ABSTRACT

Recent corporate scandals demonstrate that rank-and-file employees often remain silent in the face of significant fraud. This silence is unfortunate because corporate employees have inside knowledge of misconduct that gives them an information advantage over more traditional corporate monitors, such as independent directors and government regulators. To address this problem, the Sarbanes-Oxley Act utilized a new approach that encourages employee whistleblowers to disclose information about corporate wrongdoing. This approach, which Professor Moberly labels the “Structural Model,” requires that corporations provide a standardized channel for employees to report organizational misconduct to official monitors within the corporation. This Article offers an original framework for analyzing the effectiveness of Sarbanes-Oxley’s Structural Model. Utilizing behavioral science research that analyzes whistleblower motivations, Professor Moberly finds that the Structural Model reduces difficulties corporate employees experience in disclosing misconduct, and thereby provides an improved mechanism to encourage employees to become more active and effective corporate monitors. However, the Structural Model has significant flaws, which Professor Moberly addresses by offering several suggestions for improving the model’s usefulness as a tool against corporate crime.
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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 corporation. At great risk to their careers, a few employee whistleblowers bravely attempted to expose wrongdoing at many corporations involved in recent scandals, such as Enron, WorldCom, Global Crossing, and several mutual funds companies.¹

¹ See discussion infra Part II.B.
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. 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. Thus, while the corporate scandals demonstrate employees’ potential to monitor corporations, they also confirm that this potential often is not fully realized.

In this Article, I evaluate the most recent attempt to encourage employees to become more effective corporate monitors, the Sarbanes-Oxley Act passed by Congress in response to the corporate scandals. The Act utilizes two approaches to encourage corporate whistleblowers. 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. 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.
after the employee discloses wrongdoing. The second approach, which I label the Structural Model, requires that corporations provide employees with a standardized channel to report organizational misconduct internally within the corporation.

While academic and public attention has focused almost exclusively on Sarbanes-Oxley’s version of the Anti-retaliation Model, 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 analyzing 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.

In Part II of the Article, I use specific examples from the recent corporate scandals to illustrate these problems, both of which relate to the flow of employees’ inside knowledge of wrongdoing within a corporation. First, 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.

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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? 24 (1994) (describing ombudsmen system implemented by Otis Elevator Company); Alan R. Yuspeh, Sharing “Best Practices” Information, in GOOD CITIZEN, supra note 3, at 64.

of silence among employees.\(^9\) Second, 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. The few “successful” whistleblowers overcame these two problems; thousands of other rank-and-file employees did not.

In Part III of the Article, I describe the two approaches utilized by Sarbanes-Oxley to address these problems – the Anti-retaliation Model and the Structural Model. Here I conclude that the Anti-retaliation Model implemented by Sarbanes-Oxley is not sufficient 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 the corporate scandals. First, the Act requires that corporate boards of public companies establish avenues (i.e., structures) for employees to report wrongdoing directly to the independent directors on the board’s audit committee – not to corporate executives.\(^10\) Second, Sarbanes-Oxley made the implementation of this disclosure channel mandatory.\(^11\)

In Part IV, I evaluate these improvements and suggest that Sarbanes-Oxley’s Structural Model is more likely than the Anti-retaliation Model to reduce the flow-of-information problems that contributed to the corporate scandals, because the model provides a direct and legitimate disclosure channel from employees to the board of directors. This requirement should encourage 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 from 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

\(^11\) See id.
\(^12\) See discussion infra Part IV.A.
\(^13\) See discussion infra Part IV.B.
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.\textsuperscript{14}

Although it is an improvement over prior approaches, Sarbanes-Oxley’s Structural Model still suffers from significant flaws. In Part V, I explain the inadequacies of Sarbanes-Oxley’s Structural Model and offer several suggestions for improvement. One problem is that the model may not work well enough: corporations may implement disclosure channels that appear sound on paper, but do not work in reality.\textsuperscript{15} This “cheating” problem can be addressed in several ways. First, corporations could disclose information regarding their whistleblower system. For example, corporations could publicize the structure of their whistleblower disclosure model publicly 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. Through these disclosures, shareholders, employees, and government regulators could evaluate the effectiveness of a whistleblower disclosure system. A second way to address the cheating problem is to provide corporations 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 attend to their obligation to oversee the business of the company.\textsuperscript{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

\textsuperscript{14} See discussion infra Part IV.C.
\textsuperscript{15} See discussion infra Part V.B.
\textsuperscript{16} See discussion infra Part V.C.
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, the goal of the Structural Model should be to 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. Sarbanes-Oxley’s approach is a good start, but in its current form, it fails to provide frameworks that fully utilize employees’ ability to monitor corporations effectively.

II. THE NEED TO ENCOURAGE MORE EFFECTIVE WHISTLEBLOWING

A. Information Problems and the 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


20 See, e.g., 15 U.S.C. § 78(m) (requiring public companies to make periodic filings with the Securities and Exchange Commission). Government-like entities, such as
A primary advantage of each of these traditional corporate monitors is that they are external to the company. Directors who are independent purportedly provide dispassionate oversight of management. Gatekeepers have reputational concerns outside of their contractual relationship with corporations to inspire them to provide effective monitoring. 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, such distance presents a significant challenge: monitoring the inner workings of a company from the outside. External monitors must rely upon information they receive from corporate executives in order to fulfill their monitoring function. 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. Under the various securities listing agencies like the New York Stock Exchange, also monitor corporations.

Independent directors are a principal means by which to monitor corporate managers. Their 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, they may be more willing to disclose wrongdoing publicly, because they can do so without losing their employment. See Eisenberg, supra, at 244-48; Kostant, supra at 1237 n.100.

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

See Kostant, supra note 21, at 1239. 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).


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); 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
worst circumstances, corporate executives may affirmatively hide and 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 because they often have distorted and filtered information.

These problems contributed to the failure of traditional monitors to detect the wrongdoing at the center of the 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.29 There is sufficient blame to go around.30 Yet, as discussed below, one of the most glaring (yet 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. See 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 regarding the distortion and filtering of information from subordinates to superiors in hierarchical organization).

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 (2002); John R. Kroger, Enron, Fraud and Securities Reform: An Enron Prosecutor’s Perspective, 75 U. Colo. L. Rev. 57, 59-60 (2004).

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 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 Report, supra note 2, at 22, 148.

29 Systemic explanations for the corporate scandals include: the perverse incentives provided by managerial stock options for corporate officers to inflate a corporation’s stock price, see Coffee, supra note 19, at 304; 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 id. 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, at 59-60; Paredes, supra note 18, at 503 (“Many things contributed to Enron’s demise. There were breakdowns all around – accountants,
under-analyzed) facts regarding the scandals is that the information concerning the fraudulent conduct was available to rank-and-file employees for years. This information, however, 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 these information problems. 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 virtually requires the assistance of low and mid-level employees because of its scope

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 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 1980’s, 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: Why Whistle Blowing Is on the Rise, in WHISTLE-BLOWING: LOYALTY AND DISSENT IN THE CORPORATION 1, 10-12 (Alan Westin ed., 1981) [hereinafter Westin, Introduction].

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.

and complexity. Additionally, even if an employee does not participate in the wrongdoing, corporate accounting and finance employees who are trained in the proper methods of conducting business should recognize when corporate actions fall outside legal boundaries. In fact, even with few corporate or legal incentives provided to whistleblowing employees, roughly one-third of frauds and other economic crimes against businesses are reported by whistleblowers. Thus, given their central role in corporate activity, information from rank-and-file employees is essential to uncovering wrongdoing in a timely way. Accordingly, effectively encouraging rank-and-file 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 funds companies. These whistleblowing employees succeeded for two reasons. First and foremost, they simply spoke out and disclosed their inside knowledge regarding misconduct occurring inside their corporation. Second, the successful whistleblowing employees 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, who was the head of internal auditing at WorldCom. Cooper uncovered manifold 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

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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.


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).

investigation. By reporting Sullivan’s misconduct directly to the Board, Cooper successfully avoided his attempt to block disclosure of the fraud.

Other whistleblowers similarly were effective because they disclosed information directly to the government, another traditional corporate monitor. For example, separate, anonymous whistleblowers uncovered fraud at Symbol Technologies and Kmart when they sent letters to government regulators. 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.

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37 See id. 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.


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, at http://www.careerjourneleurope.com/myc/survive/20021217sapsford.html (Dec. 17, 2002). 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 frauds. See Alix Nyberg, Whistle-Blower Woes, CFO, Oct. 2001, at 51, 52.

40 In April 2001, an anonymous whistleblower sent a letter to the S.E.C. 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 S.E.C. lawsuits for $138 million. See id. In January 2001, 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, 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.

These whistleblowing employees themselves could not stop misconduct, but by providing information directly to traditional monitors, the employees circumvented the barriers corporate executives erected to shield external monitors from the misconduct.

2. The Many Who Failed

The success of these few individual whistleblowers, however, highlights the overall failure of corporate employees to identify and successfully report the wrongdoing occurring in these companies and others, such as Enron. Two primary failures occurred - failures that were the inverse of the successes discussed above.

a. Failing to Speak Out

First, 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 the 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


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 Report, supra note 2, at 2, 32. The amounts involved in the restatement are staggering. As set forth in the Powers Report, the restatement:


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, and “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, at http://www.thestreet.com/stocks/melissadavid/10089204.html (May 22, 2003).

43 At Enron, for example, the misrepresentations and the improper accounting practices that led to Enron’s bankruptcy were long-standing and well-known
example, when corporate executives at Enron made outlandish profit predictions, employees knew they must “gin [up]” earnings and revenues to match the predictions. 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.

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 the company’s earnings manipulation was so widespread that employees joked about it at company parties. 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. However, despite their lengthy exposure to flawed financial practices and public misrepresentations, few employees came forward to complain. Importantly, this phenomenon was not unique to Enron: the majority of employees who witnessed wrongdoing did not report it. Successful whistleblowers, by definition, overcame this inherent hesitation to speak out.

throughout the company. \textit{See}, e.g., McLean & Elkind, \textit{supra} note 3, at 116; 182-83 (giving examples of employee knowledge of Enron’s practice of inflating sales numbers); 219-20; 230; 269-70 (discussing wide-spread employee knowledge and participation in various strategies to manipulate California’s energy market); 303-04; 332.

\textit{See id.} at 289.

\textit{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, \textit{Ex-Rite Aid Officials Face U.S. Charges of Financial Fraud}, \textit{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”).

\textit{See McLean & Elkind, supra note 3, at 296.}


\textit{There are exceptions, of course. In March 2001, one Enron employee sent an anonymous letter to \textit{Fortune} magazine to complain that company executives were understating the extent of recent job cuts. See McLean \& Elkind, \textit{supra} note 3, at 332.}

\textit{Several studies have found low reporting rates among employees who witness misconduct. See, e.g., Miceli \& Near, \textit{supra} note 6, at 96-99; Terance D. Miethe, \textit{Whistleblowing at Work: Tough Choices in Exposing Fraud, Waste, and Abuse on the Job}} 31 (1999); Estlund, \textit{supra} note 9, at 119-20; Miethe \& Rothschild, \textit{supra} note 9, at 332-33 (surveying 6 studies of whistleblowing and finding that the average rate of whistleblowing is 42%).}
b. Executive Blocking and Filtering

A second flow-of-information failure occurred because, even if employees spoke out, their disclosures of wrongdoing often were ineffective. Rather than report misconduct to traditional corporate monitors, failed whistleblowers disclosed information to corporate executives, who subsequently prevented it from reaching official monitors. Executives either blocked the information entirely or filtered the information before it reached the traditional monitors to avoid alerting the monitors to the misconduct.50 These problems were apparent at many of the companies involved in the corporate fraud;51 however, the fraud at Enron presents the clearest, and most well documented,52 examples.

At the core of the Enron fraud 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

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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. Penn. 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 Fiascos, 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 Report, supra note 2 (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 Corporate Fiascos, 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, available at http://www.journalnow.com/servlet/Satellite?pagename=WSJ/MGArticle/WSJ_BasicArticle&c=MGArticle&cid=1031784558108 (“That was a clear pattern at Enron: If anyone suggested wrongdoing, they were considered a hindrance and ousted.”). From the earliest studies of whistleblowers, 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: What Can and Should Be Done to Protect Whistle Blowers in Industry, in Whistle-Blowing: Loyalty and
From the company’s earliest days, Enron executives silenced and undermined employees who raised concerns about Enron’s accounting and financial practices. 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. 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. Enron’s Board never substantively investigated the propriety or long-term impact of these entities. 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. Executives disregarded these reports and never completed internal investigations. 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. The letter, however, was never shown to Enron’s Board of Directors.

Even if employees avoided management’s information blocking, corporate executives often filtered and slanted employee
information towards executives’ goals before the information reached the traditional corporate monitors. For example, Sherron Watkins, the famed Enron whistleblower, actually 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’ error was that she complained to Enron’s CEO, Kenneth Lay, rather than to the full Board of Directors. 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. When the Board ultimately learned of Watkins’ allegations, the report was whitewashed by Vinson & Elkins’ conclusion that the transactions Watkins reported were proper. Thus, by hand-picking his friends at Vinson & Elkins to investigate Watkins’ claims, Lay successfully filtered Watkins’ full allegations from reaching the Board and the public, at least temporarily. Although Watkins certainly deserves credit for

63 Watkins was named, along Cynthia Cooper of WorldCom, 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 32, 32-33.


65 See Griffin, supra note 64, at 213-14; Powers Report, supra note 2, at 173. Lay justified this choice by concluding that the investigation would only be “preliminary” and could be conducted most quickly by V&E because the law firm was “familiar” with Enron. See Powers Report, 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.” See id. at 176.

66 See MCLEAN & ELKIND, supra note 3, at 366; Powers Report, supra note 2, at 175. 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.

being willing to step forward and report her concerns to Enron’s CEO, ultimately she was not effective as a whistleblower because she provided information to Enron’s executives rather than directly to Enron’s Board.\textsuperscript{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,\textsuperscript{69} never effectively questioned Enron’s management regarding its financial practices.\textsuperscript{70} Moreover, “gatekeepers,” such as Enron’s outside accountants and attorneys who received huge amounts of fees from Enron, did not raise red flags to anyone on Enron’s Board even though they knew that Enron’s aggressive accounting techniques were problematic.\textsuperscript{71} The close relationships between purportedly independent monitors and Enron’s executives led to “group think” that prevented them from dispassionately fulfilling their responsibilities and questioning what they were being told.\textsuperscript{72}

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68 Despite the public accolades she received, Watkins 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.”\textsuperscript{92} See Bryce, supra note 47, at 293; see also Griffin, supra note 64, at 220-21; Dan Ackman, Whistleblower?, WALL ST. J., Dec. 24, 2002, at A10.


70 See Kostant, supra note 69, at 542.

71 See Bryce, supra note 47, at 298; Powers Report, 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 (same); 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) (“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 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).
Most commentators ignored corporate employees’ role in these scandals and, instead, blamed the failures of the traditional corporate monitors for the success of the deceptions. 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. However, thousands of employees, participated in, knew about, or willfully ignored the massive misconduct occurring within their companies. As important, even if employees were not direct participants, they certainly knew information that could have been useful to corporate monitors, perhaps leading to earlier discovery of the fraud. To resolve the information problems raised by the corporate scandals, the potential of corporate employees to assist in corporate monitoring should not be ignored. Part of the response to the corporate scandals should be to encourage more employees to become whistleblowers and also to encourage more effective whistleblowing by assisting employees in avoiding the problem of blocking and filtering of information 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

Versions of both the Anti-retaliation Model and the Structural Model existed before and during the corporate scandals, yet neither encouraged employees to disclose information about corporate fraud consistently and effectively. In 2002, Congress passed the Sarbanes-Oxley Act to address many of the corporate governance inadequacies brought to light in the wake of the

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73 See, e.g., Bainbridge & Johnson, supra note 17, at 301 (blaming attorneys); Fanto, supra note 24, at 435-36 (corporate directors); Coffee, supra note 19, at 313-15 (outside auditors).

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 Corp.’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 MAGAZINE, available at http://www.cfo.com/article.cfm/3011051/1/e_3036074?f=insidedcfo (Dec. 1, 2003).
corporate scandals. As part of this legislation, Congress implemented versions of both models.75

A. Insufficiency of the Anti-retaliation Model

The anti-retaliation provision of the Sarbanes-Oxley Act76 was widely praised by academics, who called it the “gold standard” of whistleblower protection77 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. Discharged employees may be reinstated and may receive compensatory special damages, including litigation costs and attorneys’ fees.81 Furthermore, individuals may be criminally prosecuted for

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. 107-204, 116 Stat. 745 (codified in scattered sections of the United States Code).

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). Sarbanes-Oxley’s anti-retaliation provisions have been thoroughly described and analyzed in other places. See generally Kohn, supra note 8, at 59-118 (analyzing legal requirements of Sarbanes-Oxley’s anti-retaliation provision); Vaughn, supra note 8, at 8-99 (same). Accordingly, I will only briefly outline its provisions here.


78 Vaughn, supra note 8, at 105; see also Kohn, 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.


81 See id. § 1514A(c); see also Kohn, supra note 8, at 111 (noting that Sarbanes-Oxley is one of only four federal statutes that permit recovery of attorney fees as part of “special damages” that must be awarded); Vaughn, supra note 8, at 94 n.400 (noting benefits of reinstatement as a remedy).
retaliating against whistleblowers, which seemingly would further deter potential retaliation.\textsuperscript{82}

Unlike under many federal anti-retaliation statutes, employees may bring private causes of action in federal district court if they are subject to retaliation. Although an employee’s claim must first be brought to the Department of Labor (specifically, the Occupational Safety and Health Administration, or OSHA), a court claim may be brought if the administrative process is not completed within 180 days,\textsuperscript{83} which it almost certainly will not be.\textsuperscript{84}

Yet, Sarbanes-Oxley’s anti-retaliation provision suffers from significant defects. The Act protects only employees of public corporations and only if they report violations of federal securities laws.\textsuperscript{85} Its statute of limitations period of ninety days is unreasonably short.\textsuperscript{86} Further, the remedies do not include any sort of punitive or liquidated damages to provide extra encouragement for employee whistleblowers.\textsuperscript{87} Finally, jumping through the administrative hoops of OSHA before being able to bring a claim in federal district court\textsuperscript{88} can be “cumbersome rather

\textsuperscript{82} See 18 U.S.C. § 1513(e) (providing for fines and/or imprisonment of up to 10 years for retaliating against a person for providing a law enforcement officer with truthful information relating to commission of a federal crime).

\textsuperscript{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 several other federal statutes.

\textsuperscript{84} See Allen v. Stewart Enterp., Final Decision and Order Dismissing Appeal, ARB Case No. 05-059 (Aug. 17, 2005), at 3 n.5 (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 130 days for Fiscal Year 2005. See Email from Nilgun Tolek, OSHA Office of Investigative Assistance, to Richard Moberly, Asst. Prof. of Law, Univ. of Neb. College of Law (Feb. 15, 2006) (on file with author). This time period has grown significantly longer since the enactment of OSHA: in Fiscal Year 2003, the average length of a Sarbanes-Oxley investigation was 92 days. See id.

\textsuperscript{85} See 18 U.S.C. § 1514A(a).

\textsuperscript{86} See id. § 1514A(b)(2)(D).

\textsuperscript{87} See id. § 1514A(c).

\textsuperscript{88} See id. § 1514A(b); 29 C.F.R. §§ 1980.101,103, .104 (2005).
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. Of the 480 cases resolved at the initial investigative level by December 31, 2005, OSHA investigators found only 17 to have merit, while another 68 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 meaning that the “stronger” whistleblower protections of Sarbanes-Oxley are not resulting in more protections for whistleblowers.92 Moreover, of the 119 investigator decisions that were appealed by April 28, 2005, the Department of Labor’s Administrative Law Judges (ALJs) decided in favor of employees only four times, while another nineteen settled.93

Indeed, the decisions being issued by the ALJs are exacerbating Sarbanes-Oxley’s statutory shortcomings. Procedural issues eviscerate claimant’s cases. Several decisions dismissed complaints because the wrong corporate entity was named94 or because a corporation filed a registration statement with the SEC, but withdrew it before it became effective, thus denying coverage under the Act.95 Claims have been dismissed for missing the ninety-day statute of limitations window.96

90 See Email from Nilgun Tolek, OSHA Office of Investigative Assistance, to Richard Moberly, Asst. Prof. of Law, Univ. of Neb. College of Law (Feb. 15, 2006) (on file with author).
91 See Email from Nilgun Tolek, OSHA Office of Investigative Assistance, to Richard Moberly, Asst. Prof. of Law, Univ. of Neb. College of Law (July 11, 2005) (on file with author). Interestingly, OSHA considers cases that have settled to be meritorious, and thus includes settled cases in its successful 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. After basic questions regarding jurisdiction and applicability are answered by Administrative Law Judges and the courts, it may be that the success rate increases.
93 See Email from Todd Smyth, Office of Administrative Law Judges, to Richard Moberly, Asst. Prof. of Law, Univ. of Neb. College of Law (July 8, 2005) (on file with author).
including claims that missed the deadline by less than two weeks\textsuperscript{97} or because the date on which the limitations period began to run was the date the employer gave the employee two weeks’ notice rather than the date the whistleblower’s employment actually terminated.\textsuperscript{98} ALJs routinely reject equitable tolling of the statute of limitations.\textsuperscript{99} ALJs dismissed other claims because whistleblowers made complaints about the wrong topics, such as underpayment of employees,\textsuperscript{100} racial discrimination,\textsuperscript{101} or environmental violations,\textsuperscript{102} 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.\textsuperscript{103} Surveys demonstrate that most employees are unaware of the protections they may (or may not) receive should they report wrongdoing.\textsuperscript{104} 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.\textsuperscript{105} Whether a whistleblower is protected depends upon the employee’s state of residence, the industry in which the employee works, the type of misconduct reported,\textsuperscript{106} the type of retaliation endured,\textsuperscript{107} and, for


\textsuperscript{101} See Harvey, No. 2004-SOX-20.

\textsuperscript{102} See Hopkins, No. 2004-SOX-19.


\textsuperscript{104} See Miethe, supra note 49, at 54.


some laws, the willingness of administrative agencies to enforce the law.\textsuperscript{108} Sarbanes-Oxley only adds to this confusion.

The second failure of the Anti-retaliation Model is that it does not address the flow-of-information problems revealed by the recent scandals. Even if whistleblowing occurs and is protected, the model does not produce effective whistleblowing, because rarely do anti-retaliation laws indicate to whom an employee should make a disclosure. Therefore, although an employee may be protected from retaliation by reporting to a supervisor or corporate executive, the actual corporate misconduct may not stop because the traditional corporate monitors may never receive the information. 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 might block or filter the information. The Anti-retaliation Model simply does not address this issue.

To be clear, anti-retaliation provisions are important from a fairness perspective because they provide ex post protections to people who should not be hurt for engaging in socially beneficial conduct. Some surveys report that well over half of whistleblowers experience some sort of retaliation.\textsuperscript{109} Other researchers place the actual number much lower;\textsuperscript{110} nonetheless, the results of retaliation can be devastating.

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\textsuperscript{107} 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 suit to cases in which employee was actually or constructively discharged).

\textsuperscript{108} See Estlund, supra note 9, at 122 n.92.

\textsuperscript{109} See, e.g., Gerald Vinten, Whistleblowing – Fact or Fiction: An Introductory Discussion, in WHISTLEBLOWING – SUBVERSION OR CORPORATE CITIZENSHIP? 3, 11 (Gerald Vinten ed., 1994) (citing study concluding that 86 of 87 whistleblowers experienced retaliation); Alford, supra note 103, at 18-19 (citing studies in which 1/2 to 2/3 of whistleblowers lose their jobs); Brickey, supra note 33, at 365 & 365 n.35 (citing non-scientific survey of 200 whistleblowers by National Whistleblower Center finding that over ½ had lost their jobs and survey by Government Accountability Project that 90% of whistleblowers experienced retaliation or threats).

\textsuperscript{110} See Miceli & Near, supra note 6, at 203 (suggesting that generalizing about rate of retaliation is difficult because of variables in studies and citing study in which less than 20% of whistleblowers were retaliated against); Terry Morehead Dworkin & Janet Near, A Better Statutory Approach to Whistleblowing, 7 BUS. ETHICS Q. 1, 5 (1997) (arguing that studies show that most whistleblowers do not suffer retaliation, even though most people think they do).
employees have been found dead or beaten.\textsuperscript{111} Whistleblowers often lose their jobs, and as a result, their marriages may be affected, they may lose their homes, and financial ruin might ensue.\textsuperscript{112} In short, the Anti-retaliation Model is necessary. However, it is not sufficient to address the flow-of-information problems that arose during the 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 channel for employees to report misconduct.\textsuperscript{113} 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, thus working in concert with the corporation rather than at odds with it. The Structural Model encourages employees by signaling the extrinsic social and employment benefits of playing within the system and

\textsuperscript{111} 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), and more recently, the beating of an employee of Los Alamos National Laboratory 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., at http://www.washingtonpost.com/wp-dyn/content/article/2005/06/06/AR2005060601787_pf.html (July 6, 2005), and the beating of one of the primary whistleblowers in the mutual fund scandal, see O’Donnell, supra note 41.

\textsuperscript{112} See, e.g., Vinten, supra note 109, at 11; Alford, supra note 103, at 19-20. 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, George Mason Law & Economics Research Paper No. 04-56, at http://ssrn.com/abstract=622723 (Nov. 15, 2004), at 24; see also Alford, supra note 103, 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 365; Depoorter & De Mot, supra, at 24 & 24 n.95; Miethe & Rothschild, supra note 9, at 326.

\textsuperscript{113} 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).
cooperating with the corporation. Rather than hoping that an employee’s report of wrongdoing makes its way through the managerial hierarchy to an individual with the authority to stop the misconduct, the Structural Model provides a visible mechanism for that report and instructs employees to utilize it.

Despite its potential benefits, versions of the Structural Model in place in both the public and private sectors prior to the 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). Under these provisions, Congress created offices charged with (among other things) receiving and investigating federal employee claims of wrongdoing in the government. The IGA required most federal agencies to create a position of Inspector General who received complaints from that agency’s employees. The CSRA more broadly provided an outlet for reports from any federal employee by creating the Office of Special Counsel (OSC).

The beginnings of the Structural Model can be seen best in the creation of the OSC. The OSC receives whistleblower disclosures and informs the necessary federal agency about potential misconduct occurring within its ranks. By informing agencies of potential problems, Congress hoped that the OSC could become an “early warning system” for budding problems, serious enough to place agency leadership on notice and to require

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114 See discussion infra Part IV.


117 See id. § 2.


119 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).
acknowledgement.” If the OSC believed that a “substantial likelihood” existed that a whistleblower’s disclosure revealed potential wrongdoing covered by the statute, then the OSC could require the head of the agency to conduct an investigation and to submit a written report regarding the agency’s findings. The OSC would evaluate the report and determine whether the agency’s findings were reasonable and contained the appropriate information required by statute. Ultimately, the OSC submitted the agency reports to Congress and the President, and kept a public file of the report. Thus, the CSRA (and the IGA under similar provisions) went further than simply protecting whistleblowing employees from retaliation, although they theoretically did that as well. Congress intended for these statutes to encourage potential whistleblowers by providing employees with an easy channel to report misconduct.

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

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122 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 action taken as a result of the investigation. See id. § 1206(b).
123 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.
124 See Devine & Aplin, supra note 119, at 20 (“The purpose of the OSC whistleblowing disclosure channel was ‘to encourage employees to give the government the first crack at cleaning its own house before igniting the glare of publicity to force correction.’”) (footnote omitted).
125 See Win Swenson, The Organizational Guidelines’ “Carrot and Stick” Philosophy, and Their Focus on “Effective” Compliance, in GOOD CITIZEN, supra note 3, at 28-29; see also Dworkin, supra note 103, at 464; Elleta 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); Near & Dworkin, supra note 113, at 1557.
“effective program to prevent and detect violations of law.”

Under the OSG, penalties for corporations convicted of crimes could be reduced by up to 95% if the corporation previously implemented such a program; conversely, if no such program existed, then the potential fines were multiplied by up to 400 percent.

An “effective program” required that the organization exercise due diligence to prevent and to detect criminal conduct by its employees and agents. 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.”

The judiciary also gave incentives to corporations to monitor themselves more closely through structural disclosure channels. 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.” This holding encourages directors to initiate and maintain a disclosure channel for employees and agents to inform directors about problems within the corporation. In the sexual harassment context, the U.S. Supreme Court stated that employers who made 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. Furthermore, in a different decision, the Court held that a corporation may be able to avoid punitive damages in a wrongful discharge case brought by a whistleblower if the corporation has an internal reporting mechanism available for employees and agents to report problems within the organization without fear of retribution.


128 See OSG, supra note 126, § 8A1.2 (Commentary), Application Note 3(k).

129 See id. Application Note 3(k)(5).


131 See In re Caremark, 698 A.2d 959, 970 (De. Ct. Chan. 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. See id.

132 See Dworkin, supra note 103, at 466.

to report wrongdoing. These court decisions all encourage corporations to establish whistleblower disclosure channels because they allow corporations to avoid liability (and its attendant litigation costs) if sufficient processes are in place.

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 provide information about misconduct, because the channels resulted in disclosure to a party who was either non-responsive or biased. For example, under the Organizational Sentencing Guidelines, corporations could simply fail to respond to whistleblower complaints because the Guidelines do not specify to whom whistleblower disclosures must be reported. In the private sector, in order to satisfy the Guidelines, corporations implemented disclosure channels that flowed up through the corporate management hierarchy, placing employee disclosures at risk of management blocking and filtering.

The Civil Service Reform Act 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 who summarily failed to order investigations of employee complaints. Although the first two Special Counsels used this provision to order agency investigations for approximately twenty-five percent of employee complaints, beginning in 1983 a new Special Counsel drastically reduced the number of investigations ordered, to approximately 7.5% of the complaints. In other words, whistleblower disclosures were being made, but the OSC rarely required agencies to confront the problems being raised. Ultimately, the

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134 See Kolstad v. Am. Dental Ass’n, 527 U.S. 526, 545-46 (1999); see also Callahan, et al., supra note 125, at 194.
135 See Callahan, et al., supra note 125, at 192-93; Sturm, supra note 130, at 557.
136 See OSG, supra note 126, § 8A1.2, Application Note 3(k)(5).
138 Devine & Aplin, supra note 119, 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).
139 See Devine & Aplin, supra note 119, at 53.
CSRA was amended by the Whistleblower Protection Act of 1989, but the unchallenged discretion of the Special Counsel to order investigations remains,\(^{140}\) leaving in doubt the ability of government employees to report wrongdoing effectively.\(^ {141}\)

The second problem with the pre-scandal Structural Model was that companies had little incentive to implement effective whistleblower disclosure channels because courts and prosecutors rarely penalized bad systems or rewarded good ones. Specifically, corporations easily could create superficial structures

\(^{140}\) 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)) (internal quotation marks omitted). The WPA also requires that the OSC send these whistleblower comments, the final agency report, and the OSC’s evaluation to the President and a congressional oversight committee, and to place them in a public file. See 5 U.S.C. § 1219 (1994); Devine, supra, at 562 n.176. 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’s office. See 5 U.S.C. § 1206(b)(1)(1988), subsequently repealed by Pub. L. 101-12, § 3(a)(8), 103 Stat. 21 (Apr. 10, 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. The OSC only will protect the confidentiality of the whistleblower to the extent permitted by Section 1213(h). See U.S. Office of Special Counsel, Whistleblower Disclosures (May 4, 2005), at www.osc.gov. 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 Structural 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 to bureaucratic misconduct.” Devine, supra, at 561.

\(^{141}\) 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 2.6% of employee disclosures were referred to agency heads for investigation. See REPORT TO CONGRESS FROM THE U.S. OFFICE OF SPECIAL COUNSEL FOR FISCAL YEAR 2004, 15 (2005), available at www.osc.gov. The exact percentage is difficult to obtain from the annual report submitted by the OSC. During FY 2002, 2003, and 2004, the OSC closed 1841 disclosure matters. Id. During those same three years, it referred only 48 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.
merely to satisfy the OSG. These structures often provided merely “window-dressing” and were not enforced in practice. Indeed, the 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 the detection and reporting of fraud. For example, Enron appeared on its face to satisfy the OSG standards for an effective compliance program, even if the program was not compliant in reality. Moreover, not only were superficial systems easy to create, but also government provided little incentive to do anything more. Despite the possibility for substantial penalty reductions provided by the OSG, the OSG’s requirement that corporations implement “effective compliance systems” rarely helped a corporation facing criminal liability. From 1993 to 2004, only three organizations received a penalty reduction under the OSG for having an effective system.

Thus, prior to the corporate scandals, painful weaknesses of the Structural Model were enforcement and follow-through. In the private sector, disclosures were directed to corporate executives rather than traditional corporate monitors, which restricted information flow. An organization could have an excellent-appearing disclosure structure in place, but 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 implemented 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

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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 (2003-04).

143 See Fiorelli, supra note 127, at 567 & 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”).

accounting, internal accounting controls, or auditing matters. Additionally, the audit committee must be able to receive anonymous disclosures by employees regarding accounting or auditing matters. 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 of corporate executives. As recognized by the SEC when it amended its general rules and regulations to implement Section 301 of the Act, directors typically rely upon managers of companies to provide them information, but management “may not have the appropriate incentives to self-report all questionable practices.” Accordingly, the SEC rightfully recognized 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.”

Moreover, Sarbanes-Oxley provides for anonymous disclosures, 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 employees’ 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 imposed broadly rather than merely encouraged. The

146 Id. §§78j-1(m)(4)(B).
148 Id. at 18,798.  In light of the tremendous malfeasance by managers during the corporate scandals, this seems like somewhat of an understatement.
149 See id.
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
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. The penalty for noncompliance with Section 301 (and the corresponding listing rules) is delisting, which obviously can harm corporations and their shareholders significantly.

Although Sarbanes-Oxley mandated the implementation of the Structural Model, Congress did not mandate any specific requirements for the details of 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. The majority of commentators on the SEC rules 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. 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,


153 See Comments of Stanley Keller, Chair-Committee on Federal Regulation of Securities, Section of Business Law, American Bar Association (Feb. 25, 2003), available at http://www.sec.gov/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 See id.
multi-national corporations with thousands of employees in many different jurisdictions.\textsuperscript{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.\textsuperscript{157}

Sarbanes-Oxley thus responded to the failings of the pre-scandal Structural Model in two ways. First, the Act implemented 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 mandated 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-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 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. As important, this channel facilitates the movement of this information from the employees – the corporate players with the most information – to the traditional corporate monitors – the corporate players 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

\textsuperscript{156} See id.

employees to become whistleblowers and reduces several of the most significant disincentives to whistleblowing. By contrast, the Anti-retaliation Model provides little, if any, incentive to blow the whistle and addresses, somewhat poorly, only one disincentive to whistleblowing – the fear of retaliation.

Studies demonstrate that designating a uniform recipient of whistleblower complaints in an organization and directing employees to that recipient is associated with increased amounts of whistleblowing.158 Perhaps one reason for this increased whistleblowing is that employees become whistleblowers out of a sense of loyalty to their organization.159 Contrary to popular belief regarding the traitorous nature of such “snitches,” whistleblowers often are employees with long tenure who believe they 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 (albeit self-servingly) to being driven by their sense of loyalty to their organizations and appear truly disappointed that greedy corporate officers destroyed the organizations they admired.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.


159 As 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.


160 See, e.g., ALFORD, supra note 103, 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); Dworkin & Callahan, supra note 138, at 300-01.

161 See Lacayo & Ripley, supra note 63, 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”); Ripley, supra note 36, at 47-49 (describing Cooper’s reaction to discovery of WorldCom’s fraud); Jodie Morse & Amanda Bower, The Party Crasher, TIME, Dec. 30, 2002, at 53, 53 (Watkins’s reaction).
A disclosure channel harmonizes with the tendency of employee whistleblowers to report misconduct internally\(^\text{162}\) – a tendency that seems driven by the whistleblower’s sense of loyalty. Sherron Watkins reported her misgivings to Ken Lay, but not publicly 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 funds scandal, whereby an employee attempted to resolve a problem internally so that the company could fix it and remain viable.\(^\text{163}\) In fact, this type of structure 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 be willing to report internally if encouraged by the organization.\(^\text{164}\)

In addition to providing an incentive to whistleblowers 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 complaint rather than on the whistleblower. Studies demonstrate that the recipient of complaints plays a large role in determining both the outcome of that particular complaint and whether subsequent whistleblowers will feel free to come


\(^{164}\) Coffee, supra note 25, 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).
forward.\textsuperscript{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 will reduce the amount of retaliation felt by employees, and therefore encourage more whistleblowing.\textsuperscript{166} Further, this structure allows whistleblowers to avoid conflicted supervisors or high-ranking managers who are likely to feel defensive about wrongdoing occurring in their department.\textsuperscript{167} Additionally, because Sarbanes-Oxley permits employees to report wrongdoing anonymously or confidentially, employees’ fear of retaliation should be minimized.\textsuperscript{168} Thus, the Structural Model implemented by Sarbanes-Oxley reduces the significant deterrent of retaliation in a different, and perhaps more effective, manner than the Anti-retaliation Model.\textsuperscript{169}

Behavioral studies of whistleblowers demonstrate that a larger disincentive to whistleblowing than fear of retaliation is employees’ concern that nothing will be done in response to their complaints.\textsuperscript{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.\textsuperscript{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

\begin{footnotesize}
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\item \textsuperscript{165} See Miceli & Near, supra note 6, at 77.
\item \textsuperscript{166} See 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).
\item \textsuperscript{167} See Miceli & Near, supra note 6, at 184.
\item \textsuperscript{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 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.
\item \textsuperscript{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.
\item \textsuperscript{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 138, at 302, Hooks, et al., supra note 158, at 93.
\item \textsuperscript{171} See McLean & Elkind, supra note 3, at 139, 153-54, 187 (describing promotions and raises for Andrew Fastow, Ken Rice, and Ben Gilson at Enron).
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this disincentive, the Structural Model addresses it by requiring that disclosures go directly to the board of directors. This structure increases the odds of a positive corporate response to the information because the directors are corporate monitors with a fiduciary duty to address misconduct. Rather than simply providing information to a manager and hoping someone with actual authority receives it, the Structural Model guarantees that the appropriate corporate leaders will consider it.

Corporate and societal pressures to remain quiet are additional disincentives to whistleblowing. Corporations push employees into going along with illegal actions in order to be “loyal” to the organization. Furthermore, society discourages individuals from being “squealers” and betraying loyalties. Arguably, it simply may be human nature to conform to group norms and to gain acceptance from our peers. The broad employee silence during the corporate scandals is strong evidence of the existence of this behavioral norm.

Judges and other decision-makers may be hesitant to impose stiff criminal and civil sanctions upon managers who use retaliation to enforce this norm, thus making the norm especially “sticky” and difficult to overcome. 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 than “hard shoves” like the Anti-retaliation Model. In other words, the Structural Model provides a more moderate reform that is less likely to alienate the very people charged with encouraging whistleblowing. This more temperate approach may subtly alter corporate norms of secrecy and


\[173\] 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, THESTREET.COM, at http://www.thestreet.com/comment/detox/10187363.html (Oct. 15, 2004).

\[174\] See Estlund, supra note 9, at 123; Miethe & Rothschild, supra note 9, at 333-37.


\[176\] 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 presence of a social norm makes decisionmakers reluctant to carry out a law intended to change that norm”).

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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. Although enforcement of the use of the channel is limited, the mere existence of the channel may demonstrate to employees that reporting misconduct is appropriate and expected.

Sarbanes-Oxley may be specifically influential in this regard because it mandates that the board of directors receive whistleblower disclosures, a structure that signals the importance of this type of employee monitoring and reporting. As a result, the actual behavior of directors, managers, and employees may change because they have a more formal role in preventing corporate fraud. This requirement, in turn, may encourage these corporate officers to become more committed to the norm of open communication. 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

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178 See Sunstein, supra note 159, at 30 (arguing for 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 expressed anonymously” might encourage such a culture); Brett H. McDonnell, Sox Appeals, 2004 MICH. ST. L. REV. 505, 530 (2004) (asserting that “norms of good behavior can be as important a limit on managerial misbehavior” as other disciplinary mechanisms).


180 See Cass R. Sunstein, On the Expressive Function of Law, 144 U. PENN. 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 the Law, 2002 COLUM. BUS. L. REV. 71, 104 (2002) (“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”). Cf. Miceli & Near, supra note 6, at 144.

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 seems equally applicable to effect a more formalized structure for reporting misconduct may have on altering the social norm against whistleblowing that exists in many corporations. Cf. id.

183 See Kahan, supra note 176, at 635-36.
supervisors. 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.

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 like ostracism, or even employment sanctions. 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. Structural encouragements can become self-fulfilling as they are given legitimacy by legal and human resource professionals within the corporation. As Peter Kostant has argued, “[a] slight adjustment, or clarification of social meaning, can powerfully affect norms of behavior.”

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, particularly if specific whistleblowing procedures are in place. Such reporting procedures give whistleblowers more power by officially providing encouragement and protection to whistleblowers. Indeed, two of the most prominent social science researchers of whistleblowing behavior contend that the best approach for encouraging whistleblowing “would be to set up internal complaint procedures where concerned employees could report, and make sure that those procedures provide for speedy and impartial review.”

Thus, whistleblowing will increase if attitudes of significant corporate players and the corporation’s social norms encourage

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184 See id.
185 See Sunstein, supra note 180, at 2033 (discussing the development of “‘norm cascades’ as reputational incentives shift behavior in new directions”).
186 See id. at 2029-30.
187 See McCafferty, supra note 74.
189 See 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 103, at 474.
it. Indeed, it is commonly argued that, in order to encourage whistleblowers, corporations need to develop a more ethical and open corporate culture, implemented from the top of the organizational hierarchy. Yet, other than 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 of encouraging 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. Also, employees have a “cognitive conservatism” that makes it difficult to readjust one’s perspective to account for new information, 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. When combined with a bias for the status quo and a tendency to perceive information as normal rather than abnormal, employees face difficulties as corporate monitors. 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 rewards 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

194 See Miceli & Near, supra note 6, at 158-60; Miethe & Rotschild, supra note 9, at 326.
195 See Westin, Conclusion, supra note 54, at 143-49.
196 See Langevoort, supra note 181, at 86-87 (describing this tendency as “motivated inference”).
197 See id.
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).
quiet. When implemented along with anti-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, because the model provides a channel for employees to give information directly to the board of a corporation. An unimpeded avenue to the directors allows whistleblowers to bypass the information blocking and filtering by corporate executives and other managers. Moreover, because it is relatively unfiltered, the information from someone outside of the corporate governing circle may prompt directors to critically examine the information they receive from the corporate managers. The independent directors on the audit committee “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 these employees.201 One problem with the traditional monitoring system is that it relies upon enforcement of fiduciary duties for monitors through a liability system that makes it extremely difficult to prove breach of a fiduciary duty of care 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 requires action in order to fulfill their fiduciary duties. Most whistleblowing systems provide effective documentation of information passed from an employee to the responsible monitor. Indeed, after the corporate scandals, the Organizational Sentencing Guidelines were amended to require that the organization’s “governing authority,” (most likely the board of directors) must have knowledge about, and exercise

200 Kostant, supra note 69, at 556.
201 See Developments in the Law, supra note 71, at 2247 n.134.
reasonable oversight of, the compliance program. Part of this oversight must include receiving annual reports from individuals who are operationally responsible for the program. 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, they will do so at their own peril. At a minimum, a disclosure channel forces directors to 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 in that disclosures to directors are more likely to cause the corporation to address the misconduct of its executives and managers.

C. Secondary Benefits

The history of the Structural Model demonstrates that it must have some organizational acceptance in order 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. For organizational acceptance to occur, the benefits of this model to the corporation must outweigh its costs. Truly workable and effective disclosure systems are more likely to be implemented when the corporation can be convinced that encouraging whistleblowers is in its best interest. Fortunately, Sarbanes-Oxley’s Structural Model could provide significant benefits directly to the corporation.

1. Encouraging Internal Whistleblowing

An important benefit for corporations is that the Structural Model encourages internal whistleblowing. When an employee

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202 OSG, supra note 126, § 8B2.1(b)(2)(A) (2004); 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.
206 See DANIEL P. WESTMAN, WHISTLEBLOWING: THE LAW OF RETALIATORY DISCHARGE 171 (1991) ("Employees may be less likely to complain outside their organizations if they
reports wrongdoing internally rather than externally, corporations learn about mistaken employee views and perspectives before these mistaken views are made public, after which they are harder to correct. This early detection allows corporations to avoid costs related to the negative publicity and government intervention that follows external whistleblowing. It also gives corporations the opportunity to correct misconduct earlier and thereby save costs related to future litigation. Further, internal whistleblowing may attract whistleblowers who are loyal to the corporation and thus are motivated to improve the corporation— as compared to whistleblowers who report externally and may have more negative motivations. These whistleblowers also are less likely to experience retaliation when they report internally rather than externally.

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. However, Sarbanes-Oxley’s Structural Model should reduce this negative aspect of internal whistleblowing by directing whistleblower reports to corporate monitors with fiduciary duties to investigate and with significant exposure for failing to disclose any material misconduct they discover. Moreover, the Structural Model does not prohibit external whistleblowing—it simply facilitates internal whistleblowing in order to encourage a greater overall amount of whistleblowing.

believe that their companies have effective internal mechanisms for expressing dissent and achieving change.”; Dworkin & Callahan, supra note 138, at 300-02.


208 See Callahan, supra note 103, at 882, 904-06; Dworkin & Near, supra note 207, at 242.


210 See Dworkin & Callahan, supra note 138, at 302; Dworkin & Near, supra note 110, at 6.


212 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).
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.\textsuperscript{213} Boards of directors need to be open to different and dissenting points of view in order to improve the quality of their decision-making.\textsuperscript{214} 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.”\textsuperscript{215} In accordance with this viewpoint, James Fanto suggested improving the board of directors by appointing outside directors to play a “whistleblowing” function in order to combat pervasive “group think.”\textsuperscript{216} 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.\textsuperscript{217} Without dissent from individuals, groups tend to conform to more extreme positions – positions not held individually by most of the members of the group.\textsuperscript{218} 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 be mistaken.\textsuperscript{219} 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.\textsuperscript{220} Through a disclosure channel, whistleblowers can

\textsuperscript{213} See, e.g., Miceli & Near, supra note 6, at 228-29.
\textsuperscript{214} See Sunstein, supra note 159, at 2; O’Connor, supra note 23, at 1304-06; Westin, Conclusion, supra note 54, at 138-39.
\textsuperscript{215} Sunstein, supra note 159, at 2 (internal quotation not cited in original).
\textsuperscript{216} See Fanto, supra note 24, at 507-09.
\textsuperscript{217} 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.”).
\textsuperscript{218} See generally id. at 111-44 (discussing “group polarization”).
\textsuperscript{219} See id. at 66-73.
\textsuperscript{220} See id. at 118.
provide an important dissenting voice which may improve a corporation’s decision-making, particularly at the board level.

3. Reducing Monitoring Costs

Despite the benefits that whistleblowing can bring to corporations and to society, whistleblowing – like any monitoring mechanism – has 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. These costs, of course, will vary depending upon the complexity of the system, and may affect smaller companies more than larger corporations. Interestingly, though, when the SEC enacted rules implementing the structural changes of Section 301 of Sarbanes-Oxley, it did not receive any specific data in response to its request for information related to possible costs of such systems, perhaps signaling that the cost of such structures is not overwhelming for public companies.

In addition to the mechanical nuts and bolts of implementing a reporting system, opportunity costs must be considered. Executives and managers who are monitored by employees may forgo activity that is profitable and legal, but that may put them at risk of being reported. Shareholders may want these executives and managers to test or even to cross the boundaries of legality.

\[\text{221 See SEC Release, supra note 147, at 18,813 (noting that there will be “ongoing costs” in establishing procedures for handling complaints and in monitoring compliance with those procedures).}\]

\[\text{222 Cf. Matthias Schmidt, “Whistle Blowing” Regulation and Accounting Standards Enforcement in Germany and Europe – An Economic Perspective, Humboldt Univ. Bus. & Econ. Discussion Paper No. 29, available at http://ssrn.com/abstract=438840 (Aug. 2003), at 26 (noting that for internal whistleblowing rules to be effective, tremendous company resources may be required, such as continuous training for management and employees, implementing hotlines, and identifying ombudspersons).}\]

\[\text{223 See SEC Release, supra note 147, at 18,816.}\]

\[\text{224 See id. at 18,814.}\]

\[\text{225 Anecdotal evidence also supports the notion that companies may not find the cost of certain disclosure systems prohibitive, particularly when compared with the benefit of increased employee monitoring. See Judy Dahl, Whistle-Blower Program Lets Employees Speak Up, Credit Union Directors Newsletter (Dec. 2005) (describing whistleblower hotline implemented by Texas credit union, which the credit union’s internal auditor called a “bargain”) (on file with author).}\]

\[\text{226 See Ribstein, supra note 17, at 284; see also Miethe, supra note 49, at 87 (noting that over-surveillance of employees can lead to employees that are overly cautious).}\]
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. Yet, increasing the role of employees in corporate governance by encouraging monitoring and reporting may not dramatically increase the opportunity costs that the corporation already incurs through other monitoring. As 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.

While employees already are asked to monitor, organizations 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 comparison to the costs of other controls, it is noteworthy that the marginal opportunity costs of encouraging employees to report incidents of 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-

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227 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 W. N. Davidson & D. L. Worrell, The Impact of Announcements of Corporate Illegacies, 31 ACAD. MGMT. J. 195, 198 (1988)) (internal quotation marks omitted)).


229 Cf. Kraakman, supra note 19, at 75-87 (discussing costs of legal enforcement through third-party liability)
party. Having an employee engage in wrongdoing, and then subsequently exposing the wrongdoing as a company, can bring financial penalties to a corporation, litigation expenses, negative publicity, and increased scrutiny by regulators. This cost is not uniform among companies, and will be greater for those corporations that are engaging in fraudulent activities. Assuming most companies are not acting illegally, this overall cost may be insignificant for the vast majority of corporations.

Furthermore, these costs may seem higher to corporations than they are in reality, because managers often confuse their own personal costs with costs to the corporation. As Richard Painter notes, “Managers 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.” In short, corporations may actually receive benefits from getting caught earlier (because less wrongdoing occurs), but managers may underemphasize these benefits because getting caught gives managers significant legal exposure. This agency failure -- whereby managers “overemphasize costs and underemphasize benefits” of getting caught -- should make the Structural Model more attractive to shareholders to the extent it increases corporate compliance and facilitates earlier detection of corporate fraud.

An additional source of costs from a whistleblower system 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 to achieve an advantage in promotion.

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230 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”).

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

232 See Painter, supra note 230, at 224, 263.

233 See id. at 224.

234 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 27, at 295-96.

235 See Painter, supra note 230, at 263-64.

236 See id. at 264-65.

237 See MICELI & NEAR, supra note 6, at 7; Ribstein, supra note 17, at 286; Schmidt, supra note 222, at 21; Westin, Conclusion, 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
or salary by wrongly reporting a co-employee,\textsuperscript{238} or simply to hurt the employer in retaliation for some perceived slight.\textsuperscript{239} 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.\textsuperscript{240} 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.\textsuperscript{241}

Although incidents of malicious whistleblowing are rare,\textsuperscript{242} the Structural Model can serve to slightly reduce the costs of whistleblower errors in general by channeling whistleblower disclosures internally rather than externally. 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.\textsuperscript{243} This early response may keep a whistleblower from going public with flawed information, thus reducing the overall costs of defending against such charges. Moreover, even if the mistaken whistleblower makes a public accusation after an internal accusation, the company will have investigated the complaints and thus be able to explain publicly the reasons why those complaints were dismissed after the internal investigation.\textsuperscript{244}

With regard to workers that 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 intentionally retaliating against a whistleblower. Furthermore, if it is necessary, utilizing a whistleblowing structure will enable corporations to prevent retaliation against users of the system 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. 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. It is costly to create these additional systems, and further costs are imposed because the systems inefficiently restrict the normal sharing of corporate information. In a related manner, whistleblowing can undermine the organizational chain of command, which may reduce the efficiencies gained by having a clear corporate decision-making structure. In fact, any decrease in the authority of management imposes costs, as managers must spend additional time justifying themselves and their commands. 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.

245 See Callahan & Dworkin, supra note 5, at 333; Miethe & Rothschild, supra note 9, at 343.
246 See Blumberg, supra note 239, at 297.
247 See id.; Kraakman, supra note 19, at 60.
248 See JOHNSON, supra note 231, at 75.
249 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; approving of the company discharging him “to preserve administrative order in its own home”).
250 See Peter F. Drucker, What is “Business Ethics”? (on file with author).
Certainly an overly-rigorous surveillance program may lead to “risk-aversion, frustration and fears about being second-guessed.”\textsuperscript{251} Yet, the effect of increased encouragement of whistleblowing on a corporation’s culture is debatable. 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.\textsuperscript{252} As mentioned above, this research supports the opposite conclusion that whistleblowers typically are loyal employees dedicated to the organization’s goals.\textsuperscript{253} 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 reveal them to outsiders. Sarbanes-Oxley’s emphasis on internal whistleblowing also should 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.

\textbf{4. Increasing Employee Voice}

Whistleblower disclosure channels also benefit corporate employees by giving them greater voice through an additional avenue of participation in corporate governance.\textsuperscript{254} 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.\textsuperscript{255} Providing the employee more voice and participation in the

\textsuperscript{251} See Langevoort, \textit{supra} note 27, at 309.
\textsuperscript{252} See Dworkin & Callahan, \textit{supra} note 138, 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”) (footnotes omitted).
\textsuperscript{253} Id. at 303.
\textsuperscript{254} See Dworkin, \textit{supra} note 103, at 459; Estlund, \textit{supra} note 9, at 108 (“[E]mployee participation in workplace governance is increasingly viewed as both an intrinsic and an instrumental good.”).
workplace, such as through increased encouragement of whistleblowing, can lead to longer employee tenure and less turnover.256 Because work is where people get much of their “sense of community and self-worth,” increased involvement in corporate governance is valuable for employees.257 Stability is also enhanced by the increased morale and loyalty that occurs “when employees understand that they can stop wrongful conduct and contribute to shaping a working environment in which they can take pride.”258 Additionally, corporations benefit from a cooperative relationship with its employees; such a relationship increases corporate productivity by encouraging employees to develop firm-specific skills and increasing employee efficiency.259

Yet, this relationship between employees and employers needs structure to develop and to be fully realized,260 and providing structural encouragement for employee voice through whistleblowing is a good beginning. Incorporating employees as part of the corporate governance system is not as anomalous as it may sound. Suggestions have been made for decades to involve employees more in corporate governance.261 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 its “stakeholders” rather than only its “shareholders” recognizes employees as important players in the corporation.262 Although employee-designated

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257 See Estlund, supra note 9, at 108.
258 Callahan, et al., supra note 125, at 196; see also Miceli & Near, supra note 6, at 12.
259 See Estlund, supra note 9, at 109. 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-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.
260 See Estlund, supra note 9, 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.”).
directors are rare in the United States, some large employers initiate “employee participation programs,” in which employees are involved in cooperative efforts with corporate management. In fact, encouraging whistleblowing regarding financial crime may find more success than previous attempts to encourage employee voice regarding other corporate misconduct, because those previous attempts were adversarial at their core. Employee voice through unionization traditionally has been met with hostility by management because of a union’s perceived negative effect on profitability. Similarly, previous efforts to encourage whistleblowing regarding the health and safety of the public or its employees required the corporation to internalize costs it might rather externalize. For example, dumping toxic waste illegally might be cheaper for corporations than doing so in compliance with government regulations. Having a less safe work environment or underpaying employees for overtime might seem less expensive than complying with employee safety and wages legislation. With these types of activities, there is an inherent conflict of interest in asking corporations to encourage their employees to expose misconduct when corporations will lose money if the misconduct is exposed. Financial crime, however, less clearly benefits the corporation and its shareholders. Encouraging whistleblowing regarding financial crime, which by its nature adheres to the benefit of the 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

263 See Gordon, supra note 69, at 1243 (noting that an exception to this rule is employee-owned United Air Lines).

or auditing matters.\footnote{See Sarbanes-Oxley Act of 2002, § 301, 15 U.S.C. § 78j-1(m)(4)(B) (Supp. 2002).} This mandatory implementation is important and necessary, but is too limited in scope.

To be sure, government-mandated whistleblower regulation imposes upon corporate autonomy and an employer’s relationship with its employees. In fact, this burden traditionally has been justified only where a public good is being served by whistleblowers.\footnote{See, e.g., Johnson, supra note 231, at 75; Schwab, supra note 211, at 1945 (discussing protection of whistleblowers who report activities that have “third-party” effects).} In these cases, government protection is necessary because corporations likely will not reap the benefit of reporting conduct that harms the public, such as violations of environmental laws or improper use of government funds, and therefore has no incentive to encourage it.\footnote{See Schwab, supra note 211, 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 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”).} Consistent with this rationale, common law courts typically provide greater protections to whistleblowers who disclose information that affects a public, rather than a private, interest.\footnote{See Schwab, supra note 211, at 1970.} When only a private corporate interest is at stake, such as with fraud against shareholders or internal corporate theft, whistleblowers have not fared well on claims of wrongful discharge in violation of public policy.\footnote{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); Fox v. MCI Communications 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); Hayes v. Eateries, Inc., 905 P.2d 778, 788 (Okla. 1995) (refusing to protect employee who internally reported

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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.\textsuperscript{270}

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

This argument has some superficial appeal. Indeed, the work of the market in requiring whistleblower reforms already can be seen in the aftermath of the corporate scandals. Various investor and industry groups pressured corporations to utilize their employees to help detect fraud and other criminal activity. For example, in 2005 a group of institutional shareholders of Wal-Mart 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.\textsuperscript{271} 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.\textsuperscript{272} In response, the corporation publicized to its shareholders that it voluntarily instituted a “whistleblower system” for employees to raise concerns to an officer that reports directly to the CEO and the chairman of the

\textsuperscript{270} See Schwab, supra note 211, 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”).

\textsuperscript{271} See James Covert, Wal-Mart Urged to Review Controls, \textit{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”).

board.273 Other market forces may encourage whistleblowers to report matters externally if internal whistleblowers are not supported. A non-profit group called Wal-Mart Watch recently placed thousands of phone calls to Bentonville, Arkansas, where Wal-Mart is headquartered, attempting to encourage employees “who know of wrongdoing” inside the company to come forward with information.274 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.

However, these market forces often do not work effectively.275 Although the market has begun pressuring large corporations to encourage whistleblowers, several barriers exist that may prevent 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 so detection of misconduct is limited, or because penalties are set too low, or both), thus encouraging certain wrongdoing that is profitable.276 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 but do not incur costs from violations by subordinates.277 Moreover, even if directors and officers of a corporation believe that it would benefit from increased monitoring by its employees, it may face costs in that a corporation’s supervisors may resent increased monitoring and supervision. By mandating a structural whistleblowing approach, the law can relieve pressure on a corporation and lessen the extent

273 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. 12-13, 2005, at A4.
275 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.
276 See Langevoort, supra note 181, at 80.
277 See id.
to which supervisors may feel that their employer is imposing a whistleblowing system because it does not trust them.278

Furthermore, despite the private-public line that some courts attempt to draw,279 reducing illegal corporate fraud actually affects the larger public interest as well as the corporate private interest.280 Corporate fraud undermines the public’s confidence in the financial market and reduces the market’s transparency and security.281 Moreover, today’s modern corporations are the centers of economic universes and corporate fraud can harm entire communities – not only corporate shareholders.282 Given their large effect on the public interest, it may be that whistleblowers are actually more necessary in the private sector than in the public sphere. As 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

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278 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 130, at 520-21 (noting that the law can help “justify the implementation of initiatives lacking short-term economic pay-off, and legitimize the pursuit of ethical values of fairness and respectful treatment in the workplace”).

279 See Schwab, supra note 211, at 1949 (noting that the private/public distinction is often more conclusory than helpful).

280 See id. at 1970 (noting that “legislature presumably declared the act illegal in order to protect the public from wrongdoing”).

281 See 148 CONG. REC. S7352, S7360 (daily ed. July 25, 2002) (Sarbanes-Oxley Act of 2002 – Conference Report). 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 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.” See SEC Release, supra note 147, at 18,813.

282 Thousands of Enron employees lost their jobs and, as a group, Enron employees lost over $1 billion in retirement accounts containing a high proportion of Enron stock. See Kroger, supra note 26, at 58. Local businesses that relied on Enron and its employees were negatively affected. See Kate Murphy, Corporate Lepers, Local Heroes?, BUS. WK. ONLINE, available at http://www.businessweek.com/bwdaily/dnflash/jun2005/nf20050630_0279_db017.htm (June 30, 2005) (“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 239, 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).
government. In a corporation, however, a whistleblower may be more necessary because management may not be controllable by shareholders or a board of directors. 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. 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.

But, how much regulation should there be? Section 301 of Sarbanes-Oxley imposes a minimalist version of the Structural Model: it requires only that a public company’s audit committee establish procedures for receiving complaints, including confidential, anonymous concerns from employees, regarding accounting issues. 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. Others may determine that they want a more investigative function, and appoint ombudsmen or ethics officers with broad responsibilities and reporting obligations. In fact, behavioral research suggests that an organization’s structure greatly impacts the type of encouragement necessary to effectively encourage whistleblowing, such that a range of approaches may be successful. This diversity of options works well in an economy with a wide variety of workplaces. Flexibility encourages experimentation with a range of processes, and

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283 See Blumberg, *supra* note 239, at 306.
284 See id.
285 To the extent 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. Cf. 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.
ultimately will help develop various best practices for industries and companies.288

However, in order to realize the full potential of the Structural Model as a means of improving corporate governance, 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, it may be too easy for corporations to implement a system that looks acceptable on paper, but that is not functional or effective in reality. As demonstrated above, this problem contributed to the failure of the Model prior to the corporate scandals, and Sarbanes-Oxley does not fix the problem sufficiently.289

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 Structural Model may provide too much information, often 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.290

288 See Sturm, supra note 130, 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”).

289 See discussion supra Part III.B.

290 See, e.g., Bowman, supra note 144, at 675; Krawiec, supra note 142, at 491; Langevoort, supra note 181, at 107.
The effectiveness of a system is difficult for outsiders to judge, specifically courts, prosecutors, or other administrative agencies, because “the indicia of an effective compliance system are easily mimicked.”\(^{291}\) Given the difficulty of accurate and thorough outside evaluation, corporations may 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.\(^{292}\)

Sarbanes-Oxley’s Structural Model suffers from this same criticism in that it would be relatively easy for a corporation to implement a “disclosure channel” for whistleblower reporting, 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 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 can be utilized to improve Sarbanes-Oxley’s Structural Model, reduce the ability of corporations to cheat, and thus remedy this defect. As discussed in detail below, two such tools – 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 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 certain 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.\(^{293}\)

\(^{291}\) Krawiec, supra note 142, at 491-92; see also Langevoort, supra note 181, at 117-18.

\(^{292}\) Cf. Langevoort, supra note 181, at 107 (criticizing “values-based” programs as being “easy to mimic, making it difficult to separate out the sincere programs from the fakes”), 113-14; 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”).

\(^{293}\) See infra text accompanying notes 297-301.
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 results arising from disclosures made through the channel. As a further incentive to provide 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.294 These disclosures also could be posted internally, similarly to other federal employment law posting requirements,295 so that employees have direct knowledge of the procedures and results of employee whistleblowing.

Disclosure and transparency are important principles of limited government regulation of markets.296 Accordingly, Sarbanes-Oxley recognizes that other areas related to internal enforcement should be disclosed.297 Under Title IV of Sarbanes-Oxley, disclosures related to various financial and ethical obligations are required.298 For example, a corporation must disclose whether or not it has adopted a code of ethics for senior financial officers,299 as well as any change in or waiver of the code for these officers.300 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.301 As they relate to whistleblowers, however, these 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

296 Backer, supra note 228, 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).
would not detail the structure of a whistleblower disclosure channel. Furthermore, in practice these disclosures from management are little more than boilerplate attestations from executives.302

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.303 In other words, relatively specific information about the system could be disclosed. 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.304

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


303 See Comments of William F. Ezzell, CPA, Chairman, Board of Directors & Barry C. Melancon, CPA President and CEO, American Institute of Certified Public Accountants, February 18, 2003, available at http://www.sec.gov/rules/proposed/s70203/wfezzell1.htm (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.”).

304 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(16) (Supp. 2002); 17 C.F.R. § 240.16a-3; see also 17 C.F.R. § 229.406 (permitting posting of required corporate code of ethics to 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. See New York Stock Exchange Corporate Governance Rules, Section 303A, NYSE Listed Company Manual, § 10.
staggering.\textsuperscript{305} 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.\textsuperscript{306}

However, disclosure of the systems, and the subsequent certification of such disclosures by the audit committee, has many benefits. Such disclosure will reduce the temptation to implement systems that can function as mere window-dressing, an easy way to avoid truly encouraging whistleblowers. With more public disclosure, corporations (and signatory directors) will face financial and possible criminal exposure if the whistleblower system does not mirror its public description.

Certified public disclosures also would provide shareholders the opportunity to assess the effort corporations undertake to prevent fraud.\textsuperscript{307} Shareholders may prefer companies in which whistleblowing is encouraged through extensive whistleblower systems, because strong internal control systems may lead to less regulatory oversight\textsuperscript{308} as well as easier access to capital through more positive assessments from credit-rating agencies.\textsuperscript{309} In this way, disclosure can provide signaling benefits because it sends “a


\textsuperscript{306} See Comments of PricewaterhouseCoopers LLP, February 18, 2003, available at http://www.sec.gov/rules/proposed/s70203/pricewater1.htm (providing comments to 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.”).

\textsuperscript{307} See Schmidt, \textit{supra} note 222, at 26-29 (arguing that disclosure of compliance policies will put market pressure on corporations to institute whistleblower protections); cf. Ribstein, \textit{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.”).

\textsuperscript{308} See Painter, \textit{supra} note 230, 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, \textit{Living With Sarbanes-Oxley}, \textit{WALL ST. J.}, Oct. 17, 2005, at R1, R3 (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”).

\textsuperscript{309} Cf. Painter, \textit{supra} note 230, at 272 (“Most investors cannot themselves acquire, process, and verify all relevant information about issuers whose securities they purchase. The amount they would spend doing so would not be justified by the return. Investors thus rely, to a great extent, on ‘reputational intermediaries,” such as bond rating agencies, investment advisors, and investment banks to cost-effectively tap into the information market on their behalf.”).
positive message to shareholders and regulators about checks on management’s conduct.”310 To the extent shareholders value strong 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.311 Public information about weak internal controls, on the other hand, will inform shareholders about riskier investments with the greater potential for fraud.312

Moreover, disclosure of whistleblower procedures will encourage employees to report misconduct by giving them explicit instruction on the best means of making whistleblower complaints.313 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.314

In addition to disclosing information regarding the structure of the system, corporations could be required 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.).315 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

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310 Id. at 256. But see Comments of Charles M. Nathan, Committee on Securities Regulation of the Association of the Bar of the City of New York, February 18, 2003, available at http://www.sec.gov/rules/proposed/s70203/cmnathan1.htm (providing comments to SEC regarding its implementation of Section 301 of Sarbanes-Oxley) (“The Committee also recommends that listed companies be allowed to choose whether or not they disclose their procedures for handling complaints as such procedures are not in the ordinary course of interest to investors or shareholders.”).

311 See Coffee, supra note 25, at 1277-78.

312 Cf. 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.”).


315 Cf. Callahan, et al., supra note 125, at 210 (proposing that ombudsmen prepare summaries of complaints received, the investigation, and any actions taken).
restricted period after they disclose information. Some organizations already use these types of metrics to evaluate their internal compliance systems. For example, Intel measures the utilization rate of their 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. Analogously, under the NO FEAR Act, federal agencies disclose statistics regarding the number and type of discrimination complaints each agency received from its employees, including the results of those complaints.

Publication of specific results from a whistleblower disclosure system is important for several reasons. First, disclosing specific results will avoid a “lemons” 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. Companies, in other words, will be put to their proof regarding the results from their system, and 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.

Second, these public explanations from corporations will assist in developing “best practices” and promote experimentation, while also providing courts and regulators a

316 Auditors already are protected through a similar mechanism in which corporations must report the discharge of an outside accountant. See Schedule 8-K.
317 One recent survey found that 75% of U.S. public companies tracked whether their ethical codes were followed. See Neil Baker, All Done With Mirrors? Transparency and Business Ethics, INTERN’L BAR NEWS, at 5 (Aug. 2005).
318 See Sturm, supra note 130, at 559 (describing Intel’s assessment techniques).
321 Cf. Sturm, supra note 130, 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”).
viable means of judging the effectiveness of a corporation’s own system.\textsuperscript{322}

Third, publishing results from whistleblowing systems will provide employees 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.\textsuperscript{323} Requiring companies to disclose the results of whistleblower disclosures will address this concern, because it will demonstrate that violators of ethical and legal norms will be held accountable.\textsuperscript{324} Moreover, in his work on “self-regulatory” approaches to promoting employee policy compliance, 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.\textsuperscript{325} 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 revealed that the Office of Special Counsel 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 protect the whistleblower’s job.\textsuperscript{326} Only four whistleblowers (out of more than two thousand appeals) won on the merits after they appealed to the Merit Systems Protection Board.\textsuperscript{327} These statistics served as partial impetus for the passage of the Whistleblower Protection Act of 1989, which

\textsuperscript{322} 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 Comments of Cleary, Gottlieb, Steen & Hamilton, February 18, 2003, available at http://www.sec.gov/rules/proposed/s70203/clearygot1.htm (providing comments to SEC regarding its implementation of Section 301 of Sarbanes-Oxley) (“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.”).

\textsuperscript{323} See supra text accompanying notes 170-72.

\textsuperscript{324} See Trevino, supra note 25, at 1200.


\textsuperscript{326} See Devine, supra note 140, at 534.

\textsuperscript{327} See id. at 534.
addressed some of the perceived problems with the CSRA’s whistleblower system.\textsuperscript{328}

Perhaps understandably, corporations may resist disclosing these results. Mandatory disclosure requires the corporation to reveal potentially embarrassing information publicly and may place employers at the mercy of disgruntled employees. Further, 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.\textsuperscript{329} Yet, such disclosure is not markedly different than requiring disclosure of earnings and revenue numbers that embarrass the corporation. Both types of disclosures aim to present a clearer picture of the corporation to the investing public. Moreover, as with financial numbers, there will 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 and various court decisions to implement internal compliance systems. However, as discussed above, the usefulness of these incentives to create effective systems is questionable because the incentives do not necessarily prevent cheating.\textsuperscript{330} Another form of incentive may better encourage corporations to install and to enforce effective systems that encourage employee whistleblowers to come forward.

Corporations could be provided a safe harbor for installing systems that met standards for effectiveness promulgated by the SEC or another administrative agency. Such standards could include specific requirements, such as providing for an independent review of whistleblower claims and intensive training of managers. This safe harbor could be granted through a pre-approval process in which an administrative agency, such as the SEC, or a certified third-party, such as a truly independent auditor, could rigorously investigate and evaluate systems for effectiveness. This pre-approval process avoids the tricky

\begin{itemize}
\item \textsuperscript{328} See id. at 536 & 536 n.22; Dworkin & Callahan, supra note 138, at 282-83.
\item \textsuperscript{329} Cf. Coffee, supra note 25, at 1251-65 (noting that disclosure can raise a corporation’s “embarrassment cost” to a “prohibitively high level” that may actually restrict information flow).
\item \textsuperscript{330} See discussion supra Part III.B.
\end{itemize}
The benefit for the corporation would be that, in criminal and civil litigation where proof of an effective whistleblower system is meaningful, the safe harbor could provide a rebuttable presumption that the system was effective. The mechanism to implement this safe harbor would vary depending on the context. To apply to criminal sentencing, the OSG would need to be amended. To apply to discrimination cases or with regard to punitive damages, specific legislation may need to be passed to recognize such a safe harbor. Yet, even without such legislation, courts may accept such certification as the industry standard when evaluating internal control systems, thereby serving the same function as a mandatory safe harbor provision.

Corporations 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. However, my 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 guess work out of complying with incentives-based programs, such as the Organizational Sentencing Guidelines, and also ensure that corporations spent an appropriate amount of resources on the system.

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332 Admittedly, given that the Guidelines recently were amended in 2004 and the current uncertainty about their application, see U.S. v. Booker, 125 S. Ct. 738, 751 (2005) (finding that the Guidelines violate the Sixth Amendment), any proposal to amend the Guidelines along these lines may have difficulty gaining sufficient support.

333 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 sound compliance program).

334 Cf. Jennifer Arlen, The Potentially Perverse Effects of Corporate Criminal Liability, 23 J. LEGAL STUD. 833, 843 (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).
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.335 Indeed, a common occurrence after the introduction of a hotline or other disclosure channel is for employee complaints to increase.336 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 of Sarbanes-Oxley. Evidence is mounting that directors are becoming overly burdened by the requirements of Sarbanes-Oxley in general, and thus corporations may need to compensate directors more generously in order to find qualified and independent individuals to serve.337 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 could 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, it would be important that the recipient of the whistleblower disclosures 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, whether a third-party or an internal ombudsmen, would provide the audit committee with a valuable service. At the same time, however, the audit committee would retain the independent control and review that is crucial to avoid managerial blocking and filtering of disclosures.

Finally, the SEC could permit the audit committee to be shielded from disclosures regarding de minimis, or nonmaterial, offenses. This limitation ensures that directors preserve oversight over the most important information, but are not overly burdened

335 Cf. Sturm, supra note 130, at 502 (describing internal grievance system at Intel, which includes an employee call center that fields hundreds of thousands of calls).
336 See, e.g., id. at 508 (noting that after the adoption of an internal grievance system at Intel, “the number of employee complaints increased substantially”).
337 See James S. Linck, et al., Effects and Unintended Consequences of the Sarbanes-Oxley Act on Corporate Boards (August 31, 2005), at http://ssrn.com/abstract=687496, at 4 (noting that small public firms are disproportionally impacted by these higher costs).
with insignificant complaints. The limits placed on such disclosures could include only providing information to the audit committee that, if true, would necessitate public disclosure in order to comply with 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, yet again, give discretion to a non-director to screen and filter whistleblower disclosures, the danger is minimized because independent directors ultimately would still be responsible for the system. 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. Yet, given the vague mandate from Sarbanes-Oxley, these corporations may install a more expensive system in order to comply with the statute’s requirement. Such a system may be more comprehensive, but may not provide any marginal benefit to either 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 Sarbanes-Oxley’s requirement that these same directors have oversight of and responsibility for a whistleblower disclosure system.

VI. CONCLUSION

The corporate scandals demonstrated that, despite the efforts of a few employee whistleblowers, many corporate employees failed to monitor their corporation’s behavior sufficiently and 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 become corporate monitors and 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. As important, the model should 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.

Yet, this better model has limitations that can be ameliorated. The vagueness of Sarbanes-Oxley’s requirements has the potential to both under- and over-produce whistleblower complaints. As with 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 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 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, which will overwhelm directors who already are under increasing pressure from Sarbanes-Oxley’s other regulatory requirements. The SEC could explicitly permit directors to outsource their oversight of the whistleblower disclosure channel, as long as the responsibility for the channel remains with the directors. Promulgating specific, approved restrictions and options may 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 will benefit society by reducing corporate misconduct, but also will improve corporate decision-making by increasing employee voice within the corporation.