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SOX and Whistleblowing

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Richard Moberly (University of Nebraska)

Whistleblowers famously helped publicize the corporate scandals that gave rise to Sarbanes-Oxley: think Sherron Watkins at Enron and Cynthia Cooper at WorldCom—two of Time Magazine’s “Persons of the Year” for 2002. Given the importance of these employee disclosures, Congress considered it necessary to break the “corporate code of silence” that discouraged potential whistleblowers from coming forward. Indeed, SOX utilizes a unique holistic approach aimed at encouraging employees to disclose information about corporate wrongdoing.

First, and most prominently, Congress created an anti-retaliation provision to protect whistleblowers in publicly-traded companies from adverse employment actions (§ 806). Second, the Act requires that corporations create a whistleblower disclosure “hotline” for employees to report misconduct anonymously to the audit committee of the corporate board of directors (§ 301). Third, SOX contains criminal penalties for retaliating against employees who “blow the whistle” to law enforcement authorities about violations of federal law (§ 1107). Finally, SOX also requires corporate attorneys to report corporate fraud “up the ladder” to the officers and directors of the corporation (§ 307), and the Act’s regulations permit attorneys to report continuing fraud to the SEC (17 C.F.R. § 205.3(d)(2)).

At a minimum, SOX represents a positive effort to encourage employees to become valuable corporate monitors because the Act reduced two of the primary reasons employees do not report misconduct: fear of retaliation and concern that nothing will change even if they complain.

· *Fear of Retaliation.* Prior to the Act, employees were rightfully fearful of retaliation for blowing the whistle: private employees were protected from retaliation only sporadically, if at all, because state whistleblower laws were inconsistent and no federal law broadly protected corporate employees. SOX’s civil remedies and criminal penalties against retaliators potentially serve as a substantial deterrence to retaliation against whistleblowers, which should reduce employees’ fears of retaliation.

· *Concern That Nothing Will Change.* Studies consistently demonstrate that employees do not disclose wrongdoing because they do not believe anything will be done about their report. The disclosure hotline could address this concern because whistleblower disclosures will go directly to the people who have the ability and the legal incentive to correct disclosed illegalities: the Board’s audit committee. These hotlines will bypass the corporate managers who consistently blocked and filtered whistleblower disclosures during the corporate scandals. (I write about SOX’s disclosure channel requirement in a recently published [article](#) in the *BYU Law Review*.)

Tomorrow the post will address whether these changes have actually reduced the amount of corporate fraud.

