Corporations Must Cope With More Whistleblowers

INDUSTRY PERSPECTIVE
BY ROBERT ROSE

The rewards are alluring. It has never been so enticing to become a whistleblower.

Casinos attract customers by hyping slot machine winners. State governments do the same with lottery jackpots.

In September, the Internal Revenue Service touted the largest whistleblower award ever — $104 million — to a former UBS banker who exposed the largest tax evasion scheme in history. The award comes as he finished his prison sentence for involvement in that crime.

Earlier this year, the Department of Justice settled with five of the largest mortgage servicing companies and sent a $46 million share to a group of whistleblowers. The 2010 Dodd-Frank Act authorizes awards of up to 30 percent of collections for high-quality original information. The Securities and Exchange Commission made its first whistleblower award of $50,000 in August for information against an unidentified public company. With $150,000 collected thus far, the identity-protected whistleblower may be receiving more checks in the future.

The actions of informants do not have to become public. Lawyers representing whistleblowers contend that most of their clients had tried repeatedly to report their concerns internally and were punished for their efforts. A study in 2010 by a nonprofit, public interest organization found that nearly 90 percent of employees who filed qui tam — False Claim Act — suits initially reported their concerns internally, either to supervisors or compliance departments. Nearly 5 percent of whistleblowing plaintiffs actually worked in compliance departments.

Whistleblowers in the defense industry have specific protection in 10 U.S.C. 2409. "Contractor" is a broadly defined term. It is a person "awarded a contract with an agency," such as the Defense Department, Army, Air Force, Coast Guard or NASA.

To qualify for protection from retaliation, the employee must reasonably believe that he has evidence of gross mismanagement of a Defense Department contractor grant, a gross waste of government funds, a contract or grant violation, or "a substantial and specific danger to public health or safety." If such information is disclosed to a member of Congress, the representative of a congressional committee, an inspector general, the Government Accountability Office, a Defense Department contract oversight officer or the Justice Department, then the contractor may not discharge, demote or otherwise discriminate against the whistleblower.

Despite the strength of these protections, it will likely be a very difficult decision for the employee to unburden himself outside the company.

Directors can be the outlet for disclosures. Executives might wonder what directors can do when there's a serious problem in the company that management may be mishandling or ignoring. Directors typically meet a few times a year and must rely on a chief executive, chief financial officer or auditor — internal or external — for their information. Employees do not normally report misconduct to the board unless the corporate culture permits, or actually encourages, direct communications. Employees at large companies rarely know who chairs the audit committee. They may have no idea how to get in touch. Most of all, they may fear disclosure of their identities and the likelihood of retaliation, rather than appreciation. The legal department, if there is one, reports to management, and the problem may be in the top ranks.

One step is to improve internal controls with a publicized commitment to responsiveness. Having a hotline is a good start, training employees how to use it is better, but calling a director, rather than a manager, is the best. Customers and suppliers should be included. For example, if suppliers are being extorted by the purchasing agent to pay a kickback, the supplier should be permitted to call a number that goes to a board member.

Anonymity should be enouraged for better results. Retaliation claims begin with disclosure to management of the employee's identity. The best defense is to promote anonymity. An angry, outraged employee who is being ignored and fears punishment for speaking up is a disaster in the making. Directors should consider adopting a policy that would allow an employee to disclose via a lawyer, whose bill would be paid by the company, if the information is genuine.

Credit is given by investigators and regulators to companies that have thoughtful policies and robust systems, but that credit evaporates when the effort is merely on paper. Continuous training is a must. Whistleblowing happens when the established channels for internal reporting have failed.

It's all about the message, not the messenger. Whistleblowers often point to how loyal they were to the company, but that their superiors and co-workers were not. Even a disgruntled employee can speak the truth. Family-owned businesses are particularly exposed to the risk that unpleasant news will be suppressed by fearful employees, managers and family-friendly directors.

Truly independent directors earn their stripes by promoting systems that can address situations internally, before a suit is filed or a subpoena arrives. **ND**

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