

A CULTURAL REVOLUTION: THE DEMISE OF CORPORATE CULTURE THROUGH THE WHISTLEBLOWER BOUNTY PROVISIONS OF THE DODD-FRANK ACT

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I. INTRODUCTION

On July 21, 2010, in response to the global financial crisis that began in 2008, President Barack Obama signed into law The Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (Dodd-Frank), which effected a “sweeping overhaul of the financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression.”²

Section 922,³ Dodd-Frank’s far-reaching whistleblower provision, and the subsequent final whistleblower rules promulgated by the Securities and Exchange Commission (“SEC”), garnered substantial business media attention⁴ stemming from one dramatic contention: internal reporting of misconduct is not a prerequisite to external reporting, and the failure to do so does not preclude eligibility for a bounty award.⁵

With the expanded federal whistleblower provisions under Dodd-Frank—particularly the design for astronomical bounties and the circumvention of internal reporting mechanisms—members of the corporate community have

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¹ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376, 1841-42 (2010) (to be codified at 12 U.S.C. § 5301) [hereinafter Dodd-Frank].

² Press Release, The White House, Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform.

³ § 922, 124 Stat. at 1841-42.

⁴ See Jessica Luhrs, *Encouraging Litigation: Why Dodd-Frank Goes Too Far in Eliminating the Procedural Difficulties in Sarbanes-Oxley*, 8 HASTINGS BUS. L.J. 175, 176 (2012).

⁵ See *id.* at 182-83.

mounted significant opposition and distaste.⁶ The reality of the new whistleblower scheme has driven organizations to revisit their internal reporting systems in a desperate attempt to preempt external reporting to the SEC, despite the impossibility of this task.⁷

With employees being encouraged to report directly to the SEC, the Dodd-Frank era also prompts organizations to question the effectiveness of their corporate culture as well as their ability to persevere in an environment in which they are heavily undermined.⁸ In particular, as internal reporting mechanisms within the corporation continue to be circumvented, corporations are bound to realize a significant decline in the overall levels of trust and commitment to internal compliance, both essential components of a thriving, positive corporate culture.⁹ Until stronger measures are taken to fully support the internal workings of an organization, our nation will not experience the utmost prevention and detection of securities law violations.

This Comment maintains that Dodd-Frank's failure to meaningfully support internal reporting has an injurious effect on corporate cultures of trust and compliance. Part II presents details regarding the whistleblower provisions of Dodd-Frank. Part III discusses and defines corporate culture and offers particular emphasis on the importance of trust and compliance as components of organizational culture. Part IV assesses the specific erosions of corporate cultures of trust and compliance resulting from Dodd-Frank. Part V proposes a procedural mechanism in the form of an affirmative defense to reward firms for establishing an effective corporate culture of trust and compliance. Part VI offers concluding remarks.

⁶ See Luis Calvo, *Dodd-Frank Wets Whistles*, FORDHAM CORP. LAW FORUM, February 14, 2012, <http://fordhamcorporatecenter.org/2012/02/14/dodd-frank-wets-whistles/>.

⁷ See Michael D. Greenberg, *For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd Frank* 13 RAND CORP. (2011), available at http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2011/RAND_CF290.pdf [hereinafter Symposium].

⁸ See *id.*

⁹ See *id.*

II. DODD-FRANK FINANCIAL REFORM AND CONSUMER PROTECTION ACT

A. *The Whistleblower Scheme*

Among the new rules and regulations of Dodd-Frank is § 922,¹⁰ which entices whistleblowers to come forward to externally report securities law violations.¹¹ How is this accomplished? Section 922 obliges the SEC to award significant bounties to individuals who offer particular information to the SEC regarding securities violations,¹² and it provides superior anti-retaliation protections in the employment context for individuals who provide the SEC with such information¹³—notably, these anti-retaliation protections are only afforded to employees who report the information externally.¹⁴

Enacted to promote the effective and efficient detection of securities law violations, § 922 of Dodd-Frank amends the Securities Exchange Act of 1934 (the “Exchange Act”) by adding § 21F, entitled “Securities Whistleblower Incentives and Protection.”¹⁵ Pursuant to § 21F, the SEC took a largely pro-whistleblower approach to defining terms, detailing the scope of eligibility, and clarifying procedures for obtaining awards.¹⁶ The SEC is required to pay an award between ten and thirty percent of sanctions imposed to whistleblowers who (1) voluntarily provide the SEC, (2) with original information, (3) that leads to successful enforcement by the SEC, (4) and results in monetary sanctions of more than \$1 million.¹⁷

While Dodd-Frank defines original information, the SEC’s final rules further limit what will be considered “original” information.¹⁸ According to the rules, the information must be: (1) based on the whistleblower’s own knowledge

¹⁰ § 922, 124 Stat. at 1841-42.

¹¹ § 922(b) & (c), 124 Stat. at 1842-43.

¹² *Id.*

¹³ *See* § 922(h) & (c), 124 Stat. at 1845-46.

¹⁴ *Id.*

¹⁵ § 922, 124 Stat. at 1841.

¹⁶ For further analysis, see Heather Jones, *The Dodd-Frank Whistleblower Program: An Analysis of Proposed and Final Rules*, 2 AM. U. LABOR & EMP. L.F. 131 (2011).

¹⁷ 17 C.F.R. § 240.21F-3 (2010); § 922(b), 124 Stat. at 1842.

¹⁸ 17 C.F.R. § 240.21F-4(b) (2010).

or analysis, (2) not already known to the Commission from a separate source, and (3) not exclusively derived from an allegation made in a prior hearing, report, investigation, or news story.¹⁹

A whistleblower provides original information that leads to a “successful enforcement” action when the SEC brings a successful judicial or administrative action based on the information provided in one of several circumstances:²⁰ (1) the information provided to the SEC was sufficiently specific, credible, and timely to prompt the SEC to launch an examination, open an investigation, or reopen a prior investigation;²¹ (2) the information pertained to conduct that was already under examination or investigation by the SEC, and the tip significantly contributed to the success of the action;²² and (3) the whistleblower internally reported the information before or at the same time as he or she reported that information to the SEC and the entity later self-reports the information.²³

Ultimately, if all criteria are met, the determination of the amount of an award is in the discretion of the SEC;²⁴ however, the amount of the award is certain to be between ten percent and thirty percent of the amount of sanctions collected by the SEC or other authorities.²⁵

B. *Internal Reporting Under Dodd-Frank*

Although many people—particularly members of the business community—urged the SEC to require whistleblowers to first report information through internal reporting procedures, the final rules adopted by the SEC do not require employees to report information internally before reporting directly to the SEC.²⁶ In fact, those rules expressly reject the notion of mandatory internal reporting.²⁷ Instead, the SEC tried to ameliorate corporate concerns by allegedly

¹⁹ *See id.*

²⁰ 17 C.F.R. § 240.21F-4(c) (2010).

²¹ 17 § 240.21F-4(c)(1).

²² § 240.21F-4(c)(2).

²³ § 240.21F-4(c)(3).

²⁴ 17 C.F.R. § 240.21F-5(a) (2010).

²⁵ 17 § 240.21F-5(b).

²⁶ *See* Press Release, SEC Adopts Rules to Establish Whistleblower Program (May 25, 2011), available at <http://www.sec.gov/news/press/2011/2011-116.htm> [hereinafter SEC Adopts Rules].

²⁷ *See id.*

promoting internal reporting through alternative incentives intended to encourage employees to make use of their own company's internal compliance programs.²⁸

Among these supposed incentives, the final rules deem a whistleblower eligible for a bounty if the whistleblower first reports internally and the company later self-reports to the SEC regarding the same violations.²⁹ However, these incentives have little practical effect as the rules provide significant monetary incentives for employees to withhold information from a company— withholding information permits monetary sanctions to grow.³⁰

Additionally, if an employee first reports internally, and subsequently provides the same “original information” to the SEC within a 120-day grace period, the final rules treat an employee as providing “original information” if the information is not already known to the SEC as of the date the employee reported internally.³¹ Thus, employees are able to maintain their “place in line” for a potential bounty even after first reporting the information internally.³²

The SEC also has authority to use its discretion in setting bounty amounts to encourage whistleblowers to use internal compliance procedures before reporting directly to the SEC.³³ As such, a whistleblower's voluntary use of an entity's internal reporting system is a factor that can increase the amount of the bounty.³⁴ Conversely, a whistleblower's obstruction of an internal reporting system is a factor that can decrease the amount of the bounty.³⁵ In reality, this incentive is a “mere half measure” that does little to encourage internal reporting;

²⁸ *Id.*

²⁹ *Id.*

³⁰ Letter from David Hirschmann to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Feb. 15, 2011), at 2-3, available at <http://www.sec.gov/comments/s7-33-10/s73310-145.pdf>.

³¹ See Steven J. Pearlman, *New Whistleblower Policies and Incentives: A Paradigm Shift from “Oversight” to “Insight”*, at 38, in Symposium, For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd Frank, May 11, 2011, available at http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2011/RAND_CF290.pdf [*hereinafter Whistle Blows*].

³² See *id.*

³³ See SEC Adopts Rules, *supra* note 26.

³⁴ See *id.*

³⁵ *Id.*

the possibility of a subjective increase in the reward for internal reporting is not enough to combat the large risk of company remediation efforts and the resulting decrease or elimination of the bounty.³⁶ The SEC's refusal to make access to whistleblower bounties contingent on first reporting instances of misconduct internally invited significant controversy in the corporate community about the damaging effects on corporate culture, discussed in the following sections of this paper.³⁷

III. CORPORATE CULTURE

The Dodd-Frank whistleblower scheme and its potential for enormous bounties gives rise to a number of detrimental consequences, including an evisceration of corporate culture.³⁸ To provide a platform on which this consequence can be analyzed, this section discusses the definition of corporate culture as well as the importance of developing a corporate culture of trust and compliance.

A. Corporate Culture Defined

Historically, the anthropological field lacks consensus as to the meaning of culture, and naturally, its application in the corporate context also varies to a large extent.³⁹ Because corporate culture is heavily influenced by industry, geographic location, and a plethora of other factors, the term has been defined in countless ways.⁴⁰ However, in a formal sense, the term corporate culture has generated a few distinct meanings, including: the shared beliefs, values, experiences, attitudes, and processes that contribute to the unique environment of an organization and are widely shared and strongly held throughout the organization; the glue that holds organizations together by providing cohesiveness and coherence among the parts; and “the pattern of arrangement, material or behavior which has been adopted by a [corporation] ... as the accepted way of

³⁶ James J. DiGiulio, *The Dodd-Frank Whistleblower Program: A Blown Opportunity* 17 (2011), <http://www.mdmc-law.com/index.cfm/about/articles-updates/>.

³⁷ See Whistle Blows, *supra* note 31, at 34.

³⁸ *Id.*

³⁹ See Jeffrey Kerr & John W. Slocum, Jr., *Managing Corporate Culture through Reward Systems*, 19 ACAD. OF MGMT. EXECUTIVE 130, 130 (2005); Linda Smircich, *Concepts of Culture and Organizational Analysis*, 28 ADMIN. SCI. Q. 339, 339 (1983).

⁴⁰ Golnaz Sadri & Brian Lees, *Developing Corporate Culture as a Competitive Advantage*, 20 J. OF MGMT. DEV. 853, 854 (2001).

solving problems.⁴¹ More informally, and perhaps in more useful jargon, corporate culture has been readily described as “how we do things around here.”⁴² Conversely, corporate culture is not a multitude of controls, nor is it a list of rules and regulations.⁴³

Despite its intangible nature, corporate culture manifests in virtually every aspect of corporate behavior.⁴⁴ The collection of past and current philosophies that comprises corporate culture pervades the corporation’s appearance and reputation, business strategies, internal policies and procedures, community and customer relations, and expectations for growth and development.⁴⁵ Corporate culture also permeates the way in which a corporation treats its employees, the strength of employee dedication towards corporate goals and objectives, and the values and beliefs of a corporate culture, which “foster[s] norms that influence employees’ behavior.”⁴⁶ Corporate culture even impacts the way in which the corporate office looks, the names of the conference rooms, corporate slogans, and how employees dress.⁴⁷

Moreover, corporate culture generally promotes several distinguishable beliefs and values.⁴⁸ Numerous Fortune 500 companies have successfully developed and maintained strong corporate cultures that advance values such as excellent customer service,⁴⁹ open and honest communication,⁵⁰ diversity,⁵¹ philanthropy and community participation,⁵² and informality and fun.⁵³

⁴¹ See *id.*; *Organizational Culture Definition*, BUSINESSDICTIONARY.COM, <http://www.businessdictionary.com/definition/organizational-culture.html> (last visited March 13, 2012) [hereinafter *Organizational Culture*].

⁴² Shili Sun, *Organizational Culture and Its Themes*, 3 INT. J. OF BUS. & MGMT. 137, 137 (2008).

⁴³ See Margaret M. Towle, “*Culture of Compliance*” from an *Organizational Theory Perspective*, 20 THE MONITOR, Nov./ Dec. 2005, at 3, available at http://professional.financialcounsel.com/News/Economics/IMCA/2005/IMCA_11-1205.pdf.

⁴⁴ See *Organizational Culture*, *supra* note 41.

⁴⁵ See *id.*

⁴⁶ See *id.*; Kerr & Slocum, *supra* note 39, at 130.

⁴⁷ See generally *Organizational Culture*, *supra* note 41.

⁴⁸ See Towle, *supra* note 43, at 5.

⁴⁹ See Robert Reiss, *Driving a Global Corporate Culture of 1.4 Million Employees*, FORBES (March 5, 2012), <http://www.forbes.com/sites/robertreiss/2012/03/05/driving-a-global-corporate-culture-of-1-4-million-employees/>.

Regardless of the values and beliefs the firm chooses to promote, a successful corporate strategy must embody a strong corporate culture of trust and compliance. In turn, these are discussed next.

B. *Trust as a Component of Corporate Culture*

Creating, building, and sustaining trust are essential components of fostering a positive corporate culture within an organization.⁵⁴ An organization is unable to foster a corporate culture of compliance⁵⁵ without first nurturing a corporate culture of employees being able to trust the corporation.⁵⁶ However, while trust—like culture—is difficult to define, experts commonly describe trust as “a state of mind that enables its possessor to be willing to make herself vulnerable to another”⁵⁷ Organizations whose members trust each other often experience superior performance, while organizations whose members do not trust each other are more prone to competitive failures.⁵⁸ Moreover, organizations that promote trust relationships among corporate participants can significantly reduce, if not eliminate, the costs associated with controlling opportunistic behavior.⁵⁹

⁵⁰ E.g., *Corporate Vision, Philosophy and Financial Objectives*, MACY’S, INC. (Apr. 17, 2012), <http://www.macysinc.com/AboutUs/Vision/default.aspx>.

⁵¹ E.g., *Our People*, GENERAL ELECTRIC (Apr. 17, 2012), <http://www.ge.com/company/culture/people.html>.

⁵² See e.g., *Cultivating a Corporate Culture of Giving*, LOS ALTOS TOWN CRIER (Feb. 15, 2012), available at http://www.losaltosonline.com/index.php?option=com_content&task=view&id=42323&Itemid=198.

⁵³ See Sadri & Lees, *supra* note 40, at 857.

⁵⁴ See Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1758 (2001).

⁵⁵ See *infra* Part III.D.

⁵⁶ See Elleta Sangrey Callahan et. al., *Integrating Trends in Whistleblowing and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment*, 40 AM. BUS. L.J. 177, 191 (2002).

⁵⁷ Claire A. Hill & Erin Ann O’Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. REV. 1717, 1724 (2006).

⁵⁸ See *id.* at 1753.

⁵⁹ See *id.* at 1757.

There are many facets to developing a culture of trust within an organization.⁶⁰ First and foremost, the adoption of formal policies and procedures, such as a code of ethics—accompanied with a strong commitment to upholding these policies and procedures—promotes trust by defining core values and the role of employees in carrying them out.⁶¹ Moreover, clear policies permit corporate participants to become familiar with group norms, achieve cohesion, and bring together individual interests with group welfare.⁶² Secondly, organizations must promote clear communication channels, establish open door policies, and encourage the challenging of norms in all realms of corporate decision-making.⁶³ A general encouragement of questioning, without fear of retaliation—especially with regard to legal compliance—should pervade the corporate culture.⁶⁴ Unrestricted communication not only promotes trust but also helps to reassure employees that reporting internally is encouraged and valued.⁶⁵ Lastly, organizations must live and breathe a commitment to an environment where members treat each other well and where teamwork and unity are used as a means to achieving company goals.⁶⁶ Where collaboration and teamwork are encouraged, not only are employees more likely to act ethically, but they are also more likely to develop trust in internal reporting mechanisms.⁶⁷

⁶⁰ See Callahan, *supra* note 56, at 199-201.

⁶¹ See *id.* at 201-03.

⁶² *Id.* at 207-08.

⁶³ See Carl Oliver & Francis Daly, *Encouraging Internal Whistleblowing (And More!)*, <http://www.scu.edu/ethics/practicing/focusareas/business/whistleblowing-update.html> (last visited Mar. 19, 2012).

⁶⁴ Carl R. Oliver & Francis J. Daly, *Encouraging Internal Whistleblowing (And More!)*, SANTA CLARA UNIV., June 2007, <http://www.scu.edu/ethics/practicing/focusareas/business/whistleblowing-update.html>.

⁶⁵ See Callahan, *supra* note 56, at 208.

⁶⁶ See *id.*

⁶⁷ See generally Tom Taulli, *Why Corporate America's New Asset is Ethics, and Enforcement of the Sarbanes-Oxley Ought to Help the Stock Market*, FINDLAW (Jan. 14, 2003), http://writ.news.findlaw.com/commentary/20030114_tauli.html.

C. *Legal Compliance as a Component of Corporate Culture*

Corporate compliance “has traditionally been understood as conformity or obedience to regulations and legislation.”⁶⁸ However, with the recent global financial crisis, and the resulting shareholder, stakeholder, and community scrutiny, contemporary understandings of corporate compliance is becoming much more expansive in scope.⁶⁹ As such, corporate compliance is no longer viewed merely as a legal obligation that must be fulfilled, but also has developed into an integral component of corporate culture.⁷⁰ Specifically, a culture of compliance is a phrase habitually used to refer to a culture that promotes compliance with applicable laws, regulations, and policies among employees at all levels of the corporation.⁷¹ Compliance executives point toward culture as a critical priority for building successful compliance initiatives.⁷² Additionally, behavioral science indicates that a corporate culture of compliance is “the single most effective, measurable driver of compliant behavior [that]...works ‘when no one is looking.’”⁷³

Ultimately, it is not enough to have policies and procedures in place. To be successful, compliance must be embedded into the entity’s corporate culture.⁷⁴ It is well established that to cultivate a corporate culture of compliance corporations must first and foremost comply with the standards set forth in the

⁶⁸ Lisa Interligi, *Compliance Culture: A Conceptual Framework*, 16 J. OF MGMT. & ORG. 235, 235-36 (2004).

⁶⁹ *See id.* at 235.

⁷⁰ *See id.* at 236.

⁷¹ *Id.*

⁷² *Corporate Culture is the Top Priority for Ethics & Compliance Leaders in 2011, LRN Study Says*, CORPORATE COMPLIANCE INSIGHTS (May 3, 2011), <http://www.corporatecomplianceinsights.com/news/corporate-culture-is-the-top-priority-for-ethics-compliance-leaders-in-2011-lrn-study-says/>.

⁷³ News announcement from Bryan Cave, Command, Control, Culture and Compliance: Behavioral Science Findings on Corporate Culture, Employee Compliance and Reporting (June 14, 2012), <http://www.bryancave.com/newsevents/events/detail.aspx?event=1145>.

⁷⁴ Lori A. Richards, Director, Office of Compliance Inspections and Examinations of the Securities and Exchange Commission, Speech by SEC Staff: The Culture of Compliance (Apr. 23, 2003), *available at* <http://www.sec.gov/news/speech/spch042303lar.htm> [hereinafter Richards Speech].

Federal Sentencing Guidelines⁷⁵ (the “Sentencing Guidelines”) and Sarbanes-Oxley of 2002 (“Sarbanes-Oxley”).⁷⁶ From there, a corporation must advance a culture that equates corporate success with acting in a compliant manner.⁷⁷ That is, it must have a strategic vision that incorporates compliance.⁷⁸ According to the SEC, a culture of compliance should also identify specific risks that could arise within this strategic vision and establish control points for each of these risks.⁷⁹ Additionally, although a culture of compliance cannot be built overnight, it can be developed over time with a permeating “value from top to bottom that encourages compliance with the law.”⁸⁰ Thus, there must be a visible dedication and support by senior management.⁸¹ Correspondingly, there must be specific people from top to bottom that are accountable for building the corporate culture of compliance.⁸² Finally, a corporation fosters a culture of compliance not only through the promotion of legal compliance behavior but also through exuding fundamental values such as trust, which is strongly linked to employee performance and corporate commitment.⁸³

D. *The Importance of a Corporate Culture of Trust and Compliance*

Legally, building a culture of trust and compliance has many benefits, including the lessening of potential civil and criminal liability under the Sentencing Guidelines and Sarbanes-Oxley.⁸⁴ “Public policy [, as exemplified

⁷⁵ See generally U.S. SENTENCING GUIDELINES MANUAL § 8 (2012), available at http://www.uscourts.gov/Guidelines/2012_Guidelines/Manual_PDF/Chapter_8.pdf (describing the sentencing of organizational defendants).

⁷⁶ See generally Public Company Accounting Reform and Investor Protection Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2003).

⁷⁷ See Australian Competition & Consumer Commission, *Trade Practices Compliance Programs*, <http://www.accc.gov.au/media-release/guide-to-corporate-trade-practices-compliance-programs> (last visited Sept. 22, 2013).

⁷⁸ See Richards Speech, *supra* note 74.

⁷⁹ *Id.*

⁸⁰ *Trade Practices and Fair Trading: Developing a Compliance Program for Trade Practices*, DIYCOMPLY, http://www.diycomply.net/ssl/Subscription1.2/index-3_TPA_CreateCulture.aspx.

⁸¹ Stephany Watson, *Fostering Positive Corporate Culture in the Post-Enron Era*, 6 TRANSACTIONS: TENN. J. BUS. L. 7, 38 (2004).

⁸² See *id.*

⁸³ See *supra* Part III.B; Interligi, *supra* note 68, at 235.

⁸⁴ See Watson, *supra* note 81, at 31-32.

through these federal laws,] has long supported internal compliance and reporting systems.⁸⁵ In enacting these policies, the federal government recognized that a culture of trust and compliance encourages employees to report questionable conduct and “cultivates a system by which companies can stop wrongdoing promptly and take appropriate remedial action expeditiously.”⁸⁶ At the same time, this allows companies to enhance their internal policies and procedures in an effort to curb future wrongful behavior.⁸⁷

Aside from the legal motivations for developing a culture of trust and compliance, corporations have ample business incentives—both financial and non-financial—to foster a resilient and positive corporate culture of trust and compliance.⁸⁸ An organization that prioritizes a culture of trust and compliance not only tends to be more enjoyable to work for, but also is likely to experience “increased levels of teamwork, sharing of information, and openness to new ideas.”⁸⁹ Increased interaction among employees spurs open and honest communication and a continuous flow of information throughout the corporation.⁹⁰ Moreover, this environment of teamwork and information sharing contributes to an employee perception of trustworthiness, and consequently, enhanced employee morale.⁹¹

Furthermore, corporate culture that supports trust and compliance is a critical element of successful enterprise risk management for employees and shareholders.⁹² Ample evidence suggests that—in corporations supporting a culture of trust and compliance—employees who have a substantial interest in their compensation are more likely to be innovative and cost-conscious, and thus,

⁸⁵ Letter from Donna Dabney to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Dec. 17, 2010), at 9, *available at* <http://www.sec.gov/comments/s7-33-10/s73310.shtml> [hereinafter Dabney Letter].

⁸⁶ *Id.*

⁸⁷ *See id.*

⁸⁸ *See generally id.* at 8-9.

⁸⁹ Sadri & Lees, *supra* note 40, at 856 (citation omitted).

⁹⁰ *See id.*

⁹¹ *See generally* Watson, *supra* note 81, at 31-32.

⁹² Carlo V. di Florio, Office of Compliance Inspections and Examinations of the Securities and Exchange Commission, Speech by SEC Staff: The Role of Compliance and Ethics in Risk Management (Oct. 17, 2011), *available at* <http://www.sec.gov/news/speech/2011/spch101711cvd.htm>.

compliant organizations tend to be more profitable.⁹³ Many corporate leaders find that a strong ethical culture benefits the bottom line, with studies showing a direct relationship between ethics and compliance practices and the strength of numerous business success indicators, such as stock price.⁹⁴ A culture of trust and compliance has also been linked with enhanced financial and sales performance, greater access to capital, strengthened brand image, positive community relations, improved shareholder relations, improved relations with regulatory authorities, and overcoming pressure from activist groups.⁹⁵

III. DODD-FRANK UNDERMINES CORPORATE CULTURE

A. *Erosions of Trust*

Traditional analysis has asserted that external legal and market incentives are the driving force of “discouraging opportunistic behavior” and encouraging organizational trust and cooperation.⁹⁶ Recently, however, social science has demonstrated that external financial incentives are indeed less of a motivating source for governing organizational behavior than the phenomenon of internal trust.⁹⁷ Although distinguishable from the realities of the business world, social science has effectively compiled data from social dilemma games to reveal behavioral patterns in the organizational realm.⁹⁸ These games demonstrate that trust is not always most effectively promoted by promising external rewards, and in reality, external incentives can reduce levels of trust within an organization by diminishing internal motivations.⁹⁹ As such, Dodd-Frank’s advancement of external rewards and incentives for whistleblowers that report securities violations directly to the SEC without reporting first to the organization reduces the overall level of trust within organizations.

⁹³ See Watson, *supra* note 81, at 32.

⁹⁴ See *The Impact of Codes of Conduct on Corporate Culture: Measuring the Immeasurable*, LRN 3 (2006), available at

www.ethics.org/files/u5/LRNImpactofCodesofConduct.pdf.

⁹⁵ See Watson, *supra* note 81, at 33.

⁹⁶ See *id.* at 35.

⁹⁷ Blair & Stout, *supra* note 54, at 1735.

⁹⁸ See *id.* at 1777.

⁹⁹ *Id.* at 1139.

To begin, the Dodd-Frank whistleblower provisions erode trust by removing the power of organizations to require the use of their internal reporting mechanisms for exposing misconduct. Specifically, social dilemma literature demonstrates that formal instructions are powerful tools in determining the likelihood of cooperation and the existence of trust,¹⁰⁰ especially when the formal instructions originate from someone who is perceived as an authoritative figure.¹⁰¹ As a result of Dodd-Frank, authoritative figures within organizations are unable to give truly binding formal instructions—through codes of conduct, for example—to report misconduct within the organization in the first instance. Conversely, if the SEC were to explicitly support internal reporting mechanisms and corporate cultures of trust and compliance, organizations would have the backing to promote cooperation through formal instructions from internal figures of authority. As the law currently stands, however, the SEC virtually removes the authoritative power from the corporation to promulgate effective and binding formal instructions for internal reporting. As a result, a lack of cooperation with internal procedures, a lack of trust within the system, and an undermining of corporate culture is bound to follow.

Furthermore, the Dodd-Frank whistleblower provisions erode group identity and communication—both essential components of trust within an organization. The social dilemma experiments suggest that permitting players to communicate with each other significantly increases the incidence of cooperation and feelings of group identity; conversely, the incidence of cooperation and feelings of group identity are dramatically decreased when players are unable to communicate effectively.¹⁰² In turn, Dodd-Frank’s failure to promote and support internal communications by allowing whistleblowers to bypass the internal reporting systems leads to reduced communication within the organization regarding concerns about potential misconduct. Moreover, because of the lack of communication and sharing of information stemming from the desire to be the first to report original information, a “silo mentality”—an attitude found in organizations in which groups do not want to share information or knowledge—ensues.¹⁰³ Social science as well as contemporary corporate

¹⁰⁰ In one social dilemma study, two-thirds of the group that was told they were going to play “The Community Game” cooperated, while only one-third of the group that was told they were going to play “The Wall Street” game cooperated. See Blair & Stout, *supra* note 54, at 1770-71.

¹⁰¹ *Id.*

¹⁰² *Id.* at 1771.

¹⁰³ *Silo Mentality Definition*, INVESTOPEDIA.COM, <http://www.investopedia.com/terms/s/silo-mentality.asp#axzz1qR70yvNF> (last visited March 28, 2012).

experience suggests that a “silo mentality” inhibits feelings of group identity and trust and can be an overwhelming factor in the demise of corporate culture.¹⁰⁴

Moreover, the Dodd-Frank whistleblower provisions erode trust by discouraging collaboration and teamwork within an organization. The social dilemma experiments reveal that players are more prone to cooperate and trust one another in situations in which they anticipate the other players will cooperate as well.¹⁰⁵ As such, the reporting mechanisms under Dodd-Frank lead to a lack of cooperation and trust within an organization because individuals within the organization are less likely to expect that other individuals will cooperate—that is, make use of internal reporting mechanisms. Rather, individuals within the organization will naturally expect—and, in fact, Dodd-Frank encourages¹⁰⁶—employees to run directly to the SEC rather than internally report. This lack of collaboration and teamwork to solve internal dilemmas is bound to pervade all levels of the corporation. Management will expect a lack of cooperation among lower-level employees, lower-level employees will expect a lack of support from management, and employees will be less apt to turn to other employees for fear of giving them keys to a bounty. By extension, Dodd-Frank converts employees into perceived threats rather than corporate assets and converts management into unsupportive, tight-lipped actors. This compromises employee relations and chills the level of trust within the organization.

B. *Erosions of Corporate Cultures of Compliance*

Dodd-Frank erodes corporate cultures of compliance by luring employees to directly bypass their company’s internal compliance programs, and as a result, displaces long-standing federal policy prescriptions for effective and reliable internal reporting systems mandated by the Sentencing Guidelines and Sarbanes-Oxley.¹⁰⁷ Moreover, “most responsible public companies have spent a significant amount of time and money implementing,” promoting, and refining robust compliance programs that continue to serve as valuable resources for companies,

¹⁰⁴ *Id.*

¹⁰⁵ Blair & Stout, *supra* note 54, at 1771-72.

¹⁰⁶ *See supra* Part II.B.

¹⁰⁷ *Id.*

management, and employees.¹⁰⁸ “While the [Dodd-Frank rules] include provisions ‘intended *not to discourage*’ whistleblowers at companies with robust compliance programs to first report . . . internally, they do not adequately *encourage* employees to do so.”¹⁰⁹ Because the “whistleblower program . . . does not account for and fully maintain the vitality of corporate integrity programs”¹¹⁰ already established in response to federal regulations—and which have proven effective in ensuring compliance with the law—existing corporate cultures of compliance within organizations “will no longer [adequately] serve the purposes for which they were specifically designed.”¹¹¹

Moreover, the Dodd-Frank whistleblower provisions erode corporate cultures of compliance by undermining internal abilities to develop and maintain strategic visions of functional corporate compliance programs.¹¹² The lack of meaningful support sends an overriding message to employees that internal reporting mechanisms as a whole are inadequate.¹¹³ To the extent that the company’s internal reporting procedures require a company to report misconduct, “the company’s internal processes [are] rendered meaningless if the employee” can acquire information and disclose it to the SEC without consequence from the company.¹¹⁴ Also, effective compliance programs rely primarily on internal reporting to identify instances of misconduct, to investigate the facts, and to take remedial actions.¹¹⁵ However, the likelihood to receive internal reports of misconduct is significantly diminished under the current law, ultimately weakening the compliance program that is already in place.¹¹⁶ Because effective

¹⁰⁸ Letter from Neila B. Radin to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Dec. 17, 2010), at 2, *available at* <http://www.sec.gov/comments/s7-33-10/s73310.shtml> [hereinafter Radin Letter].

¹⁰⁹ Dabney Letter, *supra* note 85, at 2.

¹¹⁰ Letter from Allstate Ins.Co., et. al. to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Dec. 17, 2010), *available at* <http://www.sec.gov/comments/s7-33-10/s73310.shtml>.

¹¹¹ Letter from Jeffrey W. Rubin to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Jan. 4, 2011), at 16, *available at* <http://www.sec.gov/comments/s7-33-10/s73310.shtml> [hereinafter Rubin Letter].

¹¹² See Dave Ebersole, *Blowing the Whistle on the Dodd-Frank Whistleblower Provisions*, 6 ENTREPREN. BUS. L.J. 123, 139 (2011).

¹¹³ See *id.*

¹¹⁴ Rubin Letter, *supra* note 111, at 15.

¹¹⁵ See *id.* at 16-17.

¹¹⁶ See *id.* at 16.

corporate cultures of compliance naturally comprise functioning internal compliance programs—and because these compliance programs are weakened—the overall effect will be a deterioration of corporate cultures of compliance.¹¹⁷

Additionally, the Dodd-Frank whistleblower provisions erode corporate cultures of compliance because compliance mechanisms dwindle over time when they lack enduring institutional support.¹¹⁸ The pronouncement by the SEC that compliance is a consideration when determining the amount of the bounty to be awarded is “thin on the ground” without the direct empowerment of internal policies and corporate cultures of compliance.¹¹⁹ As such, even organizations that embrace the requisite “tone at the top” to foster a corporate culture of compliance lack the backing needed to pervade the entire organization.¹²⁰ Absent the alignment of the law with current internal policies and procedures, the benefits stemming from these aspects of internal affairs—such as promoting a culture of compliance—will be diminished, if not eradicated.¹²¹

Further, while some reports have indicated that the development of internal compliance programs is on the rise post Dodd-Frank,¹²² increased internal policing is not synonymous with a strong corporate culture of compliance. Effective corporate cultures of compliance also contemplate employee buy-in to internal compliance efforts;¹²³ however, the provisions ultimately remove the potential for this buy-in with superior monetary incentives and anti-retaliation protections for external reporting. Therefore, no matter how

¹¹⁷ Ebersole, *supra* note 112, at 139.

¹¹⁸ *See* Whistle Blows, *supra* note 31, at 39-40.

¹¹⁹ *See* Corporate Integrity in the Wake of Dodd-Frank: How Do We fortify Internal Compliance, Reporting, and Culture?, at 22, *in* Symposium, For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd Frank, May 11, 2011, *available at* http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2011/RAND_CF290.pdf [hereinafter Corporate Integrity]

¹²⁰ *See* Exploring the New World Order: Whistleblower Challenges for Corporate Management and Governance, at 14 *in* Symposium, For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd Frank, May 11, 2011, *available at* http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2011/RAND_CF290.pdf [hereinafter New World Order].

¹²¹ *See* Radin Letter, *supra* note 108, at 2-3.

¹²² *See* New World Order, *supra* note 120, at 14.

¹²³ *See supra* Part III.C

much corporations attempt to vamp up their compliance efforts, these efforts alone are not enough to prevent erosions of corporate cultures of compliance.

Lastly, Dodd-Frank erodes corporate cultures of compliance by encouraging a “mercenary mentality” among employees and diminishing the legitimate employer expectations of their employees to develop, maintain, and advance corporate cultures of compliance.¹²⁴ Monetarily, the provisions encourage employees to withhold information from an employer when early company involvement and remediation efforts could either mitigate or reduce the resulting bounty.¹²⁵ Traditionally, corporations have relied upon employees as a group to police the conduct within the corporation and safeguard the reputation of a company.¹²⁶ Correspondingly, in the past, employees who chose to report internally generally did so out of feelings of loyalty, group belonging, and an overwhelming desire to help the company “root out corruption.”¹²⁷ Now, the encouraged “mercenary mentality” will prompt employees to race to the SEC at the first sign of a violation rather than advance efforts to protect the reputation and well-being of the corporation, resulting in the erosion of a culture of compliance.¹²⁸

VI. PROPOSAL

While Dodd-Frank alleges that the whistleblower bounty provisions are not intended to discourage whistleblowers from first reporting misconduct internally to companies that have robust compliance programs, the practical effect of such provisions is, in fact, to diminish all internal reporting mechanisms relating to violations of securities laws and to undermine corporate cultures of trust and compliance. Therefore, in the event of an SEC enforcement action resulting from an external whistleblower tip in which the information was not first reported internally, Dodd-Frank should be amended to permit corporations to establish an affirmative defense for possessing an effective, well-maintained

¹²⁴ See Corporate Integrity, *supra* note 119, at 21.

¹²⁵ See Letter from David Hirschmann to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Feb. 15, 2011), at 2, available at <http://www.sec.gov/comments/s7-33-10/s73310.shtml>.

¹²⁶ Whistle Blows, *supra* note 31, at 17.

¹²⁷ See Alexandre H. Rene, et al., *Anti-Corruption: Minimizing FCPA Risk on Two Fronts: Through Corporate Policy and Corporate Culture*, BLOOMBERG LAW REPORTS: CORPORATE COUNSEL (Feb. 13, 2012), at 1.

¹²⁸ See *id.*

corporate culture of trust and compliance. Moreover, if the corporation is able to successfully establish the affirmative defense, the sanctions and monetary penalties imposed on the corporation will be reduced, and more significantly, there will be an absolute bar to the recovery of an award by a whistleblower under the bounty program.

More specifically, using a preponderance of the evidence standard—in which a corporate culture of trust and compliance is more likely to exist than not—the judge will be required to engage in a full examination of all facts and circumstances tending to prove the existence of a corporate culture of trust and compliance. However, in taking into account all facts and circumstances, the judge will be permitted to consider any information tending to show that internal whistleblowing was impractical under the circumstances. Moreover, factors tending to indicate a corporate culture of trust and compliance may include, but are not limited to:

1. A clearly defined code of ethics, accompanied with evidence tending to show a strong commitment to upholding these policies and procedures.¹²⁹
2. Apparent communication channels—such as reporting structures—and open-door policies.¹³⁰
3. Employee feedback or overall company survey results tending to indicate that teamwork, collaboration, and unity are valued as a means to achieve company goals.¹³¹
4. A compliance program that complies with the Sentencing Guidelines and Sarbanes-Oxley of 2002 and is applicable to all members of the organization.¹³²
5. A permeating value from top to bottom that encourages compliance with the law and specific instances of visible dedication and support by senior management.¹³³

¹²⁹ See Callahan, *supra* note 56, at 208.

¹³⁰ See *id.*

¹³¹ See *id.*

¹³² See *supra* Part III.A & B.

¹³³ Richards Speech, *supra* note 74.

6. Active encouragement and solicitation of employees through e-mail communications, placement of flyers, and posters to report potential violations to the company.¹³⁴
7. Specific examples of communications to employees specifying that those who report violations internally will not face retaliation, and feedback from employees who reported information internally but did not face retaliation.¹³⁵
8. Reward structures, either monetary or non-monetary for employees who significantly contribute to the values of trust and compliance.
9. Records of effective and timely investigative follow-up and responses to reported and actual violations.¹³⁶

Admittedly, because the proposal does not mandate internal reporting in an absolute sense, critics will argue that the proposed solution “does not go far enough” to support internal reporting efforts. However, this proposed solution promises an advantageous middle ground that entertains the goals and wishes of parties on each side of the whistleblower bounty provision debate. On one hand, this solution creates a positive disincentive for employees to bypass effective internal reporting procedures. Specifically, if an effective corporate culture of trust and compliance is in place, then employees will be required to make use of their internal reporting procedures prior to reporting to the SEC, or forego their prospect of a bounty. With this in mind, employees have no incentive to withhold information in attempt to allow increased sanctions, as doing so will not provide them with a direct monetary benefit. Furthermore, by allowing those entities that do embrace effective cultures to come forward with evidence demonstrating this type of corporate environment, there is no opportunity for the failure of some companies to undermine the others that have successfully implemented the requisite culture.

Conversely, critics will also argue that this proposal instead goes too far, creating too many obstacles for external whistleblower reporting. Unlike mandatory internal reporting, as urged by the corporate community, there is no mechanical assumption that the employer has an effective culture in place when

¹³⁴ See generally Memorandum from Huntsman Corporation to Elizabeth Murphy, Secretary of U.S. Securities Exchange Commission (Feb. 1, 2011), available at <http://www.sec.gov/comments/s7-33-10/s73310.shtml>.

¹³⁵ See generally *id.*

¹³⁶ See generally *id.*

the burden of proof is placed on the employer to establish an effective corporate culture of trust and compliance. Therefore, this satisfies the concerns of those individuals who vehemently oppose mandatory internal reporting—namely due to the fact that while some employers maintain robust compliance processes and cultures, others lack such established procedures and protections within their culture. Additionally, by allowing employers the opportunity to present such evidence, employers have a further incentive to make vigorous efforts to develop effective cultures of trust and compliance.

Of course, critics will argue that this proposal promotes uncertainty among employees, as employee whistleblowers will need to make their own initial assessment of the effectiveness of the culture prior to deciding whether or not they are required to report internally. However, the factors outlined under the proposed changes will provide employees with objective criteria with which to measure their corporate cultures of trust and compliance against. For the few corporations in which the culture could sway in either direction, the practical effect of the law is that employees will err on the side of caution and first report the misconduct internally. For the reasons mentioned in this paper, it seems the resulting increase in internal reporting would ultimately produce more benefits than harm.

Furthermore, critics may also argue that this proposal will lead corporations to resort to a “check the box” mentality. Specifically, they may argue that corporations will deem the task of developing an effective corporate culture of trust and compliance complete merely by “checking the box” under the list of proposed factors, when in fact the true intent of the law contemplates a continuous commitment. However, the factors listed in the proposal account for this risk and specifically demand regular and continuous measures for implementing the requisite culture. Additionally, the proposal maintains that the factors indicative of an effective corporate culture of trust and compliance are merely inclusive rather than exclusive. As such, the judge will be in a position to take into account the presence of a “check the box” mentality when determining whether or not an effective corporate culture of trust and compliance exists.

Lastly, critics will argue that this proposal leads to a system of considerable judicial discretion. However, history has demonstrated that judges are rational and logical actors who can competently apply the law to the facts to reach an appropriate decision.¹³⁷ Moreover, although the judge is not an insider

¹³⁷ Richard A. Posner, *The Jurisprudence of Skepticism*, 86 MICH. L. REV. 827, 865-66 (1988).

of the organization, the judge is in the best position to serve as a neutral party between the potentially competing views of the employer and employee.

VI. CONCLUSION

The whistleblower provisions of Dodd-Frank create unduly powerful incentives for employees to bypass internal reporting mechanisms for violations of securities laws, generating a host of perverse effects. An affirmative defense for corporations with effective cultures of trust and compliance will help to alleviate the concerns Dodd-Frank underscores by reinforcing the ability for organizations to develop, implement, and maintain strong corporate cultures and empowering those that do.