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Henry Ordower  
*Saint Louis University School of Law*

James Fisher  
*affiliation not provided to Scholarship Commons*

Ellen F. Harshman  
*Saint Louis University - Richard A. Chaifetz School of Business*

William B. Gillespie  
*Saint Louis University - Richard A. Chaifetz School of Business*

Leland Ware  
*University of Delaware*

*See next page for additional authors*

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**Authors**

Henry Ordower, James Fisher, Ellen F. Harshman, William B. Gillespie, Leland Ware, and Fred C. Yeager

# Privatizing Regulation: Whistleblowing and Bounty Hunting in the Financial Services Industries

James Fisher,<sup>1</sup> Ellen Harshman,<sup>2</sup> William Gillespie,<sup>3</sup> Henry Ordower,<sup>4</sup> Leland Ware,<sup>5</sup> and Frederick Yeager<sup>6</sup>

## Overview

In late 1999, Congress enacted financial modernization legislation that dramatically deregulated the financial services industry and expanded the powers of financial institutions in the United States. In keeping with this deregulation and expanded powers, the regulatory landscape and enforcement mechanisms also changed. While many applaud this legislation, others point to previous U.S. experience where financial deregulation overwhelmed federal regulators and resulted in massive failures of financial institutions and, consequently, in huge federal bailouts. We examine here, the prospect of supplementing regulation with certain forms of private intervention. Specifically, we address the question: Is there a role for whistleblowing and bounty hunting as means of supplementing existing regulation in the financial services industry?

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1. Associate Professor of Marketing and Director, Emerson Institute for Business Ethics, Saint Louis University, St. Louis, Missouri USA.

2. Associate Professor of Management and Associate Provost, Saint Louis University, St. Louis, Missouri USA.

3. Formerly Associate Professor of Finance, Saint Louis University, St. Louis, Missouri USA; currently attorney in private practice.

4. Professor of Law, Saint Louis University, St. Louis, Missouri USA.

5. Louis L. Redding Chair, School of Urban Affairs, University of Delaware, Newark, Delaware USA.

6. Professor of Finance, Saint Louis University, St. Louis Missouri USA.

## I. Introduction and History

Generally, governmental agencies bear the responsibility for overseeing the activities of financial services in the United States. Frequently separate agencies assume jurisdiction over the various industry groups and occasionally several agencies regulate a single industry. For example, in the United States the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency all regulate some of the functions of most commercial banks. The Securities and Exchange Commission ("SEC") has primary regulatory authority over investment banking and the markets for the purchase and sale of securities. On the other hand, no federal agency has general regulatory authority over the insurance industry, rather each of the states has an agency that regulates insurance in that state.

Conflicts and turf skirmishes between or among agencies arise with respect to overlapping authority. Both the Commodities Futures Trading Commission and the SEC, for example, have sought to regulate the same financial products. Recently, the US enacted the Financial Modernization Act of 1999,<sup>7</sup> a statute that is likely to blur the lines between the jurisdictions of various regulators. This Act removes historical barriers that precluded participation in multiple financial services sectors by a single company.<sup>8</sup> As industry participants expand their activities in response to the Financial Modernization Act, a single company may find itself subject to examination by increasing numbers of regulators; however, at the same time, regulators may find themselves overwhelmed by the numbers of industry participants the regulators must oversee. In addition, technological advances, especially the internet, as well as globalization of economic activity make the regulatory task diffuse and unwieldy.

Effective regulation may depend not only on enforcement by governmental agencies, but also on a number of private interventions. For example, as financial services become increasingly complex, regulators may find themselves relying heavily on industry participants, trade groups and private, industry-funded specialists to assemble data and develop rules and oversight methodologies. In

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7. Financial Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999); See discussion *infra* Part II.

8. Banking Act of 1933, §§ 16, 20, 21 and 32, 12 USC §§ 24, 78, 377 and 378 (1994 and Supp. II 1997) (repealed 1999) known commonly as the Glass-Steagall Act, prohibited commercial banks from engaging directly or through affiliates in investment banking or insurance underwriting. See discussion *infra* Part II.

the United States, we have a tradition of encouraging the market participant to regulate itself by adopting internal systems that require its managers and employees to comply with the law. To a limited extent, each industry may bear part of the regulatory burden through industry oversight groups and self-regulatory organizations. Industry groups commonly wield considerable authority to regulate their members' activities and discipline their members for violating industry norms. In the learned professions, professional associations define and enforce professional standards and licensing, thereby enabling the profession to guard against outside regulation while regulating the profession from within.<sup>9</sup> In the United States, self-regulatory organizations always have played major roles in the examination and licensing of brokers and dealers in the securities industry and maintenance of the securities markets.<sup>10</sup> Regulatory dependence upon the industry regulated exposes the public to market-driven regulatory standards rather than standards defined by consumer protection. Dependence also increases the risk that industry participants will be able to conceal improper behavior and practices from the regulators. When added to the inherent complexity and intricacy of the industry, active concealment and the ability of the industry participants to influence rule making will further diminish effective regulation. At the same time, the U.S. financial services industries have enjoyed diminishing government oversight over the past several decades, as the economy has grown stronger. This trend toward less government interference and less funding for regulation seems likely to continue.<sup>11</sup>

Regulators may not have the budget necessary to investigate and prosecute violations of the laws the regulators administer. Even when they choose to investigate or prosecute, regulators may have to depend upon information the industry supplies. This dependence gives the industry, even in the presence of self-regulatory authorities, the opportunity to slant its data in order to display itself and its organizations in a favorable light.

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9. The American Medical Association, for example, actively engages itself in the examination and licensing of physicians.

10. The National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE) are examples of such self-regulatory organizations.

11. Occasionally serious threats to financial stability elicit cries for increased regulation, but more restrictive laws generally have not materialized. Consider the outcries following Barings Bank's insolvency in 1995 and the enormous loss incurred by the hedge funds under Long Term Capital Management's investment management following the Russian default in August, 1998.

Regulators will find that they need help in identifying and gathering information concerning improper activities. Public awareness and participation in regulation are critical to combat the loss of effective government regulation and the inability of the regulators to meet increased demand and complexity of regulation. Non-governmental organizations may serve as private regulators by investigating and publicizing questionable activities within their areas of interest in order to limit abuses by the industry participants.<sup>12</sup> In addition, greater participation in regulation by the general public through such non-governmental organizations and in other manners can complement and enhance the efforts of the government regulators.

The role of the private citizen in law enforcement or regulation has a long history both in Great Britain and the rest of the world. Whether this tradition springs from a conscious decision to give the local population a feeling of direct and personal involvement in the affairs of the government by various sovereigns or a simple decision to employ a cheap and ready supply of law enforcement "officers" is unimportant; what is important is that this practice has been a prominent feature of the law enforcement landscape and is likely to continue as a feature of law enforcement. From proclaiming the "hue and cry" throughout the wapentake or hundreds in medieval Britain to the present-day Federal False Claims Act,<sup>13</sup> the local citizenry finds itself more or less involved in the law enforcement process that promises either a fine or amercement for failing to participate actively in the former case or a bounty for active participation in the latter.

Trial by jury may also be viewed in this context, and the Magna Carta (cap. 39) was not the first example of an effort by various authorities to bring the concept of local participation and "social pressure" into law enforcement. In addition to the aforementioned provision of the Magna Carta, one could look to the edict of Emperor Conrad II (1037) that provided that military tenants were not to be deprived of their fiefs "except by the laws of our ancestors and the judgment of their peers."<sup>14</sup> In England, the same principle

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12. For example, Greenpeace has played an active and confrontational role worldwide in order to protect the environment. On a more local level, the Association of Community Organizations for Reform Now, better known in the U.S. as ACORN, recently has enjoyed some success in addressing lending abuses by sub-prime lenders.

13. Federal False Claims Act, 31 U.S.C. §§ 3729-3733. See discussion *infra* Part IV.B.

14. See J.C. HOLT, *MAGNA CARTA* 75 (1965, reprint 1969).

is to be found in a proclamation of Henry I along with an interesting jurisdictional addition: "... each man is to be judged by his peers of the same neighborhood."<sup>15</sup>

In the United States, direct citizen participation in the law enforcement process appears in various vigilante movements. Brown defines vigilantism as "... organized [and] extralegal movements, the members of which take the law into their own hands..."<sup>16</sup> Whatever the ulterior motive(s) of these various movements, they seem to have flourished wherever formal law was either weak or non-existent (e.g. the frontier of the American West from about 1840 to the early 1900s) or where there was a clash of values or legal systems.

In the Pre-Revolutionary Southern United States there is evidence of the activities of the South Carolina Regulators from the late 1750s onward. During the earlier years of this movement one could conclude that "the law" was weak or completely non-existent, but during the immediate Ante-Bellum period the target of the Regulators seems to have been exclusively the members of the Abolitionist movement indicating a clash of cultures or values. However, the most famous (or notorious) of these movements are to be found from about 1840 in the vast empty plains of the West—present-day Montana, Wyoming and the Dakotas (an area roughly the size of Western Europe with a current population of less than 2,000,000). It was here that "the law" was what the dominant culture said it was, and the real question seemed to be: "what is the dominant culture?" Further evidence of vigilantism may be found in the Temperance Movement of the late-19th and early-20th Century where one observes private citizens acting in concert (a mob) for the purpose of eradicating a perceived evil (beverage alcohol).

Wherever these movements sprang-up, whether in San Francisco of the 1850s and 1860s or in Vermont in the mid-1880s or elsewhere throughout the mid- to late-19th Century and into the early 20th Century United States the theme(s) seem to be the same: 1) a real or perceived weakness in the warp and woof of the legal system or system of "moral values"; and 2) a more-or-less spontaneous uprising of the local population. Two further observations may be noted: 1) the victorious culture got the

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15. *Id.* at 76.

16. RICHARD MAXWELL BROWN, STRAIN OF VIOLENCE: STUDIES IN AMERICAN VIOLENCE AND VIGILANTISM 95 (1975).

advantage of cheap law enforcement; and 2) the local citizenry got a feeling of meaningful participation in the process.

While the days of vigilantism may be past, even in the Information Age of the 21st Century, the individual continues to have a role in law enforcement. Legislators at state and federal level have incorporated citizen participation into statutes defining regulation of a variety of industries. Given the need for public assistance to regulation in the financial services sectors, this paper addresses the question of whether whistleblowing and bounty hunting can play meaningful roles in the regulation of financial markets and financial services industries.

Whistleblowing and bounty hunting are discrete activities. Bounty hunting is a business and involves professionals like investigators and attorneys who are sensitive to the amount of compensation offered for their services. Whistleblowing, on the other hand, is an intrinsically personal activity. Incentives may increase contacts with informants but any correlation between the amount of the reward and the volume and quality of information received is less direct than the correlation between compensation and bounty hunting activity. Moreover, whistleblowers often require protection more than they need payments for their services and effective protection is more difficult to provide than money. With laws designed for this purpose, financial market regulators may expect enforcement assistance from both whistleblowers and bounty hunters.

In examining whistleblowing and bounty hunting, part II of the paper introduces the new financial services legislation in its historical context and warns of the dangers it poses to the integrity of the financial services market. Parts III and IV examine regulatory models that focus on the role of the private citizen. Part III offers analysis of whistleblowing and its social and economic framework in order to provide a better understanding of its possible functions and limitations. Part IV proposes expanded utilization of a variety of bounty hunting models as a means to enlist active, non-governmental participation in regulating financial services. Finally, Part V concludes that bounty hunting offers great promise in regulation but carries with it substantial risks of extortive settlement if allowed to operate without controls. Whistleblowing, on the other hand, also carries risks and is far less likely than bounty hunting to provide reliable regulatory assistance.



## II. History of Legislation in Financial Services Industry

### A. *The Glass-Steagall Act of 1933*<sup>17</sup>

Following explosive growth fueled in part by speculative lending in the 1920s, the U.S. Stock Market crashed in October 1929, signaling the beginning of the great depression. From the end of 1929 to the beginning of 1933, over five thousand banks—20 percent of the banks in the United States—failed. This condition led to enactment of the “Banking Act of 1933,” part of which commonly is known as the Glass-Steagall Act. Among other things, Glass-Steagall prohibited the payment of interest on demand deposits and authorized the Federal Reserve Board to regulate interest rates payable on savings and time deposits. The Act also provided for greater regulation of the banking system by the Federal Reserve and prohibited banks and the affiliates of banks to engage in investment banking activities. It also introduced federal deposit insurance and set the stage for a tightly controlled regulatory environment that would continue for the next several decades.

A fundamental result of this legislation enacted in the 1930s was the division of permissible activities among the various financial institutions and the division into compartments of the financial sector. Neither banks nor affiliates of banks could engage in brokerage and other security market activities. Of course, securities firms could not engage in banking. Savings and loan associations could not offer demand deposits, nor could they make commercial or most other types of loans. They were restricted almost totally to the making of home mortgage loans in their local market. Credit unions, established in 1934, could not accept demand deposits and were largely limited to the provision of credit to people “of small means” (according to the 1934 Federal Credit Union Act<sup>18</sup>).

By the 1970s, depression era conditions had faded from the minds of the American public. Federal deposit insurance and financial regulation had accomplished the objective of restoring confidence and of reducing bank and other depository institution failures to a fraction of their former numbers.<sup>19</sup> Indeed, the

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17. Banking Act of 1933 §§ 16, 20, 21 and 32, *supra* note 8.

18. Federal Credit Union Act, 12 U.S.C. § 1751 – 1795 (1988).

19. In 1934, the number of bank failures declined to sixty-one. Beginning in 1943 and for the next three decades the number of bank failures was less than ten per year.

regulatory authorities followed the practice of merging failed institutions with stronger ones, so that deposit and other creditor losses were virtually eliminated. While safety was the primary focus of earlier legislation, quality and price of financial services became the principal issues by the 1970s. The division into compartments of the financial sector was questioned, and a number of government-mandated studies were released. Many of these studies called for deregulation and greater reliance on market forces.

### *B. Winds of Change*

The 1970s and particularly the late 1970s witnessed severe inflation, interest rate increases, and financial market chaos that threatened the solvency of sizable components of the financial sector. Substantial disintermediation occurred as depositors transferred funds from savings and time deposits in financial institutions to newly created money market funds. Money market funds merely combined sums received from savers and invested those funds into money market instruments that were not subject to regulatory imposed interest rate ceilings. Fund managers were able to pass along high market returns to investors in the funds. Subject to interest rate restrictions on their deposits, depository financial institutions were unable to compete on a price basis with interest rates generated by the money market funds. This, together with certain other developments led to passage of The Financial Institution Deregulation and Monetary Control Act of 1980.

### *C. The Financial Institution Deregulation and Monetary Control Act of 1980<sup>20</sup>*

The 1980 Act, commonly referred to as the Monetary Control Act, was undoubtedly the most sweeping piece of financial legislation since the Banking Act of 1933.<sup>21</sup> Among other things, the law provided for the elimination of interest rate ceilings on deposits held by financial institutions, and thrift institutions (primarily savings and loans) were permitted to invest in consumer loans, commercial paper, and corporate debt securities. The thrust of this deregulation was to establish a "more level playing field" within the financial sector, to reduce the compartmentalization of

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20. 12 U.S.C. §§ 248, 248a, 342, 355, 360, 374b, 412, 461, 463, 505, 1425a (1988).

21. See *supra* note 8.

depository financial institutions, and generally to allow greater flexibility within the financial sector.

Importunately, conditions in the 1980s were such that the financial sector became plagued with problems. Thrift institutions took advantage of their new powers and began to restructure their portfolios, with many expanding into higher risk commercial lending and into consumer lending programs where their experience was limited. The net worth of the savings and loan industry fell by 22 percent between 1980 and 1982, and hundreds of savings and loans were merged. In the face of this continuing crisis, Congress enacted (October 1982) major legislation titled The Garn-St. Germain Depository Institutions Act of 1982<sup>22</sup> to "shore up" savings and loan associations and mutual savings banks. This 1982 act also sped up deregulation initiated by the Monetary Control Act of 1980 and generally expanded the deregulatory environment.

Because of rapid growth and expansion in areas beyond the expertise of many thrift managers, a number of these institutions experienced great difficulties. Inexperience with new areas of lending, weakly collateralized loans, outright fraud, and interest rate volatility contributed to an S&L crisis in the 1980s. By 1987, the federal insurer for S&Ls, the Federal Savings and Loans Insurance Corporation (FSLIC) depleted its assets and reached the point where it could no longer afford to close down insolvent S&Ls. Funds were no longer sufficient to reimburse depositors and incur other expenses frequently associated with closing and merging failed institutions. Consequently, Congress, in August 1987, enacted the Competitive Equality Banking Act of 1987,<sup>23</sup> a key feature of which was the reaffirmation that insurance by the FSLIC or by the FDIC represents the "full faith and credit" of the United States. Also, by the late 1980s, commercial banks were experiencing difficulties. The combination of a depressed energy industry and problems in the agricultural sector had resulted in enormous losses for large numbers of banks and thrifts. By September 1987 the volume of bank failures was double the previous year's pace.

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22. The Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 98-181, 97 Stat. 1237 (codified in various sections of 12 U.S.C.).

23. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, 101 Stat. 552.

*D. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)*<sup>24</sup>

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) laid the groundwork to restore the public's confidence in the savings and loan industry. It abolished the failing FSLIC and transferred to the Federal Deposit Insurance Corporation (FDIC) the responsibility of insuring the deposits of thrift institutions. The FDIC insurance fund created to cover thrifts was called the Savings Association Insurance Fund (FDIC-SAIF), while the fund covering banks was called the Bank Insurance Fund (FDIC-BIF). The FIRREA also raised deposit insurance premiums, created the Office of Thrift Supervision (OTS) to regulate the thrifts, and created the Resolution Trust Corporation (RTC) to liquidate failed thrifts. Within a few years of the passage of this Act, hundreds of financial institutions, primarily thrift institutions, were closed at a cost to U. S. taxpayers of several hundred billion dollars.

*E. The Financial Modernization Act of 1999 (Gramm-Leach-Bliley Act)*<sup>25</sup>

As the preceding discussion makes clear, the U.S. financial sector has undergone dramatic change over the past few decades. Severe inflation and interest rate volatility in the 1970s were followed by financial market deregulation in the 1980s. Financial institutions, consequently, began to experience new opportunities and new risks. Commercial lending activities, loans to businesses funded by relatively short term customer deposits, the margins from which were once the mainstay of banking, began to take on reduced importance. In this new environment, the management of risks associated with financial assets and liabilities, began to take on ever increasing importance. Interest rate volatility led to new and sophisticated financial innovations such as interest rate swaps, caps, futures and other derivative financial instruments. These innovations and many other new developments in financial markets were made possible with the advent of increasingly powerful computer technology together with the development of new and

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24. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub.L. No. 103-73, 103 Stat. 183 (codified in various sections of 12 U.S.C. and 18 U.S.C) [hereinafter FIRREA].

25. The Financial Modernization Act of 1999, Pub.L. No. 106-102, 113 Stat. 1338 [hereinafter Gramm-Leach-Bliley Act].

highly sophisticated software. Efficiency in the financial sector, it was reasoned, called for greater linkage of the activities of commercial banks, securities firms, insurance firms, and merchant banking. Greater linkage however, was precluded by the Depression era Glass-Steagall Act (Banking Act of 1933)<sup>26</sup> since it separated permissible activities conducted by commercial banks vs. investment banks vs. insurance companies and merchant banking. Thus these new developments and opportunities left many to conclude that existing financial legislation was outdated and was stifling the efficient advancement of financial markets and activities.

On November 12, 1999, laws separating banking, investment banking, and insurance activities for United States institutions were effectively removed with the enactment of the Gramm-Leach-Bliley Act. This new financial modernization law allowed for the formation of financial holding companies (FHCs), which are permitted to engage in "any activity that is financial in nature." The FHC may therefore engage in activities including but not limited to bank lending, insurance underwriting and other insurance activities, merchant banking, investment banking, brokerage and other securities activities. Importantly, deposits held by banks owned by the FHCs will continue to be federally insured. While many applaud the new legislation and point to the need for modernization of the U.S. financial system, others point to increased risk to the insurance fund and indeed to an increase in the level of systematic risk (the risk of widespread economic failure caused by the demise of one or a few large institutions).

According to provisions of the Gramm-Leach-Bliley Act, regulation of these new FHCs will be functional in nature. For commercial banks, federal banking regulators will supervise traditional banking operations. The U.S. Securities and Exchange Commission will supervise securities activities of banks. State insurance regulators will supervise insurance activities by these same banks.

In the new regulatory climate of the Gramm-Leach-Bliley Act, regulators will require assistance in designing regulatory structures and identifying law violators. Whistleblowers may provide valuable help in the latter category.

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26. See discussion *infra* Part II.A.

### III. Whistleblowing: Risks and Limitations

#### A. *Introduction to the Concept of Whistleblowing*

The term "whistleblower" carries more positive connotations than other terms assigned to people engaged in similar activities. Like informants, tattletales, snitches, and stool pigeons, whistleblowers disclose information concerning wrongful, illegal, or dangerous activities or behavior. The recipients of the information have direct or indirect<sup>27</sup> authority (whether or not legitimate) to prevent or punish the activity or behavior. Because whistleblowers' access to information generally flows from their close relationship with the wrongdoers, as employees, co-workers, insiders of various types, and even family members, whistleblowers risk retaliation from the wrongdoer—dismissal, demotion, ostracism, blacklisting. These personal risks to the whistleblower lend credence to the disclosure and suggest that the informant's motivations are altruistic.

Unfortunately, whistleblowing is not always unselfish and its revelations not always accurate. As with other informants, the whistleblower's motives may be selfish or evil as well, and the information provided may be false or incomplete. Like a child who informs on a sibling to a parent or on a classmate to a teacher, motivations may be as disparate as (i) a sense of an obligation to inform, (ii) the wish to see the other punished, (iii) avoidance of punishment, (iv) hope for reward, (v) the desire to protect the wrongdoer from injuring himself or (vi) the aspiration to become a hero. So long as the information is sound, its recipient should be indifferent to the informant's motivations.

However, it may not be simple to discern the reliability of information. Sometimes, perhaps frequently, the informant's motivations are so compelling that the informant becomes untrustworthy and provides falsified or embellished information. A recipient who is not suspicious of the informer's motives may fail to test the information adequately. Even when tested, the task of distinguishing useful from defective data is especially difficult when information is secret.<sup>28</sup> In addition to issues of reliability, whistleblower information suffers from other vulnerabilities. For example,

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27. News media are examples of indirect authority, in that, the media intend their public exposure of the wrongdoing to motivate those with direct authority to commence enforcement or the wrongdoer to modify his or her behavior.

28. Consider Iago in Shakespeare's *Othello*.

where the whistleblower acts from self-interest, powerful offenders may enjoy immunity because they can control potential informants through threats and rewards.<sup>29</sup> If enforcement efforts rely heavily on the data informants provide, unbalanced and selective enforcement may result. Predominantly, those wrongdoers who lack the power and resources to control the flow of information will be punished.

Unless compensations and protections offered whistleblowers are sufficient to counter the rewards and punishments proffered by influential wrongdoers, whistleblowing is unlikely to prove effective except as an occasional and incidental aide to enforcement. In the financial services industries, discovery of impermissible behavior through informers probably will be serendipitous and rare because violators tend to have resources with which to buy off the prospective informants. Moreover, fear that the wrongdoer will be able to injure the whistleblower's opportunities for future employment and advancement deters all but the most steadfast, indignant, and angry informants. Thus in the absence of a significant personal stake for the informer, the balance will likely tip in most cases against informing.<sup>30</sup> The disgruntled employee here and there who is willing to provide information as a form of revenge will surface, but anger may motivate him or her to falsify or embellish data.

Despite its limitations, whistleblowing can be an important enforcement tool. Whistleblowers conserve government resources by focusing investigations and providing secret data or keys to understanding available data that otherwise may have been obtained only at an extremely high cost. Recognizing these useful roles informants play, agencies devise methods to encourage informing. Direct monetary rewards for information resulting in the arrest and conviction of offenders became common in 19th Century America. More recently, private interests have offered rewards in order to assist law enforcement agencies in apprehending criminals and draw attention to specific criminal activity where the private party has a particular interest in seeing that the criminal is punished.<sup>31</sup>

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29. Consider the recent book and motion picture: *The Insider* that deals with the whistleblower (not spy, not stool pigeon, not tattletale) who blew the whistle (not informed) on the tobacco industry.

30. Compare and contrast sexual harassment and the reluctance of injured parties to come forward even where there is personal interest in and immediate impact on the informer.

31. See, e.g., the \$5000 reward offered by the Philadelphia Daily News in 2000 for a "tip leading to the capture and conviction" of Iriana DeJesus's killer. The same article invites additional contributions to the reward fund.

Similarly, many police departments have a small discretionary fund available to pay informants. Non-monetary payments such as informal agreements not to refer minor criminal offenses for prosecution if the alleged criminal provides information concerning more serious crimes are common. More elaborate schemes include immunity from prosecution in exchange for information concerning, and testimony against others whom the agency considers more desirable targets for prosecution. In financial markets, the best informers are likely to be individuals who have participated in the illegal scheme, so immunity grants will be critical. Less tangible are the appeals to patriotism. Governments as diverse as Nazi Germany, the Soviet Union and the McCarthy-era United States persuaded their citizenry that informing on friends and neighbors was a patriotic duty. Accompanying the encouragement to inform was the threat that one who failed to inform would be viewed as no less guilty than the wrongdoer. Along the same lines but benign are rules of conduct for professionals requiring them to disclose wrongs of which they become aware.<sup>32</sup>

But most important is developing the trust of informants who want assurance that the governmental agency is not corrupt—that it will not pass the informant's information and identity on to the wrongdoer. Altruistic informers want their risks not to be in vain. They want certainty that the agency will utilize the information provided effectively and to the detriment of the wrongdoer. Penalties must not be nominal lest the next whistleblower decide that blowing the whistle is futile and refrain from acting.

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32. With respect to lawyers, attorney-client privilege prevents attorneys from disclosing confidential communications except to prevent substantial bodily injury. MODEL RULES OF PROF'L CONDUCT R. 1.6 (1981). Some state rules require disclosure of confidences to prevent perpetration of the client's fraud. Similarly, see *Ackerman v. Schwartz*, 947 F.2d 841 (7th Cir. 1991) (observing that attorneys are not required to blow the whistle but must accept liability if their client uses the attorneys' opinions in perpetrating a fraud). More recently, the SEC has argued for much broader primary liability for attorneys when they prepare offering documents for clients. See Brief for the Securities and Exchange Commission, *Klein v. Boyd*, Nos. 97-1143 and 97-1261 (3d Cir. Filed March 9, 1998). If the SEC's standard is adopted, lawyers would have to blow the whistle publicly in order to avoid primary liability if they participate in preparing offering documents. Sec. 10A of the Securities Exchange Act of 1934 requires auditors to design procedures to ferret out illegal acts of their audit clients and compels their disclosure to the SEC.



### *B. Protecting Whistleblowers*

Essential to successful enlistment of informers is a means to protect them from retaliation. Statutes prohibiting landlords from evicting or refusing to renew leases of tenants who report housing violations are common. Similar legislation prohibits employers from dismissing employees for disloyal acts such as reporting health and safety violations by their employers. Such protections are essential to any plan to encourage people with accurate information to come forward. Likewise guarantees of anonymity for informants and witness protection programs to provide informers with new identities have been indispensable to prosecution of organized crime.

There are a number of legal avenues through which the risk may be reduced. In recognition that employees are vulnerable to discharge or other retaliation if they choose to come forward with information contrary to the interests of their employers, various legal protections have evolved. Although there is no single legal safeguard that applies to all employees in all whistleblower situations, there is precedent in several states for the application of common law doctrines to protect the employee. In addition, there are a number of state and federal statutes that provide whistleblower protections.<sup>33</sup> In addition, state and federal civil service laws similarly protect public employees from arbitrary personnel decisions and provide a mechanism for redress. And, public employees who refuse to sign oaths pledging to support federal and state constitutions, may not be summarily dismissed without a hearing or inquiry required by due process.<sup>34</sup>

When American labor unions secured the right to organize and to bargain collectively during the 1930s, one of the key ingredients of collective bargaining agreements was a clause prohibiting the arbitrary discharge of workers. This "good cause" requirement obligated employers to have a reasonable basis for terminating employees. Collective bargaining agreements also established

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33. There are at least 26 federal statutes that provide protection for whistleblowers or contain anti-retaliation provisions. Included among these are the Age Discrimination in Employment Act, 29 U.S.C. §§ 621-650; Asbestos School Hazard Detection Act of 1980, 20 U.S.C. §§ 3601-3611; Clean Air Act, 42 U.S.C. §§ 9601-9627 (2000); Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461; Fair Labor Standards Act, 29 U.S.C. § 215(a)(3)(2000); Juror's Employment Act, 28 U.S.C. §§ 1861-1878 (2000); and Occupation Safety and Health Act, 29 U.S.C. §§ 651-678 (2000).

34. *Connell v. Higginbotham*, 403 U.S. 207 (1971).

grievance processes that provided workers with a means of resolving work-related disputes. The National Labor Relations Act (NLRA)<sup>35</sup> gave powerful protection to employees participating in union activities and collective bargaining by prohibiting employers from discharging employees who participated in peaceful union activities or who gave evidence in proceedings to enforce the NLRA.<sup>36</sup>

At greatest risk are those employees who have no specific contractual protection of their employment. These so-called "at will" employees may leave or be discharged at any time for any reason or no reason. Exceptions to the "at-will" employment relationship have been promulgated by statute and common-law. These exceptions either encourage or affirmatively protect employees who take actions detrimental to their employers' interests. State courts have sought to protect the employment status of "at-will" employees under public policy exceptions to the general rule. Courts have long recognized that an employees may not be discharged for refusing to commit crimes under an employer's direction. Another public policy exception protects the whistleblower from retaliatory discharge. Under this exception, employers are prohibited from discharging workers who report violations of the law committed by the employer or fellow employees. Besides a breach of contract remedy, several states also allow the employee to file an action in tort for wrongful discharge; the contract remedy recovers lost earnings while a tort claim allows for the recovery of compensatory and punitive damages.

The protection of the whistleblower was established to support an individual's civic duty in promoting public health, safety and welfare by encouraging workers to report the unlawful activities of their employers. In *Palmateer v. International Harvester Co.*,<sup>37</sup> the Illinois Supreme Court recognized a cause of action for wrongful discharge for an employee who had been discharged after reporting a fellow employee's criminal activities. After his discharge, the worker filed suit against his employer and the Court found that allowing the summary discharge of workers for reporting unlawful conduct would be contrary to the public interest and would deter the reporting of such conduct.

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35. National Labor Relations Act, 29 U.S.C. §§151-169.

36. DANIEL P. WESTMAN, *WHISTLEBLOWING: THE LAW OF RETALIATORY DISCHARGE* 1-2 (1991).

37. *Palmateer v. International Harvester Co.*, 421 N.E. 2d 876 (Ill. 1981).

Similar reasoning can be found in *Garibaldi v. Lucky Stores*.<sup>38</sup> In that case an employee was discharged after reporting to a local health department that his employer intended to ship contaminated milk. The worker filed suit challenging his termination. The Court held that employees could not be discharged for reporting unlawful conduct because of the public interest that is served by assisting authorities in law enforcement efforts. Several states have adopted similar exceptions to the at-will tradition.

In the wake of several highly publicized reports of whistleblowing and the subsequent retaliation against federal employees, Congress enacted several statutes that protect federal employees who report misconduct. The federal laws have the same purpose as the public policy exceptions to the "at-will" employee doctrine carved out by state courts; they are designed to encourage the disclosure of unlawful activities and so aid in the protection of public health safety, and welfare from those who would engage in unlawful conduct.<sup>39</sup>

### C. *Whistleblowing's Adverse Consequences: Conflicting Duties and Social Displacements*

Even if we believe that there may be some advantages to using employees as agents of law enforcement, the potentially adverse consequences cannot be ignored. The possibility that an insider may become an informant creates inherent adversity in the employment relationship, forcing a more formal and legalistic relationship between employer and employees. This adversity breeds tension and disruption in the workplace, undermining the cooperation and collaboration among employees necessary to productivity.

The choice to become a whistleblower requires the employee to overcome legal and moral duties of loyalty to the employer. The open communication and trust essential to a productive organization are undermined as the whistleblower advances the case and the employer assembles the defense. As the employee's whistleblowing activity becomes known, conflicts may also arise between the whistleblower and other employees. Investigations often create pressures and suspicions that may cause irreparable strains in

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38. *Garibaldi v. Lucky Food Stores, Inc.*, 726 F. 2d 1367 (9th Cir. 1984), *cert. denied*, 471 U.S. 1099 (1985).

39. See Whistle Blower Protection Act of 1989, 5 U.S.C. § 1213 (1994) and Civil Reform Act of 1978, Pub. L. No. 95-454, 92 Stat. 111 (codified in various sections of 5 U.S.C.).

relationships among employees. Co-workers feel the tensions and may be drawn into attempts by the whistleblower to gather evidence against the employer, or by the employer to cover up evidence or to discredit the whistleblower.

While the employer-employee relationship may be a casualty of whistleblowing, there are also potential financial impacts on the organization. In addition to the costs associated with lost productivity and negative publicity, an organization facing allegations of wrongdoing has costs in conducting an investigation, mounting a defense, and potentially paying penalties if infractions are found. In the face of these risks to the organization, an opportunistic whistleblower is in an excellent position to extort a settlement from the employer.

The potential adverse consequences of whistleblowing are not limited to disruption of the workplace or to severe negative financial impact on the organization. Although one of the purposes of encouraging whistleblowing is to keep an organization in compliance with laws, ironically, whistleblowing may have a contrary result. The whistleblower himself may be guilty of wrongdoing. It is not uncommon for a whistleblower to copy or remove documents or other evidence from the employer's premises. And since the whistleblower may be a participant in the wrongdoing, in an effort not to reveal his intentions, he may continue improper practices while gathering evidence to use against the employer. Finally, it may be in the whistleblower's interest to allow the employer's wrongdoing to continue so as to create a case of greater magnitude.

In the ideal, whistleblowing can present a deterrent to wrongdoing; however, it may cause extreme disruption to the productivity of a business and may, ironically, prolong the wrongdoing. In addition, whistleblowers usually fare badly in these situations. Managers and co-workers view them with suspicion and distrust. They are seen as troublemakers and threats to the stability and financial well-being of the organization. Whistleblowers are often ostracized by their fellow workers. In most cases it is impossible for a whistleblower to regain the trust and confidence of colleagues. Thus, neither the protections from adverse employment actions established by whistleblower laws, nor incentives offered to these informants can remedy the harm that is done to workplace relationships.

#### D. Federal Whistleblower Reward Programs

Experience with whistleblowing rewards on the federal level in the U.S. is limited. The Internal Revenue Service has enjoyed some success with its reward program.<sup>40</sup> In 1998 for example, the Internal Revenue Service collected nearly \$84 million as a result of whistleblowing and paid nearly \$7 million in rewards for information.<sup>41</sup> Information on the number of false leads is not available. Other federal reward programs have proven less valuable.

Both FIRREA<sup>42</sup> and the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990<sup>43</sup> establish rewards for information leading to a criminal prosecution or the recovery of restitution or a civil penalty for violations under the Acts. FIRREA also provides protection for employees who act as "whistleblowers." To date, there has been no award under these bounty statutes, possibly because the criminal and civil penalties under the Acts have had a general "chilling" effect on financial institutions.<sup>44</sup>

In 1988, Congress enacted the Insider Trading and Securities Fraud Enforcement Act.<sup>45</sup> The Act strengthened existing prohibitions against insider trading and authorized the Securities and Exchange Commission to award bounties to "the person or persons who provide information leading to the imposition" of penalties for insider trading.<sup>46</sup> The bounty cannot exceed ten percent of the penalties imposed in a given case. Furthermore, the awards are entirely discretionary; the SEC's decision in a given case is not subject to judicial review. The regulations allow informants to remain anonymous unless disclosure is essential to the public interest. Despite the expectation of the legislation's authors, the

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40. I.R.S. Pub. No. 733 (1997) (authorizes rewards for information provided by individuals to the Internal Revenue Service); Payment may be up to \$2 million; see also, Treas. Reg. § 301.7623-1(b)(2) (1999).

41. Daniel Currell & Marsha Ferziger, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 99 U. ILL. L. REV. 1141, 1151 (1999) (referred in the following as *Snitching*). Sources from the Internal Revenue Service suggest informally that the bulk of whistleblowers are disgruntled spouses with disgruntled employees a close second.

42. See FIRREA, *supra* note 24.

43. The Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, Pub. L. No. 101-647, 104 Stat. 4849.

44. John R. Rowlett, *The Chilling Effect of The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and The Bank Fraud Prosecution Act of 1990: Has Congress Gone Too Far?*, 20 AM. J. CRIM. L. 239 (Winter, 1993).

45. The Insider Trading and Securities Fraud Enforcement Act, 15 U.S.C. §78 (2000).

46. *Id.* at §78u-1(e) (2000).

SEC's bounty program has not proven to be an effective weapon in the agency's enforcement arsenal. By 1992 the SEC had paid only one bounty and the program was considered dormant by 1999.<sup>47</sup>

### *E. Whistleblowing Summary*

At best then, whistleblowing produces only occasional enforcement assistance and sometimes even will be detrimental to enforcement by distracting authorities with unreliable data. Perhaps whistleblowing's most useful role is as a deterrent. One or two major disclosures of wrongdoing might persuade otherwise arrogant market participants that it is difficult to hide their wrongdoing and convince them that they are not invincible; thereby encouraging compliance with regulatory precepts. Taking all the factors into account, it nevertheless may be desirable to encourage whistleblowing so that it will play some role in policing the financial services industries.

## IV. The Business of Bounty Hunting

While whistleblower laws primarily protect employees from discharge or other acts of retaliation by the employer, there are also laws that provide inducements to expose wrongdoing.<sup>48</sup> Among these laws are those which prompt citizen behavior that has been termed bounty hunting. In its various manifestations, bounty hunting has a more promising role to play in policing the financial services industry than does whistleblowing. While whistleblowing provides information to enforcement authorities, bounty hunting supplements governmental enforcement activity with active private intervention. Like whistleblowers, bounty hunters conserve the

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47. See Ferziger et. al., *supra* note 41.

48. Included among the federal bounty statutes are: Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 103-73, 103 Stat. 183 (authorizes cash awards for reporting violations of federal banking statutes); Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, Pub. L. No. 101-647, 104 Stat. 4849 (added new financial crimes and increased the penalties for existing bank crimes); False Claims Act, 31 U.S.C. § 3729-3733 (imposes liability upon any person who defrauds the federal government); The Securities Exchange Act of 1934, 15 U.S.C. § 78u-1(e) (authorizes SEC to award a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader, from a person who tipped information to an insider trader, or from a person who directly or indirectly controlled an insider trader); U.S. Customs Bounty Scheme, 19 U.S.C. § 1619 (authorizes cash awards for original information on child pornography, export control and embargo enforcement, anti-drug initiatives, vehicle and cargo theft, and asset forfeiture programs).

government's investigatory resources by identifying wrongdoers. Unlike whistleblowers, bounty hunters frequently participate actively in apprehending and prosecuting offenders, thereby conserving governmental policing and prosecutorial resources as well. In order to encourage bounty hunters to play this active role, the financial rewards for bounty hunters must be substantial while protection from retaliation may not be necessary.

#### A. *Historical Perspectives*

Bounty hunting has a noteworthy history. Sovereigns offered bounties to enlist the services of influential subjects. When the subject was instrumental in facilitating the capture, defeat and death of the opponent, the sovereign would give the loyal subject the titles and all or part of the income producing lands previously held by the vanquished opponent.<sup>49</sup> In the early democracy in medieval Iceland, there was no governmental authority with prosecution and punishment functions. Prosecutions were private. The convicted criminal forfeited his property to the prosecutor. In order to muster support for the prosecution, the prosecutor offered shares of the criminal's property to the prosecutor's supporters in the prosecution.<sup>50</sup> Nineteenth century America saw the growth of vigilante justice and the development of a cottage industry of professional bounty hunters who made their livelihood capturing wanted individuals for the rewards offered. The industry inheres to this day.<sup>51</sup>

#### B. *Modern Manifestations of Bounty Hunting—Sharing the Government's Bounty*

Contemporary U.S. law offers a limited array of direct bounties for private assistance to public enforcement of law and a

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49. Veterans of the American Revolutionary War were entitled to land grants for their service. See New York State Archives: Applications for Land Grants ("Land Papers, 1st Series"), 1642-1803, volumes 37-3.

50. See, for example, *Hrafnkels saga*, which, although now generally considered a work of fiction, describes in detail the private nature of criminal prosecution and execution of judgments in medieval Iceland.

51. See Christian Parenti, *Psycho Bounty Hunters: Enforcers of the Bail Industry, the Progressive Media Project*, (1997) (addressing the Phoenix, Arizona killings of two individuals by professional bounty hunters. The much-publicized incident led to greater regulation of bounty hunters in Arizona) available at <http://www.progressive.org/mpparentisept.htm> (last visited March 26, 2001). For an alternative view praising the significant role bounty hunters play, see John A. Chamberlin, Note: *Bounty Hunters: Can The Criminal Justice System Live Without Them?*, 1998 U. ILL. L. REV. 1175 (1998).

panoply of incentives to direct private enforcement of law where private injuries occur. The first category, direct bounties, is no longer the "wanted dead or alive" type. Rather a very limited number of statutes encourage private litigants to report illegal activities and initiate legal action to enforce state remedies by providing a specific payment or a share of the state's recovery to the private litigants.<sup>52</sup> Other statutes reward reporting only rather than permitting active intervention, fitting better into the category of whistleblowing than bounty hunting.<sup>53</sup>

Statutes that permit or encourage private citizens to initiate legal proceedings on behalf of the government are "qui tam" laws. Qui tam actions based on bounty statutes pay financial rewards to bounty hunters.<sup>54</sup> Thus a party who files an action based on a bounty statute receives a reward as an incentive for whistleblowing and initiating the action and is protected from retaliation. The False Claims Act is the best known and most effective "bounty" statute.<sup>55</sup> The False Claims Act was originally enacted during the Civil War by President Lincoln following reports of fraud and corruption by defense contractors including Unions soldiers opening crates supposedly containing muskets only to find sawdust, and stories of the same horses and mules sold to the different U.S. Cavalry units.<sup>56</sup> Some states, including California, Florida, Illinois, Louisiana, Tennessee, Texas and the District of Columbia, have enacted false claims statutes modeled on the federal FCA that also contain *qui tam* provisions.<sup>57</sup>

With considerable regularity, private parties initiate investigations and claims for recovery under the False Claims Act. The False Claims Act imposes civil liability on "[a]ny person" who,

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52. See Federal False Claims Act, *supra* note 13.

53. See I.R.C. § 7623 (2000).

54. The term "*qui tam*" is an abbreviation of a Latin phrase that translates literally into "he who as much for the king as for himself."

55. See Peter Aronson, *Critics Gripe at Suits: Claims U.S. is Cheated out of Billions*, NAT'L L.J., August 9, 1999, at A1. The Department of Justice reported that \$2.91 billion was recovered by the federal government in False Claims cases. In 1999, 483 cases were filed with a total recovery of \$485 million. In the same year the average recovery in False Claims cases was \$5.8 million. The average relator recovered \$1 million. Since 1986 more than 2,700 suits have been filed. During that period a total of \$403 million has been awarded to relators.

56. Kent D. Strader, *Counterclaims Against Whistleblowers: Should Counterclaims Against Quit Tam Plaintiffs Be Allowed in False Claims Act Cases?*, 62 U. CIN. L. REV. 713, 728-229 (1973).

57. John C. Ruhnka, Edward J. Gac & Heidi Boerstler, *Qui tam Claims: Threat to Voluntary Compliance Programs In Health Care Organizations*, 25 J. HEALTH POL. POL'Y L. 283, 288 (2000).



“knowingly presents, or causes to be presented, to an officer or employee of the United States Government a false or fraudulent claim for payment or approval.”<sup>58</sup> Violators are potentially liable for treble damages and civil penalties of up to \$10,000 per claim. The Act authorizes private parties, designated as the “relator,” to bring *qui tam* civil actions “for the person and for the United States Government” against violators, “in the name of the Government.”<sup>59</sup> The government may intervene or assume control of the lawsuit and the private party receives a specific sum or a portion of the government’s recovery.<sup>60</sup>

In *qui tam* cases, the actions of the defendant/wrongdoer generally do public harm only. Private injury is incidental.<sup>61</sup> Since bounty hunting in these instances involves legal action, it, unlike whistleblowing, necessitates the services of a lawyer. Thus, contemporary bounty hunters employ lawyers or are lawyers themselves. Those who are not attorneys look to the reward as a source of payment for attorneys’ fees.<sup>62</sup> If the reward is small, the lawyers are unlikely to be willing to represent the plaintiff for a share of the reward. Unless the plaintiff is sufficiently outraged by the wrongdoer’s activities to be willing to pay from her own resources, she may have difficulty securing representation and must leave the action to the discretion of the governmental agency with general enforcement authority. In order to facilitate the bounty

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58. False Claims Act, 31 U.S.C. § 3729(a).

59. *Id.* at § 3730(b)(1). Of course, to initiate a proceeding under the Act, the federal government also can file a civil action directly against the claimant. *Id.* at § 3730(a).

60. When a private party brings an action, the individual must deliver a copy of the complaint, and any supporting documents, or other evidence, to the United States Justice Department. 31 U.S.C. § 3730(b)(2) and (4). Thereafter, the government has sixty days to decide whether it will initiate a civil action. If the Justice Department elects to proceed it has primary responsibility for prosecuting the action. 31 U.S.C. § 3730(c)(1). In such cases, however, the relator is allowed to participate as a party to the litigation and to share in any judgment that may be obtained. 31 U.S.C. § 3730(c)(2). If the government declines to intervene, the relator has the right to proceed without the government. 31 U.S.C. § 3730(b)(4). The relator is entitled to receive 15 to 20 percent of the proceeds from the judgment if the government proceeds with the action or, 25 to 30 percent if it does not, plus attorney’s fees and costs. 31 U.S.C. § 3730(d)(1) and (2).

61. Clearly, fraud on the government has non-governmental repercussions in costs to the citizenry, but the cost to any specific individual tends to be difficult to measure and speculative.

62. The US rule requires each party to bear its own attorneys’ fees. Where anticipated recoveries are sufficiently large, many attorneys in the US work under contingent fee arrangements and receive a portion of the recovery but nothing if there is no recovery. The rule in the UK, for example, is different; the losing party pays both parties’ fees.

hunting activities of private litigants, many modern statutes provide for the government to pay the successful litigant's attorneys' fees or require the losing defendant to pay.<sup>63</sup>

### *C. Modern Bounty Hunting: Private Remedies*

Unlike the False Claims Act and the Internal Revenue Code that include provision to criminalize and punish those who do harm to the public pocketbook,<sup>64</sup> laws regulating financial markets address actions that may inflict no direct damage to governmental revenues but nevertheless do both public and private harms. The private injuries are economic. The public injuries are perhaps more insidious in that they undermine the integrity of the marketplace and the public's confidence in the regulatory process. Securities laws, for example, seek to assure the public a fair marketplace by requiring disclosure of all material information relating to the security by those who are selling it. Without accurate and complete information, the party lacking accurate information is at an economic disadvantage relative to the party with complete information. Lending limits and related banking regulations protect the financial institution's depositors from the loss of their invested funds if the institution engages in risky lending practices, including the failure to diversify. Similarly, monopolization does private harm both by eliminating price competition and causing the consumer to pay more for goods and services than a competitive price. It also destroys the economic viability of the monopolist's potential competitors.

In many instances of securities law violations, the economic injury to any single plaintiff is small and insufficient to attract contingent fee-based, legal representation. Since most instances of use of non-public information to trade securities or other types of market manipulation involve many purchases and sales with small economic injuries to each participant, the ability to join multiple claimants renders the potential damage pool significant. The class action lawsuit in the U.S.<sup>65</sup> has proven an effective enforcement tool in instances of multiple small claims. Class actions permit the aggregation of similar claims into a single lawsuit. If the suit is

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63. Note that many modern statutes from civil rights laws to consumer protection provide incentives to private law enforcement by shifting the burden of attorneys' fees to the vanquished defendant.

64. Of course, there is private injury in that taxpayers collectively bear the government's loss from fraud and tax cheating.

65. See FED. R. CIV. P. 23 (2000) (governing class action lawsuits in federal courts).

successful, the court determines what portion of the recovery (or settlement) pool the plaintiffs' attorneys will receive for their services based on time devoted to the case and the risks that the case might not be successful. While the court has considerable discretion to decrease the attorneys' fee application, the fees in large class actions tend to be sufficient to attract a ready supply of qualified class action attorneys. The attorneys' fee award frequently dwarfs the damages each member of the class receives. Although attorneys' codes of conduct may limit the ability of the class action specialists to promote litigation,<sup>66</sup> in many respects, it is plaintiffs' lawyers as contemporary bounty hunters who support and accomplish the objective of privately enforcing the law.

In addition to class action suits, statutory punitive damages provide incentives for private enforcement by raising the stakes for the wrongdoer. Most economic crimes like monopolization, securities fraud, illegal banking practices rarely result in imprisonment of the responsible party.<sup>67</sup> Without any serious threat of imprisonment, economic crime in many instances is a matter of economic assessment. If detected and prosecuted, the issue for the offender is the cost of the punishment and civil liability. Perhaps the offender also loses face in the community, but negative impact on reputation is usually slight when the prosecution is civil rather than criminal. Even when the available remedies to the injured parties are only recovery of provable losses, perhaps plus interest, the wrongdoer may not even have to disgorge his entire profit—hardly an effective deterrent. In the U.S., Congress sought to enhance the deterrence and encourage private prosecution by trebling damages for monopolistic practices.<sup>68</sup> Under the antitrust laws, the injured competitor whose damage may be less than the monopolistic profit stands to capture a windfall from a successful prosecution. Moreover, the opportunity to receive multiple damages makes the injured competitor more willing to share the award with the contingent fee attorney. And the attorney and client together pursue the bounty.

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66. *Elliott Assocs., L.P. v. Banco De La Nacion*, 194 F.3d 363 (2nd Cir. 1999) (discusses the doctrine and its continued validity but finds it inapplicable and reverses the lower court).

67. The occasional high visibility prosecution—like Michael Milken—results in jail time and may deter other potential violators. However, most criminal prosecutions result in fines and set the stage for civil claims. Incidentally, a whistleblower provided the government with the first evidence of Milken's illegal activities.

68. Sherman Antitrust Act, 15 U.S.C. § 15 (2000).

Both the class action and multiple damage models require the quantification of the private injury. In some cases, both public and private damage is speculative or nominal. For example, failure to disclose material facts or false statements in the initial offering of securities may do little or no damage where the securities appreciate in value. Nevertheless, non-disclosure or false statements undermine the underlying structure of the regulatory system. While fines or other direct criminal penalties may be appropriate, that type of enforcement consumes governmental resources. The best alternative might be to encourage private enforcement by authorizing exemplary damages and requiring losing defendants to pay the plaintiff's attorneys' fees.<sup>69</sup> Much civil rights type legislation adopts this methodology.<sup>70</sup>

Bounty hunting models in use in the U.S. today include all the methods introduced above: payment from government collection, class actions, multiple damages, punitive damages, and attorneys' fee awards. Legislation adapting each model to financial markets and services would bolster limited governmental enforcement resources by enlisting private persons in the enforcement of the regulatory structure.

## V. Conclusion

Each bounty-hunting model requires the active participation of the bounty hunter. She must make a tangible investment of her personal resources to capture the reward. As in any business, judgments concerning deployment of resources will follow customary decision-making processes. The bounty hunter will evaluate cost, likelihood of success and potential gain. This analysis controls and limits the incidence of unfounded claims. Rational evaluation often does not determine the whistleblowers election to act. While the costs to the whistleblower may be as significant, they are less tangible. Rational decision-making conduct may be clouded by the personal motives that lead the whistleblower to report falsely.

Because bounty hunting is not altruistic, some may object to the windfall provided to successful bounty hunters because they view bounty hunting to be an unsavory activity. Moreover, given

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69. *Id.* at § 1681(n) (Attorneys' fees and punitive damages for consumer credit reporting violations).

70. Civil Rights Act of 1964, 42 U.S.C. § 1981(a) and § 2000(e)(5) (2000), (violations of the Civil Rights Act entitle successful plaintiffs to punitive damages and attorneys' fees).

the cost of defense, targets of bounty hunters, even if innocent of wrongdoing, may find it less expensive to settle the claim, thus encouraging unfounded lawsuits. As the importance of bounty hunting to financial services regulation grows, it may become necessary to review the frequency of extortionate, unfounded claims. If such claims become common, solutions such as the shifting of attorneys' fees and expenses to parties advancing questionable claims might suggest themselves.<sup>71</sup> Fee and expense shifting to losing plaintiffs is problematic. It threatens the very activity, bounty hunting, by rendering it potentially unprofitable. In that case, fee shifting may drive some of the best bounty hunters out of business and there will be no effective private regulation.

Nevertheless, increased use of bounty hunting models in financial market regulation may become essential to enforcement. Clearly systems to encourage voluntary compliance within each financial service provider's organization and management's commitment to compliance offer the best assurance that the financial services industry will maintain its integrity and protect its consumers and resources. Bounty hunting, with its threat of significant monetary cost and potential individual liability, compels managers to develop efficient, internal legal compliance mechanisms. Thus, bounty hunting, like whistleblowing, has a deterrent effect and an immediate and powerful role to play in protecting the integrity of the financial markets—but not to the exclusion of governmental enforcement. Whistleblowing, on the other hand, remains largely supplemental and serendipitous. It is far less likely to play a material role in market regulation than is a well-designed array of bounty payment structures.

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71. Under current US law, courts may order plaintiffs to pay the defendants' fees and costs when the claim is frivolous.