No. 16-1276

In The
# Supreme Court of the United States

DIGITAL REALTY TRUST, INC.,

*Petitioner,*

v.

PAUL SOMERS,

*Respondent.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

## BRIEF FOR ETHICAL SYSTEMS, INC. AS *AMICUS CURIAE* SUPPORTING RESPONDENT


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## QUESTION PRESENTED

Whether the anti-retaliation provision for "whistle-blowers" in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 extends to individuals who have not reported alleged misconduct to the Securities and Exchange Commission and thus fall outside the Act's definition of "whistleblower."

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## INTEREST OF *AMICUS CURIAE*[1]

Ethical Systems, Inc. is a collaboration of leading social and behavioral scientists who study ethics in organizations. Ethical Systems believes—based on research—that good ethics is good business. Founded in 2014 and housed in NYU Stern's Business and Society Program, Ethical Systems' mission is to improve business ethics and integrity by making academic research about business ethics available and accessible to non-academics, and by developing tools to help companies assess and improve their internal organizational cultures.

Ethical Systems is interested in this case because it involves business ethics and its outcome may have a significant impact on the development of more ethical organizational behavior. A cornerstone for building an ethical organizational system is a culture that encourages employees to speak up against wrongdoing. A decision in this case that would enable companies to retaliate against those who report misconduct internally would crack that cornerstone.

[1] The parties have consented to the filing of this brief.

No counsel for a party participated in the authoring of this brief, and no person other than *amicus curiae*, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

## SUMMARY OF ARGUMENT

To combat corporate corruption, we must protect those who report misconduct internally. Empirical evidence shows that the majority of employees who report misconduct do so through internal channels, such as reporting informally to supervisors. For any anti-corruption law to be effective, it must protect this internal reporting. Protecting internal reporting benefits not only the reporting employee, but also the company itself and the public at large, because internal reporting reduces corporate fraud and misconduct and thereby reduces the costs of fraud and misconduct that are incurred by the company and by the public agencies that are tasked with investigation and enforcement. It is therefore in everyone's best interest to protect internal reporting.

## ARGUMENT

### 1. Internal reporting is the most common way that companies learn about corporate misconduct, and there is a public interest in protecting and encouraging internal reporting.

"Tips" are the most common method for detecting corporate fraud and misconduct, and 51.5% of tips come through internal reporting by employees. Association of Certified Fraud Examiners ("ACFE"), Report to the Nations on Occupational Fraud and Abuse (2016) ("ACFE Report"), at 4, 20–26, available at https://goo.gl/PD62b6. In the United States, 37% of the discovered instances of corporate fraud are discovered through tips; the next closest method of detection is management review, which discovers only 14.3% of the instances of corporate fraud. *Id.* at 23. External audits and law enforcement agencies, combined, detect only 6.5% of the instances of corporate fraud. *Ibid.*

Notably, the losses or costs incurred by a company, due to corporate fraud, go up the longer the fraud goes undetected. *Id.* at 25. Thus, companies have a strong incentive to catch fraud and misconduct in its early stages, to reduce losses and enforcement costs. The median number of months in which fraud is detected through tips (including internal reporting) is 17, whereas the median is 24 months for external audits and 36 months for law enforcement agencies. *Ibid.* Thus, internal reporting is not only the most common method for detecting corporate fraud and misconduct, it is also better than other forms of external detection at catching misconduct in its earlier stages.

The FBI reports that in 2011 (the most recent data that is readily available) it secured over $18 billion in restitution orders and fines for financial crimes, including securities fraud. See Federal Bureau of Investigation, "Financial Crimes Report 2010-2011," available at https://goo.gl/K6v9eM. And the ACFE found that, in 2016, the median monetary loss for companies that detected corporate fraud sooner, through tips that included internal reporting, was one seventh of the median loss for companies that were notified of fraud later, by an external law enforcement agency. See

ACFE Report at 25. Thus, internal reporting is better than other forms of external detection at reducing the costs or losses resulting from corporate misconduct.

Furthermore, empirical evidence strongly suggests that the threat of retaliation for internal reporting may discourage some employees from reporting at all and will encourage some employees to report externally, thereby further increasing the costs incurred by the company. See Marcia Miceli, Janet Near, and Terry Morehead Dworkin, "A Word to the Wise: How managers and policymakers can encourage employees to report wrongdoing," 86 J. of Bus. Ethics 379–396 (2009).

Given the above, companies have a strong financial interest in protecting and encouraging internal reporting as a method for detecting corporate misconduct.[2]

Similarly, it is in the public's best interest for companies to detect and address corporate fraud internally, in its early stages, because this reduces taxpayer costs by lessening the burden on public enforcement agencies (such as the U.S. Securities and Exchange Commission), which are tasked with policing corporate misconduct using taxpayer dollars. And internal reporting also reduces the number of instances of corporate fraud that directly harm the public. Thus,

[2] Internal reporting can also give companies a more complete picture of the legal and ethical risks they face, and can enable them to address problems and improve decision-making. See Linda Klebe Trevino, Gary R. Weaver, David G. Gibson, and Barbara Ley Toffler, "Managing ethics and legal compliance: What works and what hurts," Cal. Mgmt. Rev. (Winter 1999), at 2, 41.

protecting and encouraging the internal reporting of corporate fraud and misconduct is in everyone's best interest.

### 2. Employees are less likely to report corporate misconduct internally when they fear retaliation.

Reporting corporate misconduct is a psychologically complex challenge for most employees. They view the decision as a tradeoff between loyalty to the organization and promoting justice or fairness—meaning they view it as a tradeoff between two strongly-held moral values. Adam Waytz, James Dungan, and Liane Young, "The Whistleblower's Dilemma and the Fairness-Loyalty Tradeoff," 49 J. of Experimental Social Psych. 1027–1033 (2013), available at https://goo.gl/79dLUP. Survey research shows that 59% of employees who observe (or are unsure if they have observed) misconduct in the workplace choose not to report it at all. See CEB Global, "Corporate Integrity: How Information About Business Misconduct Travels" ("CEB Survey"), available at https://goo.gl/QFkEb4 (summarizing CEB 2009–2014 RiskClarity Survey results, which are not publicly available). And those who do report corporate misconduct prefer to report it internally —either directly to their supervisors or to executives or other managers. See ACFE Report at 29; see also Janet Near and Marcia Miceli, "After the Wrongdoing: What managers should know about whistleblowing," 59 Bus. Horizon 105–114 (2016) ("In almost all cases, employees first blow the whistle internally, usually to their direct supervisor or other managers.") (citing Marcia Miceli, Janet Near, and Terry Morehead Dworkin, *Whistleblowing in Organizations*, Psychology Press (2008)).

Indeed, some research shows that over two thirds of those who reported wrongdoing used exclusively internal complaint channels. Jessica R. Mesmer-Magnus and Chockalingam Viswesvaran, "Whistleblowing in organizations: An examination of correlates of whistleblowing intentions, actions and retaliation," 62 J. Bus. Ethics 277–297 (2005). And one study shows that only 7.4% of whistleblowers reported externally to law enforcement or regulatory agencies. ACFE Report at 29. In short, employees overwhelmingly prefer to report internally, and external whistleblowers make up only a small portion of those who choose to report corporate misconduct.

Importantly, it is not the employee's moral compass that determines whether he or she will speak up about observed misconduct; instead, the decision is typically determined by context and circumstances. Mesmer-Magnus and Viswesvaran, *supra*, at 280. Humans are highly susceptible to contextual and social influence. A seminal social-psychology experiment conducted by Stanley Milgram, in 1963, showed just how subservient people can be to authority and to situational influences. In Milgram's experiment, when participants were told by an administrator to continue to administer electric shocks to a student (an actor), 65% of the participants continued to administer the shocks even when they believed they were physically hurting the student. See generally Stanley Milgram, *Obedience to Authority*, Harper & Row (1974). Social and situational influences on corporate misconduct, and on how to handle it, are similar. Business organizations are complex systems that provide formal and informal cues to employees about ethical behavior. Most employees look to their organization's leaders and to their colleagues for guidance on how to behave. When employees believe unethical behavior is the norm, there will likely be more observations of misconduct and less reporting of that misconduct. See generally Linda Trevino and Katherine Nelson, *Managing Business Ethics: Straight Talk About How To Do It Right*, John Wiley & Sons, Inc. (2011).

To encourage the reporting of misconduct, researchers recommend that organizations attempt to create internal cultures and environments that promote employee voice and dissent. See Near and Micelie, *supra*. This is because evidence shows that employees are most likely to report misconduct when they perceive that their supervisor supports them, and that the organization is likely to be responsive to the complaint. Abhijeet Vadera, Ruth Aguilera, and Brianna Caza, "Making Sense of Whistleblowing's Antecedents," 19 Bus. Ethics Q. 4, 563 (2009); Mesmer-Magnus and Viswesvaran, *supra*, at 280. Without this organizational support, employees are likely to believe that reporting misconduct is not worth the risk of retaliation.

Retaliation is the surest way to show employees that there is no support for reporting misconduct. Retaliation can be interpersonal or organizational, and it can take many forms. See Mesmer-Magnus and Viswesvaran, *supra*, at 281. Often, organizational retaliation is intended only to discourage employees from reporting *externally*, or from publicly disclosing the corporate misconduct. But such retaliatory environments tend to discourage reporting in general, thereby reducing the likelihood of internal reporting. *Ibid.*

In sum, reporting corporate misconduct is a complex and difficult decision for employees to make. Consequently, a lot of misconduct goes unreported. Employees who do decide to report misconduct prefer to report it internally. But they are less likely to do so if they fear retaliation.

### 3. Anti-retaliation protections are necessary to protect and encourage internal reporting, and to thereby protect the corporation itself and the public at large against corporate corruption.

It is in everyone's best interest to protect and encourage the internal reporting of corporate fraud and misconduct. See Section 1, *supra*. Employees prefer to report misconduct internally, but they are less likely to do so if they are not protected from retaliation. See Section 2, *supra*. Thus, it is in everyone's best interest to protect employees who report misconduct internally from retaliation.

Requiring employees to report corporate misconduct externally, in order to access the anti-retaliation protections of the Dodd-Frank Act, would produce bad results. It would likely reduce the reporting of corporate misconduct in general, insofar as some employees who might report internally would choose not to report at all. And—to the extent that some employees would turn to reporting externally instead of internally—this increase in external reporting would unnecessarily increase the costs, delays, and burdens borne by (1) the companies that have to face a governmental investigation instead of being able to address their problems internally, and (2) the enforcement agencies that must respond to and investigate these additional external reports. In other words, denying anti-retaliation protections for internal reporting would discourage internal reporting, and thereby increase the costs of corporate misconduct for both companies and regulators, and thus for the investing and taxpaying public at large.[3]

The Dodd-Frank Act is meant to protect employees who report corporate misconduct internally. See Resp. Br. 21–42. Interpreting it otherwise, to require employees to report misconduct externally in order to access protections against retaliation, runs counter not only to the text and legislative intent of the statute (see

[3] Some may argue that the Sarbanes-Oxley Act provides anti-retaliation protections for internal reporting—but in practice this is questionable. From the Act's effective date until the end of 2011, employees won only 1.8% of all the cases decided by OSHA. Richard Moberly, "Sarbanes-Oxley's Whistleblower Protections Ten Years Later," 64 S.C. L. Rev. 1 (Autumn 2012); see also Megan Mowrey, Stephen Cash, and Thomas Dickens, "Does Sarbanes-Oxley Protect Whistleblowers? The recent experience of companies and whistleblowing workers under SOX," 1 Wm. & Mary Bus. L. Rev. 2 (2010).

*id.*), but also to the government's and the public's general interest in protecting and encouraging internal reporting (see Section 1, *supra*).

Notably, this interest in protecting and encouraging internal reporting is reflected not only in the text and legislative history of the Dodd-Frank Act, but also in the U.S. Sentencing Commission's guidelines for sentencing organizations found guilty of criminal conduct. See U.S.S.G. § 8B2.1. Under these guidelines, companies may obtain some leniency in sentencing if they "have an effective compliance and ethics program." *Id.* § 8B2.1(a); see also § 8C2.5(f). The guidelines state that a *required* component of "an effective compliance and ethics program" is protection against retaliation for those employees who report misconduct internally. *Id.* § 8B2.1(b)(5)(C) ("The organization shall take reasonable steps to have and publicize a system . . . whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.").

Anti-retaliation protections are necessary to protect and encourage internal reporting. And internal reporting is crucial to protecting companies and the public at large against the costs and harms of corporate fraud and misconduct. Companies that strive to create effective compliance programs and a more ethical culture and environment will adopt anti-retaliation policies and procedures that are consistent with the Sarbanes-Oxley Act, the Dodd-Frank Act, and the sentencing guidelines for organizations. To construe the

Dodd-Frank Act narrowly, so as to strip it of anti-retaliation protections for employees who report internally, would undermine the development of ethical corporate culture and would be counter to the public interest.

## CONCLUSION

The Dodd-Frank Act was enacted to protect individuals, corporations, and society at large against corporate corruption. Most of the reporting on corporate corruption occurs internally. Thus, to effectively protect against corporate corruption, the Act must protect those who report internally against retaliation. For the reasons provided, Ethical Systems, Inc. supports the respondent's request that the judgment below be affirmed.

Respectfully submitted,

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