

FACILITATING THE COMPLIANCE FUNCTION

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In the current regulatory era in which we live, compliance is as important as ever. Practitioners, the legal academy, the government, and many organizations of all industries and sizes have responded with insights as to how to best achieve effective compliance while navigating the complex array of regulations incumbent on entities of all types. Regardless of the applicable industry, whether financial, information technology, environmental, healthcare, corporate, or non-profit, the field of compliance is comprised of certain overriding themes that are conducive to facilitating the compliance function. Some of these overriding themes may include the drafting and implementation of effective compliance programs, the development of good corporate governance practices, a responsive management team, and the dissemination of compliance practices throughout the organization. This symposium piece will focus on one running theme that was highlighted during a panel on the intersection of compliance and risk management at the third annual Rutgers Law School Corporate Compliance Institute: the facilitation of the compliance function through a whistleblower's early detection and reporting of red flags.

Whistleblowers are critical players in compliance, especially when reporting internally.¹ In bringing to the forefront red flags about potential or actual violations, whistleblowers strive to ensure that their places of employment are operating within the confines of the law.² As insiders of the organization, whistleblowers possess important

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1. Jennifer M. Pacella, *The Cybersecurity Threat: Compliance and the Role of Whistleblowers*, 11 BROOK. J. CORP. FIN. & COM. L. 39, 40–41 (2016).

2. See GEOFFREY PARSONS MILLER, *THE LAW OF GOVERNANCE, RISK MANAGEMENT, AND COMPLIANCE* 271 (2014) (describing whistleblowing as “an increasingly important mechanism for enhancing an organization’s compliance with legal norms”); Jennifer M. Pacella, *Advocate or Adversary? When Attorneys Act as Whistleblowers*, 28 GEO J. LEGAL ETHICS 1027, 1061 (2015) (discussing the contributions of whistleblowers to compliance, especially with respect to strengthening internal reporting channels).

information that is often invaluable in uncovering various intricate levels of wrongdoing.³ Contrary to what may be popular belief, statistics and studies have revealed that most whistleblowers first report their concerns on an internal basis, rather than reporting externally to the government or to the media.⁴ It is typically only when whistleblowers fear retaliation or believe that their organizations will ignore their reports that they might opt to circumvent internal reporting channels and make an external report.⁵ As such, whistleblowers provide a significant compliance service by raising concerns, often in their early stages, that may otherwise remain overlooked or unnoticed. Often, their reports turn out to be indicative of a larger problem that is worthy of serious internal investigation but can effectively be managed if caught in relatively early stages, thereby resulting in numerous organizational benefits. Such benefits may include avoiding negative consequences for the organization, such as excessive penalties and fines from regulatory enforcement actions, bad publicity, litigation, and losses for shareholders.⁶

Fear of retaliation and being ignored are the most common reasons why whistleblowers might opt to utilize external reporting channels,⁷ which would have the effect of bypassing the internal reporting systems that are so crucial to the compliance function. Research and surveys have revealed that retaliation against whistleblowers in all industries is still widespread, with whistleblowers “in high-pressure work environments—such as *Fortune* 500 companies—[being] four more times more likely to be retaliated against than those who aren’t operating under such stressful conditions.”⁸ Retaliation takes many forms. It can manifest itself in a tangible way through termination from employment, loss of a promotion, loss of bonus, or more intangibly through a general sense of alienation, exclusion from usual work activities, or job

3. See, e.g., Justin Tyler Hughes, Note, *Equity Compensation and Informant Bounties: How Tying the Latter to the Former May Finally Alleviate the Securities Fraud Predicament in America*, 82 S. CAL. L. REV. 1043, 1062–63 (2009) (noting the importance of whistleblower tips in uncovering the many high-profile corporate scandals of the 2000s).

4. See, e.g., Dana Gold et al., *Why Whistleblowers Wait: Recommendations to Improve the Dodd-Frank Law’s SEC Whistleblower Awards Program*, GOV’T ACCOUNTABILITY PROJECT 16 (Feb. 1, 2016) [hereinafter *Why Whistleblowers Wait*], https://www.whistleblower.org/sites/default/files/GAP_Report_Why_Whistleblowers_Wait.pdf.

5. *Id.* at 9–10.

6. See Norman D. Bishara et al., *The Mouth of Truth*, 10 N.Y.U. J.L. & BUS. 37, 40, 51, 76, 82 (2013) (discussing the benefits of internal whistleblowing and reporting).

7. See ETHICS RES. CTR., RETALIATION: THE COST TO YOUR COMPANY AND ITS EMPLOYEES 1 (2009).

8. See *Why Whistleblowers Wait*, *supra* note 4, at 10 (citing statistics from the Ethics Resource Center survey report).

stagnation.⁹ One additional form of retaliation that has largely been overlooked by legal protections is the inability of the whistleblower to obtain new employment. Whistleblowers who have been retaliated against at their places of employment and then become job applicants seeking new positions are subject to considerable hardship. As job applicants, they often face an implicit bias from potential new employers in their industries due to the negative reputation associated with whistleblowers that follows them within the industry.¹⁰ Numerous whistleblowers have personally experienced these biases and find themselves simply out of their industries forever.¹¹ As a result, the disincentives to whistleblowing are considerably high.

To combat these significant disincentives, organizational culture is an essential starting point. Traditional perceptions of whistleblowers tend to be negative. As dissenters from what may be a group acceptance of a situation, the psychological phenomenon of “groupthink” often works against whistleblowers, which can result in resistance from other group members who may have conformed their thinking to minimize a problematic or potentially unlawful work situation.¹² This phenomenon and foundation for potential retaliation is often most common in an organization that perpetuates a culture of silence or disregard for issues of concern.¹³ Silence within organizations is extremely detrimental to resolving ethical and legal problems and breeds feelings of resentment, fear, and humiliation among those who witness wrongdoing, thereby prompting them to stay silent.¹⁴ Cultural landscapes within organizations that are descriptive of these negative traits must shift to implement change. Such change can begin with management of an entity, including officers engaged in the daily operations of the organization, as well as the board of directors. These top leaders can facilitate the creation of a culture that promotes the free flow of information, open door policies for reporting, dissemination of resources

9. See FREDERICK D. LIPMAN, *WHISTLEBLOWERS: INCENTIVES, DISINCENTIVES, AND PROTECTION STRATEGIES* 57–60 (2012).

10. See Leora F. Eisenstadt & Jennifer M. Pacella, *Whistleblowers Need Not Apply*, 55 *AM. BUS. L.J.* 665, 666–69 (2018).

11. *Id.*

12. See James Fanto, *Whistleblowing and the Public Director: Countering Corporate Inner Circles*, 83 *OR. L. REV.* 435 *passim* (2004) (discussing Irving Janis’s groupthink theory in psychology and how it relates to whistleblowing).

13. *Id.* at 496; cf. Richard Moberly, *Sarbanes-Oxley’s Whistleblower Provisions: Ten Years Later*, 64 *S.C. L. REV.* 1, 44–45 (2012) (noting studies discussing how strong ethical cultures encourage whistleblowing).

14. Leslie A. Perlow & Stephanie Williams, *Is Silence Killing Your Company?*, *HARV. BUS. REV.*, May 2003, at 52.

to those considering reporting, and appreciation for and effective responses to those who have already reported.

In addition, various pieces of legislation seek to incentivize whistleblowers to come forward by offering bounty rewards in an effort to offset the various negative effects on livelihood that a whistleblower typically suffers. For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) provides for such bounties, requiring the SEC to reward whistleblowers with between ten and thirty percent of the total monetary sanctions collected in a successful enforcement action that is brought because of the whistleblower’s voluntary and original information.¹⁵ Another notable example of similar bounty rewards includes section 7623 of the Internal Revenue Code, which mandates the IRS to reward tax whistleblowers with between fifteen and thirty percent of the collected proceeds resulting from an administrative or judicial action that the IRS has received based on the whistleblower’s information.¹⁶ In addition, the *qui tam* program of the False Claims Act, the statute upon which the current-day tax whistleblowing program was modeled, allows private citizens, known as “relators” to bring forth a civil action on behalf of the United States against individuals who allegedly defraud the federal government.¹⁷ In *qui tam* cases, the Department of Justice has the option of intervening in the lawsuit, which, if successful, will result in a bounty of between fifteen to twenty-five percent of the proceeds of the action to the relator or between twenty-five to thirty percent if the government does not proceed with the action.¹⁸ The rationale behind bounty programs of this nature is to provide some kind of tangible incentive to whistleblowers who are often frozen between the hard choice of “telling the truth and the risk of committing ‘career suicide.’”¹⁹ By financially incentivizing whistleblowers to come forward, the government is more likely to uncover valuable inside information that it would otherwise not be able to obtain. This information is of tremendous value given statistics showing that whistleblower tips are “13 times more effective than external audits,” as they have “detected 54.1% of uncovered fraud schemes in public

15. 15 U.S.C. § 78u-6(b) (2012).

16. I.R.C. § 7623(b) (2012).

17. 31 U.S.C. § 3730(b) (2012). *Qui tam* actions are common in the healthcare sector pertaining to Medicare and Medicaid billing fraud. See Shauna Itri, *An Introduction to Whistleblower/Qui Tam Claims*, ABA (Aug. 21, 2013), https://www.americanbar.org/groups/young_lawyers/publications/the_101_201_practice_series/an_introduction_to_whistleblower_qui_tam_claims/.

18. § 3730(d)(1)–(2) (2012).

19. S. REP. NO. 111-176, at 110–11 (2010) (discussing the development of whistleblower bounty programs in federal laws).

companies” compared to a mere 4.1% by external auditors and SEC exam teams.²⁰ Since its inception until the end of fiscal year 2018, the Dodd-Frank whistleblower program has been very widely utilized, resulting in more than \$326 million paid out to fifty-nine whistleblowers since the SEC issued its first award in 2012.²¹

In addition to bounty reward programs, retaliation protections for whistleblowers are crucial. To facilitate whistleblower reporting as a key component of the compliance function, it is important that whistleblowers are amply protected from retaliation both by the law and by internal company policy that provides for such protection. From a legal standpoint, effective whistleblowing programs must include anti-retaliation components that ensure legal protections for individuals who suffer adverse effects from their reporting. Most notable whistleblowing protection statutes provide retaliation protections and utilize what is believed to be the most lenient standard for eligibility: the “reasonable belief” requirement. Under this standard, eligibility for protections requires the whistleblower to have reasonably believed that the information he/she reported was a possible violation of law.²² If it turns out that no actual violation of the law has occurred but the whistleblower was still retaliated against due to the report, he/she is still protected.²³ The reasonable belief standard has both a subjective and objective component, requiring whistleblowers to possess a subjective, good faith belief that the issue they are reporting constitutes a possible violation of the law, and an objective belief that a similarly situated person with a comparable background and skill set would also believe a violation to have occurred.²⁴ Legal protections also allow the whistleblower to obtain relief such as reinstatement of employment, lost

20. *Id.* at 110.

21. U.S. SEC. & EXCH. COMM., 2018 ANNUAL REPORT TO CONGRESS WHISTLEBLOWER PROGRAM 9 (2018) [hereinafter 2018 REPORT], <https://www.sec.gov/sec-2018-annual-report-whistleblower-program.pdf>; *see also* Press Release, U.S. Sec. & Exch. Comm’n, SEC Announces Its Largest-Ever Whistleblower Awards (Mar. 19, 2018), <https://www.sec.gov/news/press-release/2018-44>.

22. *See, e.g.*, Sarbanes-Oxley Act, 18 U.S.C. § 1514A(a)(1) (2017); Dodd-Frank Act, 17 C.F.R. § 240.21F-2(b)(1)(i) (2012).

23. *See, e.g.*, 18 U.S.C. § 1514A(a)(1) (utilizing the “reasonable belief” standard); 17 C.F.R. § 240.21F-2(b)(1)(i) (same); Fair Labor Standards Act, 29 U.S.C. § 218c(a)(2), (5) (2017) (same); *see also* United States v. Porter, 594 F.3d 1251, 1258 (10th Cir. 2010) (finding that the reasonable belief standard offers more leniency than other standards).

24. *See* Allen v. Admin. Review Bd., 514 F.3d 468, 477 (5th Cir. 2008) (explaining the objective component of the reasonable belief standard); Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,303 (June 13, 2011) (codified at 17 C.F.R. § 240.21F-2(b)(1)) (discussing the subjective component of the reasonable belief standard, under which motive of the whistleblower is not required).

wages, and compensation for attorney's fees.²⁵ The availability of these retaliation protections provides reassurance to whistleblowers that the law will be on their side should they face retaliation.

Despite the prevalence of retaliation protections in the law, a recent decision of the U.S. Supreme Court now has the effect of undermining the protections of the Dodd-Frank Act. In *Digital Realty Trust, Inc. v. Somers*, the Court reversed a decision of the Ninth Circuit and resolved a circuit split on the matter to hold that whistleblowers who report internally and not directly to the SEC are not protected from retaliation under the Dodd-Frank Act.²⁶ At issue in the case was the conflict between two separate subsections of Dodd-Frank. Two circuit courts had held that this conflict created an ambiguity on the face of the statute, thereby giving rise to the need for *Chevron* deference to the SEC's interpretation of the statute, which had provided protections for internal whistleblowers.²⁷ Subsection (h) of § 78u-6 of Dodd-Frank prohibits employers from retaliating against "a whistleblower" for taking the following actions: "providing information" to the SEC, "initiating, testifying in, or assisting in any investigation or judicial or administrative action of the" SEC based on this information, or "making disclosures that are required or protected" under specified federal laws, including those under the SEC's jurisdiction.²⁸ A "whistleblower," referred to in subsection (h), is defined in subsection (a)(6) of § 78u-6 as "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission."²⁹ Because this definition describes a "whistleblower" as one who makes a report "to the Commission," the Supreme Court simply gave effect to the plain meaning of the statute, finding that the language is not ambiguous and that whistleblowers need to report to the SEC to be eligible for the statute's retaliation protections.³⁰ However, this interpretation disregards the third prong of Dodd-Frank's § 78u-6(h)(1)(A), which protects from retaliation "disclosures that are

25. See, e.g., 18 U.S.C. § 1514A(c); 17 C.F.R. § 240.21F-2(b)(2) (citing remedies listed at 15 U.S.C. § 78u-6(h)(1)); False Claims Act, 31 U.S.C. § 3730(h) (retaliation provision).

26. 138 S. Ct. 767, 780, 782 (2018).

27. *Id.* at 776 (citing *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984)). Compare *Berman v. Neo@Ogilvy L.L.C.*, 801 F.3d 145, 153–55 (2d Cir. 2015), and *Somers v. Dig. Realty Tr. Inc.*, 850 F.3d 1045, 1047, 1051 (9th Cir. 2017) (each finding that internal whistleblowers are protected under Dodd-Frank), with *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620, 630 (5th Cir. 2013) (finding that the Dodd-Frank whistleblower program protects only those who have made an external report to the SEC).

28. 15 U.S.C. § 78u-6(h)(1)(A) (2012).

29. *Id.* § 78u-6(a)(6).

30. *Digital Realty*, 138 S. Ct. at 776–78.

required or protected under the Sarbanes-Oxley Act of 2002 [and other federal laws].”³¹ The plain language of the whistleblower program of Sarbanes-Oxley, which is incorporated by reference in Dodd-Frank, clearly protects both internal and external whistleblowers from retaliation.³² The language of Sarbanes-Oxley specifically states that employees who report “to a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)” will be protected from retaliation as whistleblowers.³³ Thus, at a minimum, the language of Dodd-Frank appears to create an ambiguity that would merit *Chevron* deference to the SEC’s interpretation of the statute. The SEC rules, in turn, state that internal whistleblowers are intended to be protected from retaliation under Dodd-Frank given that the Sarbanes-Oxley Act protects those very individuals.³⁴

Despite this apparent ambiguity, the Court in *Digital Realty* gave effect to the plain reading of the definition of “whistleblower” to require external reports to the SEC.³⁵ The Court elaborated that the whistleblower definition of Dodd-Frank “describes *who* is eligible for protection” and the “three clauses of § 78u-6(h)(1)(A) then describe what *conduct*, when engaged in by a whistleblower, is shielded from employment discrimination.”³⁶ In response to the argument that this interpretation essentially eliminates the protections envisioned by the third prong of Dodd-Frank’s § 78u-6(h)(1)(A) incorporating by reference the disclosures protected by Sarbanes-Oxley, the Court conceded that

31. § 78u-6(h)(1)(A); *see also* Jennifer M. Pacella, *Inside or Out? The Dodd-Frank Whistleblower Program’s Antiretaliation Protections for Internal Reporting*, 86 TEMP. L. REV. 721, 732 (2014).

32. The Sarbanes-Oxley Act renders unlawful retaliation against an employee who:

- (1) [P]rovide[s] information, cause[s] information to be provided, or otherwise assist[s] in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of [federal securities laws], when the information or assistance is provided to or the investigation is conducted by—
 - (A) a Federal regulatory or law enforcement agency;
 - (B) any Member of Congress or any committee of Congress; or
 - (C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)

18 U.S.C. § 1514A(a)(1)(A)–(C) (2012).

33. *Id.*

34. *See* Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,304 (June 13, 2011) (codified at 17 C.F.R. § 240.21F-2(b)(1) (2012)) (citing § 1514A(a)(1)(C)). The SEC is now in the process of adopting amendments to the rules implementing the Dodd-Frank whistleblower program to conform to the Supreme Court’s ruling in *Digital Realty Trust, Inc. v. Somers*. *See* 2018 REPORT, *supra* note 21, at 2.

35. *Digital Realty*, 138 S. Ct. at 777.

36. *Id.*

“[t]he plain-text reading of the statute undoubtedly shields fewer individuals from retaliation than the alternative [interpretation].”³⁷ Despite this limitation, the Court argued that the third prong in question protects a whistleblower who makes a report both to the SEC and to another entity but is retaliated against because of the non-SEC report— “[t]hat would be so, for example, where the retaliating employer is unaware that the employee has alerted the SEC.”³⁸ However, this interpretation largely ignores the reality that employee-whistleblowers are not likely to make a simultaneous report both internally and externally to the SEC. As discussed earlier, most whistleblowers initially report internally out of a true concern for a problem that is usually in its relatively early stages and can be managed by an effective response from a supervisor or management.³⁹ It is only when whistleblowers have been retaliated against or ignored on an internal level that they are likely to opt to make an external report.⁴⁰ In this way, whistleblowers still wish to address the underlying problem within the organization but recognize that those within the organization who are in a position to address it have disregarded the issue.⁴¹ Given these realities, the protections envisioned by the third prong of § 78u-6(h)(1)(A) are rendered moot if an external report is needed as a threshold for retaliation protection eligibility.

The effects of the *Digital Realty* decision are likely to create serious impediments to internal reporting within organizations, thereby potentially eroding the facilitation of the compliance function through these channels. This risk is especially notable for organizations that perpetuate cultures of silence or repression or do not have open-door policies for internal reporting mechanisms. In such circumstances, employee-whistleblowers would be heavily inclined to avoid an internal report altogether given the high possibility of retaliation for doing so. To add fuel to the fire, if they are also aware that the Dodd-Frank Act does not protect any retaliation they experience after making an internal report, these channels are likely to be bypassed altogether. As a result, the numerous organizational benefits that emerge from internal reporting that were discussed earlier will be impossible to obtain⁴² and the compliance function is likely to be negatively affected through an increased risk of ineffectiveness, costliness, and poor utilization. As such, it is incumbent on organizations of all sizes and industries to respond in

37. *Id.* at 779.

38. *Id.*

39. *See Why Whistleblowers Wait*, *supra* note 4, at 16.

40. *See ETHICS RES. CTR.*, *supra* note 7, at 1.

41. *See Why Whistleblowers Wait*, *supra* note 4, at 24.

42. *See supra* notes 1–6 and accompanying text.

a proactive way to the *Digital Realty* decision. Some measures that may be taken may include a review of existing compliance programs and policies by the board of directors to ensure the existence of effective reporting channels, dissemination of information and educational materials on an entity-wide basis to promote internal reporting, development of an open-door policy and “tone at the top” that promotes and encourages employee reporting, and, most importantly, the existence of an internal retaliation protection system in which employees who report and are retaliated against will be protected by the organization itself instead of needing to rely on the judicial system for protection. An internal retaliation policy should include the kind of relief that is most applicable to employee-whistleblowers, such as assurance of continued employment, benefits, and career trajectory; a zero-tolerance policy for harassment; internal representation of the whistleblower by an unbiased individual; and adverse employment consequences for any retaliators within the organization who violate the policy. These protections are especially important for facilitating internal reports when employees know that the protections of Dodd-Frank will not apply to them unless they report directly to the SEC.

An additional proactive measure would consist of the organization’s management team ensuring that no employees are required to sign confidentiality agreements that would discourage or disallow whistleblowing.⁴³ There are various ways in which employers regularly seek to silence whistleblowers, including failing to inform and educate employees about the whistleblower protections of Dodd-Frank or other whistleblower programs and requiring employees to sign agreements to waive any future award.⁴⁴ Confidentiality agreements that seek to silence whistleblowers are unlawful according to both the common law and SEC Rule 21F-17 of Dodd-Frank, which bars individuals from impeding potential whistleblowers from coming forward, including “enforcing, or threatening to enforce” confidentiality agreements.⁴⁵ Despite the unlawfulness of such agreements, their use is still common, and even though they will not be enforceable if brought to court, an employee-whistleblower may not be aware of that fact and is likely to be

43. See *Why Whistleblowers Wait*, *supra* note 4, at 13–14 (discussing the pitfalls of confidentiality agreements that discourage whistleblowing).

44. See Richard Moberly et al., *De Facto Gag Clauses: The Legality of Employment Agreements That Undermine Dodd-Frank’s Whistleblower Provisions*, 30 A.B.A. J. LAB. & EMP. L. 87, 88–89 (2014); *Why Whistleblowers Wait*, *supra* note 4, at 18.

45. 17 C.F.R. § 240.21F-17(a) (2011); see also Jennifer M. Pacella, *Silencing Whistleblowers by Contract*, 55 AM. BUS. L.J. 261, 273 (2018).

intimidated into staying silent for fear of personal liability.⁴⁶ Organizations of all industries should be cognizant of these practices, ensuring that their places of employment forbid the use of these or any other measure that may have the effect of hindering a whistleblower's report.

In conclusion, internal reporting plays a crucial role in compliance. Given the value of information that the constituents of an organization provide on an internal level, their reports should be valued and timely addressed. To facilitate the process, organizations should adopt strong anti-retaliation policies and work towards establishing cultures that welcome reporting so that whistleblowers are assured that their decision to come forward will not destroy their livelihood. Such internal protections are especially important given that legal protections, specifically in the case of Dodd-Frank, fail to apply to internal reports. With internal protections and a culture that fully embraces reporting, whistleblowers stand to play an even greater role in facilitating the compliance function.

46. See Pacella, *supra* note 45, at 272–73; *Why Whistleblowers Wait*, *supra* note 4, at 13–14.