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Internal Whistleblowing and Sarbanes-Oxley Section 806: Balancing the Interests of Employee and Employer

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I. INTRODUCTION

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")[1] was passed in response to the spate of corporate scandals and mismanagement that came to light in 2001, such as Enron, WorldCom, Global Crossing, and Tyco.[2] These scandals cost shareholders and employees billions of dollars and eroded public confidence in large corporations, securities markets, and corporate governance in general.[3] Employees of these companies were aware of fraud within their companies, but either failed to come forward because of fear of retaliation or because senior management ignored their warnings.[4] In order to encourage the reporting of such fraud in the future, Congress enacted Section 806 of Sarbanes-Oxley,[5] which protects employees against retaliation by employers for reporting alleged violations occurring within public companies. Employees are protected regardless of whether they attempt to first report alleged misconduct within the company so long as they reasonably believe in the existence of a violation.[6]

This note contends that Section 806 fails to properly balance the countervailing and often competing interests of employees, employers, and the public by allowing employees to report perceived violations outside of the company without first attempting to utilize internal channels of communication. The impact of publicity regarding potential corporate misconduct can be devastating to public companies, especially in cases where such misconduct could have been handled within the organization.[7] The goal of whistleblower protection under Sarbanes-Oxley should be to correct wrongdoing as quickly and efficiently as possible. In many cases, the most effective method of correcting corporate misconduct is by

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1. The whistleblower provision of Sarbanes-Oxley is codified at 18 U.S.C. § 1514A (Supp. IV 2004).

2. Robert G. Vaughn, *America's First Comprehensive Statute Protecting Corporate Whistleblowers*, 57 ADMIN. L. REV. 1, 2 (2005); *see* Miriam Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes-Oxley Act for Employment Law*, 79 WASH. L. REV. 1029, 1035–43 (2004) (discussing and analyzing two well-known whistleblowers, Sherron Watkins at Enron and Cynthia Cooper at WorldCom). The public attention on individuals at large companies who reported wrongdoing is illustrated by the fact that TIME Magazine named three whistleblowers "Persons of the Year" in 2002: Coleen Rowley of the FBI, Cynthia Cooper of WorldCom, and Sherron Watkins of Enron. *See* Richard Lacayo & Amanda Ripley, *Persons of the Year*, TIME, Dec. 30, 2002, at 32.

3. Vaughn, *supra* note 2, at 2.

4. *See id.* In the case of Enron, it was reported that on at least one occasion the company investigated whether it could take some employment action against an employee who raised such concerns. The Senate Judiciary Committee reported that examples such as Enron exposed a culture of "corporate silence" that created an atmosphere where corporate wrongdoing could readily occur. "The consequences of this corporate code of silence to investors in publicly traded companies, in particular, and for the stock market in general, are serious and adverse, and they must be remedied." S. REP. NO. 107-146, at 5 (2002).

5. Section 806 is titled, "Protection For Employees of Publicly Traded Companies Who Provide Evidence of Fraud." *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 806, 116 Stat. 745, 806 (codified at 18 U.S.C. § 1514A (Supp. IV 2004)).

6. *See* 18 U.S.C. § 1514A(a)(1) (protecting employees who provide information, or cause information to be provided, of conduct that the employee reasonably believes constitutes a fraud).

7. Terry Morehead Dworkin & Elletta Sangrey Callahan, *Internal Whistleblowing: Protecting the Interests of the Employee, the Organization, and Society*, 29 AM. BUS. L.J. 267, 300 (1991).

reporting violations internally to supervisors or senior managers who may be unaware of problems within the company.[8] While employees are often the most effective watchdogs within a company, employers are often in the best position to correct problems.

This note proposes that Congress amend Section 806 to encourage internal whistleblowing by requiring employees to pursue internal reporting unless the employee has a reasonable belief that the employer would not make a good faith effort to address the problem. This would promote internal reporting while still permitting external reporting where it would be impracticable for employees to communicate through internal channels. Such an amendment to Section 806 would maximize the positive aspects of whistleblowing while minimizing its potential harmful effects on employers.

Part II of this note will examine the history and development of whistleblower law from the employment-at-will doctrine to the various forms of protection available to employees who report alleged wrongdoing in the workplace. It will also discuss the distinction between internal and external whistleblowing and the reasons for encouraging employees to report alleged violations within their organization in most circumstances. Part III will examine whistleblower protection under Section 806 of Sarbanes-Oxley as well as the current statutory scheme, which favors the interests of employees over employers and may prove to be unduly harmful to employers. Finally, Part IV will propose that Section 806 be amended to require that employees pursue internal channels of communication unless they have a reasonable belief that such action will not prompt a good faith remedial effort by the employer.

II. THE PATH FROM EMPLOYMENT-AT-WILL TO WHISTLEBLOWER PROTECTION

Loyalty is a value cherished in all aspects of human relationships—from family and friends to the workplace.[9] In the workplace, employees owe a fiduciary duty to their employers, requiring them to act primarily for the benefit of their employers in matters connected to their employment.[10] In the course of employment, duties of loyalty to the employer must often be balanced with civic duties, individual rights, and other loyalties outside the workplace.[11] Whistle-

8. *Id.*

9. DANIEL P. WESTMAN & NANCY M. MODESITT, WHISTLEBLOWING: THE LAW OF RETALIATORY DISCHARGE 1 (2d ed. 2004).

10. *Id.* (citing RESTATEMENT (SECOND) OF AGENCY § 13 cmt. a (1958) ("Among the agent's fiduciary duties to the principal is the duty to account for profits arising out of the employment; the duty not to act as, or on account of, an adverse party without the principal's consent; the duty not to compete with the principal on his own account or for another in matters relating to the subject matter of the agency; and the duty to deal fairly with the principal in all transactions between them.")).

11. WESTMAN & MODESITT, *supra* note 9, at 1–2. The author describes instances where competing duties of loyalty and honesty outside of the workplace require the employee to act in ways that may be adverse to the employer. In cases where, for example, the employee is asked to violate a law in order to keep her job, that

blowing laws are an attempt to balance the competing duties of loyalty that employees may face in the workplace.[12] The law of whistleblowing has expanded significantly from the employment-at-will doctrine, which afforded employees little protection, to the myriad of legal protections available today.

A. Employment-at-Will Doctrine and Public Policy Exceptions

While there is no single definition of whistleblowing, this note will define whistleblowing as "an attempt by an employee of a corporation or business firm to disclose what he or she believes to be wrongdoing in or by the organization."[13] Whistleblower laws have evolved to mitigate the harsh impact of the employment-at-will doctrine, which allows the employer to discharge the employee for any reason and also allows the employee to leave for any reason unless there is an express agreement to the contrary.[14] The employment-at-will doctrine permits employers to "dismiss their employe[e]s at will, be they many or few, for good cause, for no cause or even for cause morally wrong, without being thereby guilty of legal wrong."[15] A strict application of this doctrine would allow an employer to terminate a whistleblower without facing any liability even if the discharge was purely for retaliatory purposes.[16] This doctrine was applied toward the end of the nineteenth century to protect freedom of industrial expansion and encourage economic growth during the Industrial Revolution under the theory that

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employee clearly deserves legal protection for choosing not to participate. This note will focus on situations where there is a delicate balance between competing loyalties and it is not clear that the employee should be protected for engaging in action that may be harmful to the employer.

12. *Id.* at 2.

13. Frank J. Cavico, *Private Sector Whistleblowing and the Employment-At-Will Doctrine: A Comparative Legal, Ethical, and Pragmatic Analysis*, 45 S. TEX. L. REV. 543, 548 (2004) ("[One possible origin of the term "whistleblowing" derives from] the act of an English bobby blowing his whistle upon becoming aware of the commission of a crime to alert other law enforcement officers and the public within the zone of danger.") (citing Dahl v. Combined Ins. Co., 621 N.W.2d 163, 167 (S.D. 2001)).

14. Julie Jones, *Give a Little Whistle: The Need for a More Broad Interpretation of the Whistleblower Exception to the Employment-At-Will Doctrine*, 34 TEX. TECH L. REV. 1133, 1137–38 (2003). Jones traces the development of the employment-at-will doctrine in the United States from the time of America's separation from Great Britain. The English common law rule deemed employment to be one year in length unless the parties had specified a different length of employment. *Id.* at 1142.

15. Payne v. W. & Atl. R.R. Co., 81 Tenn. 507, 519–20 (1884), *overruled on other grounds by* Hutton v. Watters, 132 Tenn. 527 (1915). In *Payne*, the court held that a railroad may establish a policy whereby an employee can be discharged from employment if he traded with a particular businessman. In distinguishing between acts that are *wrong* and those that are *illegal* and therefore actionable, the court stated: "The great and rich and powerful are guaranteed the same liberty and privilege as the poor and weak. All may buy and sell when they choose; they may refuse to employ or dismiss whom they choose, without being thereby guilty of a legal wrong, though it may seriously injure and even ruin others." *Payne*, 81 Tenn. at 519.

16. Jones, *supra* note 14, at 1137–38.

greater employer freedom in hiring and firing would help guard against business failure.[17]

The focus on providing legal protections to employers began to shift in the 1960s with increasing public concern for individual rights and quality of life.[18] Courts and legislatures began carving out exceptions to the general employment-at-will doctrine. One such exception, rooted in public policy concerns, became the foundation for future laws protecting terminated whistleblowers.[19] The public policy exception allows an employee to assert a cause of action against the employer for wrongful discharge if the court finds that the termination violates public policy.[20] While exceptions to the traditional doctrine have grown, it remains the default rule in all states other than Montana.[21] Even in states that do not provide statutory protection for whistleblowers, many "recognize some form of judicially created public policy exception."[22] Specifically, many state laws recognize whistleblowing as "one type of public policy exception to [the] employment-at-will" doctrine.[23]

B. The Internal Versus External Reporting Distinction

Whistleblowing generally implicates three distinct and often contradictory concerns: the employee, the organization, and society in general.[24] The employee has an interest in reporting wrongdoing without being penalized.[25] Depending on the motivations of the particular employee in reporting wrongdoing, the employee often has an interest in seeing that the violation is corrected in a timely fashion.[26] The employer, on the other hand, has an interest in maximizing con-

17. *Id.* at 1143. Likewise, employees favored this freedom of contract as businesses became less dependent on the seasons and employees felt they should not necessarily be required to work all four seasons as would be required under English common law. *Id*.

18. *Id.*

19. *Id.* at 1143–45.

20. *Id.* at 1144. This doctrine was developed in *Petermann v. Int'l Bhd. of Teamsters*, 29 Cal. Rptr. 399 (Cal. Dist. Ct. App. 1963), in which an employee was terminated for refusing to falsely testify to a legislative committee at the request of his employer. The court stated that in order to promote the public policy against perjury the court must "deny the employer his generally unlimited right to discharge an employee whose employment is for an unspecified duration, when the reason for the dismissal is the employee's refusal to commit perjury." *Id.* at 400.

21. Montana has adopted a for-cause wrongful discharge statute that requires an employer to show "good cause" for termination. MONT. CODE ANN. § 39-2-904 (2007).

22. Cherry, *supra* note 2, at 1045.

23. Jones, *supra* note 14, at 1147.

24. Dworkin & Callahan, *supra* note 7, at 268.

25. *Id*.

26. Much social-psychological research indicates that, in general, whistleblowers are loyal workers who truly seek to promote change within the organization. The typical case involves an employee who has been working in the organization for some time and who has a genuine desire to ensure that the organization corrects any wrongdoing. *See* Elletta Sangrey Callahan et al., *Integrating Trends in Whistleblowing*

trol and efficiency, minimizing any possible legal and administrative costs, and preventing negative publicity likely to result from public disclosure of negative information.[27] Additionally, the employer has an interest in maintaining loyalty and discipline within the organization and protecting confidential information.[28] Lastly, society has an interest in encouraging lawful behavior and ensuring that those responsible for wrongdoing are held accountable for their actions.[29] Balancing these interests is crucial in the development of any whistleblower law that promotes the goal of correcting wrongdoing at the least expense to all three concerns.[30]

There is an important distinction between reporting perceived violations within the organization and reporting perceived violations outside of the organization to external regulatory agencies, Congress, the media, or other public outlets.[31] Reporting within the organization can provide the employer with an opportunity to correct violations before they become public and potentially harm the organization, requiring significant expenditures for external investigations.[32] Internal reporting is also consistent with the employee's fiduciary duty to his employer and preserves confidentiality.[33] External reporting, on the other hand, may be necessary if it is likely the employer is aware or complicit in the violation and, therefore, unlikely to take appropriate measures to address the whistleblower's concern.

C. Federal and State Whistleblower Laws: Contrasting Goals and Application

Whistleblowing law, in large part, has been left to the discretion of individual states. The result is that across the country whistleblower laws vary significantly in the scope of protection afforded to employees.[34] State law protections

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and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment, 40 AM. BUS. L.J. 177, 195 (2002).

27. Dworkin & Callahan, *supra* note 7, at 268.

28. Cavico, *supra* note 13, at 643.

29. Dworkin & Callahan, *supra* note 7, at 268.

30. *Id.*

31. Because Section 806 of Sarbanes-Oxley does not include protection for reporting to the media, a discussion of the implications of such reporting is beyond the scope of this note. For an examination of disclosure to the media, see Terry Morehead Dworkin & Elletta Sangrey Callahan, *Employee Disclosures to the Media: When is a "Source" a "Sourcerer"*?, 15 HASTINGS COMM. & ENT. L.J. 357, 364 (1993).

32. Dworkin & Callahan, *supra* note 7, at 300.

33. *See* Eletta 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, 890–91 (2004); *see also* RESTATEMENT (SECOND) OF AGENCY § 395 (1958) ("[An implied duty of confidentiality requires an employee] not to use or to communicate information confidentially given him by the principal . . . to the injury of the principal . . . unless the information is a matter of general knowledge."). Comment f allows disclosure of information where the employer has committed or is about to commit a crime. *Id.* § 395 cmt. f.

34. Cherry, *supra* note 2, at 1033.

developed to protect private employees who reported illegal activity by an employer or who were terminated for refusing to participate in illegal activity.[35] Most of these laws provide "a general private cause of action for employees who report[ed] violations."[36] Today, every state recognizes some form of protection for whistleblowing, but they vary widely in the scope of protection offered and judicial opinions differ in their interpretations of such statutes.[37] Each state whistleblower statute contains an anti-retaliation provision, but beyond this similarity what remains is a divergent scope of laws.[38]

Most states offer general whistleblower protection to public employees, while a minority of states provide the same protection to all workers.[39] This reflects the traditional view that a violation must implicate a "public interest" in order to be actionable.[40] State whistleblower laws differ on many points including the appropriate recipient of the whistleblower report, the subject of protected whistleblowing, the motive of the whistleblower, the required quality of evidence of wrongdoing, and the remedies available for the whistleblower.[41] New York is on one end of the spectrum of employee protection, providing very limited protection for whistleblowers and requiring that the violation present a "substantial and specific danger to the public health or safety . . . ."[42] New Hampshire is on the other end of the spectrum, providing protection where the employee has a *reasonable belief* that the employer is engaged in a violation of any state law.[43] Between these extremes lie state whistleblower laws that take varying approaches to protecting employees who report alleged violations.

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35. *See* Trystan Phifer O'Leary, Note, *Silencing the Whistleblower: The Gap Between Federal and State Retaliatory Discharge Laws*, 85 IOWA L. REV. 663, 664 (2000).

36. *Id.*

37. Elletta Sangrey Callahan & Terry Morehead Dworkin, *The State of State Whistleblower Protection,* 38 AM. BUS. L.J. 99, 100 (2000).

38. *Id.* at 107–08.

39. *Id*. at 111.

40. WESTMAN & MOFESITT, *supra* note 9, at 41–42.

41. *See* Callahan & Dworkin, *supra* note 37, at 107–08.

42. N.Y. LAB. LAW § 740(2)(a) (McKinney 2006). Section 740(2) states:

> An employer shall not take any retaliatory personnel action against an employee because such employee does any of the following:
>
> (a) discloses, or threatens to disclose to a supervisor or to a public body an activity, policy, or practice of the employer that is in violation of law, rule or regulation which violation creates and presents a *substantial and specific* danger to the public health or safety, or which constitutes health care fraud;
>
> (b) provides information to, or testifies before, any public body conducting an investigation, hearing or inquiry into any such violation of a law, rule or regulation by such employer; or
>
> (c) objects to, or refuses to participate in any such activity, policy or practice in violation of a law, rule or regulation.

Id. § 740(2) (emphasis added).

43. N.H. REV. STAT. ANN. § 275-E:2 (2007). The statute provides, in relevant part:

Initially, protection against retaliatory discharge at the federal level was only provided if the specific statute violated by the employer contained an anti-retaliation provision.[44] This reflected the legislative choice that certain violations were sufficiently important to justify protecting employees who blew the whistle.[45] Many federal laws were originally developed with the goal of protecting the public at large by enforcing specific statutes that often related to matters of public health and safety.[46] As a result, many such laws were designed with the ultimate goal of protecting the public and not the individual employee who reported the alleged violation.[47] The anti-retaliatory provisions that accompany many federal statutes can be viewed as aiding in the enforcement of those statutes by encouraging employees to come forward and report violations by their employer.[48]

Throughout the twentieth century to the present day, business organizations have been subject to various federal regulations prohibiting certain business practices and making the violation of such regulations a crime.[49] During the 1980s, there was an increase in instances of whistleblowing as public confidence in the government's ability to prevent illegal business practices eroded.[50] There was a general trend toward deregulation and an increased reliance on the ability of

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> No employer shall discharge, threaten, or otherwise discriminate against any employee regarding such employee's compensation, terms, conditions, location, or privileges of employment because:
>
> (a) The employee, in good faith, reports or causes to be reported, verbally or in writing, what the employee has *reasonable cause to believe* is a violation of any law or rule adopted under the laws of this state, a political subdivision of this state, or the United States; or
>
> (b) The employee, in good faith, participates, verbally or in writing, in an investigation, hearing, or inquiry conducted by any governmental entity, including a court action, which concerns allegations that the employer has violated any law or rule adopted under the laws of this state, a political subdivision of this state, or the United States.

Id. (emphasis added).

44. *See* Cherry, *supra* note 2, at 1049–50.

45. O'Leary, *supra* note 35, at 663–64.

46. *See id.* at 666–67. O'Leary argues that the ultimate goal of protecting the public welfare is reflected by the fact that many federal whistleblower laws provide procedures for punishing violations of the statute without granting the employee any private remedies. Some examples of such acts include: Toxic Substances Control Act, 15 U.S.C. § 2622(b)(1)–(2) (2000); Occupational Safety and Health Act, 29 U.S.C. § 660(a) (2000); Employment Retirement Investment Securities Act, 29 U.S.C. § 1132(a) (2000); Family and Medical Leave Act, 29 U.S.C. § 2617 (2000); Federal Surface Mining Act, 30 U.S.C. § 1293(b) (2000). On the other hand some federal whistleblower statutes do offer a private remedy to employees including: Federal Deposit Insurance Corporation Improvement Act, 12 U.S.C § 1831j(b) (2000) and Energy Reorganization Act, 42 U.S.C § 5851(b) (1995).

47. O'Leary, *supra* note 35, at 666–67.

48. Cherry, *supra* note 2, at 1049.

49. WESTMAN & MODESSIT, *supra* note 9, at 10.

50. *Id.* at 11.

private citizens, rather than the government, to prevent misconduct.[51] The move toward increased deregulation of the industry reflected the view that government was not in the position to effectively remedy certain social ills.[52] This coincided with increased legal protection for whistleblowers, who were viewed as more adept at detecting and protecting against corruption and other business fraud.[53]

The deregulation trend came to an end after the now all too familiar series of corporate scandals beginning in 2001, when accounting fraud and other business abuses became public.[54] Congress responded to the public call for change by passing Sarbanes-Oxley in 2002.[55] Among the many reforms of Sarbanes-Oxley is a federal whistleblower statute that provides protection for employees from retaliatory discharge based on the theory that protecting whistleblowers will encourage disclosures of violations and prevent harm to shareholders, employees, and society.[56]

III. SARBANES-OXLEY SECTION 806

A. Change in Focus of Regulation

Before Sarbanes-Oxley, regulation and prevention of financial fraud was largely left to private agencies charged with overseeing particular industries.[57] This system of oversight relied primarily on outside agencies. These agencies were generally removed from the operations of the business, making it difficult to detect fraud in a timely fashion.[58] Outside public accounting firms were responsible for auditing the financial statements of issuers in the hopes that they would uncover any financial fraud before it affected the public.[59] Additionally, the internal audit committees of boards of directors reviewed the financial statements of their companies to detect inaccuracies before reporting information to the public.[60] This system of oversight was insufficient to guard against the abuses of senior management that cost employees and shareholders significant financial harm in scandals such as Enron, WorldCom, Tyco, and Global Crossing.[61]

51. *Id.*

52. *Id.*

53. *Id.*

54. Vaughn, *supra* note 2, at 2.

55. *Id.*

56. *Id.* at 3.

57. WESTMAN & MODESITT, *supra* note 9, at 18–19. For example the Securities and Exchange Commission ("SEC") regulated public securities markets and had enforcement powers that gave it the power to seek penalties against issuers who misled the public. *Id.* at 18.

58. *See id.* at 19.

59. *Id.* at 18.

60. *Id.*

61. *Id.*

Sarbanes-Oxley drastically altered the regulation of public companies and, in particular, increased the protections available for employees who report alleged wrongdoing either within their companies or to the public.[62]

Prior to Sarbanes-Oxley, most federal and state whistleblower laws only protected private sector employees whose reports of wrongdoing involved matters of public health or safety.[63] Financial fraud was not protected because at the time it was not considered a matter of public concern.[64] Government employees, however, received protection for reporting financial fraud because misuse of government funds meant that taxpayer funds were being wasted, and this was a matter of public concern.[65] With the passage of Sarbanes-Oxley, Congress indicated that fraud against shareholders is an issue of public concern deserving of protection.[66] The drastic increase in the size and complexity of businesses along with rapidly advancing technology has made it more difficult to prevent, uncover, and correct wrongdoing that can have a severe impact on companies, employees, and the public at large.[67] Whistleblowing has come to be viewed as a necessary device to empower those individuals who are most likely to understand and detect fraud that may otherwise go unnoticed.[68]

B. Federal Protection for Whistleblowers in Public Companies

Recognizing the need for federalized whistleblower protection in corporate America, Congress provided for a civil action to protect against retaliation in fraud cases.[69] The anti-retaliation provision applies to companies whose securities are registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act") or companies that are required to file reports under Section 15(d) of the Exchange Act.[70] Employers may not "demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and condi-

62. Sarbanes-Oxley created the Public Accounting Company Oversight Board to ensure that outside auditors perform appropriately and to ensure that they do not engage in activities likely to create conflicts of interest.

63. WESTMAN & MODESITT, *supra* note 9, at 156–57.

64. *Id.*

65. *Id.* at 157.

66. *Id.*

67. Callahan, *supra* note 33, at 881–82.

68. *Id.* at 881.

69. 18 U.S.C. § 1514A (Supp. IV 2004). Sarbanes-Oxley also includes protection against retaliatory discharge in the form of criminal penalties against employers who engage in such activity. Section 1107 of Sarbanes-Oxley provides for criminal fines or imprisonment up to ten years for anyone who, with the intent to retaliate, takes "any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense . . . ." *Id.* § 1513(e).

70. *Id.* § 1514A(a).

tions of employment" for engaging in any protected activity under the statute.[71] Employees are protected if they "provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation . . . [of securities laws] . . . or any provision of Federal law relating to fraud against shareholders."[72] Employees may provide such information to federal regulatory or law enforcement agencies, any member or committee of Congress, or any person with supervisory authority over the employee or the authority to investigate misconduct.[73] Employees are also protected if they "file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed . . . relating to an alleged violation . . . [of securities laws] . . . or any provision of federal law relating to fraud against shareholders.[74]

While many other whistleblower provisions require an actual violation to have occurred in order for an employee to state a valid claim,[75] Sarbanes-Oxley only requires that an employee reasonably believe the employer was engaging in conduct that violated federal securities laws.[76] In a statement of legislative purpose, Senator Patrick Leahy reported that Sarbanes-Oxley is designed to include all "good faith and reasonable reporting of fraud, and there should be no presumption that reporting is otherwise, absent specific evidence."[77] Sarbanes-Oxley was designed to impose the general reasonable person standard used in a variety of other contexts.[78] As such, the employee's particular experience, background, and access to information will be taken into account in the analysis of whether that employee had a reasonable belief of a securities violation.[79] The reasonable belief requirement ensures that employees who may not have specific training or knowledge of the relevant complex securities laws can still be protected.[80] Additionally, there is no requirement that the alleged violations be ma-

71. *Id.*

72. *Id.* § 1514A(a)(1).

73. *Id.* § 1514A(a)(1)(A)–(C).

74. *Id.* § 1514A(a)(2).

75. For example, the New York Labor Law prohibits retaliatory action against an employee where the employee discloses or threatens to disclose a practice that "*is* in violation of law." N.Y. LAB. LAW § 740(2)(a) (McKinney 2006) (emphasis added).

76. 18 U.S.C. § 1514A(a)(1).

77. 148 CONG. REC. S7418, 7420 (daily ed. July 26, 2002) (statement of Sen. Leahy).

78. *See generally* Passaic Valley Sewerage Comm'rs v. Dep't of Labor, 992 F.2d 474 (3d Cir. 1993).

79. Vaughn, *supra* note 2, at 16.

80. *See id.* The justifications for the reasonable belief test were discussed by the United States Merit Systems Protection Board in their interpretation of the Whistleblower Protection Act:

> [W]e cannot add requirements not found in the statute, such as a full investigation by the whistleblower before making a disclosure . . . . Congress intended to protect even partial disclosures, provided the information disclosed is sufficient to support a reasonable belief of

terial to the company or shareholders so long as the employee possesses the requisite reasonable belief of a violation.[81]

Section 806 provides for an administrative procedure to handle complaints of retaliatory discharge that is conducted by the Occupational Safety and Health Administration ("OSHA").[82] A covered employee must file a complaint with the secretary of labor within ninety days of the alleged discrimination.[83] The secretary has authority to conduct an investigation if the complainant "has made a prima facie showing that the alleged protected activity was a contributing factor" in the alleged retaliatory action.[84] The defendant then has the opportunity to show, by "clear and convincing evidence, that it would have taken the same unfavorable personnel action in the absence of the protected activity."[85] If the defendant fails to meet this burden and the secretary finds there is reasonable cause to believe that discriminatory behavior has occurred, the secretary will issue a preliminary order providing appropriate relief.[86] After the preliminary order is

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> wrongdoing, despite the possibility that examination of all the facts would reveal that the actions were not improper.

Id. at 16 n.45 (citing Spears, 75 M.S.P.R. 639, 660 (1997)).

81. Henrich, 2004-SOX-51 (ALJ Nov. 23, 2004), 2004 DOLSOX LEXIS 83, *17–21 (holding that an employee is not required to show the materiality of an employer's alleged violation of law).

82. Procedures for the Handling of Discrimination Complaints Under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, 29 C.F.R. pt. 1980 (2007).

83. 29 C.F.R. § 1980.103. The limitations period commences once the employee is aware or reasonably should be aware of the employer's decision. Equal Employment Opportunity Comm'n v. UPS, 249 F.3d 557, 562 (6th Cir. 2001).

84. *See* Procedures for the Handling of Discrimination Complaints Under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, 68 Fed. Reg. 31,860, at 31,861 (May 28, 2003) (codified at 29 C.F.R. pt. 1980). In order to state a prima facie case an employee must show that: (1) she engaged in protected activity, (2) the named person had actual or constructive knowledge that the employee engaged in the protected activity, (3) the employee suffered unfavorable personnel action, and (4) the protected activity is shown to have been a contributing factor in the unfavorable action. 29 C.F.R. § 1980.104(b)(1). Generally a prima facie case is established if the complaint shows that the adverse personnel action took place shortly after the protected activity. *Id.* Courts and administrative agencies have concluded that to prove a disclosure was a contributing factor to the retaliatory action the employee need only demonstrate that "the fact of, or the content of, the protected disclosure was one of the factors that tended to affect in any way the personnel action." Marano v. Dep't of Justice, 2 F.3d 1137, 1143 (Fed. Cir. 1993).

85. *See* Procedures for the Handling of Discrimination Complaints Under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, 68 Fed. Reg. at 31,861.

86. *Id.* at 31,861. The preliminary relief may include all relief necessary:

> [T]o make the employee whole, including, where appropriate: reinstatement with the same seniority status that the employee would have had but for the discrimination; back pay with interest; and compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney's fees.

29 C.F.R. § 1980.105(a)(1). Reinstatement is the presumptive remedy under Section 806. In *Welch v. Cardinal Bankshares Corp.*, a former chief financial officer was reinstated despite difficulties such as hostility and distrust among the rest of management. Welch, 2003-SOX-15 (ALJ Feb. 15, 2005), 2005 DOLSOX LEXIS 8.

issued both parties will have thirty days to file objections and request a hearing before an administrative law judge or else the preliminary order becomes final.[87] If a hearing is held, the secretary then has one hundred twenty days to either provide for appropriate relief or deny the complaint.[88] After issuance of this final order, any person aggrieved by the order may file an appeal with the U.S. Court of Appeals for the circuit in which the violation occurred or where the complainant resided on the date of the violation.[89] If the secretary has not issued a final decision within one hundred eighty days of the filing of the complaint, the complainant may seek a de novo hearing in Federal District Court.[90]

C. Inadequate Balancing of Interests

Although Section 806 does not go so far as to permit reporting directly to the media, the external channels that it does allow could become public news and have a dramatic effect on investor confidence in public companies.[91] Section 806 allows an employee, as a first resort, to report a broad range of alleged violations to a federal regulatory or law enforcement agency or *any* member or committee of Congress.[92] Information disclosed to federal or law enforcement agencies or to Congress has the potential to become widely disseminated.[93] Federal agencies may release information to the public at their discretion and such information can often be released without fear of liability.[94] Members or committees of Congress may release information to the media or members of the public and as a result such information may be disclosed beyond the parties identified in Section 806.[95] The provision assumes that Congress and other public bodies will consider the public interest in disclosure and weigh that against the possible risks of disclosing information outside of the company.[96] Even where Congress or another public body does determine that disclosure is in the best interests of the public, cases may arise where mistaken beliefs about wrongdoing become public and negatively im-

87. Procedures for the Handling of Discrimination Complaints Under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, 29 C.F.R. § 1980.106. If an objection is timely filed, any order of preliminary reinstatement will take effect, but the remaining remedies will not take effect until the administrative proceedings are completed. *Id.*

88. 29 C.F.R. § 1980.110(c).

89. *Id.* § 1980.112(a).

90. *Id.* § 1980.114(a).

91. Vaughn, *supra* note 2, at 58.

92. 18 U.S.C. § 1514A(a)(1)(A)–(B) (Supp. IV 2004).

93. Vaughn, *supra* note 2, at 57.

94. *Id.* at 57–58.

95. *Id.* at 58.

96. *Id*.

pact the company.[97] Internal reporting of alleged violations would provide a more effective method of vetting such concerns prior to permitting external disclosure.[98]

From the employer's perspective, the goal is to minimize the negative consequences of whistleblowing while harnessing its potential benefits.[99] Whistleblowing has the greatest potential for good where wrongdoing is first reported within the organization because it gives the employer the opportunity to correct the problem or at least mitigate the damages.[100] Where the employer does take remedial measures, internal reporting prevents negative publicity, investigations, and legal actions.[101] Perceived misconduct within the organization may result from an employee's erroneous evaluation of an employer's actions or from a disagreement about ethical standards rather than a clear violation.[102] In a case where no actual wrongdoing occurred, internal whistleblowing would allow the employer to clarify the misunderstanding before negative information becomes public.[103]

Support for internal whistleblowing has been found in a rather unlikely source, Cynthia Cooper of WorldCom, who reported "her discovery . . . of accounting fraud to the board of directors' audit committee."[104] The board fired the chief financial officer, who was responsible for the conduct, and ultimately disclosed the matter to the public.[105] Although news of the fraud at the company eventually made front-page headlines,[106] WorldCom was given the opportunity to correct the inappropriate conduct. Cooper stated in an interview that there "was only one right path to take" and advised other potential whistleblowers to take concerns to the appropriate company officer before reporting the matter externally.[107] Even where information of wrongdoing eventually becomes public, companies can often benefit from voluntarily disclosing such information in cooperation with the government.[108]

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97. Terry Morehead Dworkin & Janet P. Near, *Whistleblowing Statutes: Are They Working?*, 25 AM. BUS. L.J. 241, 243 (1987).

98. The counterargument here is that fear of disclosure might be a motivation for companies not to engage in wrongdoing in the first place. This argument, however, does not address the concerns about the negative effects of external disclosure in cases where an employee mistakenly perceives wrongdoing.

99. Dworkin & Near, *supra* note 97, at 242.

100. *Id.*

101. *Id.*

102. *Id.* at 243.

103. *Id.*

104. WESTMAN & MODESITT, *supra* note 9, at 40.

105. *Id.*

106. Lacayo & Ripley, *supra* note 2, at 44.

107. Michael Barrier, *One Right Path: Cynthia Cooper*, INTERNAL AUDITOR, Dec. 1, 2003, at 52.

108. *See infra* Part IV.

The primary goal of Section 806 should be to encourage the early recognition and correction of wrongdoing, rather than to punish the wrongdoers themselves.[109] Though the individuals responsible for corporate wrongdoing should be held accountable for their actions, it is important not to punish an entire company, as well as its shareholders, where the violation may in fact be the result of a rogue employee and not representative of the company at large. Where feasible, the employer should be presented with the opportunity to correct problems or misunderstandings internally before negative information becomes public. Such public dissemination of information presents the added problem of shareholder harm because of the possibility of decreased share value.[110]

IV. AMENDING SARBANES-OXLEY SECTION 806 TO ENCOURAGE INTERNAL WHISTLEBLOWING

A. Finding the Proper Balance Between Competing Interests

An appropriate balance to the competing and sometimes divergent interests of employee, employer, and the public would be to design whistleblowing statutes to encourage internal reporting of perceived violations while preserving outlets for external reporting in certain situations. Therefore, Section 806 should be amended to require, as a default rule, internal reporting of violations and to allow external reporting under specified conditions. External reporting should be permitted in the first instance only where the employee (1) has a reasonable belief that the employer will not make a prompt good faith effort to address the problem,[111] (2) reasonably believes an emergency is involved, or (3) reasonably fears reprisal or retaliatory action as a result of disclosure.[112] This requirement would still place the burden on the employer to develop an effective reporting procedure within the organization. Where there are insufficient procedures for reporting violations internally and the employee has a reasonable belief that the problems would not be addressed, the employee would be permitted to report the problems

109. Dworkin & Callahan, *supra* note 7, at 285. Dworkin argues that "[a]lthough prosecution may be a legitimate secondary goal of public whistleblower protection, it should not be permitted to hamper the primary objective of most whistleblowing statutes, which is to correct the wrongdoing as quickly and efficiently as possible." *Id.* Even though this article was written in 1991, the same analysis should apply today to Section 806 as well as to similar whistleblower laws.

110. For a discussion of the economic theories behind the integration of information into the price of stock, see generally Ronald J. Gilson and Reinier H. Kraakman, *The Mechanisms of Market Efficiency,* 70 VA. L. REV. 549, 549–66 (1983).

111. This could occur, for example, where the employee reasonably believes that supervisors or those individuals who would ordinarily be responsible for handling the alleged violation already know the activity or policy in question.

112. There are several states that require internal whistleblowing as a first resort and all vary in the exact wording of the statutes. The general exceptions allowed for external reporting involve emergencies, fear of reprisal, and reasonable belief that reporting internally would not result in reasonable employer action to address the matter. *See infra* Part IV.B.3.

externally. By adopting this rule, Section 806 will come closer to the ultimate goal of correcting wrongdoing in the most efficient manner while balancing the interests of the parties involved.

Requiring internal reporting as a first resort to correct potential wrongdoing would allow the management of responsible organizations an opportunity to correct any problems before they become public. Additionally, despite the current negative public perception of large corporations and senior executives resulting from several relatively recent public scandals, it is reasonable to believe employers covered under Section 806 are not always aware of violations occurring within their company. Requiring employees to initially make reports within their organizations would help to alert employers who might not have knowledge that wrongdoing is occurring within the organization. Where there is no evidence of intentional wrongdoing, employees should be encouraged to report their concerns within the organization to give managers the chance to correct problems that may in fact have been caused by negligence, oversight, mistake, or some other problem capable of internal remedy.[113] Requiring internal disclosure as a first resort would also encourage organizations to develop effective reporting and compliance mechanisms to ensure that problems are corrected within the organization in order to avoid external disclosure.[114]

B. Support for Internal Whistleblowing

There has been a relatively recent trend toward encouraging internal whistleblowing, reflected by the establishment of internal whistleblowing procedures and state laws requiring employees to first pursue internal channels of reporting, where feasible, before reporting information externally.[115] Both the courts and legislatures have directly and indirectly promoted the establishment of such procedures.[116]

1. Corporate Sentencing Guidelines

One significant congressional recognition of the importance of internal whistleblowing are the Corporate Sentencing Guidelines, which offer financial incentives to organizations to implement effective compliance and ethics programs to prevent and detect violations of law.[117] The guidelines work by as-

113. WESTMAN & MODESITT, *supra* note 9, at 39–40.

114. Dworkin & Near, *supra* note 97, at 251.

115. *See* Terry Morehead Dworkin, *Whistleblowing, MNCS, and Peace*, 35 VAND. J. TRANSNAT'L L. 457, 462–63 (2002) (arguing that this trend toward internal whistleblowing reflects a decreased reliance on the government to punish violations and an increased focus on early detection and reporting in order to deter and correct wrongdoing).

116. *Id.* at 463.

117. JEFFREY M. KAPLAN ET AL., COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES § 4:1 (2006).

signing "culpability scores" to defendant corporations that can be reduced by maintaining an effective program of prevention and detection, and also by disclosing their misconduct to the appropriate governmental authorities and cooperating in government investigations.[118] The court may reduce sentences for mitigating factors such as substantial assistance to authorities.[119]

The guidelines determine penalties for corporations convicted of federal crimes and offer reduced penalties for organizations that have implemented programs designed to detect and deter misconduct.[120] Characteristics of an effective system include a code of ethics, a workable reporting system, and protection for whistleblowers from retaliation.[121] One requirement for an effective program relates specifically to internal reporting of violations and requires that the organization "[has] and publicize[s] a system that may include mechanisms for reporting that allow for anonymity or confidentiality."[122] The guidelines offer the incentives of decreased penalties and avoidance of negative publicity for those organizations that make a good faith effort to implement effective procedures of internal compliance.[123]

2. Supreme Court Recognition of Internal Whistleblowing

The U.S. Supreme Court has recently recognized the importance of internal whistleblowing in the context of sexual discrimination claims under Title VII of the Civil Rights Act of 1964 in *Faragher v. City of Boca Raton*[124] and *Burlington Industries v. Ellerth.*[125] In these cases, decided on the same day, the Supreme Court provided guidance on how best to deal with complaints stemming from instances of sexual harassment in the workplace. The decisions provide an affirmative defense to liability under Title VII for employers if they take reasonable care to prevent and promptly stop harassment from occurring once it has been reported.[126] Employers can also be shielded from liability by showing that

118. *Id.*

119. *Id.*

120. *Id. See* Harvey L. Pitt & Karl A. Groskaufmanis, *Mischief Afoot: The Need for Incentives to Control Corporate Criminal Conduct,* 71 B.U. L. REV. 447, 452–53 (1991) (arguing that all penalties against the corporation should be eliminated where "an employee violates the company's compliance programs").

121. Dworkin, *supra* note 115, at 464. Dworkin discusses the "carrot and stick" approach taken by the guidelines whereby convicted organizations that have not made an effort to curb wrongdoing suffer the "stick" of increased penalties, sanctions, and receive negative publicity. Organizations that have made a good faith effort to implement effective procedures, on the other hand, receive the "carrot" of decreased penalties. *Id.*

122. 18 U.S.C. app. § 8B2.1 (Supp. IV 2004).

123. Dworkin, *supra* note 115, at 464.

124. 524 U.S. 775 (1998).

125. 524 U.S. 742 (1998).

126. *Id.* at 765.

they have policies in place that are designed to prevent such harassment from occurring in the first place.[127] The employer can raise a defense on the grounds that the employee "unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise."[128]

In *Faragher*, the Court discussed the rationale for providing such an affirmative defense and the competing interests involved.[129] The Court began by stating that allowing the employer to defend itself where the employee failed to take advantage of available internal opportunities for corrective action reflects "an equally obvious policy imported from the general theory of damages, that a victim has a duty to use such means as are reasonable under the circumstances to avoid or minimize the damages."[130] The Court reasoned that where the plaintiff unreasonably fails to avail herself of available remedial measures, she should not recover damages that could have been avoided if she had done so.[131]

3. State Laws Encouraging Internal Whistleblowing

Support for internal whistleblowing is currently found in a clear minority of states, where whistleblowing within the organization is required prior to reporting the alleged violation outside of the organization.[132] Although these statutes differ in the scope of protection they offer to employees, they all reflect the policy that the employee give the allegedly wrongdoing employer an opportunity to correct the activity or policy at issue.[133] Certain states require internal reporting as a first resort, whereas others include exceptions to the rule that generally allow for external reporting where the employee has a reasonable belief that an internal report would prove futile.[134]

For example, Ohio requires the employee to disclose alleged violations internally before reporting them outside of the company.[135] The statute requires employers to correct the violation or make a reasonable and good faith effort to do so within twenty-four hours after receiving a written report from the employee.[136] If the employer does not take corrective action within the twenty-four hour period, the employee may then disclose the violations externally to a public official

127. *See id.* This affirmative defense is not available when the supervisor's harassment results in "tangible employment action" such as discharge, demotion, or undesirable reassignment. *Id.*

128. *Id.*

129. *Faragher*, 524 U.S. at 806.

130. *Id.* at 806–07 (internal quotation marks omitted).

131. *Id.*

132. *See infra* Part V.

133. *See infra* Part V.

134. *See infra* Part V.

135. OHIO REV. CODE ANN. § 4113.52(A)(1)(a) (West 2006).

136. *Id.* § 4113.52(A)(1)(a).

or agency with supervisory authority over the employer.[137] Florida requires that the employee give the employer a reasonable opportunity to correct the problem before the employee may report externally.[138] New York, which provides very limited protection to whistleblowers,[139] requires the employee to bring the activity or violation to the attention to the employer and afford the employer a reasonable opportunity to correct before making any external disclosures.[140]

Other states include similar internal reporting requirements, but carve out exceptions in certain instances where internal reporting would be impossible or unlikely to prove effective. Maine requires an employee to report alleged violations to someone with supervisory authority and give the employer a reasonable opportunity to correct the problem.[141] However, internal reporting is not required if the employee has specific reason to believe that reports to the employer will not result in prompt corrective action.[142] Indiana requires the employee to report alleged violations to the employer, unless the employer is the person whom the employee believes is committing the violation.[143] New Jersey requires the employee to disclose the conduct in writing to a supervisor and includes an exception to the internal reporting requirement where the employee is: (1) reasonably certain that the activity is known to one or more supervisors of the employer, or (2) reasonably fears physical harm as a result of the disclosure, provided that the situation is emergency in nature.[144] New Hampshire's whistleblower statute provides that the employee must first report internally unless the employee "has specific reason to believe that reporting such a violation to his employer would not result in" prompt remedial measures.[145]

Alaska has a unique whistleblower statute in that it allows the employer to determine whether the employee must first make an internal disclosure prior to reporting suspected violations externally.[146] The statute allows the employee to make disclosures to a public body unless the employer has instituted a written personnel policy that requires employees to first submit a written report to the employer.[147] If the employer has instituted such a policy, then the employee is required to make an internal report unless the employee reasonably believes that:

137. *Id.* § 4113.52(A)(1)(a).

138. FLA. STAT. ANN. § 448.102(1) (West 2006).

139. New York only provides protection where the violation creates and presents a substantial and specific danger to the public health or safety. N.Y. LAB. LAW § 740(2)(a) (McKinney 2006).

140. *Id.* § 740(3).

141. ME. REV. STAT. ANN. tit. 26, § 833(2) (2007).

142. *Id.*

143. IND. CODE § 22-5-3-3(a) (2007).

144. N.J. STAT. ANN. § 34:19-4(II) (West 2007).

145. N.H. REV. STAT. ANN. § 275-E:2 (2007).

146. ALASKA STAT. § 39.90.110(c) (2006).

147. *Id.*

(1) the employer will not take prompt action to remedy the problem, (2) the problem is already known to their supervisor, (3) the situation is emergency in nature, or (4) the employer will take retaliatory action as a result of disclosure.[148]

The fact that several states include provisions requiring some form of internal reporting in their whistleblower statutes reflects the view that internal reporting should be encouraged prior to reporting outside the organization where such reporting is reasonable under the circumstances. While the states that encourage internal reporting do so in various ways, they all reflect the principle that the proper balance of interests between employee, employer, and society is found where the employee first reports suspected violations internally in most circumstances. This policy gives the employer the opportunity to take remedial action by giving it a reasonable time to respond before allowing external disclosures.[149]

V. CONCLUSION

Whistleblower law has developed over time from the employment-at-will doctrine to a wide variety of state and federal laws protecting employees from retaliatory discharge. Sarbanes-Oxley Section 806 instituted the first federal protection for employees at public companies from retaliatory discharge for reporting violations involving securities laws. Section 806 allows for civil remedies against employers for retaliatory discharge regardless of whether the employee makes any attempt to first report alleged violations within the company. Despite increasing support for internal whistleblowing demonstrated by the Corporate Sentencing Guidelines, the U.S. Supreme Court, and a substantial minority of state laws, Congress failed to include any requirement of internal reporting in Section 806. As a result, Congress failed to adequately protect employers by giving them the opportunity to correct potential mistakes internally before they are disclosed publicly. The resulting harm to the employer and its shareholders from negative publicity should have been addressed by including a requirement of internal reporting in Section 806.

Sarbanes-Oxley was passed in order to protect investors by requiring increased disclosure from public companies to their shareholders and the public.[150] One method of encouraging such disclosure has been the increase in protection afforded to employees who report suspected wrongdoing on the part of their employers. While such protections are undoubtedly necessary in light of recent history in corporate America, Congress failed to adequately balance the competing interests of employee and employer in the context of whistleblower protection.

148. *Id.* § 39.90.110(c)(1)–(4).

149. Dworkin & Callahan, *supra* note 7, at 278–79.

150. *See* Robert Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. U. L. REV. 251, 282 (2005).

While it is crucial to encourage employees to come forward and report suspected violations without fear of reprisal, this goal would be better served by requiring internal disclosure as a first resort in most circumstances. Congress should therefore amend Section 806 to require internal disclosure in most circumstances unless the employee has a reasonable belief that such disclosure would prove futile. In doing so, Congress would be able to better balance the interests of employee and employer without taking away any protection from shareholders or the public.