

**THE EFFECTIVENESS OF THE WHISTLEBLOWER PROTECTION  
UNDER SARBANES-OXLEY SECTION 806 IN CORPORATE  
GOVERNANCE**

**By**

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## **Abstract**

Whistleblowing is an action that not only can assist in exposing organizations' illegal activities to the public, but also can give employers an opportunity to find out irregularities that occur in the workplace and to rectify those mistakes in advance. As for corporate governance, it can be regarded as a structure, a system, or a means that companies set up to monitor the operation of business, to make firms' policies, and to achieve objectives more effectively and successfully. The purpose of this dissertation, on the one hand, is to research the connection between whistleblowing and corporate governance and to use whistleblowers to promote internal corporate control. On the other hand, I wish to establish a complete whistleblower provision under SOX Section 806 to prevent employees who make the disclosure from being retaliated against by companies, and to enhance the function of Section 806 to deter corporate corruption. The introduction describes how whistleblowing promotes corporate governance. The second part discusses the background of whistleblowing and employs different points of view to study whistleblowing. The third part researches on common laws, state and federal statutes that have the provision of whistleblower protection and attempts to compare their differences. The fourth part analyzes SOX Section 806 and discovers its defects on shielding corporate whistleblowers. The fifth part refers to legal articles or academic materials, and presents my suggestions or ideas for future amendments of SOX Section 806. In conclusion, I briefly review the advantages of whistleblowing in internal corporate governance and society at large. In addition, I would like to show my expectations on this dissertation, and wish that the dilemma and obstacles in SOX Section 806 can be clarified and resolved.

**Keywords:** whistleblowing, whistleblower, blow the whistle, SOX Section 806, SOX, Sarbanes-Oxley, corporate governance

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The pursuit of the doctoral degree (S.J.D.) has been such a long journey for me. Establishing the foundation of American law at the University of California at Davis and the University of Wisconsin at Madison encouraged me to achieve a higher goal and made me think of further steps to take in my life.

After receiving my master degree (M.L.I.) at UW-Madison, I transferred to the University of Kansas to pursue my doctoral degree. As the airplane arrived at Kansas City, I sincerely believed Kansas was the state that would be placed in a significant position in my academic life. Not only are the people who live here diversified since they come from different states, but the university accommodates diverse cultures and makes students who come from different countries, like me, able to integrate into this environment as soon as possible. This atmosphere lets me settle down rapidly beyond my original expectation, and makes me put more concentration on my study. In sum, this friendly atmosphere promotes my study motives and enhances my ability to learn from various cultures and different people.

Initially, I got in touch with the issue of whistleblower protection when I took the class of Securities Regulations at UW-Madison School of Law. This topic was quite interesting to me because I had no knowledge regarding whistleblowing when I was a law student in Taiwan (R.O.C.). Not only do Taiwanese laws not enact any protection for whistleblowers who disclose organizational wrongdoings, but Taiwan's legislature also has not regulated any ordinance for this topic or related issues. Even if I did not get myself involved in correlated materials too much during that period, the concept of whistleblower protection was in my mind and had become a critical impetus for my continued research.

I would not have finished my doctoral degree without many people's assistance.

Foremost, I would like to show my biggest gratitude to my dear parents. Without their financial support and constant encouragement, I deeply believe I could not have stuck to my goal and might have easily given up halfway. They cared about all my needs and relieved my depression when I felt pressure from study; their fulfilling support will not be forgotten in my life. Second, I wanted to express my thankfulness to my sisters because they gave me precious advice and emotional support to write this dissertation no matter whether I was struggling with the research or doing all the preparation. Third, I appreciated my ex-girlfriend because she was my harbor when I felt lonely and buried myself into tons of academic materials and books. Fourth, I expressed my unreserved gratitude to Prof. Hecker, the Chair of doctoral committee, because he has showed his unlimited patience and passion on my writing and research. Without his assistance, I would have failed to receive helpful comments and all kinds of information about whistleblowing, and would not have successfully graduated. In addition, I would like to thank to Prof. Schroeder, Prof. Lovitch from KU Law School, and Prof. Levin from KU Business School because they gave me a chance to orally defend my dissertation and stirred my brain by exchanging new ideas and exciting questions. For the last, I wanted to extend a special note of gratitude to all writing consultants from KU Writing Center, especially to Rachel McMurray, Eric Lackey, and Joy Bancroft, since they actually gave me considerable assistance in finding out grammar errors and tried their best to make my dissertation more professional.

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## **List of Abbreviations**

ABA	American Bar Association
AICPA	American Institute of Certified Public Accountants
ALJ	Administrative Law Judge
ARB	Administrative Review Board
CEOs	Chief Executive Officers
CFOs	Chief Financial Officers
CPA	Certified Public Accountant
CSRA	Civil Service Reform Act of 1978
DGCL	Delaware General Corporation Law
DOL	Department of Labor
D&O	Decision and Order
EAW	Employment at will
ERISA	Employee Retirement Income Security Act
FCA	False Claim Act of 1863
FDA	U.S. Food and Drug Administration
GAAP	Generally Accepted Accounting Principles
IRS	Internal Revenue Service
M&A	Mergers and Acquisitions
RMBCA	Revised Model Business Corporation Act
NLRA	National Labor Relations Act
OECD	Organization for Economic Cooperation and Development
OSHA	Occupational Safety and Health Administration
PSLRA	Private Securities Litigation Reform Act of 1995
SEC	Securities and Exchange Commission
SOL	Secretary of Labor
SOX	Sarbanes-Oxley Act of 2002
WPA	Whistleblower Protection Act of 1989

*We could make no greater mistake than to be lulled into a sense of false security by believing that some disembodied force called the government will act like a beneficent big brother and make certain that the special interests will not predominate. If the general welfare is to be protected, it will be protected by the actions of people, not the government.*

*-- Dr. A. Dale Console*

*Whistleblowing has received considerable attention in the media via regular newspaper stories, magazine articles, and television documentaries. It has eclipsed political protest as a newsworthy item, and for good reason. The whistleblowers of the 1970s and 1980s bear the mantle worn by the civil disobedients of the 1960s, shifting the object of dissent from government atrocities in Vietnam to corporate wrongdoing in the workplace.*

*-- Frederick Elliston et al.*

*Too much misinformation has proven the basis for the conventional wisdom about whistle-blowers that we see promulgated in the media, in legislatures, and elsewhere. Whistle-blowing can be a force for constructive organizational and societal change, but only if we learn more about why it happens and how to best deal with its impact.*

*-- Marcia P. Miceli et al.*

## **Chapter I. Introduction**

### *A. Organization of the Dissertation*

Whistleblowing is an essential element of internal corporate governance. The effectiveness of whistleblowing is able to be enhanced through amendments under the Sarbanes-Oxley Act (SOX) Section 806. The purpose of this dissertation is to find out the defects of whistleblower protection under SOX and provide some suggestions for future amendments. The first part of dissertation is the introduction. In this portion, I introduce what corporate governance is, and what role it can play in the operation of public companies. In addition, I would like to briefly describe the important function of whistleblower protection in corporate governance.

Second, I talk about background information in regard to whistleblowing and use different perspectives to research the whistleblower. In background information, I make a definition of whistleblowing and find out who will be the whistleblower; likewise, I study the origin and evolution of whistleblowing. As to the perspectives on the whistleblower, I intend to make use of the individual's, the professional's, and the public's views to discuss whistleblowing.

Third, I am going to employ a typical whistleblower case to do research and compare whistleblower protection among common law, state and federal statutes. In this part, the discussion puts emphasis on how to balance the conflict between the doctrine

of employment-at-will and the public policy exception. In the portion of common law, I attempt to use the precedent case of SOX Section 806, *Welch v. Cardinal Bankshares Corp.*, to study this topic. In the part of state laws, I select California, Louisiana, and Delaware to find out their differences in the whistleblower protection. The reason that I choose the state of California is since it has enacted a friendly statute to protect the whistleblower. By contrast, Louisiana is the state that has loose protection toward whistleblowing. As regards Delaware, because of its company-friendly status, I would like to know how Delaware addresses whistleblower issues under its jurisdiction. Later, in the part of federal laws, I trace back to federal legislative history and study the process that presented how federal legislators shielded the whistleblower in different areas. At last, I mention the first federal statute that is enacted to safeguard the whistleblower serving in the public company, that is, the Sarbanes-Oxley Act Section 806, and introduce its legislative background.

Fourth, I select two American corporate scandals that happened in the beginning of this century -- Enron and WorldCom -- to start the research upon SOX Section 806. My concerns in this part are to discover the obstacle and difficulty for corporate whistleblowers to unveil public companies' securities violations or related frauds, and find out how these companies make responses to employees' accusations. Besides, I bring up empirical critiques on SOX Section 806 about its insufficient protection, and point

out practical problems that Congress did not notice when it enacted SOX to deter public companies from breaching securities laws.

Fifth, not only will I refer to the advice from legal articles, materials, and academic dissertations for modifying the defects of SOX Section 806, but I will also present my suggestions and ideas for future amendments.

At last, I make a conclusion on all discussions. My expectations on this dissertation are to make the whistleblower protection in SOX Section 806 more complete, to avoid corporate employees from being afraid of disclosing public companies' fraudulent activities, to strengthen stockholders' confidence in corporate business operation, and further to promote the integrity of the public stock market.

## *B. What Corporate Governance Is and What Role It Plays in a Corporation or an Organization*

### 1. History of Corporate Governance

In recent years, the term of corporate governance has been spoken of by legal academics and economists in diverse discussions due to a series of corporate scandals and financial catastrophes. In the early 1800s of American public company's history, few people talked about the role that corporate governance can play in the public company owing to the cohesion of organization, ownership, and the limitation of org-



anizational size.<sup>1</sup> During that time, the corporation was managed by its shareholders, who not only had the ownership of company, but also took the manager's duties for their responsibilities.<sup>2</sup> However, as state legislatures canceled the restrictions on the purpose of company listed on the companies' charter, the corporation was permitted to do any business in lawful purposes, and this change resulted in the growth of the size and complexity of company.<sup>3</sup> Observing this transformation, in 1930, the notable economists Berle and Means stated that the separation of ownership and control gradually becomes the specific characteristic for the corporation. As they said, "The central mass of the twentieth century American economic revolution is a massive collectivization of property devoted to production, with an accompanying decline of individual decision-making and control, and a massive dissociation of wealth from active management."<sup>4</sup> At that time, the ownership of company was characterized not only by "a large numbers of shareholders,"<sup>5</sup> but also by "dispersal of shareholdings."<sup>6</sup> It means "patterns of shareholdings in which no single individual, firm, or compact group owns

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<sup>1</sup> Robert Charles Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treaties*, 94 Harv. L. Rev. 561, 562 (1981).

<sup>2</sup> *Id.*

<sup>3</sup> William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale L.J. 663, 664 (1974).

<sup>4</sup> Adolf A. Berle & Gariner C. Means, *The Modern Corporation and Private Property* 129 (rev. ed. 1968).

<sup>5</sup> Melvin A. Eisenberg, *Corporations and Other Business Organizations* 154 (2005).

<sup>6</sup> *Id.*

more than a tiny fraction of a corporation's stock."<sup>7</sup>

From Berle and Mean's points of view, the company's operation may be no longer controlled by its shareholders, who actually have the ownership of corporation, but the managerial power is transferred to corporate managements. In this way, even though shareholders are the substantial owners of company, they do not have actual power to manage the corporation and make a decision regarding business affairs. By contrast, corporate managers do not own the corporation, but they do have power to control all business matters and affect the company's performance. Due to this phenomenon, Berle and Means commented that the separation of ownership and control may cause the consequence of diverged interests. This means corporate managers probably will not devote themselves to promoting business and putting focus on making the maximum profit for the corporation and its shareholders. Though, they are inclined to pursue their own pecuniary gains and private benefit at the expense of shareholders' interests.<sup>8</sup>

This danger is called the agency cost in the academic area.

## 2. Definition of Corporate Governance

Since corporate governance has become a prevalent term followed by entrepreneurial corruption, academic fields employ a variety of means to define corporate governance. It not only makes the term of corporate governance have flexible usage in

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<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

different fields, but also shows this term's multi-faceted definitions in different situations. Generally speaking, corporate governance is able to be defined as "the system by which companies are directed and controlled,"<sup>9</sup> or can be described as "the set of structures and behaviours by which a company or other entity is directed and managed."

<sup>10</sup> The definition made by the Organization for Economic Cooperation and Development (OECD) states that corporate governance provides "the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."<sup>11</sup> In addition, it says that corporate governance should "provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring."<sup>12</sup> Therefore, good corporate governance can improve economic efficiency; also, it is able to enhance investors' confidence in companies' operation and the integrity of the financial market, to decrease transaction costs, and to avoid potential investment risks.<sup>13</sup> In the academic field, there are two theories employed to study corporate governance; one is called the communitarianism theory, and the other

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<sup>9</sup> Committee on the Financial Aspects of Corporate Governance (chaired by Sir Adrian Cadbury), *Report* (1992), para 2.5.

<sup>10</sup> Jane Diplock, *Corporate Governance – Principles & Public Policy*, <http://www.Sectioncom.govt.nz/speeches/2003/jds031103.shtml?print=true> (last visited Nov. 8, 2010).

<sup>11</sup> Organization for Economic Cooperation and Development, *OECD Principles of Corporate Governance* 11 (2004), <http://www.oecd.org/dataoecd/32/18/31557724.pdf>.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

is the contractarianism theory.

a. Communitarianism

Under the communitarianism theory, the goal of corporation is not only to maximize shareholders' fortunes and to promote their benefit, but it has to consider other stakeholders' interests. "Stakeholders are seen as those who have a formal, official, or contractual relationship with the corporation, and without whom the corporation could not function."<sup>14</sup> Primary stakeholders include financiers, customers, suppliers, employees, and shareholders; however, other stakeholder theorists intend to cover communities.<sup>15</sup> Typically, corporate managers have social responsibilities beyond those duties originally owed to shareholders. It means that as corporate managers make decisions on business policies, they are obligated to consider other stakeholders' benefit at the same time, not simply think about shareholders' interests. Stakeholders' benefit is advocated by communitarians, and is guaranteed under legislative protection.<sup>16</sup> Under communitarianism, because communitarians put focus on employees' loyalty to the company, several features are valued by the firm. For instance, the communitarian regime emphasizes corporate employees' integrity, identity, solidarity, and empat-

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<sup>14</sup> Andrew Keay, *Stakeholder Theory in Corporate Law: Has it Got What it Takes?* 9 Rich. J. Global L. & Bus. 249, 259 (2010).

<sup>15</sup> *Id.*

<sup>16</sup> Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of all Worlds*, 33 Vand. J. Transnat'l L. 829, 833-36 (2002).

hy for the company.<sup>17</sup> Those features “give employees greater incentives to develop and supply firm-specific human capital.”<sup>18</sup> In addition, they promote team efforts and make employees stand on the same side with the company when it has suffered financial distress or other business threats.

Even if communitarians think managers should consider non-shareholders’ interests when making corporate policies, communitarianism still has some drawbacks to think over. First, communitarians emphasize the function of an individual’s identity in the corporation, but this cannot be active in a gigantic organization. A mammoth company restricts an individual to participate in activities that enable to develop personal identities. This type of company denies opportunities for an individual to form constructive identities.<sup>19</sup> Second, communitarians put emphasis on an employee’s loyalty to the company, but it suppresses an employee’s inspiration, creativity, and initiative in the workplace. This perhaps affects the company’s competition in the market, and deteriorates the vitality of the whole group.<sup>20</sup> Third, the communitarianism theory protects stockholders’ interests and assures stakeholders’ benefit; yet, in reality, when diverse interests conflict with each other, it is difficult to decide which interest is more im-

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<sup>17</sup> Elletta 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, 181 (2002).

<sup>18</sup> Fort & Schipani, *supra* note 16, at 834.

<sup>19</sup> *Id.* at 837.

<sup>20</sup> *Id.*

portant than others, and is tough to safeguard these interests at the same time. As Callahan states this consequence as follows:

“Another drawback of communitarianism is the inevitable divergence of the interests of various claimants, which makes them virtually impossible to protect simultaneously. Large bureaucratic organizations, in particular, simply cannot be operated for the benefit of all stakeholders and may come to operate primarily to further powerful, centralized interests.”<sup>21</sup>

In this way, it can be concluded that different interests can coexist, but they are unable to be protected concurrently. While these interests are crashing against with each other, the most influential and vigorous one is going to win out.

#### b. Contractarianism

On the contrary, in the contractarianism theory, contractarians think corporate managers ought to put shareholders’ interests in the first place because they infer that when corporate managers take their efforts to maximize shareholders’ fortunes, non-shareholders’ benefit can be promoted simultaneously.<sup>22</sup> In the contractarianism theory, the relationship between the corporation and the shareholder is composed by a nexus of contracts, voluntary agreements, and market forces.<sup>23</sup> Contractarians tend to adjust or balance managers and shareholders’ interests by making use of voluntary contracts, agreements, and market forces.<sup>24</sup> Market forces, which consist of the capital

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<sup>21</sup> Callahan et al., *supra* note 17, at 182.

<sup>22</sup> Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 *Law & Contemp. Probs.* 9, 38 (1999).

<sup>23</sup> Callahan et al., *supra* note 17, at 179.

<sup>24</sup> Fort & Schipani, *supra* note 16, at 831.

market, the product market, and the managerial labor market, help shareholders observe corporate wrongdoing or examine inefficiencies of company's operation caused by managers' carelessness or ignorance, and then let shareholders be able to change subsequent contracts or agreements with the firm in time. The contractarianism theory depends upon sound public policy and complete law regime to protect and to strengthen the freedom of contract. Also, it can be facilitated by information transparency and efficient corporate operation.<sup>25</sup> Hence, the healthy market is the necessity for the contractarianism theory to operate well.

However, actually, many uncertain factors perhaps dampen or restrict the market to operate under a high expectation, and to become an ideal or efficient condition. For example, information asymmetry lets investors to make incorrect decisions, and makes them suffer potential risks of investment; the non-transparency market makes stockholders hesitate to go to the public stock market to purchase stocks owing to unforeseen situations; potential dangers of transactions let investors get away due to unanticipated damage. In addition, corporate fraud frightens shareholders from making contracts with the company because shareholders have had negative experiences on losing money. Further, as contracts are made in international business transaction, the barriers of language, legal regimes, and customs probably cause inefficient and poor contra-

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<sup>25</sup> Bradley et al., *supra* note 22, at 40.

cts. At times, property rights cannot be safeguarded because of the misunderstanding on the terms of contracts, and the confusion with domestic business matters.<sup>26</sup> Those are shortcomings of the contractarianism theory.

### 3. How Is Corporate Governance Practiced in Business Entities?

As mentioned above, corporate governance is the set of structures and behaviour by which a company or organization is directed and managed.<sup>27</sup> Yet, it is difficult to know if a corporation has followed a right direction to achieve its goals, and obeyed regulated policies; if corporate managers are reckless of doing business or are trying to embezzle a company's capital for pursuing private interests, those are issues that need to be urgently resolved. Owing to these concerns, the concept of monitoring gradually becomes an important subject matter for corporate governance. As Foucault in his book says, "Our society is one not of spectacle, but of surveillance."<sup>28</sup> This phenomenon is able to be observed by extensive legal punishment on criminal activities happening in society. Nonetheless, nowadays, this proverb also transforms to a maxim that gives the state authority to regulate the disorder of corporate operation in the United States. In view of the surveillance cannot self-effectuate, it still needs other systems or policies to make it active. Thus, for this reason, some mechanisms and agencies

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<sup>26</sup> *Id.* at 39-40.

<sup>27</sup> Diplock, *supra* note 10.

<sup>28</sup> Michel Foucault, *Discipline and Punish: The Birth of the Prison* 215-16 (1977).



are required to act as indispensable devices to enforce the action of monitoring.

Among diverse mechanisms used to monitor corporate activities and managements, the primary and traditional tools probably include:<sup>29</sup>

- Companies' board of directors supervising managers;
- Accounting firms auditing publicly-held corporations' financial statements or related materials;
- Credit-rating agencies helping the public to estimate which company is worth to be invested;
- Financial markets acting as an indirect punishment on managers for poor business performance;
- Stock exchange markets promulgating rules to promote corporate governance and regulating IPOs of public companies;
- The Securities and Exchange Commission (SEC) regulating stock markets, watching over the disclosure of corporations' substantial information, and making policies with regard to corporate governance for publicly-owned companies.

Besides, Macey said that whistleblowing is quirky governance on monitoring corporate operation, and perhaps plays a limited role in monitoring. However, in reality, whis-

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<sup>29</sup> Jonathan R. Macey, *Corporate Governance: Promises Kept, Promises Broken* 46 (2008).

whistleblowing gradually takes an influential position on enhancing corporate governance due to a series of corporate scandals.<sup>30</sup>

Above mechanisms can be divided into internal and external corporate governance. Internal governance contains the supervision of board of directors, the accountant and auditor, the shareholder and the shareholder activism, and corporate whistleblowing. External governance includes the creditor and the credit-rating agency, the investment bank and the securities analyst, corporate takeover, and the SEC's examination. The function of these mechanisms is going to be analyzed below.

a. Internal Corporate Governance

i. The Board of Directors

Followed by the guideline of the Revised Model Business Corporation Act (RMBCA) that describes the authority of board of directors, it states “[a]ll corporate power shall be exercised by or under authority of, and the business affairs of a corporation shall be managed under the direction of a board of directors.”<sup>31</sup> Also, in Delaware General Corporation Law (DGCL), it says “[t]he business and affairs of every corporation organized ... shall be managed by or under the direction of a board of directors ...”<sup>32</sup> In this way, the duty of board of directors on corporate governance is tw-

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<sup>30</sup> *Id.* at 165.

<sup>31</sup> RMBCA § 8.01(b).

<sup>32</sup> DGCL § 141(a).

ofold. First, they are experienced advisors for corporate managers when making decisions or business policies. Second, they are sincere monitors or gatekeepers of corporate management.<sup>33</sup> The board of directors holds fiduciary duties to stockholders when they manage the company and execute policies. Those fiduciary duties include the duty of loyalty that demands the board of directors to place shareholders' interests in the first place beyond their private interests, and the duty of care that requires the board of directors to do what an ordinary prudent person will do as they are in the same circumstance and position. Nevertheless, most important of all, the board of directors holds the duty of supervision. This duty not only asks the board of directors to confirm the authenticity of disclosed information, but also requests directors to pay more attention to corporate performance, operation, and to make sure financial statements and accounting are accurate.<sup>34</sup> Hence, those can be inferred that the board of directors represents shareholders' interests, and has an important function on corporate internal control.

#### ii. Accountants and Auditors

Accountants and auditors are also parts of monitoring mechanisms in corporate governance. Accountants take duties to report, gather, and compile corporate financial statements, and to make companies' accounting accurate. In order to avoid accountants from making mistakes on financial statements, auditors' duties are to rev-

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<sup>33</sup> Macey, *supra* note 29, at 53.

<sup>34</sup> Kenneth A. Kim & John R. Nofsinger, *Corporate governance* 42 (2d ed. 2007).

iew these financial materials, find out errors in business documents, and then correct these faults. During the process of examination, because auditors can access confidential information, which others are hardly able to know, this advantage makes it easier for them to find the authenticity of financial documents, and to decide whether these materials show genuine financial conditions of corporations. Financial documents created by accountants and auditors play a critical role in corporate governance since companies' creditors, investment banks, and other interest groups depend on this information to realize corporate performance and business affairs. Shareholders rely on these materials to make decisions and anticipate the profit or cost for their investments. Importantly, accountants and auditors can disclose malfeasance committed by companies as soon as possible in order to prevent unlawful actions from going worse and causing losses to stockholders as they examine those financial statements.<sup>35</sup>

### iii. Shareholders and Shareholder Activism

Corporate shareholders can be seen as a good mechanism for corporate governance when they fervently participate in companies' business matters. Shareholders' behaviour can be regarded as the shareholder activism as the following situations are satisfied. First, when shareholders like to present their opinions about business operation and try to affect managers' decisions, these actions can indicate that shar-

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<sup>35</sup> *Id.* at 25.

eholders are acting as a form of shareholder activism. Second, as shareholders regularly attend annual meetings, eagerly participate in voting, or have an experience of submitting a proposal in the meeting, these activities reveal that shareholders are active in business affairs.<sup>36</sup> Third, with respect to the issue of public policy or the reform of corporate operation, shareholders have private opportunities to discuss or enjoy public communication with the board of directors or managements, these can be inferred that shareholders have played an active role in corporations.<sup>37</sup> Hence, when stockholders positively participate in business affairs, and have chances to voice their thoughts and comments to the upper management, their actions can be named as the shareholder activism. Usually, this activism is exercised by three categories of shareholders: individual shareholders, large shareholders (stockholders who own a big portion of shares of companies) and institutional shareholders.<sup>38</sup>

In the U.S., institutional shareholders include public and private pension plans, banks, investment corporations, insurance companies, and foundations.<sup>39</sup> The fact that institutional investors' actions act as the shareholder activism is because "institutio-

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<sup>36</sup> Kim & Nofsinger, *supra* note 34, at 90.

<sup>37</sup> European Corporate Governance Institute, Shareholder Activism, <http://www.ecgi.org/activism/index.php> (last visited Sep. 10, 2010).

<sup>38</sup> Kim & Nofsinger, *supra* note 34, at 90.

<sup>39</sup> Eisenberg, *supra* note 5, at 155-56.

nal shareholdings tend to be concentrated rather than dispersed.”<sup>40</sup> As Eisenberg describes:

“The increased concentration of shareholdings ... by institutional investors, has set the stage for a dramatic increase in the shareholder role in the modern publicly held corporation. As shareholders get more sophisticated, the costs of playing an active shareholder role decrease. As shareholdings get larger, the cost-benefit ratio for investing time in playing that role improves. As shareholdings become more concentrated, coordination between shareholders becomes easier.”<sup>41</sup>

Hence, it is cost-effective for institutional investors to spend a substantial amount of time on corporations’ business affairs.

Institutional shareholders play several meaningful roles in companies’ operation. They can access corporate affairs, such as corporations’ governance structures, proposed structural changes, and overall managements’ performance. Also, they may take a leading role in adjusting companies’ policies or business strategies, and decide the replacement of chief executive officers (CEOs).<sup>42</sup> Yet, a number of legal and social forces restrict the role of institutional investors in the U.S. corporate governance.<sup>43</sup> These factors hamper the effectiveness of institutional shareholders to take participate in the process of shareholder activism. Among social forces, the conflict of interest is the

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<sup>40</sup> *Id.* at 157.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at 160-61.

<sup>43</sup> *Id.* at 157.

paramount problem, and it arises from two aspects of conflict.<sup>44</sup> First, “many institutional investors have tied to management that inhibit voting against management’s wishes.”<sup>45</sup> Given that institutional investors have a variety of commercial contacts with corporations, they tend to support managements’ proposals instead of ruining their business. Second, the Wall Street Rule – If you don’t like management, sell – has become a cultural norm among institutional investors. Institutional investors are inclined to support managements’ decisions and business policies, if they choose not to sell their shareholdings.<sup>46</sup>

As to legal forces, the Employee Retirement Income Security Act (ERISA) imposes some fiduciary obligations upon the managers of pension plans. ERISA requires that “whoever exercises discretion over plan assets must manage those assets solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefit to participants and their beneficiaries.”<sup>47</sup> ERISA asks the trustees of pension plans to be well-informed and take each decision seriously. Under ERISA, the Wall Street Rule cannot be adopted, and those exercising plan assets have to put beneficiaries’ interests in the first place. In addition to social and legal forces that restrict the effectiveness of institutional investors in corporate governance, the free-rider issue

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<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* at 158.

<sup>47</sup> *Id.* (citation omitted).

is another factor to confine the function of institutional shareholders.<sup>48</sup> Eisenberg describes this issue as follows:

“The significance of limited holdings by any given institutional investor in any given portfolio corporation is that it reduces the investor’s cost-benefit ratio for active involvement, and leads to a free-rider problem.... The free rider problem shows that institutional investor are not likely to engage in monitoring or voting activity that (i) goes beyond the monitoring and voting activity in which the investor can be expected to engage in the normal course of its shareholding capacity; (ii) would require significant expenditures; (iii) would increase the value of the institution’s holding in its portfolio companies by less than the costs of the activity; and (iv) would result in no private economic benefit to the investor beyond the increased value of that holding.”<sup>49</sup>

Due to limited holdings of firms’ shares, institutional shareholders are inclined to consider the cost-benefit ratio, and decide the extent that they would like to involve in corporate operation.

#### iv. Corporate Whistleblowing

Whistleblowing is able to be viewed as quirky corporate governance as Macey has mentioned above.<sup>50</sup> Initially, whistleblowers are alienated by social groups because not only are they seen as tattletales, but their intentions are also considered suspicious and vindictive.<sup>51</sup> Though, when a series of corporate financial scandals were disclosed by corporate employees in the beginning of this century, the attitude of the public toward whistleblowers gradually changed and did not disdain them any-

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<sup>48</sup> *Id.* at 159.

<sup>49</sup> *Id.*

<sup>50</sup> Macey, *supra* note 29, at 165.

<sup>51</sup> Gerald Vinten, Whistleblowing: Subversion or Corporate Citizenship? 4-5 (1994).



more. Whistleblowers are regarded as folk heroes and pour new power into reforming corporate governance, which are not expected historically. Once Macey states, “Whistleblowers are now thought of as an integral component of the recently regulated system of corporate governance that is supposed to result in better monitoring and control of managerial misconduct (agency costs) in large publicly held corporations.”<sup>52</sup> Observing recent corporate misconduct committed by managers and cooperative entities, it cannot be denied that employees are the most efficient instrument to do internal control and to detect organizational illegitimacy when the system of corporate supervision has collapsed.

#### b. External Corporate Governance

##### i. Creditors and Credit-Rating Agencies

Shareholders care about corporate performance because they pour their money into companies and look forward to gaining plentiful repayments. Due to this expectation, stockholders can be viewed as one type of monitors to promote corporate governance. As for the gathering of capital, not only can companies obtain funds from the public, but they also can turn to other lenders to borrow indispensable capital. These lenders are called creditors. Basically, there are two kinds of creditors; one is called institutional lenders, like commercial banks, and another is bondholders. Bond-

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<sup>52</sup> Macey, *supra* note 29, at 166.

holders are individual lenders since they buy corporate bonds publicly issued by companies. Like corporate shareholders can trade their shares in the public stock market, creditors also can sell their loans or bonds to other institutions or investors. When the performance of companies is influenced by poor management, the price of bonds and the value of loans is going to decline, and that is the same as the value of stocks. Worse, when firms collapse owing to awful corporate operation, creditors' investments probably turn to nothing, and the remnant will be zero.<sup>53</sup> Neither shareholders nor creditors are willing to bear a huge amount of losses. Then, creditors similarly play an important role in monitoring corporate operation, and indirectly promoting corporate governance in order to make sure their investments will be repaid at last.

At times, corporations have to establish a close relationship with specific banks because, on the one hand, they can get a lower interest rate of loans, and on the other hand, it is easier to negotiate the debt contract with a single creditor than with separate lenders, such as bondholders. For the sake of gaining a satisfactory interest rate, companies are required to disclose confidential information to institutional lenders. In this way, banks have more opportunities to estimate if corporations have healthy financial conditions and admirable business performance.<sup>54</sup> As to an individual bondholder, he/she fails to have such power to scrutinize corporations' affairs. Thus, he/she needs as-

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<sup>53</sup> Kim & Nofsinger, *supra* note 34, at 75.

<sup>54</sup> *Id.* at 77.

sistance from credit-rating agencies to help him/her realize financial conditions of invested companies and make decisions. Credit-rating agencies can resolve the problem of information asymmetry, and provide an individual lender with information regarding the credibility of borrowers.<sup>55</sup> Therefore, not only do bondholders have a good chance to examine and evaluate corporate operation, but they also do not fear of being damaged because of insufficient information to make decisions.

#### ii. Investment Banks and Securities Analysts

The function of investment banks is to assist corporations in selling newly-created securities and raising funds. When private companies want to become publicly-traded firms, investment banks give them a hand to design a new stock and help those companies to sell stocks in the public market. This process is called underwriting, and investment banks are named as underwriters. In addition, although firms have been publicly-held companies, at times, they still need additional capital to continue business or prepare for upcoming expansions. In this way, public companies still require the services of investment banks to raise money from the public market, and make their plans or tactics practicable.<sup>56</sup> As regards securities analysts, their primary work is to evaluate securities and provide recommendations about the time of purcha-

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<sup>55</sup> United Nations Conference on Trade and Development, Buenos Aires, Argentina., Jan 2008, *Credit Rating Agencies and their Potential Impact on Developing Countries* 1.

<sup>56</sup> Kim & Nofsinger, *supra* note 34, at 58.

sing and selling stocks. Securities analysts' reports and recommendations play a critical role in influencing the prices of corporate stocks in the public market;<sup>57</sup> further, these analysts are able to make a forecast of earnings on investment and assist their clients in making a decision regarding whether to purchase or sell stocks.<sup>58</sup>

As a result of having a function on the disclosure of information, both investment banks and securities analysts hold the positions to promote corporate governance. As investment banks design a new stock for clients, banks not only can assess companies' structures, financial conditions, and business performance, but they also can simultaneously provide information and disclose potential risks about investment to the public. Likewise, when securities analysts provide recommendations in regard to the purchase or selling of stocks for clients, securities analysts are placed in the better position to approach information than the public.<sup>59</sup> Both investment banks and securities analysts have a chance to monitor companies and detect corporate irregularity earlier. Then, investment banks and securities analysts can be seen as an integral part of external corporate governance.

### iii. Corporate Takeovers (The Market for Corporate Control)

Mergers and Acquisitions (M&A) are able be regarded as mechanis-

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<sup>57</sup> U.S. Securities and Exchange Commission, <http://www.Section.gov/divisions/marketreg/Sectionuritiesanalysts.htm> (last visited Dec. 4, 2009).

<sup>58</sup> Kim & Nofsinger, *supra* note 34, at 58.

<sup>59</sup> *Id.*

ms to enhance corporate governance. When corporate managers cannot do a good job on promoting companies' performance or breach their fiduciary duties to stockholders because of pursuing self-interest instead of investors' benefit, there is a high possibility for managers to be taken over by other corporations and lose their positions. Due to the fear of being replaced, potential corporate takeover might be seen as a disciplinary measure to ensure that not only will managers do their best for companies' interests, but also managerial authority will not be abused because managers urge to go for self-interest and to cheat shareholders' investments.<sup>60</sup>

#### iv. Role of the SEC

Whether the SEC is able to enhance corporate governance, it still leaves several arguments in academic fields. Originally, the purpose to establish the SEC was because the U.S. government tried to fix the crisis of investors' confidence under economic depression during the early 1930s. Federal government expected the SEC can become the investor's protector, and take efforts to restore investors' confidence in the public stock market, and to regain their passion for investment. However, whether this function can be practiced by the SEC as Congress originally expected, the answer is still unclear, and the debate continues until today.<sup>61</sup>

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<sup>60</sup> Michael Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. of Fin. 831, 831-80 (1993).

<sup>61</sup> Kim & Nofsinger, *supra* note 34, at 125.

Even though the role of the SEC is still arguable, I take a positive position on the contribution of the SEC because its regulations and rules can help rectifying companies' misconduct and maintaining the order of the financial market. For example, when the SEC takes actions against corporations for the violations of securities laws or regulations, the value of corporate stocks is going to decline instantly as the SEC's punishment is widely reported to the public.<sup>62</sup> The SEC's penalty can remind corporations that good corporate governance will survive their business reputation; otherwise, damage or the collapse of business is expectable. Thus, the SEC not only has a function to give a warning and prevent wrongdoings from happening in public companies, but also can regulate the disorder of the financial market and enhance investors' confidence in the operation of the national economic system.

#### 4. Effective Whistleblowing Can Save Weak Traditional Corporate Monitors

As described above, different mechanisms of corporate governance are divided into internal and external monitors. Each character has its own specific function to promote corporate governance. Good corporate governance keeps corporate operation on the right track and brings benefit to shareholders, employees, and further to the public.<sup>63</sup> Since those monitors supervise companies' activities, these actors make cor-

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<sup>62</sup> Mahmoud M. Nourayi, *Stock Price Responses to the SEC's Enforcement Actions*, 13 J. of Acct. & Pub. Pol'y 333, 333-47 (1994).

<sup>63</sup> Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 Yale L.J.

porate governance more complete and develop a sound monitoring system. Take the board of directors for example. The duty of board of directors is to monitor senior managers and prevent fraudulent conduct from harming the interests of shareholders and firms. The board of directors represents shareholders to assure their interests because stockholders in public firms are dispersed and diverse, this specific characteristic dampens shareholders' function to monitor corporate management.<sup>64</sup> Similarly, the accounting industry plays a critical role in supervising companies' operation and enhancing corporate governance. By scrutinizing corporate financial documents, accountants and auditors can access confidential materials more easily than ordinary people, and is able to rapidly detect corporate misconduct.<sup>65</sup> As to governmental securities agencies, they help shareholders keep an eye on whether corporations fulfill their obligations to disclose necessary and sufficient information to the public, and impose punishment on those companies as they violate securities laws or related regulations.<sup>66</sup>

Why do these mechanisms promote corporate governance effectively? The primary feature among them probably is their independence. Independent directors on the board execute their duties by standing outside corporate systems, and provide dispass-

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857, 863 (1984).

<sup>64</sup> Joan MacLeod Heminway, *Enron's Tangled Web: Complex Relationships; Unanswered Questions*, 71 U. Cin. L. Rev. 1167, 1170-74 (2003).

<sup>65</sup> Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L.Econ. & Org. 53, 54 (1986).

<sup>66</sup> 15 U.S.C. § 78m (2010).

ionate supervision on the management.<sup>67</sup> Accountants and auditors coming from accounting firms with good reputations perform their duties detachedly, examine corporate business materials thoughtfully, and provide conscientious and careful monitoring.

<sup>68</sup> The SEC makes detailed rules and policies to regulate the financial market. It supervises companies and ensures they are doing business on the right track. Likewise, the SEC sustains investors' confidence in corporate operation, and promotes the transparency of the public stock market.<sup>69</sup>

Ostensibly, it seems that those monitors' actions will not be affected by companies' conduct due to independence; however, being the outsider is the obstacle for them to oversee corporate activities, and that has a significant impact on those monitors to obtain accurate information and do efficient supervision.<sup>70</sup> This means monitoring actors have to depend on the information provided by corporate management to practice their duties of inspection.<sup>71</sup> This information asymmetry weakens the function of monitors, and reduces their efficiency to act as the mechanisms of corporate governance.

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<sup>67</sup> Melvin A. Eisenberg, *Corporate Governance: The Board of Directors and Internal Control*, 19 *Cardozo L. Rev.* 237, 244-50 (1997).

<sup>68</sup> John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 *B. U. L. Rev.* 301, 308-10 (2004).

<sup>69</sup> 15 U.S.C. § 78m (2010).

<sup>70</sup> Peter C. Kostant, *Breeding Better Watchdogs: Multidisciplinary Partnerships in Corporate legal Practice*, 84 *Minn. L. Rev.* 1213, 1237 (2000).

<sup>71</sup> Lawrence E. Mitchell, *Structural Holes, CEOs, and Informational Monopolies*, 70 *Brook. L. Rev.* 1313, 1349-50 (2005).



Even though corporate executives or subordinate managers agree to disclose information, sometimes, this information is deficient, or has been distorted and filtered by managements. In this way, traditional corporate monitors fail to know companies' actual financial conditions thanks to insufficient information.<sup>72</sup>

In the worse situation, as corporate executives purposely hide, block, or misrepresent information, their purposes are apparent to hinder the inspection of these monitors. In this circumstance, the public cannot receive accurate information until the explosion of corporate financial crisis or the collapse of companies. Those consequences probably cause social problems and bring damage on the society. Hence, deficient access to corporate information is the central issue for federal government to think over why traditional mechanisms of corporate governance cannot deter corporate scandals from happening again.

#### 5. How to Resolve the Problem of Information Asymmetry – Making Using of Corporate Employees as the Monitor

Few people think that corporate employees can be employed as a mechanism to monitor companies' operation and oversee the management. However, observing recent corporate corruption, the lower or middle level of employees indeed plays a significant role in disclosing employers' misconduct due to their familiarity of business.

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<sup>72</sup> John C. Coffee, Jr., *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 Va. L. Rev. 1099, 1144 (1977).

ss operation.<sup>73</sup> Corporate employees have a better information advantage than traditional monitoring actors since employees have more knowledge with regard to corporate business and are sensitive to ordinary activities occurring in companies.<sup>74</sup> Besides, concerning financial materials, professional employees are able to perceive and recognize inaccurate data immediately, and detect whether corporate actions have fallen outside the legal boundary.<sup>75</sup> Hence, it can be said that employees are the persons of foresight on mismanagement and any illegal actions committed by the management.

A recent research has showed that nearly one-third of economic crimes and fraudulent conduct occurring in companies were disclosed by corporate employees.<sup>76</sup> Nowadays, corporate employees not only are viewed as agents, who originally have to be loyal to their principles and be subject to their control, but they also are empowered to act as the representatives of public interest. In addition, employees are required to report corporate wrongdoing by timely methods, and do their best to decrease damage on shareholders and the public. In this way, how to set up a sound system to protect and encourage corporate employees to unveil employers' misconduct is an important subj-

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<sup>73</sup> Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime after Sarbanes-Oxley*, 81 Wash. U. L. Q. 357, 374 (2003).

<sup>74</sup> Ralph Nader et al., *An anatomy of Whistle Blowing*, in *Whistle Blowing: The Report of the Conference on Professional Responsibility* 3, 4 (1972).

<sup>75</sup> Richard Alexander, *The Role of Whistleblowers in the Fight against Economic Crime*, 12 J. Fin. Crim. 131, 131 (2004).

<sup>76</sup> Brickey, *supra* note 73, at 365.

ect matter to study.

### *C. What Is the Function of Whistleblower Protection in Corporate Governance?*

#### 1. Whistleblowing Employees Play a Critical Role in Recent Companies' Scandals

Observing recent corporate corruption, such as WorldCom, Enron, Symbol Technologies, and Kmart, whistleblowing employees surely have a critical function to disclose corporate misbehavior. In principle, corporate whistleblowers who share the knowledge of companies' irregularities can be categorized by three types. First, whistleblowing employees directly disclose corporate deceptive conduct to the public. Second, those employees disclose their information to traditional corporate monitors rather than to companies' executives or other managers. Third, whistleblowers do not turn to the public or traditional corporate monitors; yet, they seek assistance from companies' in-house consulting or supervising departments to report their detection of managers' misbehavior.<sup>77</sup>

The typical and the most successful whistleblowing on recent corporate scandals probably was Cynthia Cooper, who was the former vice president of internal auditing in WorldCom.<sup>78</sup> Cooper disclosed false accounting and directly spoke to WorldCom's board of directors in regard to this illegitimacy. As this scandal spread out to the public, the WorldCom's Board confessed to those accounting frauds and immediately disc-

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<sup>77</sup> Vinten, *supra* note 51, at 21-32.

<sup>78</sup> Richard Lacayo & Amanda Ripley, *Persons of the Year*, *Time*, Dec. 30, 2002, at 31-33.

charged WorldCom's CFO, Scott Sullivan, who alleged to manipulate financial cheating and had tried to deter Cooper from investigating financial wrongdoings.<sup>79</sup> Because of Cooper's endeavor and disclosure, Sullivan's fraudulent actions did not succeed, and Cooper cleared out the obstacle that blocked the disclosure of fraudulent accounting made by WorldCom's management.<sup>80</sup>

## 2. What Problems May Whistleblowing Employees Encounter as Disclosing Their Knowledge?

Corporate employees bear fiduciary duties to employers and to companies. Primarily, employees have duties of obedience, loyalty, and confidentiality when they keep employment relationship with organizations they serve. Among those duties, the duty of loyalty is the most important since it requires an employee

“to act solely for the benefit of the principal in matters entrusted to him, ... to take no unfair advantage of his position, ... and not to act or speak disloyally in matters which are connected with his employment except in the protection of his own interests or those of others.”<sup>81</sup>

Because the duty of loyalty asks employees to do everything that benefits their employers and organizations, whistleblowing that makes employees disclose corporate wrongdoing or employers' misconduct, conflicts with employees' fundamental duties ow-

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<sup>79</sup> Ken Belson, *WorldCom's Audacious Failure and Its Toll on an Industry*, N.Y. Times, Jan. 18, 2005, at C1.

<sup>80</sup> Alex Nyberg Stuart, *Whistle-Blower Woes*, CFO Mag. 51-54 (Oct. 2003), available at <http://www.cfo.com/article.cfm/3010455?f=related>.

<sup>81</sup> Restatement (Second) of Agency § 387 comment b (1958).

ed to employers and companies they serve.

When corporate employees decide to blow the whistle on employers' or companies' deceitful conduct, not only do they bear the risk of retaliation taken by employers, but their careers may also be devastated following their disclosures.<sup>82</sup> Retaliation appears in the form of wrongful termination, demotion, co-workers' harassment, the denial of advancement, or other manners of discrimination.<sup>83</sup> In employers' points of view, they rationalize adverse treatment on whistleblowing employees since employers want to sustain traditional values in the employment relationship. At times, Employers even assert that expelling is an inevitable means to keep employees loyal, avoid employees' morale from collapsing, maintain companies' internal supervising systems and procedures to work, and to reduce the likelihood that employers would be blamed by the public because of whistleblowers' intentional defamation.<sup>84</sup>

Besides bearing the threat of being retaliated against by employers, whistleblowing employees are also alienated by colleagues, and feel a lonely existence in the workplace. Likewise, Werhane observes, "The history of whistleblowers, most of whom have been fired, blackballed from their industry or profession, and have suffered pers-

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<sup>82</sup> Lois A. Lofgren, *Whistleblower Protection: Should Legislatures and the Courts Provide a Shelter to Public and Private Sector Employees Who Disclose the Wrongdoing of Employers?*, 38 San Diego L. Rev. 316, 317 (1993).

<sup>83</sup> *Id.* at 318.

<sup>84</sup> Martin H. Malin, *Protecting the Whistleblower from Retaliatory Discharge*, 16 U. Mich. J. L. Reform 277, 280 (1983).

onal problems.”<sup>85</sup> These personal problems include unaffordable legal expenses that employees spend against employers’ retaliatory actions;<sup>86</sup> also, those involve misfortunes of loss of homes and marriages.<sup>87</sup> Because of a high possibility to be blacklisted in professional areas, whistleblowing employees may find it difficult to seek other occupations after being terminated since prospective employers might be afraid of hiring discharged employees due to their disloyal records to previous employers.<sup>88</sup>

### 3. Insufficient Protection for Whistleblowers under SOX Section 806

#### a. Brief Overview of SOX Section 806

Following a series of corporate scandals and mismanagement in the wake of WorldCom, Enron, Global Crossing, Tyco, and other corrupt companies, in order to regain investors’ confidence in corporate operation and rebuild the accountability of the financial market, Congress enacted the Corporate and Criminal Fraud Accountability Act, which is also called the Sarbanes-Oxley Act (SOX),<sup>89</sup> to regulate ineffective corporate governance.<sup>90</sup> SOX sweepingly reforms the disclosure requirements in

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<sup>85</sup> Patricia H. Werhane, *Engineers and Management: The Challenge of the Challenger Incident*, 10 J. Bus. Ethics 605, 615 (1991).

<sup>86</sup> Lynne Dumas, *Blowing the Whistle*, *Woman’s Day*, Nov. 24, 1992, at 62.

<sup>87</sup> Andrew W. Singer, *The Whistleblower: Patriot or Bounty Hunter*, *Across the Board*, Nov. 1992, at 16, 21.

<sup>88</sup> Lofgren, *supra* note 82, at 317.

<sup>89</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (2010).

<sup>90</sup> Robert G. Vaughn, *America’s First Comprehensive Statute Protecting Corporate Whistleblowers*, 57 Admin. L. Rev. 1, 2 (2005).

federal securities laws for publicly-traded companies;<sup>91</sup> likewise, it provides motives and complete protection for employees bringing corporate financial frauds to light.<sup>92</sup> The whistleblower protection in SOX originated from the enactments of state and federal whistleblower laws during the late twentieth century<sup>93</sup> when the public's propensity was antagonistic and suspicious of the government and gigantic enterprises. However, the explosion of the latest corporate scandals was the crucial impetus for Congress to urge the birth of SOX.<sup>94</sup> The provision of whistleblower protection plays a significant role against companies' securities violation. Congress attempted to encourage corporate officers, directors, and employees to be foot soldiers to detect and deter corporate misconduct,<sup>95</sup> and required them to report irregularities occurring in the public company.<sup>96</sup>

SOX Section 806 states that

“[n]o company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 or that is required to file reports under Section 15(d) of the Securities Exchange Act of 1934, or any officer, employee, contractor,

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<sup>91</sup> Robert C. Brighton, Jr., *Sarbanes-Oxley: A Primer for Public Companies, and Their Officers and Directors, and Audit Firm*, 28 *Nova. L. Rev.* 605 (2004).

<sup>92</sup> Miriam A. Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes-Oxley Act for Employment Law*, 79 *Wash. L. Rev.* 1029 (2004).

<sup>93</sup> Elletta Sangrey Callahan & Terry Morehead Dworkin, *The State of State Whistleblower Protection*, 38 *Am. Bus. L.J.* 99, 99-115 (2000).

<sup>94</sup> Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 *Conn. L. Rev.* 915, 924-25 (2003).

<sup>95</sup> Valerie Watnick, *Whistleblower Protections under the Sarbanes-Oxley Act: A Primer and A Critique*, 12 *Fordham J. Corp & Fin. L.* 831, 832 (2007).

<sup>96</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (2010).

subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee...”<sup>97</sup>

This provision delineates the protected subject, the protected activity, and the regulated object that ought to be noticed, and those are going to be analyzed below:

i. Who Are to be Protected and be Regulated?

The protected subject in SOX Section 806 is employees. Although the statute does not clearly make a definition of employee, observing the legislative history and the statutory policy, it can be inferred that covered employees include current and former employees, and applicants.<sup>98</sup> As for covered employers, SOX not only applies to public corporations, but extends to contractors, subcontractors, and agents controlled or manipulated by those public firms.<sup>99</sup> Hence, the scope of protected subject and regulated object are quite broad, and the policy to shield applicants is an unprecedented breakthrough compared to other whistleblower statutes.<sup>100</sup> When covered employees determine to unveil corporate securities violation, they are not required to prove the wrongdoing actually occurs, but they have to show that they reasonably believe disclosed misconduct breaches federal securities laws, regulations, the SEC’s rules,

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<sup>97</sup> Sarbanes-Oxley Act of 2002 § 806(a), 18 U.S.C. § 1514A (a).

<sup>98</sup> 29 C.F.R. § 1980.101 (2010).

<sup>99</sup> *Id.*

<sup>100</sup> Marcia P. Miceli & Janet P. Near, *Blowing the Whistle* 15 (1992).



or regulated frauds.<sup>101</sup>

## ii. What Are to be Protected?

SOX Section 806 regulates covered employers cannot “discharge, demote, suspend, threaten, harass, or in any other manner discriminate” against employees who blow the whistle to federal regulatory agencies and courts, Congress, or someone who “has the authority to investigate, discover, or terminate misconduct” in the company.<sup>102</sup> Hence, protected activities are diversified; these activities not only include usual corporate punishment, but cover other unequal discrimination. Unlike former federal whistleblower statutes did not specify the outlet for employees to make a report,<sup>103</sup> SOX clearly provides legitimate channels for employees to disclose information about corporate wrongdoings. In SOX, employees are able to select federal regulatory or enforcement agencies, or any member or committee of Congress to share their knowledge on securities violations; or they are capable of choosing to make internal disclosure to someone in charge in the corporation.

## iii. How Is Whistleblowers to be Protected?

### (1) Process

When employees are retaliated against by employers thanks to th-

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<sup>101</sup> Sarbanes-Oxley Act of 2002 § 806(a), 18 U.S.C. § 1514A (a).

<sup>102</sup> *Id.*

<sup>103</sup> Elletta Sangrey Callahan & Terry Morehead Dworkin, *Who Blows the Whistle to the Media and Why: Organizational Characteristics of Media Whistleblowers*, 32 Am. Bus. L.J. 151, 153-54 (1994).

air disclosures, they are able to file a claim to the Department of Labor (DOL) in ninety days after getting a notice of adverse actions.<sup>104</sup> The DOL will hand the claim over to the Occupational Safety and Health Administration (OSHA) to investigate if employees' allegations are merited.<sup>105</sup> In the investigation, the employee has to "make a *prima facie* showing that the alleged protected activity was a contributing factor" for adverse actions taken by the employer.<sup>106</sup> As the employee's showing is satisfied, the employer has twenty days to meet OSHA from receiving the complaint in order to defend his/her position.<sup>107</sup> For the sake of meeting the employer's evidentiary duty, the employer has to show by "clear and convincing evidence that he[/she] would have taken the same unfavorable personal action in the absence of the protected activity."<sup>108</sup> When the employer cannot satisfy his/her burden of proof, and the OSHA investigator is also certain that a retaliatory action has been taken by the employer, the OSHA investigator will make a preliminary order for the employee to relieve his/her losses because of adverse action.<sup>109</sup> As receiving a preliminary order, both parties still can appeal the claim and ask for a hearing before an Administrative Law Judge (ALJ) in thir-

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<sup>104</sup> 29 C.F.R. § 1980.103 (2010).

<sup>105</sup> Procedures for the Handling of Discrimination Complaints under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, 29 C.F.R. § 1980 (2010).

<sup>106</sup> *Id.*; Airworthiness Directives, 68 Fed. Reg. 31 (Jan. 2, 2003) (to be codified at 14 C.F.R. pt. 39).

<sup>107</sup> Notice of Availability of a Funding Opportunity, 69 Fed. Reg. 52 (Jan. 2, 2004); Privacy Act of 1974, 69 Fed. Reg. 107 (Jan. 2, 2004).

<sup>108</sup> Airworthiness Directives, 68 Fed. Reg. 31 (Jan. 2, 2003) (to be codified at 14 C.F.R. pt. 39).

<sup>109</sup> *Id.*

ty days; otherwise, the employee's claim will be settled.<sup>110</sup>

In order to request a hearing before an ALJ, the employee has to ultimately prove by a preponderance of evidence,<sup>111</sup> and shows that (1) he/she has engaged in protected activities in Section 806, (2) the employer was aware of the protected activity, (3) he/she has suffered adverse employment actions, and (4) the protected activity was likely a contributing factor in the employer's decision to take adverse actions.<sup>112</sup> In order to avoid the time-consuming administrative procedure, Congress required OSHA to issue the final order in 180 days under this proceeding.<sup>113</sup> If the employee's claim still cannot be settled in this framed time, the employee is able to bring a civil suit to federal district court for a *de novo* review.<sup>114</sup>

## (2) Remedies

As for remedies, the statute describes that “[a]n employee prevailing in any action ... shall be entitled to all relief necessary to make the employee whole.”<sup>115</sup> The relief includes “(1) reinstatement with the same seniority status that the employee would have had, but for the discrimination; (2) the amount of back pay, wi-

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<sup>110</sup> Notice of Availability of a Funding Opportunity, 69 Fed. Reg. 52 (Jan. 2, 2004); Notice of Lodging of Consent Decree, Pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA”), 69 Fed. Reg. 106 (Jan. 2, 2004).

<sup>111</sup> Halloum v. Intel Corp., Case No. 2003-SOX-7, at 9-10 (Mar. 4, 2004).

<sup>112</sup> Welch v. Cardinal Bankshares Corp., Case No. 2003-SOX-15, at 34 (Jan. 28, 2004).

<sup>113</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (2010).

<sup>114</sup> *Id.* § 806(b)(1)(B), 18 U.S.C. § 1514A (b)(1)(B).

<sup>115</sup> *Id.* § 806(c)(1), 18 U.S.C. § 1514A(c)(1).

th interest; and (3) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.”<sup>116</sup> Hence, an employee blowing the whistle under SOX not only can be protected by being repaid his/her expenses against an employer’s retaliatory action, but also his/her original occupation will be assured and restored.

Due to sound whistleblower protection in SOX Section 806, it not only provides a motive for employees to unveil corporate securities violations without fearing of bearing discrimination, financial losses, and misfortunes, but it also ameliorates the deficiency of information asymmetry that happens in traditional mechanisms of corporate governance.

#### b. Inadequate Protection under SOX Section 806

Although SOX Section 806 provides the whole protection for employees who blow the whistle on corporate securities violations, some details have not been anticipated by Congress when it enacted the statute; these defects make SOX hard to achieve its statutory purposes. Observing the statistics compiled by the DOL,<sup>117</sup> it showed that covered employees have a low probability to be granted a preliminary order issued by OSHA and to receive satisfying relief. Even though employees file an appeal and ask for a hearing before an ALJ, they still fail to change their inferior positions

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<sup>116</sup> *Id.* § 806(c)(2), 18 U.S.C. § 1514A(c)(2).

<sup>117</sup> *Mahony v. Keyspan Corp.*, 2007 U.S. Dist. LEXIS 22042 at 2, 5 (S.D.N.Y. 2007).

and reverse unsatisfactory results. These phenomena might be inferred that traditional bias and hostility toward whistleblowers have appeared in the administrative procedure.<sup>118</sup> Below, I am going to exemplify several problems in SOX Section 806 that have been discussed by some commentators and legal scholars in academic articles.

#### i. Procedural Problems

##### (1) Problem of Timelines Obedience

SOX Section 806 has set up the framed time at each stage under the investigation of OSHA; the administrative agency designed these regulations favorably for whistleblowing employees. However, the DOL does not truly execute those timelines,<sup>119</sup> and this circumstance causes the imbalanced protection of interests between the employee and the employer.

##### (2) One-Side Submission and Issue of Accessing Witnesses

The procedure of investigation permits accused employers to make a submission to the OSHA investigator; yet, whistleblowing employees do not enjoy this right,<sup>120</sup> and this privilege results in information asymmetry. The one-side submission is harmful to employees because not only can inaccurate information be provided by employers, but those imprecise materials may also have a crucial impact on

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<sup>118</sup> Sarbanes-Oxley Whistleblower Complaints Docketed Before the U.S. Department of Labor, Office of Administrative Law Judges, Statistical Overview as of April 28, 2005.

<sup>119</sup> *Halloum*, *supra* note 111.

<sup>120</sup> Notice of Availability of a Funding Opportunity, 69 Fed. Reg. 52 (Jan. 2, 2004).

the investigator's decision. Besides, accused employers are able to freely access witnesses, and these actions probably affect the authenticity of evidence.

### (3) The Administrative Procedure Might be a Forced Waiting Period for Whistleblowing Employees

The administrative procedure is regarded as a forced waiting period for employees who suffer adverse actions. For example, when OSHA does not issue a final preliminary order to covered employees in 180 days, employees can file a civil lawsuit to federal district court for a *de novo* review. However, between the filing and the start of *de novo* review, damaged employees are forced to wait until the reviewing procedure begins. This waiting period frustrates damaged employees and exhausts their energies for litigation.<sup>121</sup>

#### ii. Substantive Problems

##### (1) Issue of Burden of Proof

As covered employees file a claim to the DOL, they have to prove that protected activities have been taken by their employers. As for the evidence, SOX does not describe what kind of evidence that employees have to present. However, observing former discrimination cases, courts might consent the plaintiff (employee) to

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<sup>121</sup> Watnick, *supra* note 95, at 841.

show discrimination with circumstantial evidence<sup>122</sup> or with proof of a pattern of past discrimination.<sup>123</sup> Nevertheless, when covered employees are the first person to disclose companies' wrongdoings, this type of evidence or information is not available for them to receive, and this situation increases the difficulty for employees to satisfy their burden of proof.<sup>124</sup>

## (2) Issue of Shifting of Burden of Proof

The shifting of burden of proof is another obstacle for whistleblowing employees to receive a satisfying result when filing a claim in SOX. As employees appeal the claim and request a hearing before an ALJ, they have to satisfy evidentiary duty by a preponderance of evidence to hold their positions.<sup>125</sup> Yet, due to a feeble position of employees to gather information, and employers' managerial power to discharge employees at any time, it is hard for employees to obtain persuasive evidence against employers' adverse actions. This inferior position raises the possibility that employees might lose their claims in the administrative procedure; likewise, it increases the difficulty for damaged employees to make up for losses thanks to the disclosure of corporate securities violation.

### iii. Difficulties to Practice SOX Whistleblower Protection

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<sup>122</sup> *Desert Palace, Inc. v. Costa*, 539 U.S. 90, 100-01 (2003).

<sup>123</sup> *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973).

<sup>124</sup> *Platone v. Atl. Coast Airlines Holdings, Inc.*, 2004 DOLSOX LEXIS 69, at 75-76 (Apr. 30, 2004).

<sup>125</sup> *Halloum*, *supra* note 111.

### (1) Pressure of Humiliation and Lay-Offs

Employees who disclose fraudulent activities taken by corporate managers have to bear the pressure from colleagues' harassment and suffer potential public disgraces. Besides, in the worst situation, it is highly probable that employees may be terminated after reporting irregularities, and then have no financial support to fight against dishonest employers and formidable companies.<sup>126</sup> These weak positions impose economic burdens and mental effects upon employees, and make them face unexpected and unknown consequences alone.

### (2) Asymmetry of Information and Limited Resources

Thanks to the inferior position to access information and witnesses in the procedure of investigation, and restricted resources to file a claim, it is hard for employees to challenge powerful, influential enterprises.<sup>127</sup> Corporate employers are placed in the advantageous position to access information, to receive corporate financial supports, and to be supplied by incomparable resources to refute employees' accusations. Hence, it can be observed that covered employees cannot call the shots in the administrative procedure under SOX whistleblower protection, and may have a difficult time fighting against employers and companies.

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<sup>126</sup> The protection of Sarbanes-Oxley is to help employees against publicly-traded corporations. *See* SOX, *supra* note 89.

<sup>127</sup> *Id.*



### (3) Few Witnesses to Share Knowledge of Fraud

Corporate whistleblowers have a dilemma as they have the knowledge with regard to deceitful conduct committed by companies. Whistleblowers do not like to share information with colleagues or supervisors since they fear to be betrayed by those people. Those whistleblowers may be seen as uncooperative<sup>128</sup> and unfriendly team players in the workplace, and are easily alienated by colleagues. In addition to being isolated by coworkers, whistleblowers also tend to alienate themselves. Because of feeling frustrated in the working atmosphere, whistleblowers have no passion for working and depreciate the values in the employment relationship. They rarely participate in companies' activities since they want to feel safer in the place of work; yet, they are inclined to take more time on gaining information about corporate wrongdoings, and strengthen their positions on the disclosure as filing a claim against companies.<sup>129</sup> Thus, it may be said that whistleblowers are alone in the way of disclosure on corporate irregularities.

### (4) Mandatory Arbitration Agreement

A mandatory arbitration agreement is an obstacle that makes whistleblower protection in SOX unsuccessful. Because at least one court's decision stated corporate whistleblowers are subject to private arbitration agreements, this preced-

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<sup>128</sup> *Platone, supra* note 124.

<sup>129</sup> *Id.* at 77.

ent made SOX Section 806 cannot achieve its statutory purpose even if SOX is a typical means to resolve employment disputes, and prevent employees from being retaliated against by employers.<sup>130</sup> Though, courts' positive positions on mandatory arbitration agreements are harmful to SOX Section 806 because those preliminary agreements tend to be unfavorable to damaged employees.<sup>131</sup>

## **Chapter II. The Background and Various Perspectives of Whistleblowing**

### *A. What Is Whistleblowing and Who Can Blow the Whistle?*

In order to define whistleblowing, it is not easy to find a specific term and ascertain its meaning in recent English dictionaries. In addition, the writer may suppose that he/she has misspelled the word since the word processing is unable to recognize this term. However, the writer's wonder is rationale because the term of "whistleblowing" is newly-created and combined by the word – "blow" and "whistle". Once a court traced back the source and stated that "whistleblowing" derived from the English bobby's action, which tried to get attention from the public and other law enforcement officers when he/she detected the occurrence of crimes in danger areas.<sup>132</sup> Unlike the alarm given by the police when he/she perceives crimes have been committed, currently, "whistleblowing" is being used more often on describing the disclosures of private

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<sup>130</sup> Boss v. Salomon Smith Barney, Inc., 263 F. Supp. 2d 684, 685 (S.D.N.Y. 2003).

<sup>131</sup> Cherry, *supra* note 92, at 1082-83.

<sup>132</sup> Daul v. Combined Ins. Co., 621 N.W. 2d 163, 167 n.4 (S.D.2001).

corporations' or organizations' unlawful activities made by their employees, managers, and other professional parties.

Hence, what is the meaning of whistleblowing, and which actions can be covered?

Several legal scholars try their best to make a definition for the sake of clarifying the term of whistleblowing. For example, Elliston describes that the act of whistleblowing occurs when four conditions are met.

“First, an individual performs an action or series of actions intended to make information public; second, the information is made a matter of public record; third, the information is about possible or actual, nontrivial wrongdoing in an organization; fourth, the individual who performs the action is a member or former member of the organization.”<sup>133</sup>

Rubinstein notes that whistleblowing is “an attempt by an employee of a corporation or business firm to disclose what he or she believes to be wrongdoing in or by the organization.”<sup>134</sup> Similarly, Jones states “[w]histleblowing is an employee’s disclosure of his supervisor’s or employer’s illegal activities to management or law enforcement officials.... [O]bjectives of whistleblowing are ‘to expose, deter, and curtail wrongdoings.’”<sup>135</sup> In addition, Berry describes that “[w]histleblowing is an avenue for maintaining integrity by speaking one’s truth about what is right and what is wrong. It is a strategy for asserting rights, protecting interests, influencing justice, and righting wrongs.

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<sup>133</sup> Frederick Elliston et al., *Whistleblowing Research: Methodological and Moral Issues* 15 (1985).

<sup>134</sup> Kevin Rubinstein, *Corporate Governance Five Years After Sarbanes-Oxley: Is There Real Change?*, 52 N.Y.L. Sch. L. Rev. 637, 640 (2007/2008) (citation omitted).

<sup>135</sup> Julie Jones, *Given a Little Whistle: The Need for a More Board Interpretation of the Whistleblower Exception to the Employment-At-Will Doctrine*, 34 Tex. Tech L. Rev. 1133, 1136 (2003).

Whistleblowing is the voice of conscience.”<sup>136</sup>

Even though these scholars use a variety of ways to describe whistleblowing, the function and the goal of whistleblowing are the same. That is, a discloser not only wants to be a reminder of organizations he/she serves, but attempts to make those bodies aware that illegitimate, immoral or fraudulent activities should be ended since misconduct has been detected and cannot be hidden any more. This discloser is called a “whistleblower” and can be defined when someone (1) takes actions stemming from appropriate moral motives of preventing unnecessary harm to others; (2) uses all available internal procedures for rectifying the problematic behaviour before public disclosure, although special circumstances may preclude this; (3) has evidence that would persuade a reasonable person; (4) perceives serious danger that can result from the violation; (5) acts in accordance with his or her responsibilities for avoiding and/or exposing the moral violation; (6) takes actions having some reasonable chance of success.<sup>137</sup> As to the violation that a whistleblower intends to preclude from occurring and causing harm to others, sometimes, it is physical, like “dumping toxic wastes or marketing unsafe drugs and cars”; financial, like “camouflaging huge cost overruns in the develop-

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<sup>136</sup> Benisa Berry, *Organizational Culture: A Framework and Strategies for Facilitating Employee Whistleblowing*, 16 *Emp. Resp. & Rts. J.* 1, 1 (2004).

<sup>137</sup> Myron Peretz Glazer & Penina Migdal Glazer, *The Whistleblowers* 4 (1989) (emphases omitted).

ent of weapon systems or misusing public funds”;<sup>138</sup> or legal, like breaking the law or violating codes of ethics. Yet, no matter what violation a whistleblower discloses, his/her motive to report organizational illegitimacy is almost unselfish because his/her “primary motivation for blowing the whistle is to correct wrongdoing and get the organization ‘back on track.’”<sup>139</sup>

In this way, whistleblowing can be seen as “the disclosure by organizational 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.”<sup>140</sup> This description is the most commonly-accepted definition for whistleblowing. In the next section, I am going to employ this definition to analyze the elements of whistleblowing, and this will refer to Miceli & Near’s book.<sup>141</sup>

#### 1. Disclosure to Persons or Divisions That May be able to Affect Actions

Whistleblowing will be complete as a discloser presents his/her concern to someone or a division in charge.<sup>142</sup> At times, the observers of questionable activities are powerless because they cannot right those wrongdoings, and are unable to prevent damage from harming an organization and the public. If fraudulent actions fail to be

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<sup>138</sup> *Id.* at 3.

<sup>139</sup> Callahan & Dworkin, *supra* note 103, at 166.

<sup>140</sup> Callahan et al., *supra* note 17, at 178.

<sup>141</sup> Miceli & Near, *supra* note 100, at 16-21.

<sup>142</sup> *Id.* at 16.

rectified by a person or a department in charge, whistleblowing will be meaningless and have no function to put organizational misconduct back on the right track. Hence, based on this standard, the following situations cannot be regarded as a complete action of whistleblowing.

First, it is not whistleblowing when an observer turns a blind eye and does not take any action to disclose unlawful activities. Second, the behaviour cannot be called whistleblowing when an observer only chats about misconduct or related matters with their colleagues, but does not seek assistance from others who can make things correct. Third, when perceiving illegal activities, an observer does not request others who have authority to rectify, but simply requires the wrongdoer to cease his/ her actions without disclosing. Fourth, it should not be called whistleblowing when an observer notices misbehavior, but chooses to quit from the organization he/she serves and not bring unlawful conduct to light.<sup>143</sup> None of these situations is whistleblowing because either non-reporting or reporting misbehavior to an observer's family, friends, or coworkers cannot right wrongdoings, and all of these outlets are not the person or the division having the power to control misconduct and having abilities to affect the consequences of unlawful activities.

## 2. Constituents of an Organization

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<sup>143</sup> *Id.*

For the sake of blowing the whistle, it is quite important for a discloser to be a member of organization when unveiling fraudulent actions. Becoming a member of organization makes a discloser have more opportunities to access and to detect illegal activities than any outsider. In addition, thanks to a discloser's profession or familiarity with job-related processes, it is easier for him/her to be a whistleblower than others who do not have knowledge or expertise in regard to the operation of organization. Thus, it is generally accepted that a whistleblower ought to be a constituent of organization when disclosing illegal conduct to the person or other institutions that have authority to rectify those mistakes.<sup>144</sup> It does not matter if a discloser is a member of organization when misconduct has been righted or disclosed to the public;<sup>145</sup> however, the status of discloser as reporting organizational wrongdoing is the only factor to be considered in this portion.

### 3. Illegal, Immoral, or Illegitimate Practices

Whenever starting to undertake a mission or work, there should be a motive or reason to act. Due to this concept, without observing the wrongdoing or misconduct occurring in an organization, there is no sufficient ground for an employee to disclose an employer's fraudulent action, and remind others that a manager is out of con-

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<sup>144</sup> *Id.* at 16-17.

<sup>145</sup> *Id.* at 17.

trol. Thus, the action of whistleblowing needs a “triggering event,”<sup>146</sup> and “there must be someone in the woods to hear the tree falling.”<sup>147</sup>

However, what kinds of organizational activities can become the target for a disclosure to blow the whistle? If a suspected activity cannot be viewed as wrongfulness, there is no motive for an employee to take care others’ business. Generally speaking, a triggering event for an employee to make a disclosure is “an activity that is considered wrongful, rather than simply an acceptable but not optimal organizational activity.”<sup>148</sup> Besides, the “wrongdoing may constitute corporate crime, which is ‘any act punishable by the state, regardless of whether it is punished by administrative or civil law, which it usually is, or under the criminal law.’”<sup>149</sup> Further, Miceli & Near said that even if the activity seems to be legal and not criminal, it still can be considered as illegitimacy.<sup>150</sup> The reason is that the observer of suspected activity may view this action operated by the organization is beyond “the realm of the organization’s authority.”<sup>151</sup> In this way, an organization’s conduct seems to be illegal as it is neither authorized nor has right to involve in the matter or the business in specific or restricted areas.

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<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*; also see Clinard, M.B., *Corporate Ethics and Crime: The Role of Middle Management* 10 (1983).

<sup>150</sup> Miceli & Near, *supra* note 100, at 18.

<sup>151</sup> *Id.*



As for omission, Miceli & Near noted that it also can be seen as a wrongful activity, even though omission is not a discrete event.<sup>152</sup> Miceli & Near took a pharmaceutical company for example and described that when “a pharmaceutical company may fail to inform customers or regulatory agencies of risks or dangers inherent in a drug they produce,”<sup>153</sup> the company is responsible to the harm imposed upon society because of omitting material information. Hence, as omission occurs, an organization is liable to its conduct and cannot get rid of punishment under the law.

As a whistleblower tries to make a disclosure, and his/her intent to disclose is not motivated to right an organization’s illegal, immoral conduct, his/her action cannot be regarded as whistleblowing.<sup>154</sup> Studying the goal of whistleblowing, a discloser tends to make misconduct be rectified and wishes that a person or a division in charge can truly affect those illegal actions and correct wrongdoings. If the communication to a recipient will not bring any difference regarding misbehavior, and wrongful activities still proceed, not only does the goal of whistleblowing fail to be achieved, but a discloser also take a risk of being retaliated against and suffering adverse actions taken by his/her employer or organization.

#### 4. Activities under the Control of an Organization

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<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

Sometimes, the act of disclosure is not only to battle with a single wrongdoer, but he/she probably struggles with a whole organization. Observing recent corporate corruption in the beginning of this century, companies' irregularities were controlled by corporate management. In the Restatement (Third) of Agency § 2.01 and § 2.03, the management is considered to have actual and apparent authority on behalf of a corporation to do business.<sup>155</sup> Most of the time, corporate managers in the highest authority are the agents of companies, what they do is on behalf of those companies. Following these concepts, it can be said that the wrongdoing committed by corporate managers is also regarded as organizational misbehavior.

According to a research that studied organizational crime, it said that poor corporate financial performance is one of the factors that makes managers commit financial fraudulent conduct.<sup>156</sup> The reason is that, on the one hand, managers are afraid of being distrusted by corporations and stockholders regarding their abilities to promote the business, and worry those inabilities affect their positions in companies. On the other hand, managers are responsible to pursue the best interest of corporations and shareholders; thus, losses are not allowable, and profits are expected by shareholders and companies. Due to potential pressures coming from companies and stockholders, managers are required to present satisfactory financial performance, and must prepare to fa-

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<sup>155</sup> Restatement (Third) of Agency § 2.01, § 2.03 (2006).

<sup>156</sup> Miceli & Near, *supra* note 100, at 20.

ce criticisms when profits fail to meet stockholders' and companies' expectations. As a result of these concerns, as managers notice corporate financial performance is not as good as they originally expect, they tend to start making up fraudulent financial statements to conceal losses. Hence, this is the primary motive for managers to commit organizational illegitimacy and try to hide all disadvantageous materials.

Although the research has pointed out that poor corporate financial performance has a connection with managers' fraudulent activities, it also described this relationship has gotten weaker in recent corporate corruption. The research found corporate fraud gradually results from managers' personal greed, even though the company's financial condition is healthy and sound. Due to the prevalence of stock options as a primary feature of executive compensation, those "stock option programs adopted by public companies yield unprecedented gains for senior executive."<sup>157</sup> Because the value of stock options is tied to the profit of the company, this compensation causes managers to have a strong personal monetary incentive to falsify financial information and materials. Since the management puts much emphasis on pursuing self-interest, instead of paying attention to corporate business and future performance, this situation not only makes fraudulent activities increase, but also changes managers' faith to be loyal

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<sup>157</sup> Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design Executive Compensation*, 69 U. Chi. L. Rev. 751, 753 (2002).

to companies and take care of stockholders' interests and firms' benefit.<sup>158</sup>

## *B. Origin of Whistleblower Protection and Its Evolution*

### 1. Overview

Before starting to study whistleblowing, it is better to be familiar with the historical process and know how the law began to protect the whistleblower. The former society did not pay too much attention to whistleblower protection since business transactions and social conditions were not as complicated as those in the present society. Then, employees did not used to be shielded from retaliation when they disclosed organizational wrongdoings in the early labor laws and regulations. Yet, followed by the increase of organizational fraud, the legislature has spent many years to realize the need of society, and enact ordinances to prevent whistleblowers from being retaliated against by employers due to the disclosure.<sup>159</sup> In addition, federal and state legislatures recognize that whistleblower protection is necessary in complex business activities because corporate employees can be the monitor to hamper employers' fraudulent actions; also, they are capable of unveiling organizations' misconduct before the misbehavior is out of control.

The primary reason to protect a whistleblower might be attributed by two aspects.

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<sup>158</sup> Miceli & Near, *supra* note 100, at 20.

<sup>159</sup> Daniel P. Westman, *Whistleblowing: The Law of Retaliatory Discharge* 2-3 (1991).

First, the interaction of human relationships has been changed.<sup>160</sup> Different from the complexity of political or commercial environment in the late 20<sup>th</sup> century, in the 19<sup>th</sup> century, an individual tended to sustain a self-sufficient life, and few large-scale organizations could affect each person's livelihood and the whole economy. Yet, following the growth of organizations and their abilities to control varied business activities, an individual gradually realized his/her life connects to others, and he/she might be easily damaged due to others' anti-social behaviour.<sup>161</sup> Since the economic condition was rapidly changed, the model of interaction in human relationships was transformed from the individualism of the nineteenth century to the interdependence of individuals of the twentieth century.<sup>162</sup> Considering an individual's perception on social structures had changed, the public not only required the government to provide more protection on economic activities, but also asked the legislature to take necessary steps to deter organizational fraud from happening.<sup>163</sup>

Second, it resulted from the observations of the legislature and courts when resolving the issues of whistleblowing in the workplace. The legislature and courts recognized whistleblower protection is required because there is an imbalance in the bargai-

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<sup>160</sup> Deborah A. Ballam, *Employment-At-Will: The Impending Death of a Doctrine*, 37 Am. Bus. L.J. 653, 656-57 (2000).

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

ning power in the employment relationship.<sup>164</sup> In organizations, employers have managerial power to assign the job, distribute the wage and welfare, decide the promotion or the discharge of employees, and address business affairs. This authority accompanying social, economic, and emotional consequences has a great influence on employees' feelings and performance when they serve in organizations. In view of imbalanced power between employers and employees, the legislature enacted many statutes to preclude employers from abusing their managerial power on employees; likewise, courts have formed several exceptions to restrict employers' authority to discharge employees at will.<sup>165</sup>

Complete whistleblower protection cannot simply depend on limited statutes, but it has to be a convergent effort made by the legislature and courts in different periods. Examining the legislative history and different whistleblower laws are the required process to realize the evolution of whistleblower protection. Under earlier whistleblower protection statutes, limited protected activities made it hard for employees to be shielded after disclosing employers' misconduct and organizations' wrongdoings.<sup>166</sup> Instead of protecting all employees, several statutes limited the scope of protection for

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<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> Lacayo & Ripley, *supra* note 78, at 32.

employees who were the members of labor union only.<sup>167</sup> When employees disclosed employers' misbehavior, but have not become the members of union, they are not covered employees in these statutes. Hence, earlier whistleblower protection laws could not safeguard all employees from suffering employers' adverse actions, but only gave limited anti-retaliation protection for employees as specific requirements have been satisfied.<sup>168</sup> Below, some typical whistleblower statutes are going to be briefly introduced, and several common features regarding remedy for a whistleblower can be found in these regulations.

The 1863 False Claims Act (FCA)<sup>169</sup> is an important federal whistleblower statute to mention as starting reviewing the evolution of whistleblower protection. FCA is the cornerstone of whistleblower protection law enacted during the U.S. Civil War.<sup>170</sup> Unlike other federal whistleblower statutes, FCA does not provide limited protection for shielding whistleblowers. Yet, its protection covers all employees no matter whether they are the members of labor union or not.<sup>171</sup> The origin to enact FCA was to prohibit private entities from taking advantage of any opportunity to gain unlawful prof-

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<sup>167</sup> Westman, *supra* note 159, at 7.

<sup>168</sup> *Id.*

<sup>169</sup> False Claims Act (FCA) of 1863, 31 U.S.C. §§ 3729-3733 (2010).

<sup>170</sup> Westman, *supra* note 159, at 4-12.

<sup>171</sup> False Claims Act, *supra* note 169.

its or benefit owing to the shortage of resources during the American Civil War.<sup>172</sup> In the FCA, a citizen could sue on behalf of the United States to companies that supplied deficient goods or products to the U.S. federal government in the Civil War.<sup>173</sup> In addition, FCA gives a financial incentive for citizens who accurately disclose corporate irregularities when those firms keep a business relationship with the U.S. federal government.<sup>174</sup> Thanks to a financial incentive, FCA probably can be regarded as the most successful whistleblower protection law to deter organizational fraud since not only can a good faith whistleblower be rewarded when corporate fraudulent acts are correctly proved, but FCA also can hold back the intent of companies to cheat the government.<sup>175</sup> Even today, FCA is still an effective whistleblower statute against corporate misbehavior that attempts to gain illegal benefit and to deceive the public.<sup>176</sup>

Differing from FCA provides a financial incentive to a discloser, other whistleblower statutes turn to set up an anti-retaliation provision to protect a reporter.<sup>177</sup> Anti-retaliation protection resulted from various labor activities that accompanied the form-

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<sup>172</sup> Westman, *supra* note 159, at 3.

<sup>173</sup> Henry Scammell, *Giantkillers: The Team and the Law that Help Whistleblowers Recover America's Stolen Billion 36* (2004).

<sup>174</sup> Callahan & Dworkin, *supra* note 93, at 100-01.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*



ation of labor union and social unrest.<sup>178</sup> The National Labor Relations Act (NLRA) is a good example. NLRA forms an anti-retaliation provision to safeguard employees from suffering employers' reprisals,<sup>179</sup> and inhibits employers from taking revenge on employees who participate in peaceful labor activities or on those who are the organizers of these activities.<sup>180</sup>

Originally, NLRA was enacted after the Great Depression, and was the statute that Congress attempted to follow a new public policy that encouraged collective bargaining.<sup>181</sup> The preface of NLRA not only describes that the function of forming a labor union promotes collective bargaining, but it also notes a labor union is a measure of "safeguarding commerce from injury, impairment, or interruption, and promoting the flow of commerce by removing certain recognized sources of industrial strife and unrest."<sup>182</sup> Because of this rationale formed by NLRA, collective bargaining can be seen as a tool to assure employees' rights and interests, and employers are restricted to employ managerial power to retaliate against employees because of their participation in the activities of labor union.<sup>183</sup>

During the 1960s and 1970s, the legislature's attention to protect a whistleblower

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<sup>178</sup> Westman, *supra* note 159, at 5.

<sup>179</sup> National Labor Relations Act (NLRA) of 1935, 29 U.S.C. §§ 151-169 (2010).

<sup>180</sup> *Id.*

<sup>181</sup> Westman, *supra* note 159, at 5-6.

<sup>182</sup> National Labor Relations Act, *supra* note 179, §151.

<sup>183</sup> Westman, *supra* note 159, at 7.

changed from the issues of economic matters to the concerns of “civil rights, consumer protection, workplace safety, environmental pollution and public health.”<sup>184</sup> This transformation was because the public started to doubt whether the integrity of corporations had been lost and could not be relied on again.<sup>185</sup> Because of this doubtfulness, numerous ordinances were enacted to prohibit private organizations’ misconduct from harming public interest. Likewise, Congress tried to maintain the public’s confidence in business activities and the financial market by regulating a sound statutory system.<sup>186</sup> Hence, in order to restore the public’s lost faith, Congress decided to intervene in the matters of private workplaces and rebuild the trustworthiness that was held by private organizations. For achieving this goal, federal legislators found complete protection that prevents employees from being retaliated against by employers when making a disclosure is a good means to deter organizations’ wrongdoings. This policy decreases the defects that arise from the imbalanced power in employment relationship; similarly, it assures employees’ job security and avoids them from being menaced by employers.<sup>187</sup>

In addition, the Civil Service Reform Act of 1978 (CSRA)<sup>188</sup> and the Whistlebl-

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<sup>184</sup> *Id.* at 8.

<sup>185</sup> *Id.* at 9.

<sup>186</sup> *Id.*

<sup>187</sup> *Id.* at 8.

<sup>188</sup> Civil Service Reform Act (CSRA) of 1978, 5 U.S.C. §§ 1101-1308 (2010).

ower Protection Act of 1989 (WPA) (CSRA was amended by WPA)<sup>189</sup> play important roles in the development of whistleblower protection. The origin to enact CSRA was because of the Watergate scandal happening in the Nixon administration. In order to restore Americans' confidence in the U.S. government, federal legislators enacted CSRA to encourage federal employees to report wastes, frauds, or corruption in the federal government to the authorized institution. Also, CSRA provides protection for federal employees and prevents them from being suffering retaliation taken by their employers.<sup>190</sup> As regards WPA, it is an amended version of CSRA and provides the same protection for federal employees against their supervisors. The difference between these two statutes is that WPA establishes the Office of Special Counsel to address whistleblowers' arguments. This department's duty is to solve employees' complaints, investigate the truthfulness of employees' allegations, and preclude employers from taking revenge on these employees.<sup>191</sup>

## 2. Negative Attitudes toward Whistleblowers

It is quite important to think about the reason why federal legislators enacted so many statutes to protect whistleblowers from being retaliated against by employers. If reporting organizational wrongdoings can prevent employers from committing

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<sup>189</sup> Callahan & Dworkin, *supra* note 93, at 105.

<sup>190</sup> Westman, *supra* note 159, at 12.

<sup>191</sup> Bruce D. Fisher, *The Whistleblower Protection Act of 1989: A False Hope for Whistleblowers*, 43 Rutgers L. Rev. 355, 400 (1991).

frauds and protect public interest, is it admirable to be a whistleblower and receive a good reputation from others? Yet, the real situation is that whistleblowing is not as popular as it seems to be because people are inclined to conceal true feelings and thoughts in their minds. People not only tend to employ false language to interact with persons they dislike, but they are used to catering to the majority opinion even if those opinions are morally wrong. Because of those phenomena, it is rational to hold that people have a negative attitude to whistleblowers. However, recently, this attitude may be changing when the media creates the impression of “heroism” on whistleblowers. The media causes the public to reverse their bad impression on whistleblowing and accept it as worthy of compliment. Despite this trend, the negative points of view of others and personal undesirable experiences still cannot instantly disappear in a short time. Below, I am going to briefly discuss the origin of the public’s negative views on whistleblowers and study those influences on whistleblowing.

The first source of negative attitude toward whistleblowers results from an individual’s childhood experiences.<sup>192</sup> A negative impression from being snitched on includes not only being punished by teachers and victimized by reporters, but self-esteem is also injured and cannot be recovered instantly. The image that reporters were stand-

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<sup>192</sup> Terance D. Miethe, *Whistleblowing at Work: Tough Choices in Exposing Fraud, Waste and Abuse on the Job* 21 (1999).

ing aside with sniggers while being blamed is unable to be vanished in our minds.<sup>193</sup> Hence, from that day on, it is obvious to know snitching or squealing is a betrayal of human relationships, and its damage is not easy to make up.<sup>194</sup> Besides, parents and home educations not only inculcate that a tattletale's action is despicable and can ruin the trust of friendships, but they indirectly give a message that interfering with others' business is superfluous.<sup>195</sup> Those experiences and instructions let people to have hostile and negative attitudes toward whistleblowers. In addition, these attitudes obstruct people from being involved in others' business, and make them avoid getting into any trouble.

Second, the mass media has a significant function to form negative points of view toward whistleblowers.<sup>196</sup> People betraying their organizations and losing trust among their friends and colleagues can be called by different names. "To mobster, he is a 'rat'<sup>197</sup>; to drug dealers, a 'snitch.'<sup>198</sup> To school children, he is a 'tattletale'<sup>199</sup>; to corporate executives, a 'whistleblower.' To cops, he is an 'informant'; to prosecutor,

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<sup>193</sup> *Id.* at 22.

<sup>194</sup> *Id.*

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> Albert D. Clark, *Ethical Implications of Whistleblowing*, 42 La. B.J. 364, 365 (1994).

<sup>198</sup> *Id.* at 365.

<sup>199</sup> Clyde H. Farnsworth, *Survey of Whistleblowers, Finds Some Retaliation but Few Regrets*, 133 Chi. Daily Bull., July 27, 1987, at 3.

a ‘cooperator.’”<sup>200</sup> Besides, they are named as “cheese-eaters,”<sup>201</sup> “M&Ms,”<sup>202</sup> or worse.<sup>203</sup> However, no matter which name these people are labeled, they are established as the figures who are “disloyal, deceitful, greedy, selfish, and weak”<sup>204</sup> in movies, in newspapers or on television, and in literature or fiction. Also, the power of the mass media cannot be ignored since it has a great influence on our society today. The media not only is a source from which people are able to receive the latest information and comments, but it also is a kind of medium that helps an individual to reach social agreements and consensus on popular issues, and to form a tasteful or distasteful impression on specific public characters, places, or events. Establishing a negative attitude to squealing is a good example here. Even though people did not have any unpleasant experience with a tattletale in their childhoods, they still might be easily influenced by the media that establishes a poor figure of tattletales in various films and movies; let alone those who had been betrayed by classmates, friends, relatives, colleagues, or other associates.

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<sup>200</sup> Michael A. Simons, *Retribution for Rats: Cooperation, Punishment, and Atonement*, 56 Vand. L. Rev. 1, 1 (2003).

<sup>201</sup> David Kocieniewski, *Officer Says He Was Hurt for Aiding an Inquiry*, N.Y. Times, July 27, 1996, at L25.

<sup>202</sup> Jacqueline P. Taylor, *The World of Whistleblowers: Are They Sinners or Saints?*, available at [http://www.womenofflorida.com/THE\\_WORLD\\_OF\\_WHISTLEBLOWERS\\_ARE\\_THEY\\_SINNERS\\_OR\\_SAINTS-Article.aspx](http://www.womenofflorida.com/THE_WORLD_OF_WHISTLEBLOWERS_ARE_THEY_SINNERS_OR_SAINTS-Article.aspx).

<sup>203</sup> Philip Jos et al., *In Praise of Difficult People: A Portrait of the Committed Whistleblower*, 49 Pub. Admin. Rev. 552, 552 (1989).

<sup>204</sup> Simons, *supra* note 200.

Though the public's perception of squealing is negative, is it any possible to change citizens' attitudes toward whistleblowers due to gradual prevalence of whistleblowing and the actions taken by the federal government to protect whistleblowers? By observing recent social phenomena to whistleblowing, the goal to form a commonly-accepted view on whistleblowing still needs lots of efforts.<sup>205</sup> In the school, the tattletale remains, and children still hate to become the victims of betrayers.<sup>206</sup> The instructions coming from parents or home education are still kept in children's minds. That is, being a tattletale is devalued behaviour, and is the quickest way to lose trust among friends. Nobody wants to be isolated by their groups because no one is willing to be a kind of loner in society. In the workplace, employees still fear of being a whistleblower because of colleagues' negative perception of whistleblowing. Employees still prefer making use of a confidential name when reporting organizations' illegal actions since they "often face ostracism from long-time friends and colleagues once it becomes known that they volunteered information of wrongdoing."<sup>207</sup> Because employees are unwilling to be called an un-cooperator or a trouble-maker in the workplace, they tend to turn a blind eye on organizational fraud and go away from the frustrating environment when observing employers' misconduct.

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<sup>205</sup> Miethé, *supra* note 192, at 23.

<sup>206</sup> *Id.*

<sup>207</sup> Pamela H. Bucy, *Information as Commodity in the Regulatory World*, 39 *Hous. L. Rev.* 905, 917 (2002).

By contrast, as employers support whistleblowing, and colleagues do not ostracize whistleblowers, it is probable that the federal legislature might not have to provide a financial incentive or give protection for employees to disclose organizational fraud.<sup>208</sup> Because a good impression toward whistleblowing has been rooted in the public, it is not necessary to provide any motive for whistleblowing employees to take an action. However, forming a positive attitude toward whistleblowing still need to take some time because “‘minding one’s own business’ is still firmly rooted in the contemporary U.S. society.”<sup>209</sup>

### 3. Modern Business Enterprises Need Whistleblowing

Before the late nineteenth century, people used to support and maintain their livelihoods by self-sufficiency, and the individual store or single commercial unit was regarded as the mainstream of business activities. At that time, business transactions and exchanged goods were simple; each person believed that this model of transaction would remain unchanged. Yet, technological innovations and a rapid flow of information made gigantic and powerful business organizations spring up, these changes altered the method of transaction and caused commerce to be more diversified and complex. Gradually, the individual store was replaced by chain stores and large-scale firms; in addition, commercial goods could be produced more efficiently and on a large

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<sup>208</sup> Miethé, *supra* note 192, at 23.

<sup>209</sup> *Id.*



scale.<sup>210</sup> Further, complicated business models need more professionals to participate in the operation of organizations, and the division of labor requires more expertise and special skills.

However, what is the connection between whistleblowing and the transformation of manufacturing? Which factor makes employees have a critical function on disclosing organizations' frauds? Miethe describes these points as follows:

“Workers in the modern era rarely are involved in the total production process from the selecting of the raw materials to the finished product. Instead, modern work is piecemeal, fragmented, and specialized. The greater distancing of the worker from the final product, specialized tasks and areas of expertise, the invisible executive structure and absentee ownership in complex bureaucratic organizations, and the greater number of workers with direct involvement in the production process and service delivery have created a wider opportunity for illegal activity and more people to blame if something goes wrong. This division of labor in modern industrial societies has resulted in the growth of specialized positions and greater vertical differentiation based on power. Workers whose tasks have now been finely subdivided in the modern workplace often experience diminished power because they have less control over the entire production or service activity. This reduced power of workers to take their own corrective action may account for the greater reliance upon whistleblowing as a control measure in modern work organization.”<sup>211</sup>

Following this observation, it may be inferred that complex organizational structures and large-scale business entities are primary reasons for the need of whistleblowing.

The division of labor is more specialized, and specific knowledge is indispensable for

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<sup>210</sup> *Id.* at 24.

<sup>211</sup> *Id.* at 24-25.

employees to hold positions in particular areas.<sup>212</sup> Also, the revolution of information and technology makes an organization's operation more complicated and increases the probability of serious business corruption to occur.<sup>213</sup> However, employees equipped with expertise have more opportunities to access confidential information and perceive frauds than others do.<sup>214</sup> These employees are able to reduce fraud to happen because they can detect wrongdoings earlier and prevent organizational irregularities from harming shareholders, stakeholders, and an organization itself; likewise, they can lessen the threats imposed upon the health and safety of society.<sup>215</sup>

Although whistleblowing can avoid the public from being damaged by organizational fraud, it is not easy for whistleblowing employees to challenge the authority set up by organizations. First, the commonly-accepted norm requesting employees to be loyal to organizations and employers is the biggest obstacle and controversial issue to address. Second, gigantic organizations are inclined to be more conservative and not good at responding to change. They tend to ignore dissenting voices from the middle and lower level employees and treat their advice like ordinary employees' meaningless complaints. Third, large-scale organizations suspect whistleblowing and are doubtf-

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<sup>212</sup> *Id.* at 25-26.

<sup>213</sup> Timothy L. Fort & Cindy A. Schipani, *The Role of the Corporation Fostering Sustainable Peace*, 35 *Vand. J. Transnat'l L.* 389, 413 (2002).

<sup>214</sup> Miethe, *supra* note 192, at 25-26.

<sup>215</sup> Elletta Sangrey Callahan et al., *Whistleblowing: Australian, U.K., and U.S. Approaches to Disclosure in the Public Interest*, 44 *Va. J. Int'l. L.* 879, 881-82 (2004).

ul of the actions of whistleblowing employees. As a result, most of the time, employees' disclosures fail to be paid attention to under in-house channels, and those responses make employees turn to outsiders for assistance. Once Elliston noted this issue as follows:

“The larger the organization and the more technologically complex the task environment, the more an organization is susceptible to whistleblowing. This occurs because of the inherent inertia and rigidity of large-scale, complex organizations. The whistleblower attempts to change the behavior or activities of individuals inside of the organization in some manner and feels compelled to go outside when he or she has exhausted all internal procedures.”<sup>216</sup>

Thus, it can be concluded that the more rigid structure an organization has, the higher possibility an organization discourages employees from disclosing its frauds. Also, an organizations' inflexibility affects employees' actions to make an internal disclosure. When those employees feel an in-house channel cannot rectify the problem, they tend to go outside and seek external assistance.

Even if employees probably have a hard time reporting organizations' misbehavior, the whistleblower's irreplaceable role in uncovering frauds still cannot be disregarded. As Sander says, “The state has other tools to fight fraud, but the reality is that we need whistleblowers ... We don't have the resources to have free-flowing investigators just looking for fraud. We rely on complaints from whistleblowers to bring cert-

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<sup>216</sup> Frederick Elliston et al., *Whistleblowing: Managing Dissent in the Workplace* 139 (1985).

ain kinds of fraud to our attention.”<sup>217</sup> Therefore, whistleblowing can be viewed as an efficient method to detect and disclose organizational illegitimacy.

People increasingly realize the importance of whistleblowing since it can be regarded as a tool to provide the public assistance to regain social control from powerful organizations.<sup>218</sup> Whistleblowing prevents the public from being cheated and manipulated by organizations.<sup>219</sup> Besides, whistleblowers have more information than others in regard to the details of illegitimacy;<sup>220</sup> whistleblowing uses employees’ familiarity with organizations’ operation to disclose misconduct, and prevents those wrongdoings from getting worse.<sup>221</sup> Hence, “whistleblowers are a check on management prerogative”<sup>222</sup> and are the monitor to see whether employers do business on the right track. No matter where whistleblowing happens, whistleblowing employees are not only “critical component[s] to effective law enforcement in a complex society,”<sup>223</sup> but they also are the firsthand witnesses of organizational corruption.

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<sup>217</sup> Libby Sander, *Fraud Whistleblowers Create Expanding Area of Law*, Chicago Lawyer, Nov 2005 (citations omitted).

<sup>218</sup> Mieth, *supra* note 192, at 26.

<sup>219</sup> George C.S. Benson, Codes of Ethics and Whistleblowing, in *Whistleblowing – Subversion or Corporation Citizenship?* 53-59 (1994).

<sup>220</sup> Stephen M. Kohn et al., *Whistleblower Law: A Guide to Legal Protections for Corporate Employees*, 3 (2004).

<sup>221</sup> John Bostleman, *Sarbanes-Oxley Deskbook, Background: Twelve Months Leading Up to the SOA*, 2-33 to 2-34 (2004).

<sup>222</sup> Mary Kreiner Ramirez, *Blowing the Whistle on Whistleblower Protection: A Tale of Reform versus Power*, 76 U. Cin. L. Rev. 183, 196 (2007).

<sup>223</sup> *Id.* at 185.

#### 4. Influence of Whistleblowing on an Organization and Society

Whistleblowing is viewed as “a form of organizational dissent.”<sup>224</sup> On the one hand, it improves decision-making in the upper management; on the other hand, it has a function to “break information cascades, in which a group of people uniformly fall in line with a few influential people who may or may not have complete access to full information.”<sup>225</sup> Moreover, because whistleblowing is able to be seen as a kind of social control,<sup>226</sup> whistleblowers not only avoid the public from being exposed to potential hazards or being damaged by organizational illegal behaviour, but they also enhance employers’ integrity and promote corporate governance.<sup>227</sup>

As for the function of whistleblowing to the public, once a court stated, “Without employees who are willing to risk adverse employment consequences as a result of whistleblowing activities, the public would remain unaware of large-scale and potentially dangerous abuses.”<sup>228</sup> In addition, being insiders, whistleblowers are able to employ their positions to observe wrongdoings and to deter misbehavior.<sup>229</sup> Once Macey said, “Tip-offs from insiders have been described as ‘by far the most common method

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<sup>224</sup> Brian Martin & Will Rifkin, *The Dynamics of Employee Dissent: Whistleblowers and Organizational Jiu-Jitsu*, 4 Pub. Org. Rev. 221, 221 (2004).

<sup>225</sup> Richard E. Moberly, *Sarbanes-Oxley’s Structural Model to Encourage Corporate Whistleblowers*, 2006 B.Y.U.L. Rev. 1107, 1121 (2006).

<sup>226</sup> Miethé, *supra* note 192, at 26.

<sup>227</sup> Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 Mich. L. Rev. 1757, 1760 (2007).

<sup>228</sup> *Dolan v. Cont’l Airlines*, 563 N. W. 2d 23, 26 (Mich, 1997).

<sup>229</sup> Callahan & Dworkin, *supra* note 93, at 108.

of detecting fraud.”<sup>230</sup> Further, disclosures and information provided by whistleblowers enable to reduce the costs of discovering and investigating organizational frauds for the public.<sup>231</sup>

With regard to the role of whistleblowing for managements and organizations, it also can play a positive role in enhancing the safety of organizations and in promoting the quality of managements’ decision-making. Dworkin & Callahan describe this point as follows:

“Whistleblowers may be seen as reformers whose actions often benefit the organization. They are one of the least expensive and most efficient sources of feedback about mistakes the firm may be making. They can help identify unsafe products or practices, wasteful or fraudulent actions, and other harmful or criminal behavior. Whistleblowers can bypass the institutional barriers to communication found especially in large organizations, benefitting their employers not only by identifying problems, but also by suggesting solutions.”<sup>232</sup>

Then, whistleblowers are capable of finding serious hazards to business operation beforehand, which might negatively affect organizations’ interests, performance, and reputations. By means of whistleblowers’ disclosures, managements can rectify these problems in time and avoid damage or losses for organizations.

Further, because organizations have to be flexible and adjust structures immedia-

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<sup>230</sup> Jonathan Macey, *Getting the Word Out about Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 Mich. L. Rev. 1899, 1902 (2007).

<sup>231</sup> Laura Simoff, *Confusion and Deterrence: The Problems that Arise from a Deficiency in Uniform Laws and Procedures for Environmental “Whistleblowers,”* 8 Dick. J. Env’tl. L. & Pol’y 325, 326 (1999).

<sup>232</sup> Terry Morehead Dworkin & Elletta Sangrey Callahan, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society*, 29 Am. Bus. L.J. 267, 299-300 (1991).

tely in order to make a response to any changes in the market, whistleblowers also play a role in these changes. As Elliston says:

“Organizations must adapt to their environments if they are to survive. With the continued acceleration of change, adaptation is becoming more difficult. Changes in technology, the economy, government regulations, consumer preferences, work patterns, and media coverage are occurring rapidly and require that organizations become more involved with forecasting changes before they occur. Whistleblowing can be taken as an attempt at warning the organization of some undesirable changes in its environment that might arise if certain adaptations are not made.”<sup>233</sup>

In this way, a whistleblower of organizations not only can be regarded as having the foresight to the changes, but he/she also can be viewed as the reminder of organizations about these changes. A whistleblower is able to benefit an organization’s activities since he/she assists an organization in knowing which interests it can go for, and what losses it should avoid.

Making a reference to Miceli and Near’s book, it analyzes the costs and benefit of whistleblowing.<sup>234</sup> Miceli and Near make comparisons on potential costs and benefit of whistleblowing and inaction between an organization and society at large. These consequences are going to be categorized below.

#### a. Potential Costs and Benefit of Not Blowing the Whistle

##### i. Potential Costs to the Employing Organization

Two problems probably arise when there is no whistleblowing in the

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<sup>233</sup> Elliston et al., *supra* note 216, at 140.

<sup>234</sup> Miceli & Near, *supra* note 100, at 4-15.

organization. First, keeping silence on organizational fraud makes employees work inefficiently. Employees might not be willing to devote themselves to working because they think that the upper management does not care about their thoughts and opinions. Instead, employees turn to complain among families, friends, and colleagues, and choose not to present their worries to promote the management's decision-making. Thus, the organization perhaps suffers negative consequences. On the one hand, the organization's performance may go down and fail to compete with business competitors. On the other hand, employees may lose their passion for working and do not want to stir their brains to think of creative ideas for work. In addition, they may not be adventurous employees since the frustrating working atmosphere decreases their willingness to grab any chance to succeed and create massive fortunes for their organizations.

Second, if employees fail to disclose employers' misconduct, employers may not be frightened to do anything wrong because employees are unable to stop employers from committing illegal actions. Hence, unlawful activities cannot be rectified if there is no whistleblower to unveil organizational illegitimacy. In the whistleblower's point of view, not only will employers' fraudulent activities bring the failure of organizations' business, but also employers' concerns in private interests will cause severe damage on organizations and public good.

## ii. Potential Benefit to the Employing Organization



The operation of bureaucratic organizations depends on the power of management. Employers' managerial power lets organizations' policies and orders be practiced smoothly and properly. When employees show their respect for employers' managerial authority, the atmosphere of workplaces will be harmonious, not hostile. Pleasant working environments can promote employees' efficiency in work and create a cooperative atmosphere to increase the productivity of organizations. Hostility does not exist in the employment relationship, and there is no distrust among colleagues. In this way, conflicts in the workplace can be avoided; adverse actions imposed on employees are unnecessary and may be thrown away. In employees' minds, absolute obedience to employers is the only faith. They do not second-guess employers' power since they believe that employers' decisions are trustworthy and accurate. In addition, if there are few complaints made by employees, organizations do not have to waste resources on investigating the truthfulness of arguments. Hence, time, money, and labor are able to be saved and be used in other ways to promote organizations' profits. Further, the decrease of complaints not only stabilizes the operation of organizations, but it also makes employees more concentrate on their work.

### iii. Potential Costs to Society at Large

Considering that most organizations' frauds may damage social interest, if employees cannot report employers' fraudulent actions outside of organizations,

the consequence will jeopardize the public's health and safety at last. Issues on pollution, potential environmental hazards, or the government's abuse of citizens' privacy are closely related to our daily lives. Whistleblowers in these areas not only can disclose organizations' wrongdoings to citizens who care about those issues, but also can be the medium that assists the public in accessing information, which people are hardly to reach. Besides, it is important to notice that the costs of not blowing the whistle to society are in proportion to the extent of the public's acceptance to whistleblowing. The more positive attitude of citizens supports whistleblowers, the greater the costs of not blowing the whistle will impose upon society.

#### iv. Potential Benefit to Society at Large

Like the benefit to organizations, if there is no whistleblower in society, the public will not be disturbed by frivolous complaints, and unrest will be decreased. Because few arguments are made, the public can save its time, money, and labor to investigate and fight against organizational illegitimacy. Likewise, the society will benefit from organizations' performance if few whistleblowing happens in organizations. Without whistleblowers' disclosures, managers are encouraged to make adventurous, but risky decisions, and can be more flexible to adjust business strategies. Managers will not worry to be second-guessed by employees and can take uncertain actions with no fear. After all, business success relies on any risky chance that managers are

willing to take, and bases on any method that managers would like to give it a shot. Thus, the public probably benefits from this phenomenon since managers do not give up any opportunity to achieve the goal. Organizations served by hard-working employees and adventurous managers promote the national economy and bring a big fortune to society.

#### b. Potential Costs and Benefit of Blowing the Whistle

##### i. Potential Costs to the Employing Organization

###### (1) Challenge to Authority Structure

Whistleblowing can be seen as a challenge to the chain of command and because it weakens the authority established by the management. In organizations, employees are asked to be loyal and obedient to employers. Dissenting voices are not allowable, and second-guesses on managers' power are not permissible. When employers' managerial authority is challenged, employers probably feel their power is restricted because they are afraid of making decisions that may raise arguments from dissenting employees. Employers are inclined to see these employees as "having gone behind their backs or over their heads."<sup>235</sup> Thus, losing authority is viewed as the cost for employers and organizations.

However, as organizations intend to encourage employees to report wrongdoings

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<sup>235</sup> *Id.* at 9.

and establish in-house channels for employees to present their concerns, whistleblowing is not a challenge for the management's authority anymore. Instead, it is an alternative form of communication between the management and employees. Hence, whether whistleblowing should be regarded as the cost for organizations, the result still has to be decided by the attitude of management and organizations.

## (2) Threats to Organizational Viability

Whistleblowing has a great influence on the survival of organizations. When employers think that immoral activities are probable to survive organizations' business, and believe that tricks may cut spending and promote organizations' profits, whistleblowers perhaps hamper employers' intent to take actions thanks to altruism. Whistleblowers do not appreciate employers to pursue short-term profits and ignore long-term business goals; though, they wish employers to look further and take efforts to preserve organizations' values and benefit. Whistleblowers realize that even if immoral actions may survive business, these actions still bring harm to organizations and society in the end. This consequence is unable to meet the public's expectation on honest commerce, and probably loses the public's trust in business activities. Therefore, whistleblowers deprive employers' freedom to go for short-term success, and restrict employers' managerial authority to take diverse, adventurous actions, even though those decisions or actions are improper and risky. Davidson & Worrell state this situa-

tion as follows:

“Ethical issues aside, from a shareholder’s standpoint, illegal acts may be worthwhile if their expected benefit outweigh their expected costs. In addition, some investors may view managerial attempts to test the legal waters as preferable to always proceeding in a risk-averse manner. Wealth-maximizing shareholders may consider it desirable for manager to occasionally get caught trying to cheat.”<sup>236</sup>

Unlike whistleblowers’ points of view, stockholders of organizations may rationalize employers’ illegal behaviour if the consequences of immoral actions can create more benefit than damage for their investments. Stockholders’ concerns are rational because making a profit is the only thing they care about; which method to make a profit is not an important factor for them to consider. Contrarily, organizational whistleblowers do not think about the profit, what they care is whether organizations can survive the business and continue their operation no matter how tough the situation they will encounter.

### (3) Limitations on Control

Whistleblowing may be the cost for organizations because it is able to restrict employers’ authority to control the whole operation of organizations. Due to managerial power, employers have the right to make decisions regarding organizations’ policies and business strategies. They enjoy the power that prevents them from being intervened in business matters by outsiders. However, whistleblowers are incli-

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<sup>236</sup> Davidson, W. N. & Worrell, D. L., *The Impact of Announcements of Corporate Illegality on Shareholder Returns*, 31 Acad. of Mgmt. J. 195, 199 (1988).

ned to restrict employers' authority when they not only recognize that employers' managerial power fails to get along well with their expectations, but also are aware that this power will bring damage on organizations. Once Miceli and Near stated about a whistleblowers, and said "not only does he or she choose not to take part in the activities, but he or she attempts to keep others from doing so."<sup>237</sup> In short, whistleblowers tend to invade the managerial area in which they are not allowed to get involved; also, they attempt to hinder employers' actions from making business decisions and preclude them from enjoying their legal authority.

#### (4) Unpredictability of Organization Member Actions

The last thing to think about whistleblowing is that nobody knows when or how their colleagues will blow the whistle, and whether the consequence will threaten the work and professional activities. Unpredictable whistleblowing is a factor that makes working environments unstable. In this situation, it not only makes employees fail to concentrate on their work, but also brings employers a potential risk to face diverse complaints. In the end, organizations' performance cannot be promoted by employers' risky, but probably successful, decisions since employers are afraid of coping with unpredictable whistleblowing; likewise, they have no idea what arguments will be made, and how whistleblowers will restrict their power to make decisions or

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<sup>237</sup> Miceli & Near, *supra* note 100, at 10.

to take business actions.

## ii. Potential Benefit to the Employing Organization

### (1) Increased Safety and Well-Being of Organization Members

Actions taken by whistleblowers have a great function to alert the members of organizations regarding diverse information, like fraudulent financial actions or hazardous conditions in the workplace. Keeping silence on organizations' wrongdoings makes potential threats worse, and further causes damage on organizations and the public. Whistleblowers, who serve in high-risk working fields, such as pharmaceutical factories, toxic materials research centers, and other high pollution-emission industries, are able to be an earlier alarm to remind people of dangers, and assure the safety and well-being of employees. For innocent employees, whistleblowers can be seen as the protectors who stand on the first line to battle against employers' mistakes that cannot be ignored and permissible.

### (2) Support for Codes of Ethics

Organizations are used to setting up ethical standards for employees to follow and encourage them to perform activities that can meet expectations under these standards. Codes of ethics show what behaviour organizations intend to promote, and which action organizations want to discourage. Building internal channels for employees to report irregularities is a method for organizations to promote emplo-

employees' ethics. By making use of in-house channels, whistleblowing can be viewed as a communication between employers and employees, and gives the management an opportunity to take notice and to timely rectify errors. Whistleblowers would like to see this result because not only can they have a direct contact with the upper management, but their actions also can satisfy organizations' expectations, and their chances of being retaliated against would decrease.

### (3) Reduction of Organizational Waste and Mismanagement

Whistleblowers can decrease the cost of production and increase the profit of business. When wrongdoers' actions have not been known by organizations, whistleblowers are able to disclose these wrongdoings to the management and to avoid organizations from suffering losses. These losses may include tangible expenses and intangible attritions. Tangible expenses contain legal fees and organizations' expenditure to offset damage. Intangible attritions include the time used to investigate illegitimacy; the labor assigned to interview witnesses and suspected wrongdoers; and the disruption in working environments. By whistleblowers' reports, organizations not only can prevent different losses, damage and exhaustion, but they also can make a response on those mistakes and correct them rapidly.

### (4) Improved Employee Morale

The support of whistleblowing is able to enhance employees' mo-



rale in organizations. Employees are aware that they are encouraged to report irregularities because organizations are inclined to give them positive responses to rectify mistakes. Employees may feel honored to take efforts to improve the integrity of organizations and promote internal corporate governance. A research has described that employees encouraged to report wrongdoings are more satisfied with their working environments than those who detect illegal activities, but choose to turn a blind eye.<sup>238</sup> In addition, another study pointed out sustaining a whistleblower-friendly working atmosphere is consistent with employees' satisfaction with their jobs and workplaces.<sup>239</sup> In this way, the positive attitude of employers toward whistleblowing not only improves employees' morale in organizations, but also develops greater cohesion for employees in business affairs and the workplace.

#### (5) Maintenance of Good Will and Avoidance of Damage Claims

Effective internal whistleblowing preserves organizations' reputations and reduces the possibility of losses on their business. As organizational corruption has been known by the public, people start doubting the trustworthiness of organizations. Distrustful actions taken by the public probably include the boycott of organizations' products, the rejection of provided services, and the refusal to purchase orga-

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<sup>238</sup> Miceli, M. P., & Near, J. P., *Individual and Situational Correlates of Whistleblowing*, 41 Pers. Psychol., 267-82 (1988).

<sup>239</sup> Zalkind, S. S., *Is Whistleblowing Climate Related to Job Satisfaction and Other Variables?* (Aug, 1987) (Paper presented at the annual meeting of the American Psychological Association, New York).

nizations' shares in the public stock market. However, internal whistleblowing can survive organizations and keep organizational mistake from being known by outsiders. In this way, organizations not only have sufficient time to resolve those problems, but also can preserve good-will of organizations and avoid future damage.

Contrarily, external whistleblowing cannot benefit organizations in this way. When employees' reports do not get positive responses from organizations, employees tend to ask for help from outsiders since they pay more attention to employees' disclosures and give more assistance than organizations. Though, external whistleblowing brings harmful results to organizational operation and reputations. Those consequences not only may cause the shutdown of business, but also would have a great impact on the financial market. Besides, these results probably bring other social problems to the society, such as massive layoffs or the rise of criminal rates.

#### (6) Avoidance of Legal Regulation

In order to make a response to citizens' expectations of discouraging organizational fraud from happening again, Congress is forced to make up ordinances to regulate varied business activities. Regulations require organizations to make more disclosures regarding their operation, and try to sustain the integrity and transparency of the financial market. However, it is not surprising that more disclosures will cause more expenses for organizations. Organizations are required to follow securities

laws to make a quarter or annual report about their financial conditions; also, it is required for them to hire more professionals to do these work. If organizations do not obey regulations, they will be punished or fined due to their disobedience, and these costs are other financial losses for organizations.

Yet, whistleblowers can give organizations a warning in advance as detecting misconduct, and make organizations have enough time to rectify those mistakes without being known by outsiders. Thus, for organizations, whistleblowers not only have a function to prevent organizations from being fined by authorized agencies, but they also can preclude the legislators' attempts from enacting more ordinances to deter organizations' misbehavior.

### iii. Potential Costs to Society At Large

The public is easily influenced by the behaviour of whistleblowers. When whistleblowers disclose organizations' wrongdoings that the public truly cares about, many social resources will be used to investigate those illegal actions. Not only will organizational fraud bring serious damage on society, but the exhaustion of social resources will also indirectly influence people's ordinary lives.

Take significant organizational irregularity for instance. Large-scale organizations' business influences the national economy; when organizational corruption is known by citizens, in order to restore the public's confidence and rebuild the order of the

financial market, the government will try any method to fix these catastrophes. Law enforcement agencies get involved in investigating corruption; also, other governmental agencies are pushed to find resolution to preclude organizational fraud from happening. Judicial resources will be occupied, and this will hinder courts from solving other critical issues. The media reports organizations' scandals all day long, and this distracts citizens' attention to their daily lives. In addition, in the worse situation, the public will lose trust in business activities, and this consequence will have an impact on cohesive forces in society and influence the operation of the whole financial market.

#### iv. Potential Benefit to Society At Large

##### (1) Increased Safety and Well-Being of Societal Members

Similar to the function that whistleblowers bring to the employing organization, whistleblowing can protect the safety and health of citizens; likewise, it is able to be an alarm and raise the public's attention on organizations' dangerous actions. The public will benefit from whistleblowing because disclosers not only share information that it cannot access, but those disclosures prevent social members from being fooled by organizations' tricks.

##### (2) Reduction of Taxes, Increases in Services

It is hard to understand why whistleblowers benefit social members by reducing taxes. However, if thinking of this way, it is not quite tough to realize

why Miceli and Near said thus.

When whistleblowers unveil organizations' illegal activities to upper managements, managers have a chance to put misconduct back on the right track. Once these mistakes are righted, organizations might be survived, and business keeps operating like before. Continued large-scale organizations are stable sources to provide sufficient taxes for the government, and these indirectly reduces the government's demand on other taxes that mostly come from ordinary people. For this reason, it may be inferred that whistleblowers not only help poorly-performed organizations' business going on, but they also relieve other citizens' onerous burdens of taxes. In addition, organizations that continue to operate provide various products and complete services for the public, and these advantages cannot be replaced by the individual commercial unit or a single person.

### (3) Less Regulation

If whistleblowers can be viewed as an effective mechanism to stop organizations' wrongdoings, it is not required for legislators to enact ordinances or ask regulatory agencies to make detailed rules to deter organizational fraud. Thus, organizations do not have to spend extra money to obey statutes or regulations. By contrast, they can use those expenses to promote the efficiency of organizational operation. For example, organizations can purchase more requisite facilities to increase their pro-

ductivities, recruit more professionals to create new products, or establish more efficient systems to decrease the cost of production.

Organizations can save their money on expensive legal counseling fees and other auditing services because it is not required for them to re-win the trust from the government and the public. Hence, whistleblowing not only cuts down organizations' expenses on complying with the requirements of related statutes and regulations, but also makes organizations become "self-policing and self-correcting, [and] social resources need not be directed toward controlling organizations."<sup>240</sup>

#### (4) Support for Codes of Ethics

The specific standard for organizations to show support on whistleblowers might be demonstrated in organizations' codes of ethics. Codes of ethics express organizations' intent to encourage whistleblowing and make whistleblowing employees be aware that their actions are going along well with the expectation of organizations. Because of this promise, whistleblowers will not be afraid of being retaliated against by employers or being ostracized from colleagues since their actions are protected and acceptable. Also, organizations benefit from whistleblowing since it not only promotes corporate governance and strengthens organizations' internal control, but it also reduces the chance that organizations may suffer financial losses and lose busi-

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<sup>240</sup> Miceli & Near, *supra* note 100, at 14.

ss reputations.

In addition, the society enjoys these results as well. Without employees who are willing to disclose wrongdoings, citizens are exposed to potential hazards, which may threaten the health and safety of the public. In this way, it can be said that not only are organizations' whistleblowers seen as the protectors of public good, but positive attitude toward whistleblowing also can be viewed as a symbol of progressive society.

### *C. Various Perspectives on Whistleblowing*

In this section, an individual and professional perspectives will be studied. The purpose of this section is to understand the attitudes of people who are placed in different positions or serving in different professional areas toward whistleblowing.

#### 1. Individual Perspective

##### a. Employee's View

Whistleblowing, by definition, involves a tension between an employee's duties to an employer and the employee's desire to promote the greater interests of society. In the employment relationship, employees have some implicit duties owed to employers. One of primary duties is the duty of obedience. The duty of obedience requires employees to follow reasonable instructions of employers.<sup>241</sup> In this way, employees do not have to obey employers' unreasonable instructions that may be illegal or

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<sup>241</sup> Restatement (Second) of Agency § 385(1) comment a (1958).

violate normal business ethics.<sup>242</sup> Unreasonable instructions made by employers not only probably constitute a crime, but also may put employees or others in a dangerous place.<sup>243</sup> Nevertheless, it should be noticed that although employees are able to refuse employers' unreasonable instructions, employees are not obligated to complain or disclose those instructions to the public.<sup>244</sup>

Another duty employees owe to employers and organizations is the duty of loyalty, and it is the principal duty in the employment relationship. The standard to decide the duty of loyalty is flexible since it is perhaps changed by the specific circumstance in each employment relationship.<sup>245</sup> The duty of loyalty requires employees

“to act solely for the benefit of the principal in matters entrusted to him [the employee], ... to take no unfair advantage of his [the employee's] position in the use of information or things acquired by him [the employee] because of his [the employee's] position, ... also ... not to act or speak disloyally in matters which are connected with his [the employee's] employment except in the protection of his [the employee's] own interests or those of others.”<sup>246</sup>

Also, employees cannot sabotage employers and distribute any information that has a high possibility to harm the disparagement of employers' products and services.<sup>247</sup> In

addition, Westman says:

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<sup>242</sup> *Id.*

<sup>243</sup> Ramirez, *supra* note 222, at 193.

<sup>244</sup> Westman, *supra* note 159, at 23.

<sup>245</sup> *Id.*

<sup>246</sup> *Id.*; Restatement (Second) of Agency § 387 comment b (1958).

<sup>247</sup> Jeffrey M. Judd, *The Implied Covenant of Good Faith and Fair Dealing: Examining Employees' Good Faith Duties*, 39 Hastings L.J. 483 (1988).



“The duty of loyalty is ... a qualified duty, in that employees are not prevented from acting outside their employment in a manner which injures their employers’ businesses. Thus, the duty of loyalty would not necessarily prevent employees from campaigning for legislation which might require expensive compliance efforts by their employers.”<sup>248</sup>

Thus, when actions taken by employees do not conflict with their employment relationship with employers, but they are consistent with the employment business, it is allowable for employees to go against their employers.

The duty of confidentiality is the third duty that employees owe to employers. It is a duty that can be implied from the duty of loyalty.<sup>249</sup> The duty of loyalty precludes employees from doing any business that conflicts with employers’ interests;<sup>250</sup> it requires employees not to be business competitors by using information, knowledge, or skills that they learn from their positions of employment. Similarly, the duty of confidentiality requests employees “not to use or to communicate information confidentially given him by the principal ... [and] to the injury of the principal ... unless the information is a matter of general knowledge.”<sup>251</sup> Confidential information includes different “unique business methods, trade secrets, customer lists, or other strategic information.”<sup>252</sup> In the employment relationship, employers are inclined to disclose confidential business information to employees, so they can have abilities to perform duties

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<sup>248</sup> Westman, *supra* note 159, at 23.

<sup>249</sup> Restatement (Second) of Agency § 395 (1958).

<sup>250</sup> *Id.* § 394.

<sup>251</sup> Restatement (Second) of Agency § 395 (1958).

<sup>252</sup> Westman, *supra* note 159, at 24.

properly and make missions be achieved successfully.

Not only is it unavoidable for employers to share confidential information and let employees operate their work efficiently, but employers have to take a risk that employees may abuse this knowledge to compete against their business.<sup>253</sup> Westman says, “The duty of confidentiality recognizes that the flow of necessary information between employers and employees would be hampered if employees made unauthorized disclosures of confidential information.”<sup>254</sup> If an employee employs confidential information against his/her employer’s business without having any permission or authorization, “under appropriate circumstances a court might find that an employee who abuses a special position of trust and confidence is liable to his employer for tortious breach of the covenant of good faith and fair dealing implied in his employment contract.”<sup>255</sup>

Yet, the duty of confidentiality does not apply to employees when employers have committed or are about to commit a crime.<sup>256</sup> Even if employees have right to report employers’ criminal acts without being restricted by duty of confidentiality, employees are still unable to unveil employers’ unethical conduct under this duty.<sup>257</sup> There

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<sup>253</sup> *Id.*

<sup>254</sup> *Id.*

<sup>255</sup> Judd, *supra* note 247, at 485.

<sup>256</sup> Restatement (Second) of Agency § 395 comment f (1958).

<sup>257</sup> Westman, *supra* note 159, at 24.

is an obscure difference between employers' criminal behaviour and unethical conduct. The dissimilarity strongly depends on employees' knowledge or experiences in the specific area. As Ramirez says, "[t]here is a fine line between criminal acts and unethical conduct, a line that may not be recognizable by the employee who does not possess expert knowledge of the law."<sup>258</sup> In this way, whether employers' actions are criminal or unethical, those not only will be determined by employees' specific knowledge and experiences of long-term employment, but also the extent of legal knowledge that employees hold will be considered.

Employees serving in organizations may be placed in the positions that make them detect fraudulent activities easier and earlier than any outsiders do. Employees have the best way to access information unknown by others and can be more efficient monitors than the national inspection system.<sup>259</sup> The nature of duty of confidentiality, obedience and loyalty have implicitly indicated that employees can disclose employers' criminal activities, and this implication originated from ancient common law that encouraged citizens to report criminal conduct to law enforcement agencies.<sup>260</sup> Observing the doctrine of misprision of felony, it constitutes a crime when a citizen knew

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<sup>258</sup> Ramirez, *supra* note 222, at 221.

<sup>259</sup> Kent D. Strader, *Counterclaims against Whistleblowers: Should Counterclaims against Qui Tam Plaintiffs be Allowed in False Claims Act Cases?*, 62 U. Cin. L. Rev. 713, 715 (1993).

<sup>260</sup> Westman, *supra* note 159, at 25.

or witnessed felonies but fails to report them to the authorities.<sup>261</sup> In this way, applying the concept of misprision of felony to employees' duties, it might be inferred that not only are employees allowed to disclose employers' criminal conduct constituting a felony, but they will also commit a crime if they are unable to report those employers' misconduct to outside authorized agencies in time.<sup>262</sup> However, where did the doctrine of misprision originate? One time, Westman made a detailed description in his book, and stated this concept as follows:

“The doctrine of misprision originated in medieval England ... Citizens of medieval England were required to raise a ‘hue and cry’ if they witnessed the commission of a felony, or came across a dead body. All males ... were required to join the hue and cry, to pursue the criminal, and to follow the instructions of the local constable.... Under English law, the doctrine of misprision did not require reporting of all offenses, but only of crimes serious enough to be classified as felonies.”<sup>263</sup>

Though, because the U.S. common law originated from England common law system, the question is whether the doctrine of misprision of felony in England still has an influence on the U.S. common law.

The answer to this question tends to be negative because of some reference sources. First, Chief Justice John Marshall in Supreme Court noted, “It may be the duty of a citizen to accuse every offender, and to proclaim every offence which comes to his knowledge; but the law which would punish him in every case for not performing this

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<sup>261</sup> *Id.*

<sup>262</sup> *Id.*

<sup>263</sup> *Id.*

duty is too harsh for man.”<sup>264</sup> Justice Marshall thought that even if the society has put expectations on a citizen to disclose illegal activities that he/she has known, the law still should not punish a citizen for the reason that is merely a social duty, not an obligated responsibility.

Second, many jurisdictions in the U.S. are inclined to make similar negative decisions. Take the Florida Court of Appeal for instance. The court stated that “[w]hile it may be desirable, even essential, that we encourage citizens to ‘get involved’ to help reduce crime, they ought not to be adjudicated criminals themselves if they don’t.... We cherish the right to mind our own business when our own best interests dictate.”<sup>265</sup> The Florida Court of Appeal also agreed that it is improper to punish a citizen for not reporting criminal conduct. Even though a citizen discloses illegal activities can benefit the safety of society, this action still should not be promoted via harsh laws or severe punishment.

Third, the doctrine of misprision of felony is criticized by some commentators since it may abuse the “orderly administration of the criminal justice system,”<sup>266</sup> and is inclined to encourage vigilantism.<sup>267</sup> Besides, the doctrine of misprision of felony can

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<sup>264</sup> *Id.*; *Marbury v. Brooks*, 20 U.S. 556, 575 (1822).

<sup>265</sup> *Id.*; *Holland v. State*, 302 So.2d 806, 810 (Fl. Dist. Ct. App. 1974).

<sup>266</sup> Jack Wenik, *Forcing the Bystander to Get Involved: A Case for a Statute Requiring Witnesses to Report Crime*, 94 Yale L.J. 1787, 1788 (1985).

<sup>267</sup> Westman, *supra* note 159, at 26.

be used to abuse the political purposes.<sup>268</sup> Westman takes Communist for example:

“[T]he two Communist scares of this century, of the 1920s and 1950s, prompted many prosecutions for disloyalty to the United States... the doctrine of misprision ... contains the potential for persecution in times of political turmoil when various forms of political conduct are made illegal.”<sup>269</sup>

Therefore, the doctrine of misprision is no longer viewed as an offense in the U.S. common law and in some jurisdictions, but the misprision of felonies that violates federal laws still can constitute federal offenses.<sup>270</sup> As Westman describes:

“The federal misprision statute modifies the original common-law offense in the same way as the state courts have, by expressly requiring the additional element of some affirmative act of concealment. Despite the outmoded nature of the criminal offense of misprision, the underlying principle that citizens should be encouraged to report serious crimes is accepted throughout the United States.”<sup>271</sup>

Then, even though federal misprisions were modified from the offenses in the common law, they are typical and serious crimes that the public tends to present many concerns. As offenses are regulated by federal statutes, a citizen will be punished when he/she has known or witnessed those offenses, but chooses not to report them. Therefore, it could be concluded that employees do not have an obligation to disclose employers’ wrongdoings;<sup>272</sup> yet, this standard will be excluded when employers commit felonies that have been regulated under federal laws,<sup>273</sup> or when states recognize that the doct-

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<sup>268</sup> *Id.*

<sup>269</sup> *Id.*

<sup>270</sup> 18 U.S.C. § 4 (1988).

<sup>271</sup> Westman, *supra* note 159, at 26.

<sup>272</sup> *Id.* at 32-33.

<sup>273</sup> *Id.* at 26.

rine of misprision still exists in their common laws.<sup>274</sup> In those situations, employees are obligated to disclose what they have witnessed or known to law enforcement agencies.

Whistleblowing is a high-risk action for employees to take. Employees are afraid of being whistleblowers because whistleblowing does not correspond to the expectations of organizations in general. The observation made by Miceli & Near can explain this point.

“[E]xpectancy theory provides a framework linking individuals’ beliefs about organizational conditions with their motivation to act. Whistleblowers’ beliefs about the legitimacy and importance of whistle-blowing may differ from others’ beliefs because they may have responded to different organizational conditions, or because their values may differ from others’ because of prior experiences.... direct experience strengthens the consistency between self-reported attitudes and behavior; because whistle-blowers have acted in support of whistleblowing by definition, they should be more supportive of it in their self-report.”<sup>275</sup>

According to this research, the primary factor for employees to consider whether they should blow the whistle is decided by employees’ beliefs in organizations’ attitudes to whistleblowing. Those beliefs are not only established by the experiences of former employees, but are also reinforced by employees’ self-experiences. The stronger belief employees hold that organizations will encourage them to blow the whistle, the more frequently organizations will receive arguments from different levels of employees

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<sup>274</sup> *Id.* at 24-27.

<sup>275</sup> Marcia Parmerlee Miceli & Janet P. Near, *The Relationships among Beliefs, Organizational Position, and Whistleblowing Status: A Discriminant Analysis*, 27 *Acad. of Mgmt. J.* 687, 689 (1984).

in the workplace.

However, what kind of features can be found on employees who push themselves to be whistleblowers? Since whistleblowers are inclined to place themselves into a dangerous position, some personal characteristics might be unique on whistleblowers as comparing to other people. Once a research said:

“[R]esearchers can draw from research on behavior that seems similar in some ways to whistle-blowing to identify predictors. One stream of research in social psychology focuses on pro-social behavior, defined as positive social behavior that is intended to benefit other persons, even though pro-social actors can also intend to gain rewards for themselves.... Previous authors have presented evidence that whistle-blowing can be considered a type of pro-social behavior that occurs in organizations. Whistle-blowers call attention to questionable practices in order to help the present and potential victims or to benefit the organization because they believe the activity is not consistent with the organization’s stated values. This suggests that predictors of pro-social behavior may also predict whistle-blowing among persons who have observed perceived organizational wrongdoing. The literature on pro-social behavior suggests that observers of wrongdoing consider whether they are responsible for correcting it.”<sup>276</sup>

According to this research, employees being whistleblowers can be regarded as a kind of pro-social behaviour. Their intentions tend to help organizations or other individuals to get away from activities that probably cause harmful damage upon them. Employees choose to stop this situation by being whistleblowers because of their higher ethical belief and moral.<sup>277</sup> Westman says this point as follows:

“From an ethical perspective, employees may feel that the act of whistleblowing is required rather than voluntary. However, it should be recognized that the co-

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<sup>276</sup> Miceli & Near, *supra* note 238, at 268.

<sup>277</sup> Glazer & Glazer, *supra* note 137, at 97-132.



impulsion employees may feel does not necessarily arise from legal sources, but instead from individually held moral or ethical beliefs. In some cases, an employee's decision to blow the whistle is tantamount to a decision that his or her individual ethical views are superior to those of his or her organization."<sup>278</sup>

Most of the time, employees who choose to be the whistleblower have held long-term careers in organizations.<sup>279</sup> They are used to being placed in pretty high positions and deeply believe that they have a stronger sense of loyalty to organizations than other fresh employees.<sup>280</sup> This point is upheld by some scholars. As Miceli & Near describe, "[T]he nature of the position one holds in the organization may influence the assessment of responsibility."<sup>281</sup> Likewise, once Moberly mentioned the similar point of view and stated:

"Studies demonstrate that designating a uniform recipient of whistleblower complaints in an organization and directing employees to that recipient results in increased amounts of whistleblowing. Perhaps one reason for the increase is that employees become whistleblowers out of a sense of loyalty to their organization. Contrary to popular belief regarding the traitorous nature of such 'snitches,' social science research demonstrates that whistleblowers often are employees with long tenure who believe they will serve the organization's best interests by providing information about organizational wrongdoing."<sup>282</sup>

Because employees who have kept long-term employments in organizations care more about business operation and organizations' reputations than others, these employe-

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<sup>278</sup> Westman, *supra* note 159, at 32-33.

<sup>279</sup> Dworkin, T.M. & Near, J.P., *Whistleblower Statutes and Reality: Is There a Need for Realignment?*, Proc. Pac. S.W. Bus. L.A. 73 (1990).

<sup>280</sup> Lena Kolarska & Howard Aldrich, *Exit, Voice, and Silence: Consumers' and Managers' Responses to Organizational Decline*, 1 *Organizational Stud* 41, 47-48 (1980).

<sup>281</sup> Miceli & Near, *supra* note 238, at 268.

<sup>282</sup> Moberly, *supra* note 225, at 1141-42.

es are convinced that whistleblowing not only can assist organizations that have committed misconduct in going back on the right track, but also can sustain organizations to continue their business.

Employees who intend to be the whistleblower have to think over two factors before stepping forward.<sup>283</sup> The reason is that being a whistleblower to report organizational fraud has to bear several costs and risks.<sup>284</sup> First, these employees have to think about whether the information they provided may change the status quo and will correct problems. Second, they must ascertain that if there is any protection in organizations, which can avoid them from bearing adverse actions,<sup>285</sup> financial losses,<sup>286</sup> or perhaps other mental effects or physical harm.<sup>287</sup> Most of the time, the primary factor to preclude employees from stepping forward is retaliation taken by employers and organizations. Organizations make use of varied adverse actions as their protective casings because managements are unwilling to disclose poor performance. Adverse action can be appeared in many forms, such as “termination, suspension, non-promotion, re-

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<sup>283</sup> U.S. Merit System Protection Board, *Whistleblowing in the Federal Government: An update*, A report to the President and the Congress of the United States by the U.S. Merit Systems Protection Board, at Ch 1 (1993).

<sup>284</sup> Cora Daniels, *It's a Living Hell*, *Fortune* (2002).

<sup>285</sup> Sandra Blakesless, *For Los Alamos, A New Puzzle: The Case of the Battered Whistleblower*, *N.Y. Times*, June 9, 2005, at A24.

<sup>286</sup> C. Fred Alford, *Whistleblowers: Broken Lives and Organizational Power* 109-10 (2001).

<sup>287</sup> Richard L. Rashke, *The Killing of Karen Silkwood: The Story Behind the Kerr-McGee Plutonium Case* (2d ed. 2000).

assignment, transfer, denial of training, withholding wages or other benefit, closer supervision, or greater scrutiny.”<sup>288</sup> Miceli & Near say this related issue as follows:

“If an organization is dependent on a questionable practice, it may provide cues that whistle-blowing will be met with retaliation to the whistleblowers and resistance to changing the questioned practice. Retaliation may be a powerful disincentive to whistle-blowing. Observers of wrongdoing may perceive that a retaliatory climate exists and decline to act – or they may rationalize inaction by attributing it to an unfavorable climate. . . . Similarly, if management appears unwilling or unable to change its questionable practices, individuals may expect that whistle-blowing will be ineffective.”<sup>289</sup>

In addition, Westman points out that

“[f]ew experiences are as frustrating as witnessing a wrong but feeling unable to correct it. Employees may feel as if they are in such a position when their companies act improperly, and if they fear loss of their jobs if they protest. Similarly, employees who participate in the decision-making processes which lead to their organizations’ decisions to take improper actions, but who opposed taking such actions, may feel powerless because their voices have gone unheeded. The only reason they do not become whistleblowers may be concern about retaliation.”<sup>290</sup>

Hence, retaliation can be seen as the biggest obstacle for employees to blow the whistle. Employees trying to be whistleblowers worry about egregious mistakes made by organizations; also, they care more about their self-interest and self-safety. Because it is difficult for employees to balance the tension, some of them choose to keep silent on organizations’ irregularities in order to survive jobs, and let organizations’ improper behaviour abuse their own business. In this situation, it is unsympathetic and unfair

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<sup>288</sup> Strader, *supra* note 259, at 719.

<sup>289</sup> Miceli & Near, *supra* note 275, at 689-90.

<sup>290</sup> Westman, *supra* note 159, at 27.

to say that these employees' choices come from their cowardice; however, the nature of human beings pushes them to make such decisions.

Besides the fear of retaliation from employers and organizations, the pressure from colleagues is another concerning factor for whistleblowers. Most of the time, whistleblowers are ostracized by fellow workers and isolated by social groups. Colleagues think that whistleblowers get involved in too many trivial matters to which they should not pay attention or care about. Whistleblowers' disclosures on fraudulent activities not only bring catastrophes to organizations, and may make the collapse of business, but these reports also cause uncertain results to coworkers' occupations and livelihoods. One time, Culp described this situation as follows:

“[R]ather than being viewed with admiration by their peers, whistleblowers are treated with scorn and disdain and are often rewarded with labels such as ‘snitch,’ ‘rat,’ and ‘tattle-tale.’ This is not to say that all whistleblowers should be viewed as heroes or knights in shining armor. Some may be ill-informed, meddling, troublemakers or ill-motivated and vindictive.”<sup>291</sup>

Therefore, those colleagues do not give much appreciation on whistleblowers' actions. On the contrary, they show no respect for whistleblowers' behaviour on the disclosures of organizations' fraudulent activities, and are inclined to nickname them by some awful characters.

#### b. Employer's View

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<sup>291</sup> David Culp, *Whistleblowers: Corporate Anarchists or Heroes? Towards a Judicial Perspective*, 13 Hofstra Lab. L.J. 109, 115 (1995).

Compared to employees' views on becoming a whistleblower, the attitude of employers toward whistleblowing is much different. Some employers may consider whistleblowing vitalizes organizations' bureaucratic systems and brings a power to promote rigid operation.<sup>292</sup> These employers believe that whistleblowing helps to supervise other employees, who may potentially commit illegal actions, and to oversee those who are difficult to be kept tabs on.<sup>293</sup> Though, it is a little far away from the reality if using the minority of employers' points of view to study this section.<sup>294</sup> Actually, the majority of employers are unwilling to let whistleblowers appear in the workplace because they are afraid of the consequences that whistleblowers probably bring about. Employers are convinced that the consequences caused by whistleblowing not only have negative influences on organizations' operation, but also pose potential threats to their positions.<sup>295</sup> In addition to worrying about personal disasters, employers are also inclined to see whistleblowing as the behaviour, which challenges their managerial power on business affairs<sup>296</sup> and affects the atmosphere of workplaces.<sup>297</sup> Dworkin & Callahan note this point as follows:

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<sup>292</sup> Alan F. Westin, *Whistleblowing!: Loyalty and Dissent in the Corporation* 141-42 (1981).

<sup>293</sup> *Id.*

<sup>294</sup> Miceli & Near, *supra* note 100, at 1-2.

<sup>295</sup> James N. Adler & Mark Daniels, *Managing the Whistleblowing Employee*, 8 *Lab. Law.* 19, 19 (1992).

<sup>296</sup> Kenneth T. Lopatka, *The Emerging Law of Wrongful Discharge – A Quadrennial Assessment of the Labor Law Issue of the 80s*, 40 *Bus. Law.* 1, 36 (1984).

<sup>297</sup> Coffee, *supra* note 72, at 1127-37.

“In terms of organizational implications, whistleblowing in any form represents an obvious challenge to the employing organization’s legitimate interest in managerial decision-making and maximizing control and efficiency.... Further, formal recognition of a role for whistleblowers may result in a less cooperative workplace atmosphere”<sup>298</sup>

For most employers, they dislike whistleblowing because it brings about the trend of second-guessing employers’ managerial authority and causes distrust in the workplace.

Not only will potential whistleblowers doubt employers’ power of decision-making, but whistleblowing will also confine employers’ authority to discharge unsatisfactory employees.<sup>299</sup> As Hubbell says:

“[T]he right to manage and discharge employees serves important and legitimate business purposes for an employer. Any exception to the employer’s right to discharge at will tends to increase costs and diminish the employer’s control and management of the business.”<sup>300</sup>

Further, employees probably take advantage of whistleblowing to disguise their actual intent of non-hardworking.<sup>301</sup> As Carlson notes this point below:

“Critics of retaliation laws have also argued that citizen employee laws impose costs in the day-to-day management of the business wholly aside from litigation expenses. According to this argument, citizen employee laws undermine managerial authority by empowering employees to question orders, delay work, miss work, or show disrespect to supervisors under the guise of acting for the public interest. Any law that protects employee traits or conduct is subject to these objections, but critics find the problem potentially more severe in the case of laws protecting the conduct of citizen employees.”<sup>302</sup>

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<sup>298</sup> Dworkin & Callahan, *supra* note 232, at 306.

<sup>299</sup> James W. Hubbell, *Retaliatory Discharge and the Economics of Deterrence*, 60 U. Colo. L. Rev. 91, 99-100 (1989).

<sup>300</sup> Richard R. Carlson, *Citizen Employees*, 70 La. L. Rev. 237, 282 (2009).

<sup>301</sup> Moberly, *supra* note 225, at 1157.

<sup>302</sup> Carlson, *supra* note 300, at 286.

In this way, whistleblowing is not used by employees to disclose organizational misconduct or corruption, but it is employed as a private instrument against their employers and organizations. Under this situation, because the intention of employees to blow the whistle probably is based on self-interest instead of public benefit, whistleblowing fails to be seen as altruism, but it is a kind of egoism.

Another reason for employers to discourage and to devalue whistleblowing is since when employees realize they are allowed to second-guess their employers, complaints will increase in the workplace, and employers have to spend more time addressing arguments and defending themselves than before.<sup>303</sup> Carlson mentions this issue in his article and notes:

“In the modern, highly regulated workplace, a putative citizen employee has a myriad of opportunities to rationalize or mischaracterize insubordinate or disrespectful conduct. Moreover, the argument continues, employees who feel empowered to question instructions or business practices may do so with such frequency and persistence that managers are forced to devote an increasing part of their time to defending themselves from unfounded charges.”<sup>304</sup>

Importantly, whistleblowing probably accompanies exposing confidential information of organizations when whistleblowers decide to disclose employers' frauds externally. Confidential information is related to the persistence and the competitiveness of organizations, and employers are obligated to protect organizations' information from being abused by others. Whistleblowers tend to divulge business information because it

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<sup>303</sup> Hubbell, *supra* note 299, at 112-13.

<sup>304</sup> Carlson, *supra* note 300, at 286.

is the required step to disclose organizations' unlawful actions; however, this behaviour is detested by employers.<sup>305</sup> As Carlson says:

“Another set of concerns sometimes raised by critics of citizen employee laws relates to the effects of such laws on communication within a firm or agency. First, critics worry whistleblowers in particular might disclose confidential business information in support of their whistleblowing claims, and employers will be pressed to respond by inhibiting information transfer within the corporation.”<sup>306</sup>

In addition, whistleblowing is able to be regarded as the behaviour of accusation as well. It not only may directly suspect the untrustworthiness of organizations, but it probably indirectly accuses the disloyalty of other individuals in the workplace. Westman presents this idea as follows:

“Whistleblowing by its nature is a form of accusation against an employee's organization, and either directly or indirectly, against another individual in the organization.... Partly for this reason, the Code of Ethics and Implementation Guidelines issued by the American Society for Public Administration provides that ‘[a]s a last resort, public employees have a right to make public their criticism but it is the personal and professional responsibility of the critic to advance only well funded criticism.’ Therefore, employees' responsibilities to their organizations and co-workers suggest that reports of wrongdoing be carefully researched for accuracy before institutional and individual reputations are called into question.”<sup>307</sup>

Based on this phenomenon, it can be inferred that negligent whistleblowing is another factor for employers to have negative perception of whistleblowers. The reason is that ill-informed whistleblowing means employees do not carefully think over the truthful-

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<sup>305</sup> Larry Ribstein, *Sarbox: The Road to Nirvana*, 2004 Mich. St. L. Rev. 279, 286 (2004).

<sup>306</sup> Carlson, *supra* note 300, at 291.

<sup>307</sup> Westman, *supra* note 159, at 29-30.



ness of allegations in regard to fraudulent activities; also, those employees are not concerned with the damage that perhaps brings to organizations and society at large.

Because of negative perception of whistleblowing, it is highly probable for employers to believe that no matter which retaliation they impose upon whistleblowers are acceptable and reasonable. Employers do not treat whistleblowing employees as a part of organizations' assets, but think that they are worthless and expendable. Therefore, in employers' views, retaliating against employees who decide to be whistleblowers is less harmful to organizations and themselves. Compared with adverse actions borne by employees, a few employers assume that organizations and society bear more damage than an employee does.<sup>308</sup> The damage includes the loss of business reputations, an unemployment disaster, the untrustworthiness of the financial market, and an unstable social atmosphere. Employers have duties to go for satisfying profits for organizations and stockholders, and it is admirable for employers to devote themselves to promoting business performance. Thus, whistleblowing employees' livelihoods are not the primary concern for employers to think about when they are administering organizations. On the contrary, the success of business and the persistence of organizations are more significant than an individual's future.<sup>309</sup>

Even though organizations' interests may be more important than an individual's,

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<sup>308</sup> Jones, *supra* note 135, at 1146.

<sup>309</sup> *Id.*

employees still should not be retaliated against or sacrificed when they simply distract employers' attention from business to organizations' irregularities.<sup>310</sup> On the contrary, employers ought to open their minds and admire what whistleblowing employees do to point out organizations' mistakes<sup>311</sup> since they are the firsthand witnesses of illegitimacy.<sup>312</sup> Although employers dislike whistleblowing, they still fail to deny the advantages that whistleblowers bring to organizations. Employers cannot, on the one hand, enjoy the benefit brought from whistleblowing; but on the other hand, they intend to employ adverse actions to avoid all deficiencies that whistleblowing may cause to organizations and themselves.

In order to resolve this deadlock, employers should change their thoughts and provide whistleblowers an in-house channel to present their concerns. It is an ideal method to balance conflicts and reach a win-win result. In this way, the costs of whistleblowing will be internalized, not externalized.<sup>313</sup> Employers like whistleblowers to disclose frauds by an internal channel rather than external one since they can rectify those wrongdoings without being known by society. If organizational corruption known by the public, it not only causes the loss of business reputation, but also makes organi-

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<sup>310</sup> *Id.*

<sup>311</sup> *Id.*

<sup>312</sup> *Id.*

<sup>313</sup> Moberly, *supra* note 225, at 1124.

zations spend more money on investigations.<sup>314</sup> However, internal whistleblowing reduces those tangible and intangible losses; likewise, it enhances employees' fiduciary duties to organizations and employers with no leaking of confidential knowledge and materials.<sup>315</sup> As Dworkin & Callahan state this point below:

“In terms of the employer's interests, benefit from whistleblowing may be maximized, and disadvantages diminished, when the whistle is blown internally. Utilization of in-house channels often gives the concerned employee access to more complete information, resolving the situation in its entirety. If problems exist, the employer has the opportunity privately to take corrective action and thereby reduce the likelihood of lost business, adverse publicity, litigation, fines or other criminal sanctions, and other adverse consequences.”<sup>316</sup>

Hence, organizations' in-house channels not only help employers promote their inside control and internal corporate governance, but assist employees in establishing a good communication with the upper management. An internal disclosure reduces the conflicts that regularly happen in the employment relationship, and decreases the costs brought by hostile environment in the workplace.

Employers are the managers of organizations. Their duties not only have to respond to changes occurring outside organizations, but also have to assure internal operation is under their control. Managerial authority gives them the power to make a decision, to cope with complaints from employees, and to protect organizations' assets or resources. While employees are making more complaints regarding business, this can

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<sup>314</sup> Rubinstein, *supra* note 134, at 639.

<sup>315</sup> *Id.*

<sup>316</sup> Dworkin & Callahan, *supra* note 232, at 300.

be implied that employers' managerial authority is being doubted. However, for some employers' points of view, employees' complaints are not the challenges for their authority, but can be positively seen as a part of managerial control. Since employees report anything wrong occurring in organizations, employers have a chance to right these mistakes in time, and put organizational misconduct back on the right track. After all, employers hold a duty to avoid organizations from suffering damage or losses, and are obligated to promote organizations' performance as well. Once Summers & Nowicki stated this similar idea as below:

“Managers are hired to execute the goals that derive from the organization's mission, vision, and values. At the same time, managers have an obligation to protect the organization. When employees point out abuses, they are functioning as part of ... [employers'] management information system. They are letting [employers] know that the goals [that employers] are charged to execute are not being met. They are part of a control system. However, when the information becomes public, the control system has gone out of control.”<sup>317</sup>

In this way, whistleblowers can be viewed as the reminder for employers to know whether everything in organizations is under their control or not. Whistleblowing employees enhance employers' abilities to administer business operation; also, they promote employers' managerial power to control organizations' matters.

As discussed above, employers like employees' complaints to remain confidential, instead of going to the public. For employers, employees who resort to any outside

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<sup>317</sup> Jim Summers & Michael Nowicki, *Whistleblowing: Does Anyone Want to Hear?* (Healthcare Financial Management 2003), available at [http://findarticles.com/p/articles/mi\\_m3257/is\\_7\\_57/ai\\_105501133/?tag=content;coll](http://findarticles.com/p/articles/mi_m3257/is_7_57/ai_105501133/?tag=content;coll).

ers represent a kind of disloyalty for them and organizations. Once Summers & Nowicki studied employers' views and found:

“Managers ... are supposed to support the mission, vision, and values of the organization. At the same time, [managers] value loyalty, which typically includes keeping the dirty linen out of sight. Exposing organizational abuse, whether or not that abuse was intentional, normally suggests organizational disloyalty. No doubt, managers would prefer that abuses brought to their attention remain confidential while they resolve the problem. Such problem-solving might involve working out a satisfactory settlement with the appropriate party, without public scrutiny. In those cases, employees may see no need for whistle-blowing to the news media or regulatory agencies. They view managers as living up to the organization's mission, vision, and values.”<sup>318</sup>

Thus, what efforts made by employers can encourage employees to make a disclosure via in-house channels? My advice is that employers not only have to show their intentions to support internal whistleblowing in the workplace, but also should set up a sound internal channel for employees to make their complaints. In addition, employers ought to create a whistleblower-friendly working atmosphere, which makes employees feel comfortable to report and believe organizations uphold their actions. Once Summers & Nowicki provided some ideas for employers to encourage internal whistleblowing, and said this as follows:

“In an organizational environment where employees believe management really upholds the mission, vision, and values of health care, the employees will inform management about abuses. Tell employees [that management] want[s] to know about these problems. Provide training programs that address employees' rights in whistle-blowing, management's preference to avoid whistle-blowing situations, and what [management] will do to take a whistle-blower's concerns in-

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<sup>318</sup> *Id.*

to account. In reality, [management] cannot possibly correct all of the problems [it] learn[s] about. Nonetheless, to avoid being perceived as indifferent, [management] can involve employees in discussions about solutions. If employees realize that the most appropriate solution will avoid causing other adverse effects, they may be satisfied.... Ignoring or discouraging employee complaints heightens the risk. Getting employees on the problem-solving team will reduce the risk of whistle-blowing more than doing nothing.”<sup>319</sup>

To sum up, in order to encourage employees to blow the whistle internally, employers not only should make employees truly convince that whistleblowing is supported by organizations, but they also have to provide each chance for employees to participate in the processes of discussion, and let employees know how their concerns will be handled, and how employers will positively respond to those reported problems.

## 2. Professional Perspective

Most of the time, professional employees have more conflicts of interest than ordinary employees do. Not only do they have to conform to codes of ethics made by the professional group, but they also have to abide by organizations’ charters or bylaws and to follow supervisors’ instructions. Ethical codes require these professionals to disclose illegal activities for the benefit of society; however, their supervisors want them to keep irregularities confidential, and request them to be loyal to organizations they serve. As Westman says:

“Professional employees who are sworn to follow ethical codes may experience acute conflicts between their duty to obey those codes, and their duty to their employers.... professionals may be required to follow the codes of ethics of th-

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<sup>319</sup> *Id.*

eir professions, many of which require or strongly encourage disclosure of improper conduct by co-workers or by clients in order to protect the public welfare. For example ... the Model Rules of Professional Conduct adopted by the American Bar Association absolutely require attorneys to report ethical violations by other attorneys, including co-workers, to the appropriate disciplinary authorities. Thus, professional employees may often be placed in positions where their responsibilities as employees and their responsibilities under ethical codes are in direct conflict. Such professional employees may feel ethically compelled to become whistleblowers, and may feel that they run the risk of professional discipline if they do not make disclosures of misconduct which affects the public safety or welfare.”<sup>320</sup>

In this way, professional employees encounter more obstacles and tough choices when facing the issue of whistleblowing. On the one hand, they are required to protect organizations’ and other employees’ interests. On the other hand, they have to think about public good because the nature of their work is to serve society, and to assure the welfare of citizens will not be influenced and damaged. Below I am going to analyze two types of professionals who regularly face the conflict of interest when being a whistleblower.

a. Lawyer’s View

i. Joseph Rose and AMPI<sup>321</sup>

Joseph Rose was a lawyer in Associated Milk Producers, Inc. (AMPI). His responsibilities covered auditing, payment of legal expenses, and the coordination of outside legal counsel in matters other than antitrust. After his disclosure on AMPI’s

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<sup>320</sup> Westman, *supra* note 159, at 28-29.

<sup>321</sup> This case refers to Westin, *supra* note 292, at 31-38.

criminal activity, a *Wall Street Journal* article characterized him as “a young attorney well on the way to corporate success.” Despite this admiration, it is hard to imagine what Rose had borne as he reported AMPI’s misconduct to his employers and AMPI’s board of directors. Also, being a professional, Rose had encountered conflict of interest and faced a difficult choice between a professional lawyer and a loyal employee. At last, he chose to obey professional ethical codes and unveil AMPI’s irregularity. However, what he lost was intolerable, and those sufferings are typical for whistleblowers. As Rose was asked to testify against AMPI’s illegal actions for the Watergate Special Prosecutor’s Office and the Senate Select Committee, he said:

“The ironic element in that statement is that because of my role in exposing AMPI’s illegal actions in the ‘milk deal,’ I have been labeled a whistle blower. I never set out to be a whistle blower; I merely tried to alert the appropriate officials at AMPI to the misconduct I became aware of – I felt that was my duty as AMPI’s in-house counsel. Even though AMPI fired me abruptly for attempting to discharge my duty, and despite their campaign to discredit me after I was fired, my personal set of ethics dictated that I attempt to shield the company because of the unsettled question of our attorney-client relationship. If I was a whistleblower, I became one reluctantly.

Even though I was a reluctant whistle blower, I paid a heavy price for it. AMPI’s campaign against me had its effect: my finances dwindled away; I had to give up my house and move my family into a small and inadequate apartment; and my wife had to go back to work to help support us, even though her health was still delicate. Our family meals consisted of cheap basics like salads, corn bread, and pinto beans. We received anonymous, threatening phone calls, and even my father, who was dying of emphysema, received derogatory calls about me. My father passed away during this period, going to his grave believing that my career had been irreversibly destroyed.

The only break I had after months of job hunting was an offer to practice law with a small firm in west Texas. I went there alone to take the job -- at a



much reduced salary from what I had been earning -- but after a short time the firm dissolved and I was thrown back into the job market. Through the subsequent months of unemployment, I remember praying daily for the help of the Lord, which I believe was the only thing that could salvage my shattered career and help get my family on its feet again. It wasn't until August 1975 – nearly two years after I was fired by AMPI – that I obtained a decent job, with the National Treasury Employees Union in Washington, D.C.”<sup>322</sup>

Observing Rose's situation, not only do professional employees confront the position-recognized conflict, but both professional and ordinary employees may also suffer tangible pressures and intangible threats to their livelihoods when they determine to be a whistleblower.

#### ii. Two Conflicting Roles as a Lawyer

In principle, there are two perspectives to examine the role of lawyer in organizations. These are the hired gun model (or total commitment model) and the gatekeeper model<sup>323</sup> (or independent lawyer model).<sup>324</sup> In the hired gun model, lawyers follow their clients' decisions and instructions and fully help them achieve business goals allowed by law, no matter whether the process or outcome will cause damage to other people or bring harmful consequences to society. As Fisch & Rosen say, “The hired gun model is based on a strong version of client primacy. The attorney is affirm-

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<sup>322</sup> *Id.* at 36.

<sup>323</sup> Jill E. Fisch & Kenneth M. Rosen, *Lessons from Enron, How did Corporate and Securities Law Fail? Is There a Role for Lawyers in Preventing Future Enrons?*, 48 *Vill. L. Rev.* 1097, 1103 (2003).

<sup>324</sup> Paul G. Haskell, *Why Lawyers Behave as They Do* 85 (1998).

actively required to assist his or her client to the fullest extent permitted by law.”<sup>325</sup>

Likewise, Haskell notes this point in his book:

“The uneasiness within the profession has been evident throughout our history. It is reflected in the professional literature by the portrayals of two models of lawyering. One is the lawyer who unquestioningly accepts the client’s objective and in its pursuit zealously employs the arsenal of tactics within the law and the professional rules, regardless of the harm inflicted upon specific others or the social consequences.”<sup>326</sup>

In this way, the hired gun model requires a lawyer to put emphasis on the interests of clients, whether the consequence that will harm other people or concern the safety and health of society is not a critical factor for a lawyer to think about.

Another vision to decide the role of lawyer is the gatekeeper model. The gatekeeper model requires a lawyer to take social duties into account when he/she follows clients’ instructions to perform his/her work. Besides, a lawyer is asked to make an independent judgment for his/her clients when being counseled, and can refuse to practice any legal action if he/she thinks that this act may violate his/her professional ethics.

As Fish & Rosen notes this idea as follows:

“The gatekeeper model incorporates public policy limitations on attorney conduct that may constrain an attorney from following some client instructions even if those instructions are legal. In addition, the model may require the attorney to take affirmative steps to prevent or limit client wrongdoing.”<sup>327</sup>

Also, Haskell says:

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<sup>325</sup> Fisch & Rosen, *supra* note 323, at 1102.

<sup>326</sup> Haskell, *supra* note 324.

<sup>327</sup> Fisch & Rosen, *supra* note 323, at 1102.

“The other model is the lawyer who in his counseling and representation exercises independent judgment in his relationship to the client. This lawyer, in his advice, provides the client the benefit of his judgment of the prudence, long-term consequences, morality, and social responsibility of the client’s objective and of the tactics and strategies for its accomplishment. If the lawyer’s judgment is that they, or any of them, are unworthy, and if the client is unconvinced that he should refrain, the lawyer may decline or terminate the representation.”<sup>328</sup>

The gatekeeper model does not request a lawyer to put his/her client’s benefit in the first place as he/she performs his/her duties. Though, it asks a lawyer to put more focus on deterring a client’s illegal action or wrongful instruction, on abiding by public policy, and further on avoiding potential risks imposed upon the public as practicing his/her work with professional ethics.

Recently, the debate between the hired gun model and the gatekeeper model on a lawyer’s role still continues. Legal scholars try their best to find the balance between these two visions, and are vexed at deciding which kind of organizations’ misconduct should be disclosed by a lawyer. Once settling the extent of disclosure, not only can a lawyer satisfy his/her social duty, but he/she may not breach his/her loyalty to clients and organizations he/she serves. Supporters of the hired gun model argue that a lawyer should not disclose his/her clients’ unlawful actions because the obligation of disclosure does not correlate with a lawyer’s duty, and it undermines a lawyer’s role if he/she puts public interest in the first place. Advocates of the gatekeeper model use the

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<sup>328</sup> Haskell, *supra* note 324.

view of public interest to make a counter-argument. They think that even though a lawyer's capacity is to serve the best interest of clients, the client primacy still cannot be superior to the interest of society.<sup>329</sup>

Although the debate has not been resolved until today, the hired gun model is predominant over the gatekeeper model in the lawyer-client relationship in the practicing area.<sup>330</sup> Haskell finds this phenomenon and describes this as follows:

“It is generally accepted that ... the hired gun model has become predominant. There are no statistics on the subject, but there seems to be a consensus in the profession that there are more lawyers who practice in that style today ... and that the style has become more aggressive than in the past. When lawyers speak of the decline of professionalism today, it is this shift in professional behavior together with a breakdown in civility among lawyers; the introduction of advertising, marketing, and solicitation of legal business; and the emphasis upon the financial ‘bottom line’ that are typically referred to. The practice of law has become more competitive and commercialized.”<sup>331</sup>

In Haskell's point of view, he said that the reason for the dominant hired gun model among lawyers is the decline of professionalism. However, which factor causes a lawyer's professionalism to fall down and gradually get away from protecting the society's interests, concerning this issue, Glazer & Glazer studied some phenomena in organizations that might result in the failure of professionalism. They demonstrate this finding as follows:

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<sup>329</sup> Fisch & Rosen, *supra* note 323, at 1102.

<sup>330</sup> Roger C. Cramton, *Professionalism, Legal Services, and Lawyer Competency*, in American Bar Association, *Justice for a Generation* 144, 149 (1985).

<sup>331</sup> Haskell, *supra* note 324.

“From the professionals’ perspective, the demand for compliance was in direct contradiction with their beliefs in their independent judgment based on their special expertise and training. Whenever they found themselves in situations where the management of large organizations made decisions that resulted in unsafe products or fraudulent acts by putting bureaucratic imperatives ahead of expert judgment and values, some professionals felt they had the obligation to resist.... Unfortunately for these professionals, their respective professional associations were not willing to step forward and support their positions. Ethical resisters have not found spirited support from the local branch of ... the association ... Some ethical resisters never even considered approaching a professional organization for fear of becoming enmeshed in yet another bureaucracy. Others gave some consideration to seeking such assistance, but decided against it when they noted that some ethics committee members were employed by large corporations that had skirted the law. Others did seek active intervention of their local societies, only to find that their appeal was ‘put on the back burner’. They began to suspect that the very groups presumably committed to maintaining professional ethics had an even larger interest in assuring good relationships with government or corporate officials whose actions the ethical resisters were calling into question.”<sup>332</sup>

Professional employees in different areas often face diverse pressures from employers, colleagues, professional associations, and organizations that they serve. Employers try to subordinate professional employees to follow their instructions because they are the group that is the most difficult to control.<sup>333</sup> Colleagues dislike associating with the professionals due to their arrogance, which results from expertise, and since they are opinionated. At times, professional employees do not feel comfortable with their professional associations as these professionals find their association members tend to ad-

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<sup>332</sup> Glazer & Glazer, *supra* note 137, at 71-72.

<sup>333</sup> Deena Weinstein, *Bureaucratic Opposition* 36-52 (1979).

here to a trend that they do not want to follow.<sup>334</sup> Because of these factors, the professionals are tired to be an isolated group in society and gradually turn to go with the standard that their employers favor, their colleagues habitually practice, and their professional associations are inclined to compliment. These phenomena probably can explain the failure of professionalism and correspond with the situation that a lawyer encounters in organizations.

Besides, not only does the actual situation push a lawyer to choose the hired gun model, but Model Rules of Professional Conduct of the American Bar Association (ABA) also have a great influence to promote this trend. For example, Model Rule 4.1 bars a lawyer from making false statements or material omissions to third parties,<sup>335</sup> but this prohibition is restricted when referring to another section. In Model Rule 1.6, a lawyer is asked to obey the duty of confidentiality and cannot leak confidential information to the public;<sup>336</sup> however, because the definition of confidentiality is ambiguous and has not been defined by Model Rules, a lawyer is inclined to keep silent when he/she observes a client's illegal actions since he/she is afraid of breaching his/her duty of confidentiality to the client.

Even though the professional rules allow a lawyer to choose the hired gun model

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<sup>334</sup> Kenneth T. Bogen, *Managing Technical Dissent in Private Industry: Societal and Corporate Strategies for Dealing With Whistleblowing Professionals*, 13 *Indus. & Lab. Rel. F.* 1, 3-12 (1979).

<sup>335</sup> ABA Model Rule of Professional Conduct § 4.1..

<sup>336</sup> Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* 37.2-37.6 (2001).

or the gatekeeper model on their own, there are still some regulations that request a lawyer to fulfill his/her social responsibility as the gatekeeper. Model Rule 1.2 describes that a lawyer not only shall not provide clients with advice for engaging in illegal actions, but also cannot assist them in committing criminal or fraudulent conduct.<sup>337</sup> Rule 1.13 asks a lawyer to realize his/her obligation is to serve the organization, not to the individual or specific group, like corporate managers or executives.<sup>338</sup> Besides, Model Rules also establish a specific procedure for a lawyer when he/she finds that his/her warning has no function to persuade clients to stop committing illegal actions. As Fisch & Rosen describe:

“The Rule permits but does not require the lawyer to ask for reconsideration of the matter, to ask for a separate legal opinion or to refer the matter to higher authority in the organization. If despite the lawyer’s efforts, the organization persists in violation of the law, the lawyer is permitted to resign.”<sup>339</sup>

Historically, some mechanisms have been made to require a lawyer to perform his/her obligation in a gatekeeper position.<sup>340</sup> First, some cases allow a malpractice claim against a lawyer as he/she is found to have negligently assisted clients in misconduct or is unable to deter clients’ wrongdoings. However, relief by means of a malpractice claim is restricted because only the trustee or receiver, such as the Federal Deposit Insu-

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<sup>337</sup> ABA Model Rule of Professional Conduct § 1.2.

<sup>338</sup> *Id.* § 1.13.

<sup>339</sup> Fisch & Rosen, *supra* note 323.

<sup>340</sup> *Id.* at 1104-06.

rance Corporation, is eligible to bring such lawsuit.<sup>341</sup> Clients are forbidden to claim the malpractice of a lawyer in order to recover their losses.

Second, Securities and Exchange Commission (SEC) requests a lawyer to perform his/her duties of gatekeeper. The SEC has had the authority to discipline the professionals for a long time, especially for securities lawyers. Formerly, whether this power was allowed, and if the SEC could be another regulatory agency to punish a lawyer was doubtful. Though, this uncertain authority held by the SEC is made clear in the Private Securities Litigation Reform Act of 1995 (PSLRA).<sup>342</sup> PSLRA affirms that the SEC can bring an action against the professionals on aiding or abetting federal securities frauds. Because of this authority given by PSLRA, PSLRA finally clarifies the suspicion on whether the SEC can be another regulatory agency against securities frauds that are aided or abetted by the professionals.

Third, a private litigation can be used to against a lawyer as he/she has aided or abetted clients in committing securities fraud. However, in the *Central Bank* case,<sup>343</sup> the U.S. Supreme Court held that the private action cannot be used against aiding and abetting in securities frauds<sup>344</sup> thanks to the SEC's Rule 10b-5 in Securities Exchange

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<sup>341</sup> *Id.* at 1104-05.

<sup>342</sup> Private Securities Litigation Reform Act (PSLRA) of 1995, U.S.C § 78u-4 (2010).

<sup>343</sup> *Cent. Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994).

<sup>344</sup> *Id.* at 191.



Act of 1934.<sup>345</sup> Further, PSLRA establishes more limitations upon private litigations because Congress intended to “discourage and weed out meritless securities fraud suits.”<sup>346</sup> PSLRA strictly regulates the pleading standard and makes it more stringent for private litigations. It describes:

“[I]n any private action arising under this [chapter] in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this [chapter], state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.”<sup>347</sup>

Because of the ambiguous definitions of “strong inference” and “required state of mind,”<sup>348</sup> it is quite difficult for the private party to find a standard to claim their actions and satisfy the requirements of PSLRA.

After the eruption of Enron’s scandal, the law started to reconsider whether it still had to leave an option for a lawyer to choose which model of professional ethics he/she wants to follow. In order to re-establish a lawyer’s professionalism, Congress enacted Section 307 under SOX and required a lawyer to bear a certain obligation to report when he/she finds the public company violates securities laws or other accounting frauds. SOX Section 307 provides that:

“Not later than 180 days after the date of enactment of this Act, the [Securities

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<sup>345</sup> 17 C.F.R. § 240.10b-5 (2010).

<sup>346</sup> Brian S. Sommer, *The PSLRA Decade of Decadence: Improving Balance in the Private Securities Litigation Arena with a Screening Panel Approach*, 44 Washburn L.J. 413, 423 (2005).

<sup>347</sup> 15 U.S.C. § 78u-4(b)(2) (2010).

<sup>348</sup> *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 407 (5<sup>th</sup> Cir. 2001).

and Exchange] Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule – (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.”<sup>349</sup>

Caher analyzed the design of Section 307, and said Section 307 “requires, for the first time, that counsel inform senior officers of corporate misdeeds. And, if action is not taken at the management level, it requires counsel to bring their concerns up the corporate ladder.”<sup>350</sup> Also, *The Wall Street Journal* describes:

“The ... bill ... steps up pressure on lawyers to report evidence of fraud and other misconduct by corporate managers – even their bosses. Under the provision, lawyers will for the first time be obligated to alert senior officers, such as the chief legal counsel or chief executive officer, of evidence of corporate misconduct in the companies they represent. If those officials fail to address problems, the lawyers are then required to report the misconduct to the board.”<sup>351</sup>

In Section 307, SOX requires the SEC to make a rule that regulates a lawyer to do the mandatory report when he/she detects corporate fraudulent activities. SOX wants a lawyer to be a risk-controller in the corporation, and let a lawyer realize his/her respon-

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<sup>349</sup> Sarbanes-Oxley Act of 2002 § 307.

<sup>350</sup> John Caher, *Corporate Reform Bill Means Changes in Client Relations*, N.Y.L.J (Jul.30, 2002), available at <http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1024079063993>.

<sup>351</sup> Richard B. Schmitt, *Lawyers Pressed to Report Fraud under New Law*, Wall St. J., July 25, 2002, at B1.

sibility is for the corporation and shareholders, not merely for an individual or a specific group. At times, a lawyer has a close relationship with managements since he/she is often counseled with legal issues. These issues not only include ordinary business matters, but probably concern other unlawful tricks that may be used for avoiding the punishment from law enforcement agencies. Due to this close connection with corporate managements, a lawyer may become an advocate of managements and help them commit misconduct. In order to prevent a lawyer from becoming a collaborator in wrongdoings, SOX poses a strict duty upon a lawyer, and requires him/her to report with the evidence of material violations of securities laws or breach of fiduciary duty to upper managements. Then, a lawyer not only has an obligation to report the company's violations of securities laws, but he/she has to ensure the report has been received by someone in the company who truly cares about the violation, starts making an investigation, and seeks to correct this corruption. As for the concern of duty of confidentiality, the lawyer will not breach this duty to his/her employer or the company he/she serves because, in SOX Section 307, the lawyer is required to make an internal disclosure in the corporation, not externally disclose the company's irregularity.

b. Accountant's/Auditor's View

i. Accountant-Client Privilege

The attorney-client privilege allows a lawyer not to make any compe-

lled disclosure to the public based on the duty of confidentiality with his/her clients. This privilege applies “where legal advice of any kind is sought from a professional legal adviser in his capacity as such, the communications relating to that purpose, made in confidence by the client, are at his instance permanently protected from disclosure by himself or by the legal adviser, except the protection be waived.”<sup>352</sup> However, unlike a lawyer, an accountant does not have such a privilege that allows him/her to not disclose those communications to society. Originally, whether an accountant can depend on a privileged communication was an uncertain issue in state and federal courts because some state courts tended to establish the accountant-client privilege, but federal courts did not. When cases that applied to state laws were litigated in federal courts, these courts would be bound by state statutes that adopt the concept of the accountant-client privilege.<sup>353</sup> Yet, after enacting Article V of the Federal Rules of Evidence,<sup>354</sup> this issue has been resolved. The Federal Rules explicitly express an accountant cannot rely on the accountant-client privilege in the federal court as he/she is asked to disclose material information about his/her clients’ illegal activities. As Graham notes as follows:

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<sup>352</sup> Benjamin H. Barton, *Do Judges Systematically Favor the Interests of the Legal Profession?* 59 Ala. L. Rev. 453, 466 (2008).

<sup>353</sup> Gaylord A. Jentz, *Accountant Privileged Communications: Is It a Dying Concept under the New Federal Rules of Evidence?* 11 Am. Bus. L.J. 149, 149 (1973).

<sup>354</sup> Michael H. Graham, *Handbook of Federal Evidence* 501.1-513.1 (1996).

“The subject of privileged communications between an accountant and his client has assumed new significance due to ... the ... adoption of ... Federal Rules of Evidence. Lack of a uniform approach towards the subject is evidenced by the wide variance in statutory scope that characterizes the attempts by a minority of states to create an accountant-client privilege, and by the wide diversity of opinions held by jurists, interested legal and professional organizations, and members of the accounting profession itself as to the appropriateness of such a privilege. The most recent authoritative statement on the subject is that contained in Article V of the new Federal Rules of Evidence. Contrary to recent statutory expansion of the privileged communication concept on the state level, the Federal Rules offer a conservative approach to the privilege doctrine and are a retreat from the recognition of privileged communications in numerous professional relationships other than that of the attorney and his client.”<sup>355</sup>

Once Wigmore thought that the exemption to testify should be narrowed, and presented a caution that it might cause damage to public interest as extensive privileged communications are allowed. He says:

“When ... come to examine the various claims of exemption ... the primary assumption that there is a general duty to give what testimony one is capable of giving, and that any exemptions which may exist are distinctly exceptional, being so many derogations from a positive general rule.... The investigation of truth and the enforcement of testimonial duty demand the restriction, not the expansion, of these privileges. They should be recognized only within the narrowest limits required by principle. Every step beyond these limits helps to provide, without any real necessity, an obstacle to the administration of justice.”<sup>356</sup>

Even if Wigmore disagreed with broadening the scope of privileged communications unlimitedly, he still showed four situations under which an accountant is able to enjoy this privilege against compelled disclosures. As he notes:

“First, the communications must originate in a confidence that they will not be disclosed. Second, this element of confidentiality must be essential to the full

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<sup>355</sup> *Id.*

<sup>356</sup> John Henry Wigmore, *Evidence in Trials at Common Law* § 2192 (1961).

and satisfactory maintenance of the relation between the parties. Third, the relation must be one which in the opinion of the community must be sedulously fostered. Forth, the injury that would inure to the relation by the disclosure of the communications must be greater than the benefit thereby gained for the correct disposal of litigation.”<sup>357</sup>

The first time the U.S. Supreme Court held that an accountant cannot have the privilege of accountant-client communication under federal courts was in the *Couch* case.<sup>358</sup>

In *Couch*, the Court states:

“... the case of a restaurant owner who, after a number of years of giving her business records to her accountant for tax return preparation, faced an Internal Revenue Service (IRS) investigation of her returns. Upon finding evidence suggesting that the restaurant owner’s tax returns substantially understated gross income, the IRS issued a summons to the accountant for the production of any of the restaurant owner’s business records in the accountant’s possession. The accountant refused to comply and transferred the records to the restaurant owner’s attorney... the restaurant owner claimed that the Fourth and Fifth Amendments to the Constitution barred production of the records due to ‘the confidential nature of the accountant-client relationship and her resulting expectation of privacy.’ Writing for the majority, Justice ... dismissed the restaurant owner’s privacy claim, finding that a taxpayer has no reasonable expectation of privacy when she transfers information to her accountant for ultimate disclosure in a tax return... although not controlling in the instant case, federal courts do not recognize an accountant-client privilege.”<sup>359</sup>

The *Couch* court’s decision noted that the accountant in this case could not enjoy the privileged communication against compelled disclosures, and held that the lack of ac-

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<sup>357</sup> *Id.* § 2285.

<sup>358</sup> *Couch v. United States*, 409 U.S. 322 (1973).

<sup>359</sup> Thomas J. Molony, *Is the Supreme Court Ready to Recognize Another Privilege? An Examination of the Accountant-Client Privilege in the Aftermath of Jaffee v. Redmond*, 55 Wash & Lee L. Rev. 247, 250 (1998).

accountant-client privilege in federal courts did not control its decision.<sup>360</sup> However, other critics argued that the U.S. Supreme Court still did not make a decision on whether an accountant can enjoy the accountant-client privilege in federal courts or not. Jakob said that *Couch*'s decision did not address the accountant-client privilege problem, but it resolved the issue regarding Fourth and Fifth Amendments.<sup>361</sup> Roloff described the *Couch*'s court only "summarily" stated the accountant-client privilege did not exist under federal laws.<sup>362</sup>

Even if the *Couch*'s holding was so ambiguous, commentators still saw *Couch*'s decision as the authority for denying the accountant-client privilege in federal laws.<sup>363</sup>

Lower courts applied *Couch*'s decision to similar cases, and perpetuated the unpersuasive reasons that sustained there is no accountant-client privilege under federal laws.

<sup>364</sup> Molony describes when lower courts addressed the issues in regard to an accountant's privileged communication, "[r]ather than applying sound legal reasoning, these courts contribute to the phenomenon of 'snowballing dicta'."<sup>365</sup> However, because of

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<sup>360</sup> *Couch*, *supra* note 358, at 335.

<sup>361</sup> Charles Q. Jakob, *Good Bad Press: Observations and Speculations about Internal Revenue Service Accountant-Informants*, 54 Ohio St. L.J. 199, 202 (1993).

<sup>362</sup> Scott W. Roloff, *Accountant Work-Product Privilege Rejected: United States v. Arthur Young & Co.*, 38 Sw. L.J. 1123, 1127 (1985).

<sup>363</sup> Travis Morgan Dodd, *Accounting Malpractice and Contributory Negligence: Justifying Disparate Treatment based upon the Auditor's Unique Role*, 80 Geo. L.J. 909, 931 (1992).

<sup>364</sup> *Platypus Wear, Inc. v. K.D. Co.*, 905 F. Supp. 808, 811 (S.D. Ca. 1995).

<sup>365</sup> Molony, *supra* note 359, at 251.

the enactment of Article V of Federal Rules of Evidence, this dispute was finally clarified and the argument had been resolved. Following the Federal Rules, they explicitly refuse an accountant to have a privileged communication in federal laws, and an accountant is obligated to divulge his/her client's confidential information to society when he/she is asked to disclose by federal courts.<sup>366</sup>

The absence of accountant-client privilege implicitly makes an accountant/auditor realize that his/her obligation is to serve public good, not just to employers and specific organizations. Once a justice made a statement concerning the responsibility of the auditor and the accountant:

“The auditor does not have the same relationship to his client that a private attorney who has a role as ... a confidential advisor and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light. ... By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing his special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This ‘public watchdog’ function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.”<sup>367</sup>

Though, when scholars presented the issue of conflict of interest, this concern confuses employers/clients about their relationships with accountants/auditors. Baker & Hayes criticized requiring accountants/auditors to put public interest in the first place is inappropriate since this “unusual arrangement poses an ethical dilemma for public ac-

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<sup>366</sup> Graham, *supra* note 354.

<sup>367</sup> Ronald F. Duska, *Contemporary Reflections on Business Ethics* 236 (2007).



countants.”<sup>368</sup> Also, Duska says the similar matter of concern as follows:

“[C]lients usually expect their accountants to perform their professional services in a matter that benefit the client.... such an expectation is misguided since ... the accountant’s responsibilities are to the legitimate users of the statements, not necessarily the client.... This creates a difficulty for while the auditors’ clients are the ones who pay the fees for the auditor’s services, the auditor’s primary responsibility is not to look out for the interests of the auditor’s employer, the client, but to look out for the interest of a third party, the public.... In sum, accountants are professionals and consequently should behave as professionals, but unlike other professionals, while offering services to their clients, they must evaluate their client’s work and make that evaluation public.”<sup>369</sup>

Even if this worry is not hard to understand and is quite rational, I still think this concern is meaningless. Considering the reason of presenting financial statements, the federal government expects to utilize the disclosure of corporate financial materials to sustain the transparency of the public market. Companies not only eager to show good business performance, but tend to use these materials to promote investors’ motives to purchase their stocks in the public market. Similarly, the disclosure can give an alarm for companies to notice their operations at each stage. Well-structured firms make business prosper, promote the development of the national economy, and reduce social problems caused by collapsed or poorly-operated companies. Besides, the sound financial market strengthens investors’ confidence in purchasing stocks in the public market and builds a good environment for investment. The final purpose of disclosing fin-

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<sup>368</sup> Baker, C.R. & Hayes, R.S., *Regulating the Public Accounting Profession: An International Perspective* 9 (1996), available at <http://les.man.ac.uk/cpa96/paper.htm/baker2.htm>.

<sup>369</sup> Duska, *supra* note 367.

ancial information is to protect public good and assure citizens' welfare. Employers/  
Clients will not feel confused as they comprehend that the benefit of financial statements is flowing to the public, not merely to corporate interests. Hence, it may be inferred that the duty of accountants/auditors is not only to help corporations make accurate financial materials, but also to preserve the integrity of the public stock market and to protect the public's interest.

#### ii. Internal Control and Accounting Standards

The accuracy of corporate financial statements is maintained and audited by accountants and auditors. Generally speaking, financial materials are checked by three different professionals before publishing to the public. Vinten describes this concept as follows:

“Management accountants are responsible for maintaining an adequate system of internal accounting controls to ensure fair presentation of financial statements and accurate internal reporting. Internal auditors serve to assure that management accountants (among others) perform their duties in accordance with management's goals, evaluating both the technical accuracy of the recorded amounts and the operational effectiveness of the organization. Finally, external auditors are required to attest to the fair presentation of the financial statements.”<sup>370</sup>

Accountants performing their jobs to maintain internal control are important because they make financial reports more reliable to the public. Based on the pamphlet issued by the Committee on Auditing Procedures of the American Institute of Accountants, it

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<sup>370</sup> Vinten, *supra* note 51, at 107.

describes:

“Internal control comprises the plan of organization and all of the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.... a ‘system’ of internal control extends beyond those matters which relate directly to the functions of the accounting and financial departments. Such a system might include budgetary control, standard costs, periodic operating reports, statistical analyses and the dissemination thereof, a training program designed to aid personnel in meeting their responsibilities, and an internal audit staff to provide additional assurance to management as to the adequacy of its outlined procedures and the extent to which they are being effectively carried out.”<sup>371</sup>

In addition, the pamphlet mentions that “[t]he primary responsibility for safeguarding the assets of concerns and preventing and detecting errors of and fraud rests on management. Maintenance of an adequate system of internal control is indispensable to a proper discharge of that responsibility.”<sup>372</sup> Hence, corporate management has to establish different mechanisms to detect, to prevent, and to correct problems that may result in the loss of corporate assets. Accountants are able to be placed in one of internal control mechanisms and play a role in assuring fair and trustworthy presentations made by managements. As for internal auditors, they can be regarded as “eyes of management.”<sup>373</sup> Internal auditors evaluate those financial reports and find out incorrect numbers or data to which accountants did not pay attention. Their jobs are to “see whet-

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<sup>371</sup> The American Institute of Certified Public Accountants, <http://www.aicpa.org/> (last visited Nov. 8, 2010).

<sup>372</sup> *Id.*

<sup>373</sup> Rampy, T. R., *The Accountant's Role in Our Present Economy*, *The Acct. Rev.* 467, 468 (1952).

her the company's estimates are based on formulas that seem reasonable in the light of whatever evidence is available and that choice formulas are applied consistently from year to year."<sup>374</sup> At last, the role of external auditors is like that of witness. They prove the authenticity of financial information and enhance the public's confidence in corporate operation and presented materials. In short, external auditors are accountants "who review the firm's financial statements and its procedures for producing them. Their job is to attest to the fairness of the statements and that they materially represent the condition of the firm."<sup>375</sup>

Thinking of the theory of the efficient market,<sup>376</sup> the responsibility and the function of independent accountants/auditors are not only to ensure or examine the authenticity of corporate financial statements, but also to provide assistance in building the healthy invested market for the public. The classic statement about this issue was made in the *Arthur Young* case.<sup>377</sup> As the Justice says:

"Corporate financial statements are one of the primary sources of information available to guide the decisions of the investing public.... Commission [SEC] regulations stipulate that these financial reports must be audited by an independent certified public accountant [CPA] in accordance with generally accepted auditing standards. By examining the corporation's books and records, the independent auditor determines whether the financial reports of the corporation have been prepared in accordance with generally accepted accounting principles

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<sup>374</sup> Encyclopedia Britannica Micropaedia, Vol. "Accounting".

<sup>375</sup> Kim & Nofsinger, *supra* note 34, at 28.

<sup>376</sup> James D. Cox et al., Securities Regulation 95-113 (2006).

<sup>377</sup> United States v. Arthur Young & Co., 465 U.S. 805 (1984).

[GAAP]. The auditor then issues an opinion as to whether the financial statements, taken as a whole, fairly present the financial position and operation of the corporation for the relevant period.”<sup>378</sup>

Besides the Judge focused on the independent position of accountants/auditors when they are making corporate financial statements, Bogle also describes the same point as follows:

“The integrity of financial markets – markets that are active, liquid, and honest, with participants who are fully and fairly informed – is absolutely central to the sound functioning of any system of democratic capitalism worth its salt.... Sound securities markets require sound financial information.... Independent oversight of financial figures is central to that disclosure system. Indeed independence is at integrity’s very core. And ... the responsibility for the independent oversight of corporate financial statements has fallen to America’s public accounting profession. It is the auditor’s stamp on a financial statement that gives it its validity, its respect, and its acceptability by investors. And only if the auditor’s work is comprehensive, skeptical, inquisitive, and rigorous, can we have confidence that financial statements speak the truth.”<sup>379</sup>

However, unlike the majority that sees the function of financial statements as the guide for investors to make a decision and as the means to sustain the transparency of the financial market, once Macey turned to use the concept of share price to analyze the purpose of financial materials. As he says:

“Accounting is, ... not particularly important to investors, except to the extent that accounting information is useful in the formation of share prices and in the allocation of economic resources that share prices facilitate. For public companies ... have well-developed capital markets, share prices provide the best lens with which to evaluate corporate performance. Share prices are less biased and they are more credible than other information about corporate performance ...

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<sup>378</sup> *Id.* at 810-11.

<sup>379</sup> John C. Bogle, *Public Accounting: Profession or Business?* Presentation at NYU (2000), [http://johncbogle.com/speeches/JCB\\_NYU\\_Lecture\\_10-00.pdf](http://johncbogle.com/speeches/JCB_NYU_Lecture_10-00.pdf).

Unlike accounting information, share prices reflect people's actual willingness to buy and sell stakes in the companies whose shares are traded. And ... stock prices ... provide an objective measure of corporate performance.... While share prices are important, the financial information contained in accounting reports constitutes an important element in the mix of data that market participants utilize when they engage in the buying and selling of shares that determines share prices.... If the accounting data that market participants use to calculate share prices is not reliable, then share price will not be reliable either."<sup>380</sup>

Based on these observations, the importance of accountants/auditors' role is twofold.

First, fair financial statements presented by accountants/auditors ensure the reliability of the securities market. Second, these materials also may be good references for investors to decide their preferences. Since the stock price is primarily reflected by financial information, the authenticity of financial statement is a necessary basis for investors to evaluate corporate performance, and these materials manipulate the willingness of investors to trade corporations' stocks in the public market.

Hence, what principles and codes regulate the responsibility of accountants/auditors and instruct them to make fair, trustworthy financial materials? As studying this issue, the Generally Accepted Accounting Principles (GAAP) and the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA Code) have to be referred to in this portion. GAAP is "the common set of accounting principles, standards and procedures that companies use to compile their financial statement. It is a combination of authoritative standards ... and simply the commonly acc-

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<sup>380</sup> Macey, *supra* note 29, at 155.

epted ways of recording and reporting accounting information.”<sup>381</sup> The principles of AICPA Code “express the profession’s recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.”<sup>382</sup> The AICPA Code has set up six principles for accountants/auditors to perform their jobs:<sup>383</sup>

- First, in carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.
- Second, members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.
- Third, to maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.
- Fourth, a member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing

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<sup>381</sup> Investopedia, <http://www.investopedia.com/terms/g/gaap.asp> (last visited Nov. 8, 2010).

<sup>382</sup> AICPA Code, Preamble, § 50.02.

<sup>383</sup> Ronald F. Duska & Brenda Shay Duska, *Accounting Ethics* 77 (2003).

and other attestation services.

- Fifth, a member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.
- Sixth, a member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

In these principles, the AICPA Code regulates accountants/auditors about their duties, serving the public interest, integrity, objectivity and independence, due care and scope, and nature of services.<sup>384</sup> Before corporations file financial statements to the SEC and the public, accountants/auditors have to follow GAAP to audit or to examine financial documents. Financial materials that have adopted GAAP can generally be regarded as being presented fairly.

However, the argument had been raised from the Committee of the AICPA during 1960s.<sup>385</sup> The Committee pointed out that even though corporate financial statements are made by GAAP, it is still doubtful if these materials can be seen as being fairly presented. The Committee described this point as follows:

“In the standard report of the auditor, he generally says that financial statements

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<sup>384</sup> *Id.* at 77-91.

<sup>385</sup> *Id.* at 118.



‘present fairly’ in conformity with generally accepted accounting principles – and so on. What does the auditor mean by the quoted words? Is he saying: (1) that the statements are fair and in accordance with GAAP; or (2) that they are fair because they are in accordance with GAAP; or (3) that they are fair only to the extent that GAAP are fair; or (4) that whatever GAPP may be, the presentation of them is fair?”<sup>386</sup>

This issue was observed by McGinn, and he described that a forensic accountant who found companies can employ “aggressive accounting moves that might camouflage a sagging business.”<sup>387</sup> Besides, these “aggressive accounting policies may distort the true financial condition of the company,”<sup>388</sup> even though these policies can be regarded as a legal accounting method in GAAP. Once Schroeder noted this concept by a specific case when publishing his observation in *Business Week*:

“Schilit’s speciality is flagging the frequent – and perfectly legal – gambit of ‘window dressing,’ which puffs up profits and revenues. He is not alleging fraud; indeed, the accounting techniques he highlights are allowed under generally accepted accounting principles (GAAP). But GAAP rules are subject to wide interpretation – and companies have great leeway in choosing how conservatively or aggressively they account for financial transactions.”<sup>389</sup>

Therefore, it may be concluded that accountants/auditors fail to defend their positions when claiming those financial materials are fairly presented because GAAP is applied.

Likewise, accountants/auditors cannot faithfully fulfill their duties when presenting financial statements by merely obeying the standard of GAPP. Thus, in addition to co-

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<sup>386</sup> Abraham J. Brillhoff, *The Truth about Corporate Accounting* 6 (1981).

<sup>387</sup> Daniel McGinn, *The Sherlocks of Finance*, *Newsweek* (Aug. 24, 1998), available at <http://www.highbeam.com/doc/1G1-21040234.html>.

<sup>388</sup> *Id.*

<sup>389</sup> Michael Schroeder, *The Sherlock Holmes of Accounting*, *BusinessWeek* (Sept. 5, 1994), available at <http://www.businessweek.com/archives/1994/b338878.arc.htm>.

mplying with GAPP, what is the extra requirement that accountants/auditors have to follow? This issue appeared in the *Herzfeld* case,<sup>390</sup> and the court stated:

“Compliance with generally accepted accounting principles is not necessarily sufficient for an accountant to discharge his public obligation. Fair presentation is the touchstone for determining the adequacy of disclosure in financial statements. While adherence to generally accepted accounting principles is a tool to help achieve that end, it is not necessarily a guarantee of fairness.”<sup>391</sup>

Also, Briloff describes the same issue, and he says:

“More disturbingly to the accounting profession ... was the language in which ... Federal Judge ... scrapped the affirmance. He said in effect that the first law for accountants was not compliance with generally accepted accounting principles, but rather full and fair disclosure, fair presentation, and if the principles did not produce this brand of disclosure, accountants could not hide behind the principles but had to go beyond them and make whatever additional disclosures were necessary for full disclosure. In a word, ‘present fairly’ was a concept separate from ‘generally accepted accounting principles,’ and the latter did not necessarily result in the former.”<sup>392</sup>

Consequently, following these views, I conclude that the way for accountants/auditors to satisfy their professional and ethical duties, not only do they have to fairly present financial statements that ought to comply with the standard of GAAP, but they are obligated to disclose correct, complete, explicit information to those who truly care about or can be influenced by these presentations. As Duska & Duska say, “Whatever the meaning of fairness, it seems to require that the picture presented be such that it gives as accurate a picture as possible to third parties that have a market interest in the fina-

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<sup>390</sup> *Herzfeld v. Laventhol et al.*, 378 F. Supp. 112 (1974).

<sup>391</sup> *Id.* at 122 (citation omitted).

<sup>392</sup> Briloff, *supra* note 386, at 4-5.

ncial statements.”<sup>393</sup>

Since accountants/auditors cannot depend on the accountant-client privilege under federal laws, not only do they have to make compelled disclosures based on the protection of public interest, but they are also asked to faithfully examine and fairly present corporate financial statements in order to shield the third parties from being damaged by these documents. Due to this obligation, it might be inferred that accountants/auditors accept to be the whistleblower when finding that corporate irregularities could be harmful to society. However, in reality, the actual situation is totally contrary to this ideal expectation. Once Vinten pointed out this phenomenon as follows:

“Despite ... expressed concern for the public interest, accountants have long opposed whistleblowing. Generally accepted auditing standards have historically required a sequential process of reporting problems such as discovered fraud ... The recent enactment of Statements on Auditing Standards ... require the auditor to communicate ‘reportable conditions’ in the internal control structure, disagreements with management, and difficulties in performing the audit (e.g. lack of client co-operation) directly to the audit committee.... Though auditors are not whistleblowing, their responsibility to the public interest is being recognized in the standards.”<sup>394</sup>

Thus, this can be concluded that the reason why accountants/auditors do not recognize themselves as the whistleblower is that the nature of their responsibilities is consistent with the protection of public interest. Because of similar process or model to respond to organizations’ irregularities, it makes accountants/auditors think that reporting wro-

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<sup>393</sup> Duska & Duska, *supra* note 383, at 119.

<sup>394</sup> Vinten, *supra* note 51, at 115.

ngful financial statements is a part of their jobs and unrelated to whistleblowing. After all, the public's negative perception on a whistleblower is quite difficult to change in a short time, and no one is willing to be viewed as a snitch, or a tattletale in his/her social relationship and network.

In order to avoid the accounting firm's conflict of interest as auditing companies' financial materials, Congress enacted SOX to restrict its consulting services. The increase of consulting services began in the 1990s due to the commodification of auditing.<sup>395</sup> Since auditing services had become commodified, and profits were not as good as the accounting firm originally expected, so it tended to provide more consulting services to its clients because those services had not been commodified, and "profit margins were very high."<sup>396</sup> However, more consulting services meant more conflicts of interest in the accounting firm. When the firm wanted to make profits and keep a steady business relationship with clients, who wanted to show financial conditions in improper ways, these brought the tension between the accounting firm's duties as auditors and interests in retaining their lucrative consulting contracts. For the sake of threatening the accounting firm to take their requests, clients used to put the pressure on the firm to fire accountants or to force the reassignment of lead auditors, who are "the me-

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<sup>395</sup> Eisenberg, *supra* note 5, at 1372-73.

<sup>396</sup> *Id.* at 1373.

mbers of the firm who led the auditing teams.”<sup>397</sup> Not only does the reassignment of lead auditors affect the relationship between the client and the accounting firm, but also the reassigned lead auditor may take a risk of losing his/her position, suffer financially, and endure setbacks in other ways.<sup>398</sup>

Because clients could punish the accounting firm when displeasing auditing services by “not renewing existing contracts or by withholding new contracts”<sup>399</sup> with the firm, in order to pursue profits, the accounting firm gradually yielded to clients’ requests, and those increased accounting fraud. As a result of this trend, as Eisenberg says, “In the 1990s the economics of the accounting profession had developed in a way that made it extremely attractive for accounting firms to abdicate their gatekeeper function by bending to their clients their client’s financial improprieties.”<sup>400</sup> This consequence not only brought the disasters of Enron and WorldCom, but also was the background for Congress to enact the Sarbanes-Oxley Act.

Under SOX, in order to “reinststate the integrity of the accounting process and improve the efficacy of financial reporting,”<sup>401</sup> Congress chiefly emphasized on four pa-

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<sup>397</sup> *Id.*

<sup>398</sup> *Id.*

<sup>399</sup> *Id.*

<sup>400</sup> *Id.*

<sup>401</sup> *Id.* at 1374.

rts in regulating auditing and the operation of accounting firms.<sup>402</sup> First, in Section 101 and 102, Congress created the Public Company Accounting Oversight Board (the Board) to oversee accounting firms. Likewise, it required accounting firms to be registered public accounting firms when they prepare, issue, or to participate in the preparation or issuance of any audit report for public companies.

Second, Congress regulated non-audit services in Section 201 and 202. These parts not only forbid accounting firms to provide certain of non-audit services to their clients, but also require the accountant to get a pre-approval from the company's audit committee, and disclose to the stockholders in the company's periodic reports, even if those non-audit services are permitted.

Third, the function of corporate audit committee has been strengthened. Not only is the public company required to have the audit committee, but the committee has to be composed of all independent directors. Besides, there should be at least one financial expert sitting on the audit committee; otherwise, the public company has to disclose this information to the public and explains why it did not hire any expert to serve on its audit committee. Further, SOX requires the audit committee to be responsible for all tasks of hiring, compensating, and supervising of outside independent auditors. It is a policy that not only can avoid auditors' conflicts of interest with senior executi-

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<sup>402</sup> *Id.* at 1374-76.

ves, who are the persons to achieve results, and these results have to be audited by auditors, but also can assure the accuracy of the company's financial statements.

Fourth, in Section 302, Congress required chief executive officers (CEOs) and chief financial officers (CFOs), or persons performing similar functions to certify annual or quarterly reports. CEOs and CFOs have to confirm that they have reviewed these reports. In addition, they have to certify that the reviews were based on their knowledge, and these reports “[do] not contain any untrue statement of a material fact or omit to state a material fact,” and “fairly present in all material respects the financial condition and results of operation of the issuer as of, and for, the periods presented in the report.”<sup>403</sup>

Because Congress made several provisions to regulate auditing and the accounting firm, it is hard to use limited pages to go through the whole details, and this may be beyond the scope of this dissertation. Yet, by observing SOX, it is easy to find that Congress intended to reinstate the role of accountants/auditors to be the gatekeeper, instead of being the accomplice of making false financial statements with companies they serve. The purpose is not only to retrieve the public's confidence in accounting fields, but also to sustain and ensure the authenticity of information disclosed by public companies in the public market.

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<sup>403</sup> Sarbanes-Oxley Act of 2002 § 302.

c. Perspective of Public Interest

i. Grace Pierce and Ortho<sup>404</sup>

Once Dr. Pierce was an associate director of medical research of Ortho Pharmaceutical Corporation (Ortho) in 1971. The story began from Dr. Pierce's strong conscience of professional ethics that caused the conflict of interest with her supervisor. She and her fellow researchers were asked to proceed with drug test on humans, but this drug was considered to have an excessively high level of saccharin – a chemical sweetener that scientists found might cause cancer. Due to this knowledge, Pierce turned down Ortho's order and refused the drug test on humans. As Dr. Pierce said, "I couldn't in good science take the high saccharin formulation out and give it to infants and old people when I knew there was a controversy over whether this could or could not be carcinogenic." Yet, her strong sense of professional ethics did not bring her big praise from Ortho. Pierce was dismissed from the research program, being demoted, and told by the supervisor that she was irresponsible and unpromotable. Because of this unbearable humiliation, she decided to quit and prepared to argue these issues in court in order to fight for her professional ethics.

The story started from Dr. Pierce's first year in Ortho. Raritan, a company focused on making contraceptives and reproductive drugs and also got much reputation on

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<sup>404</sup> This case refers to Westin, *supra* note 292, at 107-17.



this area, wanted to transfer its track to the broader field of therapeutic. As a result of this shift, Dr. Pierce was assigned to projects concerning the testing of therapeutic drugs and was later promoted to the associate director of medical research/therapeutics. The project team in which she participated was trying to research a new prescription drug, called loperamide, which can be used in the treatment of acute and chronic diarrhea. Loperamide is made as a liquid form to help infants, children, and adults, especially for the elderly, who felt uncomfortable taking a solid form of medicine. (Loperamide also has a trade name called Imodium and “Janssen’s formula”) The first challenge for the project team was to reduce the bitter taste of loperamide and make it more palatable to take. In order to resolve this problem, the project team decided to add a kind of sweetener, called saccharin, to eliminate this unfavorable taste. However, the dispute still existed in the scientific field since no one knew whether saccharin or other kinds of artificial sweeteners might cause any potential hazard to humans’ health. This worry came from an animal-fed testing, and the result revealed that large dosages of saccharin developed the formation of cancer.

The news about saccharin that probably causes cancer came out from laboratories and was broadcasted fervently by the mass media while Dr. Pierce and her colleagues were working on the test of loperamide. What Dr. Pierce concerned was that the extremely high level of saccharin in Ortho formula for making loperamide. Dr. Pierce

had observed that Ortho's formula of loperamide contained more than forty times of saccharin, which was compared to the amount of saccharin in a 12-ounce can of diet soda permitted by FDA. Other project colleagues agreed with Dr. Pierce's worries, and Dr. King, a toxicologist in the project, also concluded the amount of saccharin "in the Janssen preparation was too high and questioned using saccharin sodium at any level in the product." Concerned about the excessive usage of saccharin in loperamide, the project team reached an unanimous agreement to reject the possibility to market loperamide, and said Janssen formula "was not suitable for use in the United States" even if it has been marketed in Europe. Though, this decision was not paid attention to by Ortho. After the project team presented their opinions on loperamide, the representative of Janssen Company came to visit Ortho for the purpose of discussing the project of loperamide. After the meeting, Dr. Pasquale, the executive director of Ortho's medical research department and other company executives, made a decision to continue the process of testing project and decided to sell loperamide in the U.S. market. The whole plan of action was outlined on Ortho and Janssen's memo when discussing this schedule.

When hearing the information that Ortho was going to start the marketed plan, Dr. Pierce and colleagues were unsatisfied with this decision and presented their demur. Besides, they found the memo made in the meeting misdescribed their conclusion

as being in agreement with the marketing of loperamide. The memo said, “The presence in the drop formulation of 17.5 mg. of saccharin sodium per milliliter represents a potential problem, as FDA may not permit the use of a product with saccharin present at this level. By comparison, FDA permits 15.8 mg. per fluid ounce as a sweetener (approximately 3% of the level currently being employed in Imodium drops).” Due to these differences and other problems, the project team expressed their “reluctance to ‘lock into’ the Janssen formulation of pediatric drops as the dosage form of choice.” Because of this false expression, the project team strongly disputed the memo, and Dr. Pierce also requested some sentences should be noted in the record. She added the following sentence: “It would be difficult to justify medically and legally our position of hastening into clinical trials with a questionable formulation when preliminary work in Pharmaceutical Development indicates a more acceptable formulation will be available very soon.” The action of Pierce was supported by Dr. King, a toxicologist on the team, and he described “any intentional exposure of any segment of the human population to a potential carcinogen is not to the best interest of public health or the Ortho Pharmaceutical Corporation. We do not have to market a formulation with high levels of saccharin; we do have an alternative approach.”

However, despite the negative feedback from the project team, Ortho still turned its back on them. Ortho not only stuck to loperamide formula, but also proceeded to

the schedule of marketing. Dr. Pierce supposed the reason why Ortho did not care about any objection was that Ortho had already made up a schedule to sell loperamide to the market and did not expect any action to delay its plan. When Dr. Pierce told to the newspaper report, she said “[t]he marketing people can go-off half-cocked sometimes, they think millions of dollars are waiting to fall in their laps, promotions are to be had, careers to be made.” As regards Ortho, it still insisted that loperamide formula it presented might not cause any possible hazard to humans’ health. Ortho conceded a bottle of loperamide had a high amount of saccharin, but it strongly argued that the amount of saccharin in the dosage prescribed for a 24-hour period was less than the amount of saccharin in a 12-ounce can of diet soda, and which is acceptable and is permitted by FDA.

Under the increasing pressure from Ortho, the team members started changing their minds and were inclined to support Ortho’s view on loperamide formula. Contrarily, Dr. Pierce still reaffirmed her position and refused to attest to the safety of loperamide. She said, “I did not and do not now agree with the majority decision in this matter,” “in spite of the existing controversial evidence as to the ultimate safety of saccharin for human consumption, it is my strong opinion that justification for contemplating use or for requesting FDA permission to use the Janssen drop formulation is not evident. I respectfully request, in the interest of proceeding reasonably with this very

worthy project, that an alternate formulation with no saccharin, or as low in saccharin as possible, be used.” In Dr. Pierce’s mind, being the only physician on the project team, she sincerely believed that she had a stronger responsibility than other professionals. She thought it was her job to monitor and to analyze the result of the drug on human tests. She was obligated to understand what function the drug served, what side-effects it caused, and how safe and effective it was. Her role was not only to explain the drug’s properties for other physicians, but she also had to supervise them when they used the drug for testing other subjects. Because of this burden, she gave herself a bigger obligation to insist on her opinion and position.

At last, Dr. Pierce was informed that she was going to be demoted due to her irresponsible behaviour, and was taken off all her jobs on therapeutic drug projects. As a result of this untruthful accusation, Dr. Pierce presented her resignation and decided to take legal actions against Ortho. She filed a suit against the company and claimed the damage caused by the termination of employment relationship. The damage she claimed included the loss of her professional reputation, the disruption of her career, the loss of salary, seniority, and retirement benefit, and physical and mental distresses she had suffered.

Under the proceeding of the lawsuit, Ortho defended the claim by using the concept of employment-at-will and disputed that there was no employment contract betw-

een Ortho and Dr. Pierce. Hence, “the employment is at will of either party and may be terminated at any time, with or without justification.... It made no difference whether [Dr. Pierce] resignation was voluntary or induced.” In the lower court, the judge’s holding in favor of Ortho and stated the court ought to follow the common law principle that employees with no contract can be discharged at will. However, when the suit was appealed, the superior court reversed this decision, and “sent the case back for a trial on all of the issue raised by the pleadings.” At last, Dr. Pierce won the final victory in the case and successfully fought against Ortho.

## ii. Whistleblowing and Public Interest

Our society has advocated justice and honesty, and “has an interest in encouraging lawful behavior and ensuring that those responsible for wrongdoing are held accountable for their actions.”<sup>405</sup> Whistleblowing can promote this expectation when the disclosers of illegal activities “identify unsafe products or practices, wasteful or fraudulent actions, and other harmful or criminal behavior”<sup>406</sup> to the public and the people who truly care about the misconduct. Whistleblowers have a great function to save the federal government billions of dollars,<sup>407</sup> to prevent environment from being polluted, and to protect the safety and health of society from being harmed by oth-

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<sup>405</sup> Rubinstein, *supra* note 134, at 642.

<sup>406</sup> Dworkin & Callahan, *supra* note 232, at 299-300.

<sup>407</sup> Fisher, *supra* note 191, at 357.

ers.<sup>408</sup> From the public's point of view, whistleblowing decreases potential hazards that probably impose upon citizens without being cautioned in advance. At the same time, the public benefits from the outcomes that whistleblowing brings about because it deters organizations from being involved in illegitimate conduct. Solomon & Garcia discuss this point as follows:

“From the perspective of the wider society, the most obvious benefit of whistleblowing is its potential for reporting and subsequently deterring organizational misconduct. The enormous economic costs that are ultimately passed on to the public for such offenses as employee theft, corporate tax fraud, misappropriation of funds, consumer fraud, and other types of occupational and organizational crime may be greatly reduced by the threat of detection provided by employees as potential whistleblowers.”<sup>409</sup>

Take Dr. Pierce's case for instance. Because Dr. Pierce disclosed unsafe composition of loperamide, not only did the public get a warning or attention from her information, but she also prevented lethal misconduct that Ortho made from which citizens might suffer. Sometimes, whistleblowers are also able to save an individual from bearing physical and mental distress and to protect organizations from collapsing. However, most of the time, whistleblowers can rescue the public from enduring the loss of life, the loss of investment, and the loss of stable social environment.

Even if the public gets so many advantages from whistleblowing, citizens still require whistleblowers to weigh their actions before stepping forward. Whistleblowers

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<sup>408</sup> Lewis D. Solomon & Terry D. Garcia, *Protecting the Corporate Whistleblower under Federal Anti-Retaliation Statutes*, 5 J. Corp. L. 275, 276 (1980).

<sup>409</sup> Miethe, *supra* note 192, at 84.

not only are asked to consider if potential hazards are actually concerned with public interest or may place society into a dangerous situation,<sup>410</sup> but they also should ascertain whether these illegal activities are important to ordinary people or not. In addition, whistleblowers have to think over whether whistleblowing is the necessary and inevitable step to deter misconduct, to correct egregious errors, and to put accused organizations' illegitimacy back on the right track.<sup>411</sup> As Westman says:

“All of these ethical considerations must be weighed in determining whether whistleblowing is the proper course of action. First, the responsibility to the public interest suggests that potential whistleblowers must consider whether the subject of the potential report is truly a matter of public interest, distinguishing between matters in which the public may be interested, and matters which actually affect the public safety or welfare.... If it is determined that the subject of the potential report directly affects the public interest, employees must determine whether the public interest is either substantial or insignificant.... Potential whistleblowers must consider whether it is possible that whistleblowing will lead to correction of the imminent danger.”<sup>412</sup>

Further, the public requests whistleblowers to be motivated by good faith before taking actions to report, and requires them to make accurate disclosures. The requirement of good-faith disclosure ensures that whistleblowers' intentions are for the protection of public good, not for whistleblowers' self-interest or other political concerns. One time, Westman stated a similar issue as follows:

“From the public's point of view ... it would be better to encourage disclosures made in good faith, which after investigation prove to be unfounded, than to di-

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<sup>410</sup> Daniel Callahan & Sissela Bok, *Ethics Teaching in Higher Education* 277-95 (1980).

<sup>411</sup> Elliston et al., *supra* note 216, at 126-28.

<sup>412</sup> Westman, *supra* note 159, at 29-30.



scourage all disclosures which cannot be absolutely verified... the public has an interest in encouraging well-researched disclosures made in good faith, even if the ultimate conclusion of the investigation into the disclosure reveals that the perceived danger did not actually exist.”<sup>413</sup>

The requirement of accuracy is to ensure that the public will not waste social resources on investigating untruthful accusations. False reports may cause tremendous financial damage and bring the loss of reputations for an individual and organizations. As

Westman describes this below:

“In cases where the subject of the disclosure is less serious, however, the public has an interest in encouraging only accurate disclosures, regardless of the whistleblower’s good faith, so that public resources are not unnecessarily wasted in investigating the disclosures. As a matter of policy, therefore, well-researched whistleblower disclosures regarding serious threats to the public safety, made in good faith, should be legally protected.”<sup>414</sup>

Hence, the public requests whistleblowing employees to bear good faith and to verify the authenticity of misconduct beforehand when disclosing those serious wrongdoings.

In disclosing significant frauds, the public puts emphasis on the honesty of disclosers no matter whether the result turns out to be true or not. Contrarily, when the matter of concern is less significant and serious, the accuracy of disclosures will be paid more attention to by the public because good faith but negligent disclosures might bring harm to organizations and society.

Untruthful disclosures injure the society’s harmony and imperil social relationships. Inaccurate and excessive whistleblowing can be viewed as a source of slander and

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<sup>413</sup> *Id.* at 43.

<sup>414</sup> *Id.* at 43-44.

organizational sabotage. Even more, whistleblowing may raise much surveillance and reduce the autonomy of workers in the workplace.<sup>415</sup> Nefarious employees probably use whistleblowing as an instrument to take revenge on their employers or colleagues. Also, malicious whistleblowers can damage organizations by making wild accusations against employers' conduct and managements' policies. Those actions will harm business good-will that mostly organizations cherish, and bring disastrous financial losses to these bodies. The primary factor that supports organizations to continue business is the public's confidence in their appreciated performance and honest operation. The loss of the public's trust probably withers organizations' performance, and reduces investors' passion for the securities market from which organizations gather necessary funds and capital.

In addition, excessive whistleblowing perhaps makes employees feel uncomfortable in the workplace. The surveillance technologies watch employees to perform their jobs, and coworkers are afraid of being complained about or being reported because of their trivial mistakes. This situation not only results in the loss of workers' autonomy in their jobs, but also makes the quality of working atmosphere worse and affects employees' performance. The deficiency of excessive whistleblowing is twofold. One time, Miethe noted this point as follows:

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<sup>415</sup> Miethe, *supra* note 192, at 86.

“First, employees will become more alienated and disenchanted because their sense of autonomy at work and friendship ties with co-workers will be severely threatened by the greater surveillance. Second, both productivity and innovation in these work environments are likely to diminish because employees will be overly cautious in production activities and not willing to take chances and try alternatives, owing to fear of reprisals.”<sup>416</sup>

These results may not go along well with public interest. From the public’s point of view, it is damaging to the harmony of society as social relationships are filled with mistrust. Mistrust not only makes people feel no sympathy on everything in their daily life, but it also destroys appreciated values that maintain the operation of society and a variety of economic or social activities. Besides, the progressive society needs to be promoted by innovative organizations and creative citizens. New ideas and ingenious thoughts have to be tested and be tried before gaining the fruit of success. However, if false whistleblowing increases, an individual probably are frightened away by malevolent whistleblowers when he/she is convinced that whistleblowing will twist his/her initial intent to promote social welfare.

For organizations, the management may lose chances to promote companies’ future performance and to create a big fortune for the public since thinking about a possible risk to be reported by malicious whistleblowing employees. At the same time, the public will be exposed to potential threats that can damage the health and safety of society thanks to no trust in whistleblowing. Hence, both bad-faith whistleblowers and

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<sup>416</sup> *Id.* at 89.

false whistleblowing bring an individual, organizations, and the society at large a negative consequence when whistleblowers' actions are not motivated to put others' benefit in the first place, but contrarily, their intent is only for private interests and inclined to abuse appreciated social values.

### **Chapter III. How do Common Law, State Law and Federal Statutes Protect the Employee Blowing the Whistle in the Workplace – Study the Balance Between the Doctrine of Employment-At-Will and the Public Policy Exception**

#### *A. Introduction*

The tie between whistleblowing and employment-at-will is significant because hiring at-will makes employees fear of being discharged without any reasonable cause or sufficient explanation thanks to their disclosures on employers' misconduct. Also, this doctrine may indirectly encourage employers to commit unlawful conduct based on their superior managerial power to terminate employees at will, and will not be imposed upon any liability for their adverse employment actions.<sup>417</sup>

#### 1. What Is the Employment-At-Will Doctrine?

Before start discussing the whistleblower protection, it is quite important to get familiar with the employment relationship. Traditionally, the employment-at-

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<sup>417</sup> Elletta Sangrey Callahan, *Employment At Will: The Relationship between Societal Expectations and the Law*, 28 Am. Bus. L.J. 455, 456 (1990).

will doctrine governs the employment relationship between employers and employees, and it briefly means that each party can terminate the employment relationship at any time and for any reason.<sup>418</sup> Either a good cause or the lack of good faith needs not to be proved when this doctrine applies.<sup>419</sup> As for the complete description, Cramton states that the employment-at-will doctrine means “employers and employees are free to end their economic relationship at any time, absent express agreement to the contrary. Either party may terminate the relationship for any reason, for no reason at all.”<sup>420</sup> Likewise, Cavico describes that this doctrine exists “where an employment relation is of indefinite duration, the employer may discharge an employee or an employee may leave at any time, for any reason, without being liable thereby for any legal wrong.... moreover, [it] permits an employer to discharge an employee even for a cause which is morally wrong.”<sup>421</sup>

To employers, the doctrine of employment-at-will consents them to “dismiss their employees at will, be they many or few, for good cause, for no cause or even for cause morally wrong, without being thereby guilty of legal wrong.”<sup>422</sup> Further, a strict

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<sup>418</sup> Cheryl S. Massingale, *At-Will Employment: Going, Going...*, 24 U. Rich L. Rev. 187, 187 (1990).

<sup>419</sup> Vanessa F. Kuhlmann-Macro, *Blowing the Whistle on the Employment At-Will Doctrine*, 41 Drake L. Rev. 339, 339 (1992).

<sup>420</sup> Roger C. Cramton, *The Lawyer as Whistleblower: Confidentiality and the Government Lawyer*, 5 Geo. J. Legal Ethics 291, 306 (1991).

<sup>421</sup> Frank J. Cavico, *Employment At Will and Public Policy*, 25 Akron L. Rev. 497, 498 (1992).

<sup>422</sup> *Payne v. W. & Atl. R.R. Co.*, 81 Tenn. 507, 519-20 (1884).

application of this doctrine allows employers not to be liable, although their intentions to discharge employees are resulting from any retaliatory purpose.<sup>423</sup> To employees, this doctrine permits them to express their unwillingness to work and stop the employment relationship at any time. However, this action will be barred if employees have made an express agreement with employers, and promised they will not close the employment relationship at will.<sup>424</sup>

## 2. Source of the Employment-At-Will Doctrine

Before the doctrine of employment-at-will became prevalent, in the early of nineteenth century, the United States followed the English common law that presumes the employment relationship is for one year if there is no specific agreement between employers and employees.<sup>425</sup> Even if the employment relationship lasts one day longer over a year, the employment contract is regarded to be renewed for another one continue year.<sup>426</sup> In addition, the English common law imposes a liability upon employers as they breach an employment contract by discharging employees with no reasonable cause.<sup>427</sup> The English common law makes up this presumption is because an

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<sup>423</sup> Jones, *supra* note 135, at 1137-38.

<sup>424</sup> Rubinstein, *supra* note 134, at 640.

<sup>425</sup> Richard Wall, *At Will Employment in Washington: A Review of Thompson v. St. Regis Paper Co. and its Progeny*, 14 U. Puget Sound L. Rev. 71, 74-75 (1990).

<sup>426</sup> Kewey H. Tucker, *Erosion of the Employment-At-Will Doctrine: Recognition of an Employee's Right to Job Security*, 43 Wash & Lee L. Rev. 593, 593 (1986).

<sup>427</sup> Seymour Moskowitz, *Employment At Will and Codes of Ethics: The Professional's Dilemma*, 23 Val.

employment contract was rare before the eighteenth century, and it is necessary to establish a rule to regulate the relationship of master-servant.<sup>428</sup> Morrison describes this point as follows:

“The first sort of servants, ... acknowledged by the laws of England, are *menial servants*; so called from being *intra moeina*, or domestics. The contract between them and their masters arises upon the hiring. If the hiring be general without any particular time limited, the law construes it to be a hiring for a year; upon a principal of natural equity, that the servant shall serve, and the master maintain him, throughout all the revolutions of the respective seasons; as well when there is work to be done, as when there is not: but the contract may be made for any larger or smaller term.”<sup>429</sup>

Also, the English common law requires employers to give a notice to employees when employers decide to terminate employees' jobs, but the employment duration has been unstated. Generally speaking, the period for giving a notice varied thanks to different types of employees' positions. However, employees are basically given three months earlier notice when employers want to close the employment relationship;<sup>430</sup> this rule resulted from England's Statute of Labourers.<sup>431</sup> Although this statute had been repealed in 1863, the principle contained in this statute still influences England courts to

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L. Rev. 33, 36 (1988).

<sup>428</sup> Wayne Morrison, *Blackstone's Commentaries on the Laws of England* 425 (2001).

<sup>429</sup> *Id.* at 422.

<sup>430</sup> Philip Selznick, *Law, Society, and Industrial Justice* 126 (1969).

<sup>431</sup> The first version of Statute of Labourers was enacted in 1349, and the Second version was promulgated in 1350. The Statute was amended and modified until 1562 and replaced by the Statute of Artificers at last.

make related decisions.<sup>432</sup>

Until the late nineteenth century, the American law gradually departed from the England common law and established its own rules to govern the employment relationship. The American law abandoned one-year presumption for the employment contract and turned to favor indefinite employment relationship because of America's social and economic changes. Hence, it could be concluded that the employment-at-will doctrine was the product under diverse social phenomena. This concept first appeared in H.G. Wood's 1877 treatise, who was a New York lawyer and treatise writer.<sup>433</sup> His treatise regarding master and servant law not only provided a new solution for resolving the obstacle of one-year employment presumption in U.S. practical usage, but had a good start for American jurisprudence to foster this new doctrine.<sup>434</sup> Wood had expressed his thought about employment-at-will and said:

“With us the rule is inflexible, that a general or indefinite hiring is *prima facie* a hiring at will, and if the servant seeks to make it out a yearly hiring, the burden is upon him to establish it by proof. A hiring at so much a day, week, month or year, no time begin specified, is an indefinite hiring, and no presumption attaches that it was for a day even, but only at the rate fixed for whatever time the party may serve. It is competent for either party to show what the mutual understanding of the parties was in reference to the matter; but unless their understanding was mutual that the service was to extend for a certain fixed and definite period, it is an indefinite hiring and is determinable at the will of either party, and

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<sup>432</sup> Morrison, *supra* note 428.

<sup>433</sup> Alfred W. Blumrosen, *Employer Discipline: United States Report*, 18 Rutgers L. Rev. 428, 432 (1964).

<sup>434</sup> Horace G. Wood, *A Treatise on the Law of Master and Servant* 272-73 (1981).



in this respect there is no distinction between domestic and other servants.”<sup>435</sup>

Wood described that whenever the employment relationship has not been specified, employers and employees will not be confined by each other and can discharge or quit at any time. They do not have to bear the burden to prove whether their intent results from bad faith or lacks of reasonable causes because these are not considerable factors under the employment-at-will doctrine.

Besides Wood’s treatise created this concept for resolving the problem of one-year presumption in employment relationship; likewise, Industrial Revolution provided potential assistance for the prevalence of new doctrine in America. In the period of Industrial Revolution, because demand for merchandise in the market varied in different periods, employers had to be flexible in adjusting labor distribution to respond to a variety of changes. Maintaining the one-year presumption for the employment relationship not only wasted organizations’ expenses on hiring practices, but caused an inefficient way on the usage of labor in society. Hence, the principle allowing employers to discharge employees at will puts more focus on the flexibility of organizational adjustment than employers’ freedom to terminate employees.<sup>436</sup> In addition, employers are in favor of this doctrine because the traditional paternalistic view that requires masters to take care of servants no longer exists under this doctrine. Employers might not

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<sup>435</sup> *Id.*

<sup>436</sup> Alfred W. Blumrosen, *Workers’ Rights against Employers and Unions: Justice Francis – A Judge for Our Reason*, 24 Rutgers L. Rev. 480, 481 (1970).

be confined by the presumed employment relationship as they want to discharge unsuitable employees in the workplace.<sup>437</sup>

Not only did the industrialized society promote the prevalence of the doctrine of employment-at-will, but American jurisdictions tended to support and make favorable decisions when resolving similar issues. For example, the New York Court of Appeal adopted this doctrine in the *Martin* case in 1895.<sup>438</sup> The court held that the ordinary employment relationship could not be viewed as one-year presumption, but “a hiring at will, and therefore the defendant was at liberty to terminate [employees] ... at any time.”<sup>439</sup> Until 1913, most jurisdictions gave up the English common law and agreed with Wood’s presumption.<sup>440</sup> Further, the freedom of contract enhanced the doctrine of employment-at-will, and this view first appeared in the *Adair* case in the U. S. Supreme Court.<sup>441</sup> The Court states this concept as follows:

“In the absence, however, of a valid contract between the parties controlling their conduct towards each other and fixing a period of service, it cannot be, we repeat, that an employer is under any legal obligation, against his will ... to remain in the personal service of another... [The employee] was at liberty to quit the service without assigning any reason for his leaving. And [the employer] was at liberty, in his discretion, to discharge [the employee] from service without giving any reason for so doing.”<sup>442</sup>

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<sup>437</sup> Massingale, *supra* note 418, at 188.

<sup>438</sup> *Martin v. New York Life Ins. Co.*, 42 N.E. 416, 417 (N.Y. 1895).

<sup>439</sup> *Id.*

<sup>440</sup> 1 C. B. Labatt, *Master and Servant* § 160, at 519 (1913).

<sup>441</sup> *Adair v. United States*, 208 U.S. 161 (1908).

<sup>442</sup> *Id.* at 175-76.

In *Adair*, the Court held that the law was unconstitutional since it imposed a criminal liability upon a railroad company engaged in interstate commerce when it discharged an employee participating in a labor organization.<sup>443</sup> Then, the law violated the individual's freedom of contract regulated by the Fifth Amendment that protects the individual from being deprived of his/her property or liberty without due process.<sup>444</sup>

Also, courts used to act as the advocates of the employment-at-will doctrine and were inclined to satisfy the expectation of dominant business entities.<sup>445</sup> Once Cavico described this phenomenon in his article, as he presents:

“The employment at will doctrine emerged because it was well-suited to the favorable business-oriented social, economic, and political climate that matured its development. During that period, the judiciary, bolstered by the prevailing attitudes of laissez-faire economics and freedom of contract, encouraged industrial growth by actively supporting the right of an employer to control its own business, including approving the right to an employer to discharge at will.... The emerging capitalist employer required wide latitude in employment practices, especially the license to regulate the size of its labor force, in order to confront growing competition and to meet changing market conditions. The employment at will doctrine promoted and protected the capitalist employer by empowering its rule over the labor force. The employer now had great flexibility to upgrade its labor force or to dismiss employees during times of reduced demand for production ... The courts, in response to the economic changes sweeping the United States, performed a role as developers of the common law, and ushered in a doctrine which reflected the requirements, expectations, and beliefs of the then dominant business class.”<sup>446</sup>

Hence, observing a series of social and economic changes, courts gradually stated that

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<sup>443</sup> *Id.* at 174.

<sup>444</sup> *Id.* at 172.

<sup>445</sup> *Wagenseller v. Scottsdale Memorial Hosp.*, 147 Ariz. 370, 375 (1985).

<sup>446</sup> Cavico, *supra* note 421, at 500-01.

the concept of hiring at-will has great function on the usage of labor in markets. For employers and organizations, hiring at-will lets them rapidly respond to the market's supply and demand, and dispatch to adjust organizational operation. In addition, it can improve organizational efficiency because employers have the right to fire unsuitable employees at will, and recruit new constituents who can enhance the performance of organizations. Similarly, it is allowable for employees to quit from organizations they serve at any time since they also have the right to choose employers and organizations they want to serve and whom they like to associate with.

Further, the principle of mutuality is another concept that promoted the doctrine of employment-at-will. Its rationale is that not only can employers not be compelled to retain employees who they try to discharge, but employees also cannot be forced to serve unpleasant employers or organizations.<sup>447</sup> A court states:

“Our disinclination to expand [this case] serves to protect employees as well as employers ... In the absence of an employment contract, the counterpart part of the employer's privilege to terminate at will is the privilege of the employee to do the same ... employees have a strong interest in maintaining that privilege free from threat of suit, lest employers be supplied with a new weapon with which to harass key employees wishing to change jobs. Thus, the rights of employer and employee to decline to create conditions for termination benefit both.”<sup>448</sup>

Therefore, the privilege of termination belongs to both employers and employees, and it is not an exclusive right for any particular party. When employers have a freedom to

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<sup>447</sup> Callahan, *supra* note 417, at 457.

<sup>448</sup> Rozier v. St. Mary's Hosp, 411 N.E.2d 50, 54 (1980).

discharge employees whom they dislike or abominate, employees hold the same right to get rid of supervisors whom they do not respect or are unwilling to serve or comply with as well.

The doctrine of employment-at-will has been in the Constitution from the *Coppage* case decided by the U.S. Supreme Court.<sup>449</sup> The Court held that it is the constitutional right for an individual to decide whether he/she wants to enter into a contract or not. Freedom of contract or freedom of not making up a contract is a convergence for an individual to balance self-interest and other factors. The Court overthrew the state statute that imposed a misdemeanor upon employers who required employees to sign a contract, which precluded employees from becoming a member of labor union when they were in the employment relationship. The Court notes:

“Included in the right of personal liberty and the right of private property – partaking of the nature of each – is the right to make contracts for the acquisition of property.... If this right be struck down or arbitrarily interfered with, there is a substantial impairment of liberty in the long-established constitutional sense. The right is as essential to the laborer as to the capitalist, to the poor as to the rich; for the vast majority of persons have no other honest way to begin to acquire property, save by working for money.”<sup>450</sup>

Thus, since the doctrine has been certified by the U.S. Supreme Court, inferior courts or other agencies will not suspect the status of the employment-at-will doctrine when addressing related employment disputes. Not only has hiring at-will doctrine grown to

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<sup>449</sup> *Coppage v. State of Kansas*, 236 U.S. 1 (1914).

<sup>450</sup> *Id.* at 14.

be the standard that governs U.S. employment relationship in the workplace, but also has become the prevalent concept to decide the duties and obligations held by employees and employers.

### 3. Influence of the Employment-At-Will Doctrine in American Society

Followed by the analysis, it may be interesting to know how the employment relationship in America has been influenced by the employment-at-will doctrine.

Werhane points out this phenomenon in his book:

“Legally speaking, 55 percent of all employees in the private sector are at-will employees. What this means is that these employees are working with no assurances regarding the conditions or term of their employment, which can be unilaterally altered or terminated at any time, for good reasons, no reason, or even immoral reasons.... At-will employees range from part-time contract workers to CEOs. This category includes all those workers, managers, and executives in the private and public sectors of the economy not covered by agreements, statutes, or contracts.... these employees have no rights to due process or to appeal employment decisions, and the employer does not have any obligation to give reasons for demotions, transfers, or dismissals.... The reality is that most employees, particularly those who perform at least adequately, are generally unaffected by their at-will status. It is often not until something out-of-the ordinary occurs, such as an unforeseen altercation, corporate restructuring, layoffs, economic downturns, or a corporate merger, that people become aware of their status. While changes are taking place with regard to how employment is regulated, these changes do not significantly alter the fact that our default legal framework and mindset about employment is rooted firmly in the employment-at-will.”<sup>451</sup>

As the observation of Werhane, the employment relationship following the doctrine of employment-at-will is not be protected by due process as employees are fired. Emplo-

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<sup>451</sup> Patricia H. Werhane et al., *Employment and Employee Rights* 54-55 (2004).

yers have no responsibility to make a good cause or hold good faith when they decide to discharge employees. This situation causes several problems because of the imbalanced power between employers and employees. Even if employees have the right to quit at any time, whether they can practice this privilege is still in doubt. Do they have comparable resources, like employers, to find another job to replace the original one? Several unequal phenomena arise as a result of the application of employment-at-will doctrine. In later sections, these issues will be discussed, and other policies will be applied to against this employer-orientation doctrine.

#### 4. Criticisms of the Employment-At-Will Doctrine

In the doctrine of employment-at-will, there is no outlet for discharged employees to claim their arguments because they have no right to be protected in the legal process and to appeal those unjust treatment made by their employers. Also, employers have no obligation to explain their adverse actions imposed upon employees. This issue generally gives rise to other legal scholars' attention and makes them turn to think about whether this inherent unfairness should be maintained or not.<sup>452</sup> Because of potential imbalanced power in the employment relationship, the principle of mutuality, in reality, appears to have less function to reach practical fairness between employees and employers. In fact, employees rarely have a chance to choose work that they

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<sup>452</sup> Lawrence E. Blades, *Employment At Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 Colum. L. Rev. 1404, 1405 (1967).

really like, and to decide whether these jobs are suitable for their professional majors. The reason to find a career is that employees have to sustain their livelihoods, families, and bear necessities of life. Considering the nature of employment, employees have to evaluate geographical restriction, time, the knowledge that they have to invest in pursued careers, the possibility of promotion, and if the payment is worth for them going for because it is difficult for them to change jobs arbitrarily.<sup>453</sup> Then, employees seldom quit voluntarily and fear to be terminated with no reasonable cause; also, employees worry their positions will not be protected by the legal process after bearing employers' adverse actions.<sup>454</sup>

On the contrary, employers do not have such concerns to worry since they hold managerial power in the workplace. Employers have superior authority to choose which person they want to recruit, and have the power to make employment contracts and to amend the terms of contract.<sup>455</sup> Besides, employers may not make their livelihoods or business into trouble only because of employees' resignations. If employers intend to retain employees whose performance is admirable but think about quitting, employers can simply raise those employees' payments or increase other benefit to keep them in original positions. Otherwise, employers are able to provide more attractive terms

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<sup>453</sup> Moskowitz, *supra* note 427, at 34.

<sup>454</sup> Massingale, *supra* note 418, at 200-01.

<sup>455</sup> *Id.*



in the employment contract to attract other suitable or competent applicants to participate in their organizations.

Compared with the situations encountered by employers and employees, employees involuntarily discharged suffer more hardships in daily life than employers do because employers probably can easily change those temporary inconveniences by managerial power.<sup>456</sup> In this way, it may be inferred that the employment relationship cannot be considered as an equal, mutual, or symmetrical model. As a court notes:

“While the doctrine is cast in mutuality, affording to employee as well as employer the right of at-will termination, it cannot be seriously contended that, in reality, it impacts with equal force.... it assures equality to the employee as does the law which forbids the rich as well as the poor to sleep under bridges.”<sup>457</sup>

Because of the differences in economic and bargaining power between employers and employees, employers’ abilities to make the terms of employment contracts or control other matters related to employment will have a great influence on employees’ activities in the workplace. Following this disparate position, it increasingly raises the concern about the abuse of employers’ managerial power on the treatment of employees.<sup>458</sup>

In view of this unfair situation, courts are required to establish a rule or other exceptions to prevent employees from being punished by employers’ unjust practices. Ironically, however, before starting to adopt the employment-at-will doctrine, courts had be-

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<sup>456</sup> *Id.*

<sup>457</sup> *Ludwick v. This Minute of Carolina, Inc.*, 337 S.E.2d 213, 214 (S.C.1985).

<sup>458</sup> *Massingale*, *supra* note 418, at 189.

en criticized by not following the public's expectations as result of social and economic changes.<sup>459</sup> Likewise, coping with current disputes, courts are forced to make a new policy to respond to diverse values of society, and find some solutions to satisfy new expectations coming from employees, employers, and the public.<sup>460</sup> A court notes a similar concept below:

“Absolute employment at will is a relic of early industrial times, conjuring up visions of the sweat shops described by Charles Dickens and his contemporaries. The doctrine belongs in a museum, not in our law. As it was a judicially promulgated doctrine, this court has the burden and duty of amending it to reflect social and economic changes.”<sup>461</sup>

Courts have been criticized for being the advocates of discouraging legal and moral behaviour since former decisions support the employment-at-will doctrine.<sup>462</sup> Though, when this doctrine has been misused and has become a tool for employers to retaliate against employees, courts have to intervene in before legislatures begin to take actions to statutorily forbid those retaliatory actions.

Protecting employees from being abused by employers' authority in the workplace is extremely important because, nowadays, the operation of society not only depends on the connection of each social constituent, but also relies on the interaction of various human activities. As Tannenbaum says:

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<sup>459</sup> Arthur S. Leonard, *A New Common Law of Employment Termination*, 66 N.C.L. Rev. 631, 675 (1988).

<sup>460</sup> *Pierce v. Ortho Pharmaceutical Corp.*, 84 N.J. 58, 66 (1980).

<sup>461</sup> *Sabine Pilot Serv., Inc. v. Hauck*, 687 S.W.2d 733, 735 (Tex. Sup. Ct. 1985).

<sup>462</sup> Callahan, *supra* note 417, at 456.

“We have become a nation of employees. We are dependent upon others for our means of livelihood, and most of our people have become completely dependent upon wages. If they lose their jobs, they lose every resource, except for the relief supplied by the various forms of social security. Such dependence of the mass of the people upon others for all of their income is something new in the world. For our generation, the substance of life is in another man’s hands.”<sup>463</sup>

Since the disparity of bargaining power and economical position in the employment relationship, courts gradually transferred their focus from promoting successful business to think about the individual’s protection and public interest. The employment-at-will doctrine was strictly pursued until the 1960s.<sup>464</sup> During the 1960s, the issues about the quality of life and the protection of personal interest got the federal government’s attention.<sup>465</sup> Federal government found that even if the hiring at-will doctrine had a considerable influence to promote organizational performance and improve the usage of labor in the market, this doctrine still brought potential harm on employees’ rights and public good. Diverse social values will be violated “when the employer terminates the employee for a reason that contravenes or jeopardizes a clear and fundamental, substantial, or well established ‘public policy’ of the jurisdiction.”<sup>466</sup> Although there is managerial power owned by employers, when this power arises from employers’ bad intent and starts harming employees, it should be restricted and examined by

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<sup>463</sup> Frank A. Tannenbaum, *A Philosophy of Labor* 9 (1951) (emphases omitted).

<sup>464</sup> Ballam, *supra* note 160, at 654.

<sup>465</sup> *Id.*

<sup>466</sup> Frank J. Cavico, *Private sector Whistleblowing and the Employment-At-Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis*, 45 *S. Tex. L. Rev.* 543, 589 (2004).

authorized agencies. One time, a court stated, “Firing for bad cause – one against public policy articulated by constitutional, statutory or decisional law – is not a right inherent in the at-will contract ...”<sup>467</sup> In addition, usually, employees are wrongfully discharged for the reason that they are conscious of their social duties to protect the public’s safety and promote the public policy of jurisdiction.<sup>468</sup> One court notes this idea as follows:

“An employer should not have an absolute and unfettered right to terminate an employee for an act done for the good of the public. Therefore ... an at-will employee has a cause of action for wrongful discharge if he or she is fired in violation of a well-established public policy of the state.”<sup>469</sup>

Hence, in order to protect employees from suffering unjust treatment, courts tended to reconsider whether they should shrink the scope of the employment-at-will doctrine and brought other exceptions to restrict this principle.<sup>470</sup> Because of these concerns, the jurisdictions and the legislatures made up some exceptions and limitations as they address issues associated with the problem of the doctrine of employment-at-will.<sup>471</sup> Right now, the public policy exception is the most widely-accepted concept to modify the defects of the hiring at-will doctrine. Once a court stated, “The potentially harsh effects of the at-will doctrine have been tempered ... by the adoption of the pu-

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<sup>467</sup> Murcott v. Best Western Int’l, Inc., 9 P. 3d 1088, 1095-96 (Ariz. Ct. App. 2000).

<sup>468</sup> Doody v. Centerior Energy Corp., 739 N.E. 2d 851, 856 (Ohio Ct. App. 2000).

<sup>469</sup> Gower v. IKON Office Solutions, Inc., 155 F. Supp. 2d 1268, 1272 (D. Kan. 2001).

<sup>470</sup> Cavico, *supra* note 421, at 497.

<sup>471</sup> Ballam, *supra* 160, at 654.

blic policy exception.”<sup>472</sup> Then, how to operate the public policy exception in order to balance the conflict of interest in the employment-at-will doctrine is the next lesson to study, and is going to be discussed in the later section.

## 5. The Public Policy Exception and Its Function

The prevalent method to limit the employment-at-will doctrine is the public policy exception.<sup>473</sup> The public policy exception means employees can bring a cause of action against employers when they suffer wrongful or retaliatory discharge, and the discharge violates significant public policies. In essence, as Jones says, “The employer and employee stand on opposite sides of the issue of whether an employer should terminate employment if it is contrary to public policy.”<sup>474</sup> According to the public policy exception, some elements have to be satisfied when employees are filing a claim against the doctrine of employment-at-will. These elements include: (1) an act or refusal to act by the employee (2) an act or refusal was supported by public policy (3) an act or refusal bears a causal relationship ... to (4) the employee’s discharge.<sup>475</sup> It is hard for employees to bring the public policy exception against employers when they are fired only for a good or no reason, even for a bad reason. If the discharge is not in

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<sup>472</sup> Daul, *supra* note 132, at 166.

<sup>473</sup> Seligman, *At-Will Termination: Evaluating Wrongful Discharge Actions*, TRIAL, 60-61 (1983).

<sup>474</sup> Jones, *supra* note 135, at 1144.

<sup>475</sup> Elletta Sangrey Callahan, *The Public Policy Exception to the Employment At Will Rule Comes of Age: A Proposed Framework for Analysis*, 29 Am. Bus. L.J. 481, 490 (1991).

retaliation for the employee having engaged in conduct supported by a strong public policy.<sup>476</sup> As the discharge is with “the absence of just cause ... or [there is] the present of an unfair ulterior motive [of employers],” these kinds of discharge are insufficient in the absence of a strong public policy that protects the employee’s conduct motivating the discharge.<sup>477</sup>

The public policy exception is a compromise after courts struck the balance among employers’ managerial authority, employees’ personal security, and significant public policies.<sup>478</sup> However, some people stand for the employment-at-will doctrine because they think employers not only can efficiently make use of their managerial power to bring maximum interests, but can control workplaces and reduce unnecessary risks.<sup>479</sup> Providing a legal recourse for discharged employees may increase the chance of false allegations to occur and influence the harmony of workplaces.<sup>480</sup> The opposition contends that even though the hiring at-will doctrine strengthens employers’ power on management, this power still cannot be superior to the public’s expectations on protecting the individual’s rights, promoting public policies, and ensuring public inte-

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<sup>476</sup> William J. Holloway & Michael J. Leech, *Employment Termination: Rights and Remedies* 261 (1985).

<sup>477</sup> *Id.*

<sup>478</sup> *Palmateer v. International Harvester Co.*, 421 N.E. 2d 876, 878 (Ill. 1981).

<sup>479</sup> Jeffrey L. Harrison, *The Price of the Public Policy Modification of the Terminable-At-Will Rule*, 34 Lab. L.J. 581, 584 (1983).

<sup>480</sup> Hubbell, *supra* note 299, at 105.

rest.<sup>481</sup> Atkins states this point as follows:

“Modernly, courts strike a balance between the competing interests of employer discretion, employee security and public policy. Proponents of the at-will employment doctrine argue that the employer’s interest in controlling the working environment must be maintained. Proponents for enforcement of the at-will employment doctrine argue that, except in the most egregious instances, allowing recourse for unjust dismissal is unwarranted. These proponents contend unjust dismissal protection encourages false claims, and is an inappropriate means of enforcing public policy. Opponents contend that protection of the employee and society is of paramount importance. If employees have no recourse, employers will coerce them into committing illegal acts to the detriment of society and, potentially, the environment.”<sup>482</sup>

Organizations’ private interests cannot be superior to public welfare when the reason that employers take retaliatory actions against employees correlates with the issue of public policy or probably harms the safety and health of citizens. In these situations, courts have to restrict the employment-at-will doctrine because their actions will satisfy the expectation of social constituents and avoid the losses to the public.

## 6. Evolution of the Public Policy Exception

### a. History<sup>483</sup>

Because unfair circumstances caused by the hiring at-will doctrine, legal scholars and courts intended to make up a rule or other exceptions to restrict employers’ managerial power that can discharge employees at will; the public policy exception

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<sup>481</sup> Theodore J. St. Antoine, *A Seed Germinates: Unjust Discharge Reform Heads toward Full Flower*, 67 Neb. L. Rev. 56, 67 (1988).

<sup>482</sup> Chad A. Atkins, *The Whistleblower Exception to the At-Will Employment Doctrine: An Economic Analysis of Environmental Policy Enforcement*, 70 Denv. U. L. Rev. 537, 541 (1993).

<sup>483</sup> The history refers to Werhane et al., *supra* note 451, at 60-62.

was the product under this consideration. The public policy exception not only resolves the problem of conflicts of interest among employers, employees, and the public in the employment-at-will doctrine, but finds an outlet to address imbalanced power in the employment relationship.

The public policy exception is the concept that came from state common law. It initially appeared in the *Kouff* case<sup>484</sup> and the *Petermann* case<sup>485</sup> under the California Court of Appeal. In *Kouff*, the court held that the doctrine of employment-at-will is restricted and has to be subject to statutory limitations. Employers' allegations will be of no merit if they claim the hiring at-will doctrine trumps statutory prohibitions. Thus, the court held that the application of the employment-at-will doctrine has to follow statutory limitations and cannot be abused by employers. In *Petermann*, the court set up a concept of "public policy" to restrict the application of the employment-at-will doctrine. The court held that the doctrine of hiring at-will is limited by statutes and has to be restricted under the concerns of diverse public policies. The court states this point as follows:

"The public policy of this state ... would be seriously impaired if it were to be held that one could be discharged by reason of his refusal to commit perjury. To hold that one's continued employment could be made contingent upon his commission of a felonious act at the instance of his employer would be to encourage criminal conduct upon the part of both the employee and employer and serve to

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<sup>484</sup> *Kouff v. Bethlehem-Alameda Shipyard, Inc.*, 90 Cal. App. 2d 322 (1949).

<sup>485</sup> *Petermann v. International Brotherhood of Teamsters*, 174 Cal. App. 2d 184 (1959).



contaminate the honest administration of public affairs. This is patently contrary to the public welfare.”<sup>486</sup>

In *Petermann*, the court noted that when employees are discharged since they are unwilling to assist employers in committing perjury, in this situation, employers are restricted to terminate employees at will because of the consideration of public policy. In this way, employers will bear more restrictions to apply the employment-at-will doctrine in the workplace since the scope of limitation extends from narrow statutes to the broader concept of public policy.

Besides, the concept of wrongful discharge appearing in the public policy exception arose from the *Frampton* case decided by Indiana’s Supreme Court.<sup>487</sup> In *Frampton*, the Court held that the plaintiff should not be wrongfully terminated only because she filed a worker’s compensation claim. As the Court notes:

“If employers are permitted to penalized employees for filing workmen’s compensation claims, a most important public policy will be undermined. The fear of being discharged would have a deleterious effect on the exercise of a statutory right. Employees will not file claims for justly deserved compensation – opting, instead, to continue their employment without incident. The end result ... is that the employer is effectively relieved of his obligation.... Since the Act embraces such a fundamental ... policy, strict employer adherence is required.”<sup>488</sup>

Thus, the Court restricted employers’ right to discharge employees wrongfully merely since employees intend to exercise their statutory rights. Employers are not allowed to interfere in employees’ privileges when employees’ actions involve fundamental liber-

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<sup>486</sup> *Id.* at 189.

<sup>487</sup> *Frampton v. Central Indiana Gas Co.*, 260 Ind. 249 (1973).

<sup>488</sup> *Id.* at 251-52.

ty that are protected by statutes or regulations, which are serving the significant public policy.

Because of the *Petermann* case, many jurisdictions have recognized that in order to bring a cause of action against the employment-at-will doctrine, employees have to file their claims based on some factors. These factors include employees' "(1) refusal to commit an unlawful act, (2) performance of an important public obligation, or (3) exercise of a statutory right or privilege."<sup>489</sup> These discussions are going to be presented in later sections.

#### b. The Public Policy Exception As a Tort

Observing from the origination of the public policy exception, employees' tortious actions under the employment-at-will doctrine can be a factor for employees to have a cause of action against employers. Many jurisdictions have provided torts as a legal remedy for employees who have suffered wrongful discharge from employers whose actions contravene significant public policies.<sup>490</sup> Werhane says this point as follows:

“Exceptions to EAW [employment-at-will] are also derived from tort theory. These exceptions fall into a number of broad categories. Most of these situations target either the right of the employer to discharge the employee or the manner

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<sup>489</sup> Comm. on Labor and Employment Law, *At-Will Employment and the Problem of Unjust Dismissal*, 36 Rec. A.B. City N.Y. 170, 183-84 (1981).

<sup>490</sup> George Steven Swan, *The Economics of the Retaliatory Discharge Public Policy Action*, 9 St. Louis U. Pub. L. Rev. 605, 615 (1990).

in which an employee is discharged. Wrongful discharge based on public policy is clearly the most successful argument in many jurisdictions ... Such actions contend that the employer is preempted from discharging the employee, generally on the basis of a contrary federal or state regulation. Similarly, arguments for outrage, fraud, intentional infliction of emotional distress, and intentional interference with contract, while less successful, are also based on claims of improper motivation for discharge.<sup>491</sup>

Therefore, the wrongful discharge can be the most persuasive claim for employees to allege their terminations are worth being protected under the consideration of public policy. Though, the public policy is an unclear concept and can be shown by a variety of forms. Thus, it is important for employees to find an exact public policy, which can shield their rights from being damaged by employers before filing a claim in the legal jurisdiction.

In addition, courts find that it is not difficult for them to recognize torts because the wrongful discharge is the violation, which neither results from the agreement between employers and employees nor from the expectation in the employment relationship. Also, this violation does not satisfy the public's expectation since ordinary people not only think the discharge should result from employers' good faith, not coming from retaliatory intent, but they also believe that the wrongful discharge is unacceptable in our society.<sup>492</sup> Since employees bearing the wrongful discharge can bring a cause of action by torts against employers, physical or emotional harm will be consider-

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<sup>491</sup> Werhane et al., *supra* note 451, at 66.

<sup>492</sup> Moskowitz, *supra* note 427, at 50.

ed when courts decide to relieve employees' losses. As a court notes:

“We believe that public policy also requires us to allow a wrongfully discharged employee a remedy for his or her complete injury ... In addition to his monetary loss of wages, the employee may suffer mentally. ‘Humiliation, wounded pride, and the like may cause very acute mental anguish...’ We know of no logical reason why a wrongfully discharged employee’s damages should be limited to out-of-pocket loss of income, when the employee also suffers casually connected emotional harm.”<sup>493</sup>

Likewise, courts may impose the punitive damage in torts<sup>494</sup> upon employers for their wrongful terminations when employees’ conditions can satisfy required elements and standards.<sup>495</sup>

Even if employees can bring a cause of action by torts against employers’ wrongful discharge and relieve their losses, there are some defects when applying torts against employers’ retaliatory actions. The most difficult problem comes from the vagueness of the word “public policy”.<sup>496</sup> As a result of the ambiguity of this term, courts find it difficult to trace back the precise source when applying the public policy exception to restrict the employment-at-will doctrine.<sup>497</sup> Employees, employers and their attorneys fail to easily predict the result of the case because the unspecific public policy

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<sup>493</sup> Niblo v. Parr Mfg., Inc., 445 N.W. 2d 351, 355 (Iowa 1989).

<sup>494</sup> Swanson v. Eagle Crest Partners, Ltd., 105 Or. App. 506, 510, 805 P.2d 727, 729 (1991).

<sup>495</sup> Roberts v. Ford Aero. & Communications Corp., 224 Cal. App. 3d 793, 797, 274 Cal. Rptr. 139, 142-43 (1990).

<sup>496</sup> Ludwick, *supra* note 457, at 215.

<sup>497</sup> Berube v. Fashion Centre, 771 P.2d 1033, 1042 (Utah 1989).

of torts not only had a negative history on being rejected by some courts,<sup>498</sup> but different jurisdictions also have made divergent decisions on related issues. Thus, it is complicated to identify courts' positions as applying the public policy of torts. A vague definition of public policy and an imprecise standard to decide public policy preclude employees from filing a claim against employers' adverse employment actions. Also, these defects hinder employers from preparing for a strong defense to rebut employees' claims if their allegations are false. Then, these deficiencies cause the public policy exception to become "an amorphous source of just cause litigation";<sup>499</sup> also, they are inclined to "transform at-will employment into life tenure regardless of work performance."<sup>500</sup> The application of public policy on resolving the issues of hiring at-will doctrine is not as specific and uncomplicated as courts or legal scholars originally created this concept.

### c. Sources of the Public Policy Exception

For the sake of realizing which situation will be protected under the public policy exception, it is important to get the whole comprehension regarding the sources of public policy. Frankly speaking, the sources of public policy "typically encompass Constitutions, statutes, judicial decisions, and administrative rules, regulations

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<sup>498</sup> Burk v. K-Mart Corp., 770 P.2d 24, 28-29 (Okla. 1989).

<sup>499</sup> Henry H. Perritt, Jr., *The Future of Wrongful Dismissal Claims: Where Does Employer Self Interest Lie?* 58 U. Cin. L. Rev. 397, 407 (1989).

<sup>500</sup> *Rozier*, *supra* note 448.

or decisions.”<sup>501</sup> Even if the sources of public policy have been dominated by legislative enactments, administrative regulations, or judicial decisions; sometimes, professional codes of ethics also can be regarded as a kind of public policy and be used to ag-  
ainst employers’ wrongful terminations.<sup>502</sup> In later sections, these sources are categor-  
ized and be discussed.

#### i. Constitutional Sources

The Constitution is the foundation of law. Any legislative statutes or administrative regulations cannot conflict with it when related issues get involved in the spirit of the Constitution. Even though the Constitution prevents the individual from being damaged by state actions and not purely by private conduct,<sup>503</sup> when a specified condition interferes with the individual’s right protected by the Bill of Rights, the Constitution still can be viewed as a source of public policy to keep a person from being harmed. Therefore, as employees suffer wrongful discharge and find their constitutional rights have been infringed, they can claim violations of rights and have a cause of action against private employers under legal jurisdiction.<sup>504</sup>

When starting to discuss the public policy under the Constitution, the right of pri-  
vacy, the right of free speech, and the right of association come to mind. First,

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<sup>501</sup> Cavico, *supra* note 466, at 590.

<sup>502</sup> *Pierce*, *supra* note 460.

<sup>503</sup> *Johnson v. Carpenter Technology Corp.*, 723 F. Supp. 180, 185 (D. Conn. 1989).

<sup>504</sup> *Boyle v. Vista Eyewear, Inc.*, 700 S. W. 2d 859, 871 (Mo. Ct. App. 1985).

the right of privacy is not only cherished by an individual, but is put on the primary place in the constitutional doctrine.<sup>505</sup> Hence, if employees are discharged by employers whose actions invade their privacy, the Constitution can be the source of public policy that employees may depend on to bring a cause of action against employers.<sup>506</sup> However, employees' right of privacy may not be superior to other interests when these conflict with each other. Likewise, the right of privacy has to be balanced between employers' business discretion in the workplace and other social interests in order to decide which one will prevail.<sup>507</sup> As the public's interests are more critical than employees' privacy, individual rights should yield and keep out of the way. A court states this concept as follows:

“Where the public policy supporting [employees'] privacy in off-duty activities conflicts with the public policy supporting the protection of the health and safety of other workers, and even [employees] themselves, the health and safety concerns are paramount.”<sup>508</sup>

Thus, it is highly possible that courts would hold that employees' allegations are of no merit even though their claims are based on the privacy clause under the Constitution. Because other interests still have to be protected and considered, courts have to decide which interest has more advantages than others do when those different interests conf-

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<sup>505</sup> *Semore v. Pool*, 217 Cal. App. 3d 1087, 1092, 266 Cal. Rptr. 280, 285 (1990).

<sup>506</sup> *Davis S. Hames, Are Terminations Precipitated by an Invasion of Privacy Wrongful?* 42 Lab. L.J. 371, 375 (1991).

<sup>507</sup> *Quitmeyer v. Southeastern Penn. Transp. Auth.*, 740 F. Supp. 363, 367 (E.D. Pa. 1990).

<sup>508</sup> *Luedtke v. Nabors Alaska Drilling*, 768 P.2d 1123, 1136-37 (Alaska 1989).

lict with each other.

Second, the right of free speech is another public policy that is protected under the Constitution. This concept was coming from the *Novosel* case,<sup>509</sup> and the court stated this point as follows:

“The definition of a ‘clearly mandated public policy’ as one that ‘strikes at the heart of a citizen’s social right, duties, and responsibilities’ ... appears to provide a workable standard for the tort action.... the protection of an employee’s freedom of political expression would appear to involve no less compelling a social interest than the fulfillment of jury service or the filing of a worker’s compensation claim.”<sup>510</sup>

However, like the right of privacy, even if a person can rely on the right of free speech in the Constitution to fight against any infringements, courts still tend to balance and take other factors into account in order to decide whether this right has to be protected in the workplace or not. Once the *Novosel* court made up some inquiries for consideration before a decision came out:

- “Whether, because of the speech, the employer is prevented from efficiently carrying out its responsibilities;
- Whether the speech impairs the employee’s ability to carry out his own responsibilities;
- Whether the speech interferes with essential and close working relationship;

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<sup>509</sup> *Novosel v. Nationwide Ins. Co.*, 721 F.2d 894 (3d Cir. 1983).

<sup>510</sup> *Id.* at 899.



- Whether the manner, time, and place in which the speech occurs interfere with business operation.”<sup>511</sup>

Therefore, as observed above, courts tend to think about employers’ managerial power, employees’ protected rights, and organization’s interests before making the conclusion on the issue of freedom of speech. Not only will employers’ discretion on business be considered, but employees’ abilities to perform their duties, the working environment, and organizational operation or performance will be thought over at the same time.

Third, other courts further extend the public policy to the freedom of association,<sup>512</sup> the freedom from discrimination,<sup>513</sup> and the freedom from defamation in the private workplace.<sup>514</sup> Moreover, Perritt even claimed that due process could be regarded as one public policy when employees are discharged due to the insufficient process or an unreasonable cause. As he says:

“Due process is also constitutionally recognized. Part of substantive due process is the rationality idea: the idea that injury must be justified by some good cause. It is a relatively short logical step ... to transform the public policy tort into a legally imposed just cause standard.”<sup>515</sup>

Nonetheless, when adopting due process as a type of public policy, it may completely abolish the employment-at-will doctrine. Thus, the application of this concept should

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<sup>511</sup> *Id.* at 901.

<sup>512</sup> *Id.* at 900.

<sup>513</sup> *Rojo v. Kliger*, 52 Cal. 3d 65, 90, 276 Cal. Rptr. 130, 146 (1990).

<sup>514</sup> *Delaney v. Taco Time Int’l, Inc.*, 297 Ore. 10, 18, 681 P.2d 114, 118 (1984).

<sup>515</sup> *Perritt*, *supra* note 499, at 402.

be more careful and restrictive.

## ii. Statutory and Administrative Sources

Not only can the public policy be found in the Constitution, but courts also find other sources to mitigate the doctrine of employment-at-will in federal and state statutes,<sup>516</sup> and administrative regulations.<sup>517</sup> It is required for employees to point out a violation of specific statutes or regulations that employers breach because these sources give them a strong claim of public policy against employers' wrongful discharge.<sup>518</sup> Although statutes and administrative regulations can be viewed as the sources of public policy, some courts still tend to apply this exception conservatively.<sup>519</sup> The reason is that courts are unwilling to ruin the hiring at-will doctrine since it is the basis of the employment relationship within U.S. society.<sup>520</sup> A court noted this concern and stated that “[v]irtually every statute reflects a public policy judgment . . . To extract a public policy exception to the at-will employment doctrine from each statute would effectively eviscerate that doctrine.”<sup>521</sup> Even if courts worried the ground of employment relationships might be destroyed due to a broad definition of public poli-

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<sup>516</sup> *Wagenseller*, *supra* note 445, at 380.

<sup>517</sup> *Smith v. Calgon Carbon Corp.*, 917 F.2d 1338, 1344 (3d Cir. 1990).

<sup>518</sup> *Dabbs v. Cardiopulmonary Management Servs.*, 188 Cal. App. 3d 1437, 1443, 234 Cal. Rptr. 129, 133 (1987).

<sup>519</sup> *Sabine Pilot Serv., Inc.*, *supra* note 461.

<sup>520</sup> *Redick v. Kraft, Inc.*, 745 F. Supp. 296, 304 (E.D. Pa. 1990).

<sup>521</sup> *Id.*

cy, they still set up some rules to restrict the hiring at-will doctrine when finding employers abuse managerial power to discharge employees; these standards will be listed below.

First, under certain situations, when statutes expressly restrict employers' rights of discharge on employees, employers cannot claim their rights and are shielded under the employment-at-will doctrine.<sup>522</sup> Take Florida Statutes Section 440.205 for example, it states, "No employer shall discharge, threaten to discharge, intimidate, or coerce any employee by reason of such employee's valid claim for compensation or attempt to claim compensation under the Workers' Compensation Law."<sup>523</sup> These statutes adjust employers' managerial power and confine their discretion to discharge employees.<sup>524</sup> If employers still fire employees at will in prohibited circumstances, not only do their actions violate the public policy, but they also may be imposed upon the liabilities for their adverse employment actions.<sup>525</sup>

Second, if the reason that employees suffer terminations is since they refuse employers' requests to breach statutes<sup>526</sup> or regulations,<sup>527</sup> discharged employees can be shielded by claiming the public policy protection. Like the *Sides* court notes:

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<sup>522</sup> Juror Protection Act of 1978, 28 U.S.C. § 1875 (2010).

<sup>523</sup> Fla Stat. Ann. § 440.25 (2010).

<sup>524</sup> *Scott v. Otis Elevator Co.*, 572 So. 2d 902, 903 (Fla. 1990).

<sup>525</sup> *Albright v. Longview Police Dep't.*, 884 F.2d 835, 843-44 (5<sup>th</sup> Cir. 1989).

<sup>526</sup> *Sargent v. Cent. Nat'l Bank & Trust Co.*, 809 P.2d 1298, 1300-01 (Okla. 1991).

<sup>527</sup> *Coman v. Thomas Mfg. Co.*, 325 N.C. 172, 176-79, 381 S.E.2d 445, 447-48 (1989).

“[W]hile there may be a right to terminate a contract at will for no reason, or for an arbitrary or irrational reason, there can be no right to terminate such a contract for an unlawful reason or purpose that contravenes public policy. A different interpretation would encourage and sanction lawlessness, which law by its very nature is designed to discharge and prevent.”<sup>528</sup>

Because statutes or regulations embody the public’s expectations, which require social constituents not to diverge from social values and breach laws, those who push others to commit illegal conduct should be condemned by society.<sup>529</sup> Thus, when employees discharged is because their refusals to violate statutes or regulations, courts tend to support employees’ actions and compensate their losses from employers’ adverse actions. Once a court showed its position and stated:

“... the public policy exception is invoked when an employer requires an at-will employee, as a condition of retaining employment, to violate the law. To hold otherwise would sanction defiance of the legal process legislated ... In a nation of laws the mere encouragement that one violate the law is unsavory; the threat of retaliation for refusing to do so is intolerable and impermissible.”<sup>530</sup>

Thus, with no shield for employees who are unwilling to yield to employers’ unlawful requests and refuse to violate laws, these employees may be conflicted with balancing job security and statutory compliance.<sup>531</sup>

As for the allegation under the protection of public policy, employees have to point out the specific violation that is equal to or more than the general statement of pub-

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<sup>528</sup> *Sides v. Duke University*, 74 N.C. App. 331, 342 (1985).

<sup>529</sup> *Sargent*, *supra* note 526, at 1302.

<sup>530</sup> *Ludwick*, *supra* note 457, at 216.

<sup>531</sup> *Id.*

lic policy.<sup>532</sup> Besides, the requirement of causation is another factor for courts to decide if discharged employees have a legal right against employers' terminations. A court states this point as follows:

“[A] plaintiff must allege and prove more than that she was fired; she must allege and prove that her firing was caused by a prohibited retaliatory motive.... Without the requisite causation there might be a discharge, but not an actionable discharge.... There must be facts for a ‘casual connection’ between [a plaintiff’s] refusal to act and the discharge, facts other than the refusal and the discharge themselves.”<sup>533</sup>

Sometimes, the retaliatory motive can be proved by “rapidity and proximity in time” between employees’ refusals to violate statutes or regulations and their discharge.<sup>534</sup>

Yet, some courts adopted a stricter standard that requires employees to prove the discharge results from the only one cause, that is, the denial of breaching statutes or regulations.<sup>535</sup> Likewise, some courts even held that the public policy exception merely protects discharged employees from refusing to take criminal actions and will not be applied to civil violations.<sup>536</sup> These diverse decisions make the public policy exception complicate to apply. Nonetheless, no matter which standard or limitation courts impose upon this principle, the violation of law is not acceptable and can be a factor to give rise to the protection of public policy.

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<sup>532</sup> Lorenz v. Martin Marietta Corp., 802 P.2d 1146, 1149 (1990).

<sup>533</sup> Hamann v. Gates Chevrolet, Inc., 910 F.2d 1417, 1420 (7<sup>th</sup> Cir. 1990).

<sup>534</sup> *Id.*

<sup>535</sup> White v. American Airlines, 915 F.2d 1414, 1421 (10<sup>th</sup> Cir. 1990).

<sup>536</sup> Hancock v. Express One Int’l, Inc., 800 S.W. 2d 634, 636 (Tex. Ct. App. 1990).

Third, discharged employees can claim the public policy exception when they are terminated by pursuing the statutory right.<sup>537</sup> However, as employees bring this right against employers, employees must prove that employers' decisions of discharge exactly arise from employees' actions of pursuing statutory rights. It is not sufficient for employees to contend that the discharge violates statutory rights.<sup>538</sup> Filing a worker's compensation claim is the most prevalent allegation for employees to fight for a statutory right when being terminated by employers. In the *Frampton* case, the employee filed a claim for his compensation and received a settlement; nevertheless, he still suffered retaliatory discharge subsequently.<sup>539</sup> The court stated that the discharge because of the worker's compensation claim is a wrongful, unconscionable action, which is unallowable under the law, and held that this claim of retaliatory discharge is granted in related Indiana statutes.<sup>540</sup> The court notes this decision as follows:

“... a [retaliatorily] discharge would constitute an intentional, wrongful act on the part of the employer for which the injured employee is entitled to be fully compensated in damages.... [U]nder ordinary circumstances, an employee at will may be discharged without cause. However, when an employee is discharged solely for exercising statutorily conferred right, an exception to the general rule must be recognized.”<sup>541</sup>

Yet, like the policy of the refusal to violate statutes or regulations, employees are req-

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<sup>537</sup> Moskowitz, *supra* note 427, at 51-52.

<sup>538</sup> Cross v. Eastlund, 103 Ore. App. 138, 141, 796 P.2d 1214, 1216 (1990).

<sup>539</sup> *Frampton*, *supra* note 487, at 297.

<sup>540</sup> *Id.* at 252-54.

<sup>541</sup> *Id.* at 253.

quired to assert that the discharge has “a causal link” with the filing of the worker’s compensation.<sup>542</sup> With no connection or related evidence that is able to prove the casual link, it is difficult for discharged employees to get relief for the damage from employers’ adverse actions.

Fourth, even though there is no specific statutory protection and enumerated rights, employees who suffer retaliatory discharge still can be shielded as these terminations are inconsistent with social concerns or state public policies.<sup>543</sup> This standard extends the scope of the public policy exception, and protects other conditions that have not been specified in statutes or regulations.<sup>544</sup> In addition, this standard reduces the possibility of unequal situations that cannot go along with the public’s expectations to happen. However, this concept lacks the specific standard for courts to vindicate the reasonableness of discharge, so several courts have refused to adopt this principle when trying to find public policies.<sup>545</sup> By contrast, these courts tend to construe statutory language more broadly as resolving the issues of retaliatory discharge.<sup>546</sup>

### iii. Judicially Made Sources

Many jurisdictions have agreed that judicial decisions can be a source

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<sup>542</sup> Harris v. American Red Cross, 752 F. Supp. 737, 739 (W.D. Tex. 1990).

<sup>543</sup> Dabbs, *supra* note 518.

<sup>544</sup> Verduzco v. General Dynamics, Convair Div., 742 F. Supp. 559, 562 (S.D. Calif. 1990).

<sup>545</sup> Durham v. Fleming Cos., 727 F. Supp. 179, 181 (E.D. Pa. 1989).

<sup>546</sup> Lampe v. Presbyterian Med. Ctr., 590 P. 2d 513, 515-16 (Colo. Ct. App. 1978).

of public policy.<sup>547</sup> As a court notes:

“Limiting the scope of public policy to legislative enactments would necessarily eliminate aspects of the public interest which deserve protection but have limited access to the political process. Judicial decisions can also enunciate substantial principles of public policy in areas which the legislature has not treated.”<sup>548</sup>

Similarly, Leonard describes that “... neat separation of functions between executive, legislative, and judicial branches has become blurred over two centuries of practice.

From the very beginning, ... state courts played an important role in identifying public policy wholly apart from legislative or executive actions.”<sup>549</sup> Even though judicial

decisions can be regarded as the source of public policy, courts still have to recognize

the rule or standard that directs them to make a suitable judicially-created public poli-

cy. In general, courts are used to referring to prior judicial decisions, which do not sim-

ply resolve retaliatory discharge claims but may be related to other issues, as the so-

source of public policy when addressing wrongful dismissals.<sup>550</sup> However, judicial dec-

isions acting as the source of public policy have been criticized by commentators be-

cause they found these decisions were made subjectively and vaguely.<sup>551</sup> Judicial deci-

sions not only make it harder for later courts to decide the scope of the sources,<sup>552</sup> but

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<sup>547</sup> *Burk*, *supra* note 498, at 28.

<sup>548</sup> *Berube*, *supra* note 497, at 1043.

<sup>549</sup> Leonard, *supra* note 459, at 658.

<sup>550</sup> *Berube*, *supra* note 497.

<sup>551</sup> Leonard, *supra* note 459, at 658-59.

<sup>552</sup> Lee Crawford, *You're Fired! Public Policy Wrongful Discharge after McClendon*, 54 Tex. B.J. 330, 331 (1991).



let future parties anticipate the results of cases more difficultly.<sup>553</sup> Then, forming a precise rule is the urgent concern for courts when they are going to apply this concept as a source of public policy.

Courts have established some standards of conduct for discharged employees as they bring a cause of action against employers under public policy. First, courts set up a standard for discharged employees when they refuse to commit illegal actions requested by employers.<sup>554</sup> Once the *Hinson* court noted, “This public policy exception has been recognized in a number of cases where at-will employees have claimed they were discharged in reprisal for opposition to their employers’ illegal or unethical activities.”<sup>555</sup>

Second, employees can claim under the public policy exception when they are fired because of performing an important public obligation.<sup>556</sup> Employers’ power should be restricted and has to be re-balanced when they impose retaliatory discharge upon employees since they operate social duties. Mostly, employees suffer the discharge as testifying organizations’ illegal activities or employers’ misconduct in courts or before investigative agencies.<sup>557</sup> The action of testifying against employers not only can be

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<sup>553</sup> *Id.*

<sup>554</sup> *Hinson v. Cameron*, 742 P.2d 549, 552 (Okla. 1987).

<sup>555</sup> *Id.* at 553 n.8.

<sup>556</sup> *Hinson*, *supra* note 554, at 552-53.

<sup>557</sup> *Bishop v. Federal Intermediate Credit Bank of Wichita*, 908 F.2d 658, 662-63 (10<sup>th</sup> Cir. 1990).

regarded as altruism to protect public interest, but it also presents an individual's social responsibilities, which require each societal constituent to have the duty to sustain the order of society.

Third, codes of ethics can be viewed as a source of public policy.<sup>558</sup> Even if the term "public" is vague and is difficult for courts to determine whether employees' actions are for public interest or not, when the professionals practice their duties, there is no dispute that their jobs serve social welfare. Thus, when the professionals are discharged because of the refusal to violate their codes of ethics, they are able to claim under the public policy exception against employers' wrongful terminations.<sup>559</sup> Moskowitz describes the consequences of breaching codes of ethics and the significance for those professionals:

"[E]ach profession is based on distinctive knowledge and service to the community.... Law, medicine, and other professions play a direct role in the formation of public policy and its implementation.... They must be given the leeway to address ... problems in a manner consistent with ethical standards. In addition, the at-will professional employee motivated by ethical concerns attempts to correct a problem at the risk of the substantial financial investment in his education, his long-term financial security, and his career standing and reputation.... The professional employee may encounter more subtle retaliatory actions, such as less desirable work assignments, loss of prestige, and decrease in promotional and pay opportunities. Moreover, ... [a] professional license may be revoked because of the violation of statutes that allow discipline because of 'unprofessional' or 'unethical' conduct."<sup>560</sup>

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<sup>558</sup> *Pierce*, *supra* note 460.

<sup>559</sup> Callahan, *supra* note 417, at 458-59.

<sup>560</sup> Moskowitz, *supra* note 427, at 59-60 (citations omitted).

In addition, codes of ethics have to clearly express that the professionals' duties are to serve public interest, not to the specific entity or person.<sup>561</sup> They also should establish an explicit standard or rule that regulates the professionals' conduct to satisfy the public's expectations.<sup>562</sup> Further, codes of ethics have to demonstrate that the professionals' rights and obligations are going for public good, not solely for self-interest and private benefit.

Fourth, a few courts have formed a public policy when employees are discharged because employers have specific intent to harm employees without employees having engaged in the conduct protected by separate specific public policies.<sup>563</sup> A court notes this point below:

“[T]he novel theory of recovery ... must surely involve specific intent ... to harm [the employee] or achieve ... other proscribed goal. If a general intent, in the sense that an employer knew or should have known the probable consequences of his act, were all that a disgruntled employee need show in order to make out a cause of action, the privilege of discharge would be effectively eradicated, for some degree of harm is normally foreseeable whenever an employee is dismissed.... we made it clear that a bare recitation that defendant had act ‘intentionally, wrongfully, maliciously, fraudulently, deceitfully and without justification ‘did not satisfy the specific intent requirement.’”<sup>564</sup>

Liabilities will be imposed upon employers for the conduct specifically directed agai-

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<sup>561</sup> *Warthen v. Toms River Community Memorial Hosp.*, 199 N.J. Super. 18, 28, 488 A.2d 229, 234 (N.J. Super 1985).

<sup>562</sup> *Id.* 199 N.J. Super at 26-27, 488 A.2d at 233-34.

<sup>563</sup> *Geary v. United States Steel Corp.*, 319 A.2d 174 (1974); *Tourville v. Inter-Ocean Insurance Co.*, 508 A.2d 1263 (1986); *Mudd v. Hoffman Homes for Youth*, 543 A.2d 1092, 1094-96 (1988).

<sup>564</sup> *Id. Geary*, 319 A.2d at 177-78.

nst employees. Although this judicial decision provides employees with another ground against retaliatory discharge taken by employers, few courts adopted this concept as a kind of public policy.<sup>565</sup> There are two explanations for this outcome. First, it is because of the inaccurate application of the authority. Courts have stated that malicious discharge entails one's "disinterested malevolence"<sup>566</sup> or "ulterior purpose."<sup>567</sup> Yet, when the defendant's conduct is viewed as malicious, courts tend to impose upon him/her the liability of punitive damage, not ordinary tort liability.<sup>568</sup> Second, courts have rarely adopted tort liability as the public policy exception when employees are terminated by employers' immoral or unethical manner.<sup>569</sup> Consequently, whether employers' specific intent to damage employees is able to be treated as a kind of public policy still needs further discussion.

Fifth, courts have set up a public policy to modify the employment-at-will doctrine when employees' terminations result from the disclosure of employers' misconduct or organizations' wrongdoings. This action taken by employees is called whistleblowing and is going to be discussed in the next section.

#### d. Whistleblower Protection Is a Source of Public Policy

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<sup>565</sup> *Foley v. Presbyterian Ministers' Fund*, 749 F. Supp. 109, 111-12 (E.D.Pa. 1990).

<sup>566</sup> *Tourville*, *supra* note 563, at 1265.

<sup>567</sup> *Id.* at 1266.

<sup>568</sup> *Cavico*, *supra* note 421, at 528.

<sup>569</sup> *Wagenseller*, *supra* note 445, at 378.

It may be a common phenomenon for employees to suffer retaliatory discharge when they disclose employers' misconduct or organizations' frauds. In order to protect the health and safety of society, many courts tend to shield the whistleblowing employee and treat his/her action as one protected public policy.<sup>570</sup> The behaviour of whistleblowers-employees may be regarded as altruism when they act in good faith. Courts defined this action as "the good faith reporting of a serious infraction of ... rules, regulations, or the law [affecting public health, safety or general welfare] by a co-worker or an employer to either company management or law enforcement officials."

<sup>571</sup> Courts show their support for whistleblowers-employees who file a tort-based cause of action against employers when employees are terminated by a wrongful or retaliatory means.<sup>572</sup> Whistleblower protection can be seen as one founded public policy because it not only prevents employers from encroaching on employees' faith and loyalty to organizations, but it also safeguards public interest and social welfare from being harmed.<sup>573</sup>

Typically, whistleblower protection is applied in three situations. First, it is applied when employees are discharged because they refused to practice illegal activities

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<sup>570</sup> Callahan, *supra* note 417, at 460-61.

<sup>571</sup> *White v. General Motors Corp.*, 908 F.2d 669, 671 (10<sup>th</sup> Cir. 1990) (citation omitted).

<sup>572</sup> *Id.*

<sup>573</sup> *Collier v. Superior Court*, 228 Cal. App.3d 1117, 1121 (1991).

for which their employers demand.<sup>574</sup> The reasons are that not only employees' behaviour is moral, but also actions that sustain the law and satisfy the public's expectations should not be punished.<sup>575</sup> Also, discharged employees are protected because their motives are for social welfare, not for employers' illegal profits or self-interest. Once a court noted that the legislative purpose has to be achieved by those who are willing to assist in exercising the law.<sup>576</sup> Since whistleblowers can be viewed as internal monitors and can make sure employers' actions are under the law, with no protection for these people, nobody wants to bear a heavy social obligation and to take a risk on losing jobs or livelihoods. However, some jurisdictions restrict this application<sup>577</sup> because they hold that the time for these employees to file a claim is when they are "unacceptably forced to choose between risking criminal liability or being discharged from ... livelihood."<sup>578</sup> Because it is difficult to decide the term of "unacceptable force," employees may encounter an obstacle when filing a lawsuit in these jurisdictions.

Second, the public policy exception is implicated as employees disclose employers' misconduct and are subsequently discharged in retaliation for disclosures. Protecting employees who are terminated because of disclosing employers' unlawful actions

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<sup>574</sup> *McClanahan v. Remington Freight Lines*, 517 N.E.2d 390 (Ind. 1988).

<sup>575</sup> *Tameny v. Atlantic Richfield Co.*, 610 P.2d 1330 (Cal. 1980).

<sup>576</sup> *Sarratore v. Longview Van Corp.*, 666 F. Supp. 1257 (N.D. Ind. 1987).

<sup>577</sup> *Adams v. George W. Cochran & Co.*, 597 A.2d 28 (D.C. 1991).

<sup>578</sup> *Winters v. Houston Chronicle Pub. Co.*, 795 S.W. 2d 723, 724 (Tex. 1990).

can fulfill legislative purposes<sup>579</sup> and prevent the public from being threatened by potential risks or damage.<sup>580</sup> In addition, it may make the underlying law unenforceable if employers are allowed to discharge good-faith whistleblowers at will without providing them remedies.<sup>581</sup> As a court stated, “The law is feeble indeed if it permits [the defendant] to take matters into [the defendant’s] own hands by retaliating against [his/her] employees who cooperate in enforcing the law.”<sup>582</sup> Yet, since some jurisdictions have limited application for employees unwilling to take illegal actions,<sup>583</sup> those who merely report employers’ misconduct and then are discharged probably will not have a cause of action in these jurisdictions.<sup>584</sup>

Third, the public policy is applied as employees’ terminations arise from arguing employers’ behaviour that is legal, but may be harmful to public good. However, this situation is more difficult for employees who are retaliated against to claim because it lacks the public policy expressed in statutes. Also, in reality, many courts were unwilling to address this issue since they found it difficult to define the term “public policy.”

<sup>585</sup> In the *Geary* case,<sup>586</sup> the court refused to apply public policy to shield the salespe-

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<sup>579</sup> *Harless v. First Nat’l Bank*, 246 S.E.2d 270, 276 (W. Va. 1978).

<sup>580</sup> *Garibaldi v. Lucky Food Stores, Inc.*, 726 F.2d 1367, 1374 (9<sup>th</sup> Cir. 1984).

<sup>581</sup> *Palmateer*, *supra* note 478, at 880.

<sup>582</sup> *Id.*

<sup>583</sup> *Adams*, *supra* note 577.

<sup>584</sup> *Winters*, *supra* note 578.

<sup>585</sup> *Pierce*, *supra* note 460.

rson because he was discharged by reporting the product that he thought was unsafe to the public.<sup>587</sup> The court noted that the salesman had no duty to evaluate the safety of products, and his action had been beyond the scope of his work.<sup>588</sup> Besides, the court held that the salesman's discharge resulted from the employer's managerial power, and it did not want to intervene in the employer's authority.<sup>589</sup> Hence, the court declined to create a public policy for the terminated salesman when no statutory statement of public policy exists on which he/she can rely.

## *B. Common Law Protection*

### 1. Three Forms to Modify the Employment-At-Will Doctrine

In addition to applying the public policy exception to modify the doctrine of employment-at-will, case law has employed an implied in fact contract theory and an implied in law contractual covenant of good faith and fair dealing to restrict the hiring at-will doctrine. I will describe these theories and discuss how they are applied to the employment-at-will doctrine below.

#### a. Implied Contract Theory

Courts will impose a liability upon employers when discharged employees have relied upon an implied in fact contract from oral assurances, representations,

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<sup>586</sup> *Geary*, *supra* note 564.

<sup>587</sup> *Id.* at 180.

<sup>588</sup> *Id.* at 178.

<sup>589</sup> *Id.* at 178-79.



employee handbooks, or personnel manuals distributed in the workplace.<sup>590</sup> Under this theory, courts may find an implied contract as employers promise permanent employment or are willing to modify the at-will employment doctrine, and choose to terminate employees for a good cause unless employees perform unsatisfactory duties or are in unsuitable occupations.<sup>591</sup> The rationale of implied contract theory is “based on the premise that statements or acts indicating that an employee will be terminated only for good cause or otherwise giving assurances of job security, create in the employee the expectation of permanent employment.”<sup>592</sup> Other courts also mentioned this point and held that “[o]ral or written statements of personnel policy which result in an employee’s legitimate expectation of benefit are legally enforceable even though the employment contract is for an indefinite term.”<sup>593</sup> In some circumstances, courts tend to use the promissory estoppel theory to force employers to abide by their oral assurances. In the *Martin* case, the court stated that “... when an employee gives up another offer in exchange for and in reliance upon the employer’s promise of permanent empl-

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<sup>590</sup> Andrew D. Hill, “Wrongful Discharge” and the Derogation of the At-Will Employment Doctrine 19 (1987).

<sup>591</sup> Brian Heshizer, *The New Common Law of Employment: Changes in the Concept of Employment At Will*, 36 Lab. L. J. 95, 104-06 (1985).

<sup>592</sup> Massingale, *supra* note 418, at 196.

<sup>593</sup> William L. Mauk, *Wrongful Discharge: The Erosion of 100 Years of Employer Privilege*, 21 Idaho L. Rev. 201, 214 (1985).

oyment, that contract, if proven, is enforceable.”<sup>594</sup> Accordingly, the implied assurance made by employers cannot be repudiated once reliance has been placed in employees’ minds.

Yet, employers will not be bound by the implied contract as they have expressed their intentions by a clear and direct statement or disclaimer.<sup>595</sup> Employers can explicitly notify employees that the provision in handbooks or manuals reserves their rights to close employees’ position at will,<sup>596</sup> and there is no guarantee for job security under the employment relationship.<sup>597</sup>

#### b. Good Faith and Fair Dealing Theory

Besides making use of the implied contract theory to restrict the hiring at-will doctrine, some jurisdictions also found that there is an implied in law contractual covenant of good faith and fair dealing in the employment relationship. Thus, employers have implied duties on the performance of contracts.<sup>598</sup> Once a court stated, “The covenant encompasses an obligation to refrain from interfering with the one party’s right to receive the benefit of the contract.”<sup>599</sup> As employees bear wrongful disc-

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<sup>594</sup> Martin v. Federal Life Ins. Co., 109 Ill. App. 3d 596, 602-03, 440 N.E.2d 998, 1004 (1982).

<sup>595</sup> Batchelor v. Sears, Roebuck & Co., 574 F. Supp. 1480 (E.D.Mich. 1983).

<sup>596</sup> Novosel v. Sears, Roebuck & Co., 495 F. Supp. 344 (E.D. Mich 1980).

<sup>597</sup> Brown F., *Limiting Your Risks in the New Russian Roulette – Discharging Employees*, 8 Emp. Rel. L. J. 380, 391-92 (1982-1983).

<sup>598</sup> Hill, *supra* note 590, at 34.

<sup>599</sup> Mauk, *supra* note 593, at 245.

charge since employers violate the implied covenant of good faith and fair dealing, courts may impose the liability upon employers and then provide discharged employees remedies to compensate their losses.<sup>600</sup>

In the *Cleary* case, the California Court of Appeals stated that the implied covenant of good faith and fair dealing is present in all employment contracts.<sup>601</sup> The court held that the defendant-employer breached the implied duty because of the long-term employment and the existence of an internal grievance procedure.<sup>602</sup> The court noted this point as follows:

“Two factors are of paramount importance in reaching our result that the plaintiff has pleaded a viable cause of action. One is the longevity of service by plaintiff -- 18 years of apparently satisfactory performance. Termination of employment without legal cause after such a period of time offends the implied-in-law covenant of good faith and fair dealing contained in all contracts.... The second factor of considerable significance is the expressed policy of the employer (probably in response to the demands of employees who were union members), set forth in Regulation 135-4. This policy involves the adoption of specific procedures for adjudicating employee disputes such as this one. While the contents of the regulation ... compels the conclusion that this employer had recognized its responsibility to engage in good faith and fair dealing rather than in arbitrary conduct with respect to all of its employees.”<sup>603</sup>

Therefore, the court stated that the implied contract of good faith and fair dealing has been assured by the employee’s long-term employment relationship with the employer and by in-house channels set up for employees to present their concerns. In this way,

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<sup>600</sup> Massingale, *supra* note 418, at 198.

<sup>601</sup> *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

<sup>602</sup> *Id.* 111 Cal. App. 3d at 455, 168 Cal. Rptr. at 722.

<sup>603</sup> *Id.* 111 Cal. App. 3d at 455, 168 Cal. Rptr. at 729.

the employer is not allowed to breach this implied contract arbitrarily and to harm the employee's interest.

c. Theory of Public Policy Exception

The public policy exception may be viewed as the most widely-accepted theory to restrict the employment-at-will doctrine. Employees who are wrongfully discharged are able to file a tort<sup>604</sup> or contract<sup>605</sup> claim to recover their losses. Case law has established this exception in order to stop employers' actions that probably contravene public policies and cause harmful consequences on social interests by abusing employees.<sup>606</sup> At present, courts have applied the public policy exception in three categories of cases.<sup>607</sup>

i. *Refusing to Commit an Unlawful Act* – This situation usually occurs when employees are unwilling to make a fraudulent testimony for their employers' illegal behaviour.<sup>608</sup> In this way, as employees are discharged because of the refusal to commit unlawful conduct, they are able to file a claim against employers' unreasonable requests.

ii. *Performing an Important Public Obligation* – When employees are fired

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<sup>604</sup> *Tameny, supra* note 575.

<sup>605</sup> *Monge v. Beebe Rubber Co.*, 114 N.H. 130, 316 A.2d 549 (1974).

<sup>606</sup> *Tameny, supra* note 575, at 1335-36.

<sup>607</sup> *Mauk, supra* note 593, at 232-39.

<sup>608</sup> *Petermann, supra* note 485.

because they serve on jury duty,<sup>609</sup> disclose employers' misconduct or organizational corruption,<sup>610</sup> and refuse to violate professional codes of ethics,<sup>611</sup> they can depend on this standard to file a cause of action against employers or organizations to relieve their losses.

iii. *Exercising a Statutory Right or Privilege* – This circumstance occurs most often as employees are terminated because of filing a worker's compensation claim.<sup>612</sup> Sometimes, it is also applied to the situation in which employees refuse to take polygraph tests.<sup>613</sup> When employees are terminated because of pursuing statutory rights or privileges, their losses will be compensated, and employers have to bear the liability for their retaliatory actions.

2. The Precedent Case of SOX Section 806 – *Welch v. Cardinal Bankshares Corp.*<sup>614</sup>

The *Welch* case plays a significant role when discussing SOX Section 806. The reasons are that not only is it the precedent case that the employee filed his claim against the employer for losses because of the disclosure under SOX, but it also is the first time for the whistleblower-employee to prevail employment protection under this

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<sup>609</sup> *Nees v. Hocks*, 272 Ore. 210, 536 P.2d 512 (1975).

<sup>610</sup> *Tameny*, *supra* note 575.

<sup>611</sup> *Pierce*, *supra* note 460.

<sup>612</sup> *Frampton*, *supra* note 487, at 297.

<sup>613</sup> *Perks v. Firestone Tire & Rubber Co.*, 611 F.2d 1363 (3d Cir. 1979).

<sup>614</sup> *Welch v. Cardinal Bankshares Corp.*, 454 F. Supp. 2d 552 (2006).

newly-enacted statute.<sup>615</sup> Because the *Welch* case happened in Virginia, in this part, the differences of employment protection in Virginia common law and SOX are going to be compared and discussed.

a. Facts<sup>616</sup>

David Welch was the CFO and the Transfer Agent of Cardinal Bankshares (Cardinal). Initially, Cardinal was a bank holding company owned by Bank of Floyd, but it purchased all of Bank of Floyd's stock later. As the CFO, Welch's responsibility was monitoring and reviewing journal entries of Cardinal. As the Transfer Agent, not only did he have a duty of reviewing stock trades; canceling old stock certificates and issuing new ones, but he also had to keep records concerning who held Cardinal's shares; which way these stocks were held and how many Cardinal's stocks each investor owned. Welch was discharged and sued in SOX since he found out incorrect journal entries, noticed untied and loose business control in the company, and uncovered his employer's sequent improper inside trading.

The story began from when Welch wrote a memorandum to R. Leon Moore, who was the CEO and Chairman of the Board of Directors of Cardinal, concerning his improper insider stock trading. From Welch's observation, Moore's trading not only alw-

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<sup>615</sup> Deborah Solomon, *Risk Management: For Financial Whistleblowers, New Shield Is An Imperfect One*, Wall St. J., Oct. 4, 2004, at A1.

<sup>616</sup> Paul E. Rossler, *Running for Cover under Sarbanes-Oxley*, 41 Tulsa L. Rev. 573, 590-96 (2006).

ays happened at or near the end of the financial reporting quarter, but also made use of information that was not widely distributed or disclosed to the public market. Welch noticed Moore's behavior had already closely satisfied the definition of insider trading made by the Securities and Exchange Commission (SEC) and gave Moore a warning. However, Moore responded to Welch that he had consulted about this issue with corporate accountants and lawyers, and they found no problem with regard to his trading. Even if Moore guaranteed his trading was in no question, Welch still worried about the information that Moore was given because of Welch's understanding of the SEC rules and of recent eruptions of corporate scandals on insider trading. Even with these considerations, however, Welch still had no plan to present his concerns to any member of the board of directors and audit committee, except for Moore.

But Welch's concerns were reasonable as he found that Moore instructed Wanda Gardner, Cardinal's Vice President and Internal Auditor, to make two improper journal entries. Welch was quite surprised at Gardner's actions because he had a sufficient knowledge of generally accepted accounting principles (GAAP) and wondered why Gardner took a risk of getting involved in these improper entries. In addition, Welch also suspected various credit entries made by Moore's personal secretary and worried that she was controlled by Moore, too. Those fraudulent credit entries might increase corporate revenues and make a better look on current financial reports. However, the-

se reports' ugly side would show up in the following year. In Welch's point of view, he thought that these improper journal entries and credit entries represented a terrible financial control and might bring irreparable damage to the corporation and investors. He suggested that each stage of the financial reports should be fairly presented and be provided to shareholders with sufficient information, and let shareholders realize the company's profits and losses and understand their potential risks for investment. Even though Welch knew these reports were fraudulent and inaccurate, he still signed the consolidated financial statements and reports of condition filed with the Federal Reserve. Still, he did not report those wrongdoings to the SEC since he realized not only would he have been discharged before the passage of the Sarbanes-Oxley Act, but it also might be difficult for him to find another new occupation to replace his old career in other companies at his age.

Waiting for SOX to become effective in July of 2002, Welch examined SOX and concluded that Cardinal's conduct was fraudulent. Upon understanding SOX's regulations, Welch made up his mind and insisted that Cardinal should go back on the right track and establish a stronger financial control. Under the regulations of SOX, it requires:

“public traded companies to file two certification forms, an initial certification and a recurring quarterly certification, with their financial statements or Form 10-QSB. Both certification forms must be signed by the CEO and CFO. By signing, the CEO and CFO certify that, based on their knowledge and belief, the



financial reports accompanying the forms ‘fully comply with the requirements’ of §13(a) or §15(d) of the Securities and Exchange Act of 1934 and the information contained therein ‘fairly presents, in all material respects’ the financial condition and results of the company. The signatures also certify that the signatories are responsible for establishing and maintaining disclosure controls and procedures and have made use of those controls and procedures. The initial certification is required only for the first Form 10-QSB submitted after passage of the Act.’<sup>617</sup>

Because of the requirements of SOX, Moore, as the CEO of Cardinal, signed initial certifications to prove the authenticity of financial reports. Even if these certifications had been approved by Cardinal’s external auditor who guaranteed that there were “no violations or potential violations of laws or regulations, or irregularities involving management and employees,”<sup>618</sup> Welch, as the CFO of Cardinal, still refused to sign these initial materials because he thought that the accuracy of these documents was questionable. Later, Welch wrote a memo to Moore and told him why he did not sign these statements. He explained that his concerns on improper journal entries and on sundry credit entries made him reconsider approving these documents. He was unwilling to bear the liability of committing misconduct that he was not involved in. He also cited penalties and pointed out which material items should be presented under SOX. In addition, he argued that he did not participate in, and was not consulted about the design of internal control procedures, nor did he evaluate the effectiveness of those procedures as required by SOX. Further, he complained about his inability to access

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<sup>617</sup> *Id.* at 592.

<sup>618</sup> *Id.*

the audit committee because Moore was the medium to control how information got to the members of the committee and the board of directors. In response to Welch's arguments, Moore replied to Welch and stated that Welch had to provide more persuasive evidence to strengthen his position. Also, Moore emphasized those certifications that Welch questioned and refused to sign would still be certified.

After Moore and Welch exchanged their memos, Cardinal's board of directors set up a meeting and started to investigate Welch's allegations. Moore not only restated that there was no fraud on these certifications, but he also presented other negative statements to belittle Welch's personality and working performance. These statements included "errors made by him in past call reports, his failure to train other employees as his backup and to implement new software, and his 'excessive reliance' on internal and external auditors for help in accomplishing his work."<sup>619</sup> Douglas Densmore, a Cardinal's counsel, suggested the board to address Welch's complaints and to decide whether Welch should be terminated. Also, Densmore advised the audit committee to meet with Welch and to find out whether his concerns could be viewed as reasonable. Later, Welch requested a meeting for the purpose of preventing Cardinal from being punished by SOX. When Moore and Cardner (Vice President of Cardinal) heard that the meeting would be tape-recorded by Welch, they instantly left as did Moore's pers-

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<sup>619</sup> *Id.* at 594.

onal secretary. Despite their absence, this meeting still continued, and Welch explained his allegations with regard to Cardinal's recent financial fraud and tried to find the solution to fix it.

Following Welch's meeting, Densmore held another meeting for Moore and Welch. The participants of this meeting comprised of Moore and Michael Larowe, who was Cardinal's external auditor and Welch's former employer. Before the meeting started, Densmore and Larowe had been instructed by Vernon Bolt, the vice chairperson and chair of the audit committee of Cardinal, to ask about Welch's intentions for making his allegations. Yet, Welch did not participate in this meeting because not only was his attorney not present, but he thought Larowe was one of the participants in corporate financial corruption. Later that same day, a joint meeting of Cardinal's and the Bank's audit committee was held to discuss Welch's allegations again. Larowe restated that the journal entries were correct, and there was no fraudulent information to mislead investors. Likewise, Moore repeated his observation regarding Welch's bad performance on working and his inability in the CFO position. Besides, Densmore not only concluded that Welch "had surfaced issues, but not in the proper way or in a timely fashion,"<sup>620</sup> but he also suggested Welch should be "suspended indefinitely pending fu-

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<sup>620</sup> *Id.*

rther action by the board.”<sup>621</sup> Finally, the meeting’s participants unanimously agreed to suspend Welch’s position, and Welch received a letter from Bolt who notified Welch that this suspension resulted from “refusing to meet with Cardinal’s legal counsel and external auditor.”<sup>622</sup>

As a result of the suspension, Welch filed the complaint to the Occupational Safety and Health Administration (OSHA) under the Sarbanes-Oxley Act. Welch thought his situation was in the protected activity regulated by SOX and presented evidence to support his position that his suspension resulted from uncovering Moore’s misconduct. However, unfortunately, his claim was denied by OSHA, and he turned to file an appeal to the Administrative Law Judge (ALJ). On appeal, the ALJ made a decision in favor of Welch. First, the judge found that Welch’s actions were under the protected activity because he “reasonably believed” illegal conduct was being committed. In addition to finding two improper journal entries, Welch stated that he was isolated. For example, Larowe chose to discuss financial matters with Moore, instead of going to Welch; both Densmore and Larowe were not suspicious of Moore’s representations and completely believed the authenticity of materials. Further, these people tried to set up a barrier to keep Welch away from investigating financial wrongdoings. Hence, based on these facts, the judge held that it was reasonable for Welch to believe Cardi-

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<sup>621</sup> *Id.* at 595.

<sup>622</sup> *Id.*

nal's internal control was breaking down, and he was an innocent person in this financial corruption. Second, the judge also found "the proximity in time between Welch's protected activities and the adverse employment action was 'itself sufficient to create an inference of unlawful discrimination.'"<sup>623</sup> Third, Cardinal could not provide clear and convincing evidence to rebut Welch's *prima facie* case and did not prove Cardinal would have taken the same adverse employment action even though Welch's actions were not under the protected activity.

In this way, the judge not only found the ground to favor Welch's claim, but also relieved his losses completely from Cardinal's adverse action.

#### b. Application of Virginia Common Law

Even if Welch's claim had been resolved in SOX, the result might be different if Welch had filed a claim against Cardinal's adverse action in his homestate – Virginia. Like other jurisdictions, Virginia provides employees protection when they suffer retaliatory actions taken by employers.<sup>624</sup> However, Virginia common law established narrow exceptions to modify the at-will employment doctrine and did not use those exceptions in the broad way.<sup>625</sup> Typically, Virginia has set up three categories of exception when addressing the restriction of hiring at-will doctrine. First, the public

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<sup>623</sup> *Id.* at 596.

<sup>624</sup> *King v. Donnkenny, Inc.*, 84 F. Supp. 2d 736, 739 (W.D. Va. 2000).

<sup>625</sup> *Id.*

policy exception is applied when employees are terminated because of pursuing their statutory rights.<sup>626</sup> Second, employees are able to be protected when statutes regulate discharge that may violate the law and social interest.<sup>627</sup> Third, as discharge results from employees' refusals to commit criminal actions, the exception will restrict employers' authority to discharge employees at will.<sup>628</sup> Observing those exceptions, Virginia laws provide no cause of action for Welch to file a claim because not only does Virginia have no statute to protect the whistleblower, but its common law also has not formed the whistleblower protection as one of its public policies to restrict the doctrine of employment-at-will. Below, I am going to apply the *Welch* case in Virginia jurisdiction and try to anticipate different consequences.

#### i. Statutory Laws and the Public Policy Exception

When applying statutes and the public policy exception to terminated employees' claims, Virginia courts required employees to show their claims are based on state statutes,<sup>629</sup> and asked them to point out specific public policies on which they rely.<sup>630</sup> Then, it is not possible for employees to file a claim based on the violation of

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<sup>626</sup> *Id.* at 740.

<sup>627</sup> *Id.*

<sup>628</sup> *Rowan v. Tractor Supply Co.*, 559 S.E.2d 709, 711 (Va. 2002).

<sup>629</sup> *Leverton v. Alliedsignal, Inc.*, 991 F. Supp. 486, 490 (E.D. Va. 1998).

<sup>630</sup> *Warner v. Buck Creek Nursery, Inc.*, 149 F. Supp. 2d 246, 261-64 (W.D. Va. 2001).

federal laws against employers' adverse actions in Virginia.<sup>631</sup> Besides, Virginia common law has not set up the whistleblower protection as its public policy to protect discharged employees who report employers' misconduct. In the *Dray* case, the court notes this point as follow:

“In the present case, the plaintiff seeks to mount a generalized, common-law ‘whistleblower’ retaliatory discharge claim. Such a claim has not been recognized as an exception to Virginia’s employment-at-will doctrine, and we refuse to recognize it today.”<sup>632</sup>

Similarly, in the *Storey* case, the plaintiff argued his wrongful termination because of reporting a legal concern violated the public policy of Virginia and sought remedies to compensate his losses.<sup>633</sup> However, the court stated that there is no statute or public policy that “create[s] a right with which Storey’s termination interfered.”<sup>634</sup> Consequently, the court found that there was no cause of action for the plaintiff’s claim based on the exception of whistleblower protection.<sup>635</sup> In addition, Virginia courts stated that the termination must violate public policies<sup>636</sup> and excluded the violation of private interest.<sup>637</sup> Thus, employees have no reasonable cause of action to file a claim against employers when adverse actions do not impair public policies of Virginia.

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<sup>631</sup> *Dray v. New Mkt. Poultry Prods., Inc.*, 518 S.E.2d 312, 313 (Va. 1999).

<sup>632</sup> *Id.*

<sup>633</sup> *Storey v. Patient First Corp.*, 207 F. Supp. 2d 431, 439 (E.D. Va 2002).

<sup>634</sup> *Id.* at 455.

<sup>635</sup> *Id.*

<sup>636</sup> *Leverton*, *supra* note 629, at 492.

<sup>637</sup> *Id.*

In this way, based on these observations, Welch has no cause of action to argue his suspension in Virginia. No matter whether statutory law or the public policy exception, there is no good ground for Welch to bring a suit against Cardinal until Virginia enacts whistleblower protection statutes or adopts the exception of whistleblower protection as a matter of its public policy.

ii. Burden of Proof

Compared with SOX that provides discharged employees with a lower standard of burden of proof, Virginia gives employers a loose evidentiary burden to rebut employees' allegations in their claims.<sup>638</sup> Virginia allows a defendant-employer to prove his/her allegation by the preponderance of evidence, and this advantage can make him/her easily to refute a plaintiff-employee's argument. In addition to a lower burden imposed upon an employer, in Virginia, a discharged employee has to take the disadvantage of proving causation, and this makes it harder for a plaintiff-employee to receive a prevailing decision from the court.<sup>639</sup>

In SOX, the statute merely requires employees to prove their situations fall under the protected activity, and those are the contributing factor for employers' adverse actions.<sup>640</sup> As employees can satisfy the burden of proof and have the *prima facie* case,

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<sup>638</sup> Shaw v. Titan Corp., 498 S.E.2d 696, 698 (Va. 1998).

<sup>639</sup> *Id.* at 700.

<sup>640</sup> Marano v. Dept. of Just., 2 F.3d 1137, 1140 (Fed. Cir. 1993).



employers have to take the shifting burden by clear and convincing evidence to rebut that they would have taken the same adverse employment action even though there is no protected activity.<sup>641</sup> However, neither does Virginia employ the burden-shifting test in wrongful discharge case,<sup>642</sup> nor does it request employers to bear a stricter standard of burden of proof to rebut employees' allegations. Instead, Virginia imposes a lower preponderance standard on employers' evidentiary burden.<sup>643</sup> Thus, in the *Welch* case, Cardinal might have got different consequences in SOX and in Virginia common law. In SOX, Cardinal will have a hard time rebutting Welch's claim because it has to present clear and convincing evidence to meet its evidentiary duty. By contrast, Virginia common law makes it easier for Cardinal to defend Welch's arguments since Virginia uses a lower standard of the preponderance of evidence.

Besides different standard of burden of proof, Virginia common law uses proximate causation for employees' claims on wrongful discharge.<sup>644</sup> Proximate causation requires employees to prove their actions are the substantial cause related to the discharge.<sup>645</sup> Employees fail to satisfy this burden by proving the proximity of time betwe-

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<sup>641</sup> *McDonnell Douglas Corp.*, *supra* note 123, at 802.

<sup>642</sup> *Jordan v. Clay's Rest Home*, 483 S.E.2d 203, 207 (Va. 1997).

<sup>643</sup> *Shaw*, *supra* note 638.

<sup>644</sup> *Kerns v. Shirley Well Drilling*, 1986 WL 401732, 3 (Va. Cir. Feb. 13 1986).

<sup>645</sup> *Shaw*, *supra* note 638.

en the protected activity and the termination,<sup>646</sup> this is very different from SOX.<sup>647</sup> In the *Welch* case, Welch will lose his claim in Virginia because he cannot prove his report was the substantial cause for suspension. Yet, Cardinal may have a successful allegation to rebut Welch's claim since the evidence about Welch's bad performance probably is another cause to suspend him. In other way, Welch's allegation is valid under SOX because SOX simply requires Welch to prove his report is a contributing factor for the suspension.<sup>648</sup> SOX does not adopt proximate causation because its strictness may cause an unjust resolution of employment dispute.

### iii. Exception of the Refusal to Commit Criminal Acts

Virginia common law establishes this exception since the court held that the employment-at-will doctrine should not "serve as a shield for employers who seek to force their employees, under the threat of discharge, to engage in criminal activity."<sup>649</sup> In *Welch*, if Welch files his claim based on this exception, he has to prove that Cardinal's officers have committed illegal activities, and those would be charged by criminal liabilities.<sup>650</sup> In addition, Welch has to show that his suspension is motiv-

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<sup>646</sup> *Jordan*, *supra* note 642.

<sup>647</sup> *Welch*, *supra* note 614.

<sup>648</sup> *Marano*, *supra* note 640.

<sup>649</sup> *Rowan*, *supra* note 628.

<sup>650</sup> *Mitchem v. Counts*, 523 S.E.2d 246, 252 (Va. 2000).

ated by his refusal to accept fraudulent journal entries.<sup>651</sup> As for regulating fraudulent activities, Virginia statutes are “designed to protect the property rights, personal freedoms, health, safety, or welfare” of the general public policy.<sup>652</sup> These statutes impose a legal right or duty upon Welch or other people placed in the same position.<sup>653</sup>

Concerning statutes regulating similar financial fraud in *Welch*, Virginia has two statutes that prohibit bank officers’ fraudulent conduct.<sup>654</sup> The first statute is Virginia Code § 6.1-122, which proscribes “false entry in any book, report or statement of such bank ... with intent” to cheat organizations or their officers.<sup>655</sup> The second one is Virginia Code § 18.2-113, and it restricts “fraudulent entries ... in accounts by officers or clerks of financial institutions.”<sup>656</sup> Fraudulent entries have to be made “with the intent, in so doing, to conceal the true state of such account.”<sup>657</sup>

Turn to consider the *Welch* case, Welch probably can find both Virginia statutes on which he can depend to file a claim against Cardinal. However, he may suffer some obstacles when he tries to prove journal entries are false;<sup>658</sup> likewise, he may find it difficult to point out not only whether Moore forced him to make fraudulent entries,

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<sup>651</sup> *Id.* at 252-53.

<sup>652</sup> *Storey*, *supra* note 633, at 453.

<sup>653</sup> *Id.* at 451.

<sup>654</sup> Va. Code Ann. § 6.1-122, § 18.2-113 (2010).

<sup>655</sup> *Id.* § 6.1-122.

<sup>656</sup> *Id.* § 18.2-113.

<sup>657</sup> *Id.*

<sup>658</sup> *Cohn v. Knowledge Connections, Inc.*, 585 S.E.2d 578, 582 (Va. 2003).

but also if he refused to commit such illegal act.<sup>659</sup> It is not easy for Welch to prove two journal entries are false since accounting statements can be certified by different methods.<sup>660</sup> Accountants and auditors believe their opinions and auditing results will be correct if they have employed GAPP or other certified accounting standards to audit.<sup>661</sup> In addition, Welch cannot make a persuasive statement to prove that Moore requested him to make, to omit, to change journal entries, and to show his refusal to commit fraudulent actions that resulted in the suspension. Actually, Moore did not instruct Welch to do anything wrong, let alone Welch refused to engage in any wrongful activity. For these reasons, Welch probably will lose his claim because those requirements are going to be scrutinized in Virginia's courts before making a decision to restrict the doctrine of employment-at-will.

Similarly, the defendant's intent is another difficult issue to prove.<sup>662</sup> Welch has to provide sufficient evidence, which demonstrates that Moore's explicit intention was to make fraudulent financial materials, to cheat the corporation, and to mislead investors. Not only is Welch's reasonable belief of misconduct not sufficient and is not sati-

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<sup>659</sup> *Marano, supra* note 640.

<sup>660</sup> Matthew J. Barrett, Enron and Anderson - What Went Wrong and Why Similar Audit Failures Could Happen Again in Nancy B. Rapoport & Bala G. Dharan, *Enron: Corporate Fiascos and Their Implications* 155, 158-59 (2005).

<sup>661</sup> Jeffrey D. Bauman et al., *Corporations Law and Policy: Materials and Problems* 201 (2003).

<sup>662</sup> *Storey, supra* note 633, at 453.

sying the burden of proof,<sup>663</sup> but also the evidence has to show that Moore knowingly engaged in alleged fraudulent activities and intentionally committed them.<sup>664</sup> Consequently, Welch may find it difficult to file a claim against Cardinal in Virginia jurisdiction. Without the protection of the Sarbanes-Oxley Act, employees in Virginia encountering the same situation fail to seek a sufficient remedy and relieve their losses since Virginia courts tend to impose a strict evidentiary burden upon employees in employment cases. Virginia's judicial decisions on employment disputes make it harder to restrict the employment-at-will doctrine.

### *C. State Law Protection*

No matter whether state statutes or state common law, nearly fifty jurisdictions have their own legislative or judicial policies and remedy to protect whistleblowers. However, the whistleblower protection varies considerably from state to state<sup>665</sup> since each state has a different historical background, and the evolution of protection on the whistleblower has been piecemeal.<sup>666</sup>

Because each state's common law construes the public policy exception differen-

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<sup>663</sup> *Cohn, supra* note 658, at 578.

<sup>664</sup> *Id.* at 582.

<sup>665</sup> Michael Delikat & Jill I. Rosenberg, *Defending Whistleblower Claims under the Sarbanes-Oxley Act*, in *Understanding Developments in Whistleblower Law 2 years after Sarbanes-Oxley* 37 (2005).

<sup>666</sup> Ramirez, *supra* note 222, at 191.

tly, the requirements in state's whistleblower protection are diverse.<sup>667</sup> These divergences include what kind of whistleblowers should be protected;<sup>668</sup> what illegal activities should be reported;<sup>669</sup> what motive whistleblowers should hold; what evidence can be used to prove employers' misconduct;<sup>670</sup> what relief should be provided;<sup>671</sup> and who is able to be the recipient of whistleblowers' reports.<sup>672</sup> Among these divergences, however, the recipient of employees' arguments is the most widely-varied from state to state.<sup>673</sup> As Sinzdak talks about this point as follows:

“Several states require employees to report wrongdoing externally to a public body. Of these, some provide protection only if the employee reports wrongdoing to a government entity that is capable of taking appropriate action. Still others limit the appropriate external public recipient to one or two specific government entities. Some states take the opposite approach, requiring employee to report internally (at least initially) in order to receive protection. Many of these states, however, do provide an exception to the internal reporting requirement if the employee reasonably believes that supervisors are involved in the wrongdoing or that correction of the violation by the employer is otherwise unlikely. Only a handful of states take the broader federal approach – providing protection to employees who choose to make either an internal report to a superior or an external report to a public body. Almost all states reject or discourage reporting to third parties such as the media.”<sup>674</sup>

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<sup>667</sup> Cherry, *supra* note 92, at 1049.

<sup>668</sup> Callahan & Dworkin, *supra* note 93, at 108.

<sup>669</sup> Miceli & Near, *supra* note 100, at 233-34.

<sup>670</sup> Hale v. Touro Infirmary, 886 So. 2d 1210 (La. Ct. App. 2004).

<sup>671</sup> Robert G. Vaughn, *State Whistleblower Statutes and the Future of Whistleblower Protection*, 51 Admin. L. Rev. 581, 611-13 (1999).

<sup>672</sup> Callahan & Dworkin, *supra* note 93, at 108.

<sup>673</sup> *Id.*

<sup>674</sup> Gerald Sinzdak, *An Analysis of Current Whistleblower Laws: Defending a More Flexible Approach to Reporting Requirements*, 96 Cal. L. Rev. 1633, 1642-43 (2008).

Hence, when each state legislature considered the recipient of the disclosure, it tended to take many factors into account before deciding which outlet should be provided. Those factors consisted of the employer's managerial power, the employee's occupational security or rights, the organizations' benefit, and the public's interest or welfare.

In addition, each state made use of different standard of evidentiary burden to parties who are in litigation when discharged employees file a claim against employers.

As Cherry says:

“Plaintiffs bringing actions for retaliatory discharge in various states must also meet varying burdens of proof. Depending on the language of the specific state statute, the whistleblower may have to prove that the reported wrongdoing actually occurred. Other jurisdictions use a less strict ‘reasonable belief standard,’ requiring the whistleblower to prove that he or she had a good reason to believe the wrongdoing had occurred and thus made the report in good faith. Several courts have said that ‘bad faith’ reports should not receive protection.”<sup>675</sup>

The different standard for the burden of proof means varied results for the *prima facie* cases. As a lower standard of evidentiary burden is imposed upon employees in employment suits against employers' adverse actions, employees probably find it easier to file a claim against employers and to compensate their losses in the administrative procedure and courts.

Further, few states set up a policy to protect “embryonic whistleblowers,” which means “persons who have not disclosed irregularities but who might have been close

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<sup>675</sup> Cherry, *supra* note 92, at 1047.

to doing so at the time of and adverse employment action.”<sup>676</sup> Thus, because of these divergences, in order to get more understanding on state whistleblower protection, it would be helpful to compare each state whistleblower statutes and to find out their differences if the *Welch* case were filed in diverse jurisdictions.

## 1. California

California is the state that treats the whistleblower more kindly and provides more protection or remedies than other states. Before modifying its Whistleblower Protection Statute (WPS) to conform with the Sarbanes-Oxley Act of 2002 (SOX), not only did California restrict employers’ right from discharging employees who disclose organizations’ violations on federal or state laws,<sup>677</sup> but it prohibited employers from retaliating against employees who reported employers’ misconduct.<sup>678</sup> In addition, the statute applied to all employees, no matter whether they served in private or public entities.<sup>679</sup> Until the passage of SOX Section 806, California followed Congress’s step to strengthen its protection on whistleblowers.<sup>680</sup> California’s legislature found that whistleblowing for securities frauds is related to public interest since “unlawful activities of private corporations may result in damage not only to the corporation and its

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<sup>676</sup> Kevin M. Smith & John M. Oseth, *The Whistleblower Era: A Management Perspective*, 19 Emp. Rel. L. J. 179, 184 (1993).

<sup>677</sup> Cal. Lab. Code § 1102.5, Historical and Statutory Notes (2010).

<sup>678</sup> *Id.*

<sup>679</sup> *Id.*

<sup>680</sup> Cal. Lab. Code § 1102.5, § 1102.6, § 1102.7, § 1102.8 (2010).



shareholders and investors, but also to employee of the corporation and the public at large.”<sup>681</sup> Moreover, California’s legislature stated that public interest will be protected if corporate employees can be treated as the monitor to control internal risks and to prevent companies’ illegal activities if possible.<sup>682</sup> Because of this policy, California’s new WPS extends the coverage to those employees who report corporate securities fraud. Therefore, public interest will be assured when a sound protective system is provided for those vigilant, but aggrieved employees.

The modified California WPS has made several changes to protect employees, and these changes are

“First, it expands the WPS to protect employees who report suspected violations of state and federal rules, not just statutes and regulations. Second, [it] broadens the WPS’s authority to prohibit from retaliation in three way: (1) [it] prohibits employers from discriminating against employees who refuse to participate in any activity that would result in a violation of a state or federal statute, regulation or rule; (2) it prohibits an employer from retaliating against an employee for having exercised his or her whistleblower rights in any former employment; and (3) it establishes that a government employee’s report against his or her employer is sufficient to secure WPS protections.”<sup>683</sup>

The definition of employee under the new statute not only includes present employees, but also contains former employees.<sup>684</sup> In addition, the new WPS increases penalties imposed upon employers who deter or retaliate against employees who report organi-

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<sup>681</sup> Cal. Lab. Code § 1102.5, Historical and Statutory Notes.

<sup>682</sup> *Id.*

<sup>683</sup> Joshua L. Baker, *Chapter 484: The Strongest Whistleblower Protection Law in the Nation – Did We Need It, and Can We Really Afford It?* 35 McGeorge L. Rev. 569, 572-73 (2004).

<sup>684</sup> Cal. Lab. Code § 1102.5(c), § 1102.5(d).

zations' fraudulent conduct. Further, the new statute requires employers to establish a hotline for employees to present their concerns and asks employers to keep reporters' identities in confidence. The anonymous reporting can "help foster the early detection of financial misdoings" and provide "a safer haven of protection" for employees who find out organizational fraud."<sup>685</sup> Also, by referring to the standard of burden of proof in SOX, California's new WPS merely asks employees to "reasonably believe" the violation of law has or is about to occur<sup>686</sup> and requests them to prove the protected activity is "a contributing factor" that causes employers to make adverse employment action against them.<sup>687</sup>

Compared with a lower evidentiary burden for employees, the new statute imposes a strict standard of burden of proof upon employers. That is, in order to rebut employees' allegations, employers have to provide "clear and convincing evidence," which verifies that they would have taken the same action against employees, even if no protected activity exists.<sup>688</sup> Because of these modifications in the new California Whistleblower Protection Statute, it is much easier for Welch to file a claim against Cardinal and compensate his losses in California.

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<sup>685</sup> Baker, *supra* note 683, at 576.

<sup>686</sup> Cal. Lab. Code § 1102.5(a), § 1102.5(b), § 1102.5(c).

<sup>687</sup> Cal. Lab. Code § 1102.6.

<sup>688</sup> *Id.*

## 2. Louisiana<sup>689</sup>

Louisiana is the state that has a loose standard of burden and limited public policies to provide protection or remedy for whistleblowers. Different from California and Virginia, Louisiana's common law has not formed any public policy exception to modify the employment-at-will doctrine.<sup>690</sup> Though, Louisiana has a statute to address whistleblowing disputes when employees are retaliated against by employers because of disclosing, testifying or providing information of wrongdoings, or showing their refusals to commit any violation of law.<sup>691</sup> Under Louisiana's whistleblower protection statute, it provides that

“an employer shall not take reprisal against an employee who in good faith, and after advising the employer of the violation of law: (1) discloses or threatens to disclose a workplace act or practice that is in violation of state law; (2) provides information to or testifies before any public body conducting an investigation, hearing, or inquiring into any violation of law; (3) objects to or refuses to participate in an employment act or practice that is in violation of law.”<sup>692</sup>

In addition, the violation of law that employees disclose, testify, provide knowledge in regard to misconduct, or refuse to commit wrongdoings has to be related to Louisiana state laws<sup>693</sup> or its environmental laws.<sup>694</sup>

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<sup>689</sup> The statutes and judicial decisions of whistleblower protection in Louisiana refers to Rossler, *supra* note 616, 603.

<sup>690</sup> Quebedeaux v. Dow Chem. Co., 820 So. 2d 542, 546 (2002).

<sup>691</sup> La. R.S. 23:967 (2010).

<sup>692</sup> *Id.*

<sup>693</sup> La. Stat. Ann § 30:2027 (2010).

<sup>694</sup> *Hale, supra* note 670, at 1215-16.

Even though there is general protection for whistleblowers in Louisiana, it does not have a statute similar to SOX Section 806. Considering the *Welch* case, however, Louisiana does have a statute regulating bank officers, such as Virginia.<sup>695</sup> For the sake of getting a prevailing decision in wrongful discharge claims, Louisiana's court held that discharged employees not only have to hold more than *good faith belief* on the violation of law,<sup>696</sup> but they have to prove that the violation is related to Louisiana's *state laws*.<sup>697</sup> Merely holding *reasonable belief* in the violations of state law, such as the standard set up by SOX, is not sufficient for a plaintiff-employee to claim wrongful discharge in Louisiana, nor is claiming that these violations are regulated under *federal laws*.

Therefore, like in Virginia, Welch will encounter the same situation when he files a claim against Cardinal's adverse employment action in Louisiana. Because Louisiana has not established a similar standard of burden of proof and causation, like SOX, in its whistleblower statute and case law, Welch fails to relieve his losses in Louisiana as he initially expects under SOX Section 806.

### 3. Delaware

Delaware is a corporation-friendly state. It means that in both corporate st-

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<sup>695</sup> La. R.S. 6:420 (2010).

<sup>696</sup> *Hale*, *supra* note 670, at 1214.

<sup>697</sup> *Id.* at 1215.

atutes and judicial decisions, Delaware has set up beneficial standards and policies for the corporation's formation and its management. As for the whistleblower protection, the same as other states, Delaware has its own common law and statutory protection to modify the employment-at-will doctrine.

Under Delaware common law, Delaware courts have formed the covenant of good faith and fair dealing<sup>698</sup> and the public policy exception<sup>699</sup> to restrict employers' power to discharge employees at will. However, for the sake of avoiding its common law from "swallow[ing] the rule and effectively end[ing] at-will employment,"<sup>700</sup> Delaware courts tended to construe these judicial decisions narrowly and stand on the side of employers.<sup>701</sup> Not only did courts give employers wide latitude in power to fire employees at will,<sup>702</sup> but they also decreased the chance for employees to file a prevailing claim against employers' wrongful discharge. Though, Delaware courts intended to restrict employers' power to terminate employees as the decision of discharge is made by employers' reprisal and ill-will against employees,<sup>703</sup> and when employers' motives to take adverse actions lack reasonable causes.<sup>704</sup> In this way, discharged em-

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<sup>698</sup> E.I. DuPont de Nemours & Co. v. Pressman, 679 A.2d 436, 441-42 (1995).

<sup>699</sup> *Id.* at 441.

<sup>700</sup> *Id.* at 442.

<sup>701</sup> *Id.* at 440.

<sup>702</sup> *Id.* at 441.

<sup>703</sup> *Id.*

<sup>704</sup> *Id.*

employees have a cause of action against employers when the decision of discharge results from employers' bad faith or an unpersuasive reason. In the Delaware courts' points of view, employers' bad faith probably includes "an aspect of fraud, deceit or misrepresentation" in terms of employment,<sup>705</sup> and the violation of public policies that has been expressed in the law.<sup>706</sup> Moreover, the promissory estoppel will be applied when employees suffer wrongful discharge because of employers' bad faith.<sup>707</sup>

As for the public policy exception, Delaware courts have set up a two-prong test to decide whether discharged employees have a legal right to claim the protection under the public policy or not. As a court notes:

"First, the employee must assert a public interest recognized by some legislative, administrative or judicial authority and second, the employee must occupy a position with responsibility for advancing or sustaining that particular interest."<sup>708</sup>

In the *Lord* case, the court held that "[w]hile Lord's allegation that Souder misappropriated the property of deceased residents arguably implicates a legislatively sanctioned public interest, there is no support for the conclusion that Lord, as an administrative secretary, occupied a position with responsibility for advancing that interest. Because Lord is unable to assert a responsibility for implementing a recognized public interest,

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<sup>705</sup> *Id.* at 440.

<sup>706</sup> *Id.* at 441-42.

<sup>707</sup> *Lord v. Souder*, 748 A.2d 393, 393-94 (Del. 2000).

<sup>708</sup> *Id.* at 401.

her public policy must fail.”<sup>709</sup> Hence, Delaware courts require employees to find out the source of public policy that can support their allegations; also, the courts request employees to hold a responsible position to pursue this particular interest before filing a claim against employers’ adverse employment actions.

For the statutory protection, Delaware’s Whistleblower Protection Act (WPA)<sup>710</sup> provides the protection for a private sector employee who “refuses to commit or assist in the commission of a violation”<sup>711</sup> or “reports verbally or in writing to the employer or to the employee’s superior a violation, which the employee knows or reasonably believes has occurred or is about to occur ... .”<sup>712</sup> The violation defined by this statute includes “an act or omission by an employer,” which is “materially inconsistent with, and a serious deviation from, financial management or accounting standards implemented pursuant to a rule or regulation promulgated ... under ... the laws of this State ... or the United States ... to protect any person from fraud, deceit, or misappropriation of ... private funds or assets under the control of the employer.”<sup>713</sup>

When analyzing the *Welch* case in Delaware, first, there is no implied covenant of good faith and fair dealing for Welch to argue his suspension because Cardinal did

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<sup>709</sup> *Id.*

<sup>710</sup> 19 Del. Code Ann. § 1701-08 (2010).

<sup>711</sup> *Id.* § 1703(3).

<sup>712</sup> *Id.* § 1703(4).

<sup>713</sup> *Id.* § 1702(6)(b).

not cheat Welch in term of employment, and the suspension resulted from Welch's disclosure of Cardinal's wrongdoings, not from the violation of the implied in law contract of good faith and fair dealing. Second, Welch cannot be shielded in the public policy exception set up by Delaware's judicial decisions. Considering the two-prong test formed by Delaware courts, Welch may be unable to satisfy the first prong if he fails to prove that Moore's conduct actually violated public interest. Also, the public policy exception in Delaware does not support employees who disclose questionable, but still legal, on financial or business practices in the organization.<sup>714</sup> Then, if Welch cannot show which public interest Cardinal impaired, Welch will have a weak ground to file a claim based on the public policy exception in Delaware. Third, whether Cardinal violated Delaware's WPA is dependent on the divergence of accounting standards. If journal or sundry account entries met the requirement of General Accepted Accounting Principle (GAAP)<sup>715</sup> or satisfied the "fairly presented" standard under SOX,<sup>716</sup> this issue is still controversial among accountants, auditors, and lawyers. Since accounting is quite subjective in some aspects, it is difficult for Welch to contend that two journal and sundry account entries were fraudulent.<sup>717</sup> For those reasons, Welch perhaps will not receive the whistleblower protection within Delaware jurisdiction because

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<sup>714</sup> *E.I. DuPont de Nemours & Co.*, *supra* note 698, at 422.

<sup>715</sup> Generally Accepted Accounting Principle, *supra* note 381.

<sup>716</sup> Sarbanes-Oxley Act of 2002, § 302(a)(3).

<sup>717</sup> Bauman et al., *supra* note 661.



there are many obstacles for him to address.

#### *D. Federal Law Protection*

##### 1. Legislative Model

Federal statutes also provide whistleblower protection for employees who serve in various areas because Congress was gradually concerned that employers' power to terminate employees at will poses a potential threat upon public interest. From social constituents' points of view, it is hard to prevent the safety or health of the public from being damaged unless employees are willing to report misconduct and can be shielded from employers' threats or retaliation after the disclosure. Thus, Congress recognized that whistleblower protection probably is a good measure to promote the public's welfare and to avoid potential damage on society.

Typically, federal whistleblower statutes can be categorized by two types. The first type is related to the protection of occupational health and safety. The second one is associated with different environmental protections.<sup>718</sup> Federal statutes that regulate the health and safety of the public include the Occupational Safety and Health Act (OSHA),<sup>719</sup> the Mine Safety and Health Act,<sup>720</sup> and the Energy Reorganization Act.

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<sup>718</sup> Elliston et al, *supra* note 216, at 9.

<sup>719</sup> Occupational Safety and Health Act (OSHA) of 1970, 29 U.S.C. §§ 651-678 (2010).

<sup>720</sup> Mine Safety and Health Act of 1969, 30 U.S.C. §§ 801-965 (2010).

<sup>721</sup> As for other statutes enacted for environmental protection, they can be represented by the Clean Air Act,<sup>722</sup> the Toxic Substances Control Act,<sup>723</sup> and the Surface Mining and Reclamation Act.<sup>724</sup>

Yet, no matter whether the purpose of federal statutes is to protect occupational health and safety or the environment, these statutes intend to use employees to make an earlier observation on organizations' misbehavior, which may bring damage on the public's health and safety. The whistleblower protection can be viewed as a tool to encourage employees to unveil organizations' wrongdoings earlier, and thus can achieve the statutes purposes and secure public interest from being harmed. Although the whistleblower protection has been recognized in both federal and state laws, their functions and goals are widely different. Briefly speaking, the state protection puts more focus on shielding employees' rights; it provides the procedure and remedy for discharged employees when their terminations arise from employers' retaliation. By contrast, the federal protection does not merely ensure the individual's rights, but it emphasizes more on the protection of public good by enforcing statutory purposes.<sup>725</sup> Because federal whistleblower statutes rely more on employees' disclosures to achieve statutory

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<sup>721</sup> Energy Reorganization Act of 1974, 42 U.S.C. § 5851 (2010).

<sup>722</sup> Clean Air Act of 1955, 42 U.S.C. §§ 7401-7671 (2010).

<sup>723</sup> Toxic Substances Control Act of 1976, 29 U.S.C. §§ 2601-2697 (2010).

<sup>724</sup> Surface Mining and Reclamation Act of 1977, 30 U.S.C. §§ 1201-1328 (2010).

<sup>725</sup> Trystan Phifer O'Leary, *Silencing the Whistleblower: The Gap Between Federal and State Retaliatory Discharge Laws*, 85 Iowa l. Rev. 663, 666-67 (2000).

purposes,<sup>726</sup> Congress noticed that decreasing employees' injury or losses caused by employers' retaliation encourages employees to disclose irregularities in the organization.<sup>727</sup> Consequently, in order to make it easier for employees to relieve their losses, some federal courts are inclined to construe federal whistleblower provisions in a broader way when protecting whistleblowing employees from bearing employers' adverse actions.<sup>728</sup>

Likewise, as to the recipient of whistleblowers' reports, federal courts tend to give a wide range of interpretation. Courts not only permit employees to disclose to governmental institutions or other legal authorities, but also allow employees to make an internal report to the management or to other departments in charge.<sup>729</sup> In the *Passaic Valley Sewerage Commissioners* case,<sup>730</sup> the court applied the Clean Water Act to address the dispute and noted this point as follows:

“[W]histle-blower provisions are intended ... to encourage employees to aid in the enforcement of ... statutes by raising substantiated claims through protected procedural channels.... If the regulatory scheme [of the Clean Water Act] is to effectuate its substantive goals, employees must be free from threats to their job security in retaliation for their good faith assertions of corporate violations of the statute. [The Clean Water Act's] protection would be largely hollow if it we-

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<sup>726</sup> Callahan & Dworkin, *supra* note 103.

<sup>727</sup> E.g., Toxic Substances Control Act of 1976, 15 U.S.C. § 2622 (2010); Occupational Safety and Health Act (OSHA) of 1970, 29 U.S.C. § 660 (2010); Water Pollution Control Act of 1948, 33 U.S.C. § 1367 (2010); Energy Reorganization Act of 1974, 42 U.S.C.A. § 5851 (2010).

<sup>728</sup> O'Leary, *supra* note 725, at 667.

<sup>729</sup> Sinzdak, *supra* note 674, at 1640.

<sup>730</sup> *Passaic Valley Sewerage Comm'rs v. United States Dep't of Labor*, 992 F.2d 474 (3d Cir. 1993).

re restricted to the point of filing a formal complaint with the appropriate external law enforcement agency. Employees should not be discouraged from the normal route of pursuing internal remedies before going public with their good faith allegations.”<sup>731</sup>

The court stated that in order to achieve the statutory purpose, it is better to increase the recipient of disclosure for employees to present their concerns. If those outlets are confined, employees may find it difficult to seek a suitable recipient, and this situation not only decreases the willingness of employees to unveil organizations’ violations of law, but the society also suffers disadvantages resulting from this consequence.

In addition, some courts took a positive position on agreeing with employees to use the media as one of external recipients.<sup>732</sup> The reasons are that courts recognized employees’ disclosures are significant to the function of federal statutes,<sup>733</sup> also, employees can balance their situations and seek an appropriate way to present their concerns. If the outlet of disclosure is restricted, this will affect employees’ actions to report and decrease the efficacy of federal statutes to regulate matters of concern. Thus, federal courts reached a common consensus that it is not mandatory for employees to make a disclosure in specific ways.<sup>734</sup> No matter which recipient employees select, different recipients will not affect the effectiveness of the disclosure, and employees still can have a justified action to file a claim against employers.

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<sup>731</sup> *Id.* at 478.

<sup>732</sup> *Donovan v. R.D. Andersen Constr. Co.*, 552 F. Supp. 249 (1982).

<sup>733</sup> *Passaic Valley Sewerage Comm’rs*, *supra* note 730, at 478.

<sup>734</sup> *Id.* at 478-79.

Federal statutes equipped with the whistleblower provision have some features in common. First, the coverage of federal statutes is quite narrow.<sup>735</sup> Since federal statutes tend to be topic-specific, employees are unable to be shielded by the statute if their disclosures are beyond the area that the statute regulates. Hence, before filing a claim under federal statutes, it is better for employees to know if their disclosures are in the covered area of statutes, and to notice whether they are the protected subject or not. Even if the regulated area and the covered employee in federal statutes are narrow, federal statutes are inclined to employ broad types of whistleblowing activities to protect employees.<sup>736</sup> These statutes shield the covered employee who is going to commence, is commencing, or has commenced the protected whistleblowing activity.<sup>737</sup> As to the protected activity, employees will be shielded when they disclose wrongdoings, assist the investigation, or testify organizations' misbehavior prohibited in federal statutes, but then being retaliated against by employers.<sup>738</sup>

Second, nearly every federal whistleblower statute makes use of the administrative agency to resolve whistleblower disputes and establish a procedure to address adverse actions.<sup>739</sup> Most statutes require employees to file claims in the limited period;<sup>740</sup>

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<sup>735</sup> Miceli & Near, *supra* note 100, at 233.

<sup>736</sup> *Id.* at 234.

<sup>737</sup> *Id.*

<sup>738</sup> *Id.*

<sup>739</sup> *Id.* at 234-35.

the common period is thirty days after employers' adverse actions occur.<sup>741</sup> Employees must file a claim to the Secretary of Labor, which is an agency under the Department of Labor (DOL) to investigate and decide whether employees' allegations are merited or not.<sup>742</sup> When violations are found, the Secretary will make a preliminary order for employees; otherwise, it will dismiss employees' claims.<sup>743</sup> As the party does not comply with the preliminary order, the Secretary has a right to file a suit in federal district court to enforce its order.<sup>744</sup> In addition, each statute requires a claim to be settled within the limited period under the administrative proceeding.<sup>745</sup> When any party does not agree with the order made by the Secretary, the party is able to appeal the claim to federal court for a *de novo* review.<sup>746</sup>

Third, federal statutes provide a remedy for employees when suffering losses due to employers' adverse actions.<sup>747</sup> Typically, the remedy includes the relief, such as reinstatement, recovery of lost wages and benefits, and recovery of costs. Besides, some statutes give employees a right to claim compensatory or exemplary damage.<sup>748</sup> Furt-

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<sup>740</sup> *Id.* at 235.

<sup>741</sup> *Id.*

<sup>742</sup> *Id.*

<sup>743</sup> *Id.*

<sup>744</sup> *Id.*

<sup>745</sup> *Id.*

<sup>746</sup> *Id.*

<sup>747</sup> *Id.* at 236.

<sup>748</sup> *Id.*

her, a few statutes set up a “catch-all” provision that gives courts wide latitude of discretion to decide other forms of relief, which can compensate employees’ losses totally.<sup>749</sup> In this way, because of diverse regulations in federal statutes, unless being familiar with statutes and courts’ decisions, not only do employees bearing adverse actions find it difficult to know what relief they will be granted, but it is hard for employers to anticipate the liability that courts will impose upon them, and what damage they will be charged to indemnify for employees’ losses.

## 2. Whistleblower Protection in the Sarbanes-Oxley Act

### a. Introduction

The Sarbanes-Oxley Act of 2002 (SOX) is the product after the explosion of a series of corporate scandals, like Enron,<sup>750</sup> WorldCom,<sup>751</sup> Global Crossing,<sup>752</sup> Adelphia<sup>753</sup> and Toyco.<sup>754</sup> Observing from corporate corruption, once Kohn referred to the Judiciary Committee’s corporate reform proposal and stated:

“[I]nvestors and pensioners were being robbed by highly educated professionals who had spun an intricate spider’s web of deceit. These corporations valued pr-

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<sup>749</sup> *Id.*

<sup>750</sup> Cherry, *supra* note 92, at 1035-39.

<sup>751</sup> *Id.* at 1039-42.

<sup>752</sup> Almar Latour & Dennis K. Berman, *Global Crossing, SEC Deal Expected*, Wall St. J., Mar. 22, 2004, at A8.

<sup>753</sup> Susan Pulliam & Robert Frank, *Inside Adelphia: A Long Battle Over Disclosing Stock Options*, Wall St. J., Jan. 26, 2004, at A1.

<sup>754</sup> Colleen DeBaise & Mark Maremont, *Jurors Examine Costs of Décor Chez Kozlowski*, Wall St. J., Dec. 16, 2003, at B1.

ofit over honesty and had cook[ed] the books and trick[ed] the public and federal regulators. The auditors hired by the companies were no better and deceived the investing public and reaped millions for select few insiders.”<sup>755</sup>

In addition, the Judiciary Committee also recognized that a series of corporate scandals were the consequence that resulted from business greed and broken regulatory systems. As it described:

“Many people and institutions contributed to the Enron debacle, including the corporate officers and directors whose actions led to Enron’s failure, the well-paid professionals who helped create, carry out, and cover up the complicated corporate ruse when they should have been raising concerns, the regulators who did not protect the public or our public markets, and the Congress and the courts, which have thrown obstacles in the way of securities fraud victims.... Without discipline, professionalism, and effective legal structure, and the accountability, greed can run rampant with devastating results.”<sup>756</sup>

Moreover, not only do those corporations impose retaliatory actions upon whistleblowing employees who disclose employers’ misconduct,<sup>757</sup> but corporate cultures hinder employees from acting honestly in business affairs and from reporting companies’ unlawful activities in time.<sup>758</sup> Kohn refers to the Judiciary Committee’s proposal and describes this concept below:

“[The] corporate code of silence not only hampers investigations, but also creates a climate where ongoing wrongdoing can occur with virtual impunity. The consequences of this corporate code of silence for investigators in publicly traded companies in particular, and for the stock market in general, are serious and adverse, and they must be remedied.... Unfortunately, ... efforts to quiet whistlebl-

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<sup>755</sup> Kohn et al., *supra* note 220, at 1 (emphases omitted).

<sup>756</sup> Senate Judiciary Committee Report, “The Corporate and Criminal Fraud Accountability Act of 2002,” Senate Report No. 107-146, at 10-11 (2002).

<sup>757</sup> *Id.*

<sup>758</sup> *Id.*



lowers and retaliate against them for being disloyal to litigation risks transcend state lines. This corporate culture must change, and the law can lead the way.”

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Congress found that whistleblower protection is critical since whistleblowers can provide confidential information, which the public is unable to access. In addition, being the firsthand witness of corporate wrongdoing, companies' whistleblowers may have the chance to slow down employers' intentions to commit fraudulent actions, and decrease the possibility of corporate deceit to happen. For that reason, the whistleblower protection can be viewed as a significant means to not only benefit companies' internal control and corporate governance, but also promote business performance and safeguard society's welfare. As a result, in order to deter business fraud, the whistleblower protection is the centerpiece of SOX because this provision is able to achieve one of statutory purposes and to protect public interest.

Further, economic and political pressure arising from astonishing corporate scandals and the eroding financial market were other two factors to push Congress to enact SOX.<sup>760</sup> Corporate corruption made investors realize the recent U.S. financial market was not suitable and safe for investment;<sup>761</sup> multinational funds were withdrawn from the investing market since investors thought that terrible corporate governance in U.S.

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<sup>759</sup> *Id.* at 3 (emphases omitted).

<sup>760</sup> S. Rep. No. 107-205 (2002).

<sup>761</sup> Federal Reserve Board's Semiannual Monetary Policy Report to the Congress: Before the Senate Comm. on Banking, Housing, and Urban Affairs, 107<sup>th</sup> Cong. (July 16, 2002) (Testimony of Alan Greenspan), at 4, available at <http://www.federalreserve.gov/boarddocs/hh/2002/July/testimony.htm>.

public companies was a potential risk to lose money.<sup>762</sup> Even though official hearings were held and the U.S. President was severely rebuked for corporate illegitimacy, these still could not change the situation and restore the public's confidence in the financial market.<sup>763</sup>

Because of these phenomena, the intent of Congress to enact SOX was not only to “restore public trust in the markets,”<sup>764</sup> but also to “combat fraudulent accounting practices and other conduct defrauding shareholders.”<sup>765</sup> In addition, the purpose of SOX is “to protect investors by improving the accuracy and reliability of corporate disclosure made pursuant to the securities laws and for other purposes,”<sup>766</sup> and “to increase transparency in financial markets, which allows investors to rely on the accuracy of financial information.”<sup>767</sup> Baynes states that SOX is “designed to promote investor confidence by ensuring that the public receives more information about possible corporate fraud. Such disclosures would ensure that the markets have perfect information

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<sup>762</sup> Edmund L. Andrews, *Turmoil at WorldCom: The Overseas Reaction; U.S. Businesses Dim as Model for Foreigners*, N.Y. Times, June 27, 2002, at A1.

<sup>763</sup> Mary Kreiner Ramirez, *The Science Fiction of Corporate Criminal Liability: Containing the Machine through the Corporate Death Penalty*, 47 Ariz. L. Rev. 933, 956 (2005).

<sup>764</sup> David Hess, *A Business Ethics Perspective on Sarbanes-Oxley and the Organizational Sentencing Guidelines*, 105 Mich. L. Rev. 1781, 1782 (2007).

<sup>765</sup> Robert P. Riordan et al., *The Whistleblower Provision of Sarbanes-Oxley: Discerning the Scope of “Protected Activity”*, 24 Hofstra Lab. & Emp. L.J. 95, 95 (2006).

<sup>766</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

<sup>767</sup> Cherry, *supra* note 92, at 1055.

so that investors could make informed investment choices.”<sup>768</sup> Also, securities laws ensure the accuracy of information distributed by public corporations, and have a function to equalize the asymmetrical information between investors and companies. As Seligman states, “The primacy policy of the federal securities laws involves the remediation of information asymmetries, that is, equalization of the information available to outside investors and insiders.”<sup>769</sup> Hence, SOX can be regarded as the most efficient statute to fight against corporate corruption by strengthening corporations’ responsibilities, by requiring sufficient public disclosures, by reforming the method of accounting and financial reports, and by making sure the security of whistleblowing employees.<sup>770</sup>

Sarbanes-Oxley has some designs to achieve statutory purposes. First, SOX has an anti-retaliation provision to protect employees from suffering adverse actions after disclosing employers’ misbehavior.<sup>771</sup> Second, SOX imposes a criminal penalty upon employers when they maliciously retaliate against employees who report the violation

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<sup>768</sup> Leonard M. Baynes, *Symposium Enron and Its Aftermath: Just Pucker and Blow? An Analysis of Corporate Whistleblowers, the Duty of Care, the Duty of Loyalty, and the Sarbanes-Oxley Act*, 76 St. John’s L. Rev. 875, 890 (2002).

<sup>769</sup> Joel Seligman, *No One Can Serve Two Masters: Corporate and Securities Law After Enron*, 80 Wash. U. L.Q. 449, 450 (2002).

<sup>770</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

<sup>771</sup> *Id.*

of securities laws or related frauds.<sup>772</sup> Third, it requires public companies to set up an in-house channel for employees to anonymously present their concerns on corporate irregularities to the board of directors.<sup>773</sup> Fourth, SOX imposes a duty upon the lawyer to report material evidence regarding corporate violations of securities laws or the breach of fiduciary duties to companies' officers or the board of directors.<sup>774</sup> Among these provisions, however, Congress recognized that the anti-retaliation protection is quite critical to whistleblowing employees because there was no statute, neither federal nor state, to protect whistleblowers who disclose corporate wrongdoing at the time of enactment. Even if state statutes and common laws have established the protection for whistleblowers, state statutes cover the limited protected activity and strictly regulate certain requirements; likewise, state common laws narrowly construe public policy and set up an unequal standard of burden to restrict the employment-at-will doctrine.<sup>775</sup> In addition, federal whistleblower statutes are topic-specific, and only protect employees who disclose wrongdoing in specific areas or industries.<sup>776</sup>

Therefore, state and federal statutes or state common laws cannot provide whistleblowing employees with complete protection when they are retaliated against by em-

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<sup>772</sup> *Id.* § 1107, 18 U.S.C. § 1513(e).

<sup>773</sup> *Id.* § 301, 15 U.S.C. § 78j-1(m)(4)(A).

<sup>774</sup> *Id.* § 307, 15 U.S.C. § 7245(1).

<sup>775</sup> Miceli & Near, *supra* note 100, at 239-44.

<sup>776</sup> *Id.* at 233-34.

employers. This consequence, on the one hand, makes employees wonder if the law protects bad people and discourages ethical behaviour; on the other hand, it frightens employees away from unveiling confidential information that is probably material to affect the health or safety of the public. In this way, the anti-retaliation provision in SOX plays a significant role in stopping corporate corruption and promoting internal corporate governance by shielding loyal employees.

## b. Extensive Protection under SOX Section 806

### i. Overview

The design of anti-retaliation provision in SOX Section 806 received several compliments from academic and practical areas.<sup>777</sup> This provision was called the “gold standard” of whistleblower protection,<sup>778</sup> and indicated as “the most important whistleblower protection in the world.”<sup>779</sup> It brought the patchwork of state laws and state common laws to an end, and gave employees national protection as serving in public companies. Hence, the whistleblower protection will not be restricted by diverse standards, and be used as a general rule to shield employees employed in public firms. Initially, the intent of Congress to enact Section 806 was to affect corporate culture, which treated whistleblowers unfriendly. Because of this reason, Congress assist-

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<sup>777</sup> Vaughn, *supra* note 90.

<sup>778</sup> Cynthia Estlund, *Rebuilding the Law of the Workplace in An Era of Self-Regulation*, 105 Colum. L. Rev. 319, 376 (2005).

<sup>779</sup> Vaughn, *supra* note 90, at 105.

ed employees who show their courage to make a disclosure in getting rid of the punishment made by the management, and encouraged them to unveil organizations' frauds and misconduct with no fear. Besides, the Judiciary Committee said:

“[Section 806 of the Act] would provide whistleblower protection to employees of publicly traded companies who report acts of fraud to federal officials with the authority to remedy the wrongdoing or to supervisors or appropriate individuals within their company. Although current law protects many government employees who act in the public interest by reporting wrongdoing, there is no similar protection for employees of publicly traded companies who blow the whistle on fraud and protect investors. With an unprecedented portion of the American public investing in these companies and depending upon their honesty, this distinction does not serve the public good.”<sup>780</sup>

Thus, SOX Section 806 was a compromise after balancing corporate interest and public welfare. Due to the lack of protection on shareholders, corporate misconduct may damage investors' interests and affect the public's financial safety if there is no regulation to stop corporate securities violation. In this way, the Committee concluded that the investor's interests and the public's benefit should not be superseded by the management's misbehavior, and thought corporate whistleblowers will be an efficient means to reach this goal. That is, those whistleblowers not only can deter employers' illegal actions in time, but also can assure shareholders' investments and preserve public good at the same time.

## ii. Process of Protection under SOX Section 806

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<sup>780</sup> Senate Judiciary Committee Report, *supra* note 756, at 18-19.

Congress made a reference to the Wendell H. Ford Aviation Investment and Reform Act to establish the procedure of SOX Section 806, and authorized the Department of Labor (DOL) to adjudicate whether whistleblowers' claims are merited or not in Section 806.<sup>781</sup> Even though the DOL has the right to address whistleblowers' arguments, the DOL has delegated its authority to the Secretary of the Occupational Safety and Health Administration (OSHA) to make the investigation.<sup>782</sup> Therefore, when employees have suffered adverse actions because of the disclosure, they have to file a claim to OSHA in ninety days after the violation occurs. If employees fail to follow this requirement, their claims will be dismissed even if their allegations are the *prima facie* case.<sup>783</sup> Sometimes, this filing limitation may be extended when the doctrine of fairness is found.<sup>784</sup> Yet, this situation rarely happens, and the doctrine of fairness is hard to apply as well.<sup>785</sup> In addition, the ninety-day period begins when employees are informed of the final adverse action, not at the time as employees feel the impact of those actions.<sup>786</sup> The Administrative Review Board (ARB) noted:

“In whistleblower cases, statutes of limitation ... run from the date an employee

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<sup>781</sup> *Id.*; 49 U.S.C. § 42121(b) (2010).

<sup>782</sup> 29 C.F.R. § 1980.101 (2010).

<sup>783</sup> *Walker v. Aramark Corp.*, 2003-SOX-22, Decision and Order (D&O) of Administrative Law Judge (ALJ) (Aug 26, 2003).

<sup>784</sup> *Larry v. Detroit Edison*, 86-ERA-32, D&O of Secretary of Labor (SOL), at 12-19 (Jun. 28, 1991).

<sup>785</sup> *Hill v. United States DOL*, 65 F.3d 1331, 1335 (6<sup>th</sup> Cir. 1995).

<sup>786</sup> *Wagerle v. The Hospital of the University of Pennsylvania*, 93-Energy Reorganization Act (ERA)-1, D&O of SOL, at 3 (Mar. 17, 1995).

receives final, definitive, and unequivocal notice of an adverse employment decision. Final and definitive notice denotes communication that is decisive or conclusive, i.e. leaving no further chance for action, discussion, or change. Unequivocal notice means communication that is not ambiguous, i.e. free of misleading possibilities.... The date that an employer communicates to the employee its intent to implement an adverse employment decision marks the occurrence of a violation, rather than the date the employee experience the consequences.”<sup>787</sup>

Thus, the legal right for whistleblowing employees to claim the allegation in the administrative procedure is at the time as the adverse employment action is specific and is ready to be taken. Employees should not wait to file a claim when feeling the negative consequence caused by retaliatory actions or even wait the limited period that has passed to argue unequal treatment.

When a claim is filed to OSHA, OSHA has sixty days to make an investigation and to decide if employees’ allegations are merited.<sup>788</sup> It will assign an investigator to review the claim and related materials to see if employees have alleged a *prima facie* case. If the OSHA investigator cannot find employees’ allegations are merited, OSHA will dismiss the case and terminate the investigation.<sup>789</sup> However, before closing the case, the OSHA investigator will contact employees and ask them to provide more evidence to prove their allegations are really the *prima facie* case. Once determining that employees’ claims are the *prima facie* case, OSHA will give a notice for employers to

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<sup>787</sup> Belt v. United States Enrichment Corp., 01-ERA-19, D&O of Administrative Review Board (ARB), at 5 (Feb. 26, 2004) (emphases omitted).

<sup>788</sup> 29 C.F.R. § 1980.105(a) (2010).

<sup>789</sup> 29 C.F.R. § 1980.104(b) (2010).



rebut employees' allegations by sufficient evidence in the limited period. As the regulation describes:

“Within 20 days of receipt of the notice of the filing of the complaint, the named person may submit to the Assistant Secretary a written statement and any affidavits or documents substantiating its position. Within the same 20 days, the named person may request a meeting with the Assistant Secretary to present its position.”<sup>790</sup>

If employers' presented files or documents can be demonstrated by the “clear and convincing evidence that it [employers] would have taken the same unfavorable personnel action in the absence of the complainant's [employees'] protected behavior or conduct,” OSHA will dismiss employees' claims and terminate the investigation.<sup>791</sup> When employees' allegations can be recognized as the *prima facie* case, and employers are unable to provide sufficient evidence to hold their positions, OSHA will start a formal investigation for employees' complaints.<sup>792</sup> The investigation will be made by interviewing the witness identified by each party, and it is not required to keep the witness's identity confidential. Nonetheless, when some specific circumstances are met, it is allowable for OSHA to conceal the witness's identity, and make him/her testify anonymously.<sup>793</sup>

After the sixty-day period for the investigation, OSHA has to decide whether em-

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<sup>790</sup> 29 C.F.R. § 1980.104(c) (2010).

<sup>791</sup> *Id.*

<sup>792</sup> 29 C.F.R. § 1980.104(d) (2010).

<sup>793</sup> *Id.*

employees' allegations are true or not.<sup>794</sup> By means of reviewing related materials or interviewing the witness, when OSHA finds that there is sufficient evidence to prove that employers' actions have violated securities law or related fraud, OSHA will file a preliminary order for employees who have been retaliated against and further to compensate their losses.<sup>795</sup> On the contrary, when suspected illegal activities cannot be proved or found, OSHA will dismiss the claim and stop the investigation. Yet, no matter which party is granted to the order, the DOL has to give each party a notification that it still has a right to appeal,<sup>796</sup> and the appeal has to be filed in thirty days after receiving OSHA's preliminary order.<sup>797</sup> As the preliminary order is appealed, everything will be overturned except for the decision of reinstatement; other OSHA findings may "... carry no weight either before the Administrative Law Judge (ALJ) or the Board (Administrative Review Board)."<sup>798</sup> At last, when complaints still cannot be settled in 180 days in the administrative procedure, employees are allowed to file their claims to federal district court and ask for a *de novo* review.<sup>799</sup>

Typically, SOX Section 806 provides the party with a two-tier review on the appeal, and Kohn makes a summary for the process of appeal below:

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<sup>794</sup> 29 C.F.R. § 1980.105(a) (2010).

<sup>795</sup> 29 C.F.R. § 1980.105(a)(1) (2010).

<sup>796</sup> 29 C.F.R. § 1980.105(b) (2010).

<sup>797</sup> 29 C.F.R. § 1980.106(a) (2010).

<sup>798</sup> *Majors v. Asea Brown Boveri, Inc.*, 96-ERA-33, D&O of ARB, at 1 n. 1 (Aug. 1, 1997).

<sup>799</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

“The Sarbanes-Oxley corporate whistleblower law (SOX) has two stages of appellate review. The first is within the Department of Labor (DOL) and the second is within the federal courts. The basic steps for appeal are these:

- A DOL administrative law judge’s (ALJ) Recommended Decision and Order (RDO) on the merits of a case will become the final decision of the DOL unless a petition for review of that decision is filed with the DOL Administrative Review Board (ARB) within 10 days of the decision’s issuance.
- If appealed, the ARB is vested with jurisdiction to issue the final decision of the DOL. In order to seek judicial view of a DOL order, a party must exhaust his or her administrative remedies by filing a petition for review with the ARB.
- Within 60 days of a final decision by the ARB, any party may seek judicial review of the final DOL order in the U.S. Court of Appeals for the circuit in which the violation of SOX allegedly occurred. Decisions of the appeals court are subject to review by the U.S. Supreme Court.
- A decision by either OSHA or an ALJ to reinstate an employee is immediately enforceable in U.S. District Court. Other relief ordered by the DOL, including back pay and attorney fees, are subject to judicial enforcement only after either the ALJ or ARB issues a final order.
- The ARB has ‘inherent authority’ to hear motions for reconsideration filed by a party within a ‘reasonable time after the first decision’ is rendered.”<sup>800</sup>

Thus, observing the proceeding, it can be concluded that even if the procedure in SOX Section 806 is quite complicated, it still can be regarded as a sound system of remedy since it ensures due process for employees who blow the whistle.

### iii. Requirements of Filing a Claim

Before OSHA starts a formal investigation, employees have to provide materials and evidence to make the OSHA investigator believe that their allegations are the *prima facie* case. Employees are imposed upon the burden of proof as follo-

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<sup>800</sup> Kohn et al., *supra* note 220, at 41-42.

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### (1) They Are Employees Covered under SOX

In order to plead for the claim, plaintiffs have to be covered employees in SOX Section 806. For the sake of making discharged employees relieve their losses easier because of the disclosure, the DOL tends to broadly define the term of employee when applying SOX to address whistleblower issues. One time, the DOL described this point in an environmental whistleblower case and reasoned that

“The term ‘employee’ as used in this Act must be given a most liberal interpretation, particularly in view of the evils the Act was designed to prevent. It is obvious the Act is intended to prevent employers from engaging in acts of discrimination, whether it takes the form of termination of employment or simple intimidation. In light of these statutory objectives, the overriding policy considerations involved would compel that the term employee be as inclusive as is rationally possible.”<sup>802</sup>

The covered employee in SOX includes “... an individual presently or formerly working for a company or company representative, an individual applying to work for a company or company representative, or an individual whose employment could be affected by a company or company representative.”<sup>803</sup> A company representative means “any officer, employee, contractor or subcontractor, or agent of a company.”<sup>804</sup> In addition, based on administrative decisions and orders, and judicial decisions, the cover-

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<sup>801</sup> *Id.* at 60.

<sup>802</sup> *Landers v. Commonwealth-Lord Joint Venture*, 83-ERA-5, slip op. of ALJ 5, adopted by SOL (Sept. 9, 1983).

<sup>803</sup> 29 C.F.R. § 1980.101 (2010).

<sup>804</sup> *Id.*

ed employee contains former employees, contract workers, and probationary or temporary employees,<sup>805</sup> independent contractors,<sup>806</sup> applicants for employment and prospective employees,<sup>807</sup> and contract job shoppers.<sup>808</sup> One time, a court noted the reason for this broad definition of employee, and it stated:

“A broad interpretation of ‘employee’ is necessary in order to carry out the statutory purpose.... Protecting the reporting employee against retaliation only while that employee is in the employ of the violator has a ‘chilling effect’ and discourages, rather than encourages, the reporting of ... violation.”<sup>809</sup>

Thus, by means of giving a broad definition of employee, employees who suffer adverse employment actions can be easily covered in the statute, and will not be isolated by SOX.

## (2) They Engaged in Activities Protected under SOX

### (a) What Violations Are Reportable for Employees?

SOX regulates two categories of violations and activities that employees are allowed to report. First, employees can be protected when they

“provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonable believes constitute a violation of Section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law

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<sup>805</sup> Proud v. Cecos Int’l., 83-TSC-1, slip op. of ALJ, 2 (Sept. 30, 1983).

<sup>806</sup> Samodurov v. General Physics Corp., 89-ERA-20, D&O of SOL, at 5-7 (Nov. 16, 1993).

<sup>807</sup> Chase v. Buncombe County, N.C., etc., 85-SWD-4, D&O of Remand by SOL, at 2-4 (Nov. 3, 1986).

<sup>808</sup> O’Brien v. Stone & Webster Eng. Corp., 84-ERA-31, recommended D&O of ALJ, at 12 (Feb. 28, 1985).

<sup>809</sup> Chase, *supra* note 807, at 4.

relating to fraud against shareholders.”<sup>810</sup>

According to expansive regulations above, Kohn summarizes those violations as follows:

ows:

- “Employee allegations regarding violations of the federal criminal fraud laws, such as sections 1341, 1343, 1344, and 1348 of Title 18.
- Employee allegations of possible violations of the numerous federal civil laws related to fraud against shareholders, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1940, the Investment Company Act of 1940, the Investment Advisors Act of 1940, and the Sarbanes-Oxley Act of 2002.
- Employee allegations regarding any employer violation or noncompliance with the numerous and detailed requirements set forth in the rules and regulations of the SEC, including those rules published at Title 17 of the Code of Federal Regulations and the numerous laws administered by the SEC. Many of the laws, rules, and regulations incorporated into this provision of SOX are published by the SEC on its Internet site located at [http://\\_www.sec.gov](http://www.sec.gov).
- All laws related to fraud against shareholders. This provision potentially encompasses all of the laws, rules and regulations just referenced, and any other law, rule, or regulation that could be reasonably argued protect investors from fraud. This would clearly include those portions of the Securities Act of 1933 that permit shareholders to file civil actions concerning corporate deceit, misrepresentations, and other fraud in the sale of securities. The broad scope of this provision is reflected in the numerous class action lawsuits filed by investors related to fraud against shareholders or other violations of SEC rules and regulations.”<sup>811</sup>

In addition, SOX requires the covered employees to reasonably believe that those vio-

lations occur. Reasonable belief means employees do not have to prove the accuracy

of their concerns, but they ought to perceive in a reasonable way and show the violati-

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<sup>810</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A .

<sup>811</sup> Kohn et al., *supra* note 220, at 77.

on happens.<sup>812</sup> Although employees' allegations cannot show employers actually commit securities violation or related fraud later, the fact that employees reasonably believe employers have breached SOX is enough for them to file a claim. It does not matter whether the after-the-fact findings cannot prove the correctness of employees' belief.<sup>813</sup> Likewise, even if those claims bring potential harm to employers' reputations, when employees exercise the protected right in SOX Section 806, these claims are still effective and irrespective of the correctness or the consequence of employees' allegations for employers' misconduct.<sup>814</sup>

Second, SOX sets up a "participation clause" to protect employees.<sup>815</sup> Employees' rights can be protected, and their losses will be compensated under the participation clause when they

"file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of Section 1341, 1343, 1344, or 1348, any rule or regulation of the Security and Exchange Commission, or any provision of Federal law relating to fraud against shareholders."<sup>816</sup>

The proceeding in the regulation not only includes participation in civil or criminal lawsuits, but extends to the participation in SEC procedures and other securities-related

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<sup>812</sup> *Crosier v. Westinghouse Hanford Co.*, 92-CAA-3, SOL D&O, at 6 (Jan. 12, 1994).

<sup>813</sup> *Keene v. EBASCO Constructors, Inc.*, 95-ERA-4, D&O of Remand by ARB, at 8 (Feb. 19, 1997).

<sup>814</sup> *Pettway v. American Cast Iron Pipe Co.*, 411 F.2d 998, 1007 (5<sup>th</sup> Cir. 1969).

<sup>815</sup> *Kohn et al.*, *supra* note 220, at 78.

<sup>816</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

proceedings.<sup>817</sup>

(b) What Are Protected Activities for Employees?

Whistleblowing employees are protected in SOX Sec 806 as they provide or disclose information associated with employers' securities violations or regulated frauds to a federal regulatory or law enforcement agency; any member or any committee of Congress; or a person with supervisory authority in public firms.<sup>818</sup> About the disclosure to the federal regulatory or law enforcement agency, employees can be protected when they directly contact government agencies, federal courts, and Congress.<sup>819</sup> Similarly, this regulation may extend when employees "who make protected disclosure to the SEC, a U.S. Attorney's office, the U.S. Department of Justice, and other government agencies involved in any manner in regulating publicly traded companies, such as the Public Company Accounting Oversight Board."<sup>820</sup> Even though the federal regulatory or law enforcement agency's duties do not address the issue of securities violation, employees are still shielded when "the contents of the disclosure related to fraud against shareholders or violations of the laws or rules referenced in SOX."<sup>821</sup>

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<sup>817</sup> *Keene, supra* note at 813.

<sup>818</sup> Sarbanes-Oxley Act of 2002 § 806(a)(1)(C), 18 U.S.C. § 1514A(a)(1)(C).

<sup>819</sup> Kohn et al., *supra* note 220, at 80.

<sup>820</sup> *Id.*

<sup>821</sup> *Id.*



As to internal disclosure of violation, SOX not only protects employees disclosing securities violations or related frauds to management officials who exercise supervisory authority, but it also shields employees uncovering to “any person working for the employer who has authority to investigate, discover or terminate misconduct.”<sup>822</sup> In this way, besides the disclosure of securities violation to supervisors, it is allowable to show employees’ concerns to the audit committee and auditors, the general counsel, the chief executive office of the company, and company-instituted employee concerns programs.<sup>823</sup> In this way, as observed above, it is concluded that employees are unable to be protected when “conferring with a peer, or discussing an accounting impropriety with a subordinate internally.”<sup>824</sup>

### (3) Employers Were Aware of Protected Activities

#### (a) Covered Employers under SOX

The definition of employer is fairly broad in SOX; it not only includes publicly-held companies, but also covers “any officer, employee, contractor, subcontractor, or agent” of public companies.<sup>825</sup> Yet, “non-publicly traded companies, which serve as contractors, subcontractors, or agents of Wall Street traded firms would also be covered under SOX. In addition, individual ‘officers,’ ‘employees,’ and oth-

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<sup>822</sup> Sarbanes-Oxley Act of 2002 § 806(a)(1)(C), 18 U.S.C. § 1514A(a)(1)(C).

<sup>823</sup> Kohn et al., *supra* note 220, at 81.

<sup>824</sup> Cherry, *supra* note 92, at 1065.

<sup>825</sup> Sarbanes-Oxley Act of 2002 § 806(a) & (b)(1), 18 U.S.C. § 1514A(a) & (b)(1).

er ‘persons’ who work for or control the conduct of publicly-traded companies may also be liable under the Act.”<sup>826</sup>

In addition, the joint employer doctrine is also applied in SOX when deciding the definition of covered employer.<sup>827</sup> Joint employers mean that “separate business entities have been found liable as employers where the interrelation between the company actually employing the worker and the independent corporation was sufficient to qualify the parent company as joint employer.”<sup>828</sup> Accordingly, employees, who serve in subsidiary companies but non-publicly traded, can file anti-retaliation claims against publicly-held parent companies for which they do not directly work. So, employers or companies named by employees’ complaints may be “prohibited from engaging in discriminatory conduct against any employee, prospective employee, former employee or an employee seeking employment or working for another employer.”<sup>829</sup>

#### (b) Requirement of “Awareness”

For the sake of establishing sufficient grounds for allegations, employees have to prove that they engage in protected activities. Also, they have to show that employers’ awareness of protected activities makes employers take adverse employment actions upon employees. It is causation because if there is no negative in-

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<sup>826</sup> Kohn et al., *supra* note 220, at 69.

<sup>827</sup> McIntyre v. Merrill Lynch, 2003-SOX-23, D&O of ALJ (Sept. 4, 2003).

<sup>828</sup> Kohn et al., *supra* note 220, at 71.

<sup>829</sup> *Hudgens v. NLRB*, 424 U.S. 507, 510 n.3 (1976).

formation in employers' minds, they probably will not have any motive to take retaliatory actions against employees.<sup>830</sup> In essence, the requirement of awareness can be proven by direct or circumstantial evidence.<sup>831</sup> However, "although knowledge of the protected activity can be shown by circumstantial evidence, that evidence must show [that] ... Respondent [the employer] with authority to take the complained of action, or ... [the employer] with substantial input in that decision, had knowledge of the protected activity."<sup>832</sup> It does not matter whether the makers of final decisions know protected activities or not. As Kohn says:

"If an employer with knowledge of the protected activity contributed heavily to the decision to take an adverse action against an employee, knowledge on the part of the employer will be inferred, even if the actual decision maker had no knowledge. An employer cannot defend this element of a case by alleging that its managers did not know that a concern implicated a potential violation of law, if the employee's allegations reasonably should have been perceived as communicating such a violation."<sup>833</sup>

Thus, it is not necessary to see whether decision-makers know protected activities or not. As actions of decision-makers are influenced by employers' information, opinions, or advices with regard to the knowledge of securities violation or related fraud, which shows employers' awareness of protected activities, this influence will transfer to the actions taken by actual decision-makers. In this way, employers are unable to isolate

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<sup>830</sup> Crider v. Pullman Power Prods, Corp., 82-ERA-7, slip op. of ALJ, 2 (Oct. 5, 1982).

<sup>831</sup> NLRB v. Instrument Corp. of America, 714 F.2d 324, 328-29 (4<sup>th</sup> Cir. 1983).

<sup>832</sup> Bartlik v. TVA, 88-ERA-15, D&O of Remand by SOL, at 7 n.7 (Dec. 6, 1991). Final D&O of SOL, at 4, n. 1 (April 7, 1993).

<sup>833</sup> Kohn et al., *supra* note 220, at 96 (emphases omitted).

themselves from the liability by claiming that they are not the actual person to make retaliatory decisions.

(4) Protected Activity Was a “Contributing Factor” to Adverse Actions Taken by Employers.

(a) Contributing Factor

Employees are required to prove that the protected activity is a contributing factor for employers to take adverse actions. Hence, it is not necessary for employees to bear a strict standard of burden of proof to show the motivating factor. Frankly speaking, the definition of contributing factor means

“any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision. This test is specifically intended to overrule existing case law, which requires a whistleblower to prove that his protected conduct was a ‘significant,’ ‘motivating,’ ‘substantial,’ or ‘predominant’ factor in a personnel action ...”<sup>834</sup>

Employees do not have the obligation to show the protected activity is the primary reason for employers to take retaliatory actions, but they have a duty to prove that the protected activity is one of the factors that motivates employers to make adverse decisions.<sup>835</sup> Besides, an ALJ held that if retaliatory actions closely follow employees’ reports or disclosures, this “sequence of events” can be inferred as this causation.<sup>836</sup> Further, the DOL stated “temporal proximity between the protected activities and the ad-

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<sup>834</sup> *Marano, supra* note 640.

<sup>835</sup> *Kohn et al., supra* note 220, at 61.

<sup>836</sup> *Lederhaus v. Paschen*, 1991-ERA-13, D&O of ALJ, at 5 (Oct. 26, 1992).

verse action may be sufficient to establish the inference that the protected activity was a motivation for the adverse action.”<sup>837</sup> In practical cases, the temporal proximity has been interpreted as a period that is as long as a year between the protected activity and the adverse action taken by employers.<sup>838</sup>

#### (b) Adverse Action

SOX Section 806 prohibits employers from taking retaliatory actions that may “discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment” under protected activities regulated by SOX.<sup>839</sup> Likewise, the DOL stated that SOX forbids employers to “intimidate, threaten, restrain” or “blacklist” employees who blow the whistle with regard to employers’ misconduct.<sup>840</sup> Case law not only construes adverse employment action broadly such as SOX, but its interpretation also extends to the disciplinary action “even if no loss of salary is involved.”<sup>841</sup> The DOL even indicated that any adverse action would meet the element of employees’ claims “if it is reasonably likely to deter employees from making protected disclosures.”<sup>842</sup> However, it has to be noticed that not everything that makes employees feel uncomfortable would consti-

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<sup>837</sup> Thomas v. Arizona Pub. Serv. Co., 1989-ERA-00019, D&O of DOL, at 10 (Sept. 17, 1993).

<sup>838</sup> *Id.*

<sup>839</sup> Sarbanes-Oxley Act of 2002 § 806(a), 18 U.S.C. § 1514A(a).

<sup>840</sup> 29 C.F.R. § 1980.102(b) (2010).

<sup>841</sup> De Ford v. Secretary of Labor, 700 F.2d 281, 283, 287 (6<sup>th</sup> Cir. 1983).

<sup>842</sup> Vodicka v. Dobi Med. Int’l, Inc., 2005 DOLSOX Lexis 101, at 23-28 (Dec. 23, 2005).

tute adverse actions.<sup>843</sup> Employees still have to prove that employers' actions have an impact on "employment status" or permanently changed the employment relationship between employers and employees.<sup>844</sup>

(5) When Employees Demonstrate a "Contributing Factor," the Burden of Proof Shifts to Employers to Establish by the "Clear and Convincing Evidence" that They would Have Taken the Same Adverse Action Even If Employees Never Engaged in the Protected Activity

The standard of the clear and convincing evidence imposed upon employers is much stricter than employees' burden of proof by the preponderance of evidence. Congress adopted this standard to make employers "face a difficult time defending themselves" when being challenged by whistleblower cases.<sup>845</sup> One time, a court explained this severe standard of burden and stated, "Clear and convincing evidence has been described as evidence which produces in the mind of the trier of fact an abiding conviction that the truth of the factual contention is 'highly possible.'"<sup>846</sup> Besides, another court set up three factors to evaluate whether employers can satisfy their burden of proof to rebut employees' claims by clear and convincing evidence. These factors are "the strength of the agency's evidence in support of its personnel action;

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<sup>843</sup> *Montandon v. Farmland Indus.*, 116 F.3d 355, 359 (8<sup>th</sup> Cir. 1997).

<sup>844</sup> *Smyth v. Johnson Controls*, 98-ERA-23, D&O of ARB (June 29, 2001).

<sup>845</sup> *Grogan v. Garner*, 498 U.S. 279 (1991).

<sup>846</sup> *Am-Pro Protective Agency, Inc. v. U.S.*, 281 F.3d 1234, 1240 (Fed. Cir. 2002).

the existence and strength of any motive to retaliate on the part of the agency officials who were involved in the decision; and any evidence that the agency takes similar actions against employees who are not whistleblowers but who are otherwise similarly situated.”<sup>847</sup>

If employers meet their burden of proof and show they would have taken the same action even though the protected activity does not exist, employees still can prevail on their claims by proving employers’ legitimate reasons are pretexts for their adverse actions with the preponderance of evidence.<sup>848</sup> Employees can show pretexts by the lack of employers’ credibility<sup>849</sup> or by providing more evidence to prove protected activities really result in hostile employment actions.<sup>850</sup> Hence, it may be said that employees have to bear ultimate burden of proof to show that the protected activity strengthens employers’ motives to take retaliatory actions.<sup>851</sup>

#### iv. “Make-Whole” Remedy under SOX Section 806

SOX Section 806 provides a make-whole remedy for employees when they suffer adverse actions because of the disclosure or participation in the investigation on corporate securities violation or related fraud. SOX states the relief as follo-

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<sup>847</sup> Carr v. Social Security, 186 F.3d 1318, 1323 (Fed. Cir. 1999).

<sup>848</sup> Getman v. Sw. Section., Inc., 2003-SOX-8, D&O of Remand by ARB, at 18-19 (July 29, 2005).

<sup>849</sup> *Id.*

<sup>850</sup> Collins v. Beazer Homes USA, Inc., 334 F. Supp. 2d 1365 (N.D. Ga. 2004).

<sup>851</sup> Halloum v. Intel Corp., 2006 DOLSOX Lexis 5, at 14-15 (Jan. 31, 2006).

WS:

“(c) REMEDIES-(1) IN GENERAL – An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

(2) COMPENSATORY DAMAGES- Relief for any action under paragraph (1) shall include- (A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

(B) the amount of back pay, with interest; and

(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.”<sup>852</sup>

SOX gives the DOL and courts the power to consider employees’ situations and offer them the relief necessary to make their losses whole. To ascertain the relief that can completely make up for employees’ losses, courts and the DOL probably think about several factors. Some of these factors include the kind of retaliatory action that employees suffer, or the type of position that employees held in the organization. In short, as the authorized agency and courts consider the relief, the type of relief will not be restricted. Courts and the DOL have wide latitude discretion on damage, and employees’ losses can be relieved in non-monetary or monetary way. The form of relief can be categorized as follows: <sup>853</sup>

#### (1) Reinstatement

Reinstatement is the first remedy mentioned by SOX since it is the most practical relief for employees retaliated against by employers. Observing that

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<sup>852</sup> Sarbanes-Oxley Act of 2002 § 806(c)(2), 18 U.S.C. § 1514A(c)(2).

<sup>853</sup> Kohn et al., *supra* note 220, at 102-08.



it is difficult for employees to find a comparable employment after blowing the whistle, reinstatement is the most urgent need for whistleblowing employees. Reinstatement is viewed as the “presumed” relief because it is “normally an integral part of the remedy.”<sup>854</sup> As a court notes this point below:

“When a person loses his job ... money damages can suffice to make that person whole. The psychological benefits of work are intangible, yet they are real and cannot be ignored.... Unless we are willing to withhold full relief ... we cannot allow actual or expected ill-feeling alone to justify non-reinstatement. We also note that reinstatement is an effective deterrent in preventing employer retaliation against employees who exercise their constitutional rights. If an employer’s best efforts to remove an employee for unconstitutional reasons are presumptively unlikely to succeed, there is, of course, less incentive to use employment decisions to chill the exercise of constitutional rights.”<sup>855</sup>

Reinstatement is a remedy that restores terminated employees to ordinary lives as if adverse employment actions would not have occurred. A court states, “Unlawfully discharged workers should ordinarily be returned to their original jobs.”<sup>856</sup> However, when reinstatement cannot be available in some circumstances, such as corporate reorganization, employees discharged still have to be placed in “substantially equivalent” positions compared to their original careers when their companies have been merged into other organizations.<sup>857</sup> In addition, based on the evidence or related materials, if the information can show that terminated employees are capable of being promo-

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<sup>854</sup> *Reeves v. Claiborne County Bd. of Educ.*, 828 F.2d 1096, 1101 (5<sup>th</sup> Cir. 1987).

<sup>855</sup> *Allen v. Autauga County Bd. of Educ.*, 685 F.2d 1302, 1306 (11<sup>th</sup> Cir. 1982).

<sup>856</sup> *Tualatin Elec. Inc. v. NLRB*, 84 F.3d 1202, 1205 (9<sup>th</sup> Cir. 1996).

<sup>857</sup> *Id.* at 1206.

ted before blowing the whistle, these employees should be reinstated to higher positions or occupations that may satisfy their expectations on promotion before being discharged.<sup>858</sup>

## (2) Front Pay

Actually, front pay is not the relief described in SOX. Though, the U.S. Supreme Court stated that front pay is an indispensable part of the make-whole remedy when reinstatement is not available to relieve employees' losses.<sup>859</sup> Hence, front pay is able to be regarded as "a substitute for reinstatement" for aggrieved employees.<sup>860</sup> Typically, front pay would be given as the employment relationship is "irreparable animosity"<sup>861</sup> or where "a productive and amicable working relationship would be impossible."<sup>862</sup> The DOL allowed front pay to be a form of relief because once it said:

"Where the record reflects a sufficient level of hostility between an employer and employee that would cause irreparable damage to the employment relationship, it may be appropriate, at the request of the complainant, to order front pay in lieu of reinstatement."<sup>863</sup>

For this reason, before determining the remedy of front pay for aggrieved employees, courts and the DOL will consider whether the employment relationship is suitable to

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<sup>858</sup> Pecker v. Heckler, 801 F.2d 709, 712-13 (4<sup>th</sup> Cir. 1986).

<sup>859</sup> Pollard v. E.I. du Pont de Nemours & Co., 532 U.S. 843, 850 (2001).

<sup>860</sup> Nolan v. AC Express, 92-STA-37, Remand Order of SOL, at 15-16 (Jan. 17, 1995).

<sup>861</sup> Blum v. Witco Chem. Corp., 829 F.2d 367, 374 (3<sup>rd</sup> Cir. 1987).

<sup>862</sup> EEOC v. Prudential Federal Sav. & Loan Asso., 763 F.2d 1166, 1172 (10<sup>th</sup> Cir. 1985).

<sup>863</sup> Clifton v. U.P.S., 94-STA-16, D&O of ARB, at 2 (May 14, 1997).

be continued and steadily sustained. As they conclude that the working environment is not harmonious but hostile, courts and the DOL are inclined to end employment relationship and to compensate employees' losses by the relief of front pay.

### (3) Back Pay

Once a Judge described, "The legitimacy of back pay as a remedy for unlawful discharge or unlawful failure to reinstate is beyond dispute."<sup>864</sup> Thus, the remedy of back pay plays an irreplaceable role in relieving discharged employees' losses under whistleblower statutes. As for how to calculate the amount of back pay, another judge notes:

"The purpose of a back pay award is to make Complainant whole, which is to restore him to the same position he would have been in but for discrimination ... Complainant has the burden of establishing the amount of back pay ... However, because back pay promotes the remedial statutory purpose of making whole the victims of discrimination, 'unrealistic exactitude is not required' in calculating back pay, and 'uncertainties in determining what an employee would have earned but for the discrimination should be resolved against the discriminating [party].' The courts permit the construction of a hypothetical employment history for Complainant to determine the appropriate amount of back pay Complainant is entitled to all promotions and salary increases which he would have obtained, but for the illegal discharge."<sup>865</sup>

For the sake of estimating back pay, employees suffering adverse actions bear the burden of proof to show the amount, which they would have received if those hostile actions had not been imposed upon them. The certainty of claimed amounts is not neces-

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<sup>864</sup> NLRB v. J. H. Rutter-Rex Mfg. Co., 396 U.S. 258, 263 (1969).

<sup>865</sup> Hobby v. Georgia Power Co., 90-ERA-30, R. D&O of ALJ, at 57 (1995) (citations omitted).

sary, but employees have to “recreate the employment history” and “hypothesize the time and place of ... advancement absent the unlawful practice” to show estimated losses.<sup>866</sup> Hence, back pay cannot be awarded in exact sums like those that employees might have gotten before being affected by employers’ retaliatory actions. Back pay is a roughly calculated amount, not the complete exact relief.

#### (4) Other “Make Whole” Remedies and Interest

In addition to the relief of reinstatement, front pay, and back pay, courts and the DOL will consider other remedies that can completely relieve employees’ losses. In practical cases, the forms of relief may include “reimbursement for lost overtime; interest on the back pay award; restoration of all pension contributions; restoration of health and welfare benefit; restoration of seniority; the provision of neutral employment references; restoration of parking privileges; the provision of necessary certifications for the employee; applicable promotions; vacation pay; salary increases; training; cease and desist orders; compensation for forced sale of assets; job search expenses; expungement of personnel file; benefit; stock option and employee saving plan; forbiddance on future employers of derogatory communications that may influence future employment relationship and prohibition on laying off or terminating employees except for good causes; and an order provides good recommendations for com-

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<sup>866</sup> Ross v. Buckeye Cellulose Corp., 764 F. Supp. 1543, 1547 (M.D. Ga. 1991).

plainant”<sup>867</sup>

As mentioned above, other make whole remedies will not be banned since relief can be decided or awarded based on different situations of cases, such as the positions of aggrieved employees or their expectations of future corporate business performance. Due to assorted types of adverse employment actions, courts and the DOL are inclined to employ a broad way to award the relief for employees, so they can totally make up for losses resulting from employers’ reprisal.

#### (5) Special and Compensatory Damage

Special damage is one kind of employees’ losses listed on SOX Section 806. It contains compensatory damage, such as “damages for emotional distress caused by an employer’s retaliatory conduct.”<sup>868</sup> Under SOX, special damage includes litigation costs, expert witness fees, and reasonable attorney fees.<sup>869</sup> One time, a judge explained what damage is special, and stated, “Whether a particular kind of injury gives rise to ‘special’ damages thus depends on the tort committed. The usual consequences of a wrong are ‘general’ damages, and the unusual consequences of a wrong are ‘special.’”<sup>870</sup> In addition to emotional distress, other courts and the administrative agency have extended compensatory damage to “mental anguish, lost future earn-

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<sup>867</sup> Kohn et al., *supra* note 220, at 107.

<sup>868</sup> Hammond v. Northland Counseling Ctr., Inc., 218 F.3d 886, 892-93 (8<sup>th</sup> Cir. 2000).

<sup>869</sup> Sarbanes-Oxley Act of 2002 § 806(c)(2)(C), 18 U.S.C. § 1514A(c)(2)(C).

<sup>870</sup> Neal v. Honeywell, Inc., 191 F.3d 827, 832 (7<sup>th</sup> Cir. 1999).

ing, harassment, humiliation, loss of reputation, ostracism, depression, fear caused by threat, panic, frustration resulting from discriminatory experience and marital or family problems caused by retaliation.”<sup>871</sup>

In order to claim compensatory damage, employees must bear the burden of proof by competent evidence to show that they have suffered inconveniences and troubles.<sup>872</sup> Compensatory damage will be relieved in monetary way to make up for mental effects. However, no matter whether the relief is non-monetary or monetary, awarding a make-whole remedy for aggrieved employees retaliated against by employers because of their disclosures is the rationale for courts and the administrative agency to follow under SOX Section 806.

## **Chapter IV. Practical Events of Whistleblowing and Insufficient Protection in SOX Section 806**

### *A. Corporate Scandal*

#### 1. Sherron Watkins and Enron<sup>873</sup>

Former Enron’s Vice-President, Sherron Watkins has said, “I am incredibly nervous that we will implode in a wave of accounting scandals.” Because of this con-

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<sup>871</sup> Kohn et al., *supra* note 220, at 108.

<sup>872</sup> *Carey v. Piphus*, 435 U.S. 247, 264 (1978).

<sup>873</sup> The fact refers to Brickey, *supra* note 73, at 360-64; Cherry, *supra* note 92, at 1035-38; Jones, *supra* note 135, at 1158-60; Baynes, *supra* note 768, at 877-80.

cern, Watkins changed her role from an annoying corporate whistleblower to one of *Time Magazine's* Persons of the Year. Before being employed by Enron, Watkins earned her master's degree of professional accounting from the University of Texas at Austin. She started working life as an auditor in the accounting firm, Arthur Andersen, in 1982 and spent eight years in its Houston and New York offices. Watkins became a certified public accountant in 1983 and was hired by Enron Vice-President Andrew Fastow to manage Enron's partnership with the California Public Employee Retirement System. From June to August of 2001, she worked directly for Fastow and was assigned to various capacities. During 2001 and 2002, Watkins became the Vice President of Enron and was taking charge of examining Enron's assets and inventories to decide whether they could be sold in response to Enron's weak performance in the stock market.

While Watkins was checking out these materials, she found some "mystery assets" and "fuzzy off-the-books arrangements that seemed to be backed by nothing more than ... deflated Enron stock." She learned that Enron made use of affiliated entities to engage in accounting improprieties and believed Enron controlled gains and losses in income statements by using its own stocks. As Watkins requested someone to clarify her confusion, no one was willing to give her a response and tried to explain these arrangements. When testifying before the House Subcommittee on Oversight and Inv-

estigations, Watkins said that she had not received any satisfactory explanation from Enron's executives about those accounting transactions. The more information she learned, the more she became "highly alarmed" because her "understanding as an accountant was that a company could never use its own stock to generate a gain or avoid a loss on its income statement." Even if Watkins observed the financial misconduct, she was still afraid of reporting accounting frauds to either Fastow or to Jeffrey Skilling, Enron's then-chief executive officer, since she thought there "would have been a job terminating move" subsequently.

Because Watkins could not agree with Enron's executives' behaviour, she started job-hunting outside Enron. While she was in the process of finding a job, Skilling unexpectedly resigned. His abrupt and puzzling departure for "personal reasons" not only directed Wall Street to make negative reactions, but also made Enron's shares fall more than six percent in the stock market. When various rumors about Skilling's resignation flew between Enron's employees and the Wall Street analysts, Kenneth Lay, the chairman of the board, invited Enron's employees to drop their concerns and suggestions in a comment box. Making use of this opportunity, Watkins submitted an anonymous seven-page letter that presented her concerns in relation to Enron's accounting improprieties. In this letter, Watkins asked, "Has Enron become a risky place to work?" She referred to a document that directly pointed out one of Enron's question-



ble business practices and wrote, “There it is! This is the smoking gun. You cannot do this!” Also, she made a detailed description concerning Enron’s accounting frauds and stated, “[T]o the layman on the street it will look like we are hiding losses in a related company and will compensate that company with Enron stock in the future.” Also, Watkins showed her prescient fears on Enron’s violations of accounting standard and worried Enron’s actions might cause the implosion in a wave of accounting scandals. At the same time, Watkins wondered that whether Skilling knew Enron’s financial problems and believed accounting frauds could not be fixed, so he “would rather abandon ship now than resign in shame in two years.”

Shortly after submitting the letter, Watkins arranged a meeting with Lay and expressed her worries on Enron’s financial misconduct. In the meeting, Watkins pointed out problems on Enron’s off-book partnerships and special purpose entities. She also suggested that Enron should not conceal these accounting frauds from the public. On the contrary, she advised Enron had to present its financial conditions fairly and strengthen investors’ confidence on its performance. In addition, Watkins told Lay to hire an independent law firm to investigate these problems, and Vinson & Elkins, Enron’s attorneys, should not be retained because they seemed to help Enron make up questionable deals. Following Watkins’s requests, Lay promised an investigation would be started, and he would find out whether her observations were true or not.

However, when Lay passed Watkins's letter to Enron's general counsel, James V. Derrick, he still hired Vinson & Elkins to do the investigation. Derrick said hiring Vinson & Elkins was permissible because this investigation was a "preliminary one." In the investigation, Vinson & Elkins adopted brief and limited discovery on Watkins's allegations. This method made the result "largely predetermined by the scope and nature of the investigation and the process employed." In addition, Vinson & Elkins did not let independent accountants participate in the investigated proceeding. Therefore, the investigated result was frustrating, and Vinson & Elkins concluded that special purpose entity transactions were not questionable. Until the eruption of Enron's scandal, these wrongdoings were not disclosed nor did Watkins report her concerns to the SEC, the Department of Treasury, or any other governmental official.

When Watkins prepared testimonies before the House Subcommittee on Oversight and Investigations, she reviewed an e-mail, titled "Confidential Employee Matter," from Vinson & Elkins to Enron's executives. Its content talked about the state of Texas whistleblowing law, and part of this message was noted:

"Per your request the following are some bullet thoughts on how to manage the case with the employee who made the sensitive report ... You ... asked that I include in this communication a summary of the possible risks associated with discharging (or constructively discharging) employees who report allegations of improper accounting practices: First, Texas law does not currently protect corporate whistle-blowers. The Supreme Court has twice declined to create a cause of action for whistle-blowers who discharged.... Fourth, in addition to the risk of a wrongful discharge claim, there is the risk that the discharged employee

will seek to convince some government oversight agency (e.g., IRS, SEC, etc.) that the corporation has engaged in materially misleading reporting or is otherwise non-compliant. As with wrongful discharge claims, this can create problems even tho [sic] the allegations have no merit whatsoever.”

Watkins noticed this e-mail was in reference to her because the created date of e-mail could be traced back to two days after she talked to Lay. It was clear that Watkins had become a target as a result of her disclosure on accounting improprieties. This person at the high level of Enron might be Andrew Fastow, the chief financial officer of Enron, since knowing Watkins had talked to Lay about Enron’s accounting misbehavior, he was unhappy and told to Watkins’s direct supervisor about he wanted Watkins “out of here tonight.” Also, Watkins added, “I found out ... that Ken Lay’s first action was not to look at my concerns about fraudulent accounting but to see if they could dump me on the street.” Watkins felt frustrated and said, “I can’t believe they looked into firing me.... It was a horrible response. There’s nothing in there to remind them to remember the code of conduct, the vision and values.”

Like Vinson & Elkins’ email described, Texas laws did not provide protection for corporate whistleblowers when they disclosed employers’ wrongdoings. In the *Austin* case, the Supreme Court of Texas dismissed a cause of action that asked to protect the employee who suffered retaliatory discharge because he reported illegal activities of the private company.<sup>874</sup> Because of the lack of protection for whistleblowers in Texas

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<sup>874</sup> *Austin v. Healthtrust Inc.*, 41 Tex. Sup. Ct. J. 679 (1998).

at that time, Enron's executives would not be imposed upon any liability and had a legal consequence to discharge Watkins.

However, Enron did not get to fire Watkins, Enron's fraudulent conduct came to light and were scrutinized by Congress, the public, and its shareholders. On October 16, 2001, Enron announced a \$618 million loss in the third quarter and admitted it had overstated earnings by \$586 million. On December 2, 2001, Enron filed for bankruptcy, and Lay also resigned as the CEO of Enron on January 23, 2002. As for Watkins, her whistleblowing was getting positive reactions from her colleagues and the public in the initiation. But when Enron started laying off employees and lots of coworkers lost their livelihoods immediately, the negative criticism sprung out and blamed Watkins for not reporting those illegal activities to the SEC in time. This response is not surprising since corporate whistleblowers rarely bring a satisfying consequence in the end and are unable to meet each party's expectation at the same time as they decide to blow the whistle outside companies.

## 2. Cynthia Cooper and WorldCom<sup>875</sup>

WorldCom's scandal occurred in March of 2002 when Cynthia Cooper found financial cheating by WorldCom's executives and their affiliated accounting firm. Cooper was the president of internal auditing of WorldCom; she received a report fr-

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<sup>875</sup> The fact refers to Brickey, *supra* note 73, at 369-70; Cherry, *supra* note 92, at 1039-42; Jones, *supra* note 135, at 1157-58.

om an executive of wireless division who asserted that WorldCom employed reserves to make its revenues look better. When she mentioned this question to the outside auditor, Arthur Andersen, Cooper was told that these accounting matters were not a problem and did not have an influence on WorldCom's financial condition. While Cooper was presenting these accountings to Scott Sullivan, the CFO of WorldCom, he felt uncomfortable with Cooper's query and angrily told her to back off. Getting a negative response from Sullivan, Cooper was afraid that her action would bring her in the danger of termination; hence, in this awareness, Cooper started cleaning out her personal items from the office. However, because of her curiosity, she still did not want to back off since she thought "when someone is hostile, my [Cooper's] instinct is to find out why." Arising from the worry on WorldCom's financial frauds, Cooper and her auditors decided to go through WorldCom's computer system and tried to find the truth of questionable accounting.

The findings were astonishing. In May of 2002, Cooper and her auditors found that WorldCom had treated operating costs as capital expenditures. These mixtures made WorldCom's financial reports better than they actually were. The fraudulent accounting showed WorldCom had concealed a \$622 million loss as a \$2.4 billion profit. When Sullivan was conscious that Cooper and her team had known these frauds, he asked Cooper to stop and prohibited Cooper and her teams from reviewing these fina-

ncial materials. However, Cooper did not follow his request and refused to yield under his authority.

Cooper passed the fraudulent accounting to the board's audit committee in June of 2002 when she had found over \$2 billion false accounting entries. The audit committee notified Sullivan about this matter and gave him the limited time to explain financial treatment. A meeting was held in little more than a week; the committee found Sullivan's explanations on unorthodox accounting practices were unsatisfactory and unpersuasive, and they could not adopt his explanations as justifiable reasons to maintain his position. Thus, the Committee asked Sullivan to resign; if he did not, the committee would fire him the next day. When these financial frauds were disclosed, WorldCom was forced to admit its financial corruption, and this information was immediately spread out on newspapers and the public media. Besides, SEC filings and congressional hearings had shown more details not only on how these illegal actions were committed, but on how WorldCom's executives directed accountants to make fraudulent financial reports. Once two external investigations pointed out:

“... WorldCom kept two sets of books and that there were numerous failures in the company's corporate governance structure. In addition to the switches surrounding capital expenses and operating costs, the company also manipulated revenues, depreciation reserves, and ... taxes. Sullivan and four other WorldCom executives and employees face criminal charges for orchestrating the \$3.8 billion fraud.”<sup>876</sup>

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<sup>876</sup> Cherry, *supra* note 92, at 1041.

Also, WorldCom's corruption could trace back to its CEO who carelessly treated these financial irregularities. "The Oklahoma Attorney General has indicted former Chief Executive Officer Bernard Ebbers, who was in charge of the company when the massive fraud took place and knew about the exaggerated numbers at the end of each quarter."<sup>877</sup>

WorldCom's financial corruption not only made itself suffer a huge loss on business, but also caused many negative impacts on society. Whistleblowing is not an easy action for employees because they are used to thinking it over before taking a step. As the *Wall Street Journal* notes, "one of the reports said while dozens of people knew about the fraud, it remained hidden from public view because employees were afraid to speak out." Even though Cooper knew her report might result in the loss of her job, she was convinced that the disclosure of corporate fraud was more important than her self-interest. After reporting financial frauds of WorldCom, Cooper still stayed in the company even though she realized it was highly possible that WorldCom would file bankruptcy at last. However, she believed that there would be some changes in the business and thought "[t]here really is a corporate-governance revolution across the country. Internal-audit departments are going to be taken more seriously." Cooper supposed that her whistleblowing might cause a revolution that could affect corporate man-

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<sup>877</sup> *Id.*

agement to pay more attention to improve corporate governance and make business be run in legal and ethical processes.

Like Watkins in Enron, the initial responses that Cooper received from strangers were positive and filled with admiration. Yet, WorldCom's employees blamed Cooper that if she did not blow the whistle, they would not be laid off, and WorldCom should not be in this terrible situation. Cooper was isolated by colleagues since they stopped associating with her. Being the whistleblower, Cooper was neither given a promotion, nor did she receive respect from coworkers. She seemed like a trouble-maker in the company, and did not qualify for any rewards. At last, WorldCom could not avoid the destiny of bankruptcy, and this resulted in a massive layoff.

Unlike Watkins, who would not receive whistleblower protection in Texas after reporting Enron's financial frauds; however, Cooper was protected under Mississippi state law because Mississippi courts adopted a broad public policy to modify the doctrine of employment-at-will. In the *McArn* case, the Mississippi Supreme Court established a public policy that allowed the whistleblower to bring a cause of action against the employer's wrongful termination.<sup>878</sup> Therefore, if Cooper had been retaliated against because of her disclosure, she could have filed a claim and relieved her losses in Mississippi jurisdiction.

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<sup>878</sup> *McArn v. Allied Bruce-Terminix Co.*, 626 So. 2d 603 (Miss. 1993).



### 3. Experiences and Obstacles Whistleblowers Have When Disclosing Corporate Wrongdoing

#### a. Whistleblower Is a Trouble-Maker

Not only does the law show no sympathy for whistleblowing,<sup>879</sup> but companies and colleagues also regard it as a threat for business and careers. The management thinks that the whistleblower's behaviour is disloyal to corporations, and he/she is "a type of scoundrel"<sup>880</sup> and a "disgruntled employee with an axe to grind with his or her former employer."<sup>881</sup> Whistleblowers are troublemakers for companies and are viewed as "dissatisfied and ineffective employees who are unable to work within the system."<sup>882</sup> As for corporate cultures, "these people are perceived as turncoats, as not being team players, as people not to be trusted."<sup>883</sup> For coworkers, whistleblowers are employees who are "treated as outcasts by fellow employees."<sup>884</sup> Once Sherron Watkins said that whistleblowing at Enron was "not any easy road to take" because Enron tried to "just stick [her] in a corner and treat [her] like a pariah and sort of force [her] out."<sup>885</sup> Watkins even complained that she felt like an outcast among her colleagues

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<sup>879</sup> Cherry, *supra* note 92, at 1051.

<sup>880</sup> *Id.* at 1052.

<sup>881</sup> *Id.*

<sup>882</sup> Elliston et al., *supra* note 133, at 134.

<sup>883</sup> Summers & Nowicki, *supra* note 317.

<sup>884</sup> Culp, *supra* note 291, at 114.

<sup>885</sup> Liz Fedor, *Enron's Watkins Relishes New Role*, Minneapolis Star trib., Feb. 3, 2003, at D3.

after disclosing Enron's financial fraud.<sup>886</sup> These phenomena not only reveal that isolation is common treatment for whistleblowers because no one wants to create the illusion that shows he/she stands with the whistleblower, but also prove that whistleblowing conflicts with social values and corporate cultures cherished by American's society and companies.

In this way, no matter whether the disclosure is external or internal, whistleblowers might not receive appreciation from companies and colleagues. On the one hand, external whistleblowing breaches implied employment contract that requires employees to bear the duty of loyalty for employers and corporations;<sup>887</sup> on the other hand, internal whistleblowing is perceived as a kind of insubordination, especially as whistleblowers do not follow customary corporate in-house channel to present concerns and to disclose employers' misconduct.<sup>888</sup>

#### b. Mental Effects and Monetary Consequences

One time, Elliston in his research gave a caution for those employees who want to be whistleblowers. As he says:

“The decision to blow the whistle is not one to be taken lightly. Professionally, it can cost an employee not only his or her job but also a career. Personally, it can cost much grief – disrupted sleep, strained friendships, and diminished fortunes.

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<sup>886</sup> *Id.*

<sup>887</sup> Stefan Rutzel, *Snitching for the Common Good: In Search of A Response to the Legal Problems Posed by Environmental Whistleblowing*, 14 Temp. Env'tl. L. & Tech. J. 1, 24 (1995).

<sup>888</sup> *Id.* at 33.

Those who decide to dissent publicly should recognize that they are gambling, and the odds are against them.”<sup>889</sup>

Not only are whistleblowers isolated and relegated to dead-end positions,<sup>890</sup> but they also suffer stresses coming from the workplace, which bring them serious mental illnesses and cause other problems, such as alcohol or drug abuse.<sup>891</sup> In addition, expensive legal fee is another pressure for whistleblowers when they are discharged and lose financial sources at the same time. As Culp says:

“In fighting the retaliatory acts of their employers, they [whistleblowers] have incurred tremendous legal expenses which, when coupled with the loss of earnings resulting from termination, have resulted in disastrous financial consequences. Many whistleblowers have lost their homes and marriages as a direct result of their concern for the public health and welfare.”<sup>892</sup>

Other psychological burdens resulting from whistleblowing, like “the effects of public criticism and a lengthy stay in litigation’s limelight,” would torment whistleblowers’ minds and have a great influence on their daily lives.<sup>893</sup>

Filing a claim against employers probably fails to satisfy employees’ expectations to get rid of these terrible consequences since employees may still have a hard time proving their allegations in some state jurisdictions. Some courts impose a stricter standard of burden upon whistleblowing employees, but adopt a lower evidentiary burd-

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<sup>889</sup> Elliston et al., *supra* note 133, at 133.

<sup>890</sup> Cherry, *supra* note 92, at 1053.

<sup>891</sup> Culp, *supra* note 291, at 113.

<sup>892</sup> *Id.*

<sup>893</sup> Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U.L. Rev. 91, 95-96 (2007).

en for employers to rebut employees' arguments. Employers can easily reverse employees' claims and prove their decisions of termination result from employees' unsatisfactory performance or terrible working attitudes, not from retaliation because of employees' disclosures.<sup>894</sup> Even if employees prove their allegations are merited and granted the relief, employees still cannot restore damaged working atmosphere because the employment relationship has been ruined.<sup>895</sup> In addition, the remedy is unable to completely relieve employees' losses when they have been blacklisted in tight-knit industries and branded as a troublemaker by previous employers because of former disclosures.<sup>896</sup>

Consequently, employees blowing a whistle not only have to bear mental effects and financial stresses, but they also may get a cold shoulder from courts when courts' decisions tend to impose a stricter standard of burden upon whistleblowing employees. In this way, the consequence of whistleblowing will frustrate employees because they have to face mental and physical problems alone; similarly, other factors that they cannot anticipate and control may make their situations worse.

### c. What Is Retaliation?

#### i. Definition of Retaliation

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<sup>894</sup> Kinzel v. Discovery Drilling, Inc., 93 P.3d 427, 435 (2004).

<sup>895</sup> James Fisher et al., *Privatizing Regulation: Whistleblowing and Bounty Hunting in the Financial Services Industries*, 19 Dick. J. Int'l L. 117, 128 (2000).

<sup>896</sup> Bucy, *supra* note 207, at 953.

Once Rehg described retaliation in the employment relationship as follows:

“Retaliation against whistleblowers represents an outcome of a conflict between an organization and its employee, in which members of the organization attempt to control the employee by threatening to take, or actually taking, an action that is detrimental to the well-being of the employee, in response to the employee’s reporting, through internal or external channels, a perceived wrongful action.”<sup>897</sup>

Retaliation is a phenomenon that can show the imbalanced power in the employment relationship. Because employers hold managerial power to control the operation of organizations and can decide the positions of employees, this authority makes it harder for employees to fight against employers when employees are treated in unequal ways or suffer retaliation.

Retaliation on whistleblowing employees can be shown in various manners. Miceli defines retaliation as an “undesirable action taken against a whistleblower and in direct response to the whistleblowing.”<sup>898</sup> Also, Keenan states that retaliation is “taking an undesirable action against an employee or not taking a desirable action because that employee disclosed information about a serious problem.”<sup>899</sup> The undesirable action includes “both adverse actions taken against the whistleblower (e.g., demotion)

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<sup>897</sup> Michael T. Rehg, *An Examination of the Retaliation Process against Whistleblowers: A Study of Federal Government Employees* (Aug. 07, 1998) (Unpublished Doctoral Dissertation, Indiana University, Bloomington).

<sup>898</sup> Marcia P. Miceli et al., *Whistleblowing in Organizations* 11 (2008).

<sup>899</sup> Keenan J. P., *Comparing Indian and American Managers on Whistleblowing*, 14 *Emp. Resp. & Rts. J.* 79, 82 (2002).

and positive actions that were not taken, but otherwise would have been taken had the employee not blown the whistle (e.g., promotion).”<sup>900</sup> In addition, Cortina & Magley even make a detailed classification, and divide retaliation into two categories. One is the work-related retaliation, and can be “tangible, formal and documented in employment records.”<sup>901</sup> It includes “discharge, involuntary transfer, demotion, poor performance appraisal, and deprivation of perquisites or overtime opportunity.”<sup>902</sup> Another is the social retaliation, and comprises “antisocial behaviors, both verbal and nonverbal, that often go undocumented.”<sup>903</sup> Anti-social behaviour can be exemplified by “harassment, name-calling, ostracism, blame, threats, or the silent treatment.”<sup>904</sup> Yet, no matter what kind of retaliation is imposed upon employees, it can be concluded that adverse employment actions not only make employees suffer diverse mental effects, but also decrease the working performance and affect employees’ willingness to enhance organizations’ values.

## ii. Types of Retaliation

In SOX Section 806, the statute forbids regulated employers to discharge, demote, suspend, threaten, harass, or in any other manner that discriminates aga-

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<sup>900</sup> Miceli et al., *supra* note 898.

<sup>901</sup> Lilia M. Cortina & Vicki J. Magley, *Raising Voice, Risking Retaliation: Events Following Interpersonal Mistreatment in the Workplace*, 8 J. Occup Health Psychol. 247, 248 (2003).

<sup>902</sup> *Id.*

<sup>903</sup> *Id.*

<sup>904</sup> *Id.*

inst employees who make the disclosure of securities violation or related fraud. Besides, in practical cases, many actions still can be seen as adverse employment. Mavrommati describes the consequence of whistleblowing, and says:

“Traditionally, a worker, who blows the whistle on an employer, can expect to feel the force institutional rage; criticism; ostracism from colleagues; poor performance evaluations; punitive transfers; loss of job; black listing and even damage to health from the strain of battling against a power organization.”<sup>905</sup>

Once a report filed by the National Whistleblower Center in 2002 stated that nearly half of whistleblowers would be fired after employers’ wrongdoings are disclosed,<sup>906</sup> and other complainants would be subjected to a variety of retaliatory actions or threats from employers and colleagues.<sup>907</sup> In practice, some retaliatory actions have been viewed as discrimination, and prohibited by the administrative agency and courts. These actions are exemplified below:

- “elimination of position/reduction in force
- transfers, and demotions
- constructive discharge (or making working conditions so difficult as to force a resignation)
- blacklisting
- reassignment to a less desirable position
- negative comments in evaluation that impact employment opportunities
- a retaliatory order to undergo a psychological fitness for duty examination
- denial of unescorted access to a work site

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<sup>905</sup> Sandy Mavrommati, *The Dynamics of Gatekeepers, Corporate Culture and Whistleblowers*, 1 *The Corp. Governance L. Rev.* 385, 400 (2005) (England).

<sup>906</sup> National Whistleblower Center, *The National Status of Whistleblower Protection on Labor Day*, 2002 (Sept. 2, 2002) (unpaginated) (on file with author).

<sup>907</sup> Gail Russell Chaddock, *Enron Changes Climate for Whistleblowers*, *The Christian Sci. Monitor*, Mar. 1, 2002, at 5.

- suspension of test certifications
- denial of promotion
- threats
- retaliatory harassment or acts constituting intimidation and coercion
- transfer to position where employee could not perform supervisory duties
- circulation of negative references and other forms of bad mouthing
- moving an office and denying parking and access privileges
- negative references provided to a reference-checking company
- transfer to a position in which there was less opportunity to earn overtime pay
- refusal to rehire or denial of employment
- layoffs
- failure to recall an employee back to work
- denial of overtime or refusing to let an employee take time off
- refusal to refer an employee for work with another employer
- refusal to provide proper references and job referrals
- denial of parking privileges
- hostile work environment
- offering an employee a hush money settlement
- improperly coercive questioning concerning protected activities
- harassment which reasonably could create a chilling effect on employee speech
- enforcement of policies that directly impact or prohibit protected activity”<sup>908</sup>

Thus, as observed above, no matter which retaliatory behaviour that employers impose upon whistleblowers, it can be found that employers’ main intent is to make whistleblowers feel lonely in the workplace, and try to kick them out.

In addition, Glazer & Glazer stated that retaliation is in relation to the conflict of interest and imbalanced power in the employment relationship. They describe this point as follows:

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<sup>908</sup> Kohn et al., *supra* note 220, at 98-99 (emphases omitted).



“The retaliation against ethical resisters reveals the dark underside of American bureaucratic life. Just as the resisters personify the continuing presence of conscience and individual responsibility, so do the reprisals mounted against them expose the lengths to which management will go to crush dissent. By their actions, ethical resisters become disturbers of power, challengers of the status quo that all too often benefit a few corporate managers and government bureaucrats. While the resisters often evoke sympathy, they have no shield adequate to protect them.... The resisters usually find that they either have to accept defeat or undertake a lengthy and expensive fight.”<sup>909</sup>

Traditional employment relationship means the communication between employers and employees is vertical, not horizontal. Employers have managerial authority to control everything, but employees only can passively receive and practice the order. Employees are unable to change the position, promote the working atmosphere, and affect the management’s decision-making. By contrast, employers can decide who will be promoted or demoted, and determine whether to accept different voices from the workplace or only to treat these concerns as meaningless complaints. Employers have the power that subordinates cannot compare with and enjoy. Because of this imbalanced position, when retaliation comes along and imposes upon employees, they cannot independently fight against employers and have to take adversities by themselves.

#### 4. Consequences of Whistleblowing

Whistleblowers can select several outlets to present their concerns after balancing different factors and actual situations. They are able to disclose organizations’

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<sup>909</sup> Glazer & Glazer, *supra* note 137, at 166.

wrongdoings to complaint recipients, upper or middle-level management, governmental agencies, or other public parties.<sup>910</sup> Because there are diverse channels that whistleblowers can choose, the consequences of whistleblowing made by these recipients will be different because of various responses.<sup>911</sup> As complaints are brought by employees, some recipients probably choose to ignore or respond to these arguments by retaliation.<sup>912</sup> Hence, whistleblowing employees can adjust their steps when these responses do not meet their expectations. As retaliation is taken by respondents, whistleblowers still can find other recipients whom they think are capable of resolving the problem. If there is no recipient that whistleblowers prefer to make a disclosure, they are allowed to file a claim in a court against the recipients who have taken adverse actions upon them.<sup>913</sup> As Miceli & Near state, “Our contention is that not every case of whistleblowing plays out in the same fashion.”<sup>914</sup> Therefore, when making anticipation on the consequence of whistleblowing in each given case, some variables should be considered before the result comes out.

Observing the outcome of whistleblowing, employees may have an equal chance to be retaliated against or to be rewarded for their actions. For corporations, it is a hi-

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<sup>910</sup> Miceli & Near, *supra* note 100, at 179.

<sup>911</sup> *Id.*

<sup>912</sup> *Id.*

<sup>913</sup> *Id.*

<sup>914</sup> *Id.*

gh likelihood that they will give whistleblowing employees responses with reprisal if corporate cultures devalue these actions. However, when employers have shown intentions to uphold whistleblowing in the workplace or have educated employees whistleblowing is correspondent to companies' policies and interests, in those circumstances, the response to whistleblowing will be positive. The whistleblower-friendly atmosphere established by organizations not only reduces the obstacle for employees to present concerns, but it also lessens their fears to be retaliated against by employers or isolated by colleagues. At this time, the actions taken by whistleblowers are admirable for the management because these actions help finding mistakes in the workplace, and prevent the collapse of organization. Typically, the consequence of whistleblowing can be divided into a short-term and a long-term result. Miceli & Near make this distinction as follows:

“In the short term, the organization can decide either to terminate the alleged wrongdoing or to continue it. The response to the whistleblower – independent of the decision concerning the termination or continuation of the wrongdoing – is to reward, to treat as before, or to retaliate. In the long term, the whistleblower may respond to the organization's decision, perhaps by deciding to blow the whistle again or by deciding not to do so, under any circumstances; in addition, the whistleblower's attitudes and behavior in the organization may be affected. The long-term consequences for the organization are equally varied, and may be a mixture of good and bad results, ranging from increased costs of litigation with the whistle-blower to improved performance if the wrongdoing is terminated.”<sup>915</sup>

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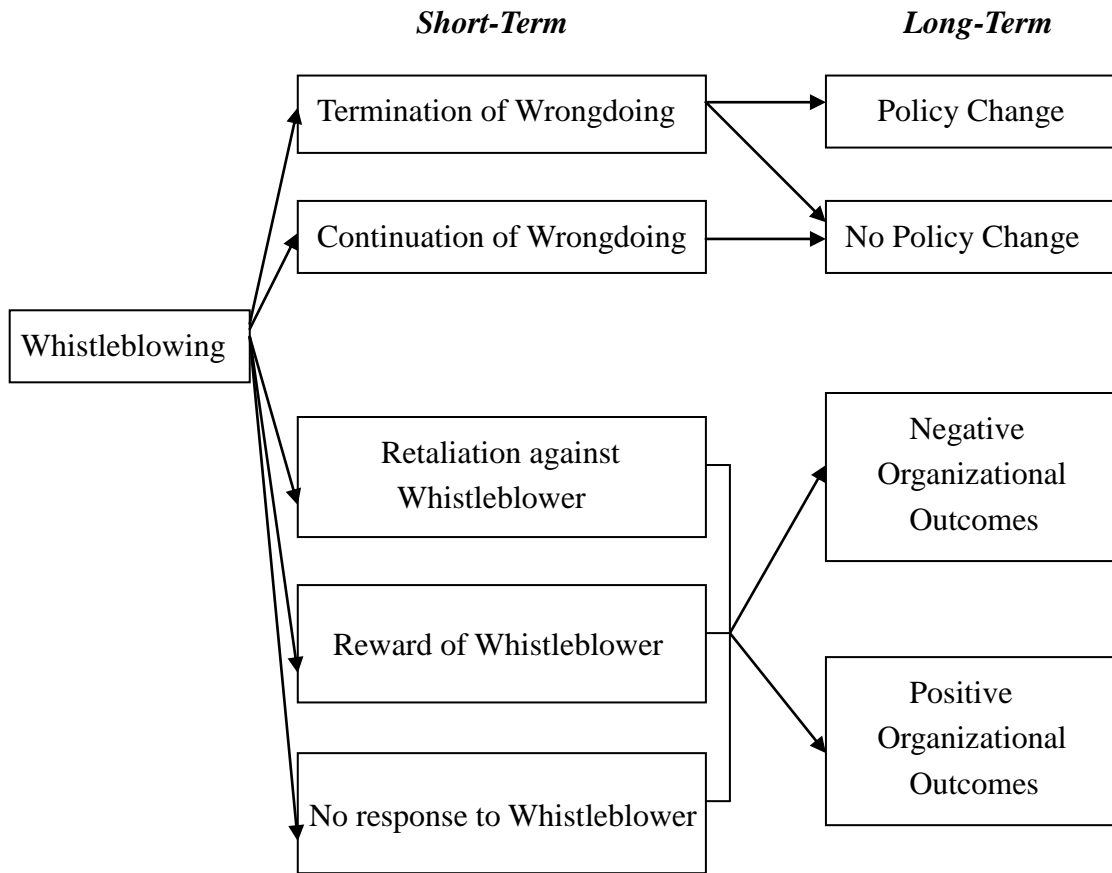
<sup>915</sup> Miceli & Near, *supra* note 100, at 179-80.

A short-term consequence of whistleblowing is probably easy for whistleblowing employees and organizations to anticipate. For whistleblowers, the purpose of blowing the whistle is to unveil organizations' wrongdoings and to correct them by internal or external help. Whistleblowers want errors to be rectified and alert wrongdoers about their unlawful actions. For organizations, they are the recipients of whistleblowers' disclosures. As organizations know misconduct, they have to decide whether to ignore the disclosure and retaliate against informants, or to take a positive action to deter mistakes from getting worse and reward whistleblowers for their loyalty to organizations. As to a long-term result, based on the responses of organizations, whistleblowers may be influenced by the management's actions or colleagues' attitudes toward their disclosures, and decide whether to make a similar report again or not. Likewise, organizations will consider the benefit and the cost of response to determine if they should treat later complaints positively or negatively. Thus, it can be said that a short-term consequence is seen as a test for employees to make a subsequent report, and a long-term consequence influences organizations to develop corporate culture upon whistleblowing. For the sake of making a systematic description, a short-term and a long-term consequence of whistleblowing can be diagrammed by Figure 4-1:<sup>916</sup>

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<sup>916</sup> *Id.* at 180.

Figure 4-1



In this way, for whistleblowers, they hope reported wrongdoing can be rectified immediately since this result is their original purpose to make a disclosure. As for the reward from supervisors or admiration from coworkers, these are viewed as extra encouragements to affirm their actions. For organizations, they probably take other factors into account before deciding whether to reward or to retaliate against these employees. For instance, the cost of response on whistleblowing is one of factors they will think about. If employers act positively on whistleblowing, they must bear a risk on the increase of the dissent from employees afterward, and this trend is detrimental to ma-

nagerial power of controlling organizations' affairs. Contrarily, when employers' responses are negative, it may be predictable for them to face the collapse of business, and to be investigated or intervened by the public or governmental agencies after the corruption breaks out.

As described above, different variables have to be taken into account before the consequence of whistleblowing comes out. In Miceli & Near's research, they have established a diagram to analyze the influence of each variable on the result of whistleblowing. This diagram is illustrated by Figure 4-2:<sup>917</sup>

Figure 4-2  
*Social Actors, Predictor Variables and Consequence of Whistleblowing*

Predictor Variables	Social Actors					
	Complaint Recipient		Co-workers		Management	
	Effectiveness	Retaliation	Effectiveness	Retaliation	Effectiveness	Retaliation
Individual						
Situational						
Organizational						
Dependence						

<sup>917</sup> *Id.* at 183.

In this diagram, Miceli & Near made use of the complaint recipient, the coworker, and the management as the respondents for whistleblowers' disclosures. Three respondents have a feature in common; that is, they are able to play different roles at the same time.<sup>918</sup> As Miceli & Near described the complaint recipient, they thought that the complaint recipient "must be someone who has the power to change the situation, whether internal or external to the organization.... the complaint recipient could be one's immediate supervisor, a coworker, a member of top management or an individual external to the organization."<sup>919</sup> Likewise, the coworker has two different roles. On the one hand, he/she is a colleague, "which implied some task interdependence and sense of norms for appropriate or even ethical behavior with regard to one's peer."<sup>920</sup> On the other hand, he/she is seen as an organizations' member, "which implied some senses of loyalty to the organization member."<sup>921</sup> As to the management, it also plays two characters; it can be the supervisor for the business matter or be the whistleblower to organizations' illegal activities. Yet, Miceli & Near thought that this situation has to depend on "their [the management] own level in the hierarchy and that of the whistleblower."<sup>922</sup> In short, these three actors are typical outlets for whistleblowing employ-

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<sup>918</sup> *Id.* at 185.

<sup>919</sup> *Id.* at 184.

<sup>920</sup> *Id.* at 185.

<sup>921</sup> *Id.*

<sup>922</sup> *Id.*

ees to present concerns, and these respondents are almost the first channel for whistleblowers to think about.

As to the leftward column of the diagram, Miceli & Near used individual, situational, organizational, and dependence as four factors for predictor variables. First of all, in the individual predictor, Miceli & Near stated that "... characteristics of the whistleblower ... would influence the organization's response to him or her as a credible source for reporting wrongdoing."<sup>923</sup> Concerning the credibility of sources, it is built by whistleblowers' power in organizations. As Miceli & Near described, "... credibility is often confounded with power, because many of the status or position variables that confer power on an organization member also make that person a respected or credible source of information."<sup>924</sup> Hence, the power of whistleblowers is a crucial factor to affect organizations' responses to whistleblowing.

Second, the situational predictor can be categorized into two portions, these are "characteristics of the wrongdoing relating to its content" and "characteristics of the wrongdoing relating to the process by which it occurs and is interpreted."<sup>925</sup> The first category means the type or the seriousness of wrongdoing affects organizations to respond to whistleblowing, and it relates to organizations' dependence on its continuati-

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<sup>923</sup> *Id.*

<sup>924</sup> *Id.* at 185-86.

<sup>925</sup> *Id.* at 186.



on. The second category describes the procedure that organizations use to make a response on wrongdoing because different processes correlate with the ways that organizations treat whistleblowers. Diverse types of misconduct or the seriousness of wrongdoing, and the procedure that reacts to illegal activities affect employers' attitudes to correct organizational fraud. It is a high possibility that when severe wrongdoings tangle with ordinary business operation, the management is unwilling to rectify them since the correction probably speeds up the collapse of organization. However, what type of wrongdoing significantly affects employers' responses to whistleblowing, this is still uncertain in recent empirical research.<sup>926</sup>

Third, the organizational predictor includes "both characteristics of the subunit and characteristics of the organization" to anticipate organizations' responses to whistleblowers.<sup>927</sup> This variable takes organizations' cultures on whistleblowing into account and considers organizations' sizes, structures, and ethical cultures.<sup>928</sup> Besides, Miceli & Near said that organizations' environments also play a role in the response, and these include "norms associated with its [organizations] task domain, and social norms that may affect the organization's ethical culture."<sup>929</sup>

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<sup>926</sup> *Id.* at 193.

<sup>927</sup> *Id.* at 187.

<sup>928</sup> *Id.*

<sup>929</sup> *Id.*

Fourth, the dependence predictor is the most complicated category of variable,<sup>930</sup>

and is able to be divided into four elements as follows:

- Dependence on the Wrongdoing

This concept correlates with the situational predictor. It means that when wrongdoings are important for organizations, and they cannot continue business or survive without depending on misconduct, organizations probably make more negative responses to whistleblowing.<sup>931</sup>

- Dependence on the Wrongdoer

This element is similar to organizations' dependence on illegal actions. When organizations' performance is highly dependent on wrongdoers, whistleblowers are hardly able to receive satisfying responses from supervisors or organizations to protect and to support their actions.<sup>932</sup>

- Dependence on the Complaint Recipient

The power of the recipient can be used to determine the density of whistleblowers. However, the result may be different because whether the recipient supports whistleblowing is a significant factor to consider. As the powerful complaint recipient is willing to stand with whistleblowing employees, those employees probably

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<sup>930</sup> *Id.*

<sup>931</sup> *Id.* at 188.

<sup>932</sup> *Id.*

have a higher possibility to receive positive responses for their disclosures. Contrarily, when the recipient dislikes the actions taken by whistleblowers, it is probable that those employees' disclosures will be ignored, and adverse actions are predictable and will be imposed upon them subsequently.<sup>933</sup>

- Dependence on the Whistleblower

This element is associated with the individual predictor above. As whistleblowers are more powerful and credible in organizations, not only will their disclosures receive more attention from organizations, but also few colleagues will suspect the authenticity of their reports. Miceli & Near described that organizations may view whistleblowers' actions as credible when they "(a) have support from others; (b) have credibility within the organization because of position or idiosyncrasy credits or how they have handled the whistleblowing; (c) have competent legal advice; (d) have shown that their case will benefit other members of the organization or at least not harm them; and (e) are considered high performers or powerful individuals for other reasons."<sup>934</sup> Yet, this element would be influenced by other elements, like organizations' dependence on the wrongdoing, the wrongdoer, or the complaint recipient. Hence, as observing this element to anticipate the consequence of whistleblowing, other elemen-

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<sup>933</sup> *Id.* at 188-89.

<sup>934</sup> *Id.* at 189.

ts still have to be thought about.<sup>935</sup>

In the analysis, Miceli & Near concluded that the individual variable appears to not playing a critical role in the effectiveness of whistleblowing<sup>936</sup> because different whistleblowers act for various reasons or motives. As for the situational variable, Miceli & Near described the type of wrongdoing affects the effectiveness of whistleblowing; the reason is that when specific misconduct is important to the operation of some industries, it is crucial to affect the result of whistleblowing.<sup>937</sup> The organizational variable, which involves organizations' sizes, structures, cultures, and competitive pressure, causes a negative result on whistleblowers' disclosures. As the size of organizations is huge; the structure of organizations is rigid; the culture of organization is conservative; and competitive pressure is intense, retaliation imposed upon whistleblowers is predictable, and affects those employees to bring effective reports on misconduct.<sup>938</sup> Likewise, the dependence variable has a function to affect organizations' responses; however, Miceli & Near stated that it still has to observe the credibility of whistleblowers in organizations, and then decide the outcome of disclosure.<sup>939</sup>

In addition, when there is less restriction on employees to make a report in speci-

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<sup>935</sup> *Id.*

<sup>936</sup> *Id.* at 230.

<sup>937</sup> *Id.* at 230-31.

<sup>938</sup> *Id.* at 215-17.

<sup>939</sup> *Id.* at 231.

fic industries, there is a higher possibility that they will receive a positive response from organizations than those restricted to blow the whistle.<sup>940</sup> Miceli & Near assumed that employees not role-prescribed can make more effective disclosures than those restricted to report because they “were trusted to report wrongdoings ... when the circumstances were so egregious that the wrongdoing could not be ignored.”<sup>941</sup> In this situation, it is inferred that the credibility of employees allowed to report is much higher than that of role-prescribed employees for employers to make a disclosure on organizations’ misbehavior.

Besides making use of variables to discuss the effectiveness of whistleblowing, in employers’ points of view, they observe that the role of whistleblowers in the disclosure may affect their decisions to make the response. Miceli & Near state this point as follows:

“How the organization’s top managers view the alleged wrongdoing and the whistle-blowing incident will depend to a large extent on whether they see the whistle-blower as a dissident or a reformer, whether they view the whistleblowing as an attempt at overall organizational change, and whether this change is believed to be desirable. If executives see only the specifics of the particular whistle-blowing incident, they are likely to act to contain the damage and maintain organizational stability. If, on the other hand, they view it as an opportunity for positive reform, they may be more open to change.”<sup>942</sup>

Hence, the intent of whistleblowers is another factor for employers to consider if they

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<sup>940</sup> *Id.*

<sup>941</sup> *Id.*

<sup>942</sup> *Id.* at 228.

ought to make a positive or negative response to the disclosure. The effectiveness of whistleblowing will depend on whether employees' reports can be seen as useful suggestions or important concerns for organizations' future performance, and not merely arising from employees' meaningless complaints or personal reprisal on employers or organizations.

#### 5. Can Whistleblowers be Secured Completely under SOX Section 806?

Considering the Enron and WorldCom cases, could Watkins or Cooper have been shielded if SOX had been in force at the time of the scandals? Cooper did not suffer retaliation after reporting WorldCom's accounting irregularities, but she was blamed by her colleagues and got negative treatment in the workplace. As for Watkins, she probably would have been fired if Enron's financial frauds had not been disclosed to the public. Enron's top management might still have gone to the outside counsel to seek suggestions by which they could legally discharge Watkins with no penalty. Enron's management would have been more confident in firing Watkins when it knew that Texas common law had not adopted the whistleblower protection as its public policy. The retaliatory action imposed upon Watkins for reporting Enron's financial frauds would come to light, and Watkins could not have any channel to claim her allegations and compensate the losses she had suffered. Yet, this situation might have been different in SOX. SOX Section 806 precludes employers from discharging employees when

the protected activity occurs. Enron could not have fired Watkins as her disclosure was regulated under SOX.<sup>943</sup> Thus, the result of Watkins's action would be no longer dependent upon Texas's public policy, and corporate whistleblowing would have been protected in SOX Section 806.

Applying SOX, Enron might have been accused for retaliatory discharge in Section 806 if it had terminated Watkins or had imposed any adverse action upon her because of her disclosure.<sup>944</sup> Since a make-whole remedy is guaranteed by SOX, Watkins can relieve losses, no matter whether mental or physical harm, from Enron's retaliation.<sup>945</sup> Concerning the relief, SOX gives the administrative agency and courts a broad horizon to decide the type of remedy that can completely make up for Watkins' losses. In addition, SOX imposes criminal liability upon Enron when it violated the regulation banned by the statute. SOX Section 1107(e) provides "[w]hoever knowingly, with the intent to retaliate, takes any action harmful to any person ... for providing to a law enforcement officer ... relating to the commission or possible commission of any Federal offence, shall be ... imprisoned not more than 10 years ... ."<sup>946</sup> Therefore, Enron's management participating in discharging Watkins might have borne criminal charges under Section 1107(e) of SOX.

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<sup>943</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

<sup>944</sup> *Id.*

<sup>945</sup> *Id.*

<sup>946</sup> *Id.* § 1107 (codified at 18 U.S.C. § 1513 (2010)).

SOX modifies the employment-at-will doctrine in American employment relationship, and resolves the imbalanced power between employers and employees. Though, SOX still has some deficiencies because it merely applies to those violations that relate to limited frauds and securities laws.<sup>947</sup> Besides, incorrect recognition, narrow interpretation, and unclear standard made by the administrative agency decrease the effectiveness of SOX. Owing to these factors, the function of SOX Section 806 is restricted and cannot meet the statutory purpose as it was originally enacted.

SOX shields whistleblowers disclosing employers' misconduct about one or more of six types of securities laws, regulations, and SEC's rules. Not only does the violation have to be associated with these specific categories, but whistleblowing employees also have to reasonably believe that employers or companies have committed the prohibited violation. The regulated violations include:

- Mail fraud,<sup>948</sup>
- Wire fraud,<sup>949</sup>
- Banking fraud,<sup>950</sup>
- Securities fraud,<sup>951</sup>

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<sup>947</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

<sup>948</sup> 18 U.S.C. § 1341 (2010).

<sup>949</sup> 18 U.S.C. § 1343 (2010).

<sup>950</sup> 18 U.S.C. § 1344 (2010).

<sup>951</sup> 18 U.S.C. § 1348 (2010).



- Any rule or regulation of the Securities and Exchange Commission;<sup>952</sup> or
- Any provision of federal law relating to fraud against shareholders<sup>953</sup>

Once Moberly did research and found that few percentages of whistleblowers can win a prevailing order from the administrative procedure when claiming their allegations in SOX.<sup>954</sup> OSHA and ALJs dismissed their claims because whistleblowers could not prove employers' violations were concerning specific types of frauds or breaching specific rules, regulations, and laws.<sup>955</sup> The research described that OSHA and ALJs stated most whistleblowers' claims were in regarding to general fraud, accounting fraud, or other types of conduct, and those could not satisfy specific categories regulated by SOX.<sup>956</sup> Hence, because whistleblowers did not meet the requirement of the statute, their claims were not merited in the administrative procedure, and could not engage in the protected activity in SOX Section 806.

Considering the low winning rate of a preliminary order for employees in the administrative procedure, Moberly assumed that some factors probably cause this phenomenon. The first factor is in regard to the attitudes of OSHA and ALJs when addressing whistleblowers' claims. As he says:

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<sup>952</sup> Bucy, *supra* note 207, at 953.

<sup>953</sup> *Id.*

<sup>954</sup> Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 *Wm and Mary L. Rev.* 65, 113-14 (2007).

<sup>955</sup> *Id.* at 114.

<sup>956</sup> *Id.* at 115-17.

“This outcome [low rating of winning a preliminary order for employees] could reflect OSHA’s and ALJs’ reluctance to define broadly the categories of whistleblower disclosures that Sarbanes-Oxley will protect. These two categories of ‘fraud’ and ‘other’ misconduct could be characterized as the most amorphous and least bound by the specific statutory language of the Act.”<sup>957</sup>

The second factor is about the narrow interpretation of protected activities made by ALJs. Once Moberly took the *Grant* case<sup>958</sup> and the *Allen* case<sup>959</sup> for examples and stated:

“Examining specific ALJ cases qualitatively demonstrates that many ALJs interpreted the Act’s ‘protected activity’ requirement narrowly. ALJs required that whistleblowing employees draw a direct line between their disclosures of misconduct and the misconduct’s relationship to shareholder fraud. For example, in *Grant v. Dominion East Ohio Gas*, an ALJ found that an employee properly reported accounting irregularities and errors, but found that the employee did not engage in ‘protected activity’ because the employee was unable to tie these irregularities directly to active fraud on the shareholders. Similarly, the employees in *Allen v. Stewart Enterprises, Inc.*, reported to their supervisors several instances of faulty interest calculations, inconsistent and untimely refunds, and improper accounting involving cost recognition. The ALJ refused to find a ‘protected activity’ because the employees could not demonstrate that these errors and omissions in financial accounting and reporting were related to a broader scheme of intentional corporate fraud.”<sup>960</sup>

Last, Moberly pointed out that ALJs requested whistleblowers to prove which specific violation regulated by SOX that employers have committed. This requirement not only imposes extra burden that is not required under SOX upon employees, but also increases the difficulty for whistleblowing employees to win a prevailing order in the ad-

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<sup>957</sup> *Id.* at 117.

<sup>958</sup> *Grant v. Dominion E. Ohio Gas*, 2004-SOX-63, at 40-44 (ALJ Mar. 10, 2005).

<sup>959</sup> *Allen v. Stewart Enterprises, Inc.*, 2004-SOX-60, at 83-84 (ALJ Feb. 15, 2005).

<sup>960</sup> Moberly, *supra* note 954, at 117-18.

ministrative procedure. As Moberly describes:

“ALJs also demanded that employee whistleblowers specifically inform the recipient of a whistleblower disclosure that the illegal activity being reported violates one of Sarbanes-Oxley’s identified federal laws. Under this interpretation, rather than merely reporting activity that an employee reasonably views as illegal, the employee must have enough legal knowledge to tie that activity to a specific illegality identified by the Act.”<sup>961</sup>

Thus, as a result of extra requirement that ALJs impose upon employees, and the narrow interpretation made by OSHA and ALJs, whistleblowers cannot truly receive complete protection as Congress’s original expectation to enact this statute. The statutory language gives whistleblowing employees a hope to relieve losses from reporting corporate misbehavior, but the administrative agency reduces their passion to disclose the wrongdoing when they find a prevailing order is difficult to be granted, and the result is not as satisfactory as they expect.

In addition, whether private subsidiaries of public companies can be in the coverage of SOX Section 806 is still a dispute in the administrative procedure. This argument is observed by different decisions made by OSHA and ALJs on meritorious cases.

Moberly shows this point as follows:

“... the statutory language does not clearly set forth whether the Act applies to privately held subsidiaries of publicly traded companies. The ALJs focused on this ambiguity much more intensely than OSHA. In 41.7% of ALJ cases using the ‘not a covered employer’ rationale, ALJs found that an employer was not covered by the Act because it was a subsidiary of either a publicly traded company or a foreign company. By contrast, OSHA made this same determination at

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<sup>961</sup> *Id.* at 118.

about one-fourth the rate, 10%. Thus, the difference in usage of the ‘covered employer’ rationale between OSHA and the ALJs seems best explained by the difference in how these administrative decision makers evaluated private subsidiaries of public companies.”<sup>962</sup>

Soon after the passage of SOX, originally, ALJs adopted a broader application on Section 806. They agreed that the employees of privately-held companies can file a claim when they have named public parent companies as respondents.<sup>963</sup> Also, by virtue of the concept that tortfeasor is always liable to others’ injury, some ALJs held that when employees specifically allege public companies also participated in adverse employment actions with privately-owned entities, these public firms are liable for retaliation.<sup>964</sup> Further, making use of the idea of “corporation’s veil piercing,” a few ALJs even held that when private companies are “mere instrumentality” of public firms,<sup>965</sup> employees bearing retaliation are allowed to bring a cause of action against those public-companies as well.

However, these broad interpretations did not continue for a long time. Beginning in late 2004, ALJs started to apply a stricter application of covered employers regulated under SOX. Some ALJs dismissed employees’ claims because they did not specifically name public companies as respondents and added them beyond the regulated pe-

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<sup>962</sup> *Id.* at 110-11.

<sup>963</sup> *Morefield v. Exelon Servs., Inc.*, 2004-SOX-2, at 2-3 (ALJ Jan. 28, 2004).

<sup>964</sup> *Gonzalez v. Colonial Bank*, 2004-SOX-39, at 3 (ALJ Aug. 20, 2004).

<sup>965</sup> *Platone*, *supra* note 124, at 19.

riod.<sup>966</sup> Besides, some ALJs directly restrained the employees of private companies to file claims against employers, and declared that those claims were of no merit.<sup>967</sup> Most ALJs stated that if employees serving in private entities want to have a cause of action against employers, they will have no ground to support their claims<sup>968</sup> since SOX whistleblower protection only regulates public companies, not including private entities.<sup>969</sup>

Therefore, as a result of ambiguous statutory language in SOX and the uncertain standard in the administrative agency, these defects affect the effectiveness of the statute to protect employees retaliated against because of the disclosure or participation in the investigation on corporate securities violation. These obstacles have to be resolved, and it is urgent to restore employees' confidence in SOX Section 806. The reasons are that these employees not only show their ethical courage to make disclosures, but also devote themselves as whistleblowers against corporate corruption, and are sincere followers of the statute.

## *B. Empirical Critiques on the Whistleblower Protection under SOX Section 806*

### 1. Insufficient Protection in Practice

#### a. Low Rate of Winning in SOX Section 806

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<sup>966</sup> Bothwell v. Am. Income Life, 2005-SOX-57, at 15 (ALJ Sept. 19, 2005).

<sup>967</sup> Grant, *supra* note 958, at 33.

<sup>968</sup> Bothwell, *supra* note 966, at 10-13.

<sup>969</sup> *Id.*

Before going to federal district court to file a suit against employers in SOX, whistleblowers have to make use of the administrative procedure to settle claims beforehand. The administrative procedure of Section 806 is modeled on other federal whistleblower laws,<sup>970</sup> and it is the result after balancing the protection of whistleblowers' rights with due process and an expedited administrative proceeding.<sup>971</sup> Yet, those procedures do not have a direct correlation with a high rate of granting a prevailing order to whistleblowers. On the contrary, they rarely succeed in getting a satisfactory decision after filing a claim in OSHA and ALJs.<sup>972</sup> Because most claims will be dismissed in the administrative procedure, this situation not only affects the number of merited allegations, but also destroys employees' belief that they will be completely relieved for losses after the disclosure. As Dworkin states, "Despite the intended promotion and use of whistleblowing to help enforce Sarbanes-Oxley and deter wrongdoing in the securities market, the statutory scheme gives the illusion of protection without truly meaningful opportunities or remedies for achieving it."<sup>973</sup>

In addition, once Moberly stated the low rate of winning a whistleblower's claim in SOX Section 806 as follows:

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<sup>970</sup> Sarbanes-Oxley Act of 2002 § 806(b)(2), 18 U.S.C. § 1514A (b)(2).

<sup>971</sup> 29 C.F.R. §1980, §1980.105, §1980.106(b)(1), §1980.107, §1980.110 (2010).

<sup>972</sup> Practising Law Institute (PLI), *Understanding Developments in Whistleblower Law 2 years after Sarbanes-Oxley*, 87-90 (2005).

<sup>973</sup> Dworkin, *supra* note 227, at 1764.

“According to OSHA, of the 784 cases resolved at the initial investigative level ... OSHA investigators found only 17 to have merit, while another 106 cases settled. The percentage of meritorious and settled cases for Sarbanes-Oxley is slightly lower than the percentage of successful claimants for other whistleblower statutes administered by OSHA ... Moreover, of the 119 OSHA-level decisions that were appealed ... the Department of Labor’s Administrative Law Judges (ALJs) decided in favor of employees only 4 times, while another 19 settled.”<sup>974</sup>

Thus, whistleblowers probably have a hard time claiming allegations when they find OSHA or ALJs show no sympathy to their positions, and few resources can be granted for losses. Likewise, whistleblowing employees may feel hopeless when they lack of legal knowledge to file the claim, and have to face financial difficulties or other mental effects after being terminated.

#### b. Situations that Cause the Weakness of SOX Section 806

Concerning defects of Section 806, Moberly states some typical problems after observing the actual practice of SOX. He says:

“Yet Sarbanes-Oxley’s anti-retaliation provision suffers from significant limitations. The Act only protects employees of public corporations and only if such employees report violations of federal securities laws. Its statute of limitations period of ninety days is unreasonably short because it does not give employees enough time to deal with the after-effects of retaliation, consider their options, hire an attorney, and have the attorney investigate the merits of the case before filing a complaint. The remedies do not include any sort of punitive or liquidated damages to provide extra encouragement for whistleblowers. Finally, requiring employees to jump through OSHA’s administrative hoops before bringing a claim in federal district court can be cumbersome rather than expeditious, biased rather than expert, [and] ineffective rather than efficient.”<sup>975</sup>

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<sup>974</sup> Moberly, *supra* note 225, at 1128.

<sup>975</sup> *Id.* at 1127-28.

In addition to the problems of covered employees and limited securities violations to disclose, some scholars also mentioned other defects, and these will be studied in the later section. Here, however, I want to put emphasis on two points that I have not discussed before. These are inappropriate usage of OSHA as the dispute-resolver and the lack of incentive for employees to blow the whistle under SOX Section 806.

First, OSHA is not an expert to investigate the issue regarding securities violation. As Solomon notes:

“Little noticed, though, was that the new law [SOX] didn’t assign the job of protecting whistle-blowers to experts on financial malfeasance, such as the Securities and Exchange Commission. Instead, the task went to the Labor Department’s Occupational Safety and Health Administration.... But OSHA investigators are trained in health and safety issues, such as claims of retaliation for reporting faulty equipment or illegal dumping of chemicals. Now they were asked to understand sophisticated financial stratagems – a task whose difficulty is clear from the failure of regulators and investors to spot fraud at Enron, WorldCom and elsewhere for many years. How OSHA handles the whistle-blower assignment is crucial to efforts to improve corporate governance, because unless workers feel protected, many will keep quiet about improprieties they see.”<sup>976</sup>

Because the investigatory authority is delegated to OSHA, which is unsophisticated in financial frauds, not authorizing securities regulators to make an investigation,<sup>977</sup> it is an obstacle for the OSHA investigator to decide whether respondents violate securities laws or related frauds. As the investigator has no related legal knowledge and is un-

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<sup>976</sup> Solomon, *supra* note 615.

<sup>977</sup> Larry E. Ribstein, *Sarbanes-Oxley after Three Years*, University of Illinois Legal Working Paper Series (Nov. 16, 2005), available at <http://law.bepress.com/cgi/viewcontent.cgi?article=1031&context=uiuclwps>.



able to take the right step to start an investigation, it is highly possible that employees' claims will be alleged of no merit. In addition, the investigator's unfamiliarity of laws puts the health and safety of society in a risk when employers' violations get involved in public interest.

Second, SOX cannot give a reward to whistleblowing employees before they relieve losses in the administrative procedure when their disclosures are proved to be true afterward. As Kobayashi & Ribstein describe this point below:

“[W]histleblowers may lack adequate incentives to disclose the fraud. Someone must determine the amount of compensation the whistleblower should receive. This has been a problem under the Sarbanes-Oxley Act, where provisions against whistleblowing have been administered with little success by the oddly chosen Occupational Safety and Health Administration.... The whistleblower faces not only an uncertain recovery, but also the possibility of retaliation from which the law may not adequately protect. Moreover, the whistleblower may incur direct costs in uncovering wrongdoing for which she may not be reimbursed.”<sup>978</sup>

The lack of incentive for employees to blow the whistle is one of the deficiencies of anti-retaliation model under SOX Section 806. SOX encourages employees to report corporate misconduct and promises to compensate their losses completely; however, it cannot create a monetary stimulus for employees to become the active monitor of corporate corruption.<sup>979</sup> As employers' wrongdoings are detected, employees tend to balance self-interest and situations before blowing the whistle. In this circumstance, em-

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<sup>978</sup> Bruce H. Kobayashi & Larry E. Ribstein, *Outsider Trading as An Incentive Device*, 40 U.C. Davis L. Rev. 21, 67-68 (2006).

<sup>979</sup> Alford, *supra* note 286, at 108-13.

employees' positions to disclose are passive, not active. This condition not only has a great influence on employees' abilities to make a spontaneous report, but also decreases the chance to unveil employers' misbehavior.

In addition, several surveys have demonstrated that most employees have no idea whether they will be rewarded or not after reporting employers' wrongdoings.<sup>980</sup> This uncertainty not only influences employees' willingness to disclose corporate financial fraud, but ruins SOX's statutory purpose to strengthen employees' positions as internal monitors to deter the management's securities violation. Even if employees are aware that SOX protects their actions, they still worry if the outcome will meet their expectations of blowing the whistle; unclear protection pushes employees back off. Similarly, courts' inconsistent recognition on whistleblower statutes makes employees fear that their positions are not strong enough against employers.<sup>981</sup>

Because of these concerns, the monetary encouragement probably re-wins employees' passion for disclosing the management's misconduct. In this way, employees do not have to worry about uncertain compensation in the administrative procedure, but they are guaranteed to receive a reward as their reports are proved to be true after the disclosure.

## 2. What Are Pros and Cons of SOX Section 806?

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<sup>980</sup> Miethé, *supra* note 192, at 54.

<sup>981</sup> Stephen M. Kohn, *Concepts and Procedures in Whistleblower Law 79-80* (2001).

a. Pros of Section 806

In comparison to other federal whistleblower laws, the whistleblower provision in SOX has some breakthroughs on deterring corporate wrongdoing. First of all, SOX Section 806 broadens its protection to the employees who disclose corporations' violations on securities laws or related frauds. Before the passage of SOX, federal and state whistleblower laws simply allowed private sector employees to report organizational illegitimacy concerning the danger of the health and safety of the public.

<sup>982</sup> These statutes did not shield employees to report securities violations that may ruin the public market. At that time, the scope of the health and safety of the public was limited because corporate illegal activities in the financial market could not be perceived as a threat on public interest. SOX is the first statute that puts emphasis on the safety of the securities market. It provides remedies for employees who show their concerns on employers' misconduct that implicates the violation of federal securities laws or related frauds,<sup>983</sup> but suffer adverse employment actions taken by employers or public companies. Then, after the passage of SOX Section 806, the coverage of whistleblower laws does not merely protect the health and safety of the public; yet, it broadens the scope and reaches out to the safety of the financial market, which probably affects public interest as well.

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<sup>982</sup> Westman, *supra* note 159, at 61-79.

<sup>983</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

Second, SOX Section 806 gives protection to corporate employees who disclose or participate in the investigation on companies' financial frauds. Before the enactment of SOX, the operation of public firms is mostly supervised by the SEC and overseen by other gatekeepers, such as public accounting firms or law firms. Though, followed by the eruption of corporate scandals, like Enron or WorldCom, many people started wondering whether those outsiders can really have a function to deter corporate securities fraud. Since before corporate corruption broke out, external monitors depended too much on financial materials supplied by executives or subordinate managers, and the information was used to turning out to be false. Because of realizing this situation, Congress transferred its attention from external gatekeepers to corporate insiders to oversee securities violations. Congress found that corporate insiders are capable of accessing the information that the public hardly gets to know. Besides, insiders are much more familiar with corporate operation than others are, and are able to be the firsthand witness of corporate misbehavior. Therefore, SOX is the first statute that practices this policy, and provides protection for those companies' insiders who show their courage and bravely disclose corporate securities violation.

Third, SOX Section 806 extends the coverage by broadening the definition of employer, and provides a complete remedy for whistleblowing employees who suffer retaliatory actions after the disclosure. SOX restricts adverse actions taken by officers,

employees or agents of public companies, not just limits its application on employers.

<sup>984</sup> As regards the relief, not only can reinstatement, front pay, back pay, or other special damages be compensated for employees, but SOX also awards aggrieved employees the make-whole relief to make up for other losses. Take reinstatement for example. SOX gives an expedited reinstatement of employment after the OSHA investigator finds that the employee's allegation is merited. In addition to rapid recovery of career, the reinstatement in the preliminary order will be kept even if the respondent appeals to ALJ with the DOL.<sup>985</sup> Also, the reinstatement will not be stayed when the employee's claim is transferred to federal district court for a *de novo* review.<sup>986</sup> The reason for this immediate relief is that reinstating the whistleblower's position can strengthen employees' confidence in SOX; similarly, it can give a potential warning to corporate management that the influence of retaliatory action has decreased because employees can be relieved losses quickly in the administrative procedure. Hence, a complete remedy for employees, on the one hand, makes employees not worry about their losses after the disclosure; on the other hand, the relief probably dwarfs corporate employers' intentions to commit illegal activities, and deters these actions from harming shareholders' investments and the national economy.

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<sup>984</sup> *Id.*

<sup>985</sup> Sarbanes-Oxley Act of 2002 § 806(b)(2)(A), 18 U.S.C. § 1514A(b)(2)(A); 29 C.F.R. § 1980.105(a)(1) (2010).

<sup>986</sup> *Id.*

Fourth, SOX Section 806 adjusts imbalanced standard of burden of proof imposed upon whistleblowing employees compared with other whistleblower laws. SOX requires employees to show reasonable belief on employers' misconduct that breaches securities laws, regulations, SEC rules, or related frauds,<sup>987</sup> and simply needs them to prove allegations by a preponderance of evidence. Contrarily, in order to rebut employees' allegations, employers have to present clear and convincing evidence, the evidence producing "a firm belief or conviction,"<sup>988</sup> to verify that their actions did not come from retaliatory intent, but were the decisions after considering other factors to take adverse actions on whistleblowing employees. These factors probably include employees' unsatisfactory performance or employees' lack of qualification on their careers in the workplace.<sup>989</sup>

Fifth, by observing SOX Section 806, it seems that the statute only regulates public companies; however, this is not true. SOX covers its protection to contractors, subcontractors, and agents of publicly-held companies, and it is highly probable that these bodies are private entities.<sup>990</sup> Because a sequence of corporate scandals broke out in the beginning of this century, this regulation may infer that Congress was inclined to protect those employees who disclose corporate financial fraud, but are employed

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<sup>987</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A .

<sup>988</sup> Stone & Webster Eng'g Corp. v. Herman, 115 F.3d 1568, 1572 (11<sup>th</sup> Cir. 1997).

<sup>989</sup> 29 C.F.R. § 1980.103 (2010).

<sup>990</sup> Sarbanes-Oxley Act of 2002 § 806(a), 18 U.S.C. § 1514A(a).

by private companies, such as the accounting firm, the law firm, or the investment bank. In addition, as mentioned above, some decisions made by ALJs approved private subsidiaries of public firms are in the coverage of SOX.<sup>991</sup> Thus, it can be concluded that no matter whether companies that take adverse actions on whistleblowers are private or public, when employees name those companies as respondents together, these firms are subject to SOX whistleblower provision.

b. Cons of Section 806

i. Problem of Limited Period of Filing

Federal whistleblower statutes have diverse requirements for employees to file a claim against employers. These diversities not only can be found in filing limitation,<sup>992</sup> but also can be shown by different period of investigation.<sup>993</sup> The role of limited period for filing and investigation, on the one hand, helps the administrative agency to determine whether employees' claims have been beyond the filing period and are still in a merit, and meets the requirement of expedited administrative procedure. On the other hand, it assists employees in knowing whether their rights are st-

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<sup>991</sup> *Morefield, supra* note 963.

<sup>992</sup> See Occupational Safety and Health Act (OSHA) of 1970, 29 U.S.C. § 660(c) (2010) (30 days); International Safe Container Act of 1977, 46 U.S.C. § app. 1506 (60 days); Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (90 days); Clean Air Act of 1955, 42 U.S.C. § 7622 (2010) & 29 C.F.R. § 24 (2010) (180 days).

<sup>993</sup> See International Safe Container Act of 1977, 46 U.S.C. § app. 1506 (30 days); Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A (60 days); Occupational Safety and Health Act (OSHA) of 1970, 29 U.S.C. § 660(c) (2010) (90 days).

ill legally protected under SOX or not. Hence, it might be said that the limited period benefits both the administrative agency and the employee because of its function of reviewing and reminding.<sup>994</sup>

The purpose of the limited period concerns the issue of balanced interest between employers and employees. As Ramirez describes:

“In selecting an appropriate statute of limitations for an omnibus statute, tension exists between the interests of the employee and the employer. An employer may prefer a shorter time period, such as the ninety-day period, because it protects the general ‘at-will’ nature of the employer-employee relationship and permits a claim to be investigated while the actions prompting the claims are still fresh in the minds of the witness. Yet, for the employee, ninety days may not be enough time to realize that an adverse employment action is based upon the whistleblowing activity of the employee.”<sup>995</sup>

Employers and colleagues prefer whistleblowing employees’ claims to be resolved as soon as possible because these complaints affect the harmonious working atmosphere, and damage the trust that has been built among employers, employees, and coworkers.<sup>996</sup> The disrupted trust is difficult to restore and can indirectly influence future business performance.<sup>997</sup> By contrast, employees prefer a longer period to file a claim since they need more time to access confidential information and potential witnesses, to investigate suspected activities, and to sustain a stable financial source to support the litigation. The purpose of employees’ preparation is to establish sufficient ground ag-

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<sup>994</sup> *Walker, supra* note 783; *EEOC v. United Parcel Serv. Inc.*, 249 F.3d 557, 561-62 (6<sup>th</sup> Cir. 2001).

<sup>995</sup> Ramirez, *supra* note 222, at 217.

<sup>996</sup> Scammell, *supra* note 173, at 35, 135, 146-47.

<sup>997</sup> *Id.*



against employers' retaliation because of their disclosures or participation in the investigation on corporate securities violation.

Observing the limitations in SOX Section 806, these designs have been criticized by legal scholars and employees who had filed their claims under SOX. Ordinarily speaking, there are two complaints about the limited period. The first one is regarding the limited period on filing employees' claims to OSHA. SOX requires employees to "file a complaint with the Secretary of Labor within 90 days after the date on which the violation occurs."<sup>998</sup> The day to start calculating regulated period is after the retaliation occurs, not after the retaliation is discovered or felt.<sup>999</sup> This regulation has several defects because it is difficult for employees to find out when the first day of the retaliation happens if they are not the decision-maker of adverse actions. In addition, even if the specific day has been known, and the retaliation is discovered in three months, this short filing period still cannot give employees enough time to decide whether to become the whistleblower of corporate misconduct, and to file a claim against employers.<sup>1000</sup>

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<sup>998</sup> Larry Cata Backer, *Symposium Enron and Its Aftermath: The Sarbanes-Oxley Act: Federalizing Norms for Officer, Lawyer, and Accountant Behavior*, 76 St. John's L. Rev. 897, 940 (2002) (citations omitted).

<sup>999</sup> Sarbanes-Oxley Act of 2002 § 806(b)(2)(D), 18 U.S.C. § 1514A(b)(2)(D).

<sup>1000</sup> John B. Chiara & Michael D. Orenstein, *Whistler's Nocturne in Black and Gold-the Falling Rocket: Why the Sarbanes-Oxley Whistleblower Provision Falls Short of the Mark*, 23 Hofstra Lab. & Emp. L.J. 235, 253 (2005).

The second criticism is that these fixed timelines are unable to be totally followed by the DOL. The regulation requests employers to meet with OSHA and to present sufficient evidence to rebut employees' allegations in twenty days after receiving the complaint.<sup>1001</sup> As the OSHA investigator finds that employees' allegations are merited and awards them a preliminary order,<sup>1002</sup> employers still have ten days to strengthen their positions after receiving a notification of the order from OSHA. In order to overturn the order, employers can present more persuasive evidence<sup>1003</sup> against OSHA's preliminary order granting the relief for employees.<sup>1004</sup> However, in reality, these timelines are not entirely enforced by the DOL.<sup>1005</sup> The DOL's noncompliance with regulated timeline not only affects an expedited administrative procedure, but also destroys balanced interests that have been set up by the administrative agency for employers and employees. If extra time is allowable in the administrative procedure, the beneficial consequence probably go to employers, not employees. These extensions will cause potential harm to employees because they are likely to be discharged at that time, and hope the immediate remedy can support their unemployed lives and relieve other hefty expenses that arise from later litigation.

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<sup>1001</sup> 69 Fed. Reg. 52 (Jan. 2, 2004); 69 Fed. Reg. 106 (Jan. 2, 2004).

<sup>1002</sup> 69 Fed. Reg. 52 (Jan. 2, 2004); 69 Fed. Reg. 107 (Jan. 2, 2004).

<sup>1003</sup> *Id.*

<sup>1004</sup> *Id.*

<sup>1005</sup> *Getman, supra* note 848 (Final Decision & Order approximately two years after initial complaint).

## ii. Issue of Burden of Proof

Employees and employers bear the burden of proof to verify their allegations and to rebut opponents' complaints in SOX. For employees, originally, they have to prove their claims are justifiable by the preponderance of evidence.<sup>1006</sup> When the OSHA investigator finds their claims are merited, the burden-shifting is occurring and turning to employers to stand their positions.<sup>1007</sup> For employers, in order to rebut employees' allegations, they have to use clear and convincing evidence to show that they would have taken the same action even though there is no protected activity.<sup>1008</sup> If employers succeed to defend employees' arguments, employees have to ultimately bear the burden of proof by the preponderance of evidence, and to show that employers' reasons are pretexts and should not be relied on.<sup>1009</sup>

Although employees bear a lower standard of burden to claim their allegations, some statistics still showed that employees have a frustrating rate of winning a preliminary order from OSHA. As Moberly describes this point as follows:

“... despite having every advantage regarding the burden of proof for causation, employees still lost at an extremely high rate at the OSHA Level, ... OSHA found that an employee satisfied the ‘contributing factor’ standard only 30.6% of the time. When the employee met this level of proof, placing a ‘clear and convincing’ burden of proof on the employer still resulted in a relatively low emplo-

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<sup>1006</sup> Sarbanes-Oxley Act of 2002 § 806(b)(2)(C), 18 U.S.C. § 1514A(b)(2)(C).

<sup>1007</sup> *Id.*

<sup>1008</sup> *Id.*

<sup>1009</sup> *Halloum, supra* note 111, at 13, 21.

ye win rate of 35.1%. Overall in these ‘causation’ cases, employees won only 10.7% of the time at the OSHA Level ....<sup>1010</sup>

Though, if the intent of Congress to enact SOX was to encourage employees to bravely disclose employers’ misconduct, and to establish a friendly framework for them to report, why do employees still have a hard time claiming their allegations and cannot be relieved for their losses in the administrative procedure? In order to clarify this confusion, two issues have to be scrutinized.

The first issue is with regard to the possibility that there is no precedent case for employees to follow.<sup>1011</sup> Before filing a claim against employers, employees may refer to others’ cases in which those people also suffered similar adverse actions by employers. These cases not only can help employees to know what evidence may be helpful for preparing their claims, but can provide them simulated situations to think about strategies of defense when similar conditions come to them. Precedent cases have a function of giving whistleblowing employees illustrations for reference. Even if past cases are not exactly the same as present cases, employees still can make use of similar factors or situations to persuade the dispute-resolver that their allegations are merited, and what they suffered is worth being relieved and protected.<sup>1012</sup> As regards the method of proof, courts are inclined to use direct evidence or circumstantial evidence

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<sup>1010</sup> Moberly, *supra* note 954, at 144.

<sup>1011</sup> Watnick, *supra* note 95, at 866-68.

<sup>1012</sup> *Desert Palace*, *supra* note 122.

to decide which party has a meritorious claim. Direct evidence is the evidence that “if believed, proves the existence of a dispute without inference or presumption.”<sup>1013</sup> As for circumstantial evidence, it can be made by various presumptions to indirectly prove the reality of claims. These inferences are exemplified by disparate treatment,<sup>1014</sup> work performance,<sup>1015</sup> or antagonism to protected activities.<sup>1016</sup> However, above advantages will be useless if precedent cases are not available for employees at the time as they decide to file a claim against employers in SOX Section 806. In this way, not only do employees have no reference to make a persuasive allegation before OSHA, but it is difficult for them to rebut employers’ reasons that are proved by clear and convincing evidence to impose legitimate adverse actions upon employees.

The second dispute is that it is much easier for employers to present a legitimate, non-discriminatory reason and to conceal their actual intent to make the adverse action.<sup>1017</sup> The reason is that employers have incomparable authority on business matters. Employers hold managerial power to make corporate policies, to control potential risks, and to evaluate employees’ working performance. In addition, employers have the right to decide whether to continue or end the employment relationship. They can ma-

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<sup>1013</sup> Kohn et al., *supra* note 220, at 63.

<sup>1014</sup> *Viracon, Inc., v. NLRB*, 736 F.2d 1188, 1192 (7<sup>th</sup> Cir. 1984).

<sup>1015</sup> *Ellis Fischel State Cancer Hosp. v. Marshall*, 629 F.2d 563, 566 (8<sup>th</sup> Cir. 1980).

<sup>1016</sup> *Housing Works, Inc. v. City of New York*, 72 F. Supp. 2d 402 (1999).

<sup>1017</sup> *Watnick, supra* note 95, at 867.

ke a decision to retain or to discharge employees and have more resources to find employees' faults in their duties.<sup>1018</sup> By contrast, employees' allegations are not easy to be proved because of limited resources and inadequate witnesses' testimony. Witnesses, most of employees' colleagues, tend to stand with employers since they fear of irritating and being retaliated against by employers. Likewise, these coworkers are unwilling to breach the duty of loyalty to organizations they serve, and are afraid of creating an illusion that they are also the whistleblower or the assistants of whistleblowing. Then, even if whistleblowing employees bear a lower standard of burden to file a claim in SOX, they still have a hard time rebutting employers' reasons for adverse actions. Not only may employees lack precedent cases to support their allegations and have inadequate resources to assist them in filing a persuasive claim, but the imbalanced power in the employment relationship makes employees more difficult to argue employers' actions lack of justification, and contend their excuses are simple pretexts for retaliation.<sup>1019</sup>

### iii. Mandatory Arbitration Agreement<sup>1020</sup>

The attitude of the U.S. Supreme Court toward a mandatory arbitration agreement upon resolving employment disputes has changed from negative to po-

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<sup>1018</sup> *Id.*

<sup>1019</sup> Taylor v. Wells Fargo, Tex., 2005 DOLSOX LEXIS 7, at 35-36. (Feb. 14, 2005).

<sup>1020</sup> The evolution of the U.S. Supreme Court's attitude toward mandatory arbitration agreement refers to Cherry, *supra* note 92, 1076-78.

sitive. The Court tended to not enforce these contracts before the early 1990s;<sup>1021</sup> however, nowadays, this insistence is not being kept anymore, and the Court favors those mutual agreements to solve a variety of employment arguments that happen in the workplace.<sup>1022</sup>

In the *Alexander* case, the Court held that even though the plaintiff participated in a collective bargaining agreement before the dispute occurred, he still retained the right to request for a hearing about race discrimination under federal courts.<sup>1023</sup> The Court noted that depriving the plaintiff's independent statutory right of filing a claim to the administrative agency or suing in courts not only will influence the administrative agency's function to resolve employment disputes, but also may weaken the individual litigant's role as a private attorney general for achieving the purpose of statutes.<sup>1024</sup> Besides, after comparing with statutory litigation and arbitration, the Court concluded that exclusive arbitration procedures are inappropriate to resolve statutory claims since these procedures may violate statutory purposes.<sup>1025</sup> Further, the Court stated that some defects of private arbitration contracts, such as limited discovery, the inapplicability of the rules of evidence, and the informality of arbitration proceedings,

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<sup>1021</sup> *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 48 (1974).

<sup>1022</sup> *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 119, 123 (2001).

<sup>1023</sup> *Alexander*, *supra* note 1021, at 59-60.

<sup>1024</sup> *Id.* at 44-45.

<sup>1025</sup> *Id.* at 56-60.

will impede the statutory plaintiff to completely relieve his/her losses in the arbitration.<sup>1026</sup> Further, the Court pointed out that the arbitrator in the *Alexander* case was ineligible to be the dispute-resolver because he lacked “general authority to invoke public laws that conflict with the bargain between the parties,”<sup>1027</sup> and his limited knowledge did not allow him to resolve the employment discrimination issue.<sup>1028</sup> Thus, the Court was inclined to show a negative attitude toward exclusive arbitration on the statutory employment claim.

However, in the *Gilmer* case, the Court changed its attitude toward the mandatory arbitration clause, and held that this agreement is enforceable and can be an exclusive remedy for employment disputes.<sup>1029</sup> Although *Gilmer*’s decision was contrary to the *Alexander* case, the *Gilmer* Court did not overturn *Alexander*’s decision because the facts of these two cases were different. The *Gilmer* Court reasoned that *Alexander*’s decision was sustained because it related to collective bargaining agreements.<sup>1030</sup> The *Alexander* Court addressed the dispute that a union restricted the plaintiff’s statutory rights,<sup>1031</sup> but not involving a contract with an individual employee, such as *Gil-*

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<sup>1026</sup> *Id.* at 57-58.

<sup>1027</sup> *Id.* at 53.

<sup>1028</sup> *Id.* at 57.

<sup>1029</sup> *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 23 (1991).

<sup>1030</sup> *Id.* at 35.

<sup>1031</sup> *Id.*



*mer.*<sup>1032</sup> Thus, the *Gilmer* Court agreed that private arbitration contracts can resolve employment claims and did not hold that these contracts are banned from applying to employment disputes. Until the *Circuit City Stores* case, the Court definitely agreed the validity of mandatory arbitration in employment disputes,<sup>1033</sup> and stated that “arbitration agreements can be enforced ... without contravening the policies of congressional enactment giving employees specific protection against discrimination prohibited by federal law ... .”<sup>1034</sup> Hence, the support of mandatory arbitration agreements is certified, and no one suspects the role of private arbitration contracts to resolve employment issues.

As observed above, the U.S. Supreme Court’s attitude toward pre-dispute arbitration contracts transferred from suspicion to encouragement, and this transformation brings advantages to settle employment disputes. By the assistance of private arbitration agreements, on the one hand, courts reduce their pressure to resolve considerable volumes of employment claims;<sup>1035</sup> on the other hand, arbitration contracts make employers and employees have freedom to decide which dispute resolution is best for their situations. Arbitration contracts not only promote the efficiency of resolving empl-

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<sup>1032</sup> *Id.* at 23.

<sup>1033</sup> *Circuit City Stores*, *supra* note 1022, at 109.

<sup>1034</sup> *Id.* at 123.

<sup>1035</sup> John J. Donohue, III & Peter Siegelman, *The Changing Nature of Employment Discrimination Litigation*, 43 *Stan. L. Rev.* 983, 985 (1991).

oyment disputes, but also save costs in future litigation.

Even if mandatory arbitration contracts put emphasis on the advantages of promoting efficiency, the freedom of contract, and fairness, other disadvantages still cannot be ignored when applying private arbitration on employment issues. As Cherry describes "... many of the problems associated with mandatory arbitration: perceived employer bias; fewer options available to the employee regarding where to bring suit; and limitations on discovery."<sup>1036</sup> Similarly, Watnick mentions "... applying ... mandatory arbitration agreements ... weakens employee positions because arbitration generally favors employers."<sup>1037</sup> These defects affect employees' rights to receive a fair judgment, and show significant imbalanced power between employees and employers on making the contract. Cherry shows the argument upon the efficiency of arbitration contracts as follows:

"... many of the arguments contending that employees ... benefit from efficiency savings are not compelling. If it would really be in an employee's 'best interest' to enter into a pre-dispute mandatory arbitration contract, then employees would not be contesting these contracts in courts around the country, claiming they are unfair and against public policy. Furthermore, if mandatory pre-dispute arbitration contracts really are in the interests of employees, then employers would not have to impose the arbitration clause ex ante, before a dispute arose. Rather, if it really were in an employee's best interest to use arbitration, the rational employee would seek binding arbitration after a dispute arises."<sup>1038</sup>

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<sup>1036</sup> Cherry, *supra* note 92, at 1076.

<sup>1037</sup> Watnick, *supra* note 95, at 873.

<sup>1038</sup> Miriam A. Cherry, *Not-So-Arbitrary Arbitration: Using Title VII Disparate Impact Analysis to Invalidate Employment Contracts that Discriminate*, 21 Harv. Women's L.J. 267, 278 (1998).

Thus, the efficiency of arbitration contracts does not actually take employees' interests into account; contrarily, it stands on employers' side to determine which method is best for employees. The rationale of arbitration contracts is based on employers' active positions to control all aspects of employment relationship, and is not established by an equal, mutual, and non-discriminative foundation.

In addition, Cherry criticized the concept of freedom of contract on the mandatory arbitration agreement as well. As she says:

“... at present there is very little ‘freedom’ of choice involved in most arbitration contracts, which in reality are little more than contracts of adhesion. At the time of contracting, an employee is relatively powerless to negotiate the terms of employment, especially in regard to these arbitration clauses. Employers may unilaterally dictate that the arbitration program in their form contracts not be subject to modification. Even if an employee is made fully aware of the differences between arbitration and a trial by a jury of her peers, it is unlikely that she would be able to negotiate different terms.”<sup>1039</sup>

In this way, if one party has no right to negotiate the terms of contracts, this may violate the spirit of freedom of contract, which authorizes both parties to reach a satisfactory agreement by themselves. When the terms of contracts are controlled by the powerful side, not only may the weak party suffer unanticipated damage when the dispute occurs, but those unequal consequences also cannot be adjusted by courts or other authorized administrative agencies later.

Concerning the issue of fairness, employees who sign mandatory arbitration con-

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<sup>1039</sup> *Id.* at 278-79.

tracts probably suffer discrimination by the gender or ethics of arbitrators.<sup>1040</sup> The diversity of arbitrators affects the outcome of arbitration, and employees have nothing to do with this. After all, employers are inclined to select groups or persons they favor as arbitrators, and hope that those bodies will make a prevailing decision on employees' business or interests as well. Employers will not mandate those jobs to others who antagonize capitalism and tend to show sympathy to weak parties, such as employees. Besides, employees' positions may be easily impaired by limited discovery in mandatory arbitration agreements. As Cherry states this concept below:

“Limited discovery usually works to disadvantage employment discrimination plaintiffs because these plaintiffs bear the burden of persuasion while at the same time are usually the party with less information. These discovery restraints deprive plaintiffs of the opportunity to make their own choice of how much time and money to spend on the discovery process, within the limits sanctioned by the courts.”<sup>1041</sup>

Unlike a complete, systematic investigation made by authorized administrative agencies or courts, the procedures of arbitration have limited time, labor, and money to totally understand the disputed issue. Arbitration having limited resources on the investigation not only affects employees' rights on finding the truth, but also decreases the possibility that employees may have sufficient ground to win a prevailing decision from an arbitrator.

Consider SOX Section 806, even though SOX gives whistleblowing employees

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<sup>1040</sup> *Id.* at 280-81.

<sup>1041</sup> *Id.* at 282.

the make-whole relief to make up for their losses,<sup>1042</sup> several whistleblower cases still did not go to the administrative agency and courts, but were sent to arbitration for being settled.<sup>1043</sup> The reason is that SOX does not expressly forbid the usage of arbitration contracts to resolve whistleblowing disputes.<sup>1044</sup> This defect indirectly allows employers to insert a provision of mandatory arbitration in the prospective employment contract and to circumvent SOX's regulations. In addition, the attitude of U.S. Supreme Court that supports private arbitration to resolve employment issues increases the prevalence of arbitration contracts. Therefore, inferior courts are supposed to follow the Court's decision and employ this presumption to resolve whistleblowing disputes.<sup>1045</sup> This consequence seriously weakens the function of SOX Section 806 that not only to protect employees from bearing adverse actions because of the disclosure, but also to assist employees in relieving their losses by an impartial, expedited administrative procedure.

#### iv. Narrow Recipient of Disclosure

In SOX, it is allowable for whistleblowing employees to report to federal regulatory or law enforcement agency, to any member or a committee of Congr-

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<sup>1042</sup> Sarbanes-Oxley Act of 2002 § 806(a), 18 U.S.C. § 1514A(a).

<sup>1043</sup> Cherry, *supra* note 1038, at 269.

<sup>1044</sup> Cherry, *supra* note 92, at 1080.

<sup>1045</sup> *Gilmer*, *supra* note 1029; *Circuit City Stores*, *supra* note 1022, at 109.

ess, or to a person having supervisory authority in the public company.<sup>1046</sup> As the legislature considered the recipient of disclosures under SOX Section 806, it had balanced the conflict of interest among related parties. Dworkin & Callahan state this point as follows:

“Principled policymaking regarding whistleblowing outlets requires the balancing of competing interests: the employee’s interest in reporting wrongdoing without penalty, the organization’s interest in maximizing control and efficiency, and society’s interest in encouraging lawful behavior and public accountability. Decisions regarding the appropriateness of outlets are crucial to the interests of the parties involved, because they determine who can act upon the information, when and how a remedial or punitive response may be made, and whose interests are furthered or impaired.”<sup>1047</sup>

When the scope of recipient is broad for employees to make a disclosure, it is highly probable that employees’ claims would not be dismissed in the administrative procedure, and their losses could be compensated easily from the administrative agency or courts. Likewise, the broad scope of recipient prevents public good from being damaged by potential threats of corporate misbehavior since the disclosure will not be blocked by specific groups or respondents easily. On the contrary, as the recipients of disclosures are confined, the influence of unveiling corporate wrongdoing is restricted. In this time, it can be inferred that employers will take the priority position to control the result of retaliation and organizations’ misbehavior, and employees cannot do anything about that.

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<sup>1046</sup> Sarbanes-Oxley Act of 2002 § 806(a)(1), 18 U.S.C. § 1514A(a)(1).

<sup>1047</sup> Dworkin & Callahan, *supra* note 232, at 268.

The broad scope of recipient benefits employees to report corporate misconduct. However, federal and state whistleblower statutes are inadequate to shield whistleblowing employees since these statutes put many restrictions on reporting requirements. They confine the scope of recipient, and if employees report beyond this scope, their claims will be dismissed and be regarded as no merit cases. Because of this limitation, when employees observe employers' illegal actions and realize their rights of blowing the whistle,<sup>1048</sup> they may feel frustrated as finding that the recipient whom they report is not regulated under the statute.<sup>1049</sup> The narrow scope of recipient not only hampers employees to show concerns on employers' misconduct, but it also hinders the public from accessing confidential information about actual corporate operation and financial conditions.<sup>1050</sup>

Before making a decision to blow the whistle, employees are inclined to take different issues into account. One of these issues is about the selection of reporting recipients. As Sinzdak notes:

“ ... because employees are generally unaware of whistleblower rights, their selection of a report recipient is primarily driven by practical considerations. These considerations include the type and significance of the alleged misconduct, the employee's status within the organization (both in terms of experience and position), the organizational status of the wrongdoers, the organization's culture,

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<sup>1048</sup> Michael Kane, *Whistleblowers: Are They Protected?*, 20 Ohio N.U.L. Rev. 1007, 1025 (1994).

<sup>1049</sup> *Collier*, *supra* note 573, 1122-24.

<sup>1050</sup> *Id.* at 1121-27.

and the fear of retaliation.”<sup>1051</sup>

As mentioned above, several variables, such as individual predictors or situational predictors, have a significant impact on employees to make an effective disclosure.<sup>1052</sup>

Therefore, employees have to consider several factors to determine which outlet is proper in their situations to report corporate irregularities. These factors are exemplified by the seriousness of wrongdoing, the extent of illegal activities that public firms rely on to survive, the position of wrongdoer, corporate cultures, and an employee’s credibility of being a whistleblower. When the broader scope of recipient can be selected, not only is it easier for employees to find a suitable channel to present their concerns, but it is highly probable that employees will make a successful disclosure and deter employers’ illegal conduct.

Thus, in the premise of good-faith whistleblowing, when reporting to other recipients fails to receive a satisfying result, extending the scope of recipient to the media and Internet as a last resort can promote the statutory purpose of SOX.<sup>1053</sup> Generally speaking, employees thinking that they can rectify wrongdoings may choose internal disclosure to show their concerns and right the mistake.<sup>1054</sup> On the contrary, powerless employees, like a newcomer, rarely get support to blow the whistle since they have

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<sup>1051</sup> Sinzdak, *supra* note 674, at 1661.

<sup>1052</sup> Concerning variables, please refers to p.179-84.

<sup>1053</sup> Making use of the media or the Internet as one of the recipients in SOX will bring another concern of balancing interests; this part can refer to p.206.

<sup>1054</sup> Elliston et al., *supra* note 216, at 133-38.



not had “idiosyncrasy credits” in organizations.<sup>1055</sup> Hence, their credibility on disclosures probably is devaluated and will not be recognized by supervisors.<sup>1056</sup> Besides, another deficiency for fresh employees is that they are more unfamiliar with reporting channels than others who have served in organizations for a long time.<sup>1057</sup> In this way, it is hard for fresh employees to generate changes and timely put organizations’ misconduct back on the right track. Moreover, the status of employees will affect their abilities to make a credible disclosure.<sup>1058</sup> Some factors that can weigh the status include the pay level, job performance, supervisory or professional status, the importance of the career, and role prescription.<sup>1059</sup> Also, special knowledge and skills held by employees are able to heighten their statuses in organizations. The reasons are that expertise is not only a requisite asset for organizations’ operation, but it also lets employees’ opinions or advice more persuasive and credible to supervisors when making a disclosure by in-house channels.<sup>1060</sup>

Since fresh, low-level, or non-professional employees lack the power to influence the change, these employees are likely to be a group that prefers making an extern-

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<sup>1055</sup> Miceli & Near, *supra* note 100, at 118.

<sup>1056</sup> Janet P. Near et al., *Explaining the Whistleblowing Process: Suggestions from Power Theory and Justice Theory*, 4 *Org. Sci.* 393, 403 (1993).

<sup>1057</sup> Miceli & Near, *supra* note 100, at 117.

<sup>1058</sup> *Id.* at 67.

<sup>1059</sup> *Id.* at 124-28.

<sup>1060</sup> *Id.* at 198-99.

al disclosure, such as making a report to the media or by Internet.<sup>1061</sup> Other employees' motives to disclose to the media are because not only it can rapidly respond to their concerns, but it also can increase the credibility of their information and effectively rectify corporate irregularity.<sup>1062</sup> Besides powerless employees regard external disclosure as their priority, sophisticated employees tend to take the same step as well.<sup>1063</sup> Because of the experiences of making reports, these employees know no matter whether the disclosure is to the management or governmental institutions, there are several defects that will affect the effectiveness of whistleblowing. Yet, disclosing to the media, their concerns will not be ignored; also, they are able to receive meaningful responses as their feedbacks, and may not be treated as annoying complainants in the workplace again.<sup>1064</sup>

However, when considering the question if SOX allows powerless employees to present concerns to the media or Internet, the answer is frustrating and negative. Observing other federal whistleblower statutes, only the False Claims Act (FCA) permits employees to use the media as one of external outlets to make a disclosure.<sup>1065</sup> Thus, since many factors have set up an obstacle for employees to report, SOX should broa-

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<sup>1061</sup> Callahan & Dworkin, *supra* note 103, at 164-65.

<sup>1062</sup> *Id.*

<sup>1063</sup> *Id.* at 167.

<sup>1064</sup> *Id.*

<sup>1065</sup> False Claims Act, *supra* note 169.

den its scope of recipient because this decreases any possibility that dwarfs the function of SOX Section 806.

v. Internal Reporting should be Previous to External Reporting

In SOX, whistleblowing employees are able to disclose internally to the person who has supervisory authority in the public company, or can report externally to federal regulatory or law enforcement agency, or to a member or any committee of Congress. Even though SOX Section 806 allows employees to disclose corporate securities violation either internally or externally, SOX still has to add a provision, which expressly requires that internal disclosure should be previous to external one. It means that whistleblowing employees are required to exhaust the internal channel for presenting their concerns before going to employ the external one. For companies, this policy is good for them because internal disclosure not only reduces potential damage to companies, but it also avoids the collapsed employment relationship happened among employers, employees, and colleagues. One time, Dworkin described the similar concept as follows:

“Benefits of internal whistleblowing include facilitating the prompt investigation and correction of wrongful conduct and minimizing the organizational costs of whistleblowing by permitting employers to rectify misconduct confidentially, with little disruption to the employer-employee relationship. Internal whistleblowing also enables the correction of misunderstanding, which reduces the likelihood that the organization and its employees will unfairly suffer harm.”<sup>1066</sup>

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<sup>1066</sup> Dworkin, *supra* note 227, at 1760.

Hence, it may be concluded that corporate whistleblowers can bring a good consequence to companies when they are persuaded to employ internal outlets to make a disclosure.<sup>1067</sup> Internal disclosure not only gives employers an opportunity to correct wrongdoing and timely put companies' misconduct back on the right track, but it also reduces the possibility that companies would suffer the loss of reputations on business as a result of employees' external reports. In addition, disclosing to internal recipients decreases the pressure of corporations to prepare for future litigation and avoids those lawsuits from disseminating confidential business information. As a court notes this point below:

“The requirement promotes the purpose ... by affording the employer the first opportunity to correct a violation. This allows the employer to avoid, among other things, unnecessary harm to its reputation, the burden of undergoing an investigation and preparation for a hearing or trial.”<sup>1068</sup>

Sometimes, the reason for employees to make a report may result from erroneous judgment on employers' behaviour or from the disagreement on ethical standards, not actually from employers' violations of law.<sup>1069</sup> Hence, since there might be no violation, internal whistleblowing assists employers in clarifying the misunderstanding and gives employers more chances to communicate with employees regarding corporate ethi-

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<sup>1067</sup> Terry Ann Halbert, *The Cost of Scruples: A Call for Common Law Protection for the Professional Whistleblower*, 10 Nova L.J. 1, 17 (1985).

<sup>1068</sup> Potomac Sys. Eng'g Inc., v. Deering, 683 So. 2d 180, 182 (Fla. Dist. Ct. App. 1996).

<sup>1069</sup> Terry Morehead Dworkin & Janet P. Near, *Whistleblowing Statutes: Are They Working?*, 25 Am. Bus. L.J. 241, 243 (1987).

cal practices.<sup>1070</sup>

Further, Dworkin & Near mention another advantage of internal whistleblowing, and say:

“... internal reporting would prevent the negative publicity, investigations, and administrative and legal actions that usually ensue after external whistleblowing. It also would give the company an opportunity to prevent the more serious consequences of continued wrongdoing, and thus to diminish the likelihood of punitive damages for such wrongdoing. Finally, a proper company response to the internal whistleblower could also prevent the negative consequences to the work environment and the whistleblower that almost inevitably follow external whistleblowing.<sup>1071</sup>

Thus, internal whistleblowing can reduce the chance that companies will be investigated by outsiders. It prevents confidential information from leaking to the public or to business competitors. When employers receive employees' arguments about corporate illegal activities, they are capable of examining the authenticity of complaints beforehand and correct misconduct in time. These early actions avoid the intervention of government, and reduce the likelihood that the public will criticize corporate wrongdoing.<sup>1072</sup> In addition, these actions save the expenditure of companies for future litigation,<sup>1073</sup> avoid administrative fines and judicial criminal sanctions, or other adverse co-

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<sup>1070</sup> *Id.*

<sup>1071</sup> *Id.* at 242.

<sup>1072</sup> Callahan et al., *supra* note 215, at 882, 904-06.

<sup>1073</sup> Robert G. Vaughn et al., *The Whistleblower Statute Prepared for the Organization of American States and the Global Legal Revolution Protecting Whistleblowers*, 35 *Geo. Wash. Int'l L. Rev.* 857, 868 (2003).

nsequences.<sup>1074</sup> As for employees, internal report prevents them from being punished by companies due to the breach of duty of loyalty;<sup>1075</sup> likewise, they may suffer less retaliation from the management when deciding to make an internal disclosure, not an external one.<sup>1076</sup>

Observing SOX Section 806, even though it provides employees a broader recipient for making a disclosure than other federal whistleblower states, it still fails to balance the conflict of interest among related parties. Although Section 806 did not cover the media as one of the recipients, but other external recipients still might bring negative effects on companies and the financial market.<sup>1077</sup> Under SOX, employees can use federal agencies, courts, or any member or committee of Congress as the external recipient to present their concerns.<sup>1078</sup> Unlike the media, who broadcasts the disclosure publicly, these external recipients probably can keep the investigation confidential. However, it is still difficult for these recipients to keep the disclosure from leaking to the public completely before the truth comes out.<sup>1079</sup>

Federal agencies tend to disclose the information based on their discretion beca-

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<sup>1074</sup> Henry H. Perritt, *Employee Dismissal: Law and Practice* 281 (1987).

<sup>1075</sup> Dworkin & Callahan, *supra* note 232, at 299-300.

<sup>1076</sup> *Id.* at 302.

<sup>1077</sup> Vaughn, *supra* note 90, at 58.

<sup>1078</sup> Sarbanes-Oxley Act of 2002 § 806(a)(1)(A)-(B), 18 U.S.C. § 1514A(a)(1)(A)-(B).

<sup>1079</sup> Vaughn, *supra* note 90, at 57.

use they do not bear the duty of confidentiality to any corporation.<sup>1080</sup> Also, the members of Congress like to discuss corporate scandal and propose their policies in public. In this way, the disclosure is inevitable to flow to the public and the press, and these situations are beyond the legislature's expectation on SOX Section 806.<sup>1081</sup> Initially, the drafters of SOX assumed that federal agencies and the constituents of Congress know how to balance the conflict of interest before leaking the disclosure; the reason is that they realize disclosed materials probably bring potential harm to companies, and affect the operation of the capital market.<sup>1082</sup> Even if these bodies think the disclosure benefits public good, they still should consider subsequent social problems before leaking the information, such as massive layoffs. Yet, these regulated external recipients do not take those consequences into account and still go their ways. If the whistleblower's report is disclosed to an internal recipient in advance, those concerns will be needless. Internal reporting not only preserves corporate interest, but it also prevents the public from being damaged by incorrect disclosures and sustains the order of the financial market.

Observing SOX Section 806, it does not consider these defects. It gives employees a right to select a recipient without thinking about any consequences. Then, it may

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<sup>1080</sup> *Id.* at 57-58.

<sup>1081</sup> *Id.* at 58.

<sup>1082</sup> *Id.*

be inferred that the purpose of disclosure is not simple to rectify employers' misconduct beforehand as Congress originally designed, but it probably can be seen as a medium to take revenge on employers or companies, and further to impair the shareholder's investment. As Rubinstein notes this point as follows:

“The primary goal of Section 806 should be to encourage the early recognition and correction of wrongdoing, rather than to punish the wrongdoers themselves. Though the individuals responsible for corporate wrongdoing should be held accountable for their actions, it is important not to punish an entire company, as well as its shareholders, where the violation may in fact be the result of a rogue employee and not representative of the company at large.... Such public dissemination of information presents the added problem of shareholder harm because of the possibility of decreased share value.”<sup>1083</sup>

Consequently, when the statutory purpose of SOX Section 806 has been twisted, it is no longer a satisfactory authority to regulate whistleblower protection. Yet, it may turn out to be an instrument employed by careless or malicious employees to affect companies' operation and to damage the society's welfare. Therefore, SOX has to establish a specific procedure that instructs whistleblowers how to present their concerns step by step, and should not merely making use of a laissez-faire process that probably depreciate the company's and the public's interests.

#### vi. Narrow Recipients and Covered Employees

SOX Section 806 has other deficiencies, and these can be categorized by two types; they are narrow recipients and limited covered employees. Although

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<sup>1083</sup> Rubinstein, *supra* note 134, at 651.



related defects have been mentioned in previous sections, here I still want to add other points worthy to be discussed.

The first defect is that the coverage of recipient is narrow in SOX Section 806 since it does not shield whistleblowing employees from disclosing to those people who have no supervisory authority. Under SOX, the disclosure to the management is restricted to report to someone in charge to correct wrongdoing, but it does not cover protection to report to colleagues or employers who are neither a supervisor nor have authority to rectify misconduct.<sup>1084</sup> However, in some situations, successful disclosures may be assisted by these people and then be reported to the person in charge. If SOX cannot think about this circumstance and extends its protection for those employees, who disclose to a wrong recipient, but still make a successful report by others' assistance, it perhaps hinders employees from being a whistleblower since it appears to test employees' legal knowledge on SOX's provision of whistleblower protection. In short, employees have to be familiar with the statute before taking an action to blow the whistle. Yet, this assumption is unreasonable because most employees do not know their rights of being a whistleblower, let alone realize the limitation of recipient regulated under SOX.<sup>1085</sup>

The second defect is that the covered employee in SOX Section 806 is restricted

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<sup>1084</sup> Ramirez, *supra* note 222, at 201.

<sup>1085</sup> Collier, *supra* note 573, 1121-27.

because it cannot cover those people who are not regulated employees, but probably have a function to disclose corporate wrongdoing. Independent professional is a good example since he/she cannot be viewed as the covered employee in SOX.<sup>1086</sup> In addition to not being shielded under SOX, at times, this professional is also unwilling to disclose his/her clients' misconduct because he/she is afraid of alienating clients and harming the client-professional's relationship. One time, Ramirez mentioned this similar concept as follows:

“Public confidence in corporations depends in large part upon the oversight of the corporation by others with professional duties and responsibilities, yet these professionals may not be protected by SOX. Some categories of ‘gatekeepers’ may not fall within SOX’s civil whistleblower protections because independent professionals arguably are not ‘officers, employees, contractors, subcontractors, or agents of such companies.’ Thus, whistleblowing by the independent professional risks harming the relationship with the client -- or even loss of the client -- without any avenue of civil protection.”<sup>1087</sup>

In some situations, independent professional cannot be regarded as the contractor, subcontractor or agent of the public company. In the *Roulett* case, the administrative agency found that financial insurance employer providing debt securities for publicly-owned companies did not make him/her the contractor, subcontractor, or agent of public firms under SOX.<sup>1088</sup> In addition, the reason that an independent professional seldom divulges the client's misconduct is not only does he/she fear losing business, but

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<sup>1086</sup> *Roulett v. Am. Capital Access*, 2004-SOX-78 (ALJ Dec. 22, 2004).

<sup>1087</sup> Ramirez, *supra* note 222, at 203-04.

<sup>1088</sup> *Roulett*, *supra* note 1086.

he/she also recognizes that no client wants a tattletale to address his/her business affairs. Since when a professional's bad reputation is spread out, he/she fails to keep a position in a specific area; also, he/she is forced to get away from this frustrating environment and to start a new live by finding other occupations.

Besides, another concern arises when deciding whether an in-house counsel can be shielded in SOX Section 806 or not.<sup>1089</sup> An in-house counsel is a typical corporate unit, and his/her function is to timely report companies' violations of law to the directors' audit committee.<sup>1090</sup> In SOX, an in-house counsel is likely to be protected since he/she is in the definition of "employee"; yet, the divergence of courts' decisions makes this application uncertain. Some courts did not want to shield an in-house counsel based on the client-attorney privilege since an attorney owes the duty of confidentiality to his/her client. Contrarily, a few courts stated that disclosing confidential information cannot be an exclusive reason to restrain a lawyer from being protected and makes him/her bear employers' retaliation.<sup>1091</sup> Thus, even if an in-house counsel discloses corporate securities violation, it is still unclear whether courts will award him/her a remedy to compensate losses when he/she is retaliated against by his/her employer because of the disclosure.

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<sup>1089</sup> *Id.* at 204.

<sup>1090</sup> Sarbanes Oxley Act of 2002 § 307, 15 U.S.C. § 7245 (2010); 17 C.F.R. §§ 205.1-205.7 (2010).

<sup>1091</sup> *Willy v. Admin. Review Bd.*, 423 F.3d 483, 500-01 (5<sup>th</sup> Cir. 2005).

Further, whether SOX Section 806 provides protection for employees who serve in U.S. enterprises or their subsidiaries, but stationed outside the U.S. borders, this issue is still uncertain.<sup>1092</sup> The purpose of SOX encourages employees to bravely disclose corporate securities fraud with no fear of retaliation, and gives them a sound remedy to relieve losses because of the disclosure.<sup>1093</sup> Yet, these merits will be meaningless when SOX is unable to apply to U.S. public companies or their subsidiaries that operate business outside the U.S. territories since the disclosure may also come from other countries' employees. This deficiency fails the function of SOX because employees serving in these companies can act the same role as Cooper in WorldCom or Watkins in Enron. Also, it is highly probable that these public parent corporations perhaps take advantage of overseas public or private subsidiaries to commit misconduct prohibited by the U.S. statutes. If SOX cannot take this situation into account and protects the employees of U.S. overseas companies and subsidiaries from being retaliated against, it is not difficult to predict corporate corruption will revive and damage the financial market again. In this way, it is better for Congress to reconsider this issue and add a new regulation in SOX Section 806. As Ramirez describes this below:

“An omnibus provision should provide specific language providing a forum in the United States to protect those would-be whistleblowers employed by employers with operation in the United States, whether the employee is stationed in

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<sup>1092</sup> Ramirez, *supra* note 222, at 202-203.

<sup>1093</sup> Sarbanes-Oxley Act of 2002 § 806(c)(2), 18 U.S.C. § 1514A(c)(2).

the United States or outside of its borders, whether the employee is working for a subsidiary or for the parent company, and whether the employer is a private or a government entity.”<sup>1094</sup>

Since there are still several deficiencies in SOX Section 806, it is hard to totally expect SOX can fully achieve its statutory purpose to protect corporate whistleblowers from suffering adverse employment actions. Corporate financial fraud will not be stopped, and employees fail to be placed in a critical position to deter the management’s wrongdoings until all defects are resolved. Therefore, Congress still needs to take efforts to make SOX’s whistleblower provision more complete and satisfying, and forms a stronger framework to prevent whistleblowing employees from taking a risk of losing jobs and encourage them to preserve the public welfare.

## **Chapter V. Suggestions and Improvements of the Whistleblower Protection in SOX Section 806**

### *A. Statute Itself*

#### 1. Broaden the Scope of Protection and Forbid Extra Requirements

##### a. Covered Employer

In SOX Section 806, besides publicly-traded corporations, SOX also restricts the contractors, subcontractors, or agents of public firms from taking any adverse action against employees who disclose securities violations or related frauds occu-

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<sup>1094</sup> Ramirez, *supra* note 222, at 203.

ring in publicly-owned companies.<sup>1095</sup> However, whether private subsidiaries of public firms can be regarded as the covered employer in SOX, it is still an arguable and ambiguous issue. In addition, the administrative agency has had an improper interpretation in the language of SOX, this misunderstanding reduces the function of the statute to prevent whistleblowing employees from being retaliated against, and assist them in receiving the relief to make up for their losses because of the disclosure or participation in the investigation on the violation. In this way, these two disputes are critical points in this part and will be discussed in this section.

i. SOX's Regulated Employers Should Clearly Cover Private Subsidiaries of Public Companies

The language of SOX Section 806 specifies that SOX forbids publicly-traded companies to retaliate against employees who disclose or participate in the investigation on corporate securities violation.<sup>1096</sup> Also, the Judiciary Committee illustrated that the regulated subject under SOX is the public company listed on the financial market.<sup>1097</sup> Hence, following this legislative scheme and statutory language, in the administrative procedure of SOX, ALJs and the ARB were inclined to exclude the private subsidiaries of public companies because they are not the regulated employer in

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<sup>1095</sup> Sarbanes-Oxley Act of 2002 § 806(a) & (b)(1), 18 U.S.C. § 1514A(a) & (b)(1).

<sup>1096</sup> *Id.* § 806(a), 18 U.S.C. § 1514A.

<sup>1097</sup> Senate Judiciary Committee Report, *supra* note 756.

SOX. Yet, whether this exclusion is appropriate and can satisfy initial statutory purpose, it is still up for discussion.

By means of financial perspective to study the relationship between private subsidiaries and public parent companies, subsidiaries are used to being treated as the agent of parent companies (or should be seen as a part of public firms) and cannot be separated from parent companies for the reason of accounting.<sup>1098</sup> One court notes this concept as follows:

“While it would not seem inappropriate to view subsidiaries as ‘agents’ of the publicly traded company ... the subsidiaries, for Sarbanes-Oxley purposes, are more than mere agents like an outside auditor or consultant. Subsidiaries ... are an integral part of the publicly traded company, inseparable from it for purposes of evaluating the integrity of its financial information, and they must be treated as such.”<sup>1099</sup>

Thus, it may be concluded that when examining the financial condition of public parent companies, subsidiaries’ financial statements still have to be presented and audited together with parent corporations. Therefore, the financial performance of subsidiaries and public parent companies should not be treated separately, and must be viewed as a whole, inclusive accounting statement. As the court states:

“When its [the publicly-traded entity] value and performance is based, in part, on the value and performance of component entities within its organization, the statute ensures that those entities are subject to internal controls applicable throughout the corporate structure ... A publicly traded corporation is, for Sarbanes-Oxley purposes, the sum of its constituent units; and Congress insisted upon

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<sup>1098</sup> *Morefield, supra* note 963, at 7.

<sup>1099</sup> *Id.*

accuracy and integrity in financial reporting at all levels of the corporate structure, including the non-publicly traded subsidiaries.”<sup>1100</sup>

As a result, the operation of private subsidiaries not only can be seen as a part of public parent companies’ internal control, but those subsidiaries are also the units for public firms to perform their corporate policies and business. One time, the court stated, “[T]he scope of Sarbanes-Oxley whistleblower protection tracks the flow of financial and accounting information throughout the corporate structure and remains as permeable to the internal ‘corporate veil’ as the financial information itself.”<sup>1101</sup> In this way, private subsidiaries and public parent companies ought to be viewed as an undivided entity while auditing financial materials. Due to this concept, the exclusion of the private subsidiaries of public firms in Section 806 is not appropriate when thinking about the statutory purpose of SOX. Thus, as the private subsidiaries of public companies are argued by their employees, those private entities have to be seen as an integral part of public parent corporations and be regulated under the covered employer in SOX Section 806 at the same time.

Accordingly, observing the structure, language, and purpose of SOX, Congress ought to explicitly cover the private subsidiaries of public companies in the regulation of SOX Section 806. Not only does a clear statement reduce conflicting decisions from the administrative agency, but the extension of regulated employers also increases

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<sup>1100</sup> *Id.* at 10.

<sup>1101</sup> *Id.* at 11.



the possibility that whistleblowing employees may be granted a preliminary order from the authorized agency.

ii. The Administrative Agency Improperly Construes SOX Section 806

ALJs improperly construe SOX Section 806 only applies to employees who serve in publicly-traded companies. ALJs held that any officer, employee, contractor, subcontractor, or agent of public firms cannot discharge, demote, suspend, threaten, harass or in any other manner that discriminates against “employees of public corporations”.<sup>1102</sup> Thus, when these contractors, subcontractors, or agents of public corporations are privately-owned entities, their own employees are not the protected objects under SOX, and these private entities will not be liable for their adverse actions imposed upon whistleblowing employees.<sup>1103</sup> Due to this misunderstanding on Section 806, ALJs declared that several claims were of no merit since the complainants were not the covered employees regulated by SOX. As a result, many whistleblowing employees bearing retaliation cannot compensate their losses even if they disclose or participate in the investigation on securities violations prohibited by the statute. Owing to ALJs’ improper explanation on Section 806, ALJs constrain SOX’s statutory purpose to employ corporate employees to unveil corporate securities fraud, and to shie-

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<sup>1102</sup> Minkina v. Affiliated Physician’s Group, 2005-SOX-19, at 6 (ALJ Feb. 22, 2005); *Roulett, supra* note 1086, at 9; Goodman v. Decisive Analytics Corp., 2006-SOX-11, at 9-10 (ALJ Jan. 10, 2006).

<sup>1103</sup> *Id.*

ld them from being retaliated against by employers.

Likewise, ALJs' recognition on SOX Section 806 seemed not to be proper because of another explanation of SOX. As Vaughn says:

“At first reading, the structure of the prohibition suggests that a protected person must be ‘an employee’ of these companies [public companies].... The structure and language of the prohibition, however, allows another interpretation. Clearly, the term ‘employee’ includes an employee of the relevant company, but an employee could also be an employee of the contractor, subcontractor, or agent of the company.”<sup>1104</sup>

Vaughn stated that the covered employee in SOX Section 806 does not simply restrict to the employees of publicly-traded companies, but it can be interpreted to include the employees of contractors, subcontractors, or agents of public corporations as well, no matter whether these bodies are private or public entities. In addition, he also said that ALJs' recognition on Section 806 is contrary to the intent of Congress because SOX does not confine its coverage only to the employees of public companies. Vaughn brings his thought as follows:

“This interpretation is not foreclosed either by the language or structure of the provision. That language and structure is different from the analogous subsection of AIR-21, which specifically labels that subsection ‘discrimination against airline employees’ before using the term ‘employee’ in a context similar to its use in the whistleblower provision of the Sarbanes-Oxley Act. The whistleblower provision of Sarbanes-Oxley contains no such express limitation of this term.”<sup>1105</sup>

In other words, “an employee” as used in Section 806(a)'s prohibition of retaliation is

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<sup>1104</sup> Vaughn, *supra* note 90, at 9.

<sup>1105</sup> *Id.*

not expressly restricted to the employees of public-traded companies and is able to just as easily be read to include the employees of those companies' contractors, subcontractors, or agents. Because Congress tends to clearly define the scope of each statute,<sup>1106</sup> if it did not definitely confine the scope of covered employees in SOX, it is not proper for ALJs to limit the coverage and affect the application of SOX on regulated activities. Likewise, Kohn supports the broad interpretation because he thinks this can be truly "consistent with the case law developed under other whistleblower laws."<sup>1107</sup>

In addition, the broad interpretation of SOX can meet the goal of the statute to deter securities fraud since the contractors, subcontractors, or agents of public firms are perhaps used as an instrument by public companies to retaliate against employees blowing the whistle. Vaughn notes this point as follows:

"Important policies support this alternative interpretation ... First, the employee of a contractor (or subcontractor or agent) may be well placed to discover fraud and abuse by the company. If that employee makes a protected disclosure ... [he/she] should be protected if the company pressures the contractor, subcontractor, or agent to retaliate against this employee.... Second ... Congress considered the role contractors, subcontractors, and agents play in enabling or condoning corruption and fraud. In these circumstances ... Congress would seek to protect the employees of these entities who could disclose that corruption or fraud."<sup>1108</sup>

In this way, not only can the employees of public companies have a function to disclose securities fraud, but the employees of contractors, subcontractors, or agents of pu-

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<sup>1106</sup> *Id.*

<sup>1107</sup> Kohn et al., *supra* note 220, at 70.

<sup>1108</sup> Vaughn, *supra* note 90, at 9-10.

public companies enable to play the same role in unveiling the wrongdoing of public firms, no matter whether these bodies are public or private. In addition, federal securities violation not merely happens in public corporations, other business entities have a high possibility to assist or to be controlled by public firms to cheat stockholders and the public. Hence, it is required to cover the employees of affiliated entities of public companies under the regulation of SOX to guard against those situations.

Thus, Congress should amend the content of Section 806 and expressly state that it not only applies to the employees of publicly-owned firms, but also covers the employees who serve contractors, subcontractors, or agents of public companies, no matter whether these bodies are private or public. In my point of view, I suggest that when regulating the covered employee in SOX Section 806, maybe it is a good thing to not confine the type of employee. The reason is that private firms may also commit or assist securities violation and retaliate against employees who blow the whistle, and these actions are perhaps controlled or manipulated by public companies. If SOX only protects the employees of public firms, this regulation seems to imply that SOX allows private entities to contribute or commit securities violations or related frauds with public companies. This consequence is contrary to the statutory purpose of SOX and confuses corporate shareholders. Accordingly, I think that no matter what kind of corporation in which employees serve, if they are willing to or have an ability to disclose

the regulated activity or to participate in the investigation regarding the violations, these employees are qualified to be shielded and to compensate their losses due to the disclosure or participation.

b. Extra Requirements on Burden of Proof and Other Protected Employees

In SOX Section 806, it provides broad covered activities to protect employees who disclose or participate in the investigation on public companies' misconduct related to the violation of federal securities laws, regulations, SEC's rules, or related frauds that may damage shareholders and the public.<sup>1109</sup> Even though regulated activities cover diverse securities violations, the administrative agency imposed other requirements upon employees when filing a claim in SOX. These extra requirements not only increase the difficulty for employees to be granted a preliminary order in the administrative procedure, but they also make wide-range reported actions become a meaningless regulation and weaken the function of SOX.

There are three practical issues under the administrative procedure.<sup>1110</sup> First, the ARB added an extra burden of proof on employees because it asked employees to verify that the disclosure is "definitely and specifically" related to regulated categories of securities violations or frauds under SOX.<sup>1111</sup>

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<sup>1109</sup> Sarbanes-Oxley Act of 2002 § 806, 18 U.S.C. § 1514A.

<sup>1110</sup> Moberly, *supra* note 954, at 138-41.

<sup>1111</sup> Platone v. FLYi, Inc., No. 04-154, at 17 (ARB Sept. 29, 2006).

Second, the ARB stated that when employees report employers' misconduct, which is a "mere possibility that a challenged practice could adversely affect the financial condition of a corporation, and that the effect on the financial condition could in turn be intentionally withheld from investors, is not enough" for employees to argue those suspected activities breach SOX's regulation.<sup>1112</sup> Once Moberly said, "The ARB also seemed to require, at the time a whistleblower makes a disclosure, that the whistleblower specifically identify the statute violated by the activities the whistleblower reports and connect the statute to Sarbanes-Oxley's provision."<sup>1113</sup> These assumptions appear to increase the difficulty for employees to satisfy their burden of proof when filing a claim under SOX Section 806 against employers' adverse actions.

Third, the ARB changed the requirement of reasonable belief for employees as they claim their disclosures are in protected activities since the ARB interpreted a "reasonable belief" of securities violations means "a high certainty that the law had been broken."<sup>1114</sup> The ARB seemed to alter the standard of proof from "reasonable belief" to "actual violation" of federal securities laws, regulations, SEC's rules, or related frauds. This change not only conflicts with the regulation of SOX, but opposes to the intent of Congress when it initially enacted the statute.

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<sup>1112</sup> Harvey v. Home Depot U.S.A, Inc., No. 04-114, at 15 (ARB June 2, 2006).

<sup>1113</sup> Moberly, *supra* note 954, at 139; also see Allen v. Stewart Enters., Inc., No. 06-081, at 12 (ARB July 27, 2006).

<sup>1114</sup> *Id.*; Allen, at 14.

To resolve these problems, Congress ought to amend the content of SOX Section 806 and expressly show its intent in the statute. Section 806 should legitimately reject the ARB's decisions that seriously restrict the statutory purpose to protect whistleblowing employees. First, Congress should reject the requirement made by the ARB that asked employees to prove the disclosure "definitely and specifically" correlates to securities violations or related frauds.<sup>1115</sup> Employees' burden of proof requests them to only show employers' activities have breached regulated violations, they are not obligated to specifically identify violated statutes, regulations, SEC's rules, or frauds that connect to SOX's provision.

Second, Congress should restate its policy of reasonable belief. Also, it ought to amend the statute to emphasize that "an employee's reasonable belief regarding the illegality of an activity reported should be compared with an employee of similar education and experience."<sup>1116</sup> By means of adopting this flexible regulation, employees are able to receive complete protection on claiming their allegations and avoid the administrative agency from making use of the same standard on the element of reasonable belief in different employment cases.

Further, because independent professionals cannot be treated as covered employees under SOX, Congress also has to make some changes in the language of Section

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<sup>1115</sup> Moberly, *supra* note 954, at 141.

<sup>1116</sup> *Id.*

806 and protect these professionals from being retaliated against by clients because of the disclosure or participation in the investigation on securities violations. Likewise, considering in-house counsels are perhaps restricted to unveil employers' misconduct because owing the duty of confidentiality to companies, Congress should make an exception in the language of Section 806, and describe that when these counsels' actions are pursuing public good or when specific conditions are satisfied, counsels' disclosures will not breach their duties to employers. In this way, it can avoid any recrimination from employers because in-house counsels' disclosures are probably in the wake of the leaking of confidential business information.

## 2. Internal Reporting Is better than External Disclosure

SOX Section 806 does not ask employees to employ internal reporting as the first resort for the disclosure. It gives employees an option to select internal or external outlets, but does not consider involved parties' interests. Internal disclosure benefits public companies since it makes the management have sufficient time to rectify the wrongdoing before this information leaks to the public. Likewise, employees making internal reports alert supervisors who have not observed mistakes, and give them a chance to put unlawful actions back on the right track. As employers or colleagues do not commit misconduct on purpose, internal disclosure is capable of raising supervisors' notices on those mistakes that probably result from others' negligence, careles-



ness, or oversight in work. Also, supervisors can timely rectify these errors and prevent damage from harming companies.<sup>1117</sup> In addition, internal disclosure not only assists firms in building efficient in-house channels to right wrongdoings, but also helps the management to establish a bridge of communication with employees to respond to complaints made in the workplace.

Internal reporting can be regarded as a trend since it has been advocated by some corporations, courts' decisions, and state laws. First, corporate sentencing guidelines are critical devices that encourage companies to establish a complete, sound in-house channel for employees to make a disclosure. The guidelines provide a financial incentive for companies that perform effective and ethics programs to deter and detect any violation of law.<sup>1118</sup> The guidelines are operated by giving accused corporations "culpability scores" that may be reduced by estimating whether these firms have sustained a useful program to avoid or rectify any illegal activities occurring in companies, or by evaluating whether companies have disclosed misconduct to proper authorities and are cooperative in the investigation.<sup>1119</sup> When the defendants-companies provide substantial assistances for the investigation, courts will consider these factors to miti-

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<sup>1117</sup> Daniel P. Westman & Nancy M. Modesitt, *Whistleblowing: The Law of Retaliatory Discharge* 39-40 (2d ed. 2004).

<sup>1118</sup> Jeffrey M. Kaplan et al., *Compliance Program and the Corporate Sentencing Guidelines* § 4:1 (2006).

<sup>1119</sup> *Id.*

gate firms' sentences.<sup>1120</sup> To decide whether companies' in-house channels are effective, courts will think about whether codes of ethics have been properly enacted; whether reporting outlets are workable; or whether firms have provided protection for whistleblowers and prevent them from being retaliated against by employers.<sup>1121</sup> These guidelines try to employ the incentive of decreased punishment and the avoidance of negative reputation to encourage firms to build a friendly, practical, and effective internal disclosure system.<sup>1122</sup> Hence, the more thorough in-house channels that companies have established, the fewer penalties or fines will be imposed upon them for their illegitimate actions.

Second, the U.S. Supreme Court also showed its intention to support an internal report, and this intent was obviously presented in sexual discrimination claims in the Civil Rights Act of 1964. The Court held that employers can take an affirmative defense if, first, they claim that they have taken reasonable care to prevent and quickly correct sexual harassment as receiving reports from employees.<sup>1123</sup> Second, employers have to prove that "employees unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise."

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<sup>1120</sup> *Id.*

<sup>1121</sup> Terry Morehead Dworkin, *Whistleblowing, MNCs, and Peace*, 35 *Vand. J. Transnat'l. L.* 457, 464 (2002).

<sup>1122</sup> *Id.*

<sup>1123</sup> *Burlington Indus. v. Ellerth*, 524 U.S. 742, 765 (1998).

<sup>1124</sup> As these two elements are certified, employers will not be liable to employees' sexual harassment claims. In addition, employers can relieve from liability when showing they have taken efforts to make policies to deter any likelihood of sexual harassment from occurring in the workplace.<sup>1125</sup> If the policy made to preclude sexual harassment from happening has found, employers will hold less liability to employees' claims. In this way, before deciding whether employers are liable to sexual harassment claims, the Court puts focus on whether any policy or step has been taken by employers to stop sexual harassment from occurring. The Court supports employers to set up a system or make a policy to deter sexual harassment in the workplace and hopes to promote internal reporting by lessening employers' liability once they are accused of sexual harassment claims.

Third, some states support that internal disclosure should be previous to external one. Although these states have a variety of standards to provide protection for employees who disclose employers' misconduct, these states still have the same policy that encourages employees to make an internal disclosure, and let the person or division in charge has a chance to right mistakes in time.<sup>1126</sup> Even if many states require employees to make an internal report as the first resort, in some circumstances, disclosing to

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<sup>1124</sup> *Id.*

<sup>1125</sup> *Id.*

<sup>1126</sup> Rubinstein, *supra* note 134, at 654.

outsiders is permissible as employees reasonably believe that in-house channels have been blocked and cannot be viewed as effective outlets to present their concerns.<sup>1127</sup> Take Maine's whistleblower statute for example. Maine's law requires employees to present their arguments to someone who has supervisory authority in advance and to make this person has enough time to respond and correct mistakes.<sup>1128</sup> Yet, internal disclosure is not needed when employees have a specific reason, and think reporting to the supervisor is futile because the management will not instantly rectify presented problems.<sup>1129</sup> In this situation, employees can show their concerns to outsiders in regard to employers' misconduct. Several states support internal reporting since they consider using inner scheme as the first resort is rational in traditional employment relationship; also, it balances the interests among employees, employers, and the public. Internal disclosure, on the one hand, precludes confidential business information from leaking to the public; on the other hand, it lessens the likelihood that false disclosures probably disturb the public stock market.

Thinking about the advantages of internal disclosure, Congress ought to amend the language of SOX Section 806 and adopt internal reporting as the default rule. External disclosure will be permitted only when some specific conditions have been sati-

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<sup>1127</sup> *Id.*

<sup>1128</sup> 26 Me. Rev. Stat. Ann. § 833(2) (2010).

<sup>1129</sup> *Id.*

sified. Rubinstein illustrates these specified situations, and says:

“External reporting should be permitted in the first instance only where the employee (1) has a reasonable belief that the employer will not make a prompt good faith effort to address the problem, (2) reasonably believes an emergency is involved, or (3) reasonably fears reprisal or retaliatory action as a result of disclosure.”<sup>1130</sup>

Employees have to bear the burden of proof to show external reporting is a necessary step to take because they reasonably believe that internal disclosure will be futile, and they will not receive a satisfactory, friendly response from the management. Likewise, when reported matters are urgent, dangerous, or critical to the public and fail to be resolved by internal disclosure, reporting corporate misconduct to outsiders is allowable for employees to present their concerns.

As for the third factor, I do not quite approve of the author’s point of view. After all, the element of “reasonably fears reprisal or retaliatory action” puts too much focus on the consideration of employees’ self-position and self-interest. As external disclosures involve in the conflict of interest between public and private fields, public interest ought to take the priority for being shielded over private one. Employees’ damage resulting from retaliation is capable of being relieved easily and fully awarded by the protection of SOX; however, the public’s confidence in business activities, the governmental agencies, and in the operation of the financial market cannot be restored

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<sup>1130</sup> Rubinstein, *supra* note 134, at 651.

merely by ordinary statutes and monetary relief. In addition, reasonable fear is an abstract idea because nobody can establish a justifiable standard to determine whether an individual's fear is reasonable or not. This ambiguous concept not only increases the difficulty for an employee to claim his/her allegation in the administrative procedure, but also indirectly wastes legal resources to address and to interpret the unclear language in the statute.

Similarly, in my point of view, in order to rebut employees' allegations in regard to external disclosure, employers have to prove by clear and convincing evidence and show that they have built a sound, complete in-house channel for employees to make a disclosure. Employees going to outsiders cannot hold their grounds when employers have an effective internal channel to cope with employees' concerns, and no argument will be ignored in the procedure of internal reporting scheme. By contrast, as there is no sufficient internal outlet for employees to show their worries, and they also reasonably believe that arguments will not be paid attention to by the management, it is allowable for employees to divulge those problems and concerns to outsiders, and relieve their losses if they suffer employers' retaliation.

Thus, Congress should adopt internal disclosure as the default rule with exceptions for external reporting in SOX Section 806. When a public company provides employees with a complete, sufficient in-house channel to show their concerns, and em-

employees also reasonably believe that the management is going to make good faith effort to address their arguments, in this situation, employees must use internal disclosure as the first resort. On the contrary, as there is no sound reporting outlet; or a company has set up an in-house channel, but employees reasonably believe that their concerns will not be paid attention to; or they reasonably believe the disclosure is an emergency, employees are allowed to utilize external disclosure for exceptions. In this way, SOX can make use of the most efficient means to resolve securities violations that occur in a public corporation and balance the conflict of interest among involved parties at the same time. Similarly, internal disclosure can decrease the possibility that malicious or bad-faith employees capitalize on external reporting as an instrument to threaten the management's actions and decisions, to affect companies' operation and business performance, or to take revenge on colleagues, employers, companies and further to influence the society.

### 3. Reporting Recipients Should Extend to the Media and the Internet

Even though SOX Section 806 has provided corporate employees wide scope of recipient to make a disclosure, it is suggested that the coverage ought to broaden to the media and Internet whistleblowing, and makes SOX whistleblower protection more complete and sufficient.

Media whistleblowing has advantages to assist employees in achieving their go-

als of disclosures. First, because the media disclosure perhaps brings a negative publicity to companies and causes a negative impact on their good-will and business performance, those harmful consequences push firms to preclude anything wrong from happening in the workplace and compel them to make wrongdoings right.<sup>1131</sup> Second, the media is able to act as a monitor of the public to supervise whether the government has started taking actions to make an investigation after the disclosure. The function of the media not only makes the government pay more attention to whistleblowing employees' reports, but also reduces the likelihood that governmental agencies are also accomplices in organizations' misconduct since they are passive to respond to the disclosure.<sup>1132</sup> Third, the confidential relationship between the media and informants prevents the information from being blocked by managements or third parties that intend to conceal organizational corruption. The feature of confidentiality supports informants to go forward and protects them from bearing retaliation taken by employers or organizations they serve.<sup>1133</sup>

As regards Internet whistleblowing, it also has benefit as follows. First, Internet disclosers can get in touch with wide audiences, which might be broader than the aud-

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<sup>1131</sup> Andres Cowan, *Scarlet Letters for Corporations? Punishment by Publicity under the New Sentencing Guidelines*, 65 S. Cal. L. Rev. 2387 (1992).

<sup>1132</sup> Terry Morehead Dworkin & Elletta Sangrey Callahan, *Employee Disclosures to the Media: When is a "Source" a "Sourcerer"?*, 15 Hastings Comm. & Ent. L.J. 357, 385-86 (1993).

<sup>1133</sup> *Id.* at 393.



iences of the media. Since the Internet will not be confined by time, areas, or locations, sometimes, Internet disclosers are capable of reaching right audiences, like companies' stockholders, supervisory bodies, or customers.<sup>1134</sup> In addition, due to its feature of expansive dissemination of information, it probably gives rise to the attention of government to make an investigation on the disclosure and further to affect those firms' behaviour to rectify mistakes.<sup>1135</sup> Second, owing to Internet, information providers can be shielded by the feature of confidentiality and show their concerns anonymously.<sup>1136</sup> Like the media disclosers, Internet whistleblowers do not have to worry about being exposed by third parties or getting reprisals from employers or organizations. Third, Internet whistleblowers need not cater to the interest of the media and have freedom to unveil varied corporate misconduct. The reason is that the media tends to select and broadcast news that the public is much interested in order to make profits and get wider audiences. Yet, newsworthy information reduces the function of whistleblowing since not every citizen cares about the same issue occurring in society.<sup>1137</sup> Fourth, Internet disclosers have the ability to control whether to disseminate the information or not. Their disclosures will not be blocked by the media owing to the press's social obligations, the conflicts of interest in the media or competitors, or other exter-

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<sup>1134</sup> Sinzduk, *supra* note 674, at 1659.

<sup>1135</sup> *Id.*

<sup>1136</sup> *Id.*

<sup>1137</sup> Dworkin & Callahan, *supra* note 1132, at 393.

nal pressures from the government, accused organizations, and interested parties.

As a result of the advantages brought by the media and Internet whistleblowing, SOX Section 806 ought to broaden the scope of recipient and cover the protection to those employees who share knowledge to the media or spread information by the Internet. Once Sinzdak suggested a three-tiered standard for employees to follow as disclosing to a recipient, as he said:

“First, a whistleblower should receive protection for internal reports to supervisors or external reports to a government body so long as the employee reasonably believes that the report recipient can remedy the alleged wrongdoing.... Second, employees who report wrongdoing to the media or third party advocacy groups should receive protection if they can show that both an internal and an external report would have been ineffective. Third, legislators should protect an employee who reports wrongdoing via the Internet if the employee has tried other channels to no avail, the employee reasonably believes that his or her posting will reach a recipient who can resolve the issue, and the employer is actually violating the law.”<sup>1138</sup>

Concerning the first-tiered requirement, Sinzdak explained “reasonably belief” has to be separately observed by objective and subjective belief. When observing objective belief, Sinzdak described that some factors have to be thought over. These factors include:

“the employee’s relationship with the employer (including the employee’s tenure, seniority, and job responsibilities); the report recipient’s identity and position within or outside the company; the seriousness of the alleged wrongdoing; the centrality of the misconduct to the organization’s mission; the identity of the wrongdoers and their role within the organization; the employer’s responsiveness to previous complaints; the existence of established internal reporting chan-

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<sup>1138</sup> Sinzdak, *supra* note 674, at 1661.

nels; and, if the report is external, the nature of the work performed by the relevant government agency.”<sup>1139</sup>

As for subjective belief, Sinzdak said that the court has to evaluate whether a whistleblowing employee “believed she was reporting the matter to an individual who would resolve the problem.”<sup>1140</sup>

Although Sinzdak has suggested a good structure for the procedure of reporting under SOX, observing this scheme, I presume that Sinzdak forgot to balance the conflict of interest among involved parties when discussing internal and external disclosure. Consequently, I cannot totally agree with Sinzdak about his three-tiered standard of reporting process.

In my point of view, the scheme of recipient in SOX Section 806 ought to be the four-tiered procedure. Foremost, it is required for corporate employees to employ internal disclosure as their first resort before going to outsiders to present their concerns. This requirement corresponds to my advocacy that internal disclosure should be the default rule in Section 806, and must give employers a chance to right mistakes in the first place.

Second, when employees reasonably believe that internal disclosure will be futile, and they will not get a positive response from employers; or reported subject matters are urgent, dangerous, and critical, and are unable to be resolved by in-house cha-

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<sup>1139</sup> *Id.*

<sup>1140</sup> *Id.* at 1662.

nnels except for seeking help from outsiders, in those situations, employees are permitted to make an external disclosure and receive a prompt, friendly, and effective response from third parties, such as legal authorities, governmental agencies, or a member or the committee of Congress.

Third, as whistleblowing employees find both internal and external recipients are incapable of correcting companies' irregularities and ineffective in deterring employees' wrongdoings from happening or going worse, these employees are allowed to go to the media and present their arguments. Yet, the standard that evaluates whether employees' disclosures to the press are necessary should not be based on the concept of "reasonable belief"; however, it has to heighten to the standard of "definite or specific belief" and makes employees bear a stricter standard of burden to hold their positions. In this policy, employees have to definitely and specifically believe that the media disclosure is the necessary and the most efficacious measure to rectify corporate securities violations or related frauds. When those violations are involved in emergency and cannot be waited for a long investigation, and those also concern severe public good, employees can go to the media and make disclosures. The reason is that media whistleblowing is highly probable to bring a more destructive consequence on a corporation and the public than the result caused by other methods. For a company, no matter whether employees' reports are proved to be true or not, not until disputes have been set-

ted, continued dissemination of negative information made by the media will affect citizen's impression on a corporation and cause a great impact on a company's business, performance, and good-will. For the public, the media disclosure also disturbs the operation of society since the disclosure probably results in social unrest and exhausts the energy of social constituents in daily lives. Since the media whistleblowing is likely to cause damage and bring harmful results on a corporation and the public, after balancing the interest of involved parties, it is reasonable to impose a stringent evidentiary burden upon employees when they select the media as the first recipient for the disclosure.

Fourth, when whistleblowing employees notice no matter which recipient (internal, external, or the media disclosure) is still unable to satisfy their expectations to right corporate irregularity and put misconduct back on the right track, it is allowable for employees to use Internet to uncover companies' wrongdoings and show their worries. In this portion, Internet disclosure means employees use "personal, individual" internet resources to unveil securities violations; these can be exemplified by Facebook, Twitter, MSN or personal blog. Other "organizational, systematic" disclosures will not be covered in this part, like the action of WikiLeaks.<sup>1141</sup> In addition, as regards internet news, such as the news that is posted on the media company's website, this

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<sup>1141</sup> WikiLeaks, <http://213.251.145.96/>.

belongs to the media disclosure in my classification and does not fit into Internet disclosure. As for the standard to decide whether Internet disclosure is an appropriate action for employees to take against corporate wrongdoing, and is a required step to make a disclosure, I hold that if employees “reasonably believe” that other recipients cannot be workable to right companies’ mistakes, employees can use Internet to make a report. The reason I made this conclusion is that Internet disclosers are less likely to access the right audience.<sup>1142</sup> This feature perhaps affects employees’ abilities to make a successful disclosure in regard to employers’ misconduct. Besides, since Internet disclosure is difficult to trace the source and verify the authenticity of information, it may have less impact on the public because most people probably think it is a kind of private reprisals or business pranks. Therefore, it is not necessary to impose a stricter standard of burden upon employees because Internet is not only a restricted method to report corporate misbehavior, but the damage it brings to related parties may be lesser than other channels will cause.

Thus, I suggest Congress ought to think about my advice and amend the procedure of reporting for employees to make a disclosure that can conform to the anticipation of involved parties. As for a sound regulation of the reporting process, not only should the effectiveness of recipient be considered, but the interests of involved parti-

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<sup>1142</sup> Sinzdak, *supra* note 674, at 1659.

es have to be thought over and be balanced. In this way, Congress has to think more and take care as resolving the issues regarding the conflict of interest, and avoids severe imbalanced interests among related groups.

## *B. Procedure Requirement*

### 1. Problem of Timelines

#### a. Extending the Period of Filing Requirement

SOX Section 806 provides whistleblowing employees a ninety-day period to file a claim against employers or companies when they receive a notice of adverse actions. However, the ninety-day limitation is an obstacle for employees to claim their allegations since in recent studies, researchers found that most claims were denied by OSHA and ALJs because of plaintiffs-employees' failures to satisfy the ninety-day requirement.<sup>1143</sup> Designing a longer filing period for employees to bring their claims is required because one study concluded that employees tend to recognize their rights of Section 806 and to file a cause of action under OSHA between 90 and 180 days after suffering employers' adverse actions.<sup>1144</sup> Hence, a shorter filing period in Section 806 cannot benefit employees because it not only reduces their chances to compensate the losses caused by employers' retaliation, but also indirectly decreases the

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<sup>1143</sup> Moberly, *supra* note 954, at 132.

<sup>1144</sup> Stone v. Duke Energy Corp., 2006-SOX-48, at 3 (ALJ Apr. 7, 2006); Stevenson v. Vertex Pharm., Inc., 2006-SOX-56, at 2 (ALJ May 8, 2006).

effectiveness of SOX to use internal employees to disclose public companies' securities violations or related frauds.

Giving employees a longer filing period to bring a claim under SOX Section 806 has some advantages. Foremost, extending the filing period reduces the possibility that OSHA and ALJs may dismiss employees' claims because of their failures to satisfy the filing requirement. As employees satisfy the regulated timeline, OSHA and ALJs are able to take the further step to find other merits in employees' allegations, and this increases employees' chances to be granted a preliminary order in the administrative procedure.<sup>1145</sup> In addition, it is highly probable that employees might have lost careers after being retaliated against; a longer filing period gives employees extra time to find other positions to replace original jobs and to sustain a stable source of income to fight against employers and prepare the litigation.<sup>1146</sup> Further, a longer period of filing, on the one hand, provides employees more time to gather evidence and to contact a competent attorney for the sake of making a persuasive claim in the administrative procedure; on the other hand, it gives an attorney sufficient time to completely realize the facts and to make thorough preparation for employees' allegations before filing a cause of action under OSHA.<sup>1147</sup>

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<sup>1145</sup> Moberly, *supra* note 954, at 132.

<sup>1146</sup> *Id.*

<sup>1147</sup> *Id.*



Second, providing employees an extended period to file a claim in Section 806 gives employees enough time to make a response to employers' retaliation. Likewise, it reduces the shock of employees as finding that they have missed the regulated timeline to claim an action against employers. Under SOX, the start of the filing period is when employees receive the final notice of retaliation; however, this design arises some disputes because employees perhaps have no idea when retaliation starts since they are not the decision-makers of adverse actions. Also, the interval between the notice and actual adverse actions is crucial in a shorter filing period because it may easily influence the merit of employees' claims in SOX Section 806.<sup>1148</sup> Due to these defects, extending the filing period is necessary since it not only avoids employees from feeling confused with the start of the filing period, but it also fixes the defect of a shorter period that makes it easier for employees to miss the regulated timeline to bring a cause of action in Section 806 against employers' adverse actions.

Third, extending the filing period will not bring a negative consequence for employees to claim an action and will not affect their abilities against employers.<sup>1149</sup> Observing other whistleblower statutes, they give whistleblowing employees a longer filing period than that of SOX Section 806. Yet, in these statutes, employees rarely weakened their positions against employers' rebuttals since employees have more time to

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<sup>1148</sup> *Id.* at 132-33.

<sup>1149</sup> *Id.* at 133.

prepare their claims. Thus, it is not required to worry about whether employees' capacity of defense will be influenced in the administrative procedure. As employees have more time to gather evidence and information, there is a higher possibility for them to make a persuasive claim and to be granted a prevailing order in the administrative procedure.

Even though most legal scholars advocate extending the filing period in Section 806, the extent of the filing requirement is still controversial, and the argument cannot be settled. Some scholars support making an extension from 90 days to 180 days,<sup>1150</sup> but others hold that the filing period should extend to one year and make employees have more time to stand their positions.<sup>1151</sup> However, not being partial to each side, in my point of view, I suggest that the extended period has to be separately observed by varied situations and then decide which filing requirement is suitable for employees to bring a cause of action under SOX Section 806.

First, when employees are discharged, suspended, or cannot endure adverse actions and choose to quit, in these situations, SOX should provide employees a one-year period to file a claim under Section 806. The reasons for holding that are below. First, employees can have more time to find other careers to substitute original jobs in order to regain a source of income to sustain their livelihoods. Second, besides finding oth-

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<sup>1150</sup> *Id.* at 134.

<sup>1151</sup> Ramirez, *supra* note 222, at 218.

er occupations, employees may have extra time to gather evidence, to hold their grounds on allegation, and to prepare future litigation. Third, the one-year filing requirement will not affect employees' abilities to discover the evidence of accused activities and influence the authenticity of information. Also, employees may have more chances to access the witness who is willing to help them against employers' adverse actions and companies' misconduct. Fourth, the one-year period provides employees enough time to recover from the disaster of physical or psychological effects and gives them courage to face the coming lawsuit.

Second, when employees have not been discharged, suspended, and still can put up with employers' adverse actions even if they resent unjust treatment, these employees should be given a six-month period (180 days) to file their claims in Section 806. The reason to give these employees a shorter period of filing than above employees is that these employees still keep their careers. This advantage not only gives those employees a chance to observe whether employers or companies are willing to put the wrongdoing back on the right track or not, but lets them be able to rapidly make a response to retaliation. On the other hand, because these employees still hold their jobs, it is easier for them to understand criminal facts, to gather evidence, or to contact the witness than those employees who have been discharged, suspended, or have quit. In this way, they only need a shorter period to decide whether to bring a cause of acti-

on against employers for the sake of shielding their rights in SOX and bringing corporate misbehavior to light.

Consequently, as a result of different situations that employees may encounter, it has to take some factors into account to decide whether to give employees a longer or shorter filing period to claim their actions. However, no matter which period employees is provided, both suggested filing requirements are still longer than given filing limitation in SOX Section 806. Then, it is required for Congress to adjust the filing period and make SOX achieve original legislative purposes more effectively. These purposes are to preclude corporate securities violations or related frauds from happening, to protect employees from being retaliated against by employers, and to rapidly relieve their losses due to the disclosure or participation in the investigation on those violations.

b. OSHA Should Strictly Adhere to the Timelines Regulated in SOX Section 806

Although SOX Section 806 sets up timelines for employees and employers to hold their grounds, the administrative agency does not strictly adhere to those regulated limitations when coping with whistleblower disputes.<sup>1152</sup> Regulated timelines not only are the result of balancing both parties' interests, but they meet the statut-

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<sup>1152</sup> Watnick, *supra* note 95, at 874.

ory purpose to give employees an expedited administrative procedure to relieve losses and to resolve employment issues.<sup>1153</sup> Under SOX, when the OSHA investigator finds the employee's claim is a *prima facie* case, the employer is required to meet OSHA and provide clear and convincing evidence to rebut the employee's allegations in twenty days once he/she receives a notice of complaint.<sup>1154</sup> After the investigation, if the OSHA investigator finds that the employee's claim is in a merit, and the employer actually violated the regulated activity, the investigator will award the employee a preliminary order to compensate his/her losses. When the employer gets a notice of order, he/she still has ten days to present more evidence to support his/her position, and argues that he/she would have taken the same adverse action even though there is no protected activity.<sup>1155</sup> However, in reality, these regulated timelines are not exactly followed by OSHA and most of the time, these timelines are extended to a longer period, and this consequence probably causes a beneficial situation for the employer to defend his/her ground.

Requiring OSHA to adhere to the timelines is necessary. First, if OSHA can strictly comply with the timelines, employees may have a better chance to file a prevailing claim against employers and to be granted a preliminary order. Compared with the

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<sup>1153</sup> 69 Fed. Reg 52, 104-05 (Jan. 2, 2004).

<sup>1154</sup> *Id.* at 107.

<sup>1155</sup> *Id.*

power of each party in the administrative procedure, employees may be placed in the superior position to allege their claims than employers in the beginning of the proceeding.<sup>1156</sup> The reason is that when employees file a claim under SOX, they usually have more knowledge about illegal actions and are familiar with the administrative procedure than employers.<sup>1157</sup> Thus, in the initial stage, employees tend to play a leading role in litigation since they have the advantage of information. However, when the period of litigation gets longer, this advantage will disappear and transfer to employers since they start having more sense and knowledge regarding accused activities.<sup>1158</sup> In addition, employers have more resources to gather information, to seek legal counselors, and have authority to persuade the witness to stand with them. By contrast, at this time, employees' positions weaken because they probably have lost their jobs and suffered financial or emotional effects at the same time.<sup>1159</sup> For that reason, employees may not have energy to keep on claims and fight against employers owing to this imbalanced power.<sup>1160</sup>

Second, if OSHA adheres to regulated timelines, employees may benefit from an expedited administrative procedure since they can receive rapid relief for their losses.

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<sup>1156</sup> Watnick, *supra* note 95, at 874.

<sup>1157</sup> *Id.*

<sup>1158</sup> *Id.*

<sup>1159</sup> *Id.*

<sup>1160</sup> *Id.*

<sup>1161</sup> If employees are discharged, they are able to restore the position because the reinstatement is one of important remedies in SOX. Likewise, they do not have to worry about other monetary or non-monetary damage since SOX promises to make up for all losses as employees bear employers' adverse actions. In this way, if the administrative agency sticks to the timelines, it can decrease the possibility that whistleblowing employees may experience financial disasters or psychological effects due to the endless litigation.

Third, all employees, corporations, and the public can enjoy the advantages from an expedited administrative procedure when OSHA adheres to the regulated timelines. For employees, they will benefit from the procedure since not only can their losses be relieved immediately, but they also may not be blamed for being a trouble-maker as a result of uncertain consequences of accusations. For companies, they can quickly make responses to wrongdoings and reduce the possibility that these illegal actions will be known by the public because of long-winded litigation. For the public, an expedited administrative procedure avoids trivial matters from wasting legal resources; also, it can rapidly settle the disputes that significantly affect the health or the safety of society and avoid social problems from happening, like the potential risk of self-suicide, the issue of divorces or broken families.

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<sup>1161</sup> *Id.*

Then, Congress ought to strictly require OSHA to adhere to the regulated timeliness and ask the DOL to supervise OSHA when proceeding with the investigation. The DOL's duty not only protects whistleblowing employees' rights under SOX, but ensures that an expedited administrative procedure has been abided by the authorized agency. In addition, OSHA should be given more resources and be authorized more power to make the investigation; this improvement perhaps enhances the efficiency of the administrative procedure, and increases the correctness of awarding a preliminary order. As Moberly says:

“To the extent OSHA is willing but unable to perform this task, Congress should provide OSHA with more resources to investigate and to adjudicate Sarbanes-Oxley claims adequately.... To provide a fuller investigation-one that is more ‘hearing-like’ -Congress should provide OSHA subpoena power in its Sarbanes-Oxley investigations, similar to the authority OSHA employs to enforce the Occupational Safety and Health Act.”<sup>1162</sup>

Thus, giving more resources and power to OSHA not only can make the investigation more complete, but it also can improve the efficiency of the administrative procedure and increase the chance that whistleblowers will be granted a preliminary order. After all, when the investigation is fully made, more evidence is able to be found, and disputes are rapidly settled, it is highly probable that whistleblowers can relieve their losses and quickly get rid of negative effects of litigation.

## 2. Issue of the Standard of Evidentiary Burden

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<sup>1162</sup> Moberly, *supra* note 954, at 145.



As regards the evidentiary burden imposed upon employees and employers in SOX Section 806, Congress set up a lower standard of burden of proof for whistleblowing employees to verify their claims; by contrast, it established a stricter evidentiary burden for employers to rebut employees' allegations. Even though this can be said that an equal standard of burden has been regulated in Section 806, employees still find it difficult to be granted a preliminary order from OSHA when they bring a cause of action against employers under SOX.

First, even if employers have to bear a stricter burden of proof to rebut employees' claims by using clear and convincing evidence, and show that their actions result from managerial power, in the administrative procedure, employers are probably able to satisfy their evidentiary duty because they have more resources and can access more potential witnesses than employees.<sup>1163</sup>

Second, in order to rebut employees' claims, employers have sufficient materials or information that can be used to point out employees' negative personalities, unsatisfactory working performance, and uncooperative attitudes in the workplace. In this way, employers are capable of indirectly suspecting the authenticity of employees' allegations and have persuasive evidence to hold their grounds.

Third, employees probably have a hard time finding witnesses to assist them ag-

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<sup>1163</sup> Watnick, *supra* note 95, at 875.

ainst employers. The reason is that witnesses, who mostly are employees' colleagues, do not want to engage in whistleblowing because of negative impression on the whistleblower. Besides, the fear of retaliation is another factor to influence their willingness to stand with whistleblowing employees.<sup>1164</sup> Further, it is not easy for whistleblowers to seek help from other employees serving in different companies because those employees may not want to damage the business relationship with accused employers or companies.<sup>1165</sup> At times, those employees have a function to assist whistleblowers in getting a prevailing order because they perhaps strengthen whistleblowers' evidence on corporate securities violation or provide other persuasive materials to prove whistleblowers' allegations. However, because of the consideration of business, it is highly probable that those outside employees will not go with whistleblowers to fight against employers' illegal actions. Also, the unwillingness of taking a side on whistleblowing among coworkers is another obstacle for whistleblowers to find extra assistance.<sup>1166</sup> Since no colleague wants to show support on whistleblowing, this makes whistleblowers feel not only isolated on the disclosure, but also helpless to hold their grounds and to relieve their losses in the administrative procedure.

In order to resolve these problems, Congress ought to take below advice into ac-

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<sup>1164</sup> *Id.* at 876.

<sup>1165</sup> *Id.*

<sup>1166</sup> *Id.* at 877.

count when modifying SOX Section 806 in later amendments. About employers' burden of proof, it is highly suggested that a stricter standard should be adopted as examining "clear and convincing evidence" presented by employers. As for the method to improve this standard, Watnick provides his advice and states:

"... employers could be required to present at least some documentary evidence to support its adverse action and to defend an employee's case of retaliatory action.... I am suggesting a normative shift in perception as to what constitutes 'clear and convincing evidence' in the case of whistleblowing employees under Sarbanes-Oxley. This shift in perception, requiring more stringent proof from employers to meet the 'clear and convincing' standard, is necessary in that the Sarbanes-Oxley whistleblower is uniquely situated."<sup>1167</sup>

Thus, while employers are trying to rebut employees' allegations by clear and convincing evidence, oral defense with no tangible materials should not be allowed and cannot satisfy employers' evidentiary duty. Not only does the "clear and convincing evidence" have to be rectified by recordable documents or papers, but the administrative agency also has to employ a higher standard to examine the evidence when determining whether employers' rebuttals are persuasive or not.

### 3. Imbalanced Information

In addition to inadequate resources and few witnesses that whistleblowing employees can access, employees also have extra obstacle that makes their situations worse. In the administrative procedure, the defendants-employers are allowed to ma-

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<sup>1167</sup> *Id.* at 875-76.

ke a submission to OSHA during the investigation, but employees are unable to make a response to those materials.<sup>1168</sup> Giving employers a privilege to make a submission is harmful to employees' interests in the administrative procedure because of fourfold deficiency. First, it is highly possible that employers will provide OSHA with false information. Not only do these inaccurate materials and knowledge fail to be examined by employees, but employees also have no chance to know or to make a comment on them. Second, an unilateral action affects employees' abilities to defend. Since employees are incapable of getting knowledge from employers, they cannot make a complete preparation for rebutting employers' responses. Third, incorrect information has a crucial impact on OSHA to make a preliminary order. Due to wrong materials, the process that the OSHA investigator to make a decision will be influenced; also, the decision made by the investigator will not totally settle the whistleblower dispute, discover the truth, and show the actual situation. Fourth, the decision relying on false statements will not be accepted by involved parties. In addition, the rightfulness of the decision will be suspected and affect employees' willingness to employ SOX Section 806 to shield their rights and relieve losses. In order to fix those defects and to avoid inequitable situation, it is necessary for OSHA to disclose the information that employers unilaterally submit to it for employees.

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<sup>1168</sup> 69 Fed. Reg. 52 (Jan. 2, 2004); 69 Fed. Reg. 106 (Jan. 2, 2004).

Although OSHA recently has modified its procedure that not only allows employees to access “at least the substance” of employers’ responses to complaints in SOX, but can receive other evidence or at least the substance of such evidence from employers, OSHA still does not permit employees to access complete, actual responses, and extra evidence that employers have presented to OSHA.<sup>1169</sup> In addition, OSHA neither clearly allows employees to comment on these materials and evidence nor permits employees to make a response to the submission made by employers to OSHA.<sup>1170</sup> In this way, OSHA’s modification on its procedure still cannot make up the defect that causes the gap of information between employees and employers, and brings an unequal consequence at the same time.

In order to resolve the problem of imbalanced information, Congress and OSHA not only should amend the regulation to allow employees to access whole statements that employers submit to OSHA, but have to provide more chances for employees to participate in the investigation. As Rankin describes, “Congress and OSHA could provide employees more influence and participation in the investigative progress, enabling OSHA to consider both sides of the dispute more fully.”<sup>1171</sup> Likewise, Moberly states, “OSHA should amend its regulations to provide itself more authority for inform-

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<sup>1169</sup> Moberly, *supra* note 954, at 147.

<sup>1170</sup> *Id.*

<sup>1171</sup> Ken Rankin, *Analysis: SOX Whistleblowers Open to Retaliation*, Accounting Today, Oct. 22 – Nov. 4, 2007, p.5.

ation gathering. Altering OSHA's policies and regulations to ensure more employees participation in the process may present OSHA with more complete information about the factual circumstances of a case."<sup>1172</sup> If Congress and OSHA can refer to the advice, the capacity of employees to scrutinize the submission, evidential materials, and to make a comment on these information not only can make the investigation be more thorough, but also can get closer to the truth by back-and-forth exchanged knowledge, and reach an ultimate resolution on whistleblower disputes.

#### 4. OSHA Is not a Good Dispute-Resolver under SOX Section 806

Although Congress authorized OSHA to address whistleblower disputes in SOX, OSHA is not a truly professional agency to resolve issues with regard to the violation of securities laws or related frauds.<sup>1173</sup> This impediment is unable to be easily moved away by giving OSHA more resources and authorities to make the investigation since the lack of expertise significantly affects OSHA to make an appropriate decision. Once Moberly made this point as follows:

“To the extent OSHA's failure is one of will, merely increasing OSHA's authority and resources may not be sufficiently drastic to respond to the agency's failure to enforce Sarbanes-Oxley adequately.... In fact, from the Act's inception, OSHA seemed like an unlikely choice to investigate corporate whistleblower claims.... the type of corporate fraud at issue in Sarbanes-Oxley cases seems far removed from the worker safety and health issues addressed by many of the

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<sup>1172</sup> Moberly, *supra* note 954, at 145.

<sup>1173</sup> Beverley H. Earle & Gerald A. Madek, *The Mirage of Whistleblower Protection under Sarbanes-Oxley: A Proposal for Change*, 44 Am. Bus. L.J. 1, 52 (2007).

other statutes under OSHA's purview."<sup>1174</sup>

Hence, because corporate fraud is much different from ordinary whistleblower issues about the danger of working environments and the safety of coworkers, it is necessary for Congress to reconsider whether OSHA is able to act as a good dispute-resolver in SOX or not.

In order to resolve this problem, it is better for Congress to transfer investigative power from OSHA to the SEC to address whistleblower disputes in SOX. The reason is twofold. First, the SEC has more knowledge regarding the violation of securities laws and other accounting tricks taken by companies. Because of the SEC's function to maintain the discipline of the financial market and to sustain the efficiency or transparency of transaction,<sup>1175</sup> the SEC is much familiar with the operation of public companies and has an ability to determine whether corporate misconduct violates securities laws or related frauds. Likewise, the SEC perhaps feels comfortable to decide the merit of employees' claims and conclude whether employers' rebuttals are persuasive or not due to its knowledge on securities violations.

Second, because the SEC has the power of enforcement against public companies, it can deter corporations from committing securities violations and reduce retaliation imposed on whistleblowing employees since companies fear the punishment ma-

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<sup>1174</sup> Moberly, *supra* note 954, at 146.

<sup>1175</sup> Kim & Nofsinger, *supra* note 34, at 125.

de by the SEC. As Moberly notes:

“A whistleblower investigation by the SEC, with its ongoing concern for corporate fraud, may better deter corporate fraud than the threat of any other agency investigation. Through Sarbanes-Oxley investigations, the SEC may learn information that could lead to charges of securities fraud against companies or individual officers, which would have much greater deterrence value than the typical whistleblower investigation of an employee complaint.... placing the SEC in charge of whistleblower investigations might encourage the agency to request that the Department of Justice utilize this additional enforcement mechanism to deter retaliation against whistleblowers.”<sup>1176</sup>

Thus, the threat of penalty or sentence made by the SEC not only prevents companies from committing securities frauds, but probably also avoids employees from being retaliated against by employers because of their disclosures.

However, it does not entirely benefit employees' interests when Congress decides to authorize the SEC to cope with whistleblower disputes in SOX Section 806. The reason is that, in reality, the SEC is not as sympathetic as OSHA with damaged employees when addressing whistleblower issues.<sup>1177</sup> The SEC is inclined to separate corporate securities violations and reprisals imposed upon whistleblowers into two different subjects, and puts no emphasis on retaliation. Once Moberly described this intention below:

“In 2004, ... Senators ... requested ... SEC explain whether the SEC intended to use its authority to file civil enforcement actions for violations of Sarbanes-Oxley ... to enforce Sarbanes-Oxley's ant-retaliation provision.... SEC responded ... the SEC puts its resources toward 'substantive' violations of securities

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<sup>1176</sup> Moberly, *supra* note 954, at 148.

<sup>1177</sup> *Id.*



laws and ... would leave Sarbanes-Oxley anti-retaliation enforcement to the Department of Labor.”<sup>1178</sup>

In this way, even if the SEC has authority to resolve whistleblower disputes under Section 806, it probably puts focus on securities violations and pays less attention to the relief that grieved employees actually care about. This intention would not only cause an unequal consequence and imbalanced interests, but also might fail to satisfy the legislative purpose that intends to compensate whistleblowing employees’ losses completely after being retaliated against by employers.

For that reason, I suggest that it is not necessary to give the SEC the whole power to settle whistleblower issues from the start to the end; yet, it ought to separate the administrative procedure under OSHA into investigation and decision. In the part of investigation, the SEC will be given the authority to investigate the violations, to examine employees’ allegations, and to scrutinize employers’ rebuttals. Once the investigation is done, in the part of decision, the SEC should hand over the result to OSHA, and let OSHA determine the relief when employees’ claims are the *prima facie* case or dismiss employees’ claims when their allegations are of no merit. As for the appeal, ALJs and the ARB will not be restricted by the investigation made by the SEC, and still can start their own investigations to decide the merit of employees’ claims. Hence, giving the SEC the power to make an investigation can actually find the truth of disp-

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<sup>1178</sup> *Id.* at 149.

utes; also, letting OSHA make a decision is able to give employees a chance to obtain the proper relief. After all, OSHA not only feels more sympathy on employees' suffering, but it is also familiar with the remedy of retaliation and knows what type of relief can truly make up for employees' losses.

### *C. Corporate Culture*

Not only is SOX required to provide whole protection to shield employees from being retaliated against when making a disclosure or participating in the investigation on public companies' violations of securities laws or regulated frauds, but it has to declare or to establish a section that definitely makes sure corporations will promote whistleblowing and abide by SOX's regulations. For the sake of making the encouragement of whistleblowing rooted in companies, forming a positive corporate culture is an effective means to reach this goal, to protect the values of companies, and to assure social interest or welfare. One time, Mavrommati talked about corporate culture in his article and stated below:

“[C]orporate culture describes all the web of relations, procedures and traditions within a company. In essence, corporate culture drives the organization and its actions, it guides how employees think, act and feel and it has been reckoned as the ‘operating system’ of the organization. As a matter of fact, corporate culture describes all the customs and traditions of a company that fall under the heading of ‘*the way we do things here.*’”<sup>1179</sup>

Thus, corporate culture can be viewed as the consensus made up by the upper level of

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<sup>1179</sup> Mavrommati, *supra* note 905, at 398.

management and the custom followed by corporate constituents. Managers anticipate employees to comply with these norms that employees can employ to address external business activities; similarly, fresh employees are able to make use of these customs to integrate into corporate internal operation as soon as possible. In addition, these values instruct employees how to perceive, to react, and to resolve a problem in a preferable way that corporations tend to favor.

Corporate culture has a significant influence on whistleblowing, and this impact can be divided into two situations. First, when companies have not formed an atmosphere that positively treats employees who blow the whistle on unlawful actions taken by managers, whistleblowing is inclined to be suppressed and rarely has a function on the disclosure of irregularities. Since the management directs the formation of corporate culture, its behaviour and actions probably affect the content of corporate culture.

As Mavrommati describes:

“... a critical factor in the formation of a corporate culture is the extent to which a corporate culture is leader-centric.... the culture of a firm is likely to reflect the personality and attitude of the company’s leaders. The behaviour that is modeled by the leader and the management team profoundly shapes and influences the final formation of the culture and the practices adopted thereof by the firm and it certainly sets the tone of the culture.”<sup>1180</sup>

Thus, managers’ attitudes are associated with the development of whistleblowing and affect employees’ responses or conduct regarding related issues and problems. When

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<sup>1180</sup> *Id.* at 399.

the management devalues whistleblowing, ethical objections from employees will be ignored and be paid less attention to by supervisors. Such corporate culture may hinder the transparency of companies' operation<sup>1181</sup> and probably makes employers employ discrimination to control employees' actions in order to keep them silent on corporate misconduct.<sup>1182</sup> Codes of silence reduce the likelihood to detect illegal activities, to make outsiders investigate companies, and indirectly imply that the wrongdoing is allowable in corporations with impunity.<sup>1183</sup> In addition, codes of silence impede the change of firms and hamper the development of pluralistic companies.<sup>1184</sup> While codes of silence are predominant in the climate of corporations, "the diverse viewpoints, opinions, preferences, and goals ... are not likely to be given voice and ... not enter into the processes by which the organization establishes objectives, decides on appropriate courses of action, and attempts to learn from experience."<sup>1185</sup> Because of blocking different concerns and advice, not only may employers' decision-making not be promoted, but also the morale of employees may be influenced and affect future business performance.

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<sup>1181</sup> *Id.* at 398.

<sup>1182</sup> Joyce Rothschild, *Freedom of Speech Denied, Dignity Assaulted: What the Whistleblowers Experience in the U.S.*, 56 *Current Soc.* 884, 885 (2008).

<sup>1183</sup> Kohn et al., *supra* note 220, at 3.

<sup>1184</sup> Elizabeth Wolfe Morrison & Frances J. Milliken, *Organizational Silence: A Barrier to Change and Development in a Pluralistic World*, 25 *Acad. of Mgmt. Rev.* 706, 707 (2000).

<sup>1185</sup> *Id.* at 719.

Second, on the contrary, if employers devote themselves to sustaining the goodwill of companies, put more emphasis on employees' loyalty on entities, and care more about the interest of society, employers may be more lenient on whistleblowing. As

Elliston states this concept below:

“When top management emphasizes economic efficiency and accountability, growth, and loyalty to the company, to the exclusion of ethical values and social responsibilities, they open the door for whistleblowing. Management should realize that whistleblowers have high ideals that extend beyond their organizations.... Management would do well to change the corporate culture by placing greater importance on reporting unethical and questionable practices with the organization.”<sup>1186</sup>

Hence, when the management opens its mind to accept different voices and does not inhibit ethical objections from employees, there is highly probable that corporate culture will be modeled by a whistleblower-friendly climate. This consequence improves corporate abilities to self-detect, self-resolve, and self-prevent misconduct that happens in the workplace. Likewise, this atmosphere enhances internal corporate governance and ensures corporate operation is on the right track.

Thus, I suggest that Congress should add up a new section under SOX. This section not only ought to establish a model for companies to refer when the management has no idea how to promote good corporate culture on whistleblowing, but also authorizes the SEC to have the right of enforcement and punishment when companies do

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<sup>1186</sup> Elliston et al., *supra* note 216, at 139.

not abide by the regulation and negatively treat whistleblowers. This reference can be categorized by three portions. The first portion concerns the issue of corporate internal policy. The management has to show its intent to support whistleblowing and advocates this action since it assures corporate interest. As Smith & Oseth note:

“... the employer must accord its compliance-related goals (and accommodation to whistleblowing protections) equal stature with – and at times explicit priority over – traditional private sector management objectives. Managers ... must recognize ... that elevating perceived public interests, and government policies that serve those interests, is not in conflict with a business calculus ordinarily focused intensely on the bottom line.”<sup>1187</sup>

Similarly, the management has to educate employees to the fact that they are given a new role as the foot soldier to fight against corporate securities violations and related frauds.<sup>1188</sup> In this way, not only do employees owe the duty of loyalty to companies, but they also bear a higher societal responsibility to protect the health and safety of the public.

The second portion is in regard to explicit statements in the management’s charter to abide by all securities ordinances and the SEC’s rules. Managers should declare that each action, which is able to assist companies in deterring misconduct or preventing wrongdoings from going worse, is being supported, such as whistleblowing. Smith & Oseth mention this point as follows:

“... employer ... should declare ... attitude about compliance with law and regu-

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<sup>1187</sup> Smith & Oseth, *supra* 676, at 188.

<sup>1188</sup> Watnick, *supra* note 95, at 878.

lation in a central compliance manager's charter and consolidate relevant functions under that individual. Such a charter would be developed explicitly to prevent and detect wrongdoing, ensure regulatory compliance, and eliminate other improprieties."<sup>1189</sup>

Therefore, not only should the management have positive attitude toward whistleblowing, but it also has to definitely show its position on supporting the actions taken by whistleblowing employees in the workplace.

The third portion is specific actions that the management is going to take to promote whistleblowing. In order to make companies benefit from whistleblowing, managers can reward and educate employees to practice such ethical conduct.<sup>1190</sup> In addition, they are able to devise a structure that is capable of promoting the efficiency of whistleblowing. It is necessary for the management to set up a system to detect corporate misbehavior, to establish a channel for employees to report corporate misconduct, and to build up a rapid, transparent, effective proceeding to rectify these mistakes. As

Smith & Oseth say:

"... a compliance manager must devise and execute (1) a system of standards, (2) a monitoring strategy that covers appropriate pressure points systematically, and (3) communication channels that facilitate early reporting and correction of what employees perceive as irregularities. The success of this effort depends critically on the nature of the compliance manager's charter and on the support (and participation) of other leaders within the employer's organization."<sup>1191</sup>

In this way, it can be concluded that the reporting structure has to accompany a posi-

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<sup>1189</sup> Smith & Oseth, *supra* 676, at 188.

<sup>1190</sup> Ramirez, *supra* note 222, at 225.

<sup>1191</sup> Smith & Oseth, *supra* 676, at 188-89.

ve attitude of management and a friendly atmosphere in the workplace toward whistleblowing. Merely establishing a sound reporting system, but forming a corporate culture that is negative upon the action of whistleblowers, is still unable to reach the goal of the deterrence of corporate misconduct via whistleblowing.

Making use of this framework to encourage companies to form positive corporate culture upon whistleblowing, I expect companies' misconduct will decrease because not only can the management's misbehavior be detected easily, but also employees are willing to disclose those unlawful activities. Besides, this framework reduces the possibility that whistleblowing employees may suffer adverse employment actions from employers since those employees' actions are admirable and supported by companies' policies and norms.

#### *D. Others*

##### 1. Mandatory Arbitration Agreement

As mentioned above, whether Congress prohibited mandatory arbitration agreements in Section 806 is a significant issue to affect the function of SOX. Since there is no expressed language that restricts the dispute of whistleblowing from being sent to arbitration agreed by both parties under SOX, it is better to observe if the legislative history intended to prevent mandatory arbitration agreements from becoming a resolution of whistleblower disputes.



Initially, SOX's earlier draft included a provision that prohibited mandatory arbitration agreements from resolving the dispute of whistleblowing. Nevertheless, in the final version of the bill, this portion seemed to be excised, and there was no reason to explain why it was cut out.<sup>1192</sup> Because it might be inferred that Congress did not want to show its attitude upon pre-dispute arbitration agreements to address the issue of whistleblowing, the legislative history did not provide any assistance on clarifying this ambiguity. Hence, the plaintiff-employee cannot have a persuasive ground to argue that Congress had inhibited mandatory arbitration agreements settling whistleblower disputes in SOX Section 806.

Because of no clear language and a negative legislative history on the forbiddance of pre-dispute arbitration agreements, it should turn to analyze legislators' intentions on this issue. The original purpose for Congress to enact Section 806 was because it not only wanted to encourage corporate employees to bravely report employers' securities violations, but it promised to relieve employees' losses when they suffer adverse actions because of the disclosure or participation in the investigation in regard to those violations. Even if Congress's intent to protect corporate employees was quite explicit, it did not point out or restrict the method to complete this mission. This omission makes others wonder whether Congress still opened a door for alternative disp-

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<sup>1192</sup> Cherry, *supra* note 92, at 1080; also see Sarbanes-Oxley Act of 2002, Pub. L. no. 107-204, 806, 116 Stat. 745, 802-04 (codified at 18 U.S.C §1514A).

ute resolutions to settle whistleblowers' arguments under SOX. Owing to this doubt, it leaves space to debate the appropriateness of other dispute resolutions for SOX Section 806. Likewise, it increases the difficulty to shield employees from being retaliated against since employers may avoid SOX's whistleblower protection by employing mandatory arbitration agreements to resolve whistleblower disputes. Besides, in the *Boss* case, the court also stated that SOX does not restrict the defendant's right from making use of arbitration to address and to settle the argument, and there was no conflict between arbitration and the statutory purposes.<sup>1193</sup> As the court notes this point as follows:

“Congress may override the presumption in favor of arbitration if it manifests its intent to do so in the text of the [statute], its legislative history, or ‘inherent conflict’ between arbitration ... and the [statute’s] underlying purposes. There is nothing in the text of the statute or the legislative history of the Sarbanes-Oxley act evincing intent to preempt arbitration of claims under the act. Nor is there an inherent conflict between arbitration and the statute’s purposes.”<sup>1194</sup>

Accordingly, the court stated that a pre-dispute arbitration agreement is allowable to resolve the issue of Section 806 since Congress did not expressly establish any restriction on this portion. This court's decision, on the one hand, adopted the rationale of the U.S. Supreme Court that presumed mandatory arbitration agreements are permissible in SOX; on the other hand, it was caused by the failure of Congress that did not mention any policy regarding the usage of arbitration on employment issues. Because

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<sup>1193</sup> *Boss*, *supra* note 130, at 684.

<sup>1194</sup> *Id.* at 685 (citation omitted).

Congress has not given any opinion on this part, courts tend to suppose that not only did Congress know arbitration is acceptable in courts, but it also implicitly permitted this resolution to settle employment disputes.

Since all specific materials and the majority of judicial decisions are inclined to support arbitration, this seems that arbitration contracts can be allowed to settle whistleblower issues in SOX. Yet, considering the defects of arbitration contract, it is inevitable to worry whether pre-dispute arbitration agreements can truly resolve the employment disputes and protect the rights of employees or not. After all, employees have less power to bargain the terms of contracts, and this defect affects their interests when the disputes are sent to arbitration.

In order to remedy this situation, Congress has to clearly and definitely show its intent on the usage of arbitration in SOX Section 806. In my point of view, in principle, I suggest Congress should prohibit mandatory arbitration agreements from settling the dispute of whistleblowing since Section 806 has a functional work to shield whistleblowers from bearing damage. In addition, it is dependent upon the concern of equality and the avoidance of one-side negotiation. Once Cherry stated this similar concept as follows:

“... arbitration of employment disputes should be taken with a healthy dose of skepticism, as arbitration in general tends to favor the employer. Many arguments, both for (efficiency) and against (fairness), have been raised regarding the use of mandatory arbitration contracts.... an argument that arbitration of Sarba-

nes-Oxley whistleblowing claims should not be foisted on employees at the time of hire, when economic realities dictate that it will be a one-side negotiation.... mandatory arbitration is not the result of parties determining ... is the best way to resolve a dispute; rather, it is a one-sided provision foisted upon employees through a contract of adhesion.”<sup>1195</sup>

Hence, considering there is highly probable that employers may use their authority to make arbitration contracts and have the privilege to control favorable terms of contracts, Congress should not allow the usage of arbitration to resolve whistleblower disputes in Section 806. Also, Congress has to take efforts to inhibit any unfair consequence happening when the power and resources of involved parties are imbalanced and may be extremely discrepant.

Nonetheless, thinking of the flexibility and efficiency of pre-dispute arbitration agreements, when the result is beneficial and impartial to damaged employees, Congress can make an exception to permit the usage of arbitration to settle the issue of whistleblowing under Section 806. As regards the formation of arbitration contract, it should return to contract laws to decide whether the contract is effective and practicable or not. These factors include: the ability of involved parties to make an arbitration contract; the timing or situation to reach the agreement; whether an arbitration contract is made due to duress, cheat, unconscionability, or other disadvantages of the powerless party; whether an arbitration contract is proper and able to resolve the dispute;

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<sup>1195</sup> Cherry, *supra* note 92, at 1082-83.

or whether both parties have reached mutual consent on the critical term of contract, such as the appropriateness of arbitrator. The competence of arbitrator is important in arbitration since the selection process of arbitrator probably shows the power of involved parties. Ramirez explains the significance of arbitrator as follows:

“Providing the option for alternative dispute resolution before an arbitrator, however, may operate as efficient means to avoid the potential duplicity ... of an administrative investigation followed by a federal district court *de novo* review. Recognizing this potential benefit ... statute should include an arbitration alternative ... but only if it is specifically limited by ... the arbitrator be selected by mutual consent to avoid placing the choice solely with the employer.”<sup>1196</sup>

Because an arbitrator can affect the result of arbitration, when the position of arbitrator defers to employers’ thoughts or opinions, the consequence will be harmful and cause dual damage on employees. In this way, mutual consent on an arbitrator is required since it not only can decrease the likelihood that an arbitrator takes a partial action for a given party, but it also can increase the accuracy of decision and avoid later arguments regarding the appropriateness of arbitrator.

## 2. Rewarding

Even if SOX has provided employees with a sound anti-retaliation scheme to keep them from fearing of reprisal, this still cannot motivate their actions to disclose employers’ misconduct or companies’ wrongdoings because of the lack of incentive. In the newly-enacted Dodd-Frank Act of 2010 Section 922, Congress authorized

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<sup>1196</sup> Ramirez, *supra* note 222, at 213.

the SEC to give a reward up to 30% of monetary sanctions exceeding 1 million dollars to an individual who provides original information that leads the SEC to successfully enforce its rules, regulations, and related actions.<sup>1197</sup> If employees receive a reward before being awarded the relief from the administrative agency, not only are they able to have a stronger motive to report corporate irregularities since a bounty is guaranteed and foreseeable, but they also can avoid the uncertain result in the administrative procedure since employees are unsure whether their claims will be merited or dismissed. Therefore, a proper incentive is necessary because it can enhance employees' motives to bring corporate misbehavior to light. In general, there are two methods that have been used to provide employees' an incentive for their disclosures.

First, the SEC provides bounties for employees who disclose insider trading and securities frauds. Congress tried to make use of the reward of bounties to encourage employees to report corporate securities violations. According to the Insider Trading and Securities Fraud Enforcement Act of 1988, the statute gives those employees who blow the whistle on regulated crimes a reward up to 10% of the penalty imposed upon violators.<sup>1198</sup> Because the violation of insider trading usually accompanies corporate infringement on securities laws and regulations, by reporting the violation of insider trading, the SEC is probably able to observe other companies' wrongdoings and deter

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<sup>1197</sup> Dodd-Frank Act (Wall Street Reform and Consumer Protection Act), 15 U.S.C. § 78u-6 (2010).

<sup>1198</sup> 15 U.S.C. § 78u-1(e) (2010); also see 17 C.F.R. § 201.61 (2010).

those from going worse.<sup>1199</sup> Similarly, when employees provide the information about insider trading and other violations of securities ordinances, employees not only can receive bounties owing to their disclosures, but also can indirectly bring corporate frauds to light.<sup>1200</sup>

However, this statute still has some deficiencies. On the one hand, the reward that employees receive is based on a percentage of the penalty imposed upon violators, not depending on the profit that violators have gained or the loss they have saved.<sup>1201</sup> This consequence affects the amount of bounty that information providers are rewarded, and has an influence on disclosers' motives to report insider trading. On the other hand, since the SEC has authority to decide whether to reward those informants a bounty or not, this makes the result harder to predict and has a high likelihood that disclosers probably receive nothing from the SEC, or the rewarded bounty is unable to satisfy informants' expectations. One time, Callahan & Dworkin described this situation as follows:

“... any determination about the awarding of bounties ... ‘including whether, to whom, or in what amount to make payments, is in the sole discretion of the Securities and Exchange Commission.’ Because there is no guarantee of any recovery, and indeed, no track record of payments, neither of these reward provisions are likely to spur much whistleblowing activity.”<sup>1202</sup>

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<sup>1199</sup> Rapp, *supra* note 893, at 117.

<sup>1200</sup> *Id.*

<sup>1201</sup> 15 U.S.C. § 78u-1(e) (2010).

<sup>1202</sup> Elletta Sangrey Callahan & Terry Morehead Dworkin, *Do Good and Get Rich: Financial*

In this way, because not only does the SEC have the discretion on the bounty and makes the result uncertain, but also there is no judicial review<sup>1203</sup> or minimum guarantee for the reward.<sup>1204</sup> These problems make this scheme not be practiced as effectively as Congress initially expected and cannot promote employees' incentives to make a disclosure.

Second, the False Claims Act (FCA) forms a scheme that allows a citizen on behalf of federal government to sue an individual or a company that has a business relationship with the government, but makes false statements to cheat on business. Besides, the FCA promises to provide this "relator" a bounty for correct information or disclosure, and this design is called qui tam provision.<sup>1205</sup> In the FCA, it is prohibited "to present knowingly to the United States a false or fraudulent claim for payment, to make a false record to statement to get a claim paid, or to make a false record or statement to avoid an obligation to transmit money or property to the government."<sup>1206</sup> There are three required elements to constitute the claim when the relator has a cause of action against the violator under the FCA. Those are presentation of a claim, falsity

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*Incentives for Whistleblowing and the False Claims Act*, 37 Vill. L. Rev. 273, 306 (1992).

<sup>1203</sup> *Id.*

<sup>1204</sup> Marsha J. Ferziger & Daniel G. Currell, *Snitching for Dollars: The Economics and Public Policy of Federal Civil Bounty Programs*, 1999 U. Ill. L. Rev. 1141, 1155 (1999).

<sup>1205</sup> 31 U.S.C. §§ 3729-3733 (2010).

<sup>1206</sup> Rapp, *supra* note 893, at 127.



or fraud, and knowledge.<sup>1207</sup>

The rationale of the FCA's qui tam provision resulted from "old-fashioned idea of holding out a temptation and setting a rogue to catch a rogue."<sup>1208</sup> The reason that Congress wanted to make use of a private citizen to disclose an illegal action is not because of the lack of resources to detect irregularities, but is based on the belief that federal employees probably also participate in those fraudulent activities so that they are unable to hamper the occurrence of false actions.<sup>1209</sup> As to the reward, the share is awarded by 15-30% of the government's damage from the violation of the FCA,<sup>1210</sup> and this bounty is quite attractive for the relator to take an action under the FCA. As

Rapp says:

"The FCA qui tam provision is designed to produce 'lucrative bounties' for the relator.... the relator's share has been 'enhanced considerably' in recent years 'in an effort to encourage informants to come forward and report fraud.' The average recovery for a qui tam relator in a successful FCA case is over one million dollars."<sup>1211</sup>

Because the rewarded bounty is generous, this monetary incentive makes the relator provide his/her knowledge of prohibited activities more actively, and reduces their fears of bearing financial plight and mental distress after filing a suit against an individual's or private companies' fraudulent actions.

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<sup>1207</sup> *Id.*

<sup>1208</sup> *Id.* (citations omitted).

<sup>1209</sup> *Id.* at 127-28.

<sup>1210</sup> 31 U.S.C. § 3730(d) (2010).

<sup>1211</sup> Rapp, *supra* note 893, at 130-31.

Compare the SEC's bounty scheme and the FCA's qui tam provision, it is better for Congress to refer to the FCA's reward system and give employees more incentives on the disclosure. The reason for holding this is twofold. First, employees do not have to worry the uncertainty of result concerning whether they are going to be awarded a bounty or not because the decision is made by the court, not the SEC. Second, employees appear to receive more rewards from the FCA's bounty provision since their shares will depend on the damage that the company suffers (the damage includes the company's actual damage and consequential losses), not just being decided by the penalty that employers or companies may be imposed upon. As regards the calculation of damage, it will leave for the court, and let it follow precedent cases to decide the specific amount.

Adopting a monetary incentive similar to the FCA's qui tam provision for SOX Section 806 benefits corporate whistleblowers to make the disclosure and achieves statutory purposes. First, a monetary incentive enhances potential whistleblowers' motives to take positive actions on the disclosure of corporate wrongdoing.<sup>1212</sup> Due to attractive bounties, it is easier for employees to weigh pros and cons of whistleblowing because a specific reward removes the disincentive of being a whistleblower. As Rapp states this point as follows:

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<sup>1212</sup> *Id.* at 135.

“... the use of financial incentives can help overcome the disincentives to a potential whistleblower. Social psychology research supports the notion that if ‘structured properly, financial incentives should encourage a new type of whistleblower to step forward.’ An individual would balance the possibility of ... reward against the risks of whistleblowing; she would be able to ‘make a deliberate cost/benefit analysis and determine whether the possible hazards are worth becoming a ‘snitch.’”<sup>1213</sup>

Since a monetary incentive is able to promote employees’ willingness to blow the whistle on corporate securities violations, considering the goal of SOX Section 806, it is not only to shield whistleblowing employees from being retaliated against, but also to encourage those employees to make a disclosure. A bounty scheme can be seen as one of effective measures to make SOX achieve its statutory purposes, and bring more corporate scandals to light.

Second, a bounty increases the likelihood that employees are more willing to disclose serious, significant corporate frauds to the public.<sup>1214</sup> It is because employees recognize that the more harmful damage companies are going to cause, the more bounties they will be awarded. In addition, compared with the anti-retaliation provision, employees would rather bear fewer risks to divulge corporate misconduct when their losses are able to be made up by bounties in advance.

Third, a monetary incentive changes the role of employees from a corporate mo-

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<sup>1213</sup> *Id.*

<sup>1214</sup> *Id.*

nitor to an information collector.<sup>1215</sup> As Rapp describes:

“The bounty model for SOX whistleblowers restructures the role of private actors as monitors of corporate misbehavior. Unlike traditional corporate monitors, employees have an ‘information advantage ... because they have more complete knowledge regarding the inner workings of a large corporation.’ In this way ... instead of the unconvincing deterrent rationale, private lawsuits in the securities context could be justified as information-generating.”<sup>1216</sup>

Consequently, because of bounty, employees may no longer be passive monitors and concern about retaliation when employers or firms discover their reports. By contrast, employees will become active information collectors owing to the inspiration of monetary reward. It is not required for employees to wait for compensation from the administrative agency or courts because of their disclosures, but they are able to take the initiative in gaining their bounties when corporate securities violations are proved to be true by the authorized agency.

Fourth, a bounty makes employees more persistent in finding the truth, even though wrongdoers attempt to suppress information from being disclosed or released to the public.<sup>1217</sup> Whistleblowing employees not only recognize the disclosure of corporate corruption is beneficial to public good, but also, more importantly, those employees are looking forward to being given a generous reward if their disclosures are proved to be accurate.

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<sup>1215</sup> *Id.*

<sup>1216</sup> *Id.*

<sup>1217</sup> *Id.* at 136.

Fifth, adopting the qui tam provision, it will strengthen the role of SOX whistleblowers to expose corporate securities violation, and make those employees have a stronger motive to bring a cause of action against employers in the administrative procedure. In addition, those employees are not easily manipulated by lawyers due to their financial expertise and monetary incentives. Thus, they are able to preclude attorney's actions from damaging their interests.<sup>1218</sup> Once Rapp discussed this concept in his article as follows:

“... a qui tam bounty model for SOX whistleblowers increases the role that private actors will play in exposing and deterring securities fraud ... Unlike pre-PSLRA ‘lawyer-driven litigation,’ where lawyers ‘manage litigation to further their own economic interests,’ the qui tam model offers a hybrid in which a traditional client exercises a fair degree of control. The qui tam whistleblower has both the interest and the ability to monitor his lawyer, unlike a dispersed plaintiff class.”<sup>1219</sup>

Because whistleblowers may have the ability to gather and to analyze the information they hold, it is not required for them to rely on other professionals to examine these materials. At times, whistleblowing employees have financial expertise, and their knowledge is probably superior to their attorneys'. Besides, in the qui tam provision, as a result of monetary incentives, those employees would like to pay more attention to their allegations and to spend more time on gathering persuasive evidence, not simply depending on lawyers to address related proceedings. Owing to these factors, the qui

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<sup>1218</sup> *Id.* at 137.

<sup>1219</sup> *Id.*

tam whistleblower has more power to control litigation and seldom leans on external assistance to bring a claim or continue a lawsuit. Likewise, this privilege reduces the problem of divergent comprehension on the issues of claims that perhaps happens between an attorney and a plaintiff.

Considering these advantages brought by the bounty model, Congress should think over whether to enact a similar qui tam provision in SOX Section 806. As whistleblowing employees have original information of securities violations or related frauds that have not been known by the administrative agency, courts, or the SEC, and then those violations are proved to be true after the investigation, it is allowable for these employees to be awarded a bounty for their disclosures. After all, not only does the reward system give employees more incentives to unveil companies' fraudulent activities, but it also can be regarded as an effective tool to promote the actions of potential whistleblowers, to hinder corporate scandal, and to sustain the confidence of society in business activities.

### 3. Extraterritorial Application Problem

The application of SOX Section 806 does not cover public companies or their subsidiaries located outside U.S. territories, this defect affects the efficiency of the statute. In view of the globalization of economy, the laws that regulate domestic markets may potentially have an extraterritorial influence on other countries' financial

systems. This phenomenon results from several factors that probably include national stock exchanges around the world are linked together; major financial and securities organizations have set up a branch or are established in various countries or locations; and corporations are able to access foreign and domestic financial markets more easily to gather requisite capital than before.<sup>1220</sup> In addition, the formation of multinational companies provides extra assistance for speeding up the globalization of the financial market around the world.<sup>1221</sup>

Because of above economic features, it is unavoidable for legal jurisdictions to face the problem of extraterritorial application of law when addressing related issues. Judicial principles prohibit courts from applying the U.S. laws on other jurisdictions because of the concern of sovereign rights; however, when the disputed matters have a substantial impact on U.S. society or domestic financial markets, courts will intervene in these matters and employ U.S. laws to regulate those violations, especially on the violations of securities regulations. Once Hamlin discussed this point in his article as follows:

“ ... courts have attempted to fashion standards and have employed various rationales in applying the statute in a number of cases involving fraud in transnational securities transactions. Generally, the courts have asserted subject matter

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<sup>1220</sup> Brad Levy, *Pretty New SOX, but Plenty of Holes: An Analysis of the Government's Inability to Apply Section 806 of the Sarbanes-Oxley Act of 2002 Extraterritorially*, 40 Tex. Tech. L. Rev. 225, 235 (2007).

<sup>1221</sup> *Id.*

jurisdiction over extraterritorial conduct that produces substantial effects within the United States and over conduct that occurs in the United States and directly causes losses to investors outside this country.”<sup>1222</sup>

Even if courts have formed a principle to regulate extraterritorial issues with regard to securities regulations, they still have not extended their authority to other areas that also may bring a harmful consequence on U.S. citizens or society. Take SOX Section 806 for example. In the *Carnero* case, the court dismissed the plaintiff’s claim to apply Section 806 extraterritorially because of his termination caused by the disclosure of corporate misbehavior. The court denied the plaintiff’s request since the company’s illegal actions did not occur in U.S. and found that Section 806 did not have extraterritorial effect.<sup>1223</sup> Although the court made a negative decision on extraterritorial application of Section 806, whether this judgment was appropriate is still up for discussion. Considering the nature of whistleblowing, employees blowing the whistle have a function on the deterrence of companies’ irregularities and promoting public interest; as employees cannot be protected by extraterritorial application of Section 806 because of their disclosures, the function of SOX is weakened, and is able to be viewed as one of the critical deficiencies on the enactment of the statute. As Levy notes this point as follows:

“In light of the fact that one of SOX’s three main purposes is to protect whistlebl-

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<sup>1222</sup> John W. Hamlin, *Exporting United States Law: Transnational Securities Fraud and Section 10(b) of the Securities Exchange Act of 1934*, 3 *Conn. J. Int’l L.* 373, 375, 384-404 (1988).

<sup>1223</sup> *Carnero v. Boston Sci. Corp.*, 433 F.3d 1, 9 (1<sup>st</sup> Cir. 2006).



lowers, this exception for foreign companies and subsidiaries is more than just a loophole. It is a gaping hole that calls for reconsideration of whether SOX is actually doing anything more than placing a burden on domestic companies—companies that must comply with all provisions of SOX face consequences if they fire employees for blowing the whistle. All the while, foreign companies can apparently rid themselves of whistleblowers without consequence.... SOX may be doing more harm than good while still allowing defiance of one of its most central provisions—a fact that seems to make SOX’s mission a harmful and futile endeavor altogether.”<sup>1224</sup>

Hence, in order to avoid imbalanced regulations on domestic and foreign companies, and to ensure the policy of whistleblower protection in SOX Section 806 to be practiced, Congress should think about whether it is much better to apply Section 806 extraterritorially to protect whistleblowing employees serving in public firms or their subsidiaries, but those are located outside the U.S. territories.

As for the method of extraterritorial application on Section 806, there are three ways for Congress to consider as resolving this problem. First, Congress can employ direct application of Section 806 on foreign corporations.<sup>1225</sup> Direct application is able to be regarded as the most efficient and easiest means to resolve extraterritorial issues on whistleblower protection. However, its consequence may be divergent because different countries have diverse points of view on whistleblowing. In the U.S., whistleblowing is important because it not only unveils companies’ irregularities unknown by the public, but also prevents the operation of the financial market from being ruin-

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<sup>1224</sup> Levy, *supra* note 1220, at 239-40.

<sup>1225</sup> *Id.* at 242.

ed. By contrast, some countries in Europe rarely adopt the policy of whistleblower protection to deter corporate corruption since they put more focus on the protection of personal reputation, and avoid an individual from being wrongfully accused.<sup>1226</sup> This tendency arose from European history and could explain why European countries are more concerned about the protection of private interests. Once Levy stated this point as follows:

“The root of the problem in European countries is that SOX contains mandatory disclosure requirements and provides hotlines for anonymous whistleblowing. Aside from the reasons that American companies might not like these aspects of SOX, European countries (especially France and Germany) particularly despise whistleblower provisions because of their resemblance to past rules from darker days in European history.... SOX whistleblower provisions are reminiscent of the types of rules enacted by the Nazis and Soviets. In Germany, the term ‘whistleblower’ suggests Gestapo-style government, and in France, whistleblowing reminds citizens of Vichy’s regime, under which neighbors betrayed neighbors. All things considered, the Europeans’ rejection of SOX whistleblower provisions is understandable.”<sup>1227</sup>

Due to unpleasant historical experiences, European countries find it difficult to accept the whistleblower protection in SOX because this policy perhaps reminds them of obnoxious memories. Also, the similar dispute may happen in other areas since whistleblowing is not a widely-accepted idea in every jurisdiction. Hence, different recognitions of whistleblowing increase the difficulty for courts and Congress to apply SOX Section 806 extraterritorially.

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<sup>1226</sup> *Id.*; also see John Gibeaut, *Culture Clash: Other Countries don't Embrace Sarbanes or America's Reverence of Whistleblowers*, A.B.A. J., May 2006, at 10.

<sup>1227</sup> *Id.* at 243.

Though, different treatment on domestic and foreign companies not only causes a loophole in SOX Section 806, but it also opens a back door for domestic companies to breach securities laws and related frauds by utilizing foreign firms and subsidiaries. In addition, SOX has pushed back companies to issue IPOs in the U.S. capital market because of its severe requirements and increased costs of compliance; this trend has occurred with no implementation of whistleblower protection. “Adding the burden of court implementation [SOX Section 806] could essentially eliminate the presence foreign companies from American exchanges”<sup>1228</sup> and make this situation worse, and seriously reduce the efficiency of the statute.<sup>1229</sup> Then, in order to avoid the loophole and regain foreign companies’ favor to the U.S. financial market, it is imperative for Congress to find other measures to substitute the direct application of SOX Section 806, and to deter corporate securities violation at the same time.

Second, SOX Section 806 can be applied extraterritorially by making a pact with countries where foreign companies or subsidiaries are located, but their shares are traded on U.S. securities exchange markets.<sup>1230</sup> However, this type of application is problematic because the usage of SOX in other jurisdictions not only probably conflicts with the laws of given countries, but various business customs or transaction methods

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<sup>1228</sup> *Id.* at 244.

<sup>1229</sup> *Id.* at 244-45.

<sup>1230</sup> *Id.* at 245.

make the U.S. laws hard to adapt to the operation of local companies.<sup>1231</sup> These consequences fail the function of SOX. In addition, there is the likelihood that the conflict of applied laws perhaps happens when given countries' laws or regulations address similar issues with SOX.

Third, compared to above approaches, the practicable method to apply SOX Section 806 to foreign companies or subsidiaries may be decreasing SOX compliance costs and reducing its onerous requirements for companies to comply with.<sup>1232</sup> Adopting this policy, foreign companies will enhance their willingness to issue IPOs and gather requisite capital in the U.S. financial market; also, this will promote the application of SOX on related regulations. As Levy mentions below:

“If courts will not apply Section 806 extraterritorially, and thus lessen the effectiveness of SOX, then legislators should amend SOX so that it does not discourage companies from making their IPOs on American exchanges. Legislators should reduce the costs of compliance and consider cutting back on penalties for minor infractions.... By doing this, companies could comply with SOX, and the government could regulate accounting practices.”<sup>1233</sup>

Observing this method, it is not necessary to extraterritorially apply SOX Section 806, but Congress still can increase the application of SOX on the financial market by lowering SOX's requirements and lessening companies' burdens to abide by related regulations. By means of making the requirements of SOX looser and less costly, com-

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<sup>1231</sup> *Id.*

<sup>1232</sup> *Id.*

<sup>1233</sup> *Id.* 245-46.

panies probably reconsider the costs and benefit on filing IPOs, and return the U.S. financial market to gather required assets. This consequence not only halts the trend that corporations tend to run away from the U.S. market because of severe U.S. regulations and expensive compliance fees, but also increases the application of SOX on deterring corporate securities frauds and shielding whistleblowers, and further truly achieve SOX's statutory purposes.

In order to make up the deficiency that foreign companies and subsidiaries may get rid of SOX Section 806, Congress has to take actions to fix this loophole. Moving out duplicate requirement and cutting down the cost of compliance in SOX can regain companies' interests in the U.S. financial market for gathering funds; also, this consequence may indirectly promote the application of SOX on related regulations. Hence, on the one hand, SOX still plays a significant role in regulating securities violations and in maintaining the order of the public market; on the other hand, employees who blow the whistle are shielded under SOX as usual. In addition, the public and investors are also able to benefit from the healthy financial market, and do not fear being damaged by corporate corruption.

Further, in my point of view, for the sake of providing sound protection for whistleblowers employed by foreign companies or subsidiaries, and of extending the application of SOX, Congress ought to consider the exemption of SOX for foreign firms,

and make those companies be more interested in the U.S. financial market. As regards the means, Congress can refer to the accommodations made by the SEC since it has adopted a similar policy to facilitate foreign listings on the NYSE and NASDQ.<sup>1234</sup>

Once Dworkin described this issue as follows:

“In 1979, the SEC began allowing foreign stock issuers to file some forms and exempted them from some sections relating to proxy rules, tender offer rules, and short swing profit rules to facilitate foreign listings. Later accommodations included the filing of different forms and different disclosure standards. In addition, the SEC has used informal procedures including the confidential treatment of filings and certain disclosures exemptions, and corporate governance issues have tended to be left to the home jurisdictions.”<sup>1235</sup>

Hence, by making use of different treatment upon foreign and domestic companies in SOX, it is highly probable that foreign firms will be more interested in accessing the U.S. financial market. When those foreign firms are listed on the U.S. public market, their activities have to be regulated by SOX, securities laws or regulations, and the SEC’s rules. This policy is going to be a win-win situation because it not only enriches the U.S. financial market, but also fixes the defect that SOX is unable to extend its protection to employees who blow the whistle in foreign companies or subsidiaries.

Also, I suggest Congress ought to add a new provision that clearly states as companies are listed on the U.S. financial market, no matter whether whistleblowing occurs in their foreign branches, firms, or subsidiaries, their actions still will be regulated

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<sup>1234</sup> Dworkin, *supra* note 227, at 1778.

<sup>1235</sup> *Id.*

by SOX Section 806 even though retaliation does not happen in America. I think this suggestion would resolve the problem made by *Carnero* court and adjust imbalanced regulations. Thus, whether whistleblowing employees' damage can be relieved is decided by SOX's regulations, not depending on the ordinances in different jurisdictions where those employees actually suffer adverse actions.

#### 4. Companies Are Required to Keep Record of Whistleblowers' Complaints in the Materials That Are Sent to the SEC and to Disclose Employees' Arguments in Annual Shareholders Meetings

In my point of view, I suggest Congress has to create a provision that requires the public company to keep record of employees' complaints into the materials sent to the SEC, and disclose those arguments in each shareholders meeting. This approach not only makes the SEC and shareholders know what has happened regarding the matters of corporate control, but also indirectly detects critical violations of securities laws by showing employees' ordinary concerns. The required disclosure of employees' arguments benefits the SEC and stockholders since both parties have interests in employees' knowledge, and are inclined to pay more attention to related information than non-investors.

Shareholders, based on the protection of private interests, care about employees' information because it assists them in knowing potential risks for investment. In addi-

tion, they are concerned to the performance of invested companies since they want to make sure their investment will be paid back, and can gain more profits at last. Moreover, the disclosures of employees' complaints not only let stockholders control more information to supervise the management's decision-making or corporate policies, but also indirectly promotes shareholders to be more active in participating in companies' annual meetings and business operation.

The SEC has an obligation to protect public interest, and to ensure the transparency of the capital market has been properly maintained. By receiving employees' knowledge in the materials presented by public firms, the SEC can be rapidly aware of information regarding corporate operation, and timely makes a quick response or enforcement on suspected illegal actions. In addition, by knowing employees' concerns as soon as possible, the SEC may have sufficient time to react and to prevent corporate misconduct from going worse; also, it is able to avoid the financial market from being ruined by corporate corruption, and to sustain the public's confidence in the business activity. Moreover, the disclosures of employees' arguments strengthen the function of SOX Section 806. This scheme not only makes the SEC get more knowledge to control corporate misbehavior, but also lets the SEC has more information with regard to internal corporate governance. Likewise, the SEC can make use of these disclosures to know how the management responds to employees' concerns, and which ac-



tion has been taken to address those arguments afterward.

Hence, by disclosing employees' ordinary complaints, it makes the SEC and shareholders observe corporate irregularity in advance, and precludes companies from taking further actions to commit securities violations or related frauds. In addition, this method not only promotes SOX's disclosure system, but also enhances the function of whistleblowing and brings more corporate scandals to light. Furthermore, this approach hampers employers' misconduct to affect employees' loyalty on companies, to reduce stockholders' reliance on corporate operation, and to influence investors' confidence in the public stock market. Thus, Congress ought to take this suggestion into account for future amendments, and make up the defect that may cause the failure of the Sarbanes-Oxley Act.

## **Conclusion**

The positive perception of whistleblowing can be viewed as a phenomenon that exists in a progressive society because it shows a more generous attitude on whistleblowing. Also, this can be inferred that it is allowable for citizens to make use of different measures to sustain the public's confidence in the financial market and business activities. This perception encourages an individual, who has valuable information regarding organizations' financial frauds, to disclose in order to prevent public good fr-

om being harmed by those dishonest organizations. In addition, whistleblowing is critical to the exchange of information because it promotes a well-informed society. The well-informed society requires diverse information or knowledge to assure the safety of transaction, and make economic conduct more efficient. Whistleblowers not only bring organizations' misconduct, which spoils stockholders' investments and damages the public stock market, to light, but also act as competent informants providing the knowledge that ordinary citizen is difficult to gain.<sup>1236</sup> Further, whistleblowers decrease the likelihood that social resources will be wasted on the investigation of organizational fraud. Similarly, they are capable of securing the evidence of those irregularities before unveiling to the authorized agency or the public.

In view of the function of whistleblowing on avoiding organizational corruption, it is required for Congress to reinforce whistleblower protection in statutes and to ensure it can play a significant role in the deterrence of illegitimacy. The Sarbanes-Oxley Act is the recent statute inclined to restore investors' confidence in the financial market, and to sustain the order of securities transaction due to a series of corporate scandals in the beginning of this century. In SOX, its whistleblower provision shields private employees from bearing adverse employment actions because of the disclosure or participation in the investigation on corporate securities violation. However, Cong-

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<sup>1236</sup> Dworkin & Callahan, *supra* note 232, at 305.

ress did not consider several details of this regulation, and this failure reduced the efficiency of SOX Section 806 to achieve its goals.

Hence, this dissertation points out these defects and provides advice for the future amendments. Those suggestions not only involve the modification of statutory language and the remedy procedure, but also concern the issues with regard to corporate culture, rewarding, the usage of arbitration contracts, extraterritorial application, and other matters of concern. If Congress can adopt those comments, I sincerely believe that internal corporate governance is able to be benefited by sound whistleblower protection. Likewise, I wish the modified provision could inspire more potential whistleblowing employees to fight against employers' misconduct, to preclude corporate wrongdoing from happening, to support proper business operation, to promote the integrity and transparency of the public stock market, and to preserve the public's confidence in economic activities.

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