

Notes

Blowing the Whistle on *Van Asdale*: Analysis and Recommendations

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This Note examines the state of whistleblower protection at the state and federal level. It focuses on the protection granted to whistleblowers of securities fraud under the Sarbanes-Oxley Act of 2002. Most courts considering the statute have required that the plaintiff have had both an objective and subjective belief that securities fraud had been committed. In 2009, the United States Court of Appeals for the Ninth Circuit decided Van Asdale v. International Game Technology. The court broke with the other circuits in not requiring the plaintiff-employees to have a subjective belief that a violation had actually occurred and, instead, conferred whistleblower protection where the plaintiff-employees merely believed that an investigation into possible securities fraud was warranted. This Note explores the implications of the Ninth Circuit's standard and argues that it should be overturned. Instead of lowering the requirements to achieve protected status, this Note argues that an expansion of whistleblowing remedies would better effectuate the goal of rooting out securities fraud. Congress should act to change the whistleblower protection scheme, as piecemeal judicial manipulation would only exacerbate the problem. The Note concludes with an examination of the whistleblower protections contained in the Dodd-Frank Act, arguing that the changes failed to correct the underlying structural problems with the federal whistleblower protection system.

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INTRODUCTION

As the dust begins to settle on what many called the Great Recession,¹ and allegations of securities fraud begin to emerge,² it is worth examining the reforms instituted in the United States after the previous recession. In 2002, with a slumping economy and the financial sector reeling from the scandals of Enron and WorldCom, the United States Congress enacted a sweeping securities reform legislation known as the Sarbanes-Oxley Act of 2002 (“SOX”).³ The Act received bipartisan support,⁴ with President George W. Bush describing it as a “far-reaching reform”⁵ and Democrats describing themselves as “grateful” for the bill’s passage.⁶ While it is impossible to discern the exact reasoning underlying each side’s support, what is clear is that fraud prevention was at the forefront of Congress’s motivations.⁷ The scandals and collapses of Enron, Arthur Andersen, WorldCom, and their ilk pressed Congress into enacting SOX.⁸ Indeed, one commentator argues that the passage of SOX “reveal[ed] a deep skepticism” on the part of Congress, leading to “an unprecedented willingness to override state corporate law.”⁹

To encourage insiders who might have information about fraud to come forward, the Act included a provision bestowing “special protection”¹⁰ on whistleblowers who report securities fraud at publicly traded companies (enacted as § 1514A of the Act).¹¹ These protections were intended to encourage whistleblowers to step forward and

1. See Justin Lahart, *The Great Recession: A Downturn Sized Up*, WALL ST. J., July 28, 2009, at A12; Robert J. Samuelson, *The Great Recession’s Aftermath*, NEWSWEEK (Jan. 4, 2010), <http://www.newsweek.com/id/229210>.

2. Dan Fitzpatrick & Kara Scannell, *Ex-BofA Chief Sued for Fraud*, WALL ST. J., Feb. 5, 2010, at A1.

3. Jeffrey T. Cook, *Recrafting the Jurisdictional Framework for Private Rights of Action Under the Federal Securities Laws*, 55 AM. U. L. REV. 621, 639 (2006).

4. Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES, July 31, 2002, at A1.

5. Valerie Watnick, *Whistleblower Protections Under the Sarbanes-Oxley Act: A Primer and a Critique*, 12 FORDHAM J. CORP. & FIN. L. 831, 831–32 (2007).

6. See Bumiller, *supra* note 4.

7. Cook, *supra* note 3, at 639.

8. *Special Report—Sarbanes-Oxley: A Price Worth Paying?*, ECONOMIST, May 21, 2005, at 81, 81.

9. JOHN C. COFFEE, JR. & HILLARY A. SALE, SECURITIES REGULATION 59 (11th ed. 2009).

10. Beverley H. Earle & Gerald A. Madek, *The Mirage of Whistleblower Protection Under Sarbanes-Oxley: A Proposal for Change*, 44 AM. BUS. L.J. 1, 2–3 (2007).

11. See Sarbanes-Oxley Act, 18 U.S.C. § 1514A(a) (2006) (“No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 . . . or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 . . . may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee . . . because of any lawful act done by the employee . . . to provide information, . . . or otherwise assist in an investigation . . .”).

companies to take seriously complaints by their employees.¹² Congress hoped to achieve these objectives by providing clearer guidance to whistleblowers than the “vagaries” of the state law provisions, which employers regularly and deftly avoided.¹³

Sherron Watkins, a vice president at Enron who reported irregularities at the company, testified before Congress and helped motivate action in the whistleblower arena.¹⁴ Ms. Watkins told a congressional subcommittee about the “highly intimidating” demeanor of Enron’s executives, particularly the Chief Financial Officer and Chief Executive Officer.¹⁵ Executives at Enron carefully cultivated an oppressive environment through “hostility and obfuscation,” seeking to prevent intra-company monitoring and reporting by employees.¹⁶ These efforts were apparently so successful that employees joked about the company’s irregular earnings reports, rather than raising their concerns or blowing the whistle.¹⁷ Perhaps most pertinent to the whistleblower protections in SOX, Ms. Watkins testified about her fear of termination if she directly reported the irregularities to executives at Enron¹⁸—a reasonably held fear, given that after her internal reporting on the company’s irregular finances, the company demoted her and confiscated her hard drive.¹⁹ Congress, it seems, hoped to deputize employees to ferret out fraud, because “[t]he corporate scandals of the Enron era demonstrated that employees had valuable information about ongoing financial and accounting fraud, and . . . very few incentives [under the existing regime] . . . to blow the whistle on their employers.”²⁰

In an attempt to remedy that incentive disparity, SOX’s whistleblower provision prohibits employers from retaliating against employees who engage in protected reporting activities related to “any conduct which the employee *reasonably believes* constitutes a violation [of certain securities laws]”²¹ The Act does not provide any guidance on what constitutes reasonable belief.²² However, by 2009, the circuit

12. Watnick, *supra* note 5, at 841.

13. *See id.* at 842.

14. *See* Dan Ackman, *Sherron Watkins Had Whistle, But Blew It*, FORBES (Feb. 14, 2002), <http://www.forbes.com/2002/02/14/0214watkins.html>.

15. *See id.*

16. Richard E. Moberly, *Sarbanes-Oxley’s Structural Model to Encourage Corporate Whistleblowers*, 2006 BYU L. REV. 1107, 1121–22 (2006).

17. *Id.* at 1120.

18. Leonard M. Baynes, *Just Pucker and Blow?: An Analysis of Corporate Whistleblowers, the Duty of Care, the Duty of Loyalty, and the Sarbanes-Oxley Act*, 76 ST. JOHN’S L. REV. 875, 877–78 (2002).

19. *See* Jodie Morse & Amanda Bower, *The Party Crasher*, TIME, Dec. 30, 2002, at 53, 53.

20. Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 109 (2007).

21. Sarbanes-Oxley Act, 18 U.S.C. § 1514A(a)(1) (2006) (emphasis added).

22. *See id.*

courts that had considered the protections of § 1514A agreed: The employee must have possessed both an objective *and* subjective belief that a violation of one of the enumerated securities laws had occurred.²³

In August 2009, after the other circuits coalesced around the objective-subjective standard, the Ninth Circuit decided a SOX whistleblower claim in *Van Asdale v. International Game Technology*.²⁴ Though the court agreed that a § 1514A claim required both objective and subjective belief, it broke with the other circuits in not requiring the plaintiff-employees to have a subjective belief that a violation had *actually occurred* and instead, conferred whistleblower protection where the plaintiff-employees merely believed that an investigation into possible securities fraud was warranted.²⁵ This interpretation of the Act broadened the sphere of protected conduct, with the court holding that “[r]equiring an employee to essentially prove the existence of fraud before suggesting the need for an investigation would hardly be consistent with Congress’s goal of encouraging disclosure.”²⁶ With *Van Asdale*, the Ninth Circuit precipitated a split among the circuits which, if left unresolved, threatens to undermine the uniform national framework Congress sought to create with respect to securities fraud whistleblowers.

In July 2010, Congress passed the financial reform bill known as the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).²⁷ This Act included several provisions related to various federal whistleblower protection schemes, including expanded protections under the False Claims Act (FCA),²⁸ qui tam awards and retaliation protection for reporting violations to the SEC,²⁹ retaliation protections for financial services whistleblowers reporting violations to the new Consumer Protection Bureau,³⁰ and finally, reduction of procedural barriers to SOX whistleblowers.³¹

This Note argues that the Ninth Circuit’s expansion of the SOX whistleblowing scheme should be overturned. This Note further argues that a limited expansion of the *remedies* for SOX whistleblowers would best effectuate Congress’s stated intentions, in contrast to an expansion of the class of plaintiffs or a proliferation of disparate statutory

23. See *Day v. Staples, Inc.*, 555 F.3d 42, 54–55 (1st Cir. 2009); *Livingston v. Wyeth, Inc.*, 520 F.3d 344, 352 (4th Cir. 2008) (“Thus, § 1514A requires both a subjective belief and an objectively reasonable belief that the company’s conduct constitutes a violation of the relevant law.”); *Allen v. Admin. Review Bd.*, 514 F.3d 468, 477 (5th Cir. 2008).

24. 577 F.3d 989 (9th Cir. 2009).

25. *Id.* at 1000–02.

26. *Id.* at 1002.

27. Pub. L. No. 111-203, 124 Stat. 1376 (2010).

28. *Id.* § 1079A(b)(2).

29. *Id.* § 922.

30. *Id.* § 1057.

31. *Id.* § 922.

protections for whistleblowers. Part I begins by analyzing the patchwork of state and federal whistleblower protections and their interaction with § 1514A. Part II discusses the circuit split, beginning with the origins of the objective-subjective requirement and the arguments in favor of the “actual violation” model of belief adopted by the First, Fourth, and Fifth Circuits. Part II then discusses the facts of *Van Asdale* and analyzes the Ninth Circuit’s adoption of, and justifications for, the “investigation” model for SOX whistleblower protections. Part III discusses the incentives and disincentives facing whistleblowers and examines the interaction between *Van Asdale* and these incentives, focusing on the risk of false claims. Part IV argues that expanding so-called retrospective remedies to improve whistleblowing protections is more methodologically sound than the Ninth Circuit’s approach. It also contends that adopting a lower standard for a whistleblower status, a bounty-like reward system, or a piecemeal expansion of existing protections would increase neither the quality nor quantity of whistleblowing under SOX. Part IV further argues that the “actual violation” model adopted by the majority of circuits provides the best mix of judicial efficiency, manageable standards, and employee incentives. Part IV concludes by noting that congressional action in this arena, with the Dodd-Frank Act, has only exacerbated the problems associated with a fractured system by failing to utilize the frameworks described in this Note.

I. STATE LAW, FEDERAL LAW, AND THE ROLE OF § 1514A

This Part discusses the history of whistleblower protections at the state and federal level. This Part further explains the role of SOX in a patchwork system, while also discussing the history, legislative reasoning, and passage of the Act generally and § 1514A specifically.

A. THE PATCHWORK QUILT OF STATE WHISTLEBLOWER PROTECTIONS

The protections and incentives for whistleblowers established by the Act are but a small portion of the state and federal whistleblowing scheme. Every state has at least some form of statutory whistleblower protection.³² Seventeen states have enacted comprehensive state whistleblower protections: Arizona, California, Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Maine, New Hampshire, New Jersey,

32. See *State Whistleblower Statutes*, NAT’L WHISTLEBLOWERS CTR., http://www.whistleblowers.org/index.php?option=com_content&task=view&id=742&Itemid=161 (last visited Dec. 17, 2010); see also Miriam A. Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes-Oxley Act for Employment Law*, 79 WASH. L. REV. 1029, 1087–120 (2004) (summarizing the state of whistleblower protection in all fifty states).

North Dakota, Ohio, Rhode Island, South Dakota, Tennessee, and Vermont.³³

The multitude of regulatory schemes at the state level is, at best, uneven and confusing. Their patchwork nature results in a system of protections that is “murky, piecemeal, disorganized, and varies from jurisdiction to jurisdiction.”³⁴ Unfortunately, they “leave many whistleblowers inadequately protected against retaliation.”³⁵ Moreover, the interaction of the numerous and incomplete federal schemes³⁶ with state laws can result in a whistleblower “fall[ing] into the gap between the federal and state laws, where neither body of law offers satisfactory protection.”³⁷

B. MAKING SENSE OF THE PATCHWORK OF FEDERAL WHISTLEBLOWER PROTECTIONS

In contrast to most state laws, which broadly prohibit retaliatory action by a class of employers (including government agencies, large private companies, and the like), federal whistleblower protections are most often designed to facilitate the reporting of a specific *type* of information.³⁸ In effect, Congress has enacted whistleblower protections on a somewhat ad hoc basis as it has considered various regulatory schemes. The notable exception to this issue-based scheme is the Whistleblower Protection Act (WPA).³⁹ The WPA prohibits retaliation against civil service employees for “any disclosure of information . . . which the employee or applicant reasonably believes evidences . . . a violation of any law, rule, or regulation.”⁴⁰ Court interpretations of the WPA, coupled with statutory restrictions, serve to blunt this general guarantee of protection and, in fact, create a much less comprehensive system than appears at first glance. For example, an employee would *not* be protected if she reported illegal activities in the course of her job duties or gave a report to an immediate supervisor.⁴¹ The WPA can be understood as being at its strongest when dealing with civil service employees—subject

33. See *State Whistleblower Statutes*, *supra* note 32.

34. Cherry, *supra* note 32, at 1049.

35. Courtney J. Anderson DaCosta, *Stitching Together the Patchwork: Burlington Northern's Lessons for State Whistleblower Law*, 96 GEO. L.J. 951, 957 (2008).

36. See *infra* Parts I.B–C.

37. Trystan Phifer O'Leary, Note, *Silencing the Whistleblower: The Gap Between Federal and State Retaliatory Discharge Laws*, 85 IOWA L. REV. 663, 676 (2000).

38. See, e.g., 20 U.S.C. § 3608 (2006) (asbestos in schools); 42 U.S.C. § 5851 (2006) (violations of the Atomic Energy Act); 49 U.S.C. § 20109 (2006 & Supp. II 2008) (railroads). For a broad overview of the federal whistleblower schema, see William Dorsey, *An Overview of Whistleblower Protection Claims at the United States Department of Labor*, 26 J. NAT'L ASS'N OF ADMIN. L. JUDGES 43 (2006).

39. 5 U.S.C. § 2302(b)(8)(A) (2006).

40. *Id.*

41. Orly Lobel, *Citizenship, Organizational Citizenship, and the Laws of Overlapping Obligations*, 97 CALIF. L. REV. 433, 448–49 (2009).

to the aforementioned limitations—but at its weakest for the private employee attempting to navigate the byzantine maze of possible statutory protections.

Additional protection at the federal level can be found in the FCA.⁴² The FCA incentivizes so-called “private attorneys-general” to bring actions against contractors who may be defrauding the federal government, primarily by means of qui tam damages awardable in the amount of fifteen to twenty-five percent of the government’s recovery.⁴³ “By providing individuals a guaranteed percentage of the recovery, the statute was designed as an incentive to encourage qui tam lawsuits.”⁴⁴ This Note will discuss, in Parts III and IV, that such bounty-like incentives would likely be inappropriate in the SOX whistleblower scheme.⁴⁵ In short, the current federal scheme is confusing, convoluted, and “results in a haphazard enforcement structure.”⁴⁶

C. SOX, § 1514A AND THE POST-ENRON NEED FOR SECURITIES FRAUD WHISTLEBLOWER PROTECTIONS

Entering this field of haphazard whistleblower protections, SOX enacted a whistleblower protection with uniformity and clarity (at least in the securities field) by creating a preemptive federal scheme that “provides greater consistency and protection for whistleblowers than state laws . . . [and] promotes a more hospitable environment for whistleblowers in the corporate and securities context through a decreased threat of employer retaliation.”⁴⁷ By providing a clear statutory protection for securities fraud whistleblowers, Congress hoped to remedy the situation whereby an employee in one state may have more or less protection than an employee in another state, despite reporting the same fraud committed by the same company.⁴⁸ While the Act does not cover every conceivable variety of securities fraud, it has definitively added to the incentives for employees who may be tempted to blow the whistle. Moreover, the protections for whistleblowers have been read rather broadly by some courts; while this potentially adds confusion to the matrix of allowable and disallowable employer actions, it appears courts have, at least in some cases, read the statute broadly.⁴⁹

42. See 31 U.S.C. §§ 3729–3733 (2006).

43. *Id.* § 3730(d).

44. Sean Hamer, *Lincoln’s Law: Constitutional and Policy Issues Posed by the Qui Tam Provisions of the False Claims Act*, 6 KAN. J.L. & PUB. POL’Y 89, 90 (1997).

45. See *infra* Parts III–IV.

46. Cherry, *supra* note 32, at 1051.

47. Marc I. Steinberg & Seth A. Kaufman, *Minimizing Corporate Liability Exposure When the Whistle Blows in the Post Sarbanes-Oxley Era*, 30 J. CORP. L. 445, 446 (2005).

48. 148 CONG. REC. S7391, S7420 (daily ed. July 26, 2002).

49. One of these cases, the topic of this Note, broadened the definition of “protected activity.” *Van Asdale v. Int’l Game Tech.*, 577 F.3d 989, 1002 (9th Cir. 2009). In the other, a judge in the Eastern

Section 1514A achieves this goal of increased securities fraud reporting by prohibiting employers from taking any adverse employment action⁵⁰ against an employee who “reasonably believes” that the company has committed fraud.⁵¹ The whistleblowing must have been a “contributing factor” in the adverse action, “mean[ing] any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision.”⁵² Employees who believe they were wronged can seek redress by filing a complaint with the Secretary of Labor,⁵³ who has delegated the authority to decide SOX whistleblower claims and issue related regulations to the Occupational Safety and Health Administration (OSHA).⁵⁴

While SOX certainly provides more clarity in the field, many commentators are nevertheless critical of what they see as shortcomings and limitations in the Act’s whistleblower protections.⁵⁵ Perhaps most compelling is the criticism that SOX does not go far enough and instead, perpetuates confusion with the federal schema—it resolves ambiguities in one field and for certain employers, but fails to solve the problem of disparate and patchwork whistleblower laws.⁵⁶

II. WHAT CONSTITUTES FRAUD: DIVERGING JUDICIAL STANDARDS

This Part analyzes the threshold test for securities fraud that employees must meet in order to fall within the Act’s whistleblower protections. A consensus seemed to be forming around the requirement for reasonable belief, entailing an objective *and* subjective standard of

District of New York held that a corporate employee who had indirectly aided in blowing the whistle by “opening a channel of communication with the company’s CEO” and thereby, giving his colleague an opportunity to complain about suspect practices was similarly protected under SOX, despite the fact that he had “no knowledge of the company’s accounting practices” apart from what he had been told by the colleague. *Mahoney v. Keyspan Corp.*, No. 04-CV-554SJ, 2007 WL 805813, at *1, *5 (E.D.N.Y. Mar. 12, 2007).

50. Sarbanes-Oxley Act, 18 U.S.C. § 1514A(a) (2006) (“[No publicly traded company] may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment . . .”).

51. *Id.* § 1514A(a)(1).

52. *Watnick*, *supra* note 5, at 850 (quoting *Marano v. Dep’t of Justice*, 2 F.3d 1137, 1140 (Fed. Cir. 1993)).

53. 18 U.S.C. § 1514A(b)(1)(A).

54. *See Watnick*, *supra* note 5, at 837–38.

55. *See Cherry*, *supra* note 32, at 1070 (arguing that the Act lacked procedures for responding to reports, and that whistleblower claims might be sent to arbitration instead of to the courts); Richard Moberly, *Protecting Whistleblowers by Contract*, 79 U. COLO. L. REV. 975, 987 (2008) (“[D]espite the best intentions of these anti-retaliation protections, taken collectively their narrow and nuanced approach undermines their commendable goals.”).

56. Mary Kreiner Ramirez, *Blowing the Whistle on Whistleblower Protection: A Tale of Reform Versus Power*, 76 U. CIN. L. REV. 183, 227–28 (2007). The author posits that Congress did not go further in consolidating whistleblower laws when passing SOX because of pressure from senior managers and the business community at-large. *Id.* at 230.

belief.⁵⁷ However, in 2009, the Ninth Circuit significantly altered the subjective prong of the standard thereby relaxing the threshold for when the Act's protections might apply.⁵⁸

A. UNDERLYING STANDARDS FOR PROTECTION IN SOX

Section 1514A protects an employee when the employee discloses information to a regulatory or law enforcement agency, a member of Congress, or a supervisor within her company, so long as she "reasonably believes [the conduct] constitutes a violation" of the enumerated securities laws.⁵⁹ The Department of Labor (DOL) has adopted regulations incorporating the same language to describe a protected activity.⁶⁰ While this Note focuses on the requirements for reasonable belief, it should be noted that the statute also requires that the alleged violation of the securities laws at least approximate a claim for securities fraud.⁶¹

B. THE EMERGING STANDARD OF OBJECTIVE AND SUBJECTIVE BELIEF

Within about one year of each other, four circuit courts settled on the same standard for analyzing whistleblower claims under SOX. Each court accepted the underlying rationale from the statute and the DOL regulations: Whistleblowing requires a subjective *and* objective belief that a violation of the enumerated securities laws has occurred.

1. *Fifth Circuit: Allen v. Administrative Review Board*

In January 2008, fully seven years after SOX became law, the Fifth Circuit was the first appellate body to rule on a SOX whistleblower case in *Allen v. Administrative Review Board*.⁶² In *Allen*, the reporting employees were in charge of quality assurance, and one was a Director of Administration for one of the company's divisions.⁶³ An internal system was systematically overcharging customers.⁶⁴ The reporting employees felt that the company was taking too long to issue refunds and that, due to this delay, the company was exposed to litigation from aggrieved customers that would potentially affect shareholder equity.⁶⁵ Furthermore, the reporting employees believed that certain SEC-mandated accounting rules were not being followed, resulting in

57. *See infra* Part II.B.

58. *See infra* Part II.C.

59. 18 U.S.C. § 1514A(a)(1).

60. 29 C.F.R. § 1980.102 (2009).

61. *Day v. Staples, Inc.* 555 F.3d 42, 55–56 (1st Cir. 2009).

62. 514 F.3d 468 (5th Cir. 2008).

63. *Id.* at 471.

64. *Id.*

65. *Id.* at 472.

overstated profits in reports disclosed to shareholders.⁶⁶ All three employees were eventually fired and later brought suit.⁶⁷

In finding that the reporting employees did not engage in protected activities, the court held that “an employee’s reasonable belief must be scrutinized under both a subjective and objective standard.”⁶⁸ For objective belief, the court noted that “[t]he objective reasonableness of a belief is evaluated based on the knowledge available to a reasonable person in the same factual circumstances with the same training and experience as the aggrieved employee.”⁶⁹ Unfortunately, the court failed to expand on this objective-subjective requirement any further and said little about the subjective aspect of the standard.⁷⁰

2. *Fourth Circuit: Livingston v. Wyeth, Inc.*

Just a few months later, in March 2008, the Fourth Circuit decided *Livingston v. Wyeth, Inc.*⁷¹ Here, the employee reported that Wyeth’s drug manufacturing facilities did not comply with FDA regulations.⁷² The employee was eventually fired for what the company claimed was continued insubordination.⁷³ He eventually brought suit, challenging the company’s claims and arguing that he was dismissed for whistleblowing. The court discussed the standard at length:

To “reasonably believe” that company conduct “constitutes a violation” of law, as those terms are used in § 1514A(a)(1), [the employee] must show not only that he believed that the conduct constituted a violation [subjective belief], but also that a reasonable person in his position would have believed that the conduct constituted a violation [objective belief]

Moreover, [§ 1514A] requires [the employee] to have held a reasonable belief about an existing violation . . . [put another way,] “the employee must have an objectively reasonable belief that a violation is actually occurring based on circumstances that the employee observes and reasonably believes.” We rejected the claim, however, that a reasonable belief that a violation has occurred or is in progress can include a belief that a violation is about to happen upon some future contingency.⁷⁴

In comparison to *Allen*, the Fourth Circuit significantly elaborated on the basic objective-subjective requirements.⁷⁵ Notably, the court emphasized

66. *Id.* at 473.

67. *Id.* at 474–75.

68. *Id.* at 477.

69. *Id.*

70. *See id.*

71. 520 F.3d 344 (4th Cir. 2008).

72. *Id.* at 347–48.

73. *Id.* at 346.

74. *Id.* at 352 (emphasis omitted) (citations omitted) (quoting *Jordan v. Alt. Res. Corp.*, 458 F.3d 332, 341 (4th Cir. 2006)).

75. *See id.*

the need for subjective belief in a *past or continuing violation* and suggested that more attenuated beliefs are insufficient to meet the threshold for statutory protection.⁷⁶ It appears from the proximity in time between the respective decisions that the Fourth Circuit arrived at this objective-subjective standard independently of the Fifth Circuit. In a later decision, the Fourth Circuit explicitly noted the conformity of its reasoning in *Livingston* with the Fifth Circuit's reasoning in *Allen*.⁷⁷

3. *First Circuit: Day v. Staples, Inc.*

The next year, in February 2009, the First Circuit would arrive at a similar conclusion in *Day v. Staples, Inc.*⁷⁸ The reporting employee in this case raised concerns about the internal practices of a Staples product return center, practices that he believed resulted in potential over- and underissuance of refunds to customers (and thus, impacted shareholder value).⁷⁹ After reporting his beliefs to numerous supervisors (and indeed, executives), the reporting employee was terminated and subsequently filed suit.⁸⁰

Here, the court agreed with the Fourth Circuit's standard of objective-subjective belief.⁸¹ For objective belief, the court required that the reporting employee's theory must "at least approximate the basic elements of a claim of securities fraud."⁸² While an employee need not show an *actual violation* of the laws, she must believe that the conduct constitutes a violation of the enumerated provisions in § 1514A, with the proviso that "general inquiries' . . . do not constitute protected activity."⁸³

On subjective belief, the court framed the standard in terms of "subjective good faith" and took notice of the district court's "concern about the plaintiff's particular educational background and sophistication," which might affect his reasonable belief.⁸⁴ Although a somewhat different approach than that taken by the other circuits, which did not, at least explicitly, consider subjective *good faith* but instead, considered only subjective *belief*, the Fifth Circuit's two-prong analysis is highly consistent with prior judicial decisions on SOX whistleblower standards.

76. *Id.*

77. *Welch v. Chao*, 536 F.3d 269, 277 n.4 (4th Cir. 2008).

78. 555 F.3d 42 (1st Cir. 2009).

79. *Id.* at 46.

80. *Id.* at 46-49.

81. *Id.* at 55 (citing *Welch*, 536 F.3d at 275).

82. *Id.* at 55-56. The court noted that a claim of securities fraud resembles the tort of deceit and misrepresentation, and requires "a material misrepresentation or omission, scienter, loss, and a causal connection between the misrepresentation or omission and the loss." *Id.* at 56.

83. *Id.* at 55 (quoting *Fraser v. Fiduciary Trust Co. Int'l*, 417 F. Supp. 2d 310, 322 (S.D.N.Y. 2006)).

84. *Id.* at 54 n.10.

4. *Seventh Circuit: Harp v. Charter Communications, Inc.*

Finally, in March 2009, the Seventh Circuit adopted the objective-subjective standard—and cited the other circuits with approval—in *Harp v. Charter Communications, Inc.*⁸⁵ The reporting employee was let go during a “reduction-in-force” and filed suit, alleging that she was terminated as the result of internal whistleblowing.⁸⁶ The employee in this case believed that Charter was authorizing payments to a contractor for work that was never performed, and that the company had taken certain restructuring actions to interfere with the employee’s attempts to prevent such abuses.⁸⁷

In ruling against the reporting employee, the court had little occasion to go into the subjective element of the standard. While the court noted that the employee “must actually have possessed [the] belief [that fraud occurred], and that belief must be objectively reasonable,”⁸⁸ it found that the employee simply could not as a matter of law have objectively believed a fraud had been committed—nor, for that matter, could she show that her termination was proximately caused by this whistleblowing.⁸⁹ In short, the court adopted the objective-subjective standard in full, but simply did not analyze the subjective element.

C. THE NINTH CIRCUIT AND *VAN ASDALE V. INTERNATIONAL GAME TECHNOLOGY*

While the First, Fourth, Fifth, and Seventh Circuits adopted the objective-subjective standard with remarkably little deviation, in August 2009, the Ninth Circuit broke with its sister circuits in *Van Asdale v. International Game Technology*.⁹⁰ Even though it was discussed only in dicta, the court dramatically lowered the standard required under the objective-subjective standard.

1. *Factual and Procedural Background*

The plaintiffs in this case, Shawn and Lena Van Asdale, worked as corporate counsel for the defendant, International Game Technology (“IGT”).⁹¹ In late 2001, IGT began negotiations with Anchor Gaming regarding a possible merger.⁹² The merger created the nexus to SOX, because the Van Asdales’ claim related to reporting potential shareholder fraud in the course of the merger.⁹³ One of Anchor’s most

85. 558 F.3d 722, 723 (7th Cir. 2009).

86. *Id.* at 722–23.

87. *Id.* at 723–25.

88. *Id.* at 723.

89. *Id.* at 726–27.

90. 577 F.3d 989 (9th Cir. 2009).

91. *Van Asdale v. Int’l Game Tech.*, 498 F. Supp. 2d 1321, 1324 (D. Nev. 2007), *rev’d*, 577 F.3d 989.

92. *Van Asdale*, 577 F.3d at 992.

93. *Id.*

valuable assets was a patent for a type of slot machine “wheel,” which a potential competitor was likely violating.⁹⁴ After the merger went through, Shawn Van Asdale discovered that a flyer had been sent by the potential competitor to Anchor’s outside patent counsel prior to the merger, a flyer that apparently invalidated Anchor’s patent.⁹⁵ As the court noted, “if Anchor’s wheel patent was invalid, the benefits of the merger may have been overvalued.”⁹⁶ Shawn Van Asdale expressed concern that the flyer had not been included in the due diligence files Anchor provided to IGT before the merger and believed that investigation was warranted.⁹⁷ IGT’s general counsel agreed and “promised to look into it.”⁹⁸ Both Van Asdales were later terminated and filed suit, claiming that they had been fired for their internal whistleblowing activities, in violation of § 1514A.⁹⁹

The district court granted IGT’s motion for summary judgment.¹⁰⁰ The court’s reasoning with respect to the plaintiffs’ SOX claims centered on whether the Van Asdales believed that fraud *had occurred* or merely believed that fraud *might* have occurred and that this possibility should be investigated:

Plaintiff Shawn Van Asdale was questioned extensively in his deposition regarding what comments he made to [IGT’s general counsel] at the November meeting, including “What did you say about the potential for fraud?”; “What did you tell him?”; “What other statement do you individually recall saying to Mr. Johnson at this meeting?”; and “Anything else you recall specifically saying to Mr. Johnson in this November 23rd meeting?” In all cases, Plaintiff Shawn Van Asdale’s answers *never mentioned shareholder fraud* in response to these questions. Instead, he gives context to the statements by saying that he told Mr. Johnson that they needed to “*investigate these issues, the potential for fraud*, before we could assert those patents because of inequitable conduct or fraud on the patent office”¹⁰¹

The district court adopted the objective-subjective standard and held that to meet the subjective requirement, “the employee must *actually* believe that the employer was in violation of the relevant law or regulations and under the objective portion of the reasonableness requirement the employee’s belief must be objectively reasonable.”¹⁰² For Lena Van Asdale, the court ruled as a matter of law that she did not have a subjective belief that fraud had occurred, because she had not

94. *Id.*

95. *Id.* at 992–93.

96. *Id.* at 993.

97. *Id.*

98. *Id.*

99. *Id.* at 993–94.

100. *Van Asdale*, 498 F. Supp. 2d at 1334–35.

101. *Id.* at 1330–31 (alteration in original) (first emphasis added) (citations omitted).

102. *Id.* at 1333.

made up her mind one way or another on this issue (and only felt that the company should investigate).¹⁰³ The defendant did not contest that Shawn Van Asdale had a subjective belief, and the court found that he also met the objective belief standard; nevertheless, the court held that Shawn Van Asdale failed to show that he was terminated *because of* his reporting and thus, failed to meet the retaliation requirement.¹⁰⁴

2. *The Ninth Circuit Modifies the Standard*

The Van Asdales appealed the grant of summary judgment to the United States Court of Appeals for the Ninth Circuit.¹⁰⁵ The court adopted the objective-subjective standard and cited the other circuits that had considered § 1514A.¹⁰⁶ The court began by analyzing the objective element and agreed with the First Circuit's holding that the employee's theory of fraud must approximate a case of securities fraud.¹⁰⁷ If true, the court reasoned, Anchor's failure to disclose the wheel patent to further its financial interests would approximate securities fraud. The court held that the Van Asdales were therefore objectively reasonable in their belief.¹⁰⁸

The Ninth Circuit proceeded to depart from the interpretations of other circuit courts when it analyzed the subjective element. The court began by examining the Act's legislative history, specifically noting that the whistleblower protections were designed to "include all good faith and reasonable reporting of fraud, and [that] there should be no presumption that reporting is otherwise, absent specific evidence."¹⁰⁹ The court next examined the following portion of Lena Van Asdale's testimony:

Q Prior to retaining [legal counsel], did you have any personal belief that a fraud had been perpetrated on the shareholders of IGT?

A I had a belief that something had happened in the due diligence with Anchor and IGT and that an investigation needed to be conducted to see if a fraud had occurred.

¹⁰³. *Id.*

¹⁰⁴. *Id.* at 1333-34.

¹⁰⁵. *Van Asdale v. Int'l Game Tech.*, 577 F.3d 989, 991 (9th Cir. 2009) ("This case presents our first opportunity to examine the substantive requirements necessary to establish a claim under the whistleblower-protection provisions of the Sarbanes-Oxley Act, 18 U.S.C. § 1514A.").

¹⁰⁶. *Id.* at 1000 ("The plain language of this section, as well as the statute's legislative history and case law interpreting it, suggest that to trigger the protections of the Act, an employee must also have (1) a subjective belief that the conduct being reported violated a listed law, and (2) this belief must be objectively reasonable." (citing *Harp v. Charter Commc'ns Inc.*, 558 F.3d 722, 723 (7th Cir. 2009); *Day v. Staples, Inc.*, 555 F.3d 42, 54 (1st Cir. 2009); *Welch v. Chao*, F.3d 269, 275 (4th Cir. 2008); *Allen v. Amin. Review Bd.*, 514 F.3d 468, 477 (5th Cir. 2008))).

¹⁰⁷. *Id.* at 1001; *see supra* note 82 and accompanying text.

¹⁰⁸. *Van Asdale*, 577 F.3d at 1001.

¹⁰⁹. *Id.* at 1002 (quoting 148 CONG. REC. S7418-01, S7420 (daily ed. July 26, 2002) (statement of Sen. Leahy)).

Q So you didn't have a specific belief that a fraud had occurred or not?

A *I had a belief that an investigation needed to occur.*

Q So you hadn't reached a conclusion one way or another as to fraud?

A No, because we were not allowed to do an investigation.

Q Okay. But you had a strong belief that an investigation needed to be done?

A Yes.¹¹⁰

Believing that Congress's intention in passing SOX was to alleviate corporate culture dissuasive of whistleblowing, the court seemed inclined to give the Van Asdales the benefit of the doubt. Ostensibly keeping with congressional intent, the court found that "[r]equiring an employee to essentially prove the existence of fraud before suggesting the need for an investigation would hardly be consistent with Congress's goal of encouraging disclosure."¹¹¹ Saying no more on the standard for reasonable belief, the court reversed and remanded.¹¹² While not explicitly overturning any of the other circuits, the court in *Van Asdale* significantly broadened the protections of SOX. Whereas prior courts had found that an employee must believe that an actual violation had occurred (or was contemporaneously occurring), the Ninth Circuit required no such definitiveness; indeed, the court seemed to find such a requirement strongly contrary to congressional intent.¹¹³

D. CONTRASTING THE APPROACHES TAKEN BY THE CIRCUITS

As noted in Part II.C, the Ninth Circuit expanded the coverage of SOX; yet it did so without explicitly noting the split. Subsequently, two other courts have cited *Van Asdale*. In *Harkness v. C-Bass Diamond, LLC*, the United States District Court for the District of Maryland had occasion to rule on a case similar to *Van Asdale*.¹¹⁴ There, the district court distinguished on the facts and made no determination regarding the validity of the *Van Asdale* approach.¹¹⁵ Most recently, the Eleventh Circuit held, in an unpublished decision, that SOX protections required an actual subjective belief that is also objectively reasonable, essentially adopting the pre-*Van Asdale* standard.¹¹⁶ While the court cited *Van Asdale*, it did not address the decision's underlying distinction and noted

110. *Id.* at 1002 (alteration in original) (emphasis added).

111. *Id.*

112. *Id.* at 1004–05.

113. *Id.* at 1002.

114. No. 08-231, 2010 U.S. Dist. LEXIS 24380, at *18–20 (D. Md. Mar. 16, 2010).

115. *Id.* at *20.

116. See *Gale v. U.S. Dep't of Labor*, No. 08-14232, 2010 U.S. App. LEXIS 13104, at *7–10 (11th Cir. June 25, 2010).

only that the Ninth Circuit required both subjective and objective belief.¹¹⁷

Either explicitly or implicitly, the First, Fourth, Fifth, Seventh, and Eleventh Circuits all deemed it necessary to show that the reporting employee actually believed a violation occurred.¹¹⁸ The Ninth Circuit's approach, at first blush, appears to be at odds with the statutory and regulatory underpinnings of the whistleblower protections, both of which utilize the same language protecting an employee who reports action they "reasonably believe[] constitutes a violation."¹¹⁹ It is clear that "like virtually every whistleblower statute, domestic or foreign, whistleblowers [under SOX] are not required to be correct in order to be protected. They must merely reasonably believe that the information concerns a covered violation."¹²⁰ The standard espoused by the Ninth Circuit can be distinguished from the protection of sincere but inaccurate belief, insofar as the reporting employee under the *Van Asdale* standard can claim whistleblower status for merely saying that something "smells fishy" and should be investigated. This would potentially benefit the employee, as she will be covered earlier in the fraud-seeking process. It also seems to be in accord with the *Van Asdale* court's view of congressional intent. However, when examined in the context of the prior circuit decisions, it becomes evident that this new standard will quickly become judicially unmanageable and expand the somewhat limited scope of protection enacted by Congress.¹²¹ This unmanageability, along with the deleterious effect that such a relaxed standard will have on employees *and* employers, is the topic of Part III.

III. THE IMPACT OF AN "INVESTIGATION STANDARD" ON SOX WHISTLEBLOWERS AND THE COMPANIES THAT EMPLOY THEM

This Part examines the interplay between the *Van Asdale* standard for subjective belief on the one hand, and Congress's goal of incentivizing whistleblowing in the securities arena on the other. Starting from a framework for determining how whistleblowers are incentivized (and by extension, how they *should and could* be incentivized), this Part analyzes the impact of the broadened standard within the existing SOX whistleblowing schema. This Part further examines the preexisting tension between corporations, who must deal with potential

117. *Id.* at *7–8.

118. *See supra* Part II.C.

119. Sarbanes-Oxley Act, 18 U.S.C. § 1514A(a)(1) (2006); 29 C.F.R. § 1980.102(b)(1) (2009).

120. Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 MICH. L. REV. 1757, 1760 (2007).

121. For example, it seems clear that the plaintiff in *Livingston v. Wyeth, Inc.* would likely have prevailed on his claim, despite the fact that the company thoroughly investigated the matter and found that there simply were no violations (or potential violations) of securities law. *See* 520 F.3d 344, 352–54 (4th Cir. 2008).

whistleblower claims and thus, seek some predictability and balance, and the whistleblowing intentions of Congress evidenced in SOX, and more abstractly, the intentions of Congress in protecting any whistleblower.

A. ENCOURAGING WHISTLEBLOWERS: FRAMEWORKS FOR INCENTIVIZING DISCLOSURE

SOX provides statutory remedies for employees who successfully report in order to “make the employee whole.”¹²² Specifically listed are compensatory damages including reinstatement, back pay with interest, and “special damages . . . including litigation costs, expert witness fees, and reasonable attorney fees.”¹²³ What is notably missing from this rubric is any sort of affirmative incentive for employees to blow the whistle and compensation for indirect damages the employee might suffer.

1. *Obstacles to Whistleblowing*

There are numerous ways that a whistleblower law could incentivize disclosure; however, these must overcome the innate harm and damage that can be caused by whistleblowing. In his discussion of incentives under SOX, Professor Christopher Rapp notes the potential harms that a whistleblower faces: Their current employer might implode like Enron; the employee might be blacklisted from future employers who fear disloyalty; coworkers might shy away; the employee might face “social ostracism”; and they might suffer psychological damage from spending time in the limelight, at the center of the scandal.¹²⁴ Professor Orly Lobel notes similar obstacles facing the potential whistleblower: fear and guilt, retaliation against family members, and threats on the employee’s life.¹²⁵ Indeed, he argues that “[w]histleblowing can thus become a form of professional suicide, effectively ending careers.”¹²⁶ The harms may be even further removed from the employee’s professional life, as one commentator relates how “[o]ne whistleblower even saw his employer interfere in private litigation concerning custody over his children.”¹²⁷ Thus, it is clear that there are a host of non-pecuniary harms caused by whistleblowing that may, individually or in combination, serve to dissuade an employee from reporting fraud at her company.

2. *Ameliorating Harm: Retrospective and Prospective Remedies*

Roughly speaking, there are two schools of thought on what incentives exist (or should exist) for whistleblowers. The first camp seeks

122. 18 U.S.C. § 1514A(c)(1).

123. *Id.* § 1514A(c)(2).

124. Rapp, *supra* note 20, at 95–96.

125. Lobel, *supra* note 41, at 486–87.

126. *Id.* at 487.

127. Pamela H. Bucy, *Information as a Commodity in the Regulatory World*, 39 Hous. L. Rev. 905, 951 (2002).

retrospective non-compensatory damages. Essentially, they argue that whistleblowers face non-pecuniary and secondary economic damages, such as those discussed above.¹²⁸ They seek to incentivize whistleblowers by ameliorating these additional harms in order to put the employee back in the same position she was in prior to reporting.¹²⁹ This is, at its simplest, the method that SOX uses to incentivize whistleblowers, though within a limited constellation of remediable harms. The second group believes whistleblowers need prospective, bounty-like incentives in order to blow the whistle.¹³⁰ Instead of placing the employee back in the position she was in before the whistleblowing, this group would place her in a better situation, drawing direct comparison to the FCA, which provides for a percentage of damages recovered by the government in contract fraud cases.¹³¹

SOX approaches the incentive problem by providing retrospective “make whole” remedies to a whistleblowing employee.¹³² While this certainly qualifies as some form of incentive, the damages available would best be described as minimal.¹³³ At first glance, it seems that non-pecuniary damages are *not* included in the plain language of § 1514A. However, it is likely that courts would interpret the “special damages” clause to include at least some non-pecuniary damages, thus expanding the scope of remedies available to a SOX whistleblower.¹³⁴

On the other hand, prospective, bounty-like remedies can be thought of as providing an employee active incentives to disclose wrongdoing by giving the employee a cut of any future recovery. Providing this type of remedy seems like a win-win: The employee is compensated for her trouble and does not have to worry about secondary effects, and the government gets the information it desires. Indeed, there appears to be a movement toward the view of whistleblowers as saints, exposing corruption, acting courageously, and receiving their just compensation from society.¹³⁵ Professor William Kovacic has identified three benefits to a bounty system for whistleblowers: (1) bounties encourage employees proximate to

128. See, e.g., Rapp, *supra* note 20, at 96.

129. *Id.* at 114.

130. See generally *id.* at 134–37 (discussing the merits of providing *qui tam* bounties for whistleblowers).

131. See *supra* note 43 and accompanying text; see also False Claims Act, 31 U.S.C. §§ 3729–3731 (2006).

132. Sarbanes-Oxley Act, 18 U.S.C. § 1514A(c)(1) (2006).

133. Pamela H. Bucy, “Carrots and Sticks”: *Post-Enron Regulation Initiatives*, 8 *BUFF. CRIM. L. REV.* 277, 286 (2004).

134. See Nina Schichor, *Does Sarbanes-Oxley Force Whistleblowers to Sacrifice Their Reputations?: An Argument for Granting Whistleblowers Non-Pecuniary Damages*, 8 *U.C. DAVIS BUS. L.J.* 272, 282 (2008).

135. See Lobel, *supra* note 41, at 488.

information about fraud to come forward instead of relying on audits, (2) incentivized whistleblowers can act faster and in areas where governmental momentum or political considerations may preclude investigation, and (3) bounties augment the limited funding available to government enforcement agencies, because the defrauder is indirectly paying the investigator's salary.¹³⁶ Professor Rapp proposes to adopt a bounty system within the SOX whistleblowing framework, modeling it on the FCA:

If increasing the volume of whistleblowing, rather than simply protecting whistleblowers from retaliation, was Congress' goal in passing SOX, financial incentives would better serve that aspiration. Moreover, financial incentives are structured to increase with the seriousness of the underlying fraud. Since the social value of disclosure of more serious frauds is particularly high, that linkage makes financial bounties a better tool than anti-retaliation provisions for maximizing effective whistleblowing.¹³⁷

While this "carrot" encouraging whistleblowers to come forward makes intuitive sense, bounties are not without their problems or detractors. Bounty programs have been described by some legislators as "Reward[s] for Rats," which rely on greed and a desire for revenge on the part of whistleblowers.¹³⁸ Frivolous or outright, false accusations by employees seeking to claim a whistleblower bounty could increase regulatory burdens and waste judicial resources. Professor Rapp argues that the amount of fraud potentially uncovered by bounty-seeking whistleblowers more than makes up for these "minimal" wasted resources.¹³⁹ This analysis though seems to miss the collateral damage caused by false whistleblowing claims: the reputational harms suffered by managers and corporations, and the reverberating effect such (false) disclosure might have on the markets before it is deemed frivolous. Disgruntled employees seeking reinstatement and back pay, revenge-seeking terminated employees, and the purely greedy would all be incentivized, along with the upstanding, fraud-reporting employee who such a system seeks to reward.¹⁴⁰

136. William E. Kovacic, *Whistleblower Bounty Lawsuits as Monitoring Devices in Government Contracting*, 29 *LOY. L.A. L. REV.* 1799, 1821–25 (1996).

137. Rapp, *supra* note 20, at 135; *see also* Dworkin, *supra* note 120, at 1774 (agreeing that an FCA-like incentive, as proposed by Rapp, could encourage whistleblowing).

138. Lobel, *supra* note 41, at 488.

139. Rapp, *supra* note 20, at 133.

140. Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 *MICH. L. REV.* 1899, 1937–38 (2007) ("One significant cost of installing whistleblower protections of the kind described in Sarbanes-Oxley is the cost of evaluating a whistleblower complaint. Particularly where bounties are involved, as noted above, there are likely to be several false complaints for every valid one. The risk of receiving false complaints is compounded when one takes into account the fact that disgruntled former employees, especially those who have been terminated, are likely to bring whistleblower complaints in order to try to obtain reinstatement

Clearly whistleblowers need *some* form of incentive, either to compensate for harms suffered by whistleblowing (pecuniary and non-pecuniary, direct and indirect) or to encourage whistleblowing by providing lucrative bounties sufficient to overcome the aforementioned harms and obstacles. While there are compelling reasons to believe that bounties would provide a socially desirable increase in fraud reporting, there are also significant questions as to the efficacy and “noise” that would surely follow.

B. *VAN ASDALE* AND THE INCENTIVE FRAMEWORK

While not explicitly mentioning it, one can find an underlying goal of increasing whistleblower protections and reporting in the Ninth Circuit’s *Van Asdale* decision. The court specifically noted its dissatisfaction with an employee having to prove the existence of fraud before reporting it, an inconsistency the court felt was contrary to congressional intent.¹⁴¹ Practically speaking, there are two paths that can be taken to encourage whistleblowing. The first involves incentives and remedies, making it a “fair deal” to report fraud. The second is more procedural in nature, expanding the class of plaintiffs and the types of behavior that will qualify for protection.

Obviously a court is limited in its ability to modify the former, as it is confined to the statutorily provided remedies. However, by expanding the class of plaintiffs and breaking with the other circuits, the Ninth Circuit has read too much into § 1514A. By expanding protections to employees who have only inchoate beliefs regarding the commission of fraud, we significantly increase the risk of false reporting and, perhaps, overwhelm the system’s ability to identify truly grievous incidents of securities fraud. Moreover, the broader class of plaintiff-employees exacerbates corporations’ fears of illegitimate reprisal. Incompetent employees may also be potential whistleblowers, and this potential increases under *Van Asdale*’s more deferential standard. The problem is one of balancing corporate interests in efficiency against the risk associated with a whistleblower suit: “Retaining incompetent employees can lead to inefficiencies that affect productivity and profitability. Nonetheless, when employers fail to adhere to the SOX whistleblower provisions, they become subject to civil and criminal liability exposure.”¹⁴²

and/or back pay. It is also likely that terminated employees will attempt to extract a measure of revenge on former supervisors, particularly those responsible for the employees’ termination.”); see also Ralph F. Hall & Robert J. Berlin, *When You Have a Hammer Everything Looks Like a Nail: Misapplication of the False Claims Act to Off-Label Promotion*, 61 *FOOD & DRUG L.J.* 653, 675 (2006) (arguing that bounty provisions can upset carefully balanced congressional policy decisions).

141. *Van Asdale v. Int’l Game Tech.*, 577 F.3d 989, 1002 (9th Cir. 2009).

142. Steinberg & Kaufman, *supra* note 47, at 457.

From a cost-benefit standpoint, two conclusions seem appropriate. First, when dealing with incentives, an expansion of remedies available under SOX to include prospective bounties would increase the costs associated with false or bad faith whistleblowing.¹⁴³ It seems clear, then, that the more appropriate method of reforming incentives would be to provide more comprehensive retrospective remedies to ameliorate the problems previously identified. This lowers costs to all parties: Employees are better guaranteed compensation for blowing the whistle, employers are shielded from frivolous lawsuits, and the government and regulatory agencies have fewer complaints to deal with and can thus focus limited resources on the most promising matters.

Second, and for similar reasons, the procedural requirements of SOX should not be lowered as the Ninth Circuit has done. In a comprehensive empirical study of SOX whistleblower claims at the administrative level, both at the level of OSHA review and as determined by an administrative law judge (ALJ), Professor Richard E. Moberly found that only 5.6% of whistleblower cases on OSHA review and 14.5% of whistleblower cases decided by an ALJ were dismissed for lack of reasonable belief.¹⁴⁴ The far greater cause of an employee's loss was a finding that the activity was not a contributing factor in the adverse employment action (35.5% and 21.7% respectively).¹⁴⁵ A finding that the employer was not covered by SOX resulted in 15.4% and 28.9% of dismissals on OSHA review and by ALJs respectively.¹⁴⁶ With respect to the reasonable belief standard, Professor Moberly concluded that "Congress should amend the Act to emphasize that an employee's reasonable belief regarding the illegality of an activity reported should be compared with an employee of similar education and experience."¹⁴⁷ Lowering the standard by which reasonable belief is judged would, it seems, result in a relatively limited benefit to employees seeking review.

143. Corporations face numerous costs when dealing with whistleblower statutes:

Employees may lodge false complaints or engage in bad faith disclosures and thereby prevent the supervisor from taking legitimate adverse actions against them; alternatively, employees may not understand that conduct that appears to the employee to be inappropriate is in fact legal. . . .

Ramirez, *supra* note 56, at 223. Moreover, these costs are hard to measure or even to anticipate:

The costs [associated with whistleblower laws] are difficult to quantify because adopting an effective program in response to anti-retaliation legislation may include the cost of time for training, establishing hotlines, potential arbitration, or even litigation. But without the legislation, businesses bear costs of mismanagement, potential litigation, and costs of crime, whether it is fraud, theft, or human life.

Id. at 225-26.

144. Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 WM. & MARY L. REV. 65, 102 (2007).

145. *Id.*

146. *Id.*

147. *Id.* at 141.

Thus employers would incur extra costs associated with whistleblower compliance, while the public received relatively little marginal increase in successful whistleblower complaints. In Part IV, this Note will propose an alternative approach that attempts to balance these competing interests in a socially beneficial manner.

IV. RESOLVING THE CONFLICT, UPDATING THE LAW: A PROPOSAL

There are essentially two conclusions to be drawn from the current state of whistleblower protections under SOX. First, the incentives to blow the whistle and the scope of the law's coverage are of paramount importance. Retrospective remedies, rather than bounties, are more appropriate for whistleblower laws. Second, *Van Asdale* should be overturned in favor of the standard reached by the other circuits.¹⁴⁸ Expanding the scope of covered employers, rather than the scope of potential employee-plaintiffs, is a more ideologically consistent method of increasing whistleblowing. Unfortunately, Congress chose to implement essentially the opposite of both these recommendations. The Dodd-Frank Act creates several new, but separate, whistleblower protections. It also incentivizes some whistleblowing by expanding the use of qui tam provisions. The Dodd-Frank Act, then, is a useful analytical tool in demonstrating how these changes *could have been*, but ultimately *were not* implemented by Congress.

A. RECOMMENDATIONS FOR INCENTIVES AND SCOPE

First, consistent with the costs and benefits identified in Part III, this Note recommends that Congress amend SOX to reflect two changes in the whistleblower protections. Congress should more explicitly protect against the harms faced by an employee reporting fraud within her company. This Note strongly endorses a grant of non-pecuniary damages to whistleblowers under SOX:

Sarbanes-Oxley should ensure, at the very least, that whistleblowers can potentially recoup all losses they will suffer for reporting wrongdoing. If we do not grant whistleblowers sufficient damages to make them whole, then whistleblowers face a perverse disincentive to act, and whistleblowers on the margin may decide not to help society.¹⁴⁹

An employee's choice to blow the whistle represents a belief that the dictates of morality, legality, economics, or ethics require the employee to report the illegal actions. Two distinct *economic* considerations may also factor into the decision: Can the employee profit from reporting,¹⁵⁰ and will the employee incur severe financial hardship?

148. See *supra* Part II.B.

149. Schichor, *supra* note 134, at 295 (footnotes omitted).

150. See F. Paul Bland, *Why "Qui Tam" Is Necessary*, NAT'L L.J., Nov. 4, 1991, at 13, 14 ("Critics

For some whistleblowers, the importance of acting ethically will result in reporting *regardless* of the consequences or the available remedies; however, “those who are on the margins, those employees who are trying to decide if reporting illegal activity is worth losing their jobs, may be influenced.”¹⁵¹ Other employees may only act if given the chance to earn a lucrative bounty, and “are motivated primarily by prospects of monetary reward rather than the public good.”¹⁵² Ultimately, this Note argues that full compensation of whistleblowers for economic and non-economic damages, and not *qui tam* bounties, represents the soundest method of encouraging whistleblowing for the public good.

The alternative to the more technical approach advocated by this Note would be a broad expansion of federal whistleblowing laws that override the narrow, issue-specific schemes currently in place. Professor Miriam Cherry persuasively argues that whistleblowers should receive protection for reporting *any* violation of federal law, subject to certain restrictions.¹⁵³ She notes that employees who may wish to report violations of myriad federal and state laws could be discouraged by the lack of protections, and that those who do report such violations may “fall through the cracks.”¹⁵⁴ This approach is harmonious with the problems and solutions identified in this Note, as it would provide more uniform and predictable protections and increase enforcement of federal law (including securities law).¹⁵⁵

While such a dramatic expansion of federal whistleblower protections would not be without its problems, a broad and cohesive whistleblowing scheme is also not without precedent. The WPA protects civil servants from retaliation for reporting violations of *any* federal law.¹⁵⁶ Likewise, the FCA incentivizes whistleblowing regarding *any* fraud against the government.¹⁵⁷ Implicit within both of these statutes is a belief that the reporting of any wrongdoing should be incentivized. It is hard to believe that a scheme incorporating the enormous federal civil service would somehow break down if expanded to the private sector.

fear that the law appeals to the worst instincts of the individual—disloyalty, greed and self-advancement.”).

151. See Cherry, *supra* note 32, at 1086.

152. *Hughes Aircraft Co. v. United States ex rel. Schumer*, 520 U.S. 939, 949 (1997) (discussing *qui tam* bounties in the context of the False Claims Act); see also *supra* Part III.A.2.

153. See Cherry, *supra* note 32, at 1085.

154. *Id.*

155. *Id.* (“Such protection would have a positive impact not only on the individual whistleblowers who receive direct protection under the law, but also on the enforcement of federal statutes. A uniform statement of state law, standardizing the types of dismissal that are against public policy, would also be a positive development.”).

156. See *supra* Part I.B.

157. *Id.*

Comparative analysis bears this out. In the United Kingdom, a broad range of employees are protected:

The U.K. law . . . defines a “qualifying disclosure” as one that a worker reasonably believes tends to show activities falling into one or more of the following categories: 1) a criminal offense; 2) failure to comply with any legal obligation; 3) a miscarriage of justice; 4) danger to the health and safety of any individual; 5) damage to the environment; or 6) the deliberate concealment of information tending to show any of these circumstances.¹⁵⁸

Limiting this broad grant of protection is a requirement that the employee have acted in good faith, as the law “explicitly withholds protection from whistleblowers who act for personal gain.”¹⁵⁹ These schemes all point to the reasonableness of a broad, non-subject-matter-based protection for whistleblowers, which relies on moral and ethical obligations instead of bounties, covers many—if not all—violations of federal law, and provides for sufficient compensation to the employee.

Additionally, the Ninth Circuit’s decision in *Van Asdale* should be overturned in favor of the predominant rule requiring belief that fraud actually occurred. The aforementioned costs and risks to employers by dissatisfied and terminated employees seeking whistleblower protections would be greatly amplified if the courts allow whistleblower claims whenever an employee feels something should be investigated. There is also the risk of either compartmentalization within corporations (to prevent “red flags” and thus, claims under the investigation standard) or the retention of employees who would otherwise have been fired but for the threat of a whistleblower suit. This Note proposes that the more appropriate mechanism for expanding whistleblower protections is legislative: an expansion of covered employers and/or subject matter. Judicial manipulation of reasonableness standards simply disrupts the balanced whistleblower scheme enacted by Congress too much. This disruption, compared to a legislatively-crafted solution, would affect a greater percentage of whistleblower cases, as only a small percentage of potential SOX claims are dismissed for lack of reasonable belief.¹⁶⁰ Maintaining the standard as-is ensures that the procedural safeguards that prevent false reporting, including the objective-subjective standard, remain in place.

158. Elletta Sangrey Callahan et al., *Whistleblowing: Australian, U.K., and U.S. Approaches to Disclosure in the Public Interest*, 44 VA. J. INT’L L. 879, 885 (2004).

159. *Id.* at 895.

160. See Moberly, *supra* note 144, at 102.

B. THE DODD-FRANK ACT

The Dodd-Frank Act, passed in July 2010, contained several provisions related to whistleblowing.¹⁶¹ Conceptually, these changes can be classified into two groups: (1) the creation of new whistleblower schemes,¹⁶² and (2) the expansion or retooling of existing schemes.¹⁶³ Each of these represents a fundamental failure to resolve the structural weaknesses in federal whistleblower laws, and each perpetuates and expands upon the underlying causes of that weakness.

The new statutory schemes follow the same subject-specific protection discussed above. For example, § 1057 prohibits employers from retaliating against an employee who “reasonably believes” that a violation of the Dodd-Frank Act’s consumer protection provisions has occurred, if that employee is in the financial services sector.¹⁶⁴ Section 748 provides similar protections for violations of the Commodities Exchange Act.¹⁶⁵ Section 922 creates a broad whistleblowing scheme for reporting any original information regarding securities fraud to the SEC.¹⁶⁶

Each of these new protections represents a distinct area of protection, and none simplifies the mosaic of statutory protections. Indeed, these additions serve only to compound the problems associated with having multiple and varying protection schemes scattered throughout the United States Code. Furthermore, all of these new whistleblower protections provide either too little compensation to the employee (§ 1057 employees are entitled to only economic damages, such as back pay and litigation costs)¹⁶⁷ or too much compensation (§ 922 provides for *qui tam* awards of between ten and thirty percent, and the provision only applies to claims of over one million dollars in value).¹⁶⁸

The Dodd-Frank Act’s changes to the existing whistleblower schemes provide no additional clarity. Sections 922 and 929A amend the SOX whistleblower provisions to correct procedural issues that had arisen, such as the liability of subsidiary companies¹⁶⁹ and the statute of limitations.¹⁷⁰ Neither change provides guidance for the split discussed in this Note, nor increases the compensation of reporting employees to provide adequately for non-pecuniary damages. Congress merely perpetuated the piecemeal system, which, this Note argues, poorly

161. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

162. *See, e.g., id.* §§ 748, 922, 1057.

163. *See, e.g., id.* §§ 922, 929A, 1079(b).

164. *Id.* § 1057(a)(1).

165. *Id.* § 748.

166. *Id.* § 922.

167. *Id.* § 1057(c)(4)(D).

168. *Id.* § 922(b)(1).

169. *Id.* § 929A.

170. *Id.* § 922(c).

incentivizes and protects whistleblowers. Congress also failed to provide any additional guidance regarding the reasonable belief standard. Unfortunately, as the weight of these disparate protections increases, we are likely to see increased confusion among employees about what is covered, who is protected, and how they should report potential violations.

CONCLUSION

Protecting whistleblowers reflects a careful balancing act. On the one hand, there is the desire to protect employees, to encourage disclosure, and to discourage corporations from engaging in fraud. On the other hand, compliance costs time and money. If we increase incentives too much, we risk self-interested employees filing false reports in pursuit of bounties, or disgruntled ex-employees seeking revenge on their old employers. The Ninth Circuit admirably sought to expand whistleblower protections by lowering the standard for what constitutes reasonable belief, thereby essentially allowing protections for allegations of inchoate fraud. As this Note has shown, this is an undesirable approach. Increasing retrospective incentives to make employees whole and thus, reduce the burdens of whistleblowing would more effectively balance the encouragement of whistleblowing with the costs of false claims made in bad faith. Alternatively, an increase in the scope of whistleblower protections at the federal level could accomplish many of these same goals, while covering a broader range of federal law. In either case, *Van Asdale* should be overturned, as it is simply too unmanageable and disruptive. With the passage of the Dodd-Frank Act, congressional motivation to fix the federal whistleblower system is likely weakening. Unfortunately, the piecemeal expansion of whistleblower protections only begets more piecemeal expansions, and a substantial overhaul of the underlying legislative rational becomes less likely. Nevertheless, movement towards a comprehensive, unified, and properly incentivized system would be invaluable in preventing future financial crises, and future legislation could yet solve this statutory quagmire.
