

Need for mandatory whistleblowers policy for companies - By Iswarya Balakrishnan & Geetanjali Sharma

The aftermath of the unexpected Satyam scam awakened India to new set of norms and policies. The Ministry of Corporate affairs realised this and began to undertake measures to patch up the loopholes to prevent future corporate frauds.¹ It has now drafted the Companies Bill, 2009 and the proposed Bill is predicted to be sufficient to counter big financial scams like the Satyam.² The bill is at its preliminary stage and before it gets passed, it is advisable that certain amendments are made to the provisions in Clause 49 of the bill to include a liability clause for violation of basic Corporate Governance norms.

Corporate governance is the acceptance of the inalienable rights of shareholders as the true owners of the corporation and of the role of the management is perceived as that of trustees on behalf of the shareholders. It encompasses commitment to values, ethical business conduct and strikes a fine distinction between personal and corporate funds in the management of a company.³ It defines the parameters of accountability, scrutinizes the reports and disclosures with the objective of fulfilling the purpose of the corporate's existence in this era of globalization with the aim directed towards the welfare of shareholders.⁴ Hence, corporate governance goes beyond the letter of law enlisted in the Statutes and tries to further the interests of the shareholders and the general public in an ethical and transparent manner in order to make the organization a responsible corporate citizen.⁵

Whistle Blowing has been defined as "the disclosure by organization members (former or current) of illegal, immoral or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action."⁶ In the context of a corporation, whistle blowers are those who expose malpractices, unethical and corrupt practices of their co-workers and seniors, for the benefit of the company, stakeholders and society at large. In India, corruption needs no elucidation when it comes to companies as the statistics for white collar crimes keep shooting every year.⁷ There is rampant personal use of company funds, misappropriation and recurrent frauds at different levels. This is clearly reflected by the Satyam scam and the stamp paper scams in the past. In India, the whistle blower policy is restricted to the public servants or in works connected with the Central Government⁸ and there exists no provision for corporate whistle blowers, except in clause 49 of the Listing Agreement. Before analysing the need for a stringent whistle blower policy in companies in India, an overview of the global legislations and conventions is vital.

Whistleblowers' protection under United Nations Convention against Corruption (UNCAC): Enforced in December, 2005 the Convention has 140 signatories and amongst them 93 states have ratified the provisions. Article 8, 13 and 33 of the Convention enumerate the duties of public officials to report matters in case of non-performance of functions by other officials. It further lays protection regime for honest reporters and ensures the maintenance of their anonymity.

Whistleblowers' protection under OECD Convention on Bribery of Foreign Public Officials in International Business Transactions (OECD Convention): Ratified by 37 nations, the Convention aims "to address the supply side of bribery by covering a group of countries accounting for the majority of global exports and foreign investment." Whistleblower regulations are a core part of the Convention where countries are mandated to establish complaint procedures, and to protect whistleblowers in the public and private sector.⁹ It is to be noted that India has not ratified this Convention.

Position in U.K. , New Zealand & Australia: In UK, The Public Interest Disclosure Act, 1998, protects whistle blowers from victimization and dismissal. The Protected Disclosure Act, 2000 of New Zealand covers employees who report serious wrongdoings including bribery which violate the general public interest. The Public Interest Disclosure Act, 1994 of Australia also aims at preserving the anonymity of the whistleblower and safeguarding him/her against unfair treatment within the organization.

Position in U.S.A.: In the U.S.A, the SOX Act, 2002 provides for the protection of whistle blowers¹⁰ and is applicable even to employees in the public listed companies. It prohibits publicly traded corporations from taking any adverse employment action against an employee that has blown the whistle.¹¹

Companies with a class of securities under Section 12 of the Securities Exchange Act of 1934 are specifically subject to SOX's whistle-blowing provisions. For the Act to apply, the Courts have applied the test of "objective reasonableness" under which the employee must attribute the business practice to a fraud.¹² The extent of the Act is such that even foreign citizen working abroad for a United States subsidiary of a foreign company which is listed on the New York Stock Exchange gains protection by the whistle-blowing provisions of SOX.¹³ The SOX Act also criminalises retaliation against whistle blowing¹⁴ and title VIII consists of seven sections, referred to as the "Corporate and Criminal Fraud Act of 2002".

The Corporate and Criminal Accountability Act and the White Collar Crime Penalty Enhancement Act also aim at identification and investigation against perpetrators of White collar crimes and ensure their prosecution, in the wake of the collapse of corporate giants like Enron, Quest, WorldCom and Tyco. It is pertinent to note that the reasons for the fall of these Corporations have been accounting manipulations, auditing failure and dereliction of the Board of Directors.¹⁵ The Racketeer Influenced and Corrupt Organisations Act also aims at protection of whistle blowers against the misdeeds of the executive.

The whistle blowing system ensures anonymity and in high-profile cases or exposure to grave danger, the person is even shifted to far-off places with a different identity at the cost of the State. Recently the Dodd-Frank Act, containing the whistleblower provisions were amended to include incentives to whistleblowers for enforcing litigation cases against public companies for alleged violations of securities and commodities laws and the Foreign Corrupt Practices Act (FCPA), 1977.¹⁶ Anyone who gives a tip to the SEC, leading the financial watchdog to bring a successful case would get entitled to up to 30% of sanctions imposed above \$1m.¹⁷ These new rewards for whistleblowers at US financial firms are expected to bring a surge in tip-offs.

Position in Canada: Legislation was enacted to create a new employment-related intimidation offence, protecting employees who report unlawful conduct within their company. But there is no legislation dealing with the private sector employees to speak out when their employer pays foreign bribes. Hence people like Allan Cutler who exposed scams in federal contracts were never protected under legal regimes.

Position in France & Germany: Even with exposure of Executive Life Scam in the year 2004 in France, no specific law governs in France. Similarly, two bills are pending before Bundestag in Germany regarding the civil servants approaching the prosecution directly, instead of their management. But the protection with regard to private sector is still under consideration.

Position in Japan & Korea: The Unfair Competition Prevention Law enacted in 2004 which came into effect in 2006, in Japan, protects whistleblowers who file complaints about foreign bribery. In Korea, Anti-Corruption Act protects whistleblowers in state-owned companies, but no law encourages whistle blowing or protects them against reprisals for exposing corruption in the private sector. Thus, the reporting of bribery in private sector remain abysmally low.

Position in India: The listed companies, are governed by Clause 49 of the Listing agreement, where whistle blowers policy is non-mandatory in nature. It reads that listed companies may establish a mechanism to enable disclosure of unethical behaviour, actual or suspected fraud or violation of company's code of conduct or ethics policy. In fact, Satyam had a whistle blower scheme since 2005,¹⁸ which speaks a lot about India's enforcement mechanism. Even the RBI now has a whistle blower policy to strengthen financial stability and enhance public confidence in financial sector. The Limited Liability Partnership Act, 2008 has also incorporated provisions to protect the interests of whistleblowers¹⁹ and ensure that they are not subjected to harassment, termination of employment or any such treat, to enhance transparency and promote an anti-corruption tendency within the company. The Narayana Murthy Report also suggested the incorporation of whistle blowers policy within the companies to enable the employees to approach the audit committee when they observe unethical or improper practice with informing their superiors and also protect them from unfair termination and other prejudicial practices.

Based on the 179th report of The Law Commission and recommendations of the Second Administrative Reforms Committee (SARC), the Protection of whistle blowers and the Public Interest Disclosure and Protection of Persons Making Disclosure Bill, 2010 (Whistleblower bill), has been drafted to protect the interest of whistleblowers and ensures punishment for whistle blowing with a mala fide. The bill, accepting the recommendations state that anonymity of the whistle blower is a must and this will be an important determinant in improving the instances of whistle blowing by honest men. However a proviso to this sub-section permits the Central Vigilance Commission (CVC) and similar competent authorities to reveal the identity of the whistleblower to the Head of the Department while seeking comments or explanations in the course of an inquiry. The Head of the Department is further barred from disclosing the identity of the whistleblower to anybody else. However this provision alone defeats the very purpose of the law. The central philosophy of whistleblower legislation is to protect the identity of the person making the public interest disclosure so that he/she may not be targeted by the Head of the Department or any colleague or any person who has a vested interest in keeping the lid on wrongdoing shut tight. The proviso to Section 4(5) negates the very purpose of the law and is inadequate to protect the rights of a whistleblower and any intimidation made to his family in the course of the process. Hence it virtually appears to be a tailor-made death sentence for sincere and honest bureaucrats.

Moreover the SARC's recommendation to cover the corporate sector under the draft, is not reflected in the Bill introduced in the Lok Sabha. The impact of the Bill will thus remain only elective for public listed companies, governed by Clause 49.

Further the scope is limited as protection can be sought only after a complaint to the CVC or State vigilance commission is made. This is not conducive for RTI activists who are threatened just by virtue of filing an RTI application, as their protection will not be sought till a complaint is registered by them. Terms like "Maladministration" or 'gross negligence' which were proposed in the 2002 draft, do not find a place in the proposed bill.

The competence of CVC as the sole competent authority to determine cases, is also doubted as it lacks independence and right to investigate at the first place. The process of investigation as mandated to be within 6 months to maximum 2 years by the previous draft, does not find a place in the current bill. Hence there are all possibilities that in the absence of a time bound investigating procedure; delay can be used as a potential tactic to avoid convictions. Investigation is not time-bound and thus there is potential to use delay as tactic.

The provisions of imprisonment and fines for those who file frivolous complaints can also be misused and manipulated to deter honest whistleblowers in the absence of strict accountability of the Competent Authority.

Some Suggested Recommendations:

Firstly, Whistle Blowing policy should be mandatory Corporate Governance tool for all private companies as well as public companies. This alone will ensure the mantra of transparency in all companies. A mere amendment to clause 49 will not suffice. On the question of what kind of provisions should be added, apart from rectifying the flaws under the Whistleblower bill, in order to punish violators or those who expose whistle blowers, it is pertinent to award criminal punishment. Only then, can publicly known murders of people like Satyendra Dubey and Manjunath Shanmugam. Strict criminal prosecution should be initiated against those preventing whistleblowers from acting against a corporation. We should model our laws along the SOX, Act, 2002 which has been effectively able to protect whistle blowers.

Secondly, Provisions should be designed to enhance the protection of RTI activists. Even though an RTI activist cannot protect his identity as a whistleblower, safeguards should be made in case he perceives a threat to his life or intimidation to his family members. In the face of any such complaint filed by the activist, it should be an incumbent duty of the policemen to ensure that he/she is not attacked. Such a duty of 'due diligence' and 'duty to act' on security forces will create greater deterrence and prevent attacks on activists. Any shortcomings in the performance of the police should be made accountable to Lokayukta or Collector. In case of any unnatural death of such whistleblower activists, expeditious investigations should begin self-automated and should be probed by competent authorities.

Thirdly, The Competent Authority designated under the Act, should be monitored continuously as it is subjected to continuous political pressure. An apolitical transparent committee should oversee its activities and it should be incumbent on the Authority to file compliance reports to the Income Tax departments. With regards to the cases filed with the body, a database should be maintained which contains the records of number of complaints filed over a period (both genuine and vexatious), the investigation process against the department and outcome of the same, details of whistleblower etc.

Fourthly, the time bound procedure as was suggested in the original draft should be retained and a provision for incentives to the whistle blower should be incorporated on the lines of Dodd- Frank Act, in U.S.A. Monetary incentives would go a long way in increasing the instances of whistle blowers. Similarly, to keep a check on unethical practices of misusing one's right as a whistleblower, a regime of imposing double penalty in the form of fines and other monetary liability should be imposed.

Lastly, it is suggested that the seat of the SFIO (Serious Fraud Investigation Officer) set up in the year 2003 under the aegis of the Ministry of Corporate Affairs should be given more teeth to bite. As this multi-disciplinary organization is already addressing several cases of corporate scams including the Satyam case, its power and functions should be expanded to investigate in the cases reported by the whistle blowers. This organization should be made responsible for disclosures of scams by the whistleblowers and hence the anomalies of disclosure to a CVC officer will get redressed as SFIO comprises of experts in the field of accountancy, forensic auditing, law, information technology, investigation, company law, capital market and taxation.

The enhancement in the functions of SFIO is already being contemplated in the form of amendments in the Companies Bill and the Apex Court has also strengthened its authority *Common Cause (A Regd. Society) v. Union of India*, to investigate bank frauds. The authority of such an officer is broadly interpreted in other nations like USA and India should adopt similar role to facilitate better investigation and prosecution in cases of corporate malpractices.

Endnotes:-

¹ Govt re-introduces Companies Bill, SEBI & Corporate Laws, *The Corporate Laws Weekly*, Vol .94, Part 1, August 17th 2009, p. Vi

² *Ibid*

³ Preamble, Narayana Murthy Report of the SEBI Committee on Corporate Governance, 2003

⁴ Chandratre K.R, *Role of Board of Directors in emerging dimensions of Corporate Governance and impending changes in Company Law*, *The Chartered Secretary*, The Institute of Chartered Secretary of India, New Delhi, May 97, p.505

⁵ Atul Mehrotara , *Corporate Governance, SEBI & Corporate Laws*, *The Corporate Laws Weekly*, Vol 90, Part 4, March 16th 2009, p. 157

⁶ Near, J.P. & Miceli, M.P, *Organizational dissidence: The case of whistle-blowing*, *Journal of Business Ethics*, 4:4, (1985)

⁷ 104 *White Collar Criminals Caught in 3 Months*, *The Times of India (Chennai)*, 17th September, 2009

⁸ Section 8 , *Central Vigilance Commission Act*, 2003

⁹ http://www.transparency.org/news_room/in_focus/2007/whistleblowers > , (Last accessed on 24th October, 2010)

¹⁰ Section 806, *SOX Act*, 2002

¹¹ 18 U.S.C. § 1514A(a)

¹² *Livingston v. Wyeth Inc.*, 520 F.3d 344 (4th Cir. 2008), *Day v. Staples Inc.*, 2009 WL 294804 (1st Cir.)

¹³ *O'Mahony v. Accenture Ltd.*, 537 F. Supp.2d 506 (S.D.N.Y. 2008)

¹⁴ Section 1107, *SOX Act*, 2002

¹⁵ Naresh Kumar, *Whistle Blowers of Unethical Business Practices*, [2009] 89 *CLA (Mag.)* 29, p. 198

¹⁶ Arpinder Singh & Vinay Garodiya, *Whistleblowers can earn a bounty*, *The Economic Times*, 5th Sep, 2010

¹⁷ US incentives 'to boost financial whistleblowing', *BBC News*, <http://www.bbc.co.uk/news/business-10911313/> (Last accessed on 25th October, 2010)

¹⁸ Vikas Dhoot, *Satyam had a whistle-blower policy since 2005*, *The Financial Express*, New Delhi, Mar. 29, 2008. Available at < <http://www.financialexpress.com/news/satyam-had-a-whistleblower-policy-since-2005/440221/2> > , (Last accessed on 10th September, 2010)

¹⁹ Section 31, *Limited Liability Act*, 2009

Narayana Murthy Report of the SEBI Committee on Corporate Governance, 2003, p.24, para 3.1.