Just Pucker and Blow?: An Analysis of Corporate Whistleblowers, the Duty of Care, the Duty of Loyalty, and the Sarbanes-Oxley Act

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"You know how to whistle, don't you, Steve? You just put your lips together—and blow."¹

INTRODUCTION

In the past year, we have seen a number of corporate scandals involving major business entities such as Enron, Adelphia, Worldcom, Arthur Andersen, Tyco, and Martha Stewart. The New York Daily News described this bad behavior by corporate executives in a caption entitled “These Little Piggies Went to Market.”² Newsweek magazine in a headline called these executives the “Bad Boys Club.”³ Well-known financial journalist Lou Dobbs called the bad boy executives “CEO Hogs.”⁴ In addition, we have seen scenes of the Adelphia senior executives being carted off to jail in handcuffs like common criminals doing the so-called “perp walk.”⁵ This corrupt conduct has involved various instances of fraud, ranging from using generally unacceptable accounting principles (like using

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³ Allan Sloan, Bad Boys Club, NEWSWEEK, July 1, 2002, at 44.


partnerships to hide corporate losses and treating ordinary expenses as capital expenses to increase corporate profits), to providing exorbitant loans to senior executives.\textsuperscript{6} Insider trading also has been alleged.\textsuperscript{7} These scandals have led investors to be fearful of investing in the stock market. They also have caused major corporations difficulty in attracting CEOs,\textsuperscript{8} as well as prompted soul searching over the direction of our capitalist system,\textsuperscript{9} the decision to become a corporate executive,\textsuperscript{10} and whether the United States has a two-tiered moral system—one for bosses and one for the rest.\textsuperscript{11}

In the midst of this new anti-corporate environment, corporate whistleblowers recently have received a lot of favorable press. For instance, Sherron Watkins has been described as the whistleblower who exposed the Enron fraud, although even she admits that she was not the first person at Enron to complain about its shady accounting practices.\textsuperscript{12} In many respects, Ms. Watkins was the prototypical, yet atypical, corporate whistleblower. This Article will examine the fiduciary obligations of corporate insiders who want to blow the whistle. It will compare the executives' contemporaneous (and often

\textsuperscript{7} See, e.g., Marc Peyser, The Insiders, NEWSWEEK, July 1, 2002, at 38.
\textsuperscript{9} See Eichenwald, supra note 6.
\textsuperscript{10} See Tim Race, New Economy, N.Y. TIMES, July 1, 2002, at C1 (subtitled “Ashamed to be an Executive”).
\textsuperscript{11} Barbara Ehrenreich, Two-Tiered Morality, N.Y. TIMES, June 30, 2002, S4, at 15.
\textsuperscript{12} Anonymous letter from Sherron Watkins to Kenneth Lay (Aug. 20, 2001), available at http://news.findlaw.com/legalnews/lit/enron/index.html (last visited Oct. 31, 2002) [hereinafter Watkins Letter] (noting that Treasurer Jeff McMahon, being “highly vexed” over the accounting practices, laid out five steps to be taken to remain as treasurer, but was transferred to be CEO of a related company). In addition, Ms. Watkins reported that she heard one Enron manager say, “I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company.” Id. Vice-President Cliff Baxter also complained about the inappropriateness of the Enron transactions with its affiliated partnerships. See id.; see also Paul Duggan, Note May Explain Death of Ex-Enron Executive, WASH. POST, Jan. 27, 2002, at A9 (noting that although many speculated that Baxter's death prior to his testimony before the Congress was the result of foul play, an autopsy indicated that his death was indeed the result of suicide); Eric Hanson & Armando Villafranca, Baxter's Suicide Note Cites Emotional Burden, HOUST. CHRON., Apr. 12, 2002, at A1 (noting Sherron Watkins referenced Baxter's complaints in her August memo to Enron CEO Ken Lay).
AN ANALYSIS OF WHISTLEBLOWING

conflicting) duties of care and loyalty. It will show how the Sarbanes-Oxley Act of 2002 (the “Act”) attempts to address these issues by providing some protection against retaliation. Finally, this Article will highlight the various considerations that the Act failed to address, but that the Securities and Exchange Commission (SEC) should take into account when promulgating its rules of implementation.

I. THE ULTIMATE WHISTLEBLOWER, SHERRON WATKINS

Ms. Watkins was a Vice-President at Enron Corp. She earned a master’s degree in professional accounting from the University of Texas at Austin. In 1982, she began her career as an auditor with the accounting firm Arthur Andersen, spending eight years at its Houston and New York offices. In 1983, she became a certified public accountant. Enron Vice-President Andrew Fastow hired Ms. Watkins to manage Enron’s partnership with the California Public Employee Retirement System. From June to August 2001, Ms. Watkins worked directly for Mr. Fastow. During this time, Ms. Watkins learned that Enron was engaging in accounting improprieties with certain affiliated entities. She believed that Enron was using its own stock to generate gains and losses on its income statement. Ms. Watkins testified before the House Subcommittee on Oversight and Investigations that she failed to receive satisfactory explanations regarding these accounting transactions from Enron executives. Ms. Watkins admitted that she was troubled by the accounting practices but was

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14 Id.
15 Id.
16 Id. Ms. Watkins held that position until 1996. From 1997 to 2000, Ms. Watkins worked for Enron International and worked on mergers and acquisitions. She was later transferred to Enron Broadband Services. Id.
17 Id.
18 Id. (noting that some Enron assets were hedged against the Raptor entity owned by LJM partnership, which was run by Mr. Fastow. Unlike other hedged assets, the Raptor hedged assets did not have a locked-in sale price). Id.
19 Id.
20 See id.
uncomfortable reporting them to either Mr. Fastow or former Enron President Jeff Skilling, fearing termination if she approached them directly. On August 15, 2001, Ms. Watkins sent to Kenneth Lay, the CEO of Enron, a seven-page anonymous letter. In the letter, Ms. Watkins asked, "Has Enron become a risky place to work?" She also more specifically described the accounting improprieties and stated that "to the layman on the street [it will look like] we are hiding losses in a related company and will compensate that company with Enron stock in the future." She shared her prescient fears that Enron might "implode in a wave of accounting scandals." On August 22, 2001, Ms. Watkins met with Mr. Lay and outlined her concerns about the accounting improprieties, and requested a transfer from working for Mr. Fastow. In late August she was reassigned to the human resources group. Ms. Watkins reported that Mr. Lay assured her that he would investigate the irregularities. Ms. Watkins never reported her concerns to the SEC, the Department of Treasury, or any other governmental official.

Upon Ms. Watkins's disclosure, Mr. Lay passed Ms. Watkins's letter to Enron's general counsel, James V. Derrick, who hired Enron's attorneys, Vinson & Elkins, to investigate, even though the law firm was involved in some of the transactions that Ms. Watkins criticized. The Vinson & Elkins

21 Id.
22 Id.
24 Id.
25 Id. (noting that Enron had reported gains of $550 million of fair value on stocks via swaps with Raptor, but much of the stock declined in value so that Enron would have to offset the losses).
26 Id.
27 Ms. Watkins reported that she first met with Cindy Olson on August 16 and showed her a copy of the previously anonymous letter. See Watkins Testimony, supra note 13.
28 Id. W. Carl Jordan of Vinson & Elkins advised Enron to agree to her transfer to a position of comparable responsibility and to document the move in a memorandum. See Enron Got Legal Advice on How to Handle Dissidents, ST. LOUIS POST DISPATCH, Feb. 18, 2002, at A2. He also suggested that Enron designate a company officer for her to contact in the event that Ms. Watkins believed that she was being retaliated against. E-mail from Carl Jordan to Sharon Butcher (Enron), Confidential Employee Matter (Aug. 24, 2001).
29 Watkins Testimony, supra note 13.
30 Id. at 20.
31 Kurt Eichenwald, Another Inquiry: Company Hobbled Investigation by Its
report indicates that Mr. Derrick acknowledged the "downside of hiring Vinson & Elkins because it had been involved." Mr. Derrick concluded that that the decision to hire Vinson & Elkins was permissible because the investigation was to be a "preliminary one." Vinson & Elkins (along with Arthur Andersen) investigated Ms. Watkins's allegations, but used no independent accountant. This investigation reported only limited cosmetic problems and no illegal activities. Vinson & Elkins' investigation, however, "was largely predetermined by the scope and nature of the investigation and the process employed."


32 Id.
33 Id.
34 Andersen may have also gotten into trouble because it allowed regional partners to overrule auditing experts, known as the Professional Standards Group (PSG). Andersen e-mails and memos show that Andersen's PSG vigorously objected to Enron's accounting practices, but they were overruled by regional Andersen partners who falsely wrote memos that the PSG approved of the transactions. Mike McNamee, Out of Control: Internal Memos Detail How the Firm's Unusually Lax Controls Allowed Its Enron Team to Call the Shots, BUS. WK., Apr. 8, 2002, at 32. A former Andersen employee said that local control over accounting issues was a selling point, and the effect was insidious because the "rainmakers were given the power to overrule the accounting nerds." Id. at 33.


36 Eichenwald, supra note 31. Some of the problems with Vinson & Elkins' review might be due to the restrictions that Enron placed on Vinson & Elkins' investigation. The law firm was told not to review the underlying accounting issues, which went to the heart of Ms. Watkins's allegations. Id. Enron, however, was Vinson & Elkins' single largest accounting client and comprised seven percent of Vinson & Elkins' total revenue. Mike France et al., One Big Client, One Big Hassle: Vinson & Elkins' Heavy Reliance on Enron is Now a Potential Liability for the Law Firm, BUS. WK., Jan. 28, 2002, at 39. In addition, according to one undisclosed Enron employee, "[Enron] might not have been able to pull off many of the transactions...without Vinson & Elkins' opinion letters." Id.
In October 2001, before Enron announced a huge third quarter loss, Arthur Andersen auditors, in a memo, warned Enron officials that its public explanation for the loss "was potentially misleading and illegal." On October 16, 2001, Enron announced a $618 million third quarter loss. Two weeks later, the SEC announced that it was investigating Enron. In early November, Enron announced that, since 1997, it had overstated its earnings by $586 million. On December 2, 2001, Enron filed for bankruptcy. On January 23, 2002, Ken Lay resigned as CEO of Enron, stating "we need someone at the helm who can focus 100 percent of his efforts on reorganizing the company."

II. AN ANALYSIS OF SHERRON WATKINS' ACTIONS

Ms. Watkins is the prototypical whistleblower because she had knowledge of damaging information and she disclosed it to her supervisor's supervisor. At the same time, she is very atypical for several reasons. First, as an accountant, she had the expertise to know that her corporation was possibly breaking the law and defrauding the public. Second, her disclosure in and of itself to the president of the corporation did not lead to the type of investigation that was necessary to stop any wrongdoing. Her actions did not cause the immediate collapse of the Enron financial giant. Third, even though she "ratted" out her boss and may have engaged in insider trading herself, her disclosure did

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37 Robert Schlesinger, Enron Chief Executive Lay Resigns Anderson Memo Says Firm Was Warned in October (sic), BOST. GLOBE, Jan. 24, 2002, at A2 (noting then-Andersen partner David Duncan wrote the warning memo). Arthur Andersen later fired Mr. Duncan because of his alleged role in destroying documents related to Enron. Id.
38 Id.
39 Id.
40 Id.
41 Id.
42 Id. (Lay stated that his decision was "reached in cooperation" with Enron's creditors committee and that he would remain a member of Enron's board of directors). Id.
43 In her testimony before the House of Representatives, Ms. Watkins acknowledged that she traded about $47,000 in Enron stock about the time that she was blowing her whistle. She claimed that she was selling the stock because she routinely diversified, and that the transactions in October 2001 were a "kneejerk reaction" to September 11th. The Financial Collapse of Enron: Hearing Before the House Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 107th Cong. (2002) (testimony of Sherron Watkins, Vice-President
not compromise her job security. In fact, Ms. Watkins has received a lot of positive press from her actions. Many have called Ms. Watkins a hero and courageous. Ms. Watkins was even named *Time* magazine's "Person of the Week." Washington Post reporter Paul Farhi noted that women like Sherron Watkins often are perceived to be insiders with "outsider values" and are more likely to blow the whistle than their male counterparts. A movie deal also is reportedly in the works that will paint Ms. Watkins as a "feminist icon," like Erin Brockovich. After her disclosure, Ms. Watkins testified that Cindy Olson told her that Mr. Fastow wanted to terminate her employment and have her computer seized. Instead, she was moved to a different position and was advised to download all pertinent data from her computer. She thus retained a job and became a symbol for corporate whistleblowers. In fact, since the collapse of Enron, the number of e-mailed complaints received by

of Corporate Development, Enron Corp.). For insider trading liability, an insider like Ms. Watkins must either refrain from trading or disclose any non-public information, neither of which she did.

44 Katie Fairbank, *You Know How to Whistle, Don't You?*, DALLAS MORN. NEWS, Feb. 27, 2002, at 1A; *Lauded by Lawmakers, Enron Whistle-Blower Escapes the Worst*, AGENCE FRANCE PRESSE, Feb. 15, 2002 [hereinafter *Lauded by Lawmakers*]. But see Julie Mason, *The Fall of Enron; Watkins' Own Ethics Questioned*, HOUS. CHRON., Feb. 15, 2002, at 21 (noting that Watkins, as a Certified Public Accountant, may have been obligated to report her concerns to state regulators or to the Securities and Exchange Commission). But see Curtis C. Verschoor, Ethics of Enron "Whistle-Blower" Questioned, 83 STRATEGIC FINANCE (May 1, 2002) (noting that since Ms. Watkins was not involved in the Andersen extrinsic audit, she was not subject to SEC Rule 10A requiring CPA reporting to the board of directors and the SEC of illegal client acts).

45 See generally Fairbank, supra note 44; *Lauded by Lawmakers*, supra note 44.

46 Frank Pellegrini, *Person of the Week: "Enron Whistleblower" Sherron Watkins*, Time.com (Jan. 18, 2002), available at http://www.time.com/time/pow/printout/0,8816,194927,00.html (noting she was not technically a whistleblower since she should have blown the whistle by writing to the Houston Chronicle long before August). The Article suggests that maybe her memo was a "cover your ass" memo. See also Dan Ackman, *Sherron Watkins Had Whistle, But Blew It*, Forbes.com (Feb. 14, 2002), available at http://www.forbes.com/2002/02/14/0214watkins.html (asserting that Ms. Watkins' actions actually provided cover for Lay and the Enron board because her warning allowed Lay to assert that he had no prior knowledge and needed to be warned).

47 Paul Farhi, *A Whistle That Can Pierce the Glass Ceiling*, WASH. POST, July 6, 2002, at C1 (noting that the most recent whistleblowers have been women, including Cynthia Cooper, the internal auditor at WorldCom, Coleen Rowley, the FBI lawyer who detailed mistakes in the September 11th investigation, and Sherron Watkins).

48 See Ackman, supra note 46.
the SEC increased from an average of 325 per day in 2001 to 763 e-mails received on February 5, 2002.\footnote{See Fairbank, supra note 44.}

So whistleblowing now is viewed more favorably than it had been historically. At least, in the popular press, the whistleblower is portrayed as heroic. In Sophocles’s Antigone, a messenger tells Creon that someone has given proper funeral rites to Polynoeices’ body and remarks “no[one] delights in the bearer of bad news.”\footnote{SOPHOCLES, ANTIGONE, available at http://classics.mit.edu/Sophocles/antigone.pl.txt (last visited Oct. 21, 2002).} As evidenced by this ancient Greek play, society has often blamed and disliked the bearer of bad news. Even in our more recent American history, whistleblowers have often been portrayed as liars,\footnote{Some thought that John Dean, who testified against former President Richard Nixon in the Watergate hearings, was initially lying, until the Watergate tapes were released. See Len Colodny, Hidden History: The Day Nixon Lost His Presidency, The Nixon Era Times, available at http://www.watergate.com/stories/watergate.asp (last visited Oct. 16, 2002) (“[T]he truth [was] never something that Dean ever [let] get in the way of his version of events.”).} sometimes vile or untrustworthy,\footnote{Many Americans had a very low opinion of Linda Tripp, who taped the telephone conversations of her friend Monica Lewinsky, which were used in the impeachment proceedings against former President Bill Clinton. See Keating Holland, Poll: Most Americans Hold Unfavorable Views Of Tripp, Lewinsky, available at http://www.cnn.com/ALLPOLITICS/1998/07/02/poll (July 2, 1998) (finding 52% of Americans have an unfavorable opinion of Tripp).} and sometimes, even racist.\footnote{Recently Eunice Stone reported that she overheard three American Muslim medical students making threats of terrorist acts in South Florida on September 13th at a Shoney’s restaurant in Georgia. She followed the students into the parking lot and reported their license plates to the authorities. A region-wide terror alert was announced, and the three men were apprehended and detained for over seventeen hours. They were released when the authorities found no incriminating evidence. After this incident, people question whether the students were playing a hoax or whether Ms. Stone might have been stereotyping them because of their swarthy appearance. See generally Clarence Page, Editorial, Muslim Students Victims of Paranoia, GRAND RAPIDS PRESS, Sept. 24, 2002, at A9; Robert Steinback, Who, If Anybody, Erred in Alligator Alley Terror Scare, MIAMI HER., Sept. 21, 2002, at 1.} Ms. Watkins is very lucky; the press and the business community probably were looking for at least one person that they could call a hero in this whole sordid affair, and she came closest to being one. Despite the recent positive press for Ms. Watkins, whistleblowing is fraught with dangers and risks. Whistleblowing sits at the vortex of a corporate officer’s fiduciary duties of care and loyalty.
The whistleblower may be damned if she does "just pucker and blow," and damned if she does not.

III. OFFICERS AND OTHER SENIOR MANAGERS

Corporations specify the number and types of officers in their bylaws. The board of directors appoints the officers. The officers select the senior managers. Both corporate officers and senior managers can be removed from their positions at any time. An officer in performing her duties shall act in good faith, with the care that a person in a like position would reasonably exercise under similar circumstances, and in a manner that the officer reasonably believes will be in the best interests of the corporation. Non-officer senior managers are agents of the corporation and, as such, are governed by the law of agency. As agents, these senior managers also have fiduciary duties to the corporation.

A. The Duty of Loyalty

Corporate officers and senior executives have a duty of loyalty to the corporation. They must act in good faith and in a manner that they reasonably believe will be in the best interests of the corporation, including safeguarding corporate information. Many times, these duties are buttressed by corporate requirements that these individuals sign confidentiality agreements. In Coady v. Harpo, Inc., Elizabeth Coady, a former senior associate producer of The Oprah Winfrey Show, signed an agreement entitled "Business Ethics, Objectivity, and Confidentiality Policy." The agreement required Ms. Coady to keep confidential, during her employment and thereafter, all information about Ms. Winfrey and her

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58 Id.
61 Id. at 246.
production company. The Court found that the agreement was enforceable.\(^6^2\) In addition, a corporation may require senior executives to sign agreements granting to the corporation all ownership of their work product. These agreements strengthen the executive’s fiduciary obligations to the corporation and specifically make the executive liable for conversion of property.\(^6^3\) They clarify what property the corporation owns. If the senior executive uses any property of the corporation, without authority, she is liable to the corporation irrespective of whether the property was used in competition against the principal.\(^6^4\) Providing confidential information to law enforcement authorities might constitute conversion. More specifically, New York makes it illegal to duplicate computer-stored information regardless of whether the information is available elsewhere.\(^6^5\)

The confidentiality and assignment of property rights agreements often give the corporation protections above and beyond the basic common law or statutory fiduciary duties. In addition, these agreements may be tied into the agent’s duty to obey the principal. “In every contract of service it is implied that the employee shall obey the lawful orders of the master . . . .”\(^6^6\) The rationales for these kinds of confidentiality agreements and for imposing the duty of loyalty and obedience on senior executives are twofold. First, the duty is designed to protect the employer from economic exploitation by the employee. For example, in *Wexler v. Greenberg*,\(^6^7\) the court stated that “[s]ociety as a whole greatly benefits from technological improvements. Without some means of post-employment protection to assure that valuable developments or improvements are exclusively those of the employer, the businessman could not afford to subsidize research or improve current methods.”\(^6^8\) Second, the duty of loyalty is enmeshed in notions of morality and is

\(^6^2\) *Id.* at 251.

\(^6^3\) *Restatement of Agency* § 402 (1958).


\(^6^5\) *N.Y. Penal Law* § 156.30 (Consol. 2000).


\(^6^7\) 160 A.2d 430 (Pa. 1960) (involving the chemist of a soap manufacturer who stole a trade secret).

\(^6^8\) *Id.* at 434–35.
designed to protect employers who may be vulnerable to exploitation from employees. For instance, the court in *Maryland Metals, Inc. v. Metzner* stated that "[f]airness dictates that an employee not be permitted to exploit the trust of his employer so as to obtain an unfair advantage in competing with the employer in a matter concerning the latter's business." The nature of the corporation requires it to rely on the officers and managers to run the day-to-day business. These employees have access to a very precious commodity, that is, vital and privileged corporate information. In the more mundane duty of loyalty cases, the senior executive has access to important corporate information dealing with customer lists, customer preferences, customer pricing, new opportunities, and secret formulas.

Even though these cases and examples generally deal with a senior executive stealing corporate opportunities, these principles still apply in the whistleblowing context. For example, the whistleblower may convert corporate proprietary information by taking corporate records and sharing them with the authorities. The whistleblower could disclose information that, at worst, could lead to civil or criminal liabilities for the corporation and its other senior officers and directors. At best, certain disclosures could lead to significant embarrassment or humiliation. In either case, deciding how to make such disclosures would usually be a decision of the board of directors and senior managers of the corporation. For example, if the disclosure might give rise to criminal or civil liability, the corporation under the best of circumstances would want to vest its decision with its attorneys in an effort to minimize its potential liability and maximize profits. If the whistleblower

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69 382 A.2d 564 (Md. 1978).
70 Id. at 568.
72 See, e.g., Corroon & Black-Rutters & Roberts, Inc. v. Hosh, 325 N.W.2d 883 (Wis.1982) (involving customer lists, which contained detailed information on customer insurance policies).
74 See, e.g., Gen. Auto. Mfg. Co. v. Singer, 120 N.W.2d 659 (Wis. 1963) (concluding that a general manager made secret profits by turning over some business to competitors).
discloses the information, she may make it impossible for the corporation and other senior executives to obtain a good deal from prosecutors. If the information disclosed is not rooted in civil or criminal misconduct, but nevertheless is scandalous, the corporation may want to refrain from disclosing such information. The whistleblower may cause a great deal of public relations harm by disclosing such information. Because of this knowledge, senior executives know where the corporation may be most vulnerable. The senior managers are in a position to inflict harm on the corporation in a way that strangers cannot.\footnote{76}

B. The Duty of Care

Corporate officers and senior executives have a duty of care to the corporation. They have an obligation to perform their duties with the care that a person in a like position would reasonably exercise under similar circumstances.\footnote{77} This duty has been analogized to the diligence, care, and skill that ordinarily prudent individuals would exercise in the management of their affairs. The classic example of a breach of the duty of care is demonstrated in Francis v. United Jersey Bank.\footnote{78} In Francis, Mrs. Pritchard and her sons were the shareholders and directors of a reinsurance brokerage business. When Mrs. Pritchard's husband died, she inherited forty-eight percent of the corporation's stock. Her two sons owned the remaining fifty-two percent.\footnote{79} Before he died, Mrs. Pritchard's husband warned her that his son Charles would "take the shirt off my back . . . ."\footnote{80} After her husband's death, Mrs. Pritchard became depressed and drank heavily.\footnote{81} She paid no attention to the business, and she failed to review any of the corporation's financial reports. As a consequence of her failure to monitor, her sons misappropriated over twelve million dollars.

The court found that Mrs. Pritchard had breached her duty of care.\footnote{82} The Francis court explained that corporate executives

\footnote{76}\text{Terry A. O'Neill, Employees' Duty of Loyalty and the Corporate Constituency Debate, 25 CONN. L. REV. 681, 705 (1993).}

\footnote{77}\text{MODEL BUS. CORP. ACT § 8.42(a)(1)-(3)(1984).}

\footnote{78}\text{432 A.2d 814 (N.J. 1981).}

\footnote{79}\text{Id. at 818.}

\footnote{80}\text{Id. at 819.}

\footnote{81}\text{Id. at 819-20.}

\footnote{82} In this case, Mrs. Pritchard breached her duty of care to the creditors of the corporation because the corporation held funds in trust for creditors. \textit{Id.} at 829.
are under a duty to obtain at least a rudimentary understanding of the business of the corporation. They are also under a continuing obligation to monitor and be informed about the corporation. More may be expected of senior corporate executives than of mere board members. For instance, in *Bates v. Dresser*, the Court found the bank president liable for the failure to detect and stop the bookkeeper’s embezzlement. The Court, however, failed to find the bank’s board members liable. The Court reasoned that the board members had no reason to suspect a problem, whereas the bank president had discovered several incidents that should have alerted him to the bookkeeper’s dishonesty. Of course, the *Francis* court points out that these senior executives can absolve themselves from liability by objecting to any wrongdoing or resigning. In fact, the duty may exceed merely resigning and objecting in cases where the corporation is in a precarious financial condition and an implied trust exists in which the corporation holds funds. In those cases, the duties imposed on senior executives might require them to use “all reasonable action to stop the continuing conversion.”

In the case of whistleblowing, tension between the duty of loyalty and duty of care exists. The senior executive is required to disclose her objections to certain actions that she believes are illegal. But how is she supposed to do that? As a non-director officer, she could disclose her objections to her supervisor or her supervisor’s supervisor like Sherron Watkins did at Enron. This objection may take the form of a “cover your ass” memo. But will this really stop wrongdoing? In some cases, such a memo may be insufficient to stop the wrongdoing, and the senior executive may

83 This enhanced fiduciary duty for officers as opposed to directors is analogous to the enhanced duties that managing partners have in a partnership. See generally *Meinhard v. Salmon*, 164 N.E. 545, 463–65 (N.Y. 1928).

84 251 U.S. 524 (1920).

85 Id. at 530–31.

86 Id. at 529–30.

87 Id. at 530–31.

88 See generally *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981) (dealing with the responsibilities of the corporate director to address wrongdoing by other members of the board; this rule probably applies to officers and senior executives). Cf. id. at 823 (pointing out “the fulfillment of the duty of a director may call for more than mere objection and resignation. Sometimes a director may be required to seek the advice of counsel”).

89 Id. at 827.
have an obligation to report the matter to the authorities. She
may, however, be in a bind because her contractual obligations
and her duty of loyalty responsibilities may limit the type of
information that she could give to the authorities. In addition,
unless someone has real inside information allowing them to
actually observe the wrongdoing and has the expertise to know
that the wrongdoing is illegal, what safe harbor exists to protect
the senior executive from mistakenly reporting wrongdoing? This
conflict may place the senior executive in a dilemma, which the
Act does not totally ease.

IV. SARBANES-OXLEY ACT'S WHISTLEBLOWING PROTECTIONS

Prior to the Sarbanes-Oxley Act, the protections for private\textsuperscript{90}
corporate whistleblowers varied depending upon state law.
Because of these varied protections, senior officers and managers
had to worry about the fact that, in some states, they held their
jobs at will. Therefore, they could be fired at any time for no
reason. Forty-two states and the District of Columbia, however,
now recognize a cause of action for retaliatory discharge.\textsuperscript{91} These
statutes and rulings protect at-will employees who “blow the
whistle” on important public policy issues.\textsuperscript{92} Therefore, an
employee who is terminated for refusing to violate the law or for
reporting a violation of the law can bring an action for wrongful
discharge against her employer. Upon successful litigation of
her suit, the “wronged” employee can get damages\textsuperscript{93} and
reinstatement to her job. The interpretations of what constitutes
protected whistleblowing varies depending on the state.\textsuperscript{94}

\textsuperscript{90} In contrast, government whistleblowers were afforded a variety of statutory
protections under the Civil Service Reform Act, 5 U.S.C. \textsection{2302(b)}, and the
Whistleblower Protection Act, 5 U.S.C. \textsection{1201}, and its 1994 amendments. 140
\textsuperscript{91} TOM DEVINE, GOVT ACCOUNTABILITY PROJECT, THE WHISTLEBLOWER'S
\textsuperscript{92} Id.
\textsuperscript{93} See Jane P. Mallor, Punitive Damages for Wrongful Discharge of At Will
Employees, 26 WM. & MARY L. REV. 449, 479-95 (1985) (discussing that several
states allow punitive damages for such wrongful dismissals); see also Elleta
Sangrey Callahan & Terry Morehead Dworkin, The State of State Whistleblower
considered the monetary relief available to whistleblowers who have statutory
claims . . . [h]owever,] [t]he majority of courts have not allowed punitive damages
under the relevant whistleblower act, particularly if the state is the defendant”).
\textsuperscript{94} DEVINE, supra note 91 (noting that there might be additional federal
protection tucked away in the confines of a variety of specialty statutes dealing with
the goals of the Act was to afford a whistleblowing employee the same protection irrespective of her state of residence.\textsuperscript{95} Most state claims for wrongful retaliation revolved around claims for wrongful discharge based on the employee's termination for refusing to violate a law, rule, or regulation or for reporting such violation.\textsuperscript{96} The employee could, however, be fired if the reported behavior did not actually violate an existing law. For example, in \textit{Bohatch v. Butler & Binion},\textsuperscript{97} a partner, Bohatch, reported to the law firm's managing partner that one of the partners was over billing a client.\textsuperscript{98} The next day, the accused partner told Ms. Bohatch that the same client was dissatisfied with her work.\textsuperscript{99} The law firm investigated the allegations, determined that the client was satisfied that the bills were reasonable, and terminated Ms. Bohatch.\textsuperscript{100} The court refused to recognize an anti-retaliation exception to the at-will nature of partnerships.\textsuperscript{101} Most states seem to protect employees who report issues of safety or who are required to report safety violations.\textsuperscript{102} Those employees who were merely reporting failures to follow company procedure were least protected.\textsuperscript{103} In addition, several states deny protection for those whistleblowers who make unfounded claims or who fail to sufficiently investigate their claims.\textsuperscript{104} These states merely require that the employee's allegation be made in "good faith."\textsuperscript{105}

The Sarbanes-Oxley Act prohibits any public company from discriminating against any employee who lawfully provides information or otherwise assists in an investigation of conduct that the employee "reasonably believes" constitutes a violation of the federal securities laws.\textsuperscript{106} This provision was designed from

environmental protection, occupational health and safety, or labor regulations).  
\textsuperscript{95} See CONG. REC. S7420 (July 26, 2002) (statement of Sen. Leahy).  
\textsuperscript{96} See Callahan & Dworkin, supra note 93, at 105.  
\textsuperscript{97} 977 S.W.2d 543 (Tex. 1998).  
\textsuperscript{98} Id. at 544.  
\textsuperscript{99} Id.  
\textsuperscript{100} Id. at 544–45.  
\textsuperscript{101} See id. at 546–47 (restating general rule that "a law firm can expel a partner to protect relationships both within the firm and with clients" and declining to carve out anti-retaliation exception).  
\textsuperscript{102} See Callahan & Dworkin, supra note 93, at 105–07, 113–14, 118.  
\textsuperscript{103} Id. at 106–07, 113–14, 118.  
\textsuperscript{104} Id. at 121.  
\textsuperscript{105} Id.  
the lessons learned from Sherron Watkins’s testimony. As Senator Patrick Leahy stated, “We learned from Sherron Watkins of Enron that these corporate insiders are the key witnesses that need to be encouraged to report fraud and help prove it in court.”\textsuperscript{107} The legislation protects an employee from retaliation by an employer for testifying before Congress or a federal regulatory agency, or giving evidence to law enforcement of possible securities fraud violations.\textsuperscript{108} To secure this protection, the employee must have assisted in an investigation, which was conducted by Congress, a federal agency, the employee’s supervisor, or anyone else authorized by the employer to conduct an investigation.\textsuperscript{109} Under the Act, within ninety days of the discriminatory act, the employee must file an administrative claim with the Secretary of Labor.\textsuperscript{110} If the Secretary of Labor fails to issue a final decision within 180 days of filing of the complaint,\textsuperscript{111} the employee can bring a private cause of action at law or equity for de novo review in federal district court.\textsuperscript{112} Relief available under this statute shall include compensatory damages, such as reinstatement with the same level of seniority, back pay with interest, and any special damages, that is, litigation costs, expert witness fees, and reasonable attorney fees.\textsuperscript{113} In addition, every public company is required to establish mechanisms to allow the employees to provide information anonymously to the corporation’s board of directors.\textsuperscript{114}

The Sarbanes-Oxley Act was designed to promote investor confidence by ensuring that the public receives more information about possible corporate fraud. Such disclosures would ensure that the markets have perfect information so that investors could make informed investment choices. Senator Leahy reported that the Act is designed to “include all good faith and

\textsuperscript{108} Sarbanes-Oxley Paves Way For Potential Whistleblowers, Too, (CNNFN television broadcast, Aug. 5, 2002) (Interview of Peter Zlotnick, corporate attorney, Mintz Levin); Transcript # 080505cb.129.
\textsuperscript{109} Id.
\textsuperscript{110} Sarbanes-Oxley Act § 806(b)(1)(A) (to be codified at 18 U.S.C. § 1514A(b)(1)(A)).
\textsuperscript{111} Id. § 806(b)(1)(B) (to be codified at 18 U.S.C. § 1514A(b)(1)(B)).
\textsuperscript{112} Id. § 806(b)(1)-(2) (to be codified at 18 U.S.C. § 1514A(b)(1)-(2)).
\textsuperscript{113} Id. § 806(c) (to be codified at 18 U.S.C. § 1514A(c)).
\textsuperscript{114} Id. § 301(m)(4) (to be codified at 15 U.S.C. § 78f-(m)(4)).
reasonable reporting of fraud, and there should be no presumption that reporting is otherwise, absent specific evidence.\textsuperscript{115} This reasonable person standard would include the usual standard used in a variety of contexts.\textsuperscript{116} In fact, Senator Leahy stated that the type of action taken by the corporation or the agency would be "strong indicia that it could support such a reasonable belief."\textsuperscript{117} In addition, Senator Leahy explained that the whistleblowing provision would exclude unlawful actions such as the "improper public disclosure of trade secret information."\textsuperscript{118}

Undoubtedly, the Sarbanes-Oxley Act provides an extra level of protection for employees. Despite this added protection and the increased prominence of whistleblowers, we must be cognizant that federal whistleblowers have low success rates in their suits before government agencies. The Whistleblowers Survival Guide reports that "the rate of success for winning a reprisal lawsuit on the merits in administrative hearings for federal whistleblower laws has risen to between 25 and 33 percent in recent years."\textsuperscript{119} Under the Act, the corporate senior executive or employee is likely to confront some of the same dilemmas, which the Act does not quite address, and is likely to also have a low rate of success under its whistleblowing provisions. First, the statute only affords protection against retaliations based on securities fraud.\textsuperscript{120} Whistleblowing of other kinds of wrongdoing remain unprotected under this Act. In these cases, the whistleblower then must rely on the vagaries of state law, which generally give preference to those allegations dealing with public safety. For example, a senior executive may overhear a high-ranking executive make disparaging remarks about a particular racial group and state that he would never hire or promote members of that group. The corporation employs very few members of this particular group and has none in senior management. The senior executive believes that the corporation is engaged in race discrimination. The senior

\textsuperscript{116} Id.
\textsuperscript{117} Id.
\textsuperscript{118} Id.
\textsuperscript{119} Devine, supra note 91, at 116.
\textsuperscript{120} See Sarbanes-Oxley Act § 806(a)(1) (to be codified at 18 U.S.C. § 1514A(a)(1)).
executive has a fiduciary obligation to hold certain corporate information like employee demographics in confidence but has an obligation to resign or object from his position when confronting corporate wrongdoing. The Act provides protection only for those matters that involve security fraud. If this senior manager discloses, she would have to rely on the protections of the state laws.

Second, low-level employees are also relatively unprotected. They probably are unaware of these new protections. They may feel particularly oppressed by the many layers of management that may exist in some corporations. Some may be unsophisticated and may not know whether certain actions violate the law. Many of the wrongful or illegal activities that they observe may not rise to the level of securities fraud. For example, an employee at McDonald’s may notice that large numbers of pre-packaged hamburgers disappear shortly after delivery. The disappearance may be the result of conversion by the store manager. The McDonald’s employee might be in the best position to ascertain whether this wrongdoing is occurring, but she is unprotected by the Sarbanes-Oxley Act because this conversion does not involve securities fraud. She will have to rely on the vagaries of state law. In addition, many of these employees rely very heavily on their paychecks; a high turnover rate exists in these jobs. Students and those re-entering the workforce hold many of these jobs. These individuals may be particularly reluctant to “rock the boat” and report wrongdoing unless they are guaranteed that their job is protected. The Act does nothing to address this population of whistleblowers.

Third, for both senior executives and low-level employees, the Sarbanes-Oxley Act gives little guidance as to the circumstances under which an employee is to disclose allegations of wrongdoing to her supervisor as opposed to law enforcement authorities. Senior executives also have an obligation to use “reasonable efforts” to disclose to the principal information, which is “relevant to affairs entrusted to [the agent]” and which the principal would desire to have.\footnote{RESTATEMENT (SECOND) OF AGENCY § 381.} To some extent, this decision may be a judgment call by the whistleblowing employee. In some instances, however, the whistleblowing employee who reports wrongdoing to her supervisor might not be doing enough
to stem the wrongdoing behavior. For instance, once she has made the report, the wrongdoing supervisor might exclude the employee from access to information that would allow her to continue to observe the wrongful behavior. In those cases, the reporting employee may have breached her duty of care to the corporation by using insufficient actions to stop the wrongdoing. In addition, her reports to her supervisor may give notice to the supervisor to claim that he had no knowledge. Conversely, if the whistleblowing employee reports the evidence of wrongdoing immediately to law enforcement authorities, she may be violating her duty of loyalty to the corporation especially if her allegations are unfounded. These senior-executives are subject to a duty not to use or to communicate confidential information acquired during their employment, “unless the information is a matter of general knowledge.” \(^{122}\) She has an obligation to protect certain proprietary and confidential corporate information. Also by going to the law enforcement authorities right away, she may be depriving the corporation of the opportunity to resolve the matter or, in the case of wrongdoing, get the best deal for the corporation. In addition, the employee who jumps the gun and goes to law enforcement authorities may be putting herself in a difficult political situation at her corporation. Even though the terms of her position and employment may remain the same, she will always, to her detriment, be remembered for making that report.

Fourth, the Sarbanes-Oxley Act gives no guidance concerning whether the whistleblowing employee should disclose the information to her direct supervisor or her supervisor’s supervisor. Who is the principal of senior executives? Is it the corporation? Is it the board of directors? Is it the senior executive’s boss? To some extent, this decision may be a judgment call by the whistleblowing employee. In some instances, however, the whistleblowing employee who reports wrongdoing to her direct supervisor might not be doing enough to prevent the wrongdoing behavior. For instance, as stated above, once she has made the report, the wrongdoing supervisor might also exclude the employee from access to information that would allow her to continue to observe the wrongful behavior. In those cases, the reporting employee may have breached her duty

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\(^{122}\) Id. § 395.
of care to the corporation by using insufficient actions to stem the wrongdoing. In addition, her reports to her supervisor may have put him on notice to claim that he had no knowledge. In those cases, she may be required to report the wrongdoing to a higher level of authority in the corporation. By immediately going to the supervisor's supervisor, however, she may be depriving her direct supervisor of the opportunity to resolve the matter, which might be in the best interest of the corporation and the supervisor. In addition, the employee who "jumps the gun" and goes to her supervisor's supervisor may be putting herself in a difficult political situation at her corporation in that her direct supervisor may never trust her. If she discloses to her supervisor's supervisor, she may be perceived as a "rat fink," which may be a career-limiting move.

Fifth, the legislative history of the Sarbanes-Oxley Act states that the employee's actions have to be reasonable in making reports. Employee actions will be deemed reasonable depending on the types of actions taken by the corporation or the investigating agency. In the context of suspected wrongdoing by others, the senior executives may be in a precarious position. Most cases may not be as clear-cut as the one involving Sherron Watkins. Because she was an accountant, she had a very good idea that Enron's accounting policies were illegal. For most other whistleblowers, they may have only a slight inkling that something might be amiss. In those circumstances, what are they supposed to do? Depending on the nature of the corporation, they may have an obligation to investigate further. We then may require the senior executives of major corporations to be "Nancy Drew, Girl Detective." With downsizing and more responsibilities, many of these employees already have many additional responsibilities. If, however, they fail to properly investigate their suspicions, they may violate their duty of care to the corporation. In addition, although Senator Leahy stated that the Act protects whistleblowers who report and disclose their reasonable suspicions, the statutory language fails to explicitly provide such protection. Whistleblowers who report and disclose their reasonable suspicions are in a tough spot if their allegations turn out to be unfounded. The Sarbanes-Oxley


124 See id.
Act’s statutory protections will fail to protect the whistleblower’s ensuing loss of credibility among her corporate peers.

Sixth, the Sarbanes-Oxley Act prohibits a corporation from “discharg[ing], demot[ing], suspend[ing], threaten[ing], harass[ing], or in any other manner discriminat[ing] against an employee in the terms and conditions of employment” because she blew the whistle.\(^\text{125}\) Senator Leahy conceded, however, that “most corporate employers, with help from their lawyers, know exactly what they can do to a whistleblowing employee under the law.”\(^\text{126}\) The types of retaliation that can occur include: (1) “attacking the [whistleblower’s] motives, credibility, [or] professional competence”;\(^\text{127}\) (2) “build[ing] a damaging record against [the whistleblower]”;\(^\text{128}\) (3) threatening the employee with “reprisals for whistleblowing”;\(^\text{129}\) (4) “reassign[ing]” the employee to an isolated work location;\(^\text{130}\) (5) “publicly humiliat[ing]” the employee;\(^\text{131}\) (6) “set[ting] . . . up [the whistleblower] for failure” by putting them in impossible assignments;\(^\text{132}\) (7) “prosecut[ing the employee] for unauthorized disclosures [of information]”;\(^\text{133}\) (8) “reorganiz[ing]” the company so that the whistleblower’s job is eliminated;\(^\text{134}\) and (9) “blacklist[ing]” the whistleblower so she will be unable to work in the industry.\(^\text{135}\) Of course some methods on this list would clearly violate the Act. A deft supervisor, however, could “set up” the whistleblowing employee for failure. For instance, the employer may place the whistleblower in a job unsuitable to her skill level to ensure her failure. The employer could then document the employee’s poor performance. The Act provides protections for whistleblowing employees except in cases where valid business reasons exist for their termination like inferior work performance. In addition, even if the employer refrains from discriminating against the whistleblowing employee in the

\(^{125}\) Sarbanes-Oxley Act § 806(a) (to be codified at § 1514A(a)).
\(^{127}\) DEVINE, supra note 91, at 28.
\(^{128}\) Id. at 31.
\(^{129}\) Id.
\(^{130}\) Id. at 32–33.
\(^{131}\) Id. at 33.
\(^{132}\) Id. at 33–34.
\(^{133}\) Id. at 35.
\(^{134}\) Id. at 37.
\(^{135}\) Id. at 38.
terms and conditions of her employment, the employer is unlikely to give that employee any opportunities for advancement. By blowing the whistle, she may have “tapped out” her career trajectory. For instance, Sherron Watkins’s present job and terms of employment are probably very secure, but can we really imagine her ever advancing from her present position at Enron? Her future supervisors will probably always worry that she is not a “team player” who may go over their heads when she suspects they are doing something wrong.

CONCLUSION

Despite the recent positive press concerning corporate whistleblowers, it is fraught with grave dangers. The whistleblower is under simultaneous duties of loyalty and care. By reporting suspicious activities, the whistleblower may violate her duty of loyalty to the corporation by misusing corporate proprietary information, but at the same time the failure to report such activities may be a violation of the duty of care. The Sarbanes-Oxley Act provides the whistleblower with some federal protection against retaliation but does not ease the tension between the whistleblower’s duty of care and loyalty. In addition, there are several matters that the Act fails to address or provide sufficient protection, i.e., (1) non-securities fraud matters are not covered; (2) low-level employees may not be aware of the protections; (3) no guidance is given as to when to report wrongdoing to outside authorities or to a supervisor; (4) no guidance is given as to when the whistleblower should go over his or her supervisor’s head to senior management; and (5) no protection is given to undercover retaliations that do not quite manifest themselves as a “discharge, demotion, suspension, threat, or other manner of discrimination.” In promulgating its rules in implementing this matter, the SEC, to the extent possible, should take some of these limitations of the Act into account. As a consequence, the corporate whistleblower cannot just pucker and blow. She has to use a great deal of thought to whether and how she may want to blow the whistle.