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Richard E. Moberly

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I. INTRODUCTION

Recent corporate scandals reveal opposing perspectives on the ability of rank-and-file employees to be corporate monitors. From one perspective, the scandals demonstrate employees' efficacy as monitors with accurate insider knowledge about the inner workings of their corporations. At great risk to their careers, a few employee

* Assistant Professor of Law, University of Nebraska College of Law; J.D., *magna cum laude*, Harvard Law School. I truly appreciate the helpful comments from Jesica Eames, Colleen Medill, Robert Moberly, Nancy Modesitt, Scott Moss, Michael Pitts, Kevin Ruser, Joseph Slater, Lynne Webb, and Steve Willborn. I also thank Aaron Bishop and Scott Newman for their excellent research assistance, and Kris Lauber and Sandra Placzek of the Marvin and Virginia Schmid Law Library for their invaluable aid in tracking down important resources. A McCollum Research Grant provided support for the research and writing of this Article.

whistleblowers bravely attempted to expose wrongdoing at many corporations involved in recent scandals, such as Enron, WorldCom, Global Crossing, and several mutual fund companies.[1]

Viewed differently, however, the scandals also illustrate the difficulty of relying upon employees to function as effective corporate monitors. The financial misconduct at Enron and other companies lasted for years before being revealed publicly.[2] Countless lower-level employees necessarily knew about, were exposed to, or were involved superficially in the wrongdoing and its concealment, but few disclosed it, either to company officials or to the public.[3] Thus, while the corporate scandals demonstrate employees' potential to monitor corporations, they also confirm that this potential often is not fully realized.

The most recent attempt to encourage employees to become more effective corporate monitors is the Sarbanes-Oxley Act of 2002, passed by Congress in response to corporate scandals.[4] The Act utilizes two approaches to encourage corporate whistleblowers.[5]

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1. *See* discussion *infra* Part II.B.

2. For example, immediately prior to declaring bankruptcy in December 2001, Enron restated its earnings for each year between 1997 through 2001 because of the accounting problems that occurred during that time. *See* WILLIAM C. POWERS, JR. ET AL., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. 2, 32 (2002), http://news.findlaw.com/hdocs/docs/enron/sicreport/sicreport020102.pdf.

3. *See* discussion *infra* Part II.B; *cf.* Rebecca Goodell, *The Ethics Resource Center's Survey of Ethics Practices and Employee Perceptions*, *in* CORPORATE CRIME IN AMERICA: STRENGTHENING THE "GOOD CITIZEN" CORPORATION, PROCEEDINGS OF THE SECOND SYMPOSIUM ON CRIME AND PUNISHMENT IN THE UNITED STATES 159, 160 (1995) [hereinafter GOOD CITIZEN] (presenting survey result that one in three employees witnessed significant corporare misconduct). Of course, many employees worked at these corporations without any reason to suspect wrongdoing. *See* BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON 239 (2003). Rather than focus on these employees, this Article is concerned with employees who have reason to suspect fraudulent conduct but do nothing about it.

4. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Star. 745 (codified in scattered sections of 15 & 18 U.S.C.).

5. A third model, the Bounty Model, has proven to be a particularly effective means of encouraging whistleblowing by giving financial incentives to whistleblowers. *See* Elletta Sangrey Callahan & Terry Morehead Dworkin, *Do Good and Get Rich: Financial Incentives for Whistleblowing and the False Claims Act*, 37 VILL. L. REV. 273, 278–82 (1992) (listing examples of various rewards to whistleblowers provided by federal and state statutes). The Bounty Model, however, is not extensively applied to encourage the reporting of fraud against corporations themselves (as opposed to fraud against the government) and, unlike the two models discussed in this Article, was not implemented in response to the corporate scandals.

The first is best described as a version of the well-known Anti-retaliation Model, which involves protecting whistleblowers from employer retaliation after they disclose wrongdoing.[6] The second approach, labeled in this Article as the Structural Model, requires that corporations provide employees with a standardized channel to report organizational misconduct internally within the corporation.[7]

While academic and public attention has focused almost exclusively on Sarbanes-Oxley's version of the Anti-retaliation Model,[8] this Article is the first comprehensive academic work to analyze the ability of Sarbanes-Oxley's Structural Model to engage corporate employees in the battle to reduce corporate fraud. Utilizing social science research that analyzes whistleblower motivations, I conclude that the Structural Model may produce more effective disclosures from whistleblowing employees than prior attempts to encourage whistleblowing because the Model addresses two significant problems that previously kept employees from consistently functioning as successful corporate monitors: (1) the corporate norm of silence, and (2) the corporate tradition of blocking and filtering employee whistleblowing.

Accordingly, although it is an intriguing idea that deserves further study, applying the Bounty Model to prevent fraud against corporations is beyond the scope of this Article.

6. *See* MARCIA P. MICELI & JANET P. NEAR, BLOWING THE WHISTLE: THE ORGANIZATIONAL AND LEGAL IMPLICATIONS FOR COMPANIES AND EMPLOYEES 232 (1992); Elletta Sangrey Callahan & Terry Morehead Dworkin, *The State of State Whistleblower Protection*, 38 AM. BUS. L.J. 99, 100 (2000); Callahan & Dworkin, *supra* note 5, at 273–78.

7. The structure of the channel can be fairly simple, such as designating an internal officer to receive such reports or setting up a "hotline" for employees to call. Organizations also might install more complex reporting systems, complete with ombudsmen who handle employee reports, ensure anonymity for the employees, investigate their concerns, and provide employees feedback on the outcome of the investigations. *See, e.g.*, Marlene Winfield, *Whistleblowers as Corporate Safety Net*, *in* WHISTLEBLOWING—SUBVERSION OR CORPORATE CITIZENSHIP? 21, 24 (Gerald Vinten ed., 1994) (describing the ombudsmen system implemented by Otis Elevator Company); Alan R. Yuspeh, *Sharing "Best Practices" Information*, *in* GOOD CITIZEN, *supra* note 3, at 84.

8. *See, e.g.*, STEPHEN M. KOHN ET AL., WHISTLEBLOWER LAW: A GUIDE TO LEGAL PROTECTIONS FOR CORPORATE EMPLOYEES (2004); Leonard M. Baynes, *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 (2002); 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); Robert G. Vaughn, *America's First Comprehensive Statute Protecting Corporate Whistleblowers*, 57 ADMIN. L. REV. 1 (2005); Ashlea Ebeling, *Blowing the Sarbanes-Oxley Whistle*, FORBES.COM, June 18, 2003, http://www.forbes.com/2003/06/18/cx_ae_0618beltway_print.html.

The Article begins by explaining the background of recent corporate scandals and the two whistleblower models found in the Sarbanes-Oxley Act. The specific examples from recent corporate scandals set forth in Part II of the Article illustrate the two problems that relate to the flow of employees' inside knowledge of wrongdoing. Part II first discusses how, during the scandals, employee information about wrongdoing did not flow readily. Despite having inside knowledge about corporate misconduct, employees rarely spoke out about wrongdoing because of a compelling norm of silence among employees.[9] Second, Part II addresses how on the rare occasion when employees spoke out, corporate executives typically blocked or filtered the information provided by employees before it reached traditional corporate monitors, such as the board of directors or the government. While a few "successful" whistleblowers overcame these two problems, thousands of other rank-and-file employees did not.

Part III of the Article describes the two approaches utilized by Sarbanes-Oxley to address these problems—the Anti-retaliation Model and the Structural Model. Ultimately, the Anti-retaliation Model implemented by Sarbanes-Oxley is not sufficient alone to address these flow-of-information difficulties. By contrast, Sarbanes-Oxley's Structural Model offers significant improvements over versions of the Structural Model utilized prior to recent corporate scandals. Namely, the Act requires that corporate boards of public companies establish avenues (i.e., structures) for employees to report wrongdoing directly to independent directors on the board's audit committee—not to corporate executives.[10] Furthermore, Sarbanes-Oxley made the implementation of this disclosure channel mandatory.[11]

Social science research can provide a framework for analyzing the effectiveness of Sarbanes-Oxley's Structural Model. Accordingly, Part IV of the Article evaluates Sarbanes-Oxley's Structural Model through this lens and suggests that it is more likely than the Anti-retaliation Model to reduce the flow-of-information problems that

9. *See, e.g.*, Cynthia L. Estlund, *Free Speech and Due Process in the Workplace*, 71 IND. L.J. 101, 119–23 (1995); Terance D. Miethe & Joyce Rothschild, *Whistleblowing and the Control of Organization Misconduct*, 64 SOC. INQUIRY 322, 332–37 (1994) (finding low levels of whistleblowing after discovery of misconduct).

10. *See* Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(m)(4)(A) (Supp. 2002).

11. *See id.*

contributed to recent corporate scandals because the Structural Model provides a direct and legitimate disclosure channel from employees to the board of directors. The Structural Model encourages *more* whistleblowing because it provides incentives to increase employee participation as corporate monitors and reduces various disincentives to employee whistleblowing.[12] Equally important, this direct channel to the board should encourage *effective* whistleblowing by circumventing information blocking and filtering by corporate executives.[13] In this way, Sarbanes-Oxley's Structural Model minimizes the principal-agent problem that arises when employees provide information about misconduct to mid-level managers and corporate executives who cover-up or ignore the fraud. Furthermore, the model should provide several secondary benefits to corporations and their employees, such as improving corporate decision-making, reducing monitoring costs, and increasing employee voice within the corporation. Such benefits may lead to greater acceptance and implementation than pre-scandal attempts to encourage whistleblowers.[14]

Although it is an improvement over prior approaches, Sarbanes-Oxley's Structural Model still suffers from significant flaws. Thus, the Article concludes in Part V by explaining the inadequacies of Sarbanes-Oxley's Structural Model and offering several suggestions for improvement. One problem is that the Model may not work well enough. That is, corporations may implement disclosure channels that appear sound on paper but do not work in reality.[15] This "cheating" problem can be addressed in several ways. First, corporations could disclose information regarding their whistleblower system. For example, corporations might publicize the structure of their whistleblower disclosure model in order to advise shareholders and employees of the extent of their system. Similarly, corporations could be required to disclose various metrics regarding the effectiveness of their disclosure channel, such as the number and type of complaints and the resolution of those complaints. Shareholders, employees, and government regulators could evaluate the effectiveness of a whistleblower disclosure system through these

12. *See* discussion *infra* Part IV.A.
13. *See* discussion *infra* Part IV.B.
14. *See* discussion *infra* Part IV.C.
15. *See* discussion *infra* Part V.B.

disclosures. A second way to address the cheating problem is to provide corporations with a true incentive to create effective whistleblower systems by permitting a limited safe harbor for corporations that implement verifiably effective whistleblower channels *prior* to any wrongdoing.

The converse of the cheating problem presents another potential difficulty: the model may work too well. Complaints from employees may overwhelm directors and prevent them from efficiently and sufficiently addressing the complaints, much less attending to their obligation to oversee the business of the company.[16] Addressing this "noise" problem may require the SEC to promulgate regulations that reduce the burden on directors, while still requiring director oversight of the information obtained through a whistleblower disclosure channel. For example, the SEC may explicitly permit directors to outsource initial review of such disclosures to ethics officers or third-parties that report directly to the board rather than to corporate executives. Approving sufficient, but limited, whistleblower structures through regulation may prevent corporations from implementing inefficient and cumbersome systems in order to satisfy Sarbanes-Oxley's vague mandate.

Ultimately, Sarbanes-Oxley's Structural Model is an improvement over prior attempts to encourage whistleblowing because the Act requires a structure that will encourage whistleblowers and help them effectively provide information about wrongdoing to corporate officers with the power to address the misconduct. But, in its current form, Sarbanes-Oxley fails to properly balance the need for employees to disclose important inside knowledge to independent directors with the need for directors to efficiently and effectively monitor all aspects of a corporation's business.

16. *See* discussion *infra* Part V.C.

II. THE NEED TO ENCOURAGE MORE EFFECTIVE WHISTLEBLOWING

A. Information Problems and Traditional Corporate Monitors

Effective corporate monitoring benefits corporate shareholders and employees, as well as the general public.[17] Traditional monitoring occurs through a variety of overlapping means. A board of directors monitors a corporation's professional management on behalf of the shareholders, who are too dispersed and diverse to monitor management themselves.[18] Professional corporate "gatekeepers," such as auditors and attorneys, provide outside monitoring of corporations that protects shareholders as well as the investing public.[19] Further, the government monitors companies through government inspectors and by requiring various corporate reports to be filed.[20]

A primary advantage of each of these traditional corporate monitors is that they are external to the company. Independent directors purportedly provide dispassionate oversight of management.[21] Gatekeepers have reputational concerns outside of

17. *See* Stephen M. Bainbridge & Christine J. Johnson, *Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307*, 2004 MICH. ST. L. REV. 299, 316; Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 863 (1984); Larry E. Ribstein, *Sarbox: The Road to Nirvana*, 2004 MICH. ST. L. REV. 279, 280–85.

18. *See* Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 495, 498 & n.14 (Nancy B. Rapoport & Bala G. Dharan eds., 2004); Joan MacLeod Heminway, *Enron's Tangled Web: Complex Relationships; Unanswered Questions*, 71 U. CIN. L. REV. 1167, 1170–74 (2003); Ribstein, *supra* note 17, at 285.

19. *See, e.g.*, John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 308–10 (2004); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 54 (1986).

20. *See, e.g.*, 15 U.S.C. § 78m (Supp. 2002) (requiring public companies to make periodic filings with the Securities and Exchange Commission). Government-like entities, such as various securities listing agencies like the New York Stock Exchange, also monitor corporations.

21. Director independence can enhance the objectivity of the board because independent directors are not as dependent on short-term corporate results to maintain their position with the corporation. *See* Melvin A. Eisenberg, *The Board of Directors and Internal Control*, 19 CARDOZO L. REV. 237, 244–50 (1997); Peter C. Kostant, *Breeding Better Watchdogs: Multidisciplinary Partnerships in Corporate Legal Practice*, 84 MINN. L. REV. 1213, 1237 n.100 (2000). Moreover, independent directors may be more willing to disclose

their contractual relationship with corporations to inspire them to provide effective monitoring.[22] When the government enforces laws and regulations, accountability to the public at large keeps regulators from being influenced by the corporation's own goals.

Despite the advantage of external monitors, however, their external position presents a significant challenge: monitoring the inner workings of a company from the outside.[23] External monitors must rely upon information they receive from corporate executives to fulfill their monitoring function.[24] Even under the best circumstances, this information is certain to be incomplete and self-serving due to information blocking and filtering by executives and subordinate managers.[25] Under the worst circumstances, corporate

wrongdoing publicly because they can do so without losing their employment. *See* Eisenberg, *supra*, at 244–48; Kostant, *supra*, at 1237 n.100.

22. *See, e.g.*, Coffee, *supra* note 19, at 308; Kraakman, *supra* note 19, at 61 n.20, 94.

23. *See* Kostant, *supra* note 21, at 1239–40. For example, the independence of a director may only exacerbate the informational asymmetries that already exist. Outside directors "devote but a small portion of their time and effort to the firm." Bainbridge & Johnson, *supra* note 17, at 310; *see also* Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1250 (2003) (noting that directors have information gathering problems because they only meet a few times a year). Therefore, they can have difficulty understanding the inner workings of the company they are charged with monitoring. *See* Eliot Spitzer, *Keynote Address, Symposium: Enron and Its Aftermath*, 76 ST. JOHN'S L. REV. 801, 807 (2002).

24. *See* James Fanto, *Whistleblowing and the Public Director: Countering Corporate Inner Circles*, 83 OR. L. REV. 435, 460 (2004); Lawrence E. Mitchell, *Structural Holes, CEOs, and Informational Monopolies*, 70 BROOK. L. REV. 1313, 1349–50 (2005).

25. Information blocking and filtering occurs when information is withheld by subordinates, and "communication upward [is] highly filtered and correspondingly inaccurate." 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) (quoting R. Likert, *A Motivational Approach to a Modified Theory of Organization and Management*, *in* MODERN ORGANIZATION THEORY 184, 195–96 (M. Haire ed., 1959)); Kostant, *supra* note 21, at 1239–40. This blocking and filtering has numerous causes, including:

> (a) a shared feeling on the part of subordinate officials that they owe their loyalty chiefly to senior management and not to the board; (b) a belief that the board is interested only in "hard" quantitative information, such as capital costs, financial ratios, and expected rates of return; (c) a sense that "everybody knows anyway," coupled with the perception that the board would rather not be put on formal notice as to the ugly "facts of life" of doing business abroad; and (d) a "lack of congruence" between the interests of the corporation and the career aspirations of individual corporate officials.

Coffee, *supra*, at 1131; *see also* Linda Klebe Trevino, *Out of Touch: The CEO's Role in Corporate Misbehavior*, 70 BROOK. L. REV. 1195, 1209–10 (2005) (describing research

executives may affirmatively hide or misrepresent information in order to evade a monitor's oversight. Thus, flow-of-information problems can arise because these traditional corporate monitors do not have enough information, and the information that they do have is often distorted and filtered.

These problems contributed to the failure of traditional monitors to detect the wrongdoing at the center of recent corporate scandals.[26] Certainly the greed of corporate executives triggered the massive fraud,[27] and traditional corporate monitors should have been more active in their oversight responsibilities.[28] Other systemic issues also contributed to this unprecedented failure in corporate governance, such as internal incentives to inflate stock prices caused by managerial stock options.[29] There is sufficient blame to go around.[30] However, as discussed below, one of the most glaring—yet

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regarding the distortion and filtering of information from subordinates to superiors in hierarchical organizations).

26. The failings of the traditional monitors in these scandals, particularly with regard to Enron, have been exhaustively detailed elsewhere. *See, e.g.*, Coffee, *supra* note 19, at 313–15; Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 CONN. L. REV. 1125, 1125–43 (2003); John R. Kroger, *Enron, Fraud, and Securities Reform: An Enron Prosecutor's Perspective*, 76 U. COLO. L. REV. 57, 59–60 (2005).

27. *See* Ribstein, *supra* note 17, at 280–81; Greg Ip, *Greenspan Issues Hopeful Outlook as Stocks Sink*, WALL ST. J., July 17, 2002, at A1 (quoting Federal Reserve Chairman Alan Greenspan in a July 16, 2002 speech in which Mr. Greenspan blamed an "infectious greed" for the corporate scandals); *see also* Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 286 (2004) ("Indeed, unrestrained greed has now become the standard trope in the social construction of these events.").

28. Fanto, *supra* note 24, at 435–36; O'Connor, *supra* note 23, at 1235–36; POWERS ET AL., *supra* note 2, at 22, 148.

29. *See* Coffee, *supra* note 19, at 304. Other explanations include: a "'bubble' atmosphere" fueled by new business techniques and a lack of investor skepticism; *see* Ribstein, *supra* note 17, at 281; the legislative undermining of private securities liability through, among other things, the Private Securities Litigation Reform Act of 1995; *see* andré douglas pond cummings, *"Ain't No Glory in Pain": How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Contributed to the Collapse of the United States Capital Markets*, 83 NEB. L. REV. 979, 1044 (2005); and a judicial tightening of burdens of proof for demonstrating aiding and abetting liability in violation of federal securities law; *see* cummings, *supra*, at 1023–24, 1048 & n.320 (citing Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994)).

30. *See* Kroger, *supra* note 26; Paredes, *supra* note 18, at 503 ("Many things contributed to Enron's demise. There were breakdowns all around—accountants, lawyers, securities analysts, and credit rating agencies (the 'gatekeepers'); the SEC, and the board of directors, not to mention the underlying corporate misconduct. Even the 'victims'—the investors—bear some responsibility for seemingly, perhaps understandably, becoming

under-analyzed—facts regarding the scandals is that the information concerning the fraudulent conduct was available to rank-and-file employees for years. Problematically, this information either never made it to the traditional corporate monitors or was so filtered that it did not inspire any of the monitors to end the misconduct until shareholders lost millions of dollars of value in their investments.[31]

B. Overcoming Information Problems—Employees as Corporate Monitors

Corporate employees could be instrumental in solving the inherent information problems of traditional external corporate monitors. Employees have an information advantage over traditional corporate monitors because they have more complete knowledge regarding the inner workings of a large corporation.[32] Financial misconduct on the scale that occurred during the recent corporate scandals necessarily requires the assistance of low- and mid-level employees because of its scope and complexity.[33] Additionally, even if an employee does not participate in the wrongdoing, corporate accounting and finance employees, who are trained in the proper

complacent after historic bull markets and failing to ask the tough questions of Enron's management that should have been asked.").

31. To some extent, this problem is not new. During corporate scandals in the 1970s relating to corporate bribery of public officials, Professor Coffee noted significant problems with information flow to the board of directors. *See* Coffee, *supra* note 25, at 1127–28. Corporate officers systematically kept information about the bribery from the board of directors, and the hierarchical structure of the corporation cut off subordinates who attempted to raise red flags. *See id.* at 1133–34. Writing in the early 1980s, Alan Westin also lamented the harmful results that occurred when corporate management blocked information from employees regarding illegalities taking place within the corporation. *See* Alan F. Westin, *Introduction* to WHISTLE-BLOWING! LOYALTY AND DISSENT IN THE CORPORATION 1, 10–12 (Alan F. Westin ed., 1981).

32. Although the statement that employees have better information about corporate conduct than outside monitors seems rationally based on common sense, Ralph Nader put it nicely in his early work on corporate whistleblowers:

> Corporate employees are among the first to know about industrial dumping of mercury or fluoride sludge into waterways, defectively designed automobiles, or undisclosed adverse effects of prescription drugs and pesticides. They are the first to grasp the technical capabilities to prevent existing product or pollution hazards. But they are very often the last to speak out, much less to refuse to be recruited for acts of corporate or governmental negligence or predation.

Ralph Nader, *An Anatomy of Whistle Blowing*, *in* WHISTLE BLOWING: THE REPORT OF THE CONFERENCE ON PROFESSIONAL RESPONSIBILITY 3, 4 (Ralph Nader et al. eds., 1972).

33. *See* Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L.Q. 357, 374 (2003); Ribstein, *supra* note 17, at 286.

methods of conducting business, should recognize when corporate actions fall outside legal boundaries.[34] In fact, even with few corporate or legal incentives provided to whistleblowing employees, roughly one-third of fraud and other economic crimes against businesses are reported by whistleblowers.[35] Given their central role in corporate activity, information from rank-and-file employees is essential to uncovering wrongdoing in a timely manner. Accordingly, effectively encouraging employees to disclose their knowledge of wrongdoing is a critical step in discovering fraud and other corporate misconduct.

1. The few who succeeded

Unlike the traditional corporate monitors during the recent scandals, some corporate employees successfully identified and reported the corporate fraud, particularly at WorldCom, Kmart, and several mutual fund companies. These whistleblowing employees succeeded for two reasons. First and foremost, they simply spoke out and disclosed their inside knowledge regarding the corporate misconduct. Second, the successful whistleblowers spoke out *effectively* by disclosing their information directly to traditional corporate monitors rather than to corporate executives.

The most famous example of a successful individual employee whistleblower may be Cynthia Cooper, the former head of internal auditing at WorldCom.[36] Cooper uncovered a wide variety of illegal accounting practices at WorldCom in 2002 and reported the illegalities directly to WorldCom's Board of Directors. The Board publicly admitted the financial manipulations and fired WorldCom's CFO Scott Sullivan, who allegedly orchestrated the fraud and tried to stop Cooper's investigation.[37] By reporting Sullivan's misconduct

34. *See* Richard Alexander, *The Role of Whistleblowers in the Fight Against Economic Crime*, 12 J. FIN. CRIME 131, 131 (2004).

35. *See* Brickey, *supra* note 33, at 365 n.37 (citing study reported in Jonathan D. Glater, *Survey Finds Fraud's Reach in Big Business*, N.Y. TIMES, July 8, 2003, at C3).

36. *See* Amanda Ripley, *The Night Detective*, TIME, Dec. 30, 2002, at 45, 46–47. Cooper was named, along with Sherron Watkins of Enron, as one of Time Magazine's People of the Year in 2002. *See* Richard Lacayo & Amanda Ripley, *Persons of the Year*, TIME, Dec. 30, 2002, at 31, 32–33.

37. *See* Ripley, *supra* note 36, at 49. WorldCom ultimately filed for the largest bankruptcy in American history. *See* Ken Belson, *WorldCom's Audacious Failure and Its Toll on an Industry*, N.Y. TIMES, Jan. 18, 2005, at C1.

directly to the Board, Cooper successfully avoided Sullivan's attempt to block disclosure of the fraud.[38]

Other whistleblowers were similarly effective because they disclosed information directly to the government, another traditional corporate monitor.[39] For example, separate, anonymous whistleblowers brought to light fraud at Symbol Technologies and Kmart when they sent letters to government regulators.[40] More recently, the mutual fund industry paid hundreds of millions of dollars to settle charges arising out of allegations made by employee whistleblowers to government investigators regarding improper practices in the industry.[41]

38. Ethics hotlines also helped whistleblowers succeed. At Duke Power, a call from an employee whistleblower to the company's ethics hotline in July 2001 led to the company's payment of a $25 million fee to state regulators. *See* Alix Nyberg Stuart, *Whistle-Blower Woes*, CFO MAG., Oct. 2003, at 51, 52, *available at* http://www.cfo.com/article.cfm/3010455?f=related; Melissa Davis, *Enron Aside, Whistle-Blowers Still Withering*, THESTREET.COM, May 29, 2003, http://www.thestreet.com/_tscs/ stocks/melissadavid/10090120.html.

39. To be sure, some whistleblowers also were successful because they disclosed information directly to the public, either through the media or an individual lawsuit. For example, a former Dynegy employee gave papers about "Project Alpha"—a financial vehicle implemented by Dynegy to exaggerate cash flow and reduce taxes—to the Wall Street Journal, which led to an SEC civil securities-fraud case that the company settled for $3 million, a shareholder lawsuit, and resignations of senior executives. *See* Jathon Sapsford & Paul Beckett, *Whistle-Blower Reels from Actions' Fallout*, WALL ST. J. ONLINE, Dec. 17, 2001, http://www.careerjournal.com/myc/survive/20021217-sapsford.html. Also, after receiving allegations in a whistleblower lawsuit about marketing fraud related to its relationship to Burger King, the Coca-Cola Company conducted an internal investigation and ultimately offered to pay Burger King $21 million to compensate for the fraud. *See* Stuart, *supra* note 38, at 52.

40. In April 2001, an anonymous whistleblower sent a letter to the SEC alleging that Symbol Technologies engaged in improper accounting. After three years of government and internal investigations, Symbol restated earnings for five years and the government indicted seven former senior executives for accounting fraud. *See* Steve Lohr, *Ex-Executives at Symbol Are Indicted*, N.Y. TIMES, June 4, 2004, at C1. In its restatements, Symbol reduced revenue by $234 million and net income by $325 million. *See id.* Symbol also settled investor and SEC lawsuits for $138 million. *See id.* In January 2002, an anonymous whistleblower sent a letter about corporate wrongdoing to Kmart's board and to government officials that resulted in at least two criminal indictments, which were allegedly based upon improperly recording payments to overstate Kmart's earnings. *See* Constance L. Hays, *2 Ex-officials at Kmart Face Fraud Charges*, N.Y. TIMES, Feb. 7, 2003, at C1.

41. *See* Jayne O'Donnell, *The Guy Who Blew the Whistle on Putnam*, USA TODAY, Nov. 20, 2003, at A1, *available at* http://www.usatoday.com/money/perfi/funds/2003-11-20-whistleblower-1a-cover_x.htm. Putnam Investments alone paid nearly $194 million to settle claims that investors were hurt by the practice of market timing. *See* Jon Chesto, *Mass. Market: Whistle-blower Law Needs Updating; No One Rewarded in 5-Year History*, PATRIOT LEDGER, July 9, 2005, http://ledger.southofboston.com/articles/2005/07/09/news/news06.txt; *60 Minutes II: Meet a Major-League Whistleblower* (CBS television broadcast Feb. 18, 2004) (text

Alone, these whistleblowing employees could not stop corporate misconduct; but by providing information directly to traditional monitors, the employees circumvented the barriers corporate executives erected to shield external monitors from uncovering wrongdoing.

2. The many who failed

The success of these few individual whistleblowers does not indicate that employee whistleblowing worked effectively. Rather, the small number of successful whistleblowers highlights the overall failure of corporate employees to promptly identify and report the wrongdoing occurring in these companies and others, such as Enron. Employees failed in two respects. First, employees failed to speak out; and second, when they did, they failed to effectively report the misconduct they witnessed.

a. Failing to speak out. Unlike the few successful individual whistleblowers, the vast majority of knowledgeable employees failed to reveal wrongdoing because they were unable or unwilling to speak out. The misconduct at many of the corporations affected by recent scandals occurred over a period of several years.[42] During this time, rank-and-file employees certainly participated, at some level, in the improper practices that led to the fraud.[43] For example, when

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of interview available at http://www.cbsnews.com/stries/2004/07/07/60II/printable628000.shtml).

42. For example, the fraud at Enron was ongoing for at least four years before the company filed for bankruptcy in December 2001. *See* POWERS ET AL., *supra* note 2, at 2, 32. The amounts involved in the restatement are staggering. As set forth in the Powers Report, the restatement

> reduced Enron's reported net income by $28 million in 1997 (of $105 million total), by $133 million in 1998 (of $703 million total), by $248 million in 1999 (of $893 million total), and by $99 million in 2000 (of $979 million total). The restatement reduced reported shareholders' equity by $258 million in 1997, by $391 million in 1998, by $710 million in 1999, and by $754 million in 2000. It increased reported debt by $711 million in 1997, by $561 million in 1998, by $685 million in 1999, and by $628 million in 2000.

Id. at 3. The HealthSouth fraud may have lasted as long as fifteen years. *See* Kurt Eichenwald, *Key Executive at HealthSouth Admits to Fraud*, N.Y. TIMES, Mar. 27, 2003, at C1. It "ranks as one of the biggest, and perhaps the most blatant, in corporate history." *See* Melissa Davis, *HealthSouth Spotlight Turns to Ex-Auditor*, THESTREET.COM, May 22, 2003, http://www.thestreet.com/_tscs/stocks/melissadavid/10089204.html.

43. At Enron, for example, the misrepresentations and the improper accounting practices that led to Enron's bankruptcy were long-standing and well-known throughout the

corporate executives at Enron made outlandish profit predictions, employees knew they must "gin . . . up" earnings and revenues to match the predictions.[44] Thus, executives may have hatched accounting scams, but often their underlings were sent to do the dirty work of executing the plan despite the underlings' knowledge that such accounting was illegal.[45]

Furthermore, even if employees did not directly participate in the fraud, employees often knew that something in the corporation was amiss. At Enron, for example, knowledge about earnings manipulation was so widespread that employees joked about it at company parties.[46] For months prior to Enron's bankruptcy filing, numerous employees knew that executives' public statements about Enron's financial strength were not true and that the company's business was failing.[47] But despite their lengthy exposure to flawed financial practices and public misrepresentations, few employees came forward to complain.[48] Importantly, this failure to report is not unique to Enron. In fact, studies reveal that the majority of corporate employees who witnessed wrongdoing did not report it.[49] Successful whistleblowers, by definition, overcame this inherent hesitation to speak out.

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company. *See, e.g.*, MCLEAN & ELKIND, *supra* note 3, at 116; *id.* at 182–83 (giving examples of employee knowledge of Enron's practice of inflating sales numbers); *id.* at 219–20, 230, 269–70 (discussing wide-spread employee knowledge and participation in various strategies to manipulate California's energy market); *see also id.* at 303–04, 332.

44. *See id.* at 289.

45. *See* Davis, *supra* note 42 (noting that the CFO of HealthSouth admitted to directing the company's auditing staff to inflate the company's earnings); Kenneth N. Gilpin, *Ex-Rite Aid Officials Face U.S. Charges of Financial Fraud*, N.Y. TIMES, June 22, 2002, at A1 (noting that the indictment of the CFO for Rite Aid alleged that he coordinated the accounting fraud by "instructing less-senior employees in the accounting department to make unsupported entries in the company's books and records that did not meet generally accepted accounting principles").

46. *See* MCLEAN & ELKIND, *supra* note 3, at 296.

47. *See, e.g.*, ROBERT BRYCE, PIPE DREAMS: GREED, EGO, AND THE DEATH OF ENRON 246–47 (2003); MCLEAN & ELKIND, *supra* note 3, at 230, 303, 332.

48. There are exceptions, of course. In March 2001, one Enron employee sent an anonymous letter to *Fortune* magazine to complain that company executives were understating the extent of recent job cuts. *See* MCLEAN & ELKIND, *supra* note 3, at 332.

49. Several studies have found low reporting rates among employees who witness misconduct. *See, e.g.*, MICELI & NEAR, *supra* note 6, at 96–99; TERANCE D. MIETHE, WHISTLEBLOWING AT WORK: TOUGH CHOICES IN EXPOSING FRAUD, WASTE, AND ABUSE ON THE JOB 31 (1999); Estlund, *supra* note 9, at 119–20; Miethe & Rothschild, *supra* note 9, at 332–33 (surveying six studies of whistleblowing and finding that the average rate of whistleblowing is forty-two percent).

b. Executive blocking and filtering. A second flow-of-information failure occurred because of executive blocking and filtering of whistleblower reports, so that even if employees spoke out, their disclosures of wrongdoing were ineffective. Many whistleblowers reported information to corporate executives rather than to traditional corporate monitors, such as the board of directors. Executives subsequently prevented such information from reaching corporate monitors in order to protect the company from penalties and scandal.[50] Such problems were apparent in many recent cases of corporate fraud;[51] however, the fraud at Enron presents the clearest and most well documented example.[52]

At the core of the Enron scandal were "massive accounting fraud and irregularities, a principal feature of which was the use of structured finance techniques designed to get debt off Enron's balance sheet and inflate Enron's profits."[53] During the course of this fraud, Enron executives successfully blocked many employee complaints regarding improper or illegal business tactics by responding to any complaint with hostility and obfuscation.[54] From

50. *See* Mitchell, *supra* note 24, at 1313–14.

51. For example, in August 2001, a Global Crossing vice president for finance wrote the company's Chief Ethics Officer claiming that the company was engaging in improper accounting techniques. *See* FRANK PARTNOY, INFECTIOUS GREED 362–63 (2003). The top executives at the company never sent this letter to its Board or its auditors. *See id.* at 363.

52. *See* Gregory Mitchell, *Case Studies, Counterfactuals, and Causal Explanations*, 152 U. PA. L. REV. 1517, 1518 n.4 (2004) (listing the "staggering amount of scholarship on Enron"); Jeffrey D. Van Niel & Nancy B. Rapoport, *Dr. Jekyll & Mr. Skilling: How Enron's Public Image Morphed from the Most Innovative Company in the* Fortune 500 *to the Most Notorious Company Ever*, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS, *supra* note 18, at 77, 87 (noting that since Enron's bankruptcy filing, Enron books "have become their own cottage industry"); *id.* at 87 n.36 (listing dozens of books published about Enron). *See generally* POWERS ET AL., *supra* note 2 (including an investigative report by special committee of the Enron Board of Directors).

53. Paredes, *supra* note 18, at 503.

54. *See* BRYCE, *supra* note 47, at 135, 149–50, 294; MCLEAN & ELKIND, *supra* note 3, at 308–09; Nancy B. Rapoport, *Enron,* Titanic, *and* The Perfect Storm, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS, *supra* note 18, at 927, 937 ("Those who objected often found themselves the subject of pressure, downright abuse, and exile."); Tim Mcguire, *More Than Work: Many Yelled 'Fire!' at Enron, But Deceit Drowned Them Out*, WINSTON-SALEM J., Aug. 21, 2005 ("That was a clear pattern at Enron: If anyone suggested wrongdoing, they were considered a hindrance and ousted."). Several researchers have described anecdotal evidence of management hostility to underlings who report wrongdoing as typical of reactions to whistleblowers. *See, e.g.*, Alan F. Westin, *Conclusion* to WHISTLE-

the company's earliest days, Enron executives silenced and undermined employees who raised concerns about Enron's accounting and financial practices.[55] This information blocking grew increasingly problematic by the late 1990s, when employees repeatedly complained to Enron's risk assessment group and corporate executives about the off-balance sheet "special purpose entities" that became the center of the Enron scandal.[56] These complaints never made it to the Board of Directors, which, on three separate occasions, waived Enron's Code of Ethics and approved the conflicts of interests these entities created.[57] Enron's Board never substantively investigated the propriety or long-term impact of these entities.[58] Furthermore, in early 2001, as Enron's businesses began to show signs of strain, a few employees reported to corporate executives that large losses were being hidden.[59] Executives disregarded these reports and never completed internal investigations.[60] At least one employee wrote a signed letter to Enron's management and the Secretary of the Board in which she detailed the misrepresentations about Enron's earnings.[61] The letter, however, was never shown to Enron's Board of Directors.[62]

BLOWING! LOYALTY AND DISSENT IN THE CORPORATION 131, 132 (Alan Westin ed., 1981); *see also* Westin, *supra* note 31, at 10–12.

55. *See* BRYCE, *supra* note 47, at 38–42 (describing actions by Ken Lay in the late 1980s to cover up internal reports regarding falsified bank statements and illegal payments to corporate officers); MCLEAN & ELKIND, *supra* note 3, at 94–95 (describing 1994 complaints by Jim Alexander regarding internal accounting issues).

56. *See* BRYCE, *supra* note 47, at 160, 226, 231; MCLEAN & ELKIND, *supra* note 3, at 192–93, 308–09; POWERS ET AL., *supra* note 2, at 166–67 (describing complaints by Jeff McMahon to Jeffrey Skilling, Enron's President and COO, regarding the failure of controls to protect Enron from Andrew Fastow's conflict of interest in creating the special purpose entities).

57. *See* POWERS ET AL., *supra* note 2, at 148–65; Paredes, *supra* note 18, at 503. As Professor Paredes noted, by utilizing these special purpose entities that he individually controlled, Enron's CFO, Andrew Fastow, "stood to make millions by, essentially, negotiating against Enron." *Id.* at 503. The Board hardly discussed this massive conflict of interest or how to monitor it. *See* MCLEAN & ELKIND, *supra* note 3, at 193. There is no indication that internal employee concerns with the arrangements ever reached the Board. *See id.*

58. *See* BRYCE, *supra* note 47, at 164–65, 228–29.

59. MCLEAN & ELKIND, *supra* note 3, at 299–304 (describing internal investigation of Enron Energy Services by Wanda Curry, an Enron accountant, which uncovered hundreds of millions of dollars worth of "unacknowledged, speculative trading losses").

60. *Id.*

61. *See id.* at 358–59.

62. *See id.* at 359.

Even when employees avoided management's information blocking, corporate executives often filtered or slanted employee reports before the information reached the monitors. For example, Sherron Watkins, the famed Enron whistleblower,[63] was unsuccessful in stopping Enron's fraud because the information she disclosed about misconduct at Enron was sanitized before it reached the Board of Directors. Watkins's error was that she complained to Enron's CEO, Kenneth Lay, rather than to the full Board of Directors.[64] Lay subsequently hired the law firm of Vinson & Elkins to investigate the allegations—the very same law firm that approved many of the transactions about which Watkins complained.[65] When the Board ultimately learned of Watkins's allegations, the report was whitewashed by Vinson & Elkins's conclusion that the transactions Watkins reported were proper.[66] Thus, by hand-picking his friends at Vinson & Elkins to investigate Watkins's claims, Lay successfully filtered Watkins's full allegations from reaching the Board and the public.[67] Although Watkins certainly deserves credit for her

63. *See* Lacayo & Ripley, *supra* note 36, at 32–33 (naming Watkins a "Person of the Year").

64. In August 2001, Watkins reported her concerns regarding the accounting problems to Lay, first in an anonymous letter, and subsequently in a meeting with Lay. *See* Cherry, *supra* note 8, at 1036–37 & n.31; Leslie Griffin, *Whistleblowing in the Business World*, *in* ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS, *supra* note 18, at 209, 210–11. Watkins presciently warned of her concern that Enron might "implode in a wave of accounting scandals." Memorandum from Sherron Watkins to Kenneth Lay (Aug. 15, 2001), *available at* http://energycommerce.house.gov/107/hearings/02142002Hearing489/tab10.pdf. For a more lengthy description of Watkins's role, see BRYCE, *supra* note 47, at 293–99, and MCLEAN & ELKIND, *supra* note 3, at 354–58.

65. *See* POWERS ET AL., *supra* note 2, at 173; Griffin, *supra* note 64, at 213–14. Lay justified this choice by concluding that the investigation would only be "preliminary" and could be conducted most quickly by Vinson & Elkins because the law firm was "familiar" with Enron. *See* POWERS ET AL., *supra* note 2, at 173. However, as noted by Enron's own Board-led investigation after the bankruptcy filing, "[t]he result of the V&E review was largely predetermined by the scope and nature of the investigation and the process employed." *Id.* at 176.

66. *See* MCLEAN & ELKIND, *supra* note 3, at 366; POWERS ET AL., *supra* note 2, at 173–77. At the Board meeting, a Vinson & Elkins attorney "assured the audit committee that [the Watkins letter] wasn't a problem; his preliminary investigation had already concluded there was no need to look any further. No Enron director asked to see Watkins's letter . . . and there was no specific discussion of her concerns about the [special purpose entities]." MCLEAN & ELKIND, *supra* note 3, at 366.

67. Eventually, Watkins unveiled much of Enron's "fuzzy" accounting to the government during her testimony to Congress in February 2002. *See The Financial Collapse of Enron—Part 3: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy & Commerce*, 107th Cong. 14–66 (2002) (testimony of Sherron Watkins).

willingness to step forward and report her concerns to Enron's CEO, she ultimately was not *effective* as a whistleblower because she provided information to Enron's executives rather than directly to Enron's Board.[68]

Finally, any conceivably problematic information that did make it to Enron's traditional monitors often was discounted or ignored based upon the close relationship between the monitors and Enron executives. Enron's Board, although ideally independent on paper,[69] never effectively questioned Enron's management regarding its financial practices.[70] Moreover, "gatekeepers," such as Enron's outside accountants and attorneys who received huge fees from Enron, did not raise red flags to anyone on Enron's Board even though they knew Enron's aggressive accounting techniques were problematic.[71] The close relationships between purportedly independent monitors and Enron executives led to "group think" that prevented such monitors from dispassionately fulfilling their responsibilities and questioning information provided by corporate executives.[72] Unfiltered information from employees, however,

However, these public disclosures occurred only after Enron filed for bankruptcy in December 2001 and Congress discovered her initial memo to Lay. *See* POWERS ET AL., *supra* note 2, at 32.

68. Despite the public accolades she received, Watkins's ineffectiveness as a whistleblower has been criticized. In his well-regarded book regarding the collapse of Enron, Robert Bryce entitled his chapter on Watkins "Sherron Watkins Saves Her Own Ass." *See* BRYCE, *supra* note 47, at 293; Griffin, *supra* note 64, at 220–21; *see also* Dan Ackman, *Whistleblower?*, WALL ST. J., Dec. 24, 2002, at A10.

69. *See* Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1241 (2002); Peter C. Kostant, *Sarbanes-Oxley and Changing the Norms of Corporate Lawyering*, 2004 MICH. ST. L. REV. 541, 542.

70. *See* Kostant, *supra* note 69, at 542.

71. *See* BRYCE, *supra* note 47, at 298; POWERS ET AL., *supra* note 2, at 17, 24–26; *see also* Bainbridge & Johnson, *supra* note 17, at 301 ("All too often, lawyers acted as facilitators and enablers of management impropriety."); Coffee, *supra* note 19, at 313–15 (discussing accountants' role); Gordon, *supra* note 69, at 1237 (discussing accountants' role); Gordon, *supra* note 26, at 1138 (noting that lawyers had "the capacity to create endless shells under which to hide and move the peas"); *Developments in the Law: Corporations and Society*, 117 HARV. L. REV. 2227, 2227 (2004) [hereinafter *Developments in the Law*] ("Lawyers' negligence almost certainly contributed to the wave of corporate scandals that shook the securities markets in 2001 and 2002.").

72. *See* Fanto, *supra* note 24, at 441–42, 446–49; O'Connor, *supra* note 23, at 1257–93. "Group think" involves a "culture of silence" in which corporate leaders discourage critical discussions and influence from individuals outside of the corporate "inner circle." Fanto, *supra* note 24, at 469; *see also* O'Connor, *supra* note 23, at 1242–55 (asserting that whatever

might have forced these monitors to fulfill their oversight responsibilities despite their close relationship with Enron management.

Most commentators ignored the role of corporate employees in these scandals and, instead, blamed the failures of the traditional corporate monitors for the success of the deceptions.[73] In part, this blame is well deserved: the duties of traditional corporate monitors to investigate potential misconduct are more pronounced and formalized—and their authority to intervene is more apparent—than the duties and authority of rank-and-file employees. Yet thousands of employees participated in, knew of, or willfully ignored the massive misconduct occurring within their companies.[74] Such information would have been useful to corporate monitors, perhaps leading to earlier discovery of the fraud.

The corporate employee's potential as an effective corporate monitor cannot be ignored. A response to the recent corporate scandals should be to encourage more employee whistleblowing and to encourage *effective* whistleblowing by assisting employees in avoiding the problems of blocking and filtering by corporate executives. The remainder of this Article examines whether the Sarbanes-Oxley Act imposes the best means of implementing these goals.

III. TWO WHISTLEBLOWER MODELS

Both the Anti-retaliation Model and the Structural Model exisred before recent corporate scandals, yet neither model effectively encouraged employees to disclose information about corporate

information is received by directors often is analyzed in the context of norms of building board cohesiveness that make it difficult to test and question what is being told to them).

73. *See, e.g.*, Bainbridge & Johnson, *supra* note 17, at 301 (blaming attorneys); Coffee, *supra* note 19, at 313–15 (blaming outside auditors); Fanto, *supra* note 24, at 435–37 (blaming corporate directors).

74. *See, e.g.*, Neal E. Boudette & Joann S. Lublin, *Delphi Discloses New Irregularities in Its Accounting*, WALL ST. J., June 10, 2005, at A3 (noting that although Delphi Corporation's "treasury staff was aware of the [undisclosed] off-balance sheet debt," no one reported it to the company's CEO, the "board of directors, or credit-rating agencies"). After the scandals, recovering corporations realized the danger of having employees who remain silent in the face of financial misconduct. New management at both WorldCom (now known as MCI) and Tyco fired employees and executives who likely knew about financial improprieties. *See* Joseph McCafferty, *Adelphia Comes Clean*, CFO MAG., Dec. 1, 2003, *available at* http://www.cfo.com/article.cfm/3011051/1/c_3036074?f=insidecfo.

fraud. As part of its response to the scandals, Congress implemented versions of both models in the Sarbanes-Oxley Act.[75]

A. Insufficiency of the Anti-retaliation Model

Academics widely praised the anti-retaliation provision of the Sarbanes-Oxley Act,[76] calling it the "gold standard" of whistleblower protection[77] and "the most important whistleblower protection law in the world."[78] For the first time, millions of employees would be protected by a national statute against retaliation.[79]

The Act provides a broad definition of retaliation. Employers may not "discharge, demote, suspend, threaten, harass, or in any other manner discriminate" against whistleblowers.[80] The Act also provides extensive remedies for employees injured by retaliation for whistleblowing. Discharged employees may be reinstated and may receive compensatory special damages, including litigation costs and attorneys' fees.[81] Furthermore, individuals may be criminally

75. The other provisions of Sarbanes-Oxley alter corporate governance on many fronts. Among other things, the Act established a Public Company Accounting Oversight Board to govern accounting firms, established rules regarding auditor and director independence, enhanced the requirements for financial disclosures, increased criminal penalties for certain white-collar crimes, and altered responsibilities for various corporate players, such as audit committees, corporate attorneys, corporate officers, and securities analysts. *See generally* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 & 18 U.S.C.).

76. The anti-retaliation provision is part of the Corporate and Criminal Fraud Accountability Act of 2002, which is Title VIII of the Sarbanes-Oxley Act. *See id.* § 806 (codified at 18 U.S.C. § 1514A (2000)). Sarbanes-Oxley's anti-retaliation provisions have been thoroughly described and analyzed in other places. *See generally* KOHN ET AL., *supra* note 8 (analyzing legal requirements of Sarbanes-Oxley's anti-retaliation provision); Vaughn, *supra* note 8 (also analyzing legal requirements of Sarbanes-Oxley's anti-retaliation provision). Accordingly, I will only briefly outline its provisions here.

77. *See, e.g.*, Cynthia Estlund, *Rebuilding the Law of the Workplace in an Era of Self-Regulation*, 105 COLUM. L. REV. 319, 376 (2005).

78. Vaughn, *supra* note 8, at 105; *see also* KOHN ET AL., *supra* note 8, at xii (stating that the whistleblower provisions of Sarbanes-Oxley are "the most systematic whistleblower protection framework enacted into federal law"). *But see* Cherry, *supra* note 8, at 1034 (concluding that Sarbanes-Oxley is a "half-measure and not the true reform that securities law needs to respond to corporate fraud").

79. *See* Vaughn, *supra* note 8, at 3.

80. *See* 18 U.S.C. § 1514A(a).

81. *See id.* § 1514A(c); *see also* KOHN ET AL., *supra* note 8, at 111 (noting that Sarbanes-Oxley is one of only four federal statutes that permit recovery of attorneys' fees as part of "special damages" that must be awarded); Vaughn, *supra* note 8, at 97 n.400 (noting benefits of reinstatement as a remedy).

prosecuted for retaliating against whistleblowers, which seemingly would further deter potential retaliation.[82]

Unlike many federal anti-retaliation statutes, an employee victimized by retaliation may bring a private cause of action under Sarbanes-Oxley in federal district court. Although an employee's claim must first be brought to the Department of Labor—specifically, the Occupational Safety and Health Administration (OSHA)—a court claim may be brought if the administrative process is not completed within 180 days,[83] which rarely happens.[84]

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.[85] 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.[86] The remedies do not include any sort of punitive or liquidated damages to provide extra

82. *See* 18 U.S.C. § 1513(e) (providing for fines and/or imprisonment of up to ten years for retaliating against a person for providing a law enforcement officer with truthful information relating to commission of a federal crime).

83. *See id.* § 1514A(b). Sarbanes-Oxley assigned responsibility for whistleblower investigations to the Department of Labor. The Department of Labor subsequently assigned the responsibility to OSHA, which also conducts whistleblower investigations under thirteen other federal statutes. *See* U.S. DEPARTMENT OF LABOR, OFFICE OF INVESTIGATIVE ASSISTANCE, THE WHISTLEBLOWER PROGRAM, www.osha.gov/dep/oia/whistleblower/index.html (last visited Oct. 25, 2006) (listing other statutes).

84. *See* Final Decision and Order Dismissing Appeal at 3 n.5, Allen v. Stewart Enter., No. 05-059 (ARB Case Aug. 17, 2005) (noting that complainants dismissed their appeal in order to file in federal district court and stating that "[a]s is the usual case, the 180-day period for deciding the case had expired before the Complainants filed their petition with the Board"); Vaughn, *supra* note 8, at 88. The complete administrative process includes an initial OSHA investigation, review by an Administrative Law Judge, and final review by the Administrative Review Board of the Department of Labor. 29 C.F.R. §§ 1980.104, .107, .110 (2005). Given the current caseload for OSHA, the initial investigation alone can take almost 180 days. The average time between the filing of a Sarbanes-Oxley complaint with OSHA and the issuance of a report by the OSHA investigator was 127 days for Fiscal Year 2005. *See* E-mail from Nilgun Tolek, OSHA Office of Investigative Assistance, to Richard Moberly, Assistant Professor of Law, University of Nebraska College of Law (Feb. 15, 2006) (on file with author). This time period has grown significantly longer since the enactment of Sarbanes-Oxley; in Fiscal Year 2003, the average length of a Sarbanes-Oxley investigation was ninety-two days. *See id.*

85. *See* 18 U.S.C. § 1514A(a).

86. *See id.* § 1514A(b)(2)(D).

encouragement for whistleblowers.[87] Finally, requiring employees to jump through OSHA's administrative hoops before bringing a claim in federal district court[88] can be "cumbersome rather than expeditious, biased rather than expert, [and] ineffective rather than efficient."[89]

These statutory restrictions likely contribute to the low success rates of employees who bring claims under Sarbanes-Oxley. According to OSHA, of the 784 cases resolved at the initial investigative level prior to September 30, 2006, OSHA investigators found only 17 to have merit, while another 106 cases settled.[90] 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,[91] perhaps suggesting that the "stronger" whistleblower protections of Sarbanes-Oxley do not result in more protections for whistleblowers.[92] Moreover, of the 119 OSHA-level decisions that were appealed by April 28, 2005, the Department of Labor's Administrative Law Judges (ALJs) decided in favor of employees only 4 times, while another 19 settled.[93]

The decisions issued by the ALJs further exacerbate Sarbanes-Oxley's statutory shortcomings. Procedural issues eviscerate claimants' cases. Several decisions dismissed complaints because the wrong corporate entity was named[94] or because a corporation filed a registration statement with the SEC but withdrew it before it

87. *See id.* § 1514A(c).

88. *See id.* § 1514A(b); 29 C.F.R. §§ 1980.101, .103, .104 (2005).

89. Robert G. Vaughn, *State Whistleblower Statutes and the Future of Whistleblower Protection*, 51 ADMIN. L. REV. 581, 621 (1999).

90. *See* Email from Nilgun Tolek, OSHA Office of Investigative Assistance, to Richard Moberly, Assistant Professor of Law, University of Nebraska College of Law (Oct. 3, 2006) (on file with author).

91. *See id.* Interestingly, OSHA considers cases that have settled to be meritorious, and thus includes settled cases in its "success" rate. *See id.*

92. Another contributing factor may be that employees are testing the outer boundaries of this new statute in the early years after its enactment. It may be that the success rate increases after ALJs, the ARB, and the courts answer basic questions regarding jurisdiction and applicability.

93. *See* Email from Todd Smyth, Office of Administrative Law Judges, to Richard Moberly, Assistant Professor of Law, University of Nebraska College of Law (July 8, 2005) (on file with author).

94. *See, e.g.*, Klopfenstein v. PCC Flow Techs. Holdings, Inc., No. 2004-SOX-11 (Dep't of Labor July 6, 2004) (dismissing complaint for failure to name both the publicly held parent company and its subsidiary).

became effective, thus denying coverage under the Act.[95] Claims have also been dismissed for missing the ninety-day statute of limitations window,[96] including claims that missed the deadline by less than two weeks.[97] ALJs routinely reject equitable tolling of the statute of limitations.[98] ALJs dismissed other claims because employees made whistleblower disclosures about topics not strictly addressed by Sarbanes-Oxley, such as underpayment of employees,[99] racial discrimination,[100] or environmental violations,[101] rather than securities fraud.

These problems with Sarbanes-Oxley's anti-retaliation provision reflect larger problems with the Anti-retaliation Model. First, anti-retaliation provisions in general do not provide realistic encouragement for employees to become corporate monitors because they focus on protection only after a disclosure is made.[102] Surveys demonstrate that most employees are unaware of the protections they may (or may not) receive should they report wrongdoing.[103] Moreover, even if an employee is aware that a disclosure might be protected, it is exceedingly difficult to determine the extent of any protection because there is little consistency among whistleblower statutes.[104] Whether a whistleblower is protected

95. *See* Roulett v. Am. Capital Access, No. 2004-SOX-00078 (Dep't of Labor Dec. 22, 2004).

96. *See, e.g.*, Lawrence v. AT&T Labs, No. 2004-SOX-00065 (Dep't of Labor Sept. 9, 2004); Kingoff v. Maxim Group L.L.C., No. 2004-SOX-00057 (Dep't of Labor July 21, 2004).

97. *See* Halpern v. XL Capital, Ltd., ALJ Case No. 2004-SOX-00054 (Dep't of Labor Aug. 31, 2005); Hopkins v. ATK Tactical Sys., No. 2004-SOX-00019 (Dep't of Labor May 27, 2004).

98. *See Halpern*, ALJ Case No. 2004-SOX-54, at 4; Harvey v. Home Depot, Inc., No. 2004-SOX-20, at 2 (Dep't of Labor June 2, 2006); Flood v. Cendent Corp., ALJ Case No. 2004-SOX-16.

99. *See* Reddy v. Medquist, Inc., No. 2004-SOX-35 (Dep't of Labor June 10, 2004).

100. *See Harvey*, No. 2004-SOX-20.

101. *See Hopkins*, No. 2004-SOX-19.

102. *See, e.g.*, C. FRED ALFORD, WHISTLEBLOWERS: BROKEN LIVES AND ORGANIZATIONAL POWER 108–13 (2001); MICELI & NEAR, *supra* note 6, at 66, 153–56; MIETHE, *supra* note 49, at 133; 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, 908–09 (2004); Terry Morehead Dworkin, *Whistleblowing, MNC's, and Peace*, 35 VAND. J. TRANSNAT'L L. 457, 474 (2002).

103. *See* MIETHE, *supra* note 49, at 54.

104. *See* 148 CONG. REC. S7420 (daily ed. July 26, 2002) (statement of Sen. Leahy) ("[C]orporate employees who report fraud are subject to the patchwork and vagaries of current state laws.").

depends upon the employee's state of residence, the industry in which the employee works, the type of misconduct reported,[105] the type of retaliation endured,[106] and, under some statutes, the willingness of administrative agencies to enforce the law.[107] Sarbanes-Oxley only adds to this confusion because of its applicability to specific types of employees making specific kinds of disclosures.

The second failure of the Anti-retaliation Model is that it does not address the flow-of-information problems revealed by recent scandals. Even if whistleblowing occurs and is protected, the Model does not produce effective whistleblowing because anti-retaliation laws rarely indicate to whom an employee should make a disclosure. Therefore, although an employee may be protected from retaliation if she reports corporate misconduct to a supervisor or corporate executive, such information may never reach traditional corporate monitors because of executive blocking and filtering. As discussed above, in order for whistleblowers to act effectively as part of the corporate monitoring system, employees must be able to report misconduct to those with the authority and responsibility to end it rather than to a supervisor who has less incentive to relay potentially damaging information. The Anti-retaliation Model simply does not address this issue.

Despite their shortcomings, anti-retaliation provisions provide important protections to whistleblowers by ensuring that they are not punished for engaging in socially beneficial conduct. Some surveys report that well over half of whistleblowers experience some sort of retaliation.[108] Other researchers place the actual number much

105. States vary widely in the type of protections they provide. Some, like Georgia, rigidly adhere to the at-will employment doctrine. *See* Goodroe v. Ga. Power Co., 251 S.E.2d 51, 52 (Ga. Ct. App. 1978) (finding that Georgia's employment-at-will statute permitted employer to fire employee because employee was about to uncover criminal activities). Others, like New Jersey, have a broad reaching statute protecting any whistleblower who reports any violation of law. *See* N.J. STAT. ANN. § 34:19 (West 2005). Federal law protects only whistleblowers who report certain types of violations in certain industries, and the extent of the protection varies depending on the statute. *See, e.g.*, STEPHEN M. KOHN, CONCEPTS AND PROCEDURES IN WHISTLEBLOWER LAW 79–80 (2001); MICELI & NEAR, *supra* note 6, at 233–34.

106. Some laws protect employees only if they are discharged and do not address other forms of retaliation. *See, e.g.*, White v. State, 929 P.2d 396, 407 (Wash. 1997) (limiting retaliation suits to cases in which an employee was actually or constructively discharged).

107. *See* Estlund, *supra* note 9, at 122 n.92 (noting statistics indicating OSHA was not sufficiently enforcing the whistleblower provisions of the Occupational Safety and Health Act).

108. *See, e.g.*, ALFORD, *supra* note 102, at 18 (citing studies in which one-half to two-thirds of whistleblowers lose their jobs); Gerald Vinten, *Whistleblowing—Fact or Fiction: An*

lower;[109] nonetheless, the results of retaliation can be devastating. Whistleblowing employees have been found dead or beaten.[110] Some whistleblowers lose their jobs and suffer emotional and financial difficulties; studies show several losing their homes, filing for bankruptcy, becoming divorced, and even attempting suicide.[111] In short, the Anti-retaliation Model is necessary but insufficient to address the flow-of-information problems uncovered in recent scandals.

B. Ineffectiveness of Pre-scandal Versions of the Structural Model

In contrast to the Anti-retaliation Model, the Structural Model focuses on encouraging and supporting whistleblowing *before* any disclosure is made. The Structural Model is based on the understanding that whistleblowing becomes easier and more acceptable when corporations provide an authorized and visible

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Introductory Discussion, *in* WHISTLEBLOWING—SUBVERSION OR CORPORATE CITIZENSHIP?, *supra* note 7, at 3, 10–11 (citing study concluding that eighty-six of eighty-seven whistleblowers experienced retaliation); Brickey, *supra* note 33, at 365 & n.35 (citing a non-scientific survey of two hundred whistleblowers by National Whistleblower Center finding that over one-half had lost their jobs, and citing a survey by Government Accountability Project that ninety percent of whistleblowers experienced retaliation or threats).

109. *See* MICELI & NEAR, *supra* note 6, at 203 (suggesting that generalizing about rate of retaliation is difficult because of variables in studies and citing a study in which less than twenty percent of whistleblowers were retaliated against); Terry Morehead Dworkin & Janet Near, *A Better Statutory Approach to Whistleblowing*, 7 BUS. ETHICS Q. 1, 6 (1997) (arguing that studies show that most whistleblowers do not suffer retaliation, even though most people think they do).

110. Although it has been difficult to connect such events to the employee's whistleblowing activities, examples of atrocities inflicted upon whistleblowers abound, including the death of Karen Silkwood. *See* Silkwood v. Kerr-McGee Corp., 464 U.S. 238 (1984). More recently, an employee of Los Alamos National Laboratory was beaten shortly before he was to testify before Congress regarding alleged fraud at the lab. *See* Bradley Graham & Griff Witte, *Whistle-Blower at Los Alamos Attacked in Parking Lot in N.M.*, WASH. POST, June 7, 2005, at A4, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2005/06/06/AR2005060601787_pf.html. One of the primary whistleblowers in the mutual funds scandal was also beaten. *See* O'Donnell, *supra* note 41.

111. *See, e.g.*, ALFORD, *supra* note 102, at 19–20; Vinten, *supra* note 108, at 11. Outside of these extremes, retaliation may take many forms, including "harassment, threats of termination, suspension, non-promotion, reassignment, transfer, denial of training, withholding wages or other benefits, closer supervision and scrutiny, or pestering." Ben Depoorter & Jef De Mot, *Whistle Blowing* 26 (George Mason Law & Econ. Res., Paper No. 04-56, 2004), *available at* http://ssrn.com/abstract=622723; *see also* ALFORD, *supra* note 102, at 31; Baynes, *supra* note 8, at 895. Even former employees may face blacklisting from certain industries or from the job market in general. *See, e.g.*, Brickey, *supra* note 33, at 364–65; Miethe & Rothschild, *supra* note 9, at 326; Depoorter & De Mot, *supra*, at 26 & n.106.

channel for employees to report misconduct.[112] Unlike the Anti-retaliation Model, which, to be utilized at all, assumes an adversarial relationship between the employee whistleblower and the employer, the Structural Model encourages employees to become part of the corporate monitoring system, allowing them to work in concert with the corporation rather than against it. The Structural Model encourages employees to report misconduct by highlighting the extrinsic social and employment benefits of monitoring ethical and regulatory standards while cooperating with the corporation.[113] Instead of impractically relying on management hierarchies to relay reports of misconduct to external regulators, the Structural Model provides a visible mechanism for employee reports to reach the ears of those who can remedy the misconduct.

Despite its potential benefits, versions of the Structural Model in place in both the public and private sectors prior to recent corporate scandals were ineffective. In the public sphere, the federal government created a structure for whistleblowing employees to report misconduct in both the Inspector General Act of 1978 (IGA) and the Civil Service Reform Act of 1978 (CSRA).[114] Under these statutes, Congress created offices specifically charged with receiving and investigating federal employee claims of wrongdoing in the government.[115] The IGA required most federal agencies to create a position of Inspector General, which received complaints from that agency's employees.[116] The CSRA was broader in its approach and provided an outlet for reports from any federal employee through the Office of Special Counsel (OSC).[117]

112. Social science research demonstrates that whistleblowing increases when there is an identifiable, specific means for whistleblowing to occur. *See, e.g.*, Janet P. Near & Terry M. Dworkin, *Responses to Legislative Changes: Corporate Whistleblowing Policies*, 17 J. BUS. ETHICS 1551, 1557 (1998).

113. *See* discussion *infra* Part IV.

114. *See* Inspector General Act of 1978, 5 U.S.C. app. §§ 1–12 (2000); Civil Service Reform Act of 1978, Pub. L. No. 95-454, 92 Stat. 1111 (codified as amended in scattered sections of title 5 of the United States Code). Both statutes also incorporated the Anti-retaliation Model by protecting federal employees who report any violations of law, rule, or regulation, or mismanagement, gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety. *See, e.g.*, 5 U.S.C. app. § 7; *id.* § 2302(b)(8).

115. *See id.* app. § 2; *id.* § 1206(b), *repealed by* Pub. L. 101-12 § 3(a)(8), 103 Stat. 16 (1989).

116. *See id.* app. § 2.

117. *See id.* § 1206(b)(3), *repealed by* Pub. L. 101-12, § 3(a)(8), 103 Stat. 16 (1989).

The beginnings of the Structural Model are best seen in the OSC. The OSC receives whistleblower disclosures and informs the necessary federal agency about potential misconduct occurring within its ranks.[118] By informing agencies of potential problems, Congress hoped that the OSC would become an "'early warning system' of budding problems, serious enough to place agency leadership on notice and to require acknowledgement."[119] If the OSC believes that a whistleblower's disclosure reveals a "substantial likelihood" of wrongdoing within a government agency, the OSC can require that agency to conduct an investigation and submit a report covering its findings.[120] The OSC evaluates the report and determines whether the agency's findings are reasonable and contain the appropriate information required by statute.[121] Ultimately, the OSC submits the agency reports to Congress and the President and keeps a public file of the report.[122] Thus, the CSRA (and the IGA under similar provisions) go further than simply protecting whistleblowing employees from retaliation, although they theoretically do that as well. Congress intended for these statutes to encourage whistleblowing by providing public-sector employees with an easy channel to report misconduct.[123]

Prior to recent corporate scandals, whistleblower disclosure channels were not imposed upon corporations in the private sector. Rather, Congress and various courts gave organizations incentives to create internal compliance systems, which often would include

118. *See id.* § 1206(b)(2); *see also* Thomas M. Devine & Donald G. Aplin, *Abuse of Authority: The Office of the Special Counsel and Whistleblower Protection*, 4 ANTIOCH L.J. 5, 52 (1986).

119. Devine & Aplin, *supra* note 118, at 19–20 (quoting 124 CONG. REC. H11822 (daily ed. Oct. 6, 1978) (statement of Rep. Schroeder)).

120. *See* 5 U.S.C. § 1206(b)(3)(A), *repealed by* Pub. L. 101-12, § 3(a)(8), 103 Stat. 16 (1989).

121. *See id.* In cases in which the OSC believed that the employee's information about misconduct was reasonably supported, the agency's report had to include a variety of information, including a summary of the investigation, a listing of any violation of law, rule, or regulation, and a description of any corrective actiou taken as a result of the investigation. *See id.* § 1206(b).

122. *Id.* § 1206(b)(5)(A). If the agency failed to submit a timely report, the OSC was to notify Congress and the President of that failure as well. *See id.*

123. *See* Devine & Aplin, *supra* note 118, at 20 ("The purpose of the OSC whistleblowing disclosure channel was 'to encoutage employees to give the government the first crack at cleaning its own house before igniting the glare of publicity to force correction.'" (footnote omitted)).

implementing disclosure channels for employees to report corporate misconduct.

In 1991, Congress approved the federal Organizational Sentencing Guidelines (OSG), which utilized a "carrot and stick" approach[124] to encourage organizations to implement an "effective program to prevent and detect violations of law."[125] Under the OSG, penalties for corporations convicted of crimes could be reduced by up to ninety-five percent if the corporation previously implemented such a program. Conversely, if no such program existed, then the potential fines could be multiplied by up to four hundred percent.[126] An "effective program" required that the organization exercise due diligence in preventing and detecting criminal conduct within the organization.[127] Such due diligence, in turn, required "having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution."[128]

The judiciary also gave incentives to corporations to monitor themselves more closely through structural disclosure channels.[129] In an influential opinion, Delaware's Chancery Court opined that a director of a corporation has a duty to be reasonably informed about the corporation, a duty which includes implementing an adequate "corporate information and reporting system."[130] This holding

124. *See* 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, 190–91 (2002); Dworkin, *supra* note 102, at 464; Near & Dworkin, *supra* note 112, at 1557; Win Swenson, *The Organizational Guidelines' "Carrot and Stick" Philosophy, and Their Focus on "Effective" Compliance*, *in* GOOD CITIZEN, *supra* note 3, at 27, 29.

125. U.S. SENTENCING GUIDELINES MANUAL § 8A1.2, Application Note 3(k) (1991) [hereinafter OSG]. The OSG were amended after the corporate scandals in November 2004. *See* UNITED STATES SENTENCING COMMISSION, ORGANIZATIONAL GUIDELINES AND COMPLIANCE, http://www.ussc.gov/orgguide.htm (last visited Nov. 8, 2006) (providing manual of federal sentencing guidelines and policy statements effective Nov. 1, 2004).

126. *See* Paul Fiorelli, *Will U.S. Sentencing Commission Amendments Encourage a New Ethical Culture Within Organizations?*, 39 WAKE FOREST L. REV. 565, 567 (2004).

127. OSG, *supra* note 125, § 8A1.2, Application Note 3(k).

128. *Id.* § 8A1.2, Application Note 3(k)(5).

129. *See* Callahan et al., *supra* note 124, at 190; Susan Sturm, *Second Generation Employment Discrimination: A Structural Approach*, 101 COLUM. L. REV. 458, 480–84 (2001).

130. *In re* Caremark, 698 A.2d 959, 970 (Del. Ch. 1996). Failure to set up such a corporate reporting structure may expose the director to breach of fiduciary charges if the lack of such a system caused a loss. *Id.*

encourages directors to initiate and maintain a disclosure channel for employees and encourages agents to inform directors about problems within the corporation because a breach of this duty could result in director liability.[131] In the sexual harassment context, the U.S. Supreme Court stated that employers who make reasonable efforts to deter and correct illegally harassing behavior may have an affirmative defense available to them against a sexual harassment plaintiff who has not been subject to a tangible employment action.[132] The Court has further held that if a corporation has an internal mechanism available to report wrongdoing, then it may be able to avoid punitive damages in a later wrongful discharge case brought by a whistleblower.[133] These judicial holdings encourage corporations to establish whistleblower disclosure channels because they mitigate corporate liability for misconduct, along with its attendant litigation costs, if sufficient processes are in place.[134]

Yet, these pre-scandal versions of the Structural Model, like the Anti-retaliation Model, failed to encourage effective whistleblowing. One problem was that whistleblower disclosure systems often did not provide a legitimate outlet for employees to report misconduct because the channels resulted in disclosure to a non-responsive or biased party. For example, the OSG do not specify to whom whistleblower disclosures must be reported.[135] Thus, in order to satisfy the OSG, corporations implemented disclosure channels that flowed up through the corporate management hierarchy,[136] placing employee disclosures at risk of management blocking and filtering.

The CSRA exemplifies the related problem of reporting to a biased party. The CSRA's whistleblowing channel did not work, in large part because of the anti-employee bias of a series of Special Counsels that summarily failed to order investigations of employee

131. *See* Dworkin, *supra* note 102, at 466.

132. *See* Burlington Indus., Inc., v. Ellerth, 524 U.S. 742, 765 (1998); Faragher v. City of Boca Raton, 524 U.S. 775, 807 (1998).

133. *See* Kolstad v. Am. Dental Ass'n, 527 U.S. 526, 545–46 (1999); *see also* Callahan et al., *supra* note 124, at 194.

134. *See* Callahan et al., *supra* note 124, at 192–93; Sturm, *supra* note 129, at 557.

135. *See* OSG, *supra* note 125, § 8A1.2, Application Note 3(k)(5).

136. *See* Andrew R. Apel, *A National Study of Compliance Practices*, *in* GOOD CITIZEN, *supra* note 3, at 127, 127–30; Edward S. Petry, *A Study of Compliance Practices in "Compliance Aware" Companies*, *in* GOOD CITIZEN, *supra* note 3, at 139, 139–42.

complaints.[137] Although the first two Special Counsels ordered agency investigations for approximately 25 percent of employee complaints, beginning in 1983, a new Special Counsel drastically reduced the number of investigations ordered to approximately 7.5 percent of the complaints.[138] In other words, whistleblower disclosures were being made, but the OSC rarely required agencies to confront the problems being raised. Ultimately, the CSRA was amended by the Whistleblower Protection Act of 1989, but the unchallenged discretion of the Special Counsel to order investigations remains,[139] leaving in doubt the ability of government employees to report wrongdoing effectively.[140]

137. Devine & Aplin, *supra* note 118, at 52. The discretion was magnified because "no standards of accountability were established for the OSC, the opportunity for judicial review was minimal, and no private right of action was created by the Act." Terry Morehead Dworkin & Elletta Sangrey Callahan, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society*, 29 AM. BUS. L.J. 267, 282 (1991) (footnotes omitted).

138. *See* Devine & Aplin, *supra* note 118, at 53.

139. The WPA made several changes to the whistleblower disclosure channel provisions of the CSRA. For example, the WPA now permits a whistleblower to comment upon an agency's report after it is submitted to the OSC. *See* 5 U.S.C. § 1213(e)(1) (1994). This is an important provision because "the whistleblower is often in a good position to evaluate whether the agency's response represents a good faith investigation." Thomas M. Devine, *The Whistleblower Protection Act of 1989: Foundation for the Modern Law of Employment Dissent*, 51 ADMIN. L. REV. 531, 562 n.174 (1999) (quoting H.R. Rep. No. 100-274, at 25 (1987)). Further, the WPA reduces the risk to whistleblowers themselves by making it more difficult for the OSC to reveal a whistleblower's identity. Under the CSRA, the OSC could reveal a whistleblower's identity "in order to carry out the functions of the Special Counsel." *See* 5 U.S.C. § 1206(b)(1)(1988), *repealed by* Pub. L. No. 101-12, § 3(a)(8), 103 Stat. 16 (1989). Under the WPA, the OSC may only identify a whistleblower without his or her consent if exposure "is necessary because of an imminent danger to public health or safety or imminent violation of any criminal law." 5 U.S.C. § 1213(h) (1994); *see also* Devine, *supra*, at 563–64 (describing this provision). Importantly, however, the OSC will not accept anonymous disclosures and will only protect the confidentiality of the whistleblower to the extent permitted by § 1213(h). *See* U.S. Office of Special Counsel, Whistleblower Disclosures (May 4, 2005), http://www.osc.gov/wbdisc.htm. Of course, this process requires a fair amount of trust in the OSC by a federal whistleblowing employee.

Despite these changes, the WPA's focus was on the Anti-retaliation Model, not the Srructural Model. This failure to give sufficient attention to the whistleblower disclosure channels led one commentator to argue that the WPA "bypassed the process of maximizing constructive potential from dissent, a curious omission since one of the WPA's objectives is to spark increased challenges of bureaucratic misconduct." Devine, *supra*, at 561.

140. The most recent Annual Report from the OSC suggests that the OSC's disclosure channel still does not operate consistently to provide a whistleblower's information to his or her agency head. From 2002 through 2004, only about 2.9% of employee disclosures were referred to agency heads for investigation. *See* U.S. OFFICE OF SPECIAL COUNSEL FISCAL YEAR 2004 ANNUAL REPORT 15 (2005), *available at* http://www.osc.gov/library.htm#annual. The exact percentage is difficult to obtain from the annual reports submitted by the OSC. During

Another problem with the pre-scandal Structural Model was that companies had little legal incentive to implement effective whistleblower disclosure channels because courts and prosecutors rarely penalized bad systems or rewarded good ones.[141] Specifically, corporations could easily create superficial structures that satisfied the OSG but were ineffective. These structures were often little more than "window-dressing," which did little to encourage actual whistleblowing.[142] Indeed, the recent corporate scandals occurred with little outcry from corporate employees despite every appearance at the scandal-ridden corporations that sufficient mechanisms were in place to encourage detection and reporting of fraud. For example, Enron appeared to satisfy the OSG standards for a compliance program even though the program was not effective in reality.[143] Moreover, not only were superficial systems easy to create, but also the government provided few valuable incentives for companies to implement effective reporting mechanisms. Despite the OSG's penalty reduction incentive, the OSG's requirement that corporations implement "effective compliance systems" rarely helped a corporation facing criminal liability. From 1992 to 2005, only three organizations received a penalty reduction under the OSG for having an effective system.[144]

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fiscal years 2002, 2003, and 2004, the OSC closed 1841 disclosure matters. *Id.* During those same three years, it referred only forty-eight matters to agency heads. *Id.* The closed matter numbers do not exactly correspond to agency referrals because there may be some overlap from year to year. However, these raw numbers present a stark picture of the continued failure of the OSC to serve as the disclosure clearinghouse envisioned by the CSRA and the WPA.

141. The market could have provided incentives for corporations to implement effective whistleblowing disclosure systems. However, several barriers prevent the market from working efficiently in this area. These barriers are addressed *infra* in Part V.A.

142. *See* Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491 (2003); *see also* Lawrence A. Cunningham, *The Appeal and Limits of Internal Controls To Fight Fraud, Terrorism, Other Ills*, 29 J. CORP. L. 267, 314 (2003–2004).

143. *See* Fiorelli, *supra* note 126, at 567 & n.10; *see also* Charles M. Elson & Christopher J. Gyves, In Re Caremark*: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 702 (2004) (noting that Enron, Tyco, WorldCom, and Adelphia each had compliance systems, "none of which, obviously, was very effective").

144. *See* Frank O. Bowman III, *Drifting Down the Dnieper with Prince Potemkin: Some Skeptical Reflections About the Place of Compliance Programs in Federal Criminal Sentencing*, 39 WAKE FOREST L. REV. 671, 684 (2004) (providing information from 1992–2002); *see also* U.S. SENTENCING COMM'N, 2005 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS tbl. 54 (2006), *available at* http://www.ussc.gov/ANNRPT/2005/SBTOC05.htm; U.S. SENTENCING COMM'N, 2004 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS tbl.54 (2005), *available at* http://www.ussc.gov/ANNRPT/2004/SBTOC04.htm; U.S.

Thus, prior to recent corporate scandals, enforcement and follow-through weaknesses in the Structural Model prevented effective employee whistleblowing. In the private sector, disclosures were directed to corporate executives rather than traditional corporate monitors, which restricted information flow. An organization might have an excellent disclosure structure in place, but would simply refuse to support it by actually responding to whistleblower disclosures. Ineffective and unsupported disclosure channels failed to encourage employees to become whistleblowers and, if employees did blow the whistle, their disclosures rarely reached parties willing and able to address them.

C. Sarbanes-Oxley's Structural Model

Sarbanes-Oxley implements a new and improved version of the Structural Model. Under Section 301 of Sarbanes-Oxley, the audit committee of the board of directors of public companies must establish procedures for receiving complaints regarding accounting, internal accounting controls, or auditing matters.[145] Additionally, the audit committee must be able to receive anonymous disclosures by employees regarding accounting or auditing matters.[146] These requirements significantly alter the pre-scandal Structural Model in two ways.

First, Sarbanes-Oxley improves the legitimacy of the disclosure channel. It requires that independent directors on the board's audit committee receive whistleblower disclosures. This direct line to a traditional corporate monitor with the authority and responsibility to address whistleblower concerns enables whistleblowers to avoid the blocking and filtering from corporate executives. As recognized by the SEC when it amended its general rules and regulations by implementing Section 301,[147] directors typically rely upon company managers to provide information, but managers "may not have the

SENTENCING COMM'N, 2003 SOURCEBOOK OF FEDERAL SENTENCING STATISTICS tbl. 54 (2004), *available at* http://www.ussc.gov/ANNRPT/2003/SBTOC03.htm.

145. 15 U.S.C. § 78j-1(m)(4)(A) (Supp. 2002).

146. *Id.* § 78j-1(m)(4)(B).

147. *See* Standards Relating to Listed Company Audit Committees Nos. 33-8220 & 34-47654, 68 Fed. Reg. 18,788 (Apr. 16, 2003) [hereinafter SEC Release] (promulgating 17 C.F.R. § 240.10A-3, including subsection (b)(3) related to procedures for complaints).

appropriate incentives to self-report all questionable practices."[148] Accordingly, the SEC rightfully asserted that "[t]he establishment of formal procedures for receiving and handling complaints should serve to facilitate disclosures, encourage proper individual conduct and alert the audit committee to potential problems before they have serious consequences."[149] Moreover, Sarbanes-Oxley provides for *anonymous* disclosures,[150] which should improve the willingness of employees to come forward with information. Requiring a legitimate disclosure channel will unleash the true potential of the Structural Model and reveal its power to overcome the information problems that undermined employee effectiveness as corporate monitors during the corporate scandals. The Model's ability to improve information flow is discussed in the next Part.

Second, for the first time in the private sector, the Structural Model is broadly imposed rather than merely encouraged.[151] The Act instructs the Securities and Exchange Commission to direct the national securities exchanges and national securities associations (e.g., the New York Stock Exchange and the National Association of Securities Dealers) to prohibit the listing of any security of a company that is not in compliance with this requirement.[152] The penalty for noncompliance with Section 301 and the corresponding listing rules is delisting, which can harm corporations and their shareholders significantly.[153]

148. *Id.* at 18,798. In light of the tremendous malfeasance by managers during recent corporate scandals, this seems like somewhat of an understatement.

149. *Id.*

150. *See* 15 U.S.C. § 78j-1(m)(4)(B).

151. The Structural Model also has been imposed in specific instances through consent decrees and other settlements by government agencies. For example, in a consent decree with the SEC, Qwest Communications agreed to install a chief compliance officer, with reporting obligations to a committee of outside directors, who is responsible for responding to employee reports about misconduct. *See* SEC Charges Qwest Communications International Inc. with Multi-faceted Accounting and Financial Reporting Fraud, SEC Litig. Release No. 18936 (Oct. 21, 2004), *available at* http://www.sec.gov/litigation/litreleases/lr18936.htm (cited in Marc I. Steinberg & Seth A. Kaufman, *Minimizing Corporate Liability Exposure when the Whistle Blows in the Post Sarbanes-Oxley Era*, 30 J. CORP. L. 445, 456 n.90 (2005)). With regard to discrimination complaints, courts also have been active in approving corporate structural reform to address accusations of systematic bias within individual corporations. *See* Sturm, *supra* note 129, at 509–19, 557 (describing system mandated by consent decree involving Home Depot).

152. 15 U.S.C. § 78j-1(m)(1)(A).

153. *See* E-mail from Stanley Keller, Chair of Committee on Federal Regulation of Securities, Section of Business Law, Am. Bar Ass'n (Feb. 25, 2003), http://www.sec.gov/

Although Sarbanes-Oxley mandated the implementation of the Structural Model, Congress did not dictate specific requirements for such a reporting system. Moreover, the SEC did not require specific procedures when it promulgated rules implementing Sarbanes-Oxley's mandate—despite the fact that commentators who responded to the proposed rule "were split" over how specific the SEC should be.[154] The majority of commentators argued that the rules should give audit committees the flexibility to develop individualized procedures to receive complaints because of the diversity of companies affected by the rule.[155] The SEC based this minimalist regulatory approach on the diverse needs of a variety of corporations, arguing that corporations themselves

> should be provided with flexibility to develop and utilize procedures appropriate for their circumstances. The procedures that will be most effective to meet the requirements for a very small listed issuer with few employees could be very different from the processes and systems that would need to be in place for large, multi-national corporations with thousands of employees in many different jurisdictions.[156]

Following the SEC's lead, both the New York Stock Exchange and the NASDAQ merely required that their listed companies have audit committees that complied with the SEC's rule.[157]

Sarbanes-Oxley thus responds to the failings of the pre-scandal Structural Model in two ways. First, the Act implements a whistleblower disclosure channel that provides information directly to independent corporate directors. As described in the next Part, this change directly addresses the flow-of-information problems demonstrated by the corporate scandals. Second, Sarbanes-Oxley mandates the implementation of a disclosure channel in every public corporation. Although this mandatory implementation is an improvement, I suggest in Part V of this Article that Sarbanes-

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rules/proposed/s70203/skeller1.htm ("Delisting is a remedy with significant adverse consequences both to the issuer and its shareholders. Realistically, the failure to conform to a corporate governance listing standard in one primary market will leave no alternative comparable trading opportunity available for the company.").

154. *See* SEC Release, *supra* note 147, at 18,798.

155. *Id.*

156. *Id.*

157. *See* NASD Rules § 4350(d)(3) (2005); NYSE, Inc., Listed Company Manual § 303A (2004).

Oxley's minimalist approach fails to address key potential problems with the Model.

IV. THE POWER OF SARBANES-OXLEY'S STRUCTURAL MODEL

As utilized by Sarbanes-Oxley, the Structural Model should encourage more effective whistleblowing than either the Anti-retaliation Model or previous versions of the Structural Model. Sarbanes-Oxley's Structural Model overcomes the flow-of-information problems exposed by the recent scandals by implementing a legitimate whistleblower disclosure channel. Through its legitimacy, the channel encourages employees to become active corporate monitors and to disclose corporate misconduct. Equally important, this channel facilitates the movement of such information from the employees (those with the most information) to the traditional corporate monitors (those with the power and responsibility to utilize the information effectively). Thus, the Structural Model's power lies in its ability to increase both the amount and the effectiveness of disclosures from whistleblowing employees.

A. More Disclosures

Sarbanes-Oxley's Structural Model should increase the amount of whistleblowing because it provides incentives for employees to become whistleblowers and reduces several of the most significant disincentives. By contrast, the Anti-retaliation Model provides little, if any, incentive to blow the whistle and addresses, somewhat poorly, only one disincentive—the fear of retaliation.

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.[158] Perhaps one reason for the increase is that employees become whistleblowers out of a sense of loyalty to their organization.[159]

158. *See* Karen L. Hooks et al., *Enhancing Communication To Assist in Fraud Prevention and Detection*, 13 AUDITING: J. PRAC. & THEORY 86, 92–93 (1994).

159. As Professor Cass Sunstein has noted with regard to people who dissent publicly:

> There is an ironic point here . . . . Conformists are often thought to be protective of social interests, keeping quiet for the sake of the group. By contrast, dissenters tend to be seen as selfish individualists, embarking on projects of their own. But in an important sense, the opposite is closer to the truth. Much of the time, dissenters benefit others, while conformists benefit themselves.

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.[160] The whistleblowers involved in the recent corporate scandals seem to satisfy this documented generalization. Both Sherron Watkins of Enron and Cynthia Cooper of WorldCom profess that they were driven by their sense of loyalty to their organizations and that they were disappointed in the corporate misconduct that ultimately destroyed their corporations.[161] An internal disclosure channel provides a way for employees to demonstrate their loyalty by disclosing misconduct without having to report colleagues to "outside" authorities.

A disclosure channel also harmonizes with a whistleblower's tendency to report misconduct internally[162]—a tendency likely driven by this sense of loyalty. Sherron Watkins reported her misgivings to Ken Lay, but she did not make a public report until she was called to testify before a House committee investigating Enron's bankruptcy. Cynthia Cooper reported her findings first to WorldCom's CFO and then to the company's Board of Directors. A similar pattern emerged in the scandals at Xerox, Global Crossing, Duke Power, and in the mutual fund scandal, whereby an employee attempted to resolve a problem internally so that the company could fix it and remain in

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CASS R. SUNSTEIN, WHY SOCIETIES NEED DISSENT 6 (2003).

160. *See, e.g.*, ALFORD, *supra* note 102, at 79–80; MICELI & NEAR, *supra* note 6, at 169–70; David Culp, *Whistleblowers: Corporate Anarchists or Heroes? Towards a Judicial Perspective*, 13 HOFSTRA LAB. & EMP. L.J. 109, 115 (1995–1996); Dworkin & Callahan, *supra* note 137, at 300–01.

161. *See* Lacayo & Ripley, *supra* note 36, at 32 (asserting that Watkins and Cooper, along with Coleen Rowley of the FBI, are the "truest of true believers . . . ever faithful to the idea that where they worked was a place that served the wider world in some important way"); Jodie Morse & Amanda Bower, *The Party Crasher*, TIME, Dec. 30, 2002, at 53 (describing Watkins's reaction); Ripley, *supra* note 36, at 47–49 (describing Cooper's reaction to discovery of WorldCom's fraud).

162. *See, e.g.*, MYRON PERETZ GLAZER & PENINA MIGDAL GLAZER, THE WHISTLEBLOWERS: EXPOSING CORRUPTION IN GOVERNMENT AND INDUSTRY 195 (1989); KAREN L. SOEKEN & DONALD R. SOEKEN, A SURVEY OF WHISTLEBLOWERS: THEIR STRESSORS AND COPING STRATEGIES 160 (1987); Callahan et al., *supra* note 124, at 195; Dworkin & Callahan, *supra* note 137, at 300–01; Miethe & Rothschild, *supra* note 9, at 335–37; Gregory R. Watchman, *Sarbanes-Oxley Whistleblowers: A New Corporate Early Warning System*, at 8, http://www.whistleblower.org/doc/GAP%20Analysis%20Sarbanes%2DOxley%2Epdf (last visited Nov. 9, 2006).

business.[163] This type of situation fits well with the psyche of the American employee, whose sense of loyalty to the organization keeps her from reporting misconduct externally, but who may report internally if encouraged by the organization.[164]

In addition to providing incentives by encouraging loyalty, the Structural Model should reduce the most visible disincentives to whistleblowing behavior. For example, the Model should reduce the amount of retaliation against whistleblowers because the Model focuses on the *recipient* of a whistleblower's complaint rather than on the whistleblower. Studies demonstrate that the recipient of complaints plays a large role in determining both the outcome of each complaint and whether subsequent whistleblowers will feel free to come forward.[165] By requiring that the top echelon of a corporation receive complaints, whistleblowers are more likely to have support from upper levels of the corporation. This "top-down" support should reduce the amount of retaliation felt by employees and, therefore, encourage more whistleblowing.[166] This structure further allows whistleblowers to avoid conflicted supervisors or high-ranking managers who are likely to feel defensive about wrongdoing occurring in their department.[167] Additionally, because Sarbanes-Oxley permits employees to report wrongdoing anonymously or confidentially, employees' fear of retaliation should be minimized.[168]

163. *See* PARTNOY, *supra* note 51, at 362–63 (explaining the Global Crossing scandal); Davis, *supra* note 42 (explaining the Duke Power scandal); O'Donnell, *supra* note 41 (explaining more about the mutual fund scandal); *see also* Christine Dugas, *Whistle-Blower Tells Story of Mutual Fund Scandal*, USA TODAY, May 26, 2005, *available at* http://www.yourlawyer.com/articles/read/7377 (explaining the mutual fund scandal); *Whistleblowing: Peep and Weep*, ECONOMIST, Jan. 11, 2002, *available at* http://www.cfo.com/printable/article.cfm/3002918?f=options (explaining the Xerox scandal). This tendency is clear in Watkins's letter to Ken Lay, in which she attempted to present solutions for Enron to "fix" the accounting improprieties she discovered. *See* Letter from Sherron Watkins to Kenneth Lay (on file with author).

164. *See* Coffee, *supra* note 19, at 1242 (asserting that encouraging external whistleblowing may be ineffective because it is so ingrained in corporate mentality to be loyal and to withhold adverse information).

165. *See* MICELI & NEAR, *supra* note 6, at 77.

166. Marcia P. Miceli et al., *Can Laws Protect Whistle-Blowers? Results of a Naturally Occurring Field Experiment*, 26 WORK & OCCUPATIONS 129, 134, 143–44 (1999).

167. *See* MICELI & NEAR, *supra* note 6, at 184.

168. Not surprisingly, studies consistently demonstrate that individuals are more willing to state a dissenting viewpoint if they can do so anonymously. *See* MIETHE, *supra* note 49, at 54–57; SUNSTEIN, *supra* note 159, at 20. Permitting such anonymous reporting does have downsides: often such reports are not as trustworthy and there is little opportunity for feedback

Thus, the Structural Model implemented by Sarbanes-Oxley most likely reduces the significant deterrent of retaliation in a different, and perhaps more effective, manner than the Anti-retaliation Model.[169]

The Structural Model also increases employees' confidence that their complaints will yield positive results. Studies of whistleblowers demonstrate that an even larger concern than retaliation is the fear that nothing will be done in response to a whistleblowing complaint.[170] This concern was justified during the latest corporate scandals, as employees in scandal-ridden companies routinely watched those who broke the law receive promotions and raises.[171] Understandably, employees are usually unwilling to take the tremendous career and social risks associated with whistleblowing if their report has little potential to change the status quo. While the Anti-retaliation Model does little to reduce this disincentive, the Structural Model addresses it by requiring that disclosures go directly to the company's directors, who all have a fiduciary duty to address misconduct.[172] Rather than simply providing information to a manager and hoping someone with actual authority receives it, Sarbanes-Oxley's Structural Model guarantees that the appropriate corporate leaders will consider a whistleblower's disclosure.

Corporate and societal pressures that encourage silence are additional disincentives to whistleblowing. Some corporations push employees—in the name of organizational loyalty—to go along with illegal corporate actions and to refrain from betraying the company

or follow-up. However, to the extent the Anti-retaliation Model is not working effectively, anonymous reporting may encourage those who are otherwise reluctant to speak out for fear of retribution.

169. The Structural Model also reinforces the Anti-retaliation Model. As a practical matter, retaliating against a whistleblowing employee will be significantly more difficult if the employee utilizes an internal reporting structure. The employee's disclosure will be documented and any subsequent employment action against the employee most likely will trigger extra review by the corporation.

170. *See* Miethe & Rothschild, *supra* note 9, at 333–37 (citing survey responses to assert that a primary reason employees do not blow the whistle is because the employee believes that nothing will be done to correct the activity); *see also* MICELI & NEAR, *supra* note 6, at 65–66; Dworkin & Callahan, *supra* note 137, at 302; Hooks et al., *supra* note 158, at 93.

171. *See* MCLEAN & ELKIND, *supra* note 3, at 139, 153–54, 187 (describing promotions and raises for Andrew Fastow, Ken Rice, and Ben Glisan at Enron).

172. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

through disclosure.[173] Additionally, society discourages individuals from becoming "squealers" and betraying loyalties.[174] Arguably, it simply may be human nature to conform to group norms and to gain acceptance from our peers,[175] as evidenced by the broad employee silence during recent corporate scandals.

The Structural Model's moderate approach is well suited to combat corporate pressure on employees. Such pressure to be silent in the face of wrongdoing is particularly problematic because of its prevalence, which may cause judges and other decision-makers to hesitate before imposing stiff criminal and civil sanctions upon managers who use retaliation to enforce employee conformity and silence.[176] Moderate measures are more likely to achieve positive results. To paraphrase Dan Kahan's theory regarding sticky norms in general, sometimes a "gentle nudge" like the Structural Model may be more effective in altering sticky norms, such as employee silence, than "hard shoves" like the Anti-retaliation Model.[177] In other words, the Structural Model provides a more moderate reform that is less likely to alienate persons who encourage whistleblowing. This more temperate approach may subtly alter corporate norms of secrecy and retaliation to make open communication more viable. Implementing a whistleblower disclosure channel will signal to employees that the management and ownership of the firm are committed to corporate ethics.[178] Although Sarbanes-Oxley does not

173. For example, a whistleblower at Fannie Mae recently stated that other employees did not report wrongdoing at the company because of Fannie Mae's corporate environment, which he described as "one of intimidation, restraint of dissenting opinions, and pressure to be part of the 'Team,' giving [corporate officers] the numbers [they] desired to please the markets." *See* Peter Eavis, *Fannie's Hedging Deals Look Thorny*, Oct. 15, 2004, http://www.thestreet.com/comment/detox/10187363.html.

174. *See* Estlund, *supra* note 9, at 123 (citing MICELI & NEAR, *supra* note 6, at 132–35, 175–78); Miethe & Rothschild, *supra* note 9, at 333–37.

175. *See* SUNSTEIN, *supra* note 159, at 9; Cunningham, *supra* note 142, at 317; John M. Darley, *The Cognitive and Social Psychology of Contagious Organizational Corruption*, 70 BROOK. L. REV. 1177, 1189–92 (2005).

176. *See* Dan M. Kahan, *Gentle Nudges vs. Hard Shoves: Solving the Sticky Norms Problem*, 67 U. CHI. L. REV. 607, 607 (2000) (describing the "sticky norms problem" whereby "the prevalence of a social norm makes decision makers reluctant to carry out a law intended to change that norm").

177. *Id.* at 608; *see also* Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1730–31 (1996).

178. *See* SUNSTEIN, *supra* note 159, at 30 (advocating the importance of creating a culture that "welcomes disagreement and that does not punish those who depart from the prevailing orthodoxy," and suggesting that creating "channels by which dissent can be

enforce employee use of the channel,[179] the mere existence of a viable channel may demonstrate to employees that reporting misconduct is appropriate and expected.[180]

The Sarbanes-Oxley Model also indirectly encourages whistleblowing by requiring that disclosures go directly to the board of directors—a structure that signals the importance of employee monitoring and reporting.[181] As a result, the actual behavior of directors and managers may change because their employees have a more formal role in preventing corporate fraud.[182] These corporate officers may therefore become more committed to the norm of open communication.[183] Employees, in turn, will take their cue not only from the existence of the structural disclosure channel, but also from the acceptance of the channel by their managers and supervisors.[184] This changing social attitude can cascade and expand until a more pervasive norm develops, one in which employees understand that reporting misconduct is expected and encouraged because disclosures ultimately benefit the corporation.[185]

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expressed anonymously" might encourage such a culture); Brett H. McDonnell, *Sox Appeals*, 2004 MICH. ST. L. REV. 505, 530 (asserting that "norms of good behavior [can be] as . . . important [a] limit on managerial misbehavior" as other disciplinary mechanisms).

179. Enforcement is geared toward requiring the existence of the channel, not toward regulating its use. *See* Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(m)(1)(A) (Supp. 2002); 17 C.F.R. § 240.16a-3(a) (2000).

180. *See* Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021, 2032 (1996) (arguing that even an under-enforced law may serve an expressive function that can alter behavior in "signaling appropriate behavior and in inculcating the expectation of social opprobrium and, hence, shame in those who deviate from the announced norm").

181. *See* Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, 2002 COLUM. BUS. L. REV. 71, 104 ("If the firm's commitment to certain behaviors can be communicated successfully, this should be a strong pull. And if other agents publicly signal their adherence to the policy, conformity pressures will go to work as well. A positive compliance culture will evolve."); *cf.* Estlund, *supra* note 77, at 375 (noting that Sarbanes-Oxley plays an important role "by protecting and institutionalizing employee whistleblowing").

182. *Cf.* Kostant, *supra* note 69, at 556–58 (arguing that corporate lawyers may become better corporate watchdogs because of their more formalized role under Sarbanes-Oxley). Professor Kostant's arguments that Sarbanes-Oxley may change the social norms for attorneys support the argument that a formalized structure for reporting misconduct may alter the social norm against whistleblowing that exists in many corporations. *See id.*

183. *See* Kahan, *supra* note 176, at 635–36.

184. *See id.*

185. *See* Sunstein, *supra* note 180, at 2033 (discussing the development of "*norm cascades*, as reputational incentives [that] shift behavior in new directions") (citing TIMUR KURAN, PRIVATE TRUTHS, PUBLIC LIES: THE SOCIAL CONSEQUENCES OF PREFERENCE FALSIFICATION 3 (1995)).

Accordingly, under the Structural Model, *not* reporting may actually be seen as *disloyal,* and those who stand mute in the face of wrongdoing may be considered defectors from the norm, subject to social sanctions, such as ostracism, or even employment sanctions, such as discipline for not reporting misconduct.[186] For example, when WorldCom emerged from bankruptcy as MCI, the company conducted an intensive internal investigation and fired fifty employees, many of whom were not involved in the fraud but who likely knew about it.[187] Structural encouragements can become self-fulfilling as they are given legitimacy by legal and human resource professionals within the corporation.[188] As Professor Peter Kostant has argued, "a slight adjustment, or clarification of social meaning, can powerfully affect norms of behavior."[189]

This theoretical approach to social norms finds support in research regarding influences on whistleblowing behavior. Studies demonstrate that internal whistleblowing increases when ethical and legal compliance policies exist in an organization,[190] particularly if specific whistleblowing procedures are in place.[191] Such reporting procedures give whistleblowers more power by officially providing encouragement and protection.[192] Indeed, two of the most prominent social science researchers of whistleblowing behavior contend that the best approach for encouraging whistleblowing is to "set up internal complaint procedures where concerned employees could report, and make sure that those procedures provide for speedy and impartial review."[193]

Thus, whistleblowing will likely increase if the attitudes of corporate players and the corporation's social norms encourage it.[194] It is commonly argued that in order to encourage whistleblowers, corporations need to develop a more ethical and open culture,

186. *See id.* at 2029–30.

187. *See* McCafferty, *supra* note 74.

188. *See* Lauren B. Edelman, *Legal Environments and Organizational Governance: The Expansion of Due Process in the American Workplace*, 95 AM. J. SOC. 1401, 1406–17 (1990).

189. Kostant, *supra* note 69, at 553.

190. *See* Trevino, *supra* note 25, at 1198–1201.

191. *See* MICELI & NEAR, *supra* note 6, at 150.

192. *See id.* at 223.

193. *Id.* at 249; *see also* Dworkin, *supra* note 102, at 474.

194. *See* MICELI & NEAR, *supra* note 6, at 158–60; Miethe & Rothschild, *supra* note 9, at 326.

implemented from the top of the organizational hierarchy.[195] Yet, beyond relying upon enlightened corporate leaders, specific recommendations regarding how society can implement such a corporate culture are rare because it is difficult—if not impossible—for the government to mandate a culture of honesty. Sarbanes-Oxley's Structural Model might provide a means to encourage the development of such an ethical corporate culture by mandating both a process for whistleblowers to follow and a high-level recipient for whistleblower disclosures.

There are obvious limitations to the ability of the Structural Model to turn employees into corporate monitors. Like any corporate monitor, employees suffer from cognitive biases that may inhibit them from spotting and reporting wrongdoing. For example, in the face of ambiguous evidence of wrongdoing, employees tend to interpret information to avoid conflict.[196] Also, employees have a "cognitive conservatism" that makes it difficult to readjust one's perspective to account for new information,[197] particularly if, as some theorize, corrupt corporate behavior begins with acts that are only minimally improper, which then gradually expand into larger acts of wrongdoing.[198] When combined with a bias for the status quo and a tendency to perceive information as normal rather than abnormal, employees face difficulties as unbiased corporate monitors.[199]

These difficulties suggest that employees should not be a corporation's sole source of monitoring. But, employees can, and should, be one part of the overall corporate monitoring system. As part of that system, a visible and legitimate whistleblower disclosure channel that encourages and responds to the reporting of misconduct may cause employees to give credence to their own concerns by challenging their inherent assumptions and biases. The structure of an effective disclosure channel will reduce disincentives to coming forward by reducing corporate and societal pressures to remain quiet. When implemented in conjunction with anti-

195. *See* Westin, *supra* note 54, at 143–49.

196. *See* Langevoort, *supra* note 181, at 86–87 (describing this tendency as "motivated inference").

197. *See id.* at 87–88.

198. *See* Darley, *supra* note 175, at 1186–88.

199. *See* Langevoort, *supra* note 181, at 86–90 (discussing these same attributes as they apply to whether supervisors can capably monitor employees to prevent wrongdoing).

retaliation protections, the Structural Model should encourage more whistleblowing from corporate employees.

B. Less Blocking and Filtering

A second significant benefit of the Structural Model is that it should increase whistleblowers' effectiveness by providing a channel for employees to bypass potential blocking and filtering by corporate executives and to report information directly to the board of directors. Moreover, because the channel to the board is relatively unfiltered, such information may prompt directors to critically examine information received from the corporate managers that might be contradictory to that of the employee. This critical examination is likely because directors "have a tremendous reputational stake in compliance with the law, and almost no countervailing financial stake in its violation . . . [therefore, they] are likely to insist on correcting internal problems rather than covering them up."[200] Providing reports to the traditional monitors, particularly the board of directors, will be the key to the Model's success.

Furthermore, Sarbanes-Oxley's Structural Model makes it more difficult for directors to ignore the information received from whistleblowing employees.[201] One problem with the traditional monitoring system is that it relies upon a liability system that makes proof of a monitor's breach of fiduciary care extremely difficult unless direct knowledge of wrongdoing is demonstrated. Thus, the traditional system encourages directors to avoid receiving information about potential misconduct in the corporation because there is no breach of fiduciary duty when the directors have no direct knowledge of wrongdoing.

The Structural Model makes it more difficult for directors to avoid the type of knowledge that makes them responsible for corporate wrongdoing. Most whistleblowing systems provide effective documentation of information passed from an employee to the responsible monitor. Indeed, after the recent corporate scandals, the Organizational Sentencing Guidelines were amended to require that the organization's "governing authority"—most likely the board

200. Kostant, *supra* note 69, at 556 (citing David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1812 (2001)).

201. *See Developments in the Law*, *supra* note 71, at 2247 n.134.

of directors—must have knowledge about, and exercise reasonable oversight of, the compliance program.[202] Part of this oversight must include receiving annual reports from individuals who are operationally responsible for the program.[203] Similarly, under Sarbanes-Oxley's Structural Model, directors could not claim—as they did with Enron—that they were unaware of potential misconduct. Although directors may still ignore or underestimate the information because it comes from a source outside of their small group,[204] they will do so at their own peril. At a minimum, a disclosure channel forces directors to either confront officers with the information or be liable for their failure to do so. In this way, the Structural Model reinforces the already-existing duties and obligations of the traditional monitors.

Thus, by circumventing the blocking and filtering of corporate executives, Sarbanes-Oxley's Structural Model will make whistleblower disclosures more effective because disclosures to directors are more likely to cause the corporation to address the misconduct of its executives and managers.

C. Secondary Benefits

Sarbanes-Oxley's Structural Model is likely to provide significant benefits directly to the corporation and thereby gain organizational acceptance. Indeed, the history of the Structural Model demonstrates that such organizational acceptance is crucial for the Model to work. For example, the disastrous reign of two Special Counsels eviscerated the disclosure provisions of the Civil Service Reform Act because they did not follow through on employee disclosures effectively.[205] For organizational acceptance to occur, the benefits of this Model *to the corporation* must outweigh its costs. A corporation will implement a truly workable and effective disclosure system when encouraging whistleblowers is in its best interest. Fortunately, Sarbanes-Oxley's Structural Model could provide significant benefits directly to the corporation.

202. OSG, *supra* note 125, § 8B2.1(b)(2)(A), Application Note 1.

203. *Id.* § 8B2.1(b)(2)(C), Application Note 3.

204. *See* Fanto, *supra* note 24, at 460–72.

205. *See* discussion *supra* Part III.B.

1. Encouraging internal whistleblowing

An important benefit for corporations is that the Structural Model encourages internal whistleblowing.[206] When an employee reports wrongdoing internally rather than externally, corporations learn about mistaken employee views and perspectives before these mistaken views are made public, at which point they are harder to correct.[207] This early detection allows corporations to avoid costs related to the negative publicity and government intervention that follows external whistleblowing.[208] It also gives corporations the opportunity to correct misconduct earlier and thereby save costs related to future litigation.[209] Furthermore, internal whistleblowing may attract whistleblowers who are loyal to the corporation and thus are motivated to improve the corporation.[210] These whistleblowers also are less likely to experience retaliation when they report internally rather than externally.[211]

One criticism of encouraging internal whistleblowing is that it may not be beneficial for society because misconduct is more easily hidden and covered up if it is reported internally.[212] However, Sarbanes-Oxley's Structural Model should reduce this negative aspect of internal whistleblowing by directing whistleblower reports to corporate monitors who are subject to sanctions for failing to investigate and disclose material misconduct.[213] Moreover, the Structural Model does not prohibit external whistleblowing—it

206. *See* DANIEL P. WESTMAN, WHISTLEBLOWING: THE LAW OF RETALIATORY DISCHARGE 169 (1991) ("Employees may be less likely to complain outside their organizations if they believe that their companies have effective internal mechanisms for expressing dissent and achieving change."); Dworkin & Callahan, *supra* note 137, at 300–02.

207. *See* Callahan et al., *supra* note 102, at 904–06; Dworkin & Callahan, *supra* note 137, at 299–300; Terry Morehead Dworkin & Janet Near, *Whistleblowing Statutes: Are They Working?*, 25 AM. BUS. L.J. 241, 243 (1987); Vaughn, *supra* note 89, at 599.

208. *See* Callahan et al., *supra* note 102, at 882, 904–06; Dworkin & Near, *supra* note 207, at 242.

209. *See* Culp, *supra* note 160, at 124, 132; 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).

210. *See* Dworkin & Callahan, *supra* note 137, at 299–300.

211. *See id.* at 302; Dworkin & Near, *supra* note 109, at 6.

212. *See* Dworkin & Callahan, *supra* note 137, at 284; Stewart J. Schwab, *Wrongful Discharge Law and the Search for Third-Party Effects*, 74 TEX. L. REV. 1943, 1966–68 (1996).

213. *See* Cherry, *supra* note 8, at 1073 (noting that the reporting channel of Sarbanes-Oxley would provide evidence for government investigators and plaintiff's attorneys regarding corporate knowledge of wrongdoing).

simply facilitates internal whistleblowing in order to encourage a greater overall amount of whistleblowing.

2. Better corporate decision-making

To the extent that a corporation truly implements structural changes that improve the flow of information, corporate decision-making should improve.[214] Boards of directors need to be open to different and dissenting points of view in order to improve the quality of their decision-making.[215] Evidence from studies of corporate boards demonstrates that "companies do best if they have highly contentious boards 'that regard dissent as an obligation and that treat no subject as undiscussable.' Well-functioning boards contain a range of viewpoints and encourage tough questions, challenging the prevailing orthodoxy."[216] In accordance with this viewpoint, Professor James Fanto suggested improving the board of directors by appointing outside directors to play a "whistleblowing" function in order to combat pervasive "group think."[217] Sarbanes-Oxley's Structural Model augments this suggestion by directing actual whistleblowers to disclose information to the board of directors, thereby providing the board information with which to make more informed decisions.

On a broader note, the Structural Model also helps encourage dissent more generally by encouraging employees to speak out immediately and directly. This process may lead to better decision-making for the corporation because groups make better decisions when a variety of viewpoints are considered.[218] Without dissent from individuals, groups tend to conform to more extreme positions—positions not held individually by most of the members of the group.[219] Moreover, dissenters can play an important role in breaking informational cascades, in which a group of people uniformly fall in line with a few influential people who may or may not have complete

214. *See, e.g.*, MICELI & NEAR, *supra* note 6, at 228–29.

215. *See* SUNSTEIN, *supra* note 159, at 2; O'Connor, *supra* note 23, at 1304–06; Westin, *supra* note 54, at 138–39.

216. SUNSTEIN, *supra* note 159, at 2.

217. *See* Fanto, *supra* note 24, at 507–09.

218. *See* SUNSTEIN, *supra* note 159, at 9 ("[C]lose-knit groups, discouraging conflict and disagreement, often do badly because of this type of conformity. The problem is that people are failing to disclose what they know and believe.").

219. *See generally id.* at 111–44 (discussing "group polarization").

access to full information.[220] The essential problem with such cascading is that individuals with a minority view often self-censor in the face of this group pressure, which keeps valuable information from the group and leads to inferior decision-making.[221] Through a disclosure channel, whistleblowers can provide an important dissenting voice which may improve a corporation's decision-making, particularly at the board level.

3. Reducing monitoring costs

Despite the many benefits of prompt and efficient whistleblowing, whistleblowing—like any monitoring mechanism—has its costs. Sarbanes-Oxley's Structural Model, however, minimizes those costs and, where appropriate, reduces the costs of whistleblowing more effectively than the Anti-retaliation Model.

The Structural Model has obvious costs associated with maintaining a structure to receive, disseminate, and investigate employee disclosures.[222] These costs, of course, vary depending upon the complexity of the system[223] and may affect smaller companies more than larger ones.[224] However, when the SEC enacted rules implementing the structural changes of section 301, it did not receive any specific data in response to its request for information related to possible costs of such systems,[225] perhaps signaling that the cost of such structures is not overwhelming for public companies.[226]

220. *See id.* at 66–73.

221. *See id.* at 118.

222. *See* SEC Release, *supra* note 147, at 18,813 (noting that there will be "ongoing costs" in establishing procedures for handling complaints and in monitoring compliance with those procedures).

223. *Cf.* Matthias Schmidt, *"Whistle Blowing" Regulation and Accounting Standards Enforcement in Germany and Europe—An Economic Perspective* 26 (Humboldt Univ. Bus. & Econ. Discussion, Paper No. 29, 2003), *available at* http://ssrn.com/abstract=438480 (noting that for internal whistleblowing rules to be effective, tremendous company resources may be required, such as continuous training for management and employees, implementing hotlines, and identifying ombudspersons).

224. *See* SEC Release, *supra* note 147, at 18,816.

225. *See id.* at 18,814.

226. Anecdotal evidence also supports the notion that companies may not find the cost of certain disclosure systems prohibitive, particularly when compared with the benefit of increased employee monitoring. *See generally* Judy Dahl, *Whistle-Blower Program Lets Employees Speak Up*, DIRECTORS NEWSLETTER (Credit Union), Dec. 2005 (on file with author) (describing the whistleblower hotline implemented by Texas credit union, which the credit union's internal auditor called a "bargain").

In addition to the mechanical nuts and bolts of implementing a reporting system, opportunity costs must be considered. Executives and managers monitored by employees might forgo activity that is profitable and legal, but that may put them at risk of being reported.[227] Shareholders might want these executives and managers to test, or even to cross, the boundaries of legality because at times it may be more profitable for shareholders if a corporation violates the law, particularly if the penalties and the chance of being caught are low.[228] Yet corporations already incur these opportunity costs because of current employee monitoring unrelated to the Structural Model. As Professor Larry Backer has noted,

> [M]uch of the obligations imposed on directors, officers and gatekeepers, all fall on employees. Employees are usually the people who actually gather the information necessary for the functioning of the due diligence, monitoring, or information systems mandated by [Sarbanes-Oxley] and related statutes. Employees tend also to be responsible for first cut analysis and decisions with respect to the relevance of particular bits of information. To a large extent, a large firm must rely on its employees, a large number of whom must be trusted to gather, analyze and produce information that is essential for the compliance by responsible officers, directors and gatekeepers of their legal obligations.[229]

Increasing the role of employees in corporate governance by encouraging them to report misconduct may not dramatically increase these opportunity costs. While employees are already asked to monitor, corporations fail to offer an incentive to accurately report their findings to corporate leadership. Thus, because all monitoring mechanisms have costs that must be considered in

227. *See* Ribstein, *supra* note 17, at 284; *see also* MIETHE, *supra* note 49, at 87 (noting that over-surveillance of employees can lead to employees that are overly cautious).

228. *See* MICELI & NEAR, *supra* note 6, at 10 ("[E]thical issues aside, from a shareholder's standpoint, illegal acts may be worthwhile if their expected benefits 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 managers to occasionally get caught trying to cheat." (quoting Wallace N. Davidson III & Dan L. Worrell, *The Impact of Announcements of Corporate Illegalities on Shareholder Returns*, 31 ACAD. MGMT. J. 195, 198 (1988) (internal quotation marks omitted))).

229. Larry Catá Backer, *Surveillance and Control: Privatizing and Nationalizing Corporate Monitoring After Sarbanes-Oxley*, 2004 MICH. ST. L. REV. 327, 370.

comparison to the costs of other controls,[230] it is noteworthy that the marginal opportunity costs of encouraging employees to report misconduct may not be significant given employees' current monitoring roles.

Another cost of encouraging whistleblowing (and the monitoring that goes along with it) is that a corporation may discover wrongdoing for which it may be liable to some third party.[231] When a company exposes its own employee's wrongdoing, it can incur financial penalties, litigation expenses, negative publicity, and increased scrutiny by regulators.[232] This cost is not uniform among companies and will be greater for those corporations that are engaging in fraudulent activities.[233] Assuming most companies are not acting illegally, this overall cost may be insignificant for the vast majority of corporations.[234]

Furthermore, these costs may seem higher to corporations than they really are because managers often confuse their own personal costs with costs to the corporation. As Professor Richard Painter notes, "[m]anagers often lose their careers if misconduct is disclosed, whereas organizations may suffer only temporary loss of reputation. Managers usually bear the brunt of criminal liability for misconduct, whereas organizations do not go to jail."[235] In short, while corporations may actually benefit from getting caught early because wrongdoing is thereby forestalled, managers may underemphasize these benefits because getting caught can be a personal disaster for managers.[236] A corporation's agents—its managers and executives—may not implement protections that would benefit the corporation itself because of the increased risk to the agent. The Structural

230. *Cf.* Kraakman, *supra* note 19, at 75–87 (discussing costs of legal enforcement through third-party liability).

231. *Cf.* Richard W. Painter, *Toward a Market for Lawyer Disclosure Services: In Search of Optimal Whistleblowing Rules*, 63 GEO. WASH. L. REV. 221, 224 (1995) (noting that an obvious cost to clients of engaging an attorney who will be a whistleblower is the "cost of misconduct being exposed").

232. *See* MICELI & NEAR, *supra* note 6, at 282; *see also* ROBERTA ANN JOHNSON, WHISTLEBLOWING: WHEN IT WORKS—AND WHY 75 (2003).

233. *See* Painter, *supra* note 231, at 224, 263.

234. *See id.* at 224.

235. *Id.* at 263–64. Of course, management turnover may impose its own costs, such as replacement costs and a "loss of cohesion within the organization." *See* Langevoort, *supra* note 181, at 295–96.

236. *See* Painter, *supra* note 231, at 263–64.

Model addresses this "agency failure"—whereby managers "overemphasize costs and underemphasize benefits" of getting caught[237]—because it increases corporate compliance and facilitates earlier detection of corporate fraud.

Another cost of whistleblowing comes from likely error, including intentional error by purported whistleblowers. Whistleblowers could use the system opportunistically to gain some sort of job security by disclosing imaginary misconduct,[238] to achieve an advantage in promotion or salary by wrongly reporting a co-employee,[239] or simply to hurt the employer in retaliation for some perceived slight.[240] Alternatively, reporting errors could occur simply because an employee does not fully understand an ambiguous and complex situation in which it might be difficult to discern legal from illegal conduct.[241] The costs of such erroneous claims include costs associated with internal investigations, litigation expenses, opportunity costs, potential penalties, and costs related to becoming a possible target for government regulators.[242]

The Structural Model can reduce the costs of whistleblowing errors, whether made maliciously or in good faith, because the Model channels whistleblower disclosures internally rather than

237. *See id.* at 264–65.

238. *See* MICELI & NEAR, *supra* note 6, at 7; Ribstein, *supra* note 17, at 286; Schmidt, *supra* note 223, at 21; Westin, *supra* note 54, at 134. The costs here mirror the typical list of costs that are asserted regarding any restriction on a corporation's ability to fire its employees at-will. *See* James W. Hubbell, *Retaliatory Discharge and the Economics of Deterrence*, 60 U. COLO. L. REV. 91, 99, 123 (1989) (arguing that inhibiting the right of an employer to fire an employee will raise the cost of labor because it reduces the ability to fire inefficient employees, which makes the employer's workforce less efficient, and thus more costly, and it will also raise the costs of administrating the employment relationship because it will lead to spurious claims that increase litigation and administrative expenses). *See generally* Steven L. Willborn, *Individual Employment Rights and the Standard Economic Objection: Theory and Empiricism*, 67 NEB. L. REV. 101 (1988).

239. *Cf.* Palmateer v. Int'l Harvester Co., 421 N.E.2d 876, 884 (1981) (Ryan, J., dissenting) (expressing concern about protecting whistleblowers in the workplace because it encourages employees to turn in other employees).

240. *See* Phillip I. Blumberg, *Corporate Responsibility and the Employee's Duty of Loyalty and Obedience: A Preliminary Inquiry*, 24 OKLA. L. REV. 279, 298 (1971).

241. *See id.*; *see also* Westin, *supra* note 54, at 134 ("Putting the whistle to one's lips does not guarantee that one's facts are correct.").

242. *See* Gerald Vinten, *Enough is Enough: An Employer's View—The Pink Affair*, *in* WHISTLEBLOWING—SUBVERSION OR CORPORATE CITIZENSHIP?, *supra* note 7, at 118–32 (describing the costs incurred by an employer that investigated thoroughly but could not substantiate a whistleblower's claims); Kraakman, *supra* note 19, at 60.

externally.[243] Although there will be investigative costs, a corporation that receives erroneous disclosures internally at least has the possibility of providing feedback and correct information to a whistleblowing employee.[244] This early response may keep a good faith whistleblower from going public with flawed information, thus reducing the overall costs of defending against such charges. Moreover, even when a good faith whistleblower makes a public accusation in the face of contrary evidence, the company will have investigated the complaints and will be able to explain publicly the reasons why those complaints were disregarded after the internal investigation.[245]

With regard to malicious whistleblowers who intentionally make false claims, Sarbanes-Oxley's Structural Model may actually reduce costs associated with such accusations. Employers likely will document any whistleblowing disclosures made through the approved channel as well as any subsequent investigation, which may lessen the factual "he said/she said" nature of whistleblowing claims regarding when a disclosure was made, the content of the disclosure, and the relationship of the disclosure to an employment action. Moreover, whistleblower disclosures may never be provided to supervisors who make employment decisions, thus shielding these supervisors from unintentionally retaliating against a whistleblower. Furthermore, the Structural Model will enable corporations to prevent intentional retaliation by frustrated managers, which also will reduce litigation expenditures.

Finally, a common argument against promoting whistleblowing is that it will undermine corporate culture by encouraging secrecy, destabilizing management authority, and diminishing morale.[246] Each of these phenomena represents potential costs for a corporation. Whistleblowing may damage a corporation's ability to maintain confidential business information, thus forcing it to create systems to maintain secrecy of its vital corporate information.[247] It is costly to create these additional systems, and further costs are

243. It should be noted that incidents of malicious whistleblowing are rare. *See* Dworkin & Callahan, *supra* note 137, at 303.

244. *See id.* at 304.

245. *See* Westin, *supra* note 554, at 150.

246. *See* Callahan & Dworkin, *supra* note 5, at 333; Miethe & Rothschild, *supra* note 9, at 343.

247. *See* Blumberg, *supra* note 240, at 297.

incurred because the systems inefficiently restrict the normal sharing of corporate information.[248] Similarly, whistleblowing can undermine the organizational chain of command, which may reduce the efficiencies gained by having a clear corporate decision-making structure.[249] In fact, any decrease in the authority of management imposes costs, as managers must spend additional time justifying themselves and their commands.[250] Reduced morale, among both executives and employees, also may lead to less productivity and efficiency. In its extreme version, this argument analogizes a culture of whistleblowing to the type of informing that is encouraged by tyrannical regimes.[251]

Certainly an overly-rigorous surveillance program may lead to "risk-aversion and frustration that stem from the fear that one will be incorrectly second-guessed."[252] Yet the actual effect of increased encouragement of whistleblowing on a corporation's culture is unclear. As an initial matter, the concern that encouraging whistleblowing will cause corporate disruption seems to lack demonstrable support in the extensive social science research regarding whistleblowers.[253] As mentioned above, this research supports the opposite conclusion: that whistleblowers typically are loyal employees dedicated to the organization's goals.[254] Furthermore, most employees are accustomed to surveillance by managers and other superiors through performance reviews and evaluative metrics, such that additional monitoring is unlikely to affect morale negatively. Moreover, the Structural Model encourages whistleblowing within the corporate system, which should work to maintain corporate secrets rather than exposing them to outsiders. Sarbanes-Oxley's emphasis on internal whistleblowing should also

248. *See id.*; Kraakman, *supra* note 19, at 60.

249. *See* JOHNSON, *supra* note 232.

250. *See* MICELI & NEAR, *supra* note 6, at 9–10; *see also* Geary v. U.S. Steel Corp., 319 A.2d 174, 178 (Pa. 1974) (denying whistleblower claim because whistleblower bypassed immediate supervisors in his reporting and breached the chain of command, and approving of the company discharging him "to preserve administrative order in its own house").

251. *See* Peter F. Drucker, *What is "Business Ethics"?*, 63 PUB. INT. 18 (1981).

252. *See* Langevoort, *supra* note 27, at 309.

253. *See* Dworkin & Callahan, *supra* note 137, at 303–04 (summarizing research and concluding that "[f]ears that internal whistleblowing is disruptive of employee control and productivity, or that it serves purely private interests, are unsupported by social-psychological research" (citation omitted)).

254. *Id.* at 301–03.

keep the potential for organizational disruptions to a minimum because it reinforces, rather than undermines, the corporate hierarchy. By providing information to the board of directors rather than to corporate management, Sarbanes-Oxley's Structural Model emphasizes the primacy of the board of directors as a regulatory player in the corporate structure.

4. Increasing employee voice

Whistleblower disclosure channels also benefit corporations by giving corporate employees greater voice through an additional avenue of participation in corporate governance.[255] With union membership on the decline, the opportunity for employee participation in the workplace has been greatly reduced, leading to higher worker turnover and lower worker satisfaction.[256] Providing the employee with more voice and participation in the workplace by encouraging whistleblowing can lead to longer employee tenure and less turnover.[257] Because work is where an employee gets a "sense of community and self-worth," increased involvement in corporate governance is valuable for an employee.[258] Stability is also enhanced by the increased morale that occurs "when employees understand that they can stop wrongful conduct and contribute to shaping a working environment in which they can take pride."[259] Additionally, corporations benefit from cooperative relationships with their employees; such relationships increase corporate productivity by encouraging employees to develop firm-specific skills. This will in turn increase employee efficiency.[260]

255. *See* Dworkin, *supra* note 102, at 459; Estlund, *supra* note 9, at 108 ("[E]mployee participation in workplace governance is increasingly viewed as both an intrinsic and an instrumental good.").

256. *See, e.g.*, PAUL C. WEILER, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW 29 (1990); Samuel Issacharoff, *Reconstructing Employment*, 104 HARV. L. REV. 607, 624 n.86 (1990) (reviewing WEILER).

257. *See* RICHARD B. FREEMAN & JAMES L. MEDOFF, WHAT DO UNIONS DO? 162–80 (1984); Estlund, *supra* note 77; Issacharoff, *supra* note 256, at 624.

258. *See* Estlund, *supra* note 9, at 108.

259. Callahan et al., *supra* note 124, at 196; *see also* MICELI & NEAR, *supra* note 6, at 12.

260. *See* Estlund, *supra* note 77. Professor Estlund summarizes the reasons why a corporation may not implement such structural protections and reforms on its own, even if they increase productivity. Such reasons include (1) the possibility that increased productivity may not lead to increased profits, (2) the difficulty for managers who desire control to understand the value to the corporation of employee voice and participation, and (3) the long-

Yet, this relationship between employees and employers must have structure before these benefits can be realized,[261] and providing structural encouragement for employee voice through whistleblowing is a good beginning. Incorporating employees as part of a broad corporate governance system is not as impractical as it sounds; in fact, scholars have suggested involving employees in corporate governance for decades.[262] For example, much of the union movement has rested upon employees becoming more involved in their working conditions. The movement to broaden corporate accountability to "stakeholders" rather than only "shareholders" recognizes employees as important players in the corporation.[263] Although employee-designated directors are rare in the United States,[264] some large employers initiate "employee participation programs," in which employees are involved in cooperative efforts with corporate management.[265]

Significantly, encouraging whistleblowing regarding *financial crime* under Sarbanes-Oxley may be more successful than previous attempts to encourage whistleblowing regarding other types of corporate misconduct because those previous attempts were fundamentally adversarial. In the union context, employee voice through unionization traditionally has been met with hostility by management because of a union's perceived negative effect on profitability.[266] Similarly, with regard to the health and safety of employees or the public, previous efforts to encourage whistleblowing required corporations to internalize costs they might

term benefits of encouraging employee voice may be intangible when compared with short-term benefits a corporation believes it receives by reducing employee voice. *See id.* at 110 n.25.

261. *See id.* at 109 ("Employee voice, to be effective in workplace governance and in monitoring regulatory compliance, must be channeled into workable and representative structures with power within the workplace . . . .").

262. *See, e.g.*, Michael H. LeRoy, *Employee Participation in the New Millennium: Redefining a Labor Organization Under Section 8(a)(2) of the NLRA*, 72 S. CAL. L. REV. 1651, 1653–54 & n.8 (1999) (discussing team-based workplaces).

263. *See* Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45, 48–50 (1991).

264. *See* Gordon, *supra* note 26, at 1243 (noting that an exception to this rule is employee-owned United Air Lines).

265. *See, e.g.*, LeRoy, *supra* note 262, at 1661–66; Robert B. Moberly, *The Story of Electromation*, *in* LABOR LAW STORIES 315, 320–22 (Laura J. Cooper & Catherine L. Fisk eds., 2005).

266. *See* FREEMAN & MEDOFF, *supra* note 257, at 181–83.

rather externalize.[267] For instance, dumping toxic waste may be cheaper for corporations to do illegally rather than legally. Increasing employee hazards or underpaying an employee for overtime might ultimately cost less than complying with employee safety and wage legislation. There is thus an inherent conflict of interest in asking corporations to encourage whistleblowing when corporations will lose money if misconduct is exposed. Financial crime, however, less clearly benefits the corporation and its shareholders. Encouraging whistleblowing regarding financial crime, which by its nature benefits shareholders, might be easier to implement because the corporation's self-interest is involved.

V. STRENGTHENING THE STRUCTURAL MODEL

A. Mandating the Model Effectively

The Sarbanes-Oxley Act is the first attempt to mandate a whistleblower disclosure channel in the private sector. Yet, despite its broad application to all publicly-traded corporations, Sarbanes-Oxley fails to detail any specifics regarding the disclosure channel. The Act requires only a single channel for employees of public companies to report questionable accounting or auditing matters.[268] This mandatory implementation is important and necessary, but it is too limited in scope.

To be sure, government-mandated whistleblower regulation affects corporate autonomy and an employer's relationship with its employees. Traditionally, such regulations have been justified only where whistleblowers patently serve a public good.[269] In those cases, government protection is necessary because corporations would not otherwise reap benefits from reporting conduct hurtful to the public, such as environmental law violations or improper use of government funds.[270] Consistent with this rationale, common law courts typically

267. *See* Schwab, *supra* note 212, at 1970.

268. *See* Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(m)(4)(B) (2001–2003).

269. *See, e.g.*, JOHNSON, *supra* note 232; Schwab, *supra* note 212, at 1945 (discussing protection of whistleblowers who report activities that have "third-party" effects).

270. *See* Schwab, *supra* note 212, at 1970. As put by Dean Schwab in 1996, five years before Enron declared bankruptcy:

> Certainly, a billion-dollar financial fraud involving elderly pensioners can have greater harm on third parties than a trivial oil spill. But in general, companies have great internal incentives to police financial fraud, either to protect their shareholders

provide greater protections to whistleblowers who disclose information that affects a public, rather than a private, interest.[271] When only a private corporate interest is at stake, such as in the case of shareholder fraud or internal corporate theft, whistleblowers have not fared well in their claims for wrongful discharge.[272] In these "private interest" cases, it is arguable that a corporation is due more deference in its treatment of whistleblowers because the corporation has the incentive to determine how much whistleblowing should be permitted and encouraged.[273]

This same argument can be expanded to question the need for government oversight of structural changes to corporate whistleblowing. The argument follows that if the Structural Model provides such benefits to the corporation by encouraging whistleblowers, then perhaps the law should not require these reforms. Smart, self-interested corporations will adopt efficient whistleblowing disclosure channels and prosper, while those entities that do not encourage whistleblowing will founder.

This argument is in some senses effective. Indeed, the work of the market in requiring whistleblower reforms already can be seen in the aftermath of the corporate scandals. Various investor and

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> or their reputation among creditors. Companies often cannot capture the gains from an action that protects public health or safety, and thus that factor often remains external to their calculus. Allowing a wrongful discharge action to be asserted by employees fired for blowing the whistle on actions against public health and safety is one small way to encourage companies to internalize these costs.

Id.; *see also* Cynthia Estlund, *Wrongful Discharge Protections in an At-Will World*, 74 TEX. L. REV. 1655, 1674 (1996) (asserting that actions that are protected from retaliation benefit third-parties and are "public goods that are likely to be 'underproduced' even without the threat of retaliation").

271. *See* Schwab, *supra* note 212, at 1970.

272. For example, whistleblowers who report financial wrongdoing have not been particularly successful in wrongful discharge suits. *See, e.g.*, Adler v. Am. Standard Corp., 830 F.2d 1303, 1305–07 (4th Cir. 1987) (upholding discharge of employee for preparing to disclose commercial bribery and alteration of records); Foley v. Interactive Data Corp., 765 P.2d 373, 375, 380 (Cal. 1988) (refusing to protect employee who internally reported that a supervisor was under investigation for past embezzlemenr); Hayes v. Eateries, Inc., 905 P.2d 778, 788 (Okla. 1995) (refusing to protect employee who internally reported embezzlement by a supervisor); Fox v. MCI Commc'ns Corp., 931 P.2d 857, 860–61 (Utah 1997) (finding that employee was not wrongfully discharged because employee's internal disclosure regarding statutory violations did not implicate a clear and substantial public policy).

273. *See* Schwab, *supra* note 212, at 1949 (noting that a corporation "is in the best position to weigh whether the information the employer gains from co-worker tattling is worth the cost of breakdowns in the corporate chain of command and reduced trust among coworkers").

industry groups pressured corporations to utilize their employees to help detect fraud and other criminal activity. For example, in 2005 a group of Wal-Mart's institutional shareholders requested that the company review its internal controls, in part because of concern that the company weakened the resolve of its employees to report wrongdoing when Wal-Mart fired an employee who disclosed alleged accounting abuse by the corporate vice-chairman.[274] Similarly, the chairman of Nortel Networks recently disclosed that no employee at any level of the company alerted the board to accounting improprieties that were revealed the previous year.[275] In response, the corporation publicized to its shareholders that it voluntarily instituted a "whistleblower system" for employees to raise concerns to an officer who "answers to" the CEO and the chairman of the board.[276]

Other market forces may encourage whistleblowers to report matters externally if internal whistleblowers are not supported. A group called Wal-Mart Watch recently placed thousands of phone calls to Bentonville, Arkansas, Wal-Mart's headquarters, attempting to encourage employees "who know[] of wrongdoing" inside the company to come forward with information.[277] In short, from the "free market" perspective, the market and other non-governmental forces can and do provide incentives to corporations to encourage the disclosure of internal fraud by their employees.

But these market forces often do not work effectively.[278] Although the market has begun pressuring large corporations to encourage whistleblowers, several barriers exist that may prevent

274. *See* James Covert, *Wal-Mart Urged To Review Controls*, WALL ST. J., June 2, 2005, at B7 (quoting a representative of an institutional investor as saying, "[i]ndependent directors need to demonstrate to shareholders that Wal-Mart hasn't built an ostrich culture—where employees are better off sticking their heads in the sand than speaking up").

275. *See* David Paddon, *Nortel Shareholders Vent Anger over Fallen Stock Price, Accounting Scandal*, CANADIAN PRESS, June 29, 2005, *available at* http://www.cbc.ca/cp/business/050629/b062984.html.

276. *Id.* In addition, Volkswagen AG recently responded to disclosures of alleged bribery and other wrongdoing by corporate executives by announcing that it would hire two ombudsmen to receive anonymous employee complaints. *See* Stephen Power, *Volkswagen Strengthens Controls In Wake of Internal Bribery Probe*, WALL ST. J., Nov. 12, 2005, at A4.

277. *See* John Harwood, *Washington Wire: Help Wanted*, WALL ST. J., June 3, 2005, at A4.

278. Securities regulation is justified, in part, because a collective action problem often prevents dispersed shareholders from implementing reforms that could better protect their interests. *See* McDonnell, *supra* note 178, at 535.

corporations from voluntarily implementing a sufficient system. For example, it may be efficient for corporations not to monitor effectively because the law may under-enforce certain regulations—either because there is imperfect monitoring or because penalties are set too low, or both—thus encouraging certain wrongdoing that is profitable.[279] Further, it is unlikely that the majority of public companies will draw the type of media and investor scrutiny that Wal-Mart has encountered. Additionally, managers may implement less-than-effective monitoring systems because they personally benefit from certain undetected misconduct by their subordinates but do not incur significant costs from these violations.[280] Moreover, even if corporate directors believe that the corporation would benefit from increased monitoring by its employees, managers and supervisors may block such changes because they resent increased monitoring and supervision. By mandating a structural whistleblowing approach, the law can relieve pressure on corporations and lessen the extent to which supervisors may feel that their employers are imposing a whistleblowing system because of a lack of trust.[281]

Despite the private-public distinction made by some courts,[282] reducing illegal corporate fraud actually affects the larger public interest as well as the corporate private interest.[283] Corporate fraud undermines the public's confidence in the financial market and reduces the market's transparency and security.[284] Moreover, today's

279. *See* Langevoort, *supra* note 181, at 80.

280. *See id.*

281. *See* Cunningham, *supra* note 142, at 293 ("Mandatory controls serve a sanitizing function for modulating the trust-suspicion trade-off. Controls mandated by law may be imposed by the corporation on employees without expressing a particularized mistrust of them."); Sturm, *supra* note 129, at 520–21 (noting that the law can help "justify the implementation of initiatives lacking short-term economic pay-off, and legitim[ize] the pursuit of ethical values of fairness and respectful treatment in the workplace").

282. *See* Schwab, *supra* note 212, at 1949 (explaining that the private/public distinction is often more conclusory than helpful).

283. *See id.* at 1970 ("The legislature presumably declared the act illegal in order to protect the public from wrongdoing.").

284. *See* 148 CONG. REC. S7352, S7360 (daily ed. July 25, 2002) (statements of Sen. Gramm and Sen. Kerry). As noted by the SEC when it issued rules requiring that audit committees set up a system to receive employee complaints:

> [v]igilant and informed oversight by a strong, effective and independent audit committee could help to counterbalance pressures to misreport results and impose increased discipline on the process of preparing financial information. Improved oversight may help detect fraudulent financial reporting earlier and perhaps thus

modern corporations are the center of the economic universe, and corporate fraud can harm entire communities—not just corporate shareholders.[285] Given their large effect on the public interest, whistleblowers may actually be ***more*** necessary in the private sector than in the public sphere. As Professor Phillip Blumberg noted over three decades ago, in the public sphere, an opposition party usually will be able to provide oversight regarding the administration of the government.[286] In a corporation, however, a whistleblower may be more necessary because shareholders or a board of directors may not be able to control management.[287] If effect on the public interest is the sine qua non of government intervention, then reducing corporate fraud should satisfy this standard, particularly in light of the significant public impact of the recent corporate scandals.

Thus, the government can address weaknesses of the "free market" approach by imposing some structural reform.[288] Sarbanes-Oxley's mandatory approach to whistleblower disclosure channels improves upon previous versions of the Structural Model, which provided only weak incentives for corporations to implement structural change.

> deter it or minimize its effects. All of these benefits imply increased market efficiency due to improved information and investor confidence in the reliability of a company's financial disclosure and system of internal controls.

SEC Release, *supra* note 147, at 18,813.

285. Thousands of Enron employees lost their jobs and, as a group, Enron employees lost over one billion dollars in retirement accounts containing a high proportion of Enron stock. *See* Kroger, *supra* note 26, at 58 (noting that local businesses that relied on Enron and its employees were negatively affected); Kate Murphy, *Corporate Lepers, Local Heroes?*, BUS. WK. ONLINE, June 30, 2005, http://www.businessweek.com/bwdaily/dnflash/jun2005/nf20050630_0279_db017.htm ("Enron employees who lost their jobs and retirement savings weren't the only people hurt. From local Porsche dealers to caterers, graphic designers, and travel agents, many folks either went out of business or took a tremendous hit because of what happened at Enron."); *cf.* Blumberg, *supra* note 240, at 299 (noting that large corporations can have characteristics of a private government because of their large revenues and substantial number of employees and shareholders).

286. *See* Blumberg, *supra* note 240, at 306.

287. *See id.*

288. To the extent that a mandatory system remains unappealing, certain required disclosures could still encourage the development of whistleblower systems. For example, rather than mandate certain disclosure systems, regulators could develop a list of "best practices" for such compliance systems. Corporations could comply with these practices or disclose why they do not. *See* Paredes, *supra* note 18, at 526 (suggesting such a system for corporate governance more broadly). Although this is a second-best option, it may prove more viable in a regime where mandatory regulation is disfavored.

But how much regulation should there be? Section 301 imposes a minimalist version of the Structural Model: it requires only that a public company's audit committee establish procedures for receiving complaints regarding accounting issues, including confidential, anonymous concerns from employees.[289] In many ways, not requiring any specific procedures makes sense. Small corporations may prefer to outsource the complaint procedure to a third-party to handle "hotline" calls. Other corporations may determine that they want a more investigative function and appoint ombudsmen or ethics officers with broad responsibilities and reporting obligations. In fact, social science research suggests that corporate structure greatly impacts the type of encouragement necessary to effectively encourage whistleblowing, such that a variety of approaches may be successful.[290] This diversity of options works well in an economy with a wide variety of workplaces. Flexibility encourages experimentation with a range of processes and ultimately will help develop various best practices for industries and companies.[291]

To realize the full potential of the Structural Model as a means of improving corporate governance, however, certain specifics could be fleshed out and expanded upon through legislation or regulation. In particular, Sarbanes-Oxley's vagueness contributes to two significant problems with its Structural Model.

The first problem is that the Model *may not work well enough.* Specifically, without supplemental requirements, corporations might easily implement a system that looks acceptable on paper but that is not functional or effective in reality. As demonstrated above, this "cheating" problem contributed to the failure of the Model prior to the corporate scandals, and Sarbanes-Oxley does not fix the problem sufficiently.[292]

Conversely, the second problem is that the Model *may work too well.* Employees may make too many complaints about matters that do not merit director investigation. In other words, a powerful

289. *See* Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(m)(4) (Supp. 2002).

290. *See* Granville King III, *The Implications of an Organization's Structure on Whistleblowing*, 20 J. BUS. ETHICS 315, 324 (1999).

291. *See* Sturm, *supra* note 129, at 492 (discussing structural systems to address employment discrimination issues and criticizing a "one-size-fits-all model or a predetermined set of criteria" because it would "cut off the process of organizational development and experimentation that is so crucial to an effective regulatory system").

292. *See* discussion *supra* Part III.B.

Structural Model may provide too much information, called "noise," with only a fraction of the information actually proving useful. Busy corporate directors and officers may spend an inefficient amount of time responding to insubstantial employee complaints.

The future success of Sarbanes-Oxley's Structural Model depends upon addressing both of these concerns. Below, I suggest solutions that involve mandating slightly more structure than is currently imposed by Sarbanes-Oxley. These suggestions are aimed at achieving an efficient level of information flow to directors, while still permitting corporations flexibility in constructing whistleblower disclosure systems that work best for their organizational configuration.

B. Addressing the Cheating Problem

Perhaps the most widely cited problem with internal compliance systems is that it can be easy for a corporation to "cheat" by implementing a superficial and ineffective system.[293] Outsiders, specifically courts, prosecutors, or other administrative agencies, have difficulty judging the effectiveness of a system because "the indicia of an effective compliance system are easily mimicked."[294] The difficulty of accurate and thorough outside evaluation allows corporations to install programs that look good on paper and permit them to check the necessary compliance boxes but have little or no effect on whether individuals in an organization commit less crime.[295]

Sarbanes-Oxley's Structural Model also suffers from this criticism. Corporations could implement a facially compliant "disclosure channel" relatively easily, yet implicitly discourage the use of the channel by director inattentiveness to complaints, lack of publicity of the procedures necessary to utilize the program, or subtle retaliation against employees who report misconduct. Given

293. *See, e.g.*, Bowman, *supra* note 144, at 675; Krawiec, *supra* note 142, at 491; Langevoort, *supra* note 181, at 106–07.

294. Krawiec, *supra* note 142, at 491–92; *see also* Langevoort, *supra* note 181, at 117–18.

295. *Cf.* Krawiec, *supra* note 142, at 487, 491 (noting that such programs may be mere "window-dressing" and can have several negative effects, including an "under-deterrence of corporate misconduct" and "a proliferation of costly—but arguably ineffective—internal compliance structures"); Langevoort, *supra* note 181, at 106 (criticizing "values-based" programs as being "easy to mimic, making it difficult to separate out the sincere programs from the fakes").

the relative weakness of anti-retaliation laws to protect the more subtle forms of discouragement, this cheating problem may undermine the effectiveness of the Structural Model if it is not addressed.

Tools typically found in the corporate regulatory regime—disclosure and incentives—may significantly mitigate the cheating problem. First, corporations could be required to disclose information regarding their whistleblowing channels. This disclosure could include both a description of the structure of the channel as well as its results, such as a summary of evaluative metrics about the performance of the structure. Second, corporations could be given more incentive to implement a fully developed and effective disclosure channel. One suggestion is that a corporation could be provided a safe harbor from certain claims if it satisfies specific whistleblower disclosure channel standards through a pre-approval process. Surprisingly, although these tools were used in other parts of Sarbanes-Oxley to bolster the Act's reform efforts, they were not applied to support further encouragement of whistleblowers.[296]

1. Disclosure of structure and results

Cheating can be discouraged by requiring companies to disclose information regarding both the structure of their whistleblowing disclosure channel as well as the channel's results. In fact, disclosure and transparency are important principles of limited government regulation of markets.[297] Requiring disclosure can help directors and other monitors perform their oversight functions. These monitors will more readily comply with their duties of care and diligence because they know that certain decisions and problems will be exposed through a corporation's mandatory disclosure.[298] Accordingly, Sarbanes-Oxley recognizes that other areas related to internal enforcement should be disclosed.[299] Title IV of Sarbanes-Oxley requires disclosure related to various financial and ethical

296. *See infra* text accompanying footnotes 299–303.

297. Backer, *supra* note 229, at 331 n.8; Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 861 (2003).

298. *See* Thompson & Sale, *supra* note 297, at 872–75.

299. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 745 (stating that the purpose of the Sarbanes-Oxley Act is to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws").

obligations.[300] For example, a corporation must disclose whether or not it has adopted a code of ethics for senior financial officers[301] as well as any change in, or waiver of, the code for these officers.[302] Sarbanes-Oxley also requires that a corporation's annual report must contain an "internal control report" that contains an assessment of the effectiveness of its internal control structure.[303]

As they relate to whistleblowers, however, Sarbanes-Oxley's disclosure provisions are narrowly drawn. A code of ethics would not necessarily involve whistleblowers, and the disclosures for internal controls relate only to financial reporting, which likely would not detail the structure of a whistleblower disclosure channel. Furthermore, in practice these internal control disclosures from management are little more than boilerplate attestations from executives.[304]

More could be required regarding the disclosure of whistleblower channels. SEC regulations could require publication of a description of the individuals responsible for top-level review of complaints from employee whistleblowers and how that review is accomplished, such as whether entire files are reviewed at that level or whether and how files are screened. Further, corporations could reveal whether the disclosure system is provided internally or is outsourced (and to whom), the method by which employees are encouraged to report misconduct, and the means by which employee concerns are evaluated and investigated.[305] In other words, relatively specific information about the system could be disclosed.

300. *See* Sarbanes-Oxley Act of 2002 §§ 401–09 (codified in scattered sections of title 15 of the United States Code (Supp. 2002)).

301. 15 U.S.C. § 7264(a) (Supp. 2002).

302. *See id.* § 7264(b).

303. *See id.* § 7262.

304. *See, e.g.*, THE COCA-COLA COMPANY, ANNUAL REPORT 117 (2006), *available at* http://thecoca-colacompany.com/investors/forms/pdfs/form_10K_2005.pdf ("[M]anagement believes that the Company maintained effective internal control over financial reporting as of December 31, 2005.").

305. *See* Letter from William F. Ezzell, CPA, Chairman, Board of Directors, & Barry C. Melancon, CPA, President, and CEO, American Institute of Certified Public Accountants, to U.S. Securities and Exchange Commission (Feb. 18, 2003) (providing comments to SEC regarding its implementation of Section 301 of the Sarbanes-Oxley Act: "The company should annually disclose whether or not they have a system in place, and whether that system relies on internal resources, or they have engaged an external service provider. If substantive changes are made to the procedures during the year, that fact should be reported via Form 8-K and the next annual disclosure should provide similar detail.").

As with other regular corporate disclosures, disclosures relating to the whistleblower system could be required in a corporation's periodic or annual reports as well as on corporate websites.[306] To provide a further incentive for accurate information, these disclosures could be certified by the head of the audit committee in the same manner that other important corporate information requires executive level certification when it is disclosed to the public.[307] These disclosures also could be posted internally, similar to other federal employment law posting requirements,[308] so that employees have direct knowledge of the procedures and results of employee whistleblowing.

Of course, disclosure is not the answer to every problem. Disclosure may be costly for corporations because compiling and presenting the required information accurately can be an enormous undertaking. Currently, corporations are revolting against Sarbanes-Oxley's requirement that they disclose their internal financial controls because they claim the costs are staggering.[309] Moreover, too much disclosure to the market may produce too much information for investors, such that the marginal benefit of the disclosed information to investors does not justify the increased cost to the corporation of making the disclosure.[310]

306. Sarbanes-Oxley and SEC regulations currently require other information about a corporation to be posted on corporate websites, such as statements related to the beneficial ownership of securities of a corporation. *See* 15 U.S.C. § 78p(a)(4)(C); 17 C.F.R. § 240.16a-3(k) (2006); *see also* 17 C.F.R. § 229.406(c)(2) (permitting posting of required corporate code of ethics onto corporate website). Similarly, the New York Stock Exchange requires each of its listed companies to post its code of business conduct and ethics on their corporate website. NEW YORK STOCK EXCHANGE, NYSE LISTED COMPANY MANUAL § 303A.10 (2006), http://www.nyse.com/RegulationFrameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1145486468873.html&displayPage=/listed/1022221393251.html.

307. *See, e.g.*, 15 U.S.C. § 7241 (requiring personal certification by officers of various publicly disclosed reports); *id.* § 1350 (requiring personal certification by officers of various publicly disclosed reports).

308. *See, e.g.*, 42 U.S.C. § 2000e-10 (2000) (requiring the posting of notice to employees regarding legal protections of Title VII of the Civil Rights Act of 1964).

309. *See* Deborah Solomon, *At What Price?*, WALL ST. J., Oct. 17, 2005, at R3.

310. *See* Letter from PricewaterhouseCoopers LLP to U.S. Securities and Exchange Commission (Feb. 18, 2003), *available at* http://www.sec.gov/rules/proposed/s70203/pricewater1.htm (commenting to the SEC regarding its implementation of Section 301 of Sarbanes-Oxley: "While we acknowledge the fact that these disclosures may be meaningful to investors, we believe that there needs to be a balance between relevant information and information overload.").

However, the cost of disclosing the type of whistleblower channels implemented by a corporation should not be great. It would require nothing more than an accurate description of the program, which would likely already be in corporate papers authorizing it. To counterbalance these costs, there are many benefits to disclosing the whistleblower systems. For example, such disclosure will reduce the temptation to implement systems that can function as mere window-dressing, an easy way to avoid truly encouraging whistleblowers. Corporations, and directors who certify the disclosure, will face financial and possible criminal exposure if the whistleblower system does not mirror its public description.

Also, corporations that provide certified public disclosures about whistleblower channels would increase shareholder support. Such disclosures provide shareholders the opportunity to assess the effort corporations undertake to prevent fraud.[311] Shareholders may prefer companies in which whistleblowing is encouraged through extensive whistleblower systems because strong internal control systems may lead to less regulatory oversight[312] as well as easier access to capital through more positive assessments from credit-rating agencies.[313] In this way, disclosure can provide signaling benefits because it sends "a positive message to shareholders and regulators about checks on management's conduct."[314] To the extent shareholders value strong

311. *See* Schmidt, *supra* note 223, at 26–29 (arguing that disclosure of compliance policies will put market pressure on corporations to institute whistleblower protections); *cf.* Ribstein, *supra* note 17, at 291 ("A fully informed market arguably ought to be able to evaluate the adequacy of firms' monitoring and control mechanisms and to encourage firms to efficiently balance the costs and benefits of adopting additional controls.").

312. *See* Painter, *supra* note 231, at 268 (noting that regulators have limited enforcement budgets and might direct enforcement activity towards actors it believes have not given proper incentives to encourage internal reporting, thus reducing costs because a regulator might "require less frequent and less burdensome reporting, request fewer documents, and conduct less extensive investigations"); Diya Gullapalli, *Living With Sarbanes-Oxley*, WALL ST. J., Oct. 17, 2005, at R1 (noting that Dow Chemical strengthened its relationship with "key regulators at the SEC and the accounting-oversight board" by developing a "reputation for transparency and activism in compliance").

313. *Cf.* Painter, *supra* note 231, at 272 (noting that most investors rely on "reputational intermediaries" because they cannot process all relevant information themselves).

314. *Id.* at 256. *But see* Letter from Charles M. Nathan, Comm. on Sec. Regulation of the Ass'n of the Bar of the City of N.Y., to U.S. Securities and Exchange Commission (Feb. 18, 2003), *available at* http://www.sec.gov/rules/proposed/s70203/cmnathan1.htm (providing comments to the SEC regarding its implementation of Section 301 of Sarbanes-Oxley and recommending that companies be allowed "to choose whether or not they disclose their procedures for handling complaints").

internal control systems, the required disclosure of whistleblower polices could encourage managers to implement enhanced internal controls to increase the company's attractiveness to shareholders.[315] Public information about weak internal controls, on the other hand, will inform potential shareholders about risky investments with a greater likelihood for fraud.[316]

Moreover, disclosure of whistleblower procedures will encourage employees to report misconduct by giving them explicit instruction on the best means of making whistleblower complaints.[317] Under the current Sarbanes-Oxley version of the Structural Model, there is no obligation to publicize the existence of the disclosure procedures, which may cause employees to underutilize the whistleblower channel. This omission is odd given the utilization of such required disclosures to employees in other federal employment statutes, such as Title VII.[318]

In addition to disclosing information regarding whistleblower procedures, the SEC could issue regulations requiring corporations to disclose the *results* of their whistleblower disclosure system. Specifically, corporations could disclose information such as the number of complaints received by the system, the types of complaints (accounting, theft, discrimination, work conditions, etc.), and the resolution or procedural posture of the complaints (found to be without merit, substantiated, etc.).[319] Corporations could be further required to disclose the current employment status of employees who submitted complaints to clarify whether whistleblowers suffer any tangible employment action during a restricted period after they disclose information.[320] Analogously, under the NO FEAR Act, federal agencies disclose statistics

315. *See* Coffee, *supra* note 19, at 1277–78.

316. *See* MICELI & NEAR, *supra* note 6, at 14 ("[I]nvestors and potential investors who are warned of financial wrongdoing may avoid the loss of substantial resources by investing in more ethical or better managed organizations.").

317. *See* Near & Dworkin, *supra* note 112, at 1557; *cf.* Memorandum from Larry D. Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Att'ys 10 (Jan. 20, 2003), http://www.usdoj.gov/dag/cftf/business_organizations.pdf.

318. *See, e.g.*, 42 U.S.C. § 2000e-10 (2000).

319. *Cf.* Callahan et al., *supra* note 124, at 210 (proposing that ombudsmen prepare summaries of complaints received, the investigation, and any actions taken).

320. Auditors already are protected through a similar mechanism in which corporations must report the discharge of an outside accountant. *See* SEC Form 8-K, http://www.sec.gov/about/forms/form8-k.pdf.

regarding the number and type of discrimination complaints each agency received from its employees, including the results of those complaints.[321]

Although reporting such specific results will add cost, the marginal cost might not be significant because some organizations already use these types of metrics to evaluate their internal compliance systems.[322] For example, Intel measures the utilization rate of its internal dispute resolution system, the number of internal versus external complaints, the type of complaints and their resolutions, and the perceived effectiveness of the system as measured by employee and manager feedback.[323]

Publicizing specific results from a whistleblower disclosure system might result in several benefits. First, disclosing specific results will avoid a "lemon" problem that might develop, whereby companies may be unable to signal that they have superior whistleblowing procedures if companies with inferior procedures can send similar signals.[324] Companies, in other words, will be put to their proof regarding the results from their system, and they will not merely be able to rely on impressive looking window-dressing. Corporations will be forced to explain and to justify their disclosure channel structure as well as their own evaluation of the structure's effectiveness.[325]

Second, these public explanations from corporations will assist in developing "best practices" and promote experimentation, while also

321. *See* Notification and Federal Employee Antidiscrimination and Retaliation Act of 2002, Pub. L. No. 107–174, § 203, 301, 116 Stat. 566, 569, 573 (2002).

322. One recent survey found that seventy-five percent of U.S. public companies tracked whether their ethical codes were followed. *See* Neil Baker, *All Done With Mirrors? Transparency and Business Ethics*, 59 INT'L BARRISTER NEWS 4, 5 (2005).

323. *See* Sturm, *supra* note 129, at 559 (describing Intel's assessment techniques). Intel is certainly not alone in its attempt to evaluate the success of its own disclosure program. *See* Kenneth D. Martin, *Where Theory and Reality Converge: Three Corporate Experiences in Developing "Effective" Compliance Programs*, *in* GOOD CITIZEN, *supra* note 3, at 39–40 (describing metrics kept by Sundstrand Corp. regarding its compliance program).

324. *Cf.* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 488–89 (1970) (evaluating quality uncertainty by examining good and bad cars); Painter, *supra* note 231, at 275–76 (describing this problem in a market for attorneys who must report wrongdoing).

325. *See* Sturm, *supra* note 129, at 559 (describing a system whereby courts examine the effectiveness of an internal grievance system by requiring employers "to develop and justify criteria of effectiveness in problem solving for their own internal systems," thereby encouraging "employers to . . . evaluate their own systems, rewarding employers who do so").

providing courts and regulators a viable means of judging the effectiveness of a corporation's own system.[326]

Third, publishing results from whistleblowing systems will encourage employees to report misconduct by providing them with information regarding the effectiveness of their own monitoring efforts. As discussed above, a significant disincentive for employees to report misconduct is their concern that nothing will be done about their report.[327] Requiring companies to disclose the results of whistleblower disclosures will address this concern by demonstrating that violators of ethical and legal norms will be held accountable.[328] Assuming corporations disclose positive results, employees will begin to trust the disclosure channel and be more willing to utilize it. Furthermore, Professor Tom Tyler has argued that employees are more willing to follow workplace rules and think positively about their employer when the organization demonstrates that it treats employees with procedural fairness.[329] Thus, publicizing that the system "works" and that procedures are fairly administered not only can encourage employees to report misconduct but also can persuade employees to behave more appropriately themselves.

Fourth, publishing results can serve as an important impetus for reform. For example, published results of whistleblower disclosures under the Civil Service Reform Act (CSRA) revealed that the Office of Special Counsel (OSC) and the Merit Systems Protection Board failed to protect and encourage whistleblowers. In the eleven years after passage of the CSRA, only one whistleblower received a hearing by the OSC to restore the whistleblower's job.[330] On appeal to the Merit Systems Protection Board, only four out of more than two thousand whistleblowers won on the merits of their claims.[331] These

326. *See id.*; *cf.* Langevoort, *supra* note 181, at 114–15 (noting that the "legal standard underlying an affirmative monitoring requirement" should "be set at a moderate height," such as industry best practices). *But see* Letter from Cleary, Gottlieb, Steen & Hamilton to U.S. Securities and Exchange Commission (Feb. 18, 2003), http://www.sec.gov/rules/proposed/s70203/clearygot1.htm ("Disclosure about procedures and changes to those procedures may have an unintended chilling effect. If an issuer is forced to disclose its procedures, the audit committee may be less innovative and less willing to try different approaches . . . .").

327. *See supra* text accompanying notes 170–72.

328. *See* Trevino, *supra* note 25, at 1200.

329. *See* Tom R. Tyler, *Promoting Employee Policy Adherence and Rule Following in Work Settings: The Value of Self-Regulatory Approaches*, 70 BROOK. L. REV. 1287, 1303–05 (2005).

330. *See* Devine, *supra* note 139, at 534.

331. *See id.*

results served as partial impetus for the passage of the Whistleblower Protection Act of 1989, which addressed some of the perceived problems with the CSRA's whistleblower system.[332]

Of course, corporations may still resist disclosure of results. Mandatory disclosure requires the corporation to reveal potentially embarrassing information publicly and may place employers at the mercy of disgruntled employees. Furthermore, disclosing results may have the opposite of the desired effect. Rather than increase whistleblower disclosures, it may pressure managers to suppress complaints in order to make a company's numbers look better.[333] Yet, such disclosure is not markedly different than requiring disclosure of earnings and revenue numbers that might embarrass the corporation. Both types of disclosures aim to present a clearer picture of the corporation to the investing public. As with financial numbers, there should be no restriction on a corporation's truthful efforts to explain and to justify poor results.

2. Providing incentive

Corporations already receive limited incentives from the Organizational Sentencing Guidelines (OSG) and various court decisions to implement internal compliance systems. But as discussed above, the usefulness of these incentives to create *effective* systems is questionable because the incentives do not necessarily prevent cheating.[334] Another form of incentive may better encourage corporations to install and enforce effective systems that encourage employee whistleblowing.

Corporations could be provided a safe harbor for installing systems that meet SEC or other administrative standards for effectiveness. Such standards might include specific requirements, such as providing for an independent review of whistleblower claims and intensive training of managers and employees. This safe harbor might be granted through a pre-approval process in which an administrative agency (such as the SEC) or a certified third-party (such as an independent auditor) rigorously investigates and

332. *See id.* at 536 & n.22; Callahan & Dworkin, *supra* note 5, at 282–83.

333. *Cf.* Coffee, *supra* note 19, at 1251–65 (noting that disclosure can raise a corporation's "embarrassment cost" to a "prohibitively high level" that may actually restrict information flow).

334. *See* discussion *supra* Part III.B.

evaluates systems for effectiveness. This pre-approval process would avoid the tricky inquiry that arises when courts and prosecutors must externally evaluate corporate programs *after* misconduct is detected.

The corporate benefits of pre-approval are also considerable: safe harbors could provide a rebuttable presumption that the corporate system is effective. Such a presumption would be enormously helpful in criminal and civil litigation where proof of an effective whistleblower system is significant.[335]

The mechanisms that could be used to implement a "safe harbor" vary depending on the context. The OSG would necessarily need to be amended in order to apply safe harbors to a criminal sentencing.[336] In the case of punitive damages or sexual harassment, legislation may need to be passed to recognize such a safe harbor. Yet, even without such legislation, courts might implicitly implement such a safe harbor by recognizing "certified" internal control systems as meeting industry standards. Importantly, even where a corporation had met "safe harbor" standards, it would still be encouraged to prevent wrongdoing through other means because the presumption would not reduce a company's vicarious liability for the acts of its employees.[337]

This proposal would provide incentive to implement a true whistleblower disclosure system by reducing a corporation's exposure to the extreme punishments imposed upon corporations, such as criminal fines and punitive damages. This system would take the guesswork out of incentives-based program compliance, such as

335. *See* Kolstad v. Am. Dental Ass'n, 527 U.S. 526, 545–46 (1999) (protecting corporations with internal compliance systems from punitive damages); Burlington Indus., Inc. v. Ellerth, 524 U.S. 742, 765 (1998) (providing affirmative defense in sexual harassment cases); Faragher v. City of Boca Raton, 524 U.S. 775, 807 (1998) (providing affirmative defense in sexual harassment cases); UNITED STATES SENTENCING COMMISSION, U.S. SENTENCING GUIDELINES MANUAL §§ 8B2.1, 8C2.5 (2004) (providing substantial reduction in penalties for corporation with effective compliance and ethics program).

336. Admittedly, given the Guidelines' recent amending in 2004 and the current uncertainty about their application, any proposal to amend the Guidelines along these lines may have difficulty gaining sufficient support. *See* United States v. Booker, 543 U.S. 220, 220–35 (2005) (finding that the Guidelines violate the Sixth Amendment).

337. *See* Langevoort, *supra* note 181, at 114–15 (noting that firms should not be absolved of vicarious liability simply for installing monitoring systems because firms need to internalize sanctions for wrongdoing in order to have incentive to develop a sound compliance program).

the OSG, and also ensure that corporations spent an appropriate amount of resources on the system.[338]

C. Addressing the Noise Problem

A second problem with the Structural Model is that whistleblower disclosure channels may be too successful. They may open the floodgates for employee dissatisfactions related to a wide range of injustices, real and perceived.[339] Indeed, a common occurrence after the introduction of a hotline or other disclosure channel is for employee complaints to increase.[340] This "noise" problem could be a significant concern for any system that requires reporting to be channeled to directors, such as the system mandated by Section 301. Increasing the burden on directors may require corporations to compensate directors more generously in order to find qualified and independent individuals.[341] A particularly active whistleblower disclosure channel may only amplify these concerns.

Sarbanes-Oxley's Structural Model can be improved to address this issue. Specifically, the SEC might promulgate rules permitting—but not requiring—certain restrictions on the systems to reduce the burden on directors. For example, the SEC could specify that directors may outsource the reporting requirement to a third-party or permit the corporation to install an ombudsman to supervise the system. In either case, the recipient of whistleblower disclosures must provide regular reports to the audit committee regarding the number and types of complaints made through the system. Furthermore, the recipient should be responsible solely to the audit committee, not to a corporate executive. This recipient would provide the audit

338. *See* Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 842–43 (1994) (noting that corporations will spend less on detection of criminal acts if there is not sufficient reduction in fines and penalties for these self-enforcement efforts because additional enforcement expenditures would increase expected criminal liability by detecting more crime).

339. *Cf.* Sturm, *supra* note 129, at 502 (describing an employee call center that fields hundreds of thousands of calls as part of an internal grievance system at Intel).

340. *See id.* at 508 (noting that after the adoption of an internal grievance system at Intel "the number of employee complaints increased substantially").

341. There is evidence that directors are becoming increasingly burdened by Sarbanes-Oxley's numerous requirements. *See* James S. Linck et al., *Effects and Unintended Consequences of the Sarbanes-Oxley Act on Corporate Boards*, AM. FIN. ASS'N 2006 MEETINGS, May 16, 2006, at 4 (noting that small public firms are disproportionately impacted by these higher costs).

committee with a valuable service. At the same time, the audit committee would retain the independent control and review necessary to avoid managerial blocking and filtering of disclosures.

Finally, the SEC might shield the audit committee from disclosures regarding de minimis or nonmaterial offenses. This limitation would ensure that directors preserve oversight over the most important information, but are not overburdened by insignificant complaints. The limits placed on such disclosures might include only reporting information to the audit committee that, if true, would necessitate public disclosure in light of previous public filings. Such a limit would essentially incorporate the definition of "materiality" from federal securities laws regulating public disclosure in other contexts.

While these suggestions may give discretion to a non-director to filter whistleblower disclosures, the danger is minimized because independent directors would ultimately be responsible for the system. Unlike what occurred at Enron after Sherron Watkins reported misconduct to Ken Lay—where a corporate executive appointed a conflicted law firm to "investigate" the disclosures[342]—under this proposal *directors* would be charged with appointing and supervising the review process. Directors, rather than corporate executives, would be responsible for determining what is "material" and what should be disclosed publicly. Moreover, such limitations may simply be a practical necessity for large corporations with tens of thousands of employees.

Approving certain restrictions to the disclosure system could save corporations from implementing overly rigorous and inefficient structures in an attempt to satisfy Sarbanes-Oxley's ambiguous mandate. For example, some corporations may not need all of the bells and whistles of a full ombudsman program and would benefit from the set cost of a third-party system. Currently, the vague nature of Sarbanes-Oxley might cause a corporation to install a system more extensive than is necessary to meet the statute's requirements. Such a system might ultimately be more comprehensive, but it may not provide any marginal benefit to the corporation or its employees. Providing absolute minimums for the disclosure channel permits a corporation to balance its need for directors to have time and energy to oversee the actual business activities of the corporation with the

342. *See supra* text accompanying notes 65–68.

need to oversee Sarbanes-Oxley's requirement for a whistleblower disclosure system.

VI. CONCLUSION

Recent corporate scandals demonstrated that, despite the efforts of a few employee whistleblowers, many corporate employees failed to report the misconduct they observed. Problems with information flow from employees to traditional corporate monitors undermined the ability of employees to perform any monitoring role effectively.

Sarbanes-Oxley's Structural Model presents an improved attempt to encourage corporate employees to overcome these flow-of-information problems. The Model should lead to more employee whistleblowing because it better corresponds with employee motivations and reduces the most prominent disincentives to whistleblowing. Also, the Model will likely improve the effectiveness of whistleblower disclosures because it encourages reporting directly to independent corporate directors who have the authority and responsibility to respond to information about wrongdoing.

Though this better Model has limitations, those limitations can be addressed. The vagueness of Sarbanes-Oxley's requirements has the potential to both under- and over-produce whistleblower complaints. Like other attempts to implement effective compliance systems, it will be possible for corporations to utilize disclosure systems that are mere "window-dressing," thus resulting in too few whistleblower disclosures. Requiring corporations to publicly disclose information about their systems—and the results achieved through those systems—may reduce this cheating problem. Additionally, permitting some safe harbor for corporations that satisfy a pre-approval process performed by an external entity may permit more external oversight of the effectiveness of whistleblower disclosure systems.

Conversely, a direct channel to the board of directors may result in too many disclosures, overwhelming the directors. The SEC might first explicitly permit directors to outsource their oversight of the whistleblower disclosure channel as long as the responsibility for the channel remains with the directors. Next, the SEC could promulgate specific, approved restrictions and options to reduce the burden on directors while still facilitating the transfer of information about corporate misconduct from front-line employees to the

corporate monitors with the authority and responsibility to address the wrongdoing.

These reforms will help Sarbanes-Oxley's Structural Model encourage employees to play an active role in monitoring corporate behavior—a role that not only benefits society by reducing corporate misconduct, but also improves corporate decision-making by increasing employee voice within the corporation.