The Significance of the Sarbanes-Oxley Whistleblower Provisions

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I. Introduction

Three years of litigation under the whistleblower provisions of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) have illustrated how different litigation of such disputes can be from litigation of other types of employment disputes. This article discusses the Sarbanes-Oxley whistleblower provisions in the context of other preexisting whistleblower protection laws, how unique features of Sarbanes-Oxley have led to results that would be unusual in other types of employment litigation, how the Sarbanes-Oxley whistleblower provisions are affecting the development of state law, and how those provisions are influencing corporate governance practices.

II. How Sarbanes-Oxley Differs from Prior Whistleblower Protection Laws

A. *Broadened Scope of Subjects of Protected Disclosures*

The whistleblower provisions of Sarbanes-Oxley differ substantially from previous federal and state whistleblower protection laws. Until Sarbanes-Oxley, most federal and state whistleblower laws applicable to the private sector protected only employees who raised concerns about dangers to the public health or safety.[1] Most such laws did not protect private sector employees who raised concerns about fraud against shareholders, because such issues were not perceived as affecting public health or safety.

In contrast, most federal and state laws covering government sector whistleblowers did protect government employees who raised concerns about waste of funds.[2] The public interest in financial abuse in the government sector has always been clear because such abuse involves waste of taxpayer funds. However, until Sarbanes-Oxley, the issue of financial fraud in the private sector was viewed as of concern only to shareholders.

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1. *See* Daniel P. Westman & Nancy M. Modesitt, Whistleblowing: The Law of Retaliatory Discharge, Ch. 4 and App. B (2d ed., BNA Books 2004) [hereinafter Whistleblowing].

2. *Id.*, at Ch. 3 and App. A.

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Sarbanes-Oxley breaks through the conceptual barrier that previously caused public policy to be more narrowly defined in the private sector than the government sector. With the failures of several major corporations, and the corresponding investment losses suffered by millions of employees and shareholders, Congress decreed in Sarbanes-Oxley that fraud against shareholders is an issue of public concern justifying significant new civil and criminal protections for private sector employees who raise concerns about financial fraud. For the first time, Sarbanes-Oxley creates a civil remedy for whistleblowers in the private sector who raise concerns about financial matters that implicate violations of federal securities laws.[3] Thus, the subject matter of protected disclosures has been significantly broadened beyond the categories of dangers to the public health and safety.

B. *"Undersight" as an Element of Securities Regulation*

Sarbanes-Oxley also uses whistleblower protection as a key component of federal securities law enforcement. The concept of "oversight" has been familiar to lawyers since the passage of the Securities Exchange Act of 1934, which created the Securities and Exchange Commission (SEC) to police the securities markets. "Gatekeepers," such as public accounting firms and law firms, also have been viewed as having a role in overseeing the reporting of corporate financial data to ensure its accuracy. Of course, corporate boards of directors have been responsible for overseeing the operations of their corporations, including ensuring the accuracy of financial reports.

Oversight, however, did not prevent the frauds of recent years at companies such as Enron, WorldCom, Adelphia, and others. These events have shown how difficult it can be for corporate outsiders like the SEC, and accounting and law firms, to peer into the inner workings of corporations to determine whether financial fraud is occurring. Outsiders must rely on others to supply information about corporate financial reports, and that information may be misleading. Sarbanes-Oxley ensures that individuals at the operational level who are intimately

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3. Section 806 of Sarbanes-Oxley creates a federal civil right of action on behalf of any employee of a publicly traded company, or any employee of a contractor of a publicly traded company, who is subject to discrimination in retaliation for reporting corporate fraud or accounting abuses. Sarbanes-Oxley Act, 18 U.S.C. § 1514(A) (2002). Section 806 prohibits publicly traded companies from discriminating against an employee in retaliation for any lawful act done by the employee to: (1) provide information or otherwise assist in any investigation regarding conduct that the employee reasonably believes constitutes a violation of federal securities fraud statutes or SEC rules, provided the investigation is conducted by a federal regulatory or law enforcement agency, any Member of Congress or congressional committee, or a person with managerial authority within the publicly traded corporation; or (2) file, testify, participate in, or otherwise assist in any proceeding related to an alleged violation of corporate fraud laws or regulations. *Id.*

involved in a company's business have the ability to inform outsiders when they see financial fraud.

"Undersight" is a term I have introduced to describe the concept of internal monitoring from the bottom up.[4] Now, corporate insiders who observe the daily operations of companies are protected by Sarbanes-Oxley if they report concerns about financial fraud. In addition to strengthening "oversight" by creating the Public Company Accounting Oversight Board and mandating other actions, Sarbanes-Oxley also added new "undersight" provisions to protect corporate insiders who witness fraud firsthand.

Woven throughout Sarbanes-Oxley is the theme that protection of employees who report financial abuse may help to prevent future corporate collapses and securities frauds. The Report of the Senate Judiciary Committee on the bill that became Sarbanes-Oxley states: "In a variety of instances when corporate employees at both Enron and Andersen [the accounting firm which audited Enron's books] attempted to report or 'blow the whistle' on fraud, but (sic) they were discouraged at nearly every turn."[5] Protection for employees engaging in "undersight" is reflected in many facets of Sarbanes-Oxley:

- Section 301 requires corporate Audit Committees to create mechanisms for receiving anonymous employee concerns about financial improprieties;[6]
- Section 806 creates new civil protection for employees who report concerns about alleged fraud upon shareholders,[7] and section 1107 creates new criminal penalties for retaliation that extend more broadly than does section 806;[8]
- Section 307 requires the SEC to issue regulations setting forth minimum standards of practice applicable to attorneys who practice before the SEC.[9] The rules issued by the SEC require attorneys who are aware of financial fraud by their clients to alert the issuers' executive management, and then the issuers' boards of directors if executive management does not respond appropriately;[10]
- Section 501 requires the SEC to promulgate rules that prohibit brokerage firms from retaliating against securities analysts because of an "unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the

4. WHISTLEBLOWING, *supra* note 1, at Ch. 1.III, 18–22.
5. S. REP. NO. 107–146, at 4–5 (2002).
6. 15 U.S.C. § 78f(m)(4) (2002).
7. 18 U.S.C. § 1514A (2002).
8. 18 U.S.C. § 1513 (2002).
9. *See* 17 C.F.R. pt. 205 (2005).
10. *Id.*

research report."[11] This new legal protection for securities analysts was driven by concerns that brokerage firms were pressuring securities analysts to write overly favorable evaluations of stocks in order to obtain additional investment banking business; and

- Section 406 requires issuers of publicly traded securities to disclose whether they have codes of ethics applicable to senior financial officers.[12] Both the New York Stock Exchange and the National Association of Stock Dealers have gone further by requiring companies who wish to maintain their listings on those exchanges to implement Codes of Ethics not limited to executive management, and to include in such codes provisions that protect from retaliation employees who report alleged violations.[13]

Given Sarbanes-Oxley's pervasive concern for whistleblower protection, it is not surprising that the statute contains substantive and procedural elements that are favorable to employees.

C. *Stronger Civil and Criminal Remedies for Reprisals*

Sarbanes-Oxley significantly strengthens the penalties for retaliation against whistleblowing. The civil provisions of Sarbanes-Oxley allow for immediate reinstatement of whistleblowing employees, even before an evidentiary hearing on the merits. The criminal provisions of Sarbanes-Oxley create severe penalties (including substantial fines and up to ten years in prison) for retaliation against whistleblowers who raise concerns about violation of *any* federal criminal statute, not simply laws limited to financial fraud.[14] These criminal penalties may apply to *any* employer, regardless of whether the employer is publicly traded or privately held, and may apply to individual managers as well as to corporate employers.

1. Reinstatement

Reinstatement of employment has been required in Sarbanes-Oxley whistleblower cases in circumstances where such relief would be unlikely in other types of employment litigation. The statute and implementing regulations allow reinstatement of employment after investigations by OSHA investigators (to whom investigations have been delegated), but before any hearing on the merits before an administrative law judge (ALJ) with the U.S. Department of Labor (DOL).[15] Re-

11. 15 U.S.C. § 780-6(a)(1)(c) (2002).
12. 15 U.S.C. § 7264(a) (2002).
13. See New York Stock Exchange Listed Company Manual, Section 303A; National Association of Securities Dealers, Inc., Rule 4350(m) and Interpretive Memorandum IM-4350-7.
14. 18 U.S.C. § 1513(e) (2002).
15. 18 U.S.C. § 1514A(b)(2)(A) (2002). *See also* 29 C.F.R. § 1980.105(a)(1) (2005).

instatement is not stayed even if the defendant requests a *de novo* hearing on the merits.[16]

This provision is not surprising in the DOL context because the DOL enforces whistleblower statutes in the nuclear energy, aviation, and other safety-sensitive industries. Because employees are viewed by the DOL as the front line of safety inspection inside the containment vessels of nuclear energy installations, or inside airport hangars, the DOL's view has been that reinstating a whistleblower to a position from which additional safety problems might be reported is the best way to deter unsafe conditions. From this perspective, immediately reinstating a Sarbanes-Oxley whistleblower theoretically aids in deterring potential financial fraud.

However, reinstatement in other types of employment litigation is an unusual remedy where the relationship between the parties has become adversarial. Therefore, it was a surprise to the employers in two cases when the ALJs ordered reinstatement of the employees. In *Welch v. Cardinal Bankshares Corp.*, the employer was a small bank that presented evidence to the ALJ that the bank's management, board of directors and shareholders all did not wish the plaintiff, who was the former chief financial officer, to return to his job.[17] The ALJ reinstated the employee notwithstanding those objections.[18] The bank has publicly stated it intends to appeal.[19] In *Bechtel v. Competitive Technologies, Inc.*, the ALJ ordered reinstatement of two vice presidents who alleged that they had been terminated for raising concerns about financial fraud.[20] The employer objected strongly to the ALJ's order and delayed their reinstatement.[21] The employees then sought and obtained an injunction in federal court compelling the employer to obey the ALJ's reinstatement order.[22]

2. Criminal Penalties

Section 1107, titled "Retaliation Against Informants," imposes criminal penalties on any individual who "knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense . . ."[23] This provision supplements the existing federal criminal penalties for

16. *Id.*

17. Welch v. Cardinal Bankshares Corp., 2003-SOX-15, at 2, 10 (ALJ Feb. 15, 2005). A comprehensive library of whistleblower decisions is posted by the U.S. Department of Labor *at* http://www.oalj.dol.gov/public/wblower/refrnc/sox1list.htm.

18. *Id.* at 15.

19. *The Long, Lonely Battle of David E. Welch*, 115:8 U.S. BANKER (August 2005).

20. Bechtel v. Competitive Tech, Inc., 2005-SOX-33, at 1–2, 8 (ALJ Mar. 29, 2005).

21. Bechtel v. Competitive Tech., Inc., 369 F. Supp. 2d 233, 235 (D. Conn. 2005).

22. *Id.* at 237.

23. 18 U.S.C. § 1513(e) (2002).

witness intimidation. The penalties include a fine and/or imprisonment up to ten years.[24]

In contrast to the civil remedies created by section 806, the criminal provisions of section 1107 are not limited to the actions of publicly traded companies, nor are they restricted in scope to matters involving corporate fraud or accounting abuses.[25] However, section 1107 is limited to "external" whistleblowers and does not, by its terms, protect "internal" whistleblowers who only voice concerns within their employers' organizations.[26]

The potential scope of this new criminal statute is very broad. Federal crimes have been created by many labor and employment statutes, including the Occupational Safety and Health Act (for making false statements, for giving advance notice of inspections),[27] the National Labor Relations Act (for loans by management to unions, for willfully interfering with agents of the Board, for employing as union employees felons convicted of certain crimes),[28] the Employee Retirement Income Security Act (for employing convicted felons as fiduciaries),[29] the Railway Labor Act (for refusal to obey certain sections of the statute),[30] and many more too numerous to list here. There are federal crimes in the environmental protection statutes, securities statutes, and the Food and Drug Act. In addition, corporations have been criminally prosecuted under the federal conspiracy statute, the Racketeer Influenced and Corrupt Organizations Act, the mail and wire fraud statutes, the Foreign Corrupt Practices Act, the tax laws, perjury statutes, and obstruction of justice statutes.

In reviewing these partial lists, it is apparent that many employees who provide information to law enforcement officials could potentially fall within the protections of the criminal provisions of Sarbanes-Oxley, and that many companies and individual managers could face criminal prosecutions under Sarbanes-Oxley.

3. Individual Liability

The civil provisions of section 806 apply broadly to prohibit retaliation by officers, employees, or agents of publicly traded companies.[31] In contrast, many employment statutes prohibit only "employers" from engaging in retaliation, and such statutes have been construed not to

24. *Id.*
25. *Id.*
26. *Id.*
27. *See* 29 U.S.C. § 666 (2002).
28. *See* 29 U.S.C. §§ 186, 504 (2002).
29. *See* 29 U.S.C. § 1111 (2002).
30. *See* 45 U.S.C. § 152 (2002).
31. 18 U.S.C. § 1514A (2002).

provide remedies against individual managers.[32] The regulations implementing Section 806 provide for individual liability.[33]

The criminal provisions contained in section 1107 are phrased broadly as well, stating that "[w]hoever" interferes with the lawful employment of any person is guilty of a felony.[34] The author is not aware of any criminal prosecutions brought under section 1107. However, the availability of civil and criminal penalties against individuals demonstrates how aggressively Sarbanes-Oxley intends to deter retaliation against whistleblowers.

D. *Burdens of Proof Favorable to Employees*

The Sarbanes-Oxley whistleblower provisions set forth different burdens of proof for plaintiffs and defendants. In most civil litigation, both the plaintiff and defendant must prove their cases by a "preponderance" of the evidence, meaning that the judge or jury finds that the evidence of one party is more likely to be true than the evidence of the other party.

Under the Sarbanes-Oxley whistleblower provisions, however, the relatively light "preponderance" of the evidence burden is applicable only to plaintiffs.[35] In contrast, defendants must prove that they did not retaliate against plaintiffs by "clear and convincing" evidence, usually meaning evidence producing "a firm belief or conviction."[36] This is a heavier burden than the "preponderance" standard, though not as difficult to satisfy as the "beyond a reasonable doubt" standard used in criminal cases.

Several decisions under the Sarbanes-Oxley whistleblower provisions have reached results in favor of employees that appear to have been driven by these differing burdens of proof. For example, in *Platone v. Atl. Coast Airlines* and *Welch v. Cardinal Bankshares Corp.*, the employees were found to have met their burdens of proving by a preponderance of the evidence that they had a reasonable, good-faith belief that they had raised concerns about financial fraud, but the defendants were found not to have satisfied the "clear and convincing" standard.[37]

In both cases, the defendants argued that they had good reasons to terminate the plaintiffs. In *Platone*, the plaintiff's job was to represent management's position in dealings with the company's labor

32. *See, e.g.*, Reno v. Baird, 957 P.2d 1333 (Cal. 1998) (interpreting antidiscrimination provisions of California Fair Employment and Housing Act).

33. 29 C.F.R. § 1980.101 (2005).

34. 18 U.S.C. § 1513(e) (2002).

35. Stone & Webster Eng'g Corp. v. Herman, 115 F.3d 1568, 1572 (11th Cir. 1997).

36. *Id.*

37. Platone v. Atl. Coast Airlines, 2003-SOX-27, at 28 (ALJ Apr. 30, 2004); Welch v. Cardinal Bankshores Corp., 2003-SOX-15, at 47 (ALJ Jan. 28, 2004).

unions.[38] The defendant argued that Ms. Platone was terminated because she had concealed from the defendant that she was having a romantic relationship with the representative of one of the company's unions.[39] Perhaps the defendant would have persuaded the ALJ that concealing a potentially compromising relationship was the real reason for the plaintiff's discharge under the preponderance of the evidence standard. However, the ALJ ruled that the defendant had not proven by clear and convincing evidence that the romantic relationship was the true reason for the termination.[40]

In *Welch*, the plaintiff was the chief financial officer of a small bank who raised concerns about potential financial fraud.[41] The bank terminated his employment when the plaintiff refused to talk with the bank about his concerns unless his attorney was present.[42] The ALJ ruled that the plaintiff had proven by a preponderance of the evidence that he had a good faith belief in his report, but that the defendant bank had not proven its defense of failure to cooperate in the bank's investigation by clear and convincing evidence.[43]

E. *The Diminished Role of "Materiality"*

Under the civil remedy created by section 806, employees need only "reasonably believe" that they are reporting a violation of securities fraud statutes or SEC rules.[44] As discussed above, employees need only prove their reasonable belief by a preponderance of the evidence. Under the criminal provisions of section 1107, employees are protected for reporting "truthful information," whether or not the information proves a violation of law.[45]

The "reasonable belief" standard under section 806 has generated anomalous results to date in several cases in which the employer defended the case on the ground that the alleged fraud complained about by employees did not satisfy the "materiality" standard under federal securities law. In one case, the plaintiff worked in the accounts payable department and alleged that he had been instructed to delay payments of invoices until later quarters of the fiscal year.[46] The employer used the accrual method of accounting, which meant that the invoices were reflected on the company's books at the time the invoices were received, not when they were paid.[47] Accordingly, the company argued that it was legally impossible for there to have been any securities fraud, be-

38. *Platone*, 2003-SOX-27, at 5.
39. *Id.* at 28.
40. *Id.*
41. *Welch*, 2003-SOX-15, at 3, 15 (ALJ Jan. 28, 2004).
42. *Id.* at 34.
43. *Id.* at 47.
44. 18 U.S.C. § 1514A(a)(1) (2002).
45. 18 U.S.C. § 1513(e) (2002).
46. Halloum v. Intel Corp., 2003-SOX-7, at 1 (ALJ Mar. 4, 2004).
47. *Id.* at 2.

cause delaying the payments of the invoices until later quarters could not have had any effect on the financial statements of the company.[48] Nevertheless, the ALJ found that the employee had satisfied his burden of proving that he had a "reasonable belief" that a violation of statute or regulation had occurred.[49]

The regulations promulgated under Sarbanes-Oxley allow the SEC to weigh in on securities issues by participating in proceedings under section 806 as *amicus curiae.*[50] However, to date the SEC does not appear to have acted as *amicus curiae* in any significant way. The parties in Sarbanes-Oxley whistleblower litigation should assume that they, and not the SEC, will have to explain how federal securities law plays into each case.

F. *Enhanced Credibility of Anonymous Complaints*

Prior to Sarbanes-Oxley, anonymous employee complaints often were hard to take seriously. Anonymous complaints could be difficult to investigate if the complaints did not provide sufficient details, and it could be difficult or impossible to ask follow-up questions of an anonymous source. Also, the unwillingness of anonymous complainants to identify themselves may have undermined their credibility in some eyes.

Section 301 of Sarbanes-Oxley requires audit committees of publicly traded companies to implement mechanisms for receipt, investigation, and tracking of anonymous employee complaints.[51] Now, employees know that anonymous complaints cannot be summarily dismissed by management but must be taken seriously by a committee of the board of directors.

G. *Potential for Claims by Lawyers, Accountants, and Other "Gatekeepers"*

Sarbanes-Oxley does not apply solely to publicly traded companies. The criminal protections set forth in section 1107 are not limited to publicly traded companies. The civil whistleblower protections in section 806 apply on their face to "contractors" of publicly traded companies.[52] This is easily remembered if one recalls the example discussed in the congressional debates of employees of the Arthur Andersen accounting firm who could not effectively blow the whistle on fraud at Enron. Congress apparently wished to protect employees of accounting firms, law firms, or other contractors who report concerns about financial fraud, whether the contractors themselves are privately or publicly

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48. *Id.* at 13.
49. *Id.* at 10.
50. *See* 29 C.F.R. §§ 1980.104(a) (copies of complaints are provided to the SEC), §§ 1980.108(b) (SEC may act as *amicus curiae*).
51. 15 U.S.C. § 78f(m)(4) (2002).
52. 18 U.S.C. § 1514A(a) (2002).

held. Also, the early cases decided under Sarbanes-Oxley have protected employees of privately held subsidiaries of publicly traded companies on the theory that the finances of the private subsidiaries have an effect on the financial reports of the public parents.[53]

Applying these principles in practice, it is clear that many privately held enterprises, including investment banks, accounting firms, and law firms, may be subject to both the civil and criminal whistleblower provisions of Sarbanes-Oxley.

H. *The Attorney Whistleblower Rules*

Sarbanes-Oxley requires the SEC to promulgate rules of professional responsibility that require attorneys to report material violations of federal securities law to their clients' chief legal counsel or chief executive, or, if such officers do not respond appropriately, to their clients' boards of directors.[54] The SEC has promulgated rules that broadly define which attorneys are viewed as practicing before the SEC, which include attorneys who work both in corporate legal departments and in outside law firms.[55]

These provisions create the possibility for Sarbanes-Oxley whistleblower claims by attorneys who allege that their employment was terminated in retaliation for carrying out their legal obligations under the SEC rules. To be sure, the ethical obligation of attorneys to preserve attorney-client confidences may present an obstacle to such actions. The Administrative Review Board (ARB) within the DOL has ruled as a matter of federal common law that whistleblowers may not use attorney-client privileged information offensively in order to prove their cases but may use privileged information only to defend themselves.[56] While the author is not aware of any Sarbanes-Oxley claims having been filed by attorneys as of this date, prudent companies and law firms should anticipate such claims and implement practices to minimize their risks.

III. The Effect of Sarbanes-Oxley's Whistleblower Provisions on State Law

Federal laws of the magnitude of Sarbanes-Oxley often significantly affect the development of state law. At least two state legislatures, those of California[57] and Connecticut,[58] have enacted whistleblower protection statutes paralleling the civil provisions contained in section 806 of Sarbanes-Oxley. Equally if not more significant may be the effect of Sarbanes-Oxley on the development of the common law.

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53. *See* Morefield v. Exelon Serv., Inc., 2004-SOX-2, at 2 (ALJ Jan. 28, 2004).
54. 15 U.S.C. § 7245 (2002).
55. 17 C.F.R. pt. 205.
56. *See* Willy v. The Coastal Corp., ARB No. 98-060, at 23 (ARB Feb. 27, 2004).
57. *See* CAL. LAB. CODE § 1102.5 (Deering 2005).
58. 2003 Conn. Acts 03-259 (Reg Sess.).

A. *Wrongful Termination in Violation of Public Policy*

The Sarbanes-Oxley whistleblower provisions may have a significant effect upon the development of the common law theory of wrongful termination in violation of public policy. Many states allow such causes of action to be premised upon federal statutes.[59] Even before Sarbanes-Oxley, one court began its opinion in a case allowing the plaintiff to proceed with a claim for wrongful termination in violation of public policy as follows: "With the sole exception of the war on terrorism, no issue dominates current thought more than the corporate and accounting ethical scandals which have rocked our country."[60] In the aftermath of Sarbanes-Oxley, it is conceivable that some state courts may recognize claims for wrongful termination in violation of public policy predicated on either the civil provisions of section 806 or the criminal provisions of section 1107.

B. *Breach of Implied Contract*

Similarly, state courts may recognize causes of action for breach of implied contract based upon codes of ethics required by the national stock exchanges. Under section 405 of Sarbanes-Oxley, publicly traded companies are required to disclose whether they have codes of ethics applicable to senior executive officers.[61] In response, the New York Stock Exchange and the National Association of Stock Dealers have issued rules that require companies listed on those exchanges to adopt codes of conduct or ethics applicable to all employees, not just senior executives, and requiring that such codes contain a provision forbidding retaliation against employees who disclose potential violations of the codes.[62] As a result, most publicly traded companies now have codes of conduct or ethics that forbid retaliation against employees who raise concerns about violations of those codes.

In many states, written employment policies such as codes of conduct may be the basis for lawsuits for breach of contract.[63] Accordingly, some states may permit breach of contract claims by employees who allege that they were terminated in violation of the antiretaliation provision contained in a code of conduct or ethics. Some jurisdictions allow employers to avoid liability for breach of contract by use of prominent disclaimers stating that the policies do not create enforceable contractual rights.[64] However, use of disclaimers may undermine the effec-

59. *See* WHISTLEBLOWING, *supra* note 1, at Ch. 5.I.C., 99–100.

60. McGarrity v. Berlin Metals, Inc., 774 N.E.2d 71, 74 (Ind. Ct. App. 2002).

61. 15 U.S.C. § 7264(a) (2002).

62. *See* New York Stock Exchange Corporate Governance Rules, Section 303A of the NYSE Listed Company Manual; National Association of Stock Dealers, Inc., Rule 4350(m), and Interpretive Memorandum IM-4350-7.

63. WILLIAM J. HOLLOWAY & MICHAEL J. LEECH, EMPLOYMENT TERMINATION RIGHTS AND REMEDIES App. C (2d ed. 1993 & Supp. 2003).

64. *Id.*

tiveness of the codes by discouraging employees from making disclosures, which may cause the codes to be deemed insufficient under the stock exchange rules. Because many codes of conduct or ethics are broadly worded to encourage "honest and ethical" behavior, a very broad range of employee concerns may be protected beyond the subject of financial fraud against shareholders.

IV. Other Corporate Governance Effects

A. *Privately Held Companies*

While primarily aimed at reforming corporate governance of publicly traded companies, Sarbanes-Oxley has sparked discussion among privately held companies about whether Sarbanes-Oxley's provisions should be adopted as "best practices," including the whistleblower provisions. For example, charitable organizations that rely on donations for their existence have asked why their donors are any less entitled to corporate transparency than shareholders of publicly traded companies and why employees of charitable organizations should not be protected for raising concerns about misuse of donations.

B. *Overseas Issues*

In addition to spilling over from publicly traded to privately held entities, the Sarbanes-Oxley whistleblower protections may spread to countries outside the United States. At present, the only law on the issue appears to be that overseas employees of foreign subsidiaries of U.S. parent corporations are not protected by the Sarbanes-Oxley whistleblower provisions.[65] Nevertheless, U.S. parents intent on eliminating fraud overseas may wish to use codes of conduct or ethics to encourage foreign employees to report potential violations.

Requiring overseas employees to report violations may violate the privacy laws of other countries, or cultural sensitivities. Many countries have had repressive governments that encouraged informants to report on behavior of neighbors and co-workers. In some such countries, elaborate privacy laws have been enacted that forbid reporting illegal behavior of co-workers to anyone other than the proper governmental authorities. In other countries, individuals identify so strongly with groups to which they belong that it would be contrary to their culture for a whistleblower to bring shame upon the group by suggesting that someone in the group acted improperly. Thus, any employer thinking of implementing whistleblower policies outside the United States should carefully consider the legal and cultural climate of each specific country.

C. *Additional Legal and Cultural Developments*

"All that is necessary for the triumph of evil is that good men do nothing." Edmund Burke's famous eighteenth century dictum encap-

65. Carnero v. Boston Scientific Corp., No. 04-10031-RWZ, 2004 U.S. Dist. LEXIS 17205, at *5 (D. Mass. Aug. 27, 2004).

sulates why compliance efforts cannot rely on written policies or codes of conduct alone. After all, Enron had policies on paper forbidding the practices that brought down the company. Without people willing to report violations of law or codes of conduct, compliance efforts inevitably will be frustrated. The whistleblower provisions of Sarbanes-Oxley, coupled with growing acceptance of whistleblowing in both the law and popular culture, may create a climate in which employees more frequently engage in "undersight" to report violations of law, rather than doing nothing.

There is growing recognition in the law, apart from Sarbanes-Oxley, that protection against retaliation is an essential component of any statutory enforcement scheme. Recently, the U.S. Supreme Court held that protection against retaliation is necessary to enforcement of Title IX of the Education Amendments of 1972, even though Title IX itself did not contain a provision forbidding retaliation. In *Jackson v. Birmingham Board of Education*, a male coach of a girls' high school basketball team alleged that his employment had been terminated in retaliation for his complaints that the girls' team was underfunded in violation of Title IX.[66] Acknowledging that Title IX itself did not contain a provision forbidding retaliation, the Court implied a private right of action for retaliation.[67] The Court stated: "Reporting incidents of discrimination is integral to Title IX enforcement and would be discouraged if retaliation against those who report went unpunished. Indeed, if retaliation were not prohibited, Title IX's enforcement scheme would unravel."[68]

Popular culture has kept pace with these legal developments. Today, whistleblowers may be held up to public esteem, as occurred in the December 30, 2002, issue of *TIME* magazine.[69] The cover of that issue named "The Whistleblowers" as Persons of the Year, and carried a photograph of Cynthia Cooper of WorldCom, Colleen Rowley of the FBI, and Sherron Watkins of Enron.[70] Hollywood has sympathetically portrayed whistleblowers in films including *Erin Brockovich* and *The Insider*.[71]

D. *Will Legal Protections for "Undersight" Create Cultures of Compliance?*

Fraud examiners have long known that the most common source of tips reporting fraud originate from employees. In 2004, the Association of Certified Fraud Examiners reported that over 40 percent of

66. Jackson v. Birmingham Bd. of Educ., 125 S. Ct. 1497, 1500 (U.S. 2005).
67. *Id.* at 1507.
68. *Id.* at 1508.
69. *Persons of the Year*, TIME MAGAZINE, Dec. 30, 2002.
70. *Id.*
71. *See* ERIN BROCKOVICH (Universal Pictures 2000); THE INSIDER (Buena Vista Pictures Distribution 1999).

corporate fraud was discovered through employee tips.[72] However, fear of being ostracized or fired may have deterred some employees from blowing the whistle in the past. After Sarbanes-Oxley, the question is whether the significant changes in legal protections for whistleblowers, coupled with more favorable depictions in the popular culture, will encourage employees to engage in "undersight" with greater frequency. A number of factors suggest that employees may more freely report legal or ethical violations today than in the past.

First, high ranking executives now have a compelling personal interest in knowing whether fraud is occurring within their organizations. Thanks to section 302 of Sarbanes-Oxley, CEOs and CFOs must personally certify the accuracy of corporate financial reports, on pain of criminal prosecution.[73] Employees who engage in "undersight" and disclose potential fraud may help to ferret out fraud, thereby improving the accuracy of financial reports and lessening the risk of prosecutions against CEOs and CFOs. Realizing this, executives may devote sufficient resources to compliance to convince the workforce to actively report potential fraud.

Second, Sarbanes-Oxley requires investigation of anonymous employee complaints. To the extent that fear of retaliation has deterred employees from identifying themselves by openly raising concerns, the ability to make anonymous complaints knowing that such complaints must be investigated may encourage whistleblowing.

Third, popular culture has long been ambivalent about "informing on" or "turning in" co-workers. Pejorative terms such as "fink" or "stool pigeon" exemplify such ambivalence. However, almost every American who had an investment in the stock markets suffered significantly by the meltdowns of Enron, WorldCom, and others, and the resulting stock market collapse. Today, employees may feel that reporting potential fraud is necessary to protect their own personal financial interests, as well as the interests of the investing public. After Sarbanes-Oxley, it may not be as easy to turn a blind eye to fraud based on the rationalization that "it's not my problem."

E. *Steps Employers May Take to Avoid Whistleblower Litigation*

A whistleblower claim can generate negative publicity that may undermine investor confidence, draw the attention of regulators, and weaken employee morale and loyalty. Some basic steps can help to avoid such claims.[74]

72. Association of Certified Fraud Examiners, *2004 Report to the Nation on Occupational Fraud and Abuse*, at 20.
73. 15 U.S.C. § 7241 (2002).
74. *See generally* WHISTLEBLOWING, *supra* note 1, at Ch. 10, 263–78.

1. Establish an Employee Concerns Program

Establishing a forum in which employees can raise concerns and have some assurance that their concerns will be investigated can be an effective means of resolving an employee's grievance before a lawsuit is filed. In addition, an Employee Concerns Program can help alert management to wrongdoing early on, providing an opportunity to intervene and prevent further damage.

2. Train Managers and Supervisors to Instill a Corporate Culture of Compliance

One of the lessons of the recent accounting scandals is the importance of maintaining a culture conducive to raising concerns. Indeed, Congress appears to have concluded that many of the companies whose conduct precipitated Sarbanes-Oxley had cultures in which employees were dissuaded from asking probing questions. Managers and supervisors should be trained to encourage employees to raise concerns without fear of reprisal.

3. Take Disciplinary Action Against Those Who Engage in Retaliation

All employees should be put on notice (e.g., through training and the employee handbook) that if they retaliate, harass, or discriminate against another employee for raising a concern, they will be subject to disciplinary action.

4. Document Performance Issues, Contemporaneously

In defending against a whistleblower claim, to satisfy the "clear and convincing" burden, it is critical to have thorough, unambiguous evidence demonstrating that the same unfavorable personnel action would have been taken in the absence of the plaintiff's protected conduct. Accordingly, managers should thoroughly document performance issues on a routine basis. If there is not a contemporaneous documentary record of performance issues, then it may appear that the employer is making up performance issues after the fact to justify the adverse personnel action.

V. Conclusion

Sarbanes-Oxley clearly intends to deter future repetitions of Enron, WorldCom, and the like by encouraging employee whistleblowing about fraud on the financial markets. The U.S. capital markets have been the primary engine of the world's economic growth in the last several centuries. If the Sarbanes-Oxley whistleblower provisions that facilitate "undersight" actually work in practice to deter frauds, then they may be among the most significant employment law developments in recent times.