".[4] Second, there is a significant body of literature on regulatory reform that relates the ineffectiveness of many traditional "command and control" forms of regulation to the costs and difficulties which are inherent in government monitoring and detection of wrongdoing.[5] Third, one of the most generally held tenets of contemporary criminology is that increasing the likelihood of detection and prosecution tends to be a more effective means of strengthening deterrence than making sanctions more severe. In other words, it is better to put another cop on the beat than to build more jail cells.[6]

This study is intended to help redress the inadequate emphasis on monitoring and detection in the current debate on corporate criminal and

regulatory responsibility. Accepting the proposition that direct monitoring of corporate conduct by government as a means of detection is unlikely to be cost-effective, our concern is to identify agents *within* the corporation who can be enlisted in the cause of monitoring and detection,[7] and to consider how public policies can provide stronger incentives, and make it easier, for these agents to identify and disclose wrongdoing within the corporation. In conducting this analysis, we begin by considering one such policy that has generated sustained public attention and controversy over the last decade: so-called "whistleblower protection."

Recognizing that agents within corporations (and government institutions) risk retaliation in the form of dismissal if they disclose corporate wrongdoing, many jurisdictions in North America have adopted legislation to protect employee whistleblowers, either by providing them with a private right of action when dismissed in retaliation for whistleblowing or through outright prohibition of dismissal or other disciplinary measures motivated by retaliation.[8] It is not, however, these modest protective provisions that have captivated the public imagination, nor have these provisions contributed significantly to the disclosure of spectacular corporate frauds. Rather, it is the offer (or prospect) of substantial rewards or bounties to whistleblowers, most notably under the *False Claims Act*, a federal U.S. statute (as amended in 1986), that has produced this result.[9] Under the provisions of this statute,[10] an individual[11] who discovers wrongdoing that has injured the U.S. federal government (fraud in defence procurement, for example) may launch a private lawsuit against the corporate wrongdoer. The government has the option to join the action or not, but the individual may nevertheless proceed even if the government declines to do so. If successful, the whistleblower may recover a bounty calculated to be between 25 percent and 30 percent of the total penalties or other damages assessed against the wrongdoer. In cases where the Justice Department joins the action, the *minimum* recovery is reduced to 15 percent. If unsuccessful, the whistleblower is responsible for her own legal costs but is not responsible for the legal costs of the defendant *except* where the court is convinced that the action is vexatious. The most spectacular whistleblower suits have centred on multi-million dollar frauds, particularly in the areas of defense and health-care procurement and have usually resulted in convictions. In these instances, whistleblowers have often received what appear to be very large payoffs, which, in effect, reflect the size of the scam uncovered and the enormous savings to government.

Despite the arguable savings to the public from this type of action, under the *False Claims Act* the practice of providing bounties to whistleblowers has been controversial. First, there is the argument that much of the information divulged through actions under the *False Claims Act* would have been divulged even if much smaller bounties had been offered. Second, corporations are vulnerable to false claims made by opportunistic whistleblowers who may be motivated to force corporations into financial settlements in order to avoid

the adverse reputational and related effects caused by highly public, albeit ill-founded, accusations. Third, it is sometimes argued that rewards for external whistleblowing frustrate efforts at internal compliance, or act as disincentives to "internal" whistleblowing. For instance, an employee may be dissuaded from reporting a misconduct in a timely fashion within the corporation because of the prospect of receiving a large reward by disclosing corporate wrongdoing through litigation, thereby undermining internal efforts at corporate compliance (the importance of which is often stressed in a wide range of the relevant policy and legal literature).[12] Fourth, it is often suggested that the calibration of the amount of the reward from whistleblowing directly to the amount of the penalty (and thereby to the degree of seriousness and extent of the wrongdoing) provides whistleblowers with an incentive to report wrongdoing later rather than earlier, and to do so only after the corruption has produced much more serious consequences, rather than disclosing evidence of corruption in the corporation immediately.

Finally, some analysts worry that the practice of rewarding whistleblowing may have deleterious effects on trust and team spirit within corporations, ingredients seen by many as critical to the success of corporations as economic institutions. As is evident from the variety of pejorative colloquial expressions for whistleblowing (ratting, squealing, tattling, etc.), reporting co-workers, associates or superiors to the authorities often has negative moral connotations. These connotations have been powerfully reinforced in our time by the frequent use of "informers" by totalitarian regimes, both left and right, a practice often closely identified with the repellent nature of those regimes.

This study draws primarily on analytical techniques and empirical studies from the literature of the law, economics and organizational behaviour. Since understanding the effects of rewarding whistleblowers depends on an understanding of their motivations and the effects of their actions on the essential ethical life of the corporation (as a human association), it is our hope that this study will also contribute to the more subtle and informed debate over the morality of whistleblowing.

Do We Need More Incentives?

The obvious question in the debate over whistleblowing is: Is there any need for new instruments that may be used to increase the probability of detecting criminal or quasi-criminal conduct by corporations? If, as the economics literature suggests,[13] penalties set for corporate wrongdoing are based on the social consequences of the impugned behaviour divided by the probability of detection, the total social costs of corporate regulation and wrongdoing should be minimized – which consequently maximizes social welfare.[14] According to this theory, any weakness in detection and prosecution can be offset by increasing the weight of the penalty that is imposed. However, in practice there are several impediments to this theory. As mentioned earlier,

there is a growing awareness in the criminology literature that increasing the magnitude of sanctions cannot easily compensate for low probabilities of detection. Another factor that weighs against relying on added penalties as a way of constraining corporate wrongdoing relates to the marginal deterrence problem; that is, there is a tendency for optimal fines to become level across different types of crimes, which reduces the incentive for wrongdoers to refrain from engaging in more socially damaging forms of conduct. Further, to the extent that financial penalties are relied on principally to enforce desired forms of conduct, the efficacy of those penalties is contingent upon the financial solvency of wrongdoers. Where fines exceed the assets of wrongdoers, then the magnitude of the expected penalty is effectively capped, possibly at levels far below what is socially optimal.

This problem is particularly acute in the case of corporations, where shareholders, the nominal principals of the corporation, enjoy limited liability (i.e., the amount of their financial exposure from corporate wrongdoing is limited to the amount of funds that they have actually invested or committed to have invested in the corporation). For shareholders, therefore, increasing the magnitude of financial penalties above their existing wealth levels will have only a limited effect on their behaviour, and therefore on the behaviour of the corporation.[15] However, there is some evidence to suggest that shareholders are not generally the driving force behind corporate wrongdoing, at least within widely held public corporations.[16] As Jennifer Arlen notes, "[c]orporate crimes are not committed by corporations; they are committed by agents of the corporation".[17] Nevertheless, the limited liability of shareholders *does* inhibit the deterrent effect of fines and penalties in that it reduces shareholders' incentive to engage in active monitoring of the corporation's agents. Moreover, while other investors (namely creditors) may suffer financial losses in the event that the shareholders' equity is less than the magnitude of the fine levied on the corporation for wrongdoing, contractual and legal restrictions limit the scope for creditor voice.[18] In this vein, Polinsky & Shavell (1993) have argued that the difficulties in raising fines to the levels necessary to create optimal penalties provide a rationale for relying on state sanctions for wrongdoing, particularly imprisonment of individual corporate actors.[19] Nevertheless, while imprisonment may be effective for some types of corporate wrongdoing, its utility is impaired by endemic information problems which make it difficult for the state to identify the corporate agents responsible for wrongful corporate conduct.[20]

If increasing the magnitude of the penalty is not an effective way to constrain corporate wrongdoing, then why not rely on state monitoring to increase the probability of detection, thereby securing optimal levels of corporate compliance? An overriding consideration militating against reliance on external monitoring is, of course, the strained fiscal resources of the public sector.[21] Since the beginning of the post-war period, as the breadth and intensity of public demands upon governments in industrialized democracies have

increased, so too has their inability to generate the revenues necessary to fund new programs, even where it is clear that the new programs can yield greater social benefits than those generated by existing programmes. In the case of marginal investments in monitoring-related activities, the lack of demonstrable showcase effects emanating from such expenditures, combined with the existence of stable and powerful coalitions in favour of existing programmes, undercuts the ease with which public officials can re-direct scarce public resources to allegedly more valuable activities, such as increased monitoring to ensure corporate compliance with public goals.

The inability of the public sector to muster or re-direct resources to monitoring, however, is only part of the reason why additional expenditures are not made. The comparative inefficiency of public *versus* private monitoring mechanisms is also implicated. 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 resources. To coordinate internal corporate activity, shareholders (or their managerial representatives) make fixed investments in internal information and control systems which can also be used to acquire, transmit and analyze information respecting corporate compliance decisions, thereby exploiting economies of scope. In contrast, external government monitors may have difficulty accessing firm information systems, and may therefore have to invest in duplicative (and perhaps more costly) information systems.

Second, while duplicative investments in monitoring can be avoided to some extent by having government concentrate its efforts on auditing rather than on continuous monitoring, the reliability of information gleaned from such activity is very low. Firms can easily manipulate the data culled by government authorities, thereby conveying a more favourable impression of their compliance effort than is accurate. Alternatively, even in the absence of a deliberate attempt to "cook the books", the information obtained by government auditors may be unreliable due to stochastic variances in the way a corporation's production functions. For instance, government environmental monitors could inadvertently sample the emissions discharged by a corporate polluter during periods when the level of regulated emissions was unusually low.

Even if government did have the technological capability to gather raw information regarding the incidence of wrongful corporate conduct, it often encounters significant barriers in being able to interpret and analyze these data against firm and industry practices. In part, this impediment is a function of public-sector compensation constraints, which weaken the attraction of government service to highly qualified industry specialists. In part, it is also a function of the difficulties that any industry outsider confronts in understanding and assessing the effects of novel corporate practices in a setting of rapid and profound organizational and technological change. Regulation of financial markets is a case in point; the ingenuity and contrivances of unscrupulous market actors typically outstrip the analytical expertise of government

inspectors and compliance officers, with the result that wrongdoing is often effectively hidden from public regulatory authorities.[22]

Even if public authorities were able to generate optimal levels of enterprise liability for corporations without having to rely on excessive financial penalties, a great many daunting compliance problems would be raised by internal agency conflicts. Commencing with Berle & Means (1932), numerous scholars of corporate behaviour have focused on the issue of accountability in the modern corporation, particularly with respect to the responsibilities of managers to shareholders.[23] The concern is that management will exploit the delegation of power it receives from shareholders to advance its own interests. Subsequently, law and economics scholars have formalized and generalized these accountability problems through the use of agency analysis. The analysis focuses on the accountability problems that arise in the modern corporation when principals delegate power to agents in the absence of perfect information.[24] In the context of corporate wrongdoing, the concern is that managers will ignore the shareholders' direction to comply with legislated responsibilities because of the private benefits they realize from engaging in sanctioned behaviour, namely increases in compensation or other perquisites. For instance, by chiselling or scrimping on the expenditures required to be made pursuant to various types of regulatory compliance programs (*e.g.*, environmental or occupational health and safety), managers may be able to increase the level of reported earnings, which, assuming the existence of incentive-based compensation arrangements, will result in their receiving increased compensation. Although there is the risk that the misconduct will be detected and punished by the state (with losses imposed on shareholders), the existence of substantial lags between misconduct and detection, difficulties in determining levels of personal responsibility for culpable conduct within the organization, and problems of collective action that undermine the ability of shareholders to discipline managerial misconduct, all combine to reduce the likelihood that wrongdoing will result in sanctions (including job losses) for senior managers. Of course, to the extent that managers are risk-averse because of their high levels of firm-specific human capital investment, this propensity may undercut the willingness of managers to engage in wrongdoing that entails the threat of job loss.

So far, we have focused on the agency problems that exist between shareholders and senior managers. However, as the organizational behaviour literature demonstrates, issues of accountability are not confined to senior levels of the corporation; these problems are also inherent in the relationships that exist among senior-, mid- and lower-level employees. For instance, lower-level management may pursue goals that conflict with those set out by senior managers because the private gains from deviation more than offset the accompanying costs. These internal agency problems (often referred to as "sub-goal pursuits") are also manifested in distorted information flows from lower-level managers to senior managers (often expressed as "information impactedness"). The net effect is to hobble the capacity of senior management

to implement and operate an effective compliance regime.[25] These problems are undoubtedly exacerbated by "collective folly", the documented tendency of groups to engage in excessive forms of risk-taking (compared to the levels of risk that individuals would be willing to assume). Thus, to the extent that middle- and lower-level management coalesce as a group, they may be willing to run greater risks, even of job loss, in failing to adhere to firm-mandated compliance strategies.

In combination, the factors enumerated suggest the need for additional instruments to align corporate and social interests in ensuring responsible corporate conduct. In the next section, we consider the role for one such instrument – whistleblowing – in fostering this alignment.

THE CASE FOR WHISTLEBLOWING

THE CASE FOR WHISTLEBLOWING AS AN INSTRUMENT of corporate control rests on its ability to induce corporate actors with local knowledge of corporate misconduct to report that information in real time to internal and external monitors. Essentially, rewards for whistleblowing seek to destabilize coalitions within the firm that are committed to conspiring against the public weal by enhancing the attraction of personal defection strategies. Whistleblowing inducements are also attractive for their ability to exploit existing internal information systems. As mentioned earlier, in contrast to external monitoring mechanisms, whistleblowing draws on the benefits of sunk investment costs in existing internal management and information systems. Against these benefits, however, there are certain costs.

First, the existence of whistleblowing inducements may distort optimal information flows and decision-making structures within the corporation. To the extent that senior managers are committed to wrongdoing and lack the confidence that lower-level employees will support their activities by keeping quiet, they can be expected to recast organizational routines and decision-making systems in order to limit the access of potential "employee-defectors" to information that indicates or suggests any wrongdoing. Obviously, if decision-making and information systems for compliance are also used to coordinate firm production, the distortion of these systems to support managerial misconduct can be expected to inflict significant costs on the productive efficiency of the firm. This concern is especially relevant given the growing premium that the organizational literature places on the benefits derived from decentralized decision-making in securing firm-competitive advantage.

A second and related point is that whistleblowing may cause senior managers to make lower-level employees over-invest in firm- or industry-specific human capital in order to magnify the downside costs of whistleblowing. High levels of firm- or industry-specific human capital, particularly when the costs of such investment are borne principally by employees in return for

future compensation, increase the vulnerability of employees to retaliation by the firm for whistleblowing, particularly through job displacement.

A third concern has to do with the effect of whistleblowing on firm culture and teamwork. Some analysts claim that by creating strong individual incentives for defection from perverse corporate policies, whistleblowing subverts the ability of managers to create durable commitments to firm culture and teamwork. However, it is important to avoid overstating the importance of this concern. Whistleblowing incentives will not undermine a corporate culture that is based on honesty and fair play; rather, it will jeopardize only those cultures that are based on a perverse commitment to conspire against the public weal.

Whistleblower awards of the magnitude frequently seen over the last decade in the United States are unquestionably costly. Like other government payments intended to influence conduct (such as subsidies to businesses), an obvious question is whether the cost of these payments is justified in terms of its ability to procure benefits by altering the conduct of the recipient. There is the possibility that much of the action taken by the whistleblower might occur even without a payment or with a lesser inducement. Perhaps an appropriate starting point for investigating the costs and benefits of whistleblower awards is to examine the "base-line" of human conduct upon which the awards operate. That is to say, apart from whistleblowing awards, what are the incentives that operate upon individuals, particularly upon actors within the corporation, to report wrongdoing? What are the disincentives?

One major factor that probably influences reporting of corporate misconduct is a sense of public duty or responsibility, and the satisfaction that comes from performing that duty.[26] There are cases, as well, where the corporation's wrongdoing exposes whistleblowers, their friends and/or their families to risks that may constitute genuine hazards (for example, hazards created by non-compliance with regulations relating to occupational health and safety, nuclear and aviation safety, etc.). Such risks provide employees with a powerful incentive to engage in whistleblowing. Third, continual serious wrongdoing may have disastrous reputational effects on the corporation and its management. This can lead to the corporation's economic decline, which in turn can result in greater risk of employee job loss or, in the case of senior management, a decline in the value of their stock in the corporation or other performance-related compensation. Fourth, in some corporations, senior management may actually reward employees who report wrongdoing where this leads to avoidance of liability, or reduced liability for the corporation itself.[27] Finally, in some instances, the opportunity to neutralize one's rivals or punish one's enemies within the corporation may provide a motivation for whistleblowing.

The most powerful disincentives to whistleblowing derive from the prospect of retaliation by fellow employees or by the corporation itself, including dismissal of the whistleblower.[28] Other disincentives include the fear that

detection of wrongful conduct will harm the corporation, thereby increasing the risk that the employee will lose her job or that her own reputation will be tarnished by association with the corporation when the wrongdoing is exposed.

Given the range of incentives to whistleblowing identified above, one might expect a high rate of whistleblowing to be achieved merely by removing the principal disincentive – the fear of retaliation. However, existing statutory protection for whistleblowers (statutes that allow whistleblowers to sue for wrongful dismissal or which otherwise deter retaliatory conduct) has serious limitations. In the first place, most whistleblower-protection statutes do not provide remedies for retaliatory actions that fall short of dismissal – such as demotions, unwanted geographical transfers, failure to consider an employee for promotion, freezing an employee out of a decision-making role consonant with level of seniority, inordinate scrutiny and surveillance in and outside the workplace, and psychological pressures.[29]

Of course, individually and/or cumulatively, some of these acts might be regarded as "constructive dismissal". However, even assuming a creative application of the constructive dismissal doctrine, and allowing for statutory protections that extend to forms of discipline or revenge that stop short of dismissal, serious evidentiary and interpretative obstacles exist in judicial or regulatory surveillance of employer treatment of an employee *ex post* an act of whistleblowing. In some instances, action taken by the employer that an employee attributes to revenge may have legitimate corporate purposes, or it may be cloaked under legitimate corporate purposes. A presumption that any *ex post* treatment of an employee that is sub-optimal from the perspective of that employee's interests constitutes retaliation would risk constraining otherwise efficient business decisions. Conversely, placing too great a burden of proof on the employee to show a retaliatory intent could easily lead to under-sanctioning retaliatory acts that can be more-or-less masked as normal personnel policies. Even assuming that the right balance could be struck, in most instances, deterring the more subtle forms of retaliation would involve on-going judicial scrutiny of micro-decisions within corporations – at a considerable cost to the whistleblower, the corporation, and the public purse.

Even where a whistleblower can ultimately exit the firm with a wrongful dismissal settlement, the reputational effects of having blown the whistle may harm the whistleblower's prospects of re-employment elsewhere in the same industry or community. (However, depending on how other employers view the wrongful conduct disclosed, they *might* welcome a whistleblower; but this is not a prospect a potential whistleblower can count on.) Glazer & Migdal studied the fates of some 41 whistleblowers whom they characterized as ethical resisters. Of the 41, 28 (68.3 percent) had difficulty finding employment after blowing the whistle and, of the 28, 18 had to settle for employment in "fields unrelated to their previous work".[30]

Common law and statutory protection against retaliation insulates whistleblowers and their families even less effectively from the severe psychological pressures that come from standing up to the corporation. Whistleblowers must be prepared to have their personal backgrounds investigated, to have their charges challenged as lies, to lose the support of fellow-employees, and to be accused of threatening jobs and prosperity in the firm and perhaps in the broader community. In some circumstances, whistleblowers may even risk physical harm. Of course, where whistleblowers are able to survive (psychologically and physically) until the corporation or the wrongdoers within the corporation are brought to justice, they may become heroes – compensating for their earlier vilification. However, whistleblowers must also face the risk that the information they divulge, however persuasive, may not be sufficient to sustain a criminal conviction, in which case the corporation may well be vindicated in the eyes of colleagues and the community. Thus, if it is unlikely that the legal protection of whistleblowers against retaliation is sufficient to redress the imbalance between the disincentives and incentives for whistleblowing, there is a plausible *prima facie* case that additional incentives are needed to achieve a socially optimal level of whistleblowing. This appears to be supported by anecdotal evidence that the 1986 changes in the *False Claims Act* elicited responses and brought forth information about fraudulent practices that might have been, but was not, reported before the legislation offered substantial rewards to whistleblowers.[31]

Issues in Calculating Incentives to Whistleblowers

Under the *False Claims Act*, the whistleblower's reward is calculated as a percentage of the total penalties and other damages assessed against the corporation. It has been argued that this method of determining the amount of the reward creates perverse incentives for whistleblowers to withhold information or to come forward significantly later than when they first suspect wrongdoing (on the assumption that the longer the wrongdoing continues, the more serious it will become and the larger the ultimate reward will be). In the well-known case of *United States et al.* v. *General Electric*,[32] the U.S. Justice Department sought to have the Court reduce the award to the whistleblower, Chester Walsh, from $14.9 million to $4.5 million, on the grounds that Walsh and his lawyers could have avoided loss to the United States by reporting the wrongdoing in question immediately after it first came to Walsh's attention. The Court, however, accepted Walsh's claim that much of the delay was justified by the difficulty of obtaining sufficient evidence of wrongdoing without undue risk to his own security. It therefore reduced Walsh's reward only by a small amount, from 25 percent to 22.5 percent. The Justice Department initially sought to appeal the decision but

eventually settled with Walsh for $11.5 million, a reduction from the $13.4 million ordered by the Court.

The ability of a whistleblower under the *False Claims Act* to increase the amount of a reward through delay in the reporting of wrongdoing seems like an obvious moral hazard problem. However, there are good reasons to favour the Court's cautious approach in addressing this problem in the *General Electric* case. Encouraging immediate or precipitous reporting of wrongdoing may have undesirable effects, given the characteristics of whistleblowers and of the situations they face. First, whistleblowers are likely to be persons who have a strong sense of loyalty to the corporation as a whole.[33] Confronted with the initial evidence of wrongdoing, their immediate reaction may well be disbelief. If whistleblower awards are tied to immediate reporting, such individuals may well not come forward at all since they will be disinclined to jump quickly to a conclusion that an organization for which they have a long-standing respect is guilty of major wrongdoing. Second, the empirical evidence suggests that employees are more likely to consider whistleblowing as justified in instances of clearly illegal, serious misconduct than where it appears that the conduct in question in merely unethical.[34] This suggests that if, in order to obtain an award that provides sufficient compensation for the risk of retaliation, it is necessary to act before one has been able to determine unambiguously that serious wrongful conduct is occurring, some individuals will simply not feel prepared to come forward.

This leads to a related point. In order to recover an award, the whistle-blower must obtain a conviction of the wrongdoer in court. The whistleblower bears the risk that a court will find insufficient evidence of wrongdoing, thereby saddling the whistleblower with legal costs in addition to all of the harmful reputational effects that may result from having blown the whistle (apparently) unjustifiably. For this reason, whistleblowers may be unlikely to come forward before they have assembled a body of evidence that makes a conviction all but certain. This will often occur considerably later than the first suspicions of wrongdoing given that the whistleblower may be required to assemble evidence surreptitiously, often at considerable personal risk. This is reinforced by the fact that the whistleblower will not know *ex ante* of blowing the whistle whether the Justice Department will join the action with its investigatory resources or whether the whistleblower herself will have to bear all of the responsibility for assembling the evidentiary record. Furthermore, while earlier whistleblowing may in some instances avert further wrongdoing, in other circumstances it may provide the opportunity for wrongdoers to conceal or destroy evidence of more serious wrongdoing.

In addition to these legitimate reasons for delayed reporting, it is also important to recall that a purely opportunistic strategy of delaying the reporting of wrongdoing in order to obtain a larger reward is not without serious risks to the interests of the whistleblower. The longer the whistleblower delays taking any action, the higher the risk that another whistleblower will come forward

to relate information of the wrongdoing and capture all or part of the reward. Moreover, delay may result in evidence being destroyed or rendered unavailable or unuseable, either intentionally or inadvertently. Computer tapes may be erased, potential witnesses may die or be assigned overseas, and so forth. The existence of these risks inherent in delay impose an intrinsic curb on whistleblower opportunism.

The implications of this analysis are that, while it may be appropriate to allow courts some discretion to reduce a reward where purely opportunistic or inexplicable delay in relating information has occurred, the requirement to report wrongdoing immediately should not be a condition for recovering a substantial reward.

Another important implication has to do with the nature of the financial bounty provided to whistleblowers and the clash between compensation and deterrence objectives entailed thereby. Given that the rewards to whistleblowers offered under the *False Claims Act* are based on a percentage of the penalties ultimately assessed against the corporation, the bounty is generally understood as giving expression to deterrence goals; the corporation is not expected to compensate whistleblowers in excess of the fines prescribed by optimal penalties. Nevertheless, it is clear that using a percentage of the fines ultimately levied against the corporation as a basis for bounties paid to whistleblowers may cause payments to diverge systematically from the levels necessary to compensate whistleblowers for the risk of loss to their human capital from corporate retaliation. In some cases, the specified percentage of the fine levied against the corporation will undercompensate whistleblowers, while in other cases, it will have the opposite effect. From an economic perspective, under-compensation is more vexing because a prospective whistleblower who determines *ex ante* that the bounty will not be sufficiently large to compensate for the risk to her human capital will refrain from whistleblowing. Overcompensation is less of a problem as it merely constitutes a windfall transfer from the corporation to the whistleblower, which should not affect actual behaviour.[35] For these reasons, it may make more sense to consider the adoption of a minimum floor for whistleblowing bounties. This would ensure that a whistleblower always obtains sufficient compensation to cover the risks to her human capital.

Internal and External Whistleblowing: Conflicts or Complements?

A major strand in the fabric of contemporary scholarship about regulation and corporate responsibility suggests the desirability of encouraging internal mechanisms of self-regulation and self-monitoring within the corporation.[36] It is sometimes claimed by corporations that providing substantial rewards to external whistleblowers frustrates efforts to create such internal

mechanisms. If an employee can collect millions of dollars by reporting wrongdoing externally, why would she wish to report internally in the first instance?[37] Based on this logic, a plausible case can be made that an employee should have to attempt to deal with the problem internally before she can bring an (external) lawsuit for the reason that it does involve a potential reward for whistleblowing.[38]

A closer examination of the relationship between external and internal whistleblowing, however, puts in doubt whether such a requirement would produce desirable results. First, recent studies of employee attitudes toward whistleblowing suggest that, generally, employees *are* inclined to report wrongdoing internally before reporting such information to authorities outside the firm *as long as they do not fear retaliation from internal whistleblowing.*[39] Second, employees may justifiably be afraid that internal whistleblowing mechanisms (such as supposedly anonymous "hotlines") will be abused to identify troublemakers, and may allow wrongdoers the opportunity to destroy, conceal or tamper with evidence or intimidate potential witnesses by tipping them off that wrongdoing has been discovered.[40] Even where shareholders, directors, or senior management are strongly committed to positive internal disclosure policies, employees may still fear retaliation from immediate supervisors or middle managers. As Near & Miceli conclude, an organizational strategy to "encourage valid [internal] whistle blowing may be difficult to implement even if accepted by top managers. The weak link in such a strategy appears to be the immediate supervisors and managers who retaliate against the whistle blower, seemingly at will".[41] These findings are consistent with the application of the theory of agency costs to corporate wrongdoing, which suggests that the interests of shareholders, senior managers, and other stakeholders within the corporation may diverge significantly with respect to corporate wrongdoing.[42]

If, as argued, a requirement of prior internal disclosure acts as a disincentive to external whistleblowing, then it may, in turn, actually operate as a disincentive to corporations that adopt internal disclosure policies to protect workers against retaliation for – and thereby encourage – *internal* whistleblowing. The fear of being exposed to prosecution as a consequence of external whistleblowing may be an important incentive for some corporations to adopt *credible* internal disclosure policies and procedures. Such policies might very well gain employee trust and increase the number of internal disclosures.[43]

While we do not believe that weakening incentives for external whistleblowing is likely to increase incentives for internal whistleblowing (in fact, we would expect the contrary to be true), it is also important that an external whistleblower not be disadvantaged in recovering a reward by virtue of having pursued internal channels before engaging in external whistleblowing. The fact that delay in relating information may be due to the employee's efforts to seek a solution to the problem within the corporation is an additional reason for *not* requiring that the whistleblower disclose immediately after learning of the wrongdoing.

A rather different concern about the relationship between internal and external whistleblowing is that internal whistleblowing (even where it does not result in retaliation, destruction of evidence etc.) may produce an outcome that is not favourable to the public interest. First, internal whistleblowing may afford the corporation or specific corporate actors an opportunity to pay hush money to an internal whistleblower. Second, even where the corporation takes steps to avoid future wrongdoing, it may be disinclined to inform the authorities of past wrongdoing because of the prospect of having to pay substantial penalties. This problem is particularly acute in the case of corporate fraud, where keeping the matter within the corporation may well lead to the government foregoing recovery of substantial past losses. Again, since whistleblowers tend to be conservative individuals with strong loyalty to the corporation, they may well be satisfied by an outcome that prevents future wrongdoing and entails internal discipline of past wrongdoers.

Whistleblower Complicity in Corporate Wrongdoing

A SPECIAL DIFFICULTY IS APPARENT when a whistleblower is involved in the wrongdoing she has reported, either through complicity or through active initiative. At the crudest level, the prospect of obtaining a large reward for reporting wrongdoing in which one is involved may actually encourage misconduct. Moreover, since obtaining a reward obviously depends upon other employees also being involved in the wrongdoing, there may be an incentive to corrupt other employees. Finally, since the reward is determined as a percentage of the total penalties assessed against the corporation, a wrongdoer-whistleblower has an incentive to increase the amount of wrongdoing by other employees as much as possible. (Increasing her own wrongdoing may, of course, lead to a larger award but it could also lead to larger criminal sanctions against the whistleblower, thereby mitigating the effect of the former).

While these considerations appear to militate in favour of a hard-and-fast rule that a whistleblower should not be entitled to a reward for reporting wrongdoing to which she is a party, other factors may weigh against such a rule. For example, in some cases insiders are likely to be the only plausible whistleblowers or the only individuals with access to the kind of evidence likely to secure a conviction. It is well-known that, in the context of organized crime, successful prosecutions have often depended on inducing members of a conspiracy, criminal organization or ring to "turn state's evidence".

Similarly, under a rule that largely eliminates the incentive to whistleblow where the erstwhile whistleblower is herself implicated in wrongdoing, the "leaders" of crime within the corporation have a strong incentive to induce other employees to engage in wrongdoing so as to immunize them against becoming whistleblowers – an incentive which, of course, is mitigated by the

risk that the employees will refuse and, now alerted to the wrongdoing, will blow the whistle *before* becoming implicated.

A related concern is that some employees who become involved in wrongdoing may do so under pressure from managers or co-workers, or under threat of retaliation. These employees are excellent candidates for whistle-blowing. Too weak to do the right thing on principle but not inherently corrupt, they may well be induced to whistleblow by the prospect of a reward that mitigates the risks of doing so. It would seem perverse, then, to exclude this class of individuals from eligibility for a whistleblowing reward. Nonetheless, it can be argued that the prospect of such a reward in the first instance should have been sufficient to induce such persons to whistleblow when pressure was first put on them to engage in wrongful activity. However, when they first succumb to such pressure these individuals may not yet be aware of the seriousness or extent of wrongdoing. They may, for instance, think that they are only being asked to cheat a little "around the edges", to help out a colleague or the corporation or, alternatively, they may not (yet) have access to the kind of evidence required to be confident of securing a conviction and therefore obtaining a reward.

These considerations suggest that it would be undesirable to have a hard-and-fast rule preventing an individual who is implicated in wrongdoing from recovering a whistleblowing reward. Arguably, the best approach is to provide the court with discretion to examine, on a case-by-case basis, whether the nature of the individual's wrongdoing in the circumstances justifies a reduction or elimination of the award. Here, relevant factors will include whether the individual has been a "leader" or a "follower" in the wrongdoing, whether she became involved under pressure from co-workers or supervisors, at what point she could have been expected to identify a clear pattern of serious wrongful activity, and the extent to which she profited from wrongful activity before blowing the whistle.

This suggests that the existing approach of the *False Claims Act* is not off the mark. The Act allows the court to reduce an award where the action is brought by an individual who herself has been involved in wrongdoing, but only where the whistleblower has "planned and initiated" the wrongful conduct. Furthermore, even in the case of an action by a whistleblower who planned or initiated the wrongdoing, recovery is not barred altogether and the reduction is not required by the statute, but rather is a matter for the discretion of the judge, depending on the circumstances. This is somewhat offset, however, by the proviso that a whistleblower who receives a criminal conviction for the wrongful conduct that is the basis for the action shall be barred altogether from recovery. This means that for the incentive of a reward to operate on a whistleblower who herself is implicated in the wrongdoing, the whistleblower might have to be assured of immunity from criminal prosecution.

The Risk of Fabricated Claims

As Callahan & Dworkin (1992) note,[44] it is often claimed that the prospect of large awards to whistleblowers provides an incentive for employees to fabricate claims of wrongdoing for personal profit. If this were true, one would anticipate that serious costs would follow, including harm to the corporation's reputation and that of individual employees, wasted time and money in defending against false claims, and a deterioration of morale within the corporation. However, as Callahan & Dworkin further note,[45] there are several features of the *False Claims Act* that make fabricating claims of wrongdoing a very high-risk strategy. First, the whistleblower must either convince the Justice Department to pursue an action against the corporation or bear the costs of the action herself. In the latter case, this involves either significant out-of-pocket legal and investigatory expenses or persuading a lawyer that the chances of success are sufficient to merit investing time on a contingency-fee basis. Second, if the court determines that the action "was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment",[46] the whistleblower may be required to pay the corporation's costs. A more serious risk is that a fabricated or exaggerated claim may be used by a whistleblower to obtain a settlement from the corporation. This risk is probably greatest in the case of a disgruntled employee who already doubts her future within the corporation, or where the potential settlement is sufficiently large to outweigh possible dismissal and other retaliation for such conduct. (This is also the risk that the reputational effects attached to such behaviour may lead to "blacklisting" by other potential employers).

At one level, one might ask why a corporation (usually a "deep-pocket" litigant) would be prepared to settle a meritless claim for a substantial amount of money. It is possible to imagine a scenario where even unfounded allegations of corruption could effect a decline in the value of a corporation's shares. Unproven allegations could, perhaps, also dissuade governments from entering into new contracts with a corporation until the matter is "cleared up". A fraudulent whistleblower could time her demand for a settlement strategically; for example, at a time when the corporation is on the verge of winning a major contract, is about to float a new equity issue, is about to be acquired, or is about to undertake a merger.

The main difficulty facing the fraudulent whistleblower in these circumstances is that a large settlement of the whistleblower's claim is unlikely to save the corporation's reputation. Shareholders and others may well infer from such a settlement that wrongdoing has in fact occurred. It is true that the corporation might be able to keep a settlement secret for a time, but eventually a large disbursement must be reflected in the corporation's books and somehow accounted for in its regular reporting to shareholders. Nevertheless, a settlement might have the short-term value of pulling the corporation through a critical period. In some circumstances, it might also be possible to disguise a

settlement as a generous "golden handshake". Furthermore, if agency theory is introduced into the analysis, even where it is not in the corporation's best interests to settle with the whistleblower, individual employees or managers may be quite happy to spend the corporation's money to silence a troublemaker, particularly where the whistleblower's allegations impugn their personal reputations.

These considerations qualify the claim of Callahan & Dworkin that "settlement leverage to be gained from a meritless claim is minimal".[47] However, it is important to recognize that this leverage has little to do with the availability of an award if the whistleblower has the option of being able to succeed with the claim in court. Rather, it has everything to do with the ability to do reputational harm to the corporation and/or its managers and employees *before* the claim can be judicially scrutinized. The likelihood that a corporation would settle, not because of this immediate threat but because of the risk that a court might actually accept a truly fraudulent or fabricated claim *is* probably minimal.

A related concern is that of vigilantism. In the hope of gaining a large reward if they actually uncover wrongdoing, employees may invest inefficient amounts of time and resources in attempting to detect wrongdoing. This would likely occur where at least some of the time and resources expended are corporate, for which the individual employee does not bear the full opportunity cost. Moreover, vigilantism may have subtle negative effects on corporate interests where, for example, potential whistleblowers break into confidential files or spy on other employees in the hope of uncovering wrongdoing. It is important to note that it is not a requirement of the *False Claims Act* that a whistleblower obtain information about wrongdoing either inadvertently or in the normal course of her duties. Conversely, vigilante-like conduct, particularly where no wrongdoing exists, can be legitimately and effectively disciplined within the workplace – ultimately by dismissal if necessary. Intuitively, it is unlikely that a potential whistleblower would run such risks unless she already had plausible evidence of misconduct. Nevertheless, in some circumstances, a disgruntled employee facing termination for other reasons might decide there is little to lose in such behaviour.

While it might prevent some inefficient employee investments of company time and resources in detecting wrongdoing, a rule preventing recovery where the informer has not obtained information in the course of her normal duties might also deter some efficient investments. Moreover, even if she discovers some hint of wrongdoing in the normal course of her duties, it will often be unlikely that she can gather decisive evidence of wrongdoing except through active efforts. In fact, in many circumstances, using company time and resources to gather evidence may be inevitable. Finally, given that whistleblowers typically consider themselves to be acting out of loyalty to the *corporation*, they will be most inclined to make investments of corporate time and resources in uncovering wrongdoing where they believe that doing so is in the best interests of the *corporation*.

GUARDING THE GUARDIANS: THE CASE FOR A PRIVATE RIGHT OF ACTION

A DISTINCTIVE ASPECT OF THE WHISTLEBLOWER provisions of the *False Claims Act* is that they allow the whistleblower to pursue a private right of action where the Justice Department refuses to take up the claim. A much higher *minimum* level of award is provided to the whistleblower, where she pursues an action on her own (25 percent as compared to 15 percent). This seems reasonable, given the greater costs and risks of a whistleblower bearing the carriage of the action. However, it is sometimes argued that allowing a private right of action invites frivolous claims, which would otherwise be screened out by public prosecutors.

In fact, as noted by Callahan & Dworkin, of the nearly 300 claims filed between 1986 and 1992, only 42 were joined by the Justice Department.[48] At first glance it may seem odd that it could be socially efficient for a private individual to pursue a whistleblower action but it is not socially efficient for the Justice Department to do so. Callahan & Dworkin suggest that the government may actually be saving money by allowing private individuals to bring actions. However, any such savings are likely outweighed by the higher payment generally owed to a whistleblower in compensation for having brought the action (unless we assume that whistleblowers are able to use legal resources more efficiently than the government, which may very well be the case). This may also be partly explained by the departmental budgets which put ceilings on internal resources for investigation and prosecution and which cannot easily be raised in the short term. Under these circumstances, it can be predicted that Justice Department lawyers will decline to prosecute even where it is socially efficient to do so if the anticipated benefit is outweighed by the opportunity cost of foregoing prosecution of a more promising claim. If there were no fixed limits on prosecutorial resources, the Justice Department would pursue every action where the marginal social benefit[49] of doing so is equal to the marginal cost in prosecutorial resources and where the marginal cost of prosecutorial resources that are *equal in effectiveness to those that would be marshalled by the whistleblower herself* is less than the cost to the government of the whistleblower pursuing her own action (i.e., where a higher percentage of the total recovery goes to the whistleblower to reflect her carriage of the action, with a corresponding smaller recovery for the public purse).

If we introduce assumptions related to public choice, the government's decision whether to prosecute or not may not be determined solely by considerations of maximizing social welfare or the public interest. The government's decision will also be influenced by agency theory assumptions that the decisions of bureaucrats regarding individual prosecutions will be affected by their own interests and not only the government's (whether the latter is defined in terms of public interest or public choice). Moreover, the availability of a private right of action may have much broader consequences than the above

account suggests. From a public choice standpoint, the government may be reluctant to prosecute a corporation that wields influence on government generally and to which it is indebted for, or from which it expects to receive, political contributions. A government may also be reluctant to prosecute where an investigation and trial could reveal government complicity in corporate wrongdoing.

The possibility of the government failing to prosecute wrongdoing for such reasons reinforces the value of a private right of action as a means of "guarding the guardians". The potential for using whistleblower legislation in this way is important to bear in mind when considering some of the specific issues in design and interpretation of whistleblower provisions in the *False Claims Act*. First, the possibility that a government may not prosecute in order to conceal its own complicity with wrongdoing suggests that governmental complicity should not act as a bar or a kind of estoppel defence against an action whose carriage is born by the whistleblower herself. This supports the result in the case of *Hagood* v. *Sonoma County Water Agency*, where the United States Court of Appeals, Ninth Circuit, held that awareness by government officials of the falsity of a contractual claim did not provide a valid defence to a whistleblower suit against the contractor.[50]

A more subtle issue in the design of an optimal whistleblower statute is also raised by the facts of this case. The legislative history of the *False Claims Act*, reviewed by the Court in *Hagood*, suggests a preoccupation with designing statutory provisions which do not require that the government forego significant revenue to compensate a whistleblower for information already available to the government. The assumption is that it is inefficient to pay for something that one already owns. However, it is precisely when the government is in complicity with the wrongdoing that the information, by definition, will already have been available to it. The latest version of the *False Claims Act*, as amended in 1986, allows a whistleblower to recover even where she was not the primary source of the information, although it does provide for a reduction in the amount of the award to a maximum of 10 percent when the whistleblower has not been the primary source, provided the information had not previously been made public.[51] However, where the Justice Department does not intervene, there is no requirement that an award be discounted even where the information provided by the whistleblower would already have been available to government. This has precisely the salutary effect of not deterring whistleblower actions where the government has deliberately decided not to act on information independently available to it.

From an agency theory perspective, even where the government itself is acting in the public interest, delegated decision-makers within government, such as prosecuting attorneys or investigators, may have interests that are not fully aligned with those of government. For example, where prosecutors are not fully compensated for overtime, they may shirk from undertaking a case that involves significant extra work unless they believe it offers them strong

career advantages. Bureaucrats who want to leave open the possibility of a private sector career upon leaving government may be disinclined to offend major corporate interests. In the case of the defense sector, defense contractors are a major source of employment for former government employees, as are major government contractors generally. This consideration may weigh less on Justice Department lawyers themselves and more on officials in the line department that signed the government contract who would likely be consulted on whether prosecution is warranted.[52] A third factor is that there appears to be some institutional bias against whistleblowers in the Justice Department, which may explain why the Department frequently declines not only to recommend that the Department join an action but often seeks to frustrate a whistleblower's own recovery, arguing on various grounds that the whistleblower's reward should be reduced. As the Court pointedly noted in one whistleblower's suit,

> [n]o one likes snitches but they can be valuable. In view of their widespread use, it is worthy of note that the Department of Justice has considered such individuals as adversaries rather than allies. This is not the first case where this Court has noted the antagonism of the Justice Department to a whistleblower. The reason continues to be unknown, but the attitude is clear.[53]

On the basis of common explanations of bureaucratic conduct, a number of reasons come to mind why Justice officials might have a bias against whistleblowers despite the apparent social utility of their role. First, Justice officials are themselves "team players" in a large organization and may be distrustful of dissenters or apparent traitors within other large organizations. Lennane (1993) suggests in a study of Australian whistleblowers that: "It is disappointing that statutory authorities so often fail to help, seeming, like most workmates, to side with employers as part of the authority system."[54] Second, where whistleblowers pursue an action that the Justice Department fails to join, they may in effect second-guess the judgement of Justice Department officials in deciding not to prosecute. Finally, officials may react out of jealousy or envy at the large awards that whistleblowers and/or their lawyers may receive if successful.

CONCLUSIONS

THIS STUDY HAS EXPLORED THE SCOPE for whistleblowing to serve as an important instrument in the arsenal of public policy designed to ensure corporate compliance with broad social responsibilities. We believe that attention to whistleblowing serves as a welcome addition to the debate over corporate social responsibility. Traditionally, this debate has focused on issues of discretionary directorial duties at the expense of dealing with more mundane but significantly more important issues of corporate compliance. Whistleblowing

holds considerable promise as an instrument capable of increasing the probability of detection of perverse corporate behaviour, but at a relatively low resource cost. In this respect, whistleblowing bounties are similar in nature to other types of instruments that permit valuable corporate information to be disseminated in a timely and accurate way to public authorities, and which in turn enhance the quality of the regulatory system governing corporations. While there are certainly vexing and subtle design issues involved in the creation of workable whistleblowing schemes, we view these concerns as not so formidable as to militate against the adoption of such schemes, and we recommend them strongly to Canadian policy makers.

ENDNOTES

1 Illegal corporate conduct means illegal actions undertaken by the corporation's agents for personal gain.
2 See, e.g., B. Fisse and J. Braithwaite, *Corporations, Crime and Accountability*, Cambridge: Cambridge University Press, 1993; J. Arlen, "The Potentially Perverse Effects of Corporate Criminal Liability", *Journal of Legal Studies*, 23, 1994, p. 833; J. C. Coffee Jr., "'No Soul to Damn: No Body to Kick': An Unscandalized Inquiry into the Problem of Corporate Punishment", *Michigan Law Review*, 79, 1981, p. 386; R. H. Kraakman, "Corporate Liability Strategies and the Costs of Legal Controls", *Yale Law Journal*, 93, 1984, p. 857; various articles in symposium issue on corporate criminal liability, *Boston University Law Review*, 71 (2), 1991, pp. 189-453.
3 See, e.g., Arlen, *ibid.*
4 Arlen, *ibid.* at 835.
5 See, e.g., W. K. Viscusi and R. J. Zeckhauser, "Optimal Standards with Incomplete Enforcement", *Public Policy*, 27, 1979, p. 437; R. B. Stewart, "Regulation, Innovation, and Administrative Law: A Conceptual Framework", *California Law Review*, 69, 1981, p. 1259; C. R. Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State*, Cambridge, MA: Harvard University Press, 1990; R. Howse, J. R. S. Prichard and M. J. Trebilcock, "Smaller or Smarter Government?", *University of Toronto Law Journal*, 40, 1990, p. 498.; I. Ayres and J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford: Oxford University Press, 1995.
6 See particularly, R. J. Herrnstein and J. Q. Wilson, *Crime and Human Nature*, New York: Simon & Schuster, 1985.
7 See R. Howse, "Retrenchment, Reform or Revolution? The Shift to Incentives and the Future of the Regulatory State", *Alberta Law Review*, 31, 1993, pp. 455 at 476-477; Arlen, *supra* n. 2 at 835.

8 For overviews of such protection in the United States, see M. H. Malin, "Protecting the Whistleblower From Retaliatory Discharge", *University of Michigan Journal of Legal Reference*, 16, 1983, Ref. p. 277; S. M. Kohn and M. D. Kohn, "An Overview of Federal and State Whistleblower Protections", *Antioch Law Journal*, 4, 1986, p. 99; and more recently, T. Barnett, "Overview of State Whistleblower Protection Statutes", *Labor Law Journal*, 43, 1992, p. 440. For Canada, see L. J. Brooks, "Whistleblowers ... Learn to Love Them", *Canadian Business Review*, 20, 1993, pp. 19-21.
9 *False Claims Act*, 31 U.S.C. § 3730.
10 For a much more detailed analysis of the development and wording of the statute, see E. S. Callahan and T. M. Dworkin, "Do Good and Get Rich: Financial Incentives For Whistleblowing and the False Claims Act", *Villanova Law Review*, 37, 1992, 273 at pp. 302-18.
11 The individual need not be an employee or officer of the corporation in order to recover under the statute, which extends its incentive effect to clients, customers, competitors and others who have the opportunity to discover corporate wrongdoing.
12 See Fisse & Braithwaite, *supra* n. 2; Arlen, *supra* n. 2.
13 See, *e.g.*, G. Becker, "Make the Punishment Fit the Corporate Crime", *Business Week*, 13 March, 1989, 22, col. 2; M. K. Block, "Optimal Penalties, Criminal Law and the Control of Corporate Behaviour", *Boston University Law Review*, 71(2), 1991, p. 395; J. S. Parker, "Criminal Sentencing Policy for Organizations: The Unifying Approach of Optimal Penalties", *American Criminal Law Review*, 26, 1989, p. 513; W. M. Landes, "Optimal Sanctions for Antitrust Violations", *University of Chicago Law Review*, 50, 1983, p. 652; and R. A. Posner, *Economic Analysis of Law*, Boston: Little Brown and Company, 1986, 2nd ed., c. 7.
14 However, as J. Arlen, *supra* n. 2 at 842, has stressed, the standard analysis of corporate crime should be broadened to incorporate sensitivity to "the relationship between corporate enforcement expenditures, the probability of detection, and the corporation's expected liability".
15 See discussion Kraakman, *supra* n. 2; R. H. Kraakman, "Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy", *Journal of Law, Economics and Organization*, 2, 1986, p. 53.
16 C. R. Alexander and M. A. Cohen, "Why Do Corporations become Criminals?" (unpublished manuscript, Dec. 1994).
17 Arlen, *supra* n. 2 at 834.
18 For a more extensive discussion of this issue in the setting of bank debt interests, see R. Daniels and G. Triantis, "The Role of Debt in American Corporate Governance", *California Law Review*, (forthcoming, 1995).
19 A. M. Polinsky and S. Shavell, "Should Employees Be Subject to Fines and Imprisonment Given the Existence of Corporate Liability?", *International Review of Law and Economics*, 13, 1993, p. 239.

20 As A. Etzioni has noted in "Going Soft on Corporate Crime", *Washington Post*, 1 April, 1990, C3, col. 1, "[b]ecause the crimes may involve complex financial transactions over long time periods, it may not be possible to determine exactly which individuals are responsible for what actions".
21 See M. Trebilcock, *The Prospects for Reinventing Government*, Toronto: C. D. Howe Institute, 1994.
22 The recent debacles over the misuse of financial derivative instruments by financial institutions and public issuers underscores this point. Normally, these instruments are a device for limiting or at least controlling corporate risk exposure, but with only modest changes in contractual arrangements, the riskiness of these instruments for the sponsoring institution can be increased dramatically. The difficulty for public authorities is, first, in being able to determine when derivative instruments are being used and, second, in being able to distinguish those cases of benign risk management from perverse risk-taking.
23 A. Berle and G. Means, *The Modern Corporation and Private Property*, New York: Harcourt, Brace & World, 1932.
24 These accountability problems are observed in a number of different relationships within the corporation: between shareholder and manager, between shareholder and creditor, and between majority and minority shareholders. For an introduction to agency theory in the corporate context, see: A. Barnea, R. A. Haugen, and L.W. Senbet, *Agency Problems and Financial Contracting*, Englewood Cliffs, New Jersey: Prentice-Hall, 1985, or W. A. Klein and J. C. Coffee, *Business Organizations and Finance: Legal and Economic Principles*, Mineola, New York: Foundation Press, 1990, 4th ed.
25 Recent trends toward organizational de-layering and increased focus reduce, although do not obliterate, the scope for sub-goal pursuit.
26 J. B. Dozier and M. P. Miceli, "Potential Predictors of Whistle-Blowing: A Prosocial Behaviour Perspective", *Academic Management Review*, 10, 1985, p. 823; M. P. Miceli, B. L. Roach, and J. P. Near, "The Motivations of Anonymous Whistle-Blowers: the Case of Federal Employees", *Public Personnel Management*, 17, 1988, p. 281; M. P. Glazer and P. Migdal, *The Whistleblowers: Exposing Corruption in Government and Industry*, New York: Basic Books, 1989, c. 4, "The Power of Belief Systems for Ethical Resisters".
27 See Arlen, *supra* n. 2.
28 See J. P. Near and M. P. Miceli, "Retaliation Against Whistle Blowers: Predictors and Effects", *Journal of Applied Psychology*, 71, 1986, p. 137; E. S. Callahan and J. W. Collins, "Employee Attitudes Toward Whistleblowing: Management and Public Policy Implications", *Journal of Business Ethics*, 11, 1992, p. 939.
29 Glazer and Migdal, *supra* n. 26; a catalogue of the "Ways of Punishing Whistleblowers" can be found in B. D. Fisher, "The Whistleblower

Protection Act of 1989: A False Hope for Whistleblowers", *Rutgers Law Review*, 43, 1991, p. 355 at 363-68.

30 Glazer and Migdal, *supra* n. 26 at 210.

31 F. Strasser, "When the Big Whistle Blows ...", *National Law Journal*, 8 May, 1989, p. 1; R. B. Schmitt, "Honesty Pays Off", *Wall Street Journal*, 11 January, 1995, A1-2, col. 6.

32 808 F. Supp. 580 (S.D. Ohio 1992).

33 Dozier and Miceli, *supra* n. 26; F. Elliston *et al.*, *Whistleblowing Research: Methodological and Moral Issues*, New York: Praeger, 1984, p. 26.

34 Callahan and Collins, *supra* n. 28 at 944-55; Miceli, Roach & Near, *supra* n. 26.

35 A further difficulty is the inherent uncertainty of the value of the whistleblower award; not only must the prospective whistleblower worry about the likelihood and costs of corporate retaliation, but she can only speculate on the expected value of the bounty in the event that her claim succeeds. Here, as mentioned earlier, the prospective whistleblower must consider the actual social damages inflicted by the corporation, the extent of corporate culpability (if this is an element of the offence), the level and quality of resources expended by the state on prosecution, and the ultimate disposition of the claim. The uncertainty inherent in these calculations creates risks for the whistleblower which must be offset with additional compensation. The design of incentive-based contracts is discussed in P. R. Milgrom and J. Roberts, *Economics, Organization and Management*, Englewood Cliffs, New Jersey: Prentice-Hall, 1992, at c. 7.

36 Ayres and Braithwaite, *supra* n. 5.

37 A. K. Naj, "Internal Suspicions; GE's Drive to Purge Fraud is Hampered by Workers' Mistrust", *Wall Street Journal*, 22 July, 1992, A1-2,6, col. 1.

38 See T. M. Dworkin and E. S. Callahan, "Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society", *American Business Law Journal*, 29, 1991, p. 267 at 273.

39 Callahan and Collins, *supra* n. 28; T. Barnett, D. S. Cochran and G. S. Taylor, "The Internal Disclosure Policies of Private-Sector Employers: An Initial Look at Their Relationship to Employee Whistleblowing", *Journal of Business Ethics*, 12, 1993, p. 127.

40 For anecdotal evidence of such abuse, see M. Mason, "The Curse of Whistle-Blowing", *Wall Street Journal*, 14 March, 1994, A14, col. 3.

41 Near and Miceli, *supra* n. 28 at 142.

42 See generally, J. R. Macey, "Agency Theory and the Criminal Liability of Organizations", *Boston University Law Review*, 71(2), 1991, p. 315.

43 Barnett, Cochran and Taylor, *supra* n. 39 at 129, 134.

44 Callahan and Dworkin, *supra* n. 10 at 325.

45 *Ibid.* at 326-27.

46 31 U.S.C. § 3730 (d) (4) (1988). However, as W. Kovacic notes, "Whistleblower Bounty Lawsuits as Monitoring Devices in Government

Contracting" (unpublished manuscript, October 1994), there has not yet been a reported case where a court has ordered a *qui tam* plaintiff to pay the defendant's costs under this provision of the *False Claims Act.* This fact may mitigate, at least to some degree, the extent to which this cost-rule actually creates a disincentive to fabricated claims in practice.

47 Callahan and Dworkin, *supra* n. 10 at 326.

48 *Ibid.* at 325.

49 Here, the social benefit includes not only recovery of public moneys lost due to fraud but also the specific and general deterrence effects that result from sanctioning wrongful conduct.

50 929 F.2d. 1416 (9th Cir. 1991), foll'd *Heckler, Secretary of Health and Human Services v. Community Health Services of Crawford County, Inc., et al.*, 467 U.S. 51 (3rd Cir. 1984).

51 31 U.S.C. § 3730(d)(1) (1988).

52 A related issue is the extent to which government employees or former employees should be entitled to bring whistle-blower law suits based on information about corporate wrongdoing learned while fulfilling their duties as agents of the government. For a thorough consideration of this issue, see Kovacic, *supra* note 46.

53 *U. S. v. General Electric, supra* n. 32 at 584.

54 K. J. Lennane, "'Whistleblowing: A Health Issue", *British Medical Journal,* 307, 1993, p. 667 at 669.

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