

# Corporate Ethics and the Rights of Whistleblowers

By Josef Rashty

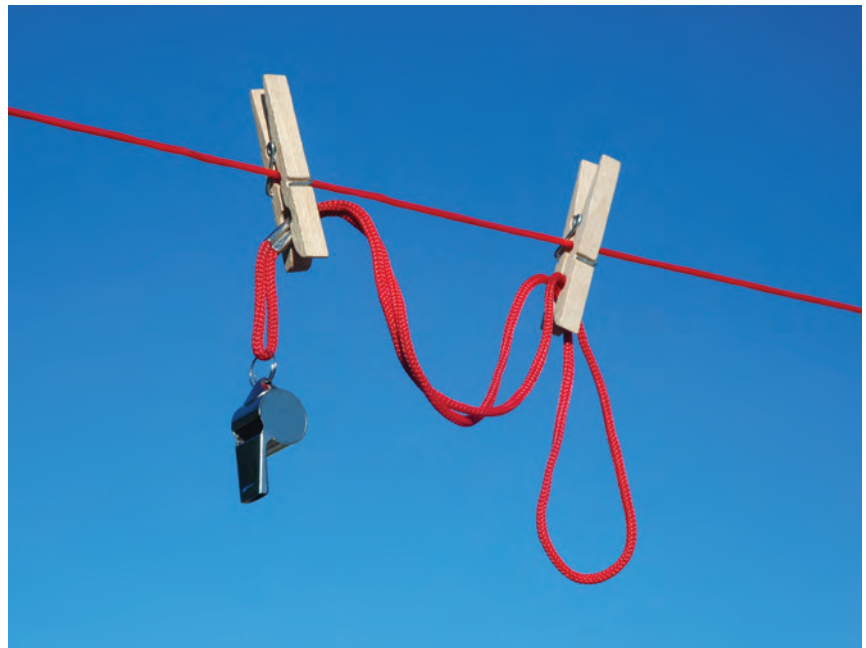
On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law. Although the Dodd-Frank Act focuses mostly on the financial services sector, secondary provisions in the act impact the corporate governance and compliance programs of nonfinancial publicly held companies. Included in its coverage of corporate governance, the Dodd-Frank Act includes whistleblower procedures and protections (Josef Rashty, “The Dodd-Frank Act Addresses Corporate Governance: Internal Controls, Whistleblower Provisions, and Disclosure Regulations,” *The CPA Journal*, April 2012, pp. 40–42).

In implementing the whistleblower provisions under section 21F of the Securities Exchange Act of 1934 (added by section 922 of the Dodd-Frank Act), on May 25, 2011, the SEC issued a final rule that set forth financial rewards for whistleblowers who provide the SEC with “original information” leading to securities law enforcement actions resulting in the imposition of monetary sanctions greater than \$1 million.

This article will discuss whistleblowers’ rights of contestability and their protection against retaliatory actions by their employers in exercising that right. It will explore the controversy of the SEC rule, recent court rulings, and the ethical implications of whistleblowers.

## The Promulgation of the SEC Final Rule

The Dodd-Frank Act’s whistleblower provisions create a system of financial incentives and protections to encourage those individuals with information about possible violations of the securities or commodities laws to submit their complaints directly to the SEC. If a tip provides original information, a whistleblower can



receive between 10% and 30% of any amounts collected in a successful regulatory enforcement action with monetary sanctions of over \$1 million.

The SEC rule encourages, but does not obligate, whistleblowers to report the information internally first before contacting the SEC. In addition to addressing the amount of the awards and the eligibility criteria, the final SEC rule addresses the anti-retaliatory provisions of section 21F and the eligibility of whistleblowers who are culpable of misconduct to receive awards.

As part of the Dodd-Frank Act’s effort to enhance the SEC’s authority and operations to better protect the investing community, the SEC created the Office of the Whistleblower to deal with the associated complaints and rewards ([www.sec.gov/whistleblower](http://www.sec.gov/whistleblower)).

## The Controversy

Opponents of the SEC rule initially argued that the whistleblower rule undermines the internal control systems of companies because it allows whistleblowers to go to the SEC directly. Although the final rule includes a provision that allows whistleblowers to first report the violation internally and establishes a 120-day, look-back grace period for reporting it to the SEC, opponents contended this period would not be sufficient for companies to fully investigate and resolve such matters internally.

Subsequent to this promulgation, the SEC received dozens of letters from companies and their attorneys complaining that the SEC rule allowing a whistleblower to go directly to the SEC undermines a company’s internal fraud-detection programs. A letter to the SEC dated December 27, 2010, from General Electric represents one example of

corporate dissatisfaction with the SEC whistleblower rule. Google, Honeywell, J.P. Morgan Chase, Microsoft, and Northrop Grumman also signed the letter (Rachel Louise Ensign and Christopher M. Matthews, "The Whistleblower Debate," *Wall Street Journal*, August 12, 2013, p. B4).

### The Unsettled Question

The unsettled question is whether whistleblowers must take their case to the SEC to qualify for this protection. In a major reversal of their original position, many U.S. corporations have surprisingly answered in the affirmative. This is at odds with their earlier argument that the Dodd-Frank Act's whistleblower provision has undermined the internal control systems of their companies.

As a convenient way to escape any liability for retaliating against whistleblowers, many U.S. corporations are increasingly claiming that tipsters who do not report their complaint to the SEC are not protected by the Dodd-Frank Act. This dispute arose from an ambiguity in the SEC rule that defines "whistleblower" as a person who reports information to the SEC while acknowledging he is protected from retaliation regardless of how the information is reported.

To date, at least five U.S. district courts have ruled that whistleblowers are protected from retaliation under the Dodd-Frank Act. On the appellate level, on May 21, 2014, the Eighth U.S. Circuit Court of Appeals held that a whistleblower who reported alleged violations of federal money laundering laws internally and participated in an investigation by an industry regulator qualified for protection under the Dodd-Frank Act. Although the plaintiff never reported the wrongdoing to the SEC, the suit maintained that plaintiff's disclosures qualified her for protection under subsection (iii) of Dodd-Frank's anti-retaliation provisions, which covers a broad array of disclosures to entities other than the SEC. The final decision is pending an interlocutory appeal (*Bussing v. Cor Clearing LLC*; <http://www.whistleblower-defense.com/files/2014/06/Bussing-v.-COR-Clearing-LLC.pdf>).

However, on July 17, 2014, the Fifth U.S. Circuit Court of Appeals denied such protection for a whistleblower. In *Asadi v. G.E. Energy (USA), LLC*, the Fifth Circuit ruled that an employee must report securities

violations directly to the SEC to be considered a whistleblower protected from retaliation pursuant to Dodd-Frank section 922 of retaliation (<http://www.ca5.uscourts.gov/opinions%5Cpub%5C12/12-20522-CV0.wpd.pdf>). In this case, the plaintiff, an executive of the corporation, claimed that he was fired after he internally reported an incident of bribery in violation of the Foreign Corrupt Practices Act. General Electric denied the plaintiff's claim of retaliation arguing the executive did not qualify as a whistleblower because he never raised the claim with the SEC.

Obviously, if the Eighth Circuit affirms its decision, it would be inconsistent with the Fifth Circuit decision and create a split of authority on this issue among the circuits, providing an opportunity for the U.S. Supreme Court to provide a definitive answer.

Finally, another recent case has added to the uncertainty on this issue. In this case, a former Siemens employee alleged that the company retaliated against him in violation of Dodd-Frank's protections. The U.S. District Court for the Southern District of New York declined to decide whether the plaintiff qualified as a whistleblower. The plaintiff appealed, and in February 2014 the SEC filed an amicus brief in support of the plaintiff, arguing that the courts should defer to SEC's interpretation of Rule 21F-2(b)(1) that the anti-retaliation provisions of the Dodd-Frank Act protect all whistleblowers (Steven Pearlman and Keith Goodwin, March 22, 2014, <http://www.mondaq.com/unitedstates/x/301624/Whistleblowing/SECs+Amicus+Brief+Internal+Whistleblower+Reports+Covered+By+DoddFrank+AntiRetaliation+Provision>).

### Recent Developments

On June 16, 2014, the *Wall Street Journal* reported that, for the first time, the SEC took action under the 2011 Rule to protect a whistleblower who reported violations on securities laws.

The SEC said, "The SEC charged hedge-fund advisory firm Paradigm Capital Management Inc. with engaging in prohibited principal transactions and then retaliating against the former head trader who had reported the activity to the SEC. After Paradigm found out the tipster had

reported the allegations to the agency, it demoted him from head trader to compliance assistant."

The Albany, N.Y.-based Paradigm company agreed to pay \$2.2 million to settle the charges without admitting or denying wrongdoing (Rachel Louise Ensign, "Paradigm Settles with SEC in Whistleblower Case," <http://online.wsj.com/articles/paradigm-settles-with-sec-in-whistleblower-case-1402935592>). This SEC action indicates that it will be vigilant in protecting whistleblowers' rights under Dodd-Frank.

On August 18, 2014, the *Wall Street Journal* reported that a federal appeals court held that the provisions of Dodd-Frank Act prohibiting retaliation against whistleblowers do not apply outside the United States. In a case involving a former Siemens China staffer, the court held that because the whistleblower, his employer, and the other entities involved in the alleged wrongdoing all resided out-



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side the United States, and the alleged corrupt activity and retaliation also occurred abroad, they were not subject to the Dodd-Frank Act's retaliation provisions. The court concluded that simply being an issuer on a U.S. exchange does not mean the entity is subject to all U.S. laws (Rachel Louise Ensign, "A Cloud on Whistleblowers," *Wall Street Journal*, August 18, 2014, p. B4). Clearly, this ruling was a disappointing setback for the rights of whistleblowers.

### Corporate Virtues

Virtue is a disposition that, together with understanding, helps us see things as they are, whereas vice distorts an appreciation of the qualities of the relevant situations. In "Can There Be Institutional Virtues?," Miranda Fricker, a British philosopher at the University of Sheffield, argued that virtues and vices can be attributed not only to individuals, but also to collectives and institutions (<http://www.bbk.ac.uk/philosophy/our-staff/academics/InstVirOffPrint.pdf>).

The social context behind the actions of these collectives and institutions exerts intense pressure on individual members to behave in a certain manner—sometimes this pressure has good effects and sometimes bad. Individuals may therefore exhibit their virtues and vices in their personal lives that are different from what they may exhibit in their professional and working environment. As a result, individuals may act differently when they are part of a corporation, and corporate culture unconsciously drives employees to act in a certain manner—again, producing good or bad effects.

Employees of a corporation follow certain behavior because the corporation that they work for expect that type of behavior. Arguably, in a democratic society, employees have the choice to work for any employer they choose. Therefore, if they do not approve of a corporate employer's behavior, they can simply find another job. However, the reality is not that simple. Due to social and economic circumstances, many individuals cannot change employment that easily.

### Right of Contestability

Because the morality code of an employee of a corporation tends to be different

from a personal code of ethics, there is often a conflict between what a worker as an individual and as an employee of a corporation views as right or wrong. In most instances, an employee follows the corporate morality guidance. At times, however, the conflict is so deep that an employee feels obligated to contest the corporate morality framework and rightfully resist the corporate authority.

Under these circumstances, an employee must have the right to contest any wrongful actions by corporations whether they stem from improper corporate guidelines or wrongful acts by other employees of the corporation. For this reason, it is imperative that a whistleblower's right of contestability be protected from any form or even appearance of retaliation. In the end, the right of contestability must be an integral part of the corporate structure and its effective execution is fundamental to corporate justice and fairness.

### Corporate Governance

The Dodd-Frank whistleblower rule impacts the corporate governance as well as the internal control compliance programs of publicly held companies. In that regard, the following is a list of measures that public companies' compliance programs should consider implementing:

- Reinforce to all employees at all levels of the organization the importance of reporting any concerns regarding the compliance programs.
- Emphasize the company's commitment to dealing with any compliance violations.
- Understand the antiretaliation provisions of the Dodd-Frank Act and the SEC's stance on this matter.
- Develop a plan for dealing with reported compliance violations.
- Be prepared to deal with the SEC if the company is informed of any compliance violations.
- Have a plan for contacting the audit committee, outside counsel, and independent public accountants in the case of a reported violation.
- Be prepared for any potential security litigation as a result of a compliance violation.
- Provide and protect employees' right of contestability through an effective and rigorous compliance program.

The most important aspect of this compliance program is what Fricker refers to as "testimonial justice," where employees

can contest and report any unjust and wrongful treatment by a corporation or any of the employees of that corporation. The structure of each corporation should provide for the right of contestability through the highest level of authority, so that each employee can speak for himself or allow another to speak for him with credibility in presenting grievances. In the author's opinion, a corporation lacking such a feature is not a fair and just institution.

Based on a December 2014 survey by the law firm Freshfields Bruckhaus Deringer, approximately half of employees surveyed stated that their companies either did not publicize their whistleblower policies or had no such policies. Nearly 40% of respondents said they feared reprisals for whistleblowing, despite legal protection from retaliation (<http://www.bloomberg.com/news/2014-12-01/companies-ignore-risks-benefits-of-whistleblowing.html>).

### Final Remarks

In July 2010, the Dodd-Frank Act was signed into law. One of the major provisions of the act was to provide corporate whistleblowers with financial incentives for speaking out as well as protection from retaliation for doing so.

Protecting whistleblowers who exercise their right of contestability against any retaliatory acts is not only consistent with the spirit of Dodd-Frank Act, but also an ethical act and good corporate governance. In the author's opinion, corporations are well advised to have a program that facilitates hearing from their employees and protects them from any form or appearance of retaliation—even if, at times, their views may be contrary to the company's culture and beliefs. Arguably, if a robust whistleblower program had been in place, large corporations like Lehman Brothers, Enron, and WorldCom may have avoided their sudden demise, and the subsequent repercussions. □

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