WHISTLEBLOWER PROTECTION LEGISLATION OF THE EAST AND WEST: CAN IT REALLY REDUCE CORPORATE FRAUD AND IMPROVE CORPORATE GOVERNANCE?

A STUDY OF THE SUCCESSES AND FAILURES OF WHISTLEBLOWER PROTECTION LEGISLATION IN THE US AND CHINA

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The United States Sarbanes-Oxley Act was passed in 2002 in response to the increasing corporate fraud plaguing the American business sector. A key provision of this legislation, section 806, provides whistleblower protection to defend fraud-exposing employees against retaliatory action taken by their employers. In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act reformed section 806 and significantly strengthened the protection available to whistleblowers. On the other side of the world, China too has realized the important role whistleblower protection plays in the fight against corporate fraud. China recently promulgated what many consider to be the Chinese analogue of Sarbanes-Oxley, "The Basic Standard for Enterprise Internal Control." The new Chinese law, commonly referred to as China SOX, became effective on July 1, 2009. China SOX contains a whistleblower protection provision and also requires companies in China to set up whistleblower mechanisms for fraud alert. Despite the recentness of its passage, critics in the regulatory and business sectors have already voiced serious concern that China SOX and its whistleblower protection will not be strongly enforced, and that many Chinese corporations will fail to fully comply with the new regulatory scheme. These criticisms focus on a variety of issues, including the vagueness of the statutory text, and more generally, the inadequacies of China's developing legal system.

This Note attempts to dispel the preconceived notion that the whistleblower protection provisions of China SOX will do little, if anything, to reduce corruption among corporate management in China. In particular, this paper's analysis addresses two crucial factors that will contribute to the success of China SOX's whistleblower protection: (1) the success of both China's Labor Contract Law and Labor Dispute Resolution Law, and the capability of these laws' arbitration procedures to effectively enforce China SOX's whistleblower protection in employer retaliation claims, and (2) China's ability to learn from the American experience with private sector whistleblower protection and to avoid its shortfalls.

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I.
INTRODUCTION

Whistleblowing, which involves the disclosure by members of an organization of the illegal practices of their employer, is an important mechanism in revealing and deterring corporate fraud. "To many . . . the word 'whistleblower' represents heroes who risk their lives or careers for the benefit of society. On the other hand, critics perceive them to be nothing short of 'tattletales,' 'snitches,' or 'industrial spies' who toss out employee loyalty for furtherance of their own political, ethical, moral, or personal agendas."[1] However, either way the term is defined, there is no escaping the fact that whistleblowing significantly contributes to the effort to improve corporate governance and reduce corporate fraud. Unfortunately, there are numerous disincentives to whistleblowing. One of the most central discouragements of blowing the whistle is the fear of employer retaliation, whether in the form of termination, demotion, or other disciplinary action. In order to conquer this

1. Joan Corbo, Kraus v. New Rochelle Hosp. Med. Ctr.: *Are Whistleblowers Finally Getting the Protection They Need?*, 12 HOFSTRA LAB. & EMP. L.J. 141, 141 (1994).

major disincentive and increase the incidence of whistleblowing to the level necessary to effectively deter corporate malfeasance, it is crucial that governments provide legal protection for employee whistleblowers against such retaliation.

The United States realized the important role of whistleblowing in revealing and preventing corporate fraud following the massive corporate scandals that emerged in 2001. In the aftermath of this outbreak of corporate fraud, the United States also recognized the need for greater protection of whistleblowers. When companies such as Enron, WorldCom, and Tyco unexpectedly sank into bankruptcy, it was the reports of whistleblowing employees that finally revealed to the public these companies' internal accounting fraud and other business abuses. However, many employees within these companies were aware of the fraudulent activities well before 2001 and the onset of the companies' collapse. Such employees did not come forward with their reports of corporate wrongdoing primarily due to fear of retaliation by their employers. Therefore, if adequate legal protection of whistleblowers had existed, it is likely that the fraudulent activities of these corporations would have been revealed and corrected before they resulted in the loss of billions of dollars to shareholders, employees, and other corporate constituencies. As a result the Sarbanes-Oxley Act of 2002 (US SOX), and later the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), were passed by the US Congress.

Prior to the passage of US SOX and Dodd-Frank, employees of publicly traded companies who made complaints of corporate fraud had little or no federal legal protection. However, US SOX section 806 and the recent Dodd-Frank reforms now provide a civil remedy through which whistleblowers who have suffered employer retaliation can be made whole.[2] Since 2002, China has also experienced a massive outbreak of corpo-

2. *See* 18 U.S.C. § 1514A(c)(1) (2002). US SOX section 301 is also part of the whistleblower protection regime and states that "each audit committee shall establish procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters." *See* 15 U.S.C. § 78f(m)(4) (2002). US SOX also makes it a criminal offense to retaliate against whistleblowing employees, carrying penalties of up to ten years imprisonment and/or fines. *See* 18 U.S.C. § 1513(e) (2002). This paper focuses primarily on the civil remedy provided by US SOX section 806.

rate malfeasance and has responded by taking action very similar to the US approach. The Chinese government now acknowledges the direct positive effect whistleblowing can have on reducing corporate fraud and improving corporate governance, and has therefore promulgated a Chinese analogue of US SOX to provide legal protection to whistleblowers. This new Chinese law, commonly referred to as China SOX, was passed in 2008 and became effective as of July 1, 2009. Article 43 of China SOX serves a similar purpose as US SOX section 806, which is to protect whistleblowers from retaliation and thereby encourage more acts of whistleblowing.

Now that China has taken the first step toward ensuring protection of corporate whistleblowers, the question becomes whether China has the ability and willingness to successfully enforce this new law and provide realistic means through which whistleblowers can vindicate their rights. This paper reaches the conclusion that China does in fact have the ability to effectively implement China SOX whistleblower protection, but whether China will actually take the necessary action to carry out such implementation is uncertain.

Much of the Chinese government's ability to enforce its newly created whistleblower protection legislation depends on its taking into account China's unique circumstances. Therefore, Part 1 of this paper discusses the specific need for whistleblower protection in China in terms of China's corporate fraud epidemic, weak governmental securities regulation regime, and the criminal and other severe punishments often imposed on Chinese whistleblowers. Part 1 also discusses how US SOX section 806 does not apply extraterritorially to protect employees of Chinese companies listed in the US. The first part of the paper then concludes by analyzing the prevalent criticisms of the China SOX whistleblower protection provision and revealing the misconceived notions that underlie the critics' arguments.

The experiences the United States has had with whistleblower protection legislation can also provide great insight into how China can bring about effective enforcement of China SOX. Therefore, Part 2 of this paper begins with a discussion of the features of US SOX whistleblower protection and the problems the US has encountered in implementing US SOX section 806, which include problems of narrow interpretation, confidential arbitrations, and lack of a *qui tam* in-

centive system. The Dodd-Frank Act and the reforms it has made toward resolving some of the issues of US SOX section 806 are also discussed.

Finally, the paper concludes with the proposition that combining China's unique legal system with lessons learned from abroad will enable effective enforcement of China's new whistleblower protection legislation. Following a description of China's Labor Contract Law and Labor Dispute Resolution Law, the final section explains how these labor dispute resolution procedures can be used to successfully enforce China SOX article 43 and avoid the problems that plagued the application of US SOX section 806. Other mechanisms that China can implement to further improve the operation of its new whistleblower protection regime, including procedural rules that favor employee-plaintiffs in retaliation cases and anonymous reporting, are also discussed.

II.
WHISTLEBLOWING IS NECESSARY TO CONTROL CORPORATE FRAUD AND IMPROVE CORPORATE GOVERNANCE

The detection of fraud in the corporate sector requires the effective operation of many different mechanisms. Government agencies (such as the Securities Exchange Commission, or SEC, in the US and the Chinese Securities Regulation Commission, or CSRC, in China), financial auditors, industry regulators, the media, and employees within the corporations each play crucial roles in monitoring corporate action and reporting fraud. None of these actors alone can sufficiently discover and reveal the numerous incidents of corporate fraud that occur each year, but instead the monitoring conducted by each of these actors in tandem is necessary to make any significant progress in the quest to eliminate corporate fraud. According to a recent study by the National Bureau of Economic Research, on average 6% of corporate fraud cases in the US are revealed by the SEC, 14% by auditors, 14% by the media, 16% by industry regulators, and 19% by employee whistleblowers.[3] The importance of whistleblowers in revealing corporate fraud and improving corporate governance

3. Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 12882), *available at* http://www.nber.org/papers/w12882.pdf.

on an international scale is further demonstrated by the 2007 Global Economic Crime Survey, which reported that almost one-third of fraud cases in the corporate sector are revealed by whistleblowers and other internal tip-offs from employees of the corporation.[4] Furthermore, the 2009 Global Corruption Report conducted by Transparency International found that after self-reporting by companies, the single most important source of public disclosure of corporate fraud worldwide is employee whistleblowers.[5]

Due to their pivotal role in revealing corporate fraud, the existence of employee whistleblowers can serve as an effective deterrent for corrupt business practices and a stimulus for companies to improve their corporate governance. Corporate corruption is prevalent throughout the world. In the 2007 Global Economic Crime Survey, almost one in three companies reported incidents of asset misappropriation and more than one in ten reported having been affected by accounting fraud during a four-year period, while senior and middle management were found to be involved in a half of all cases of economic crime.[6] If directors and managers of the corporation have real fear that their fraudulent actions may be discovered and revealed by corporate employees, they will think twice before partaking in such illegal activity. Companies worldwide have recognized this immensely important role that employee whistleblowers play in ensuring effective corporate governance and detecting corporate fraud, and as a result have increasingly integrated whistleblower hotlines and other complaint systems into their compliance and fraud detection programs.[7] In addition, corporations and governments in the US and abroad have recognized that empowering and encouraging employees to take on the role of whistleblower requires

4. PRICEWATERHOUSECOOPERS, ECONOMIC CRIME: PEOPLE, CULTURE AND CONTROLS: THE 4TH BIENNIAL GLOBAL ECONOMIC CRIME SURVEY 10, 23 (2007), *available at* http://www.pwc.com/en_GX/gx/economic-crime-survey/pdf/pwc_2007gecs.pdf. The compiled tables of the survey results reveal the importance of whistleblowing in revealing corporate fraud.

5. TRANSPARENCY INT'L, GLOBAL CORRUPTION REPORT 2009: CORRUPTION AND THE PRIVATE SECTOR, at xxvii, xxxiii, 94 (2009), *available at* http://www.transparency.org/publications/gcr/gcr_2009.

6. *Id.* at 18; PRICEWATERHOUSECOOPERS, *supra* note 4, at 5.

7. TRANSPARENCY INT'L, *supra* note 5, at 94.

that strong legal protection be provided to protect such whistleblowers from retaliation by their employer.[8]

Corporate employees can be instrumental in solving the inherent information problems of traditional external corporate monitors, which include a company's independent directors, attorneys and external auditors, and government agencies. Employees have an information advantage over these traditional corporate monitors because they have a more intimate and complete knowledge of the inner workings of the large corporations within which they work.[9] Financial misconduct on the scale that occurred in the Enron and WorldCom corporate scandals could not have been completed without the assistance of low-and mid-level employees because of the wide scope and complexity of such financial malfeasance.[10] Moreover, even if an employee does not participate in the wrongdoing, corporate accounting and finance employees who are trained in the proper methods of conducting business are likely better able than the traditional external monitors to quickly recognize when corporate wrongdoing has occurred.[11] Rank-and-file employees tend to play a central role in most corporate activities, and their insider knowledge of corporate action renders such employees essential to revealing corporate wrongdoing in a timely manner.[12] It is therefore critical to the discovery and prevention of corporate fraud that employees be effectively encouraged to disclose their knowledge of corporate malfeasance.

The act of whistleblowing can improve corporate governance by deterring corporate managers and directors from partaking in fraudulent activities, which if revealed, would result in serious consequences to themselves and to the financial

8. TRANSPARENCY INT'L, *supra* note 5, at xxxiii.

9. Richard E. Moberly, *Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 B.Y.U. L. REV. 1107, 1113-18 (2006).

10. Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L.Q. 357, 374 (2003).

11. Richard Alexander, *The Role of Whistleblowers in the Fight Against Economic Crime*, 12 J. FIN. CRIME 131, 131 (2004).

12. Larry E. Ribstein, *Sarbox: The Road to Nirvana*, 2004 MICH. ST. L. REV. 279, 286 (2004).

health of the company.[13] At the same time that it deters corporate fraud, whistleblowing also promotes good governance practices among corporate management.[14] These good governance practices entail properly balancing the needs for efficiency and profit with the equitable treatment of corporate constituencies, which include shareholders and employees, as well as creditors, suppliers, and society at large.[15]

In order to encourage corporate employees to overcome the disincentives of blowing the whistle on the illegal activities of the companies that employ them, legal protection for such whistleblowers must be provided.

With the creation of broader [legal] whistleblower protection, employers will feel a sense of responsibility and accountability, and employees will have the ammunition to step up and fight for what is right without fearing threats to their careers.

The legal system as a whole must take charge of this mandate for increasing protections for whistleblowers. Working together in a concerted effort, the legal system can lead society in forming a more positive and encouraging environment for blowing the whistle on employers' illegal activities.[16]

Therefore, in order to more fully detect corporate fraud and advance corporate integrity, an adequate level of whistleblower legal protection and enforcement of such legal provisions are crucial. In Part 1, the need for whistleblower protection in China will be demonstrated, followed by a discussion of the adequacy and enforcement of the whistleblower protection provisions of the new China-SOX. Then, in Part 2, China's legal protection of whistleblowers will be analyzed in light of the US experience with section 806 of the Sarbanes-Oxley Act and the Dodd-Frank reforms.

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13. *See* Marlene Winfield, *Whistleblowers as Corporate Safety Net, in* WHISTLEBLOWING: SUBVERSION OR CORPORATE CITIZENSHIP? 21, 22 (Gerald Vinten ed., 1994).

14. *See* Elletta Sangrey Callahan, et al., *Integrating Trends in Whistleblowing and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment*, 40 AM. BUS. L.J. 177, 178-80, 195-96 (2002).

15. *See* Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VAND. J. TRANSNAT'L L. 829, 832-33 (2000).

16. Julie Jones, *Give a Little Whistle: The Need for a More Broad Interpretation of the Whistleblower Exception to the Employment-at-Will Doctrine*, 34 TEX. TECH. L. REV. 1133, 1164 (2003).

PART 1: WHISTLEBLOWING IN CHINA

I.
THE NEED FOR ANTI-CORPORATE FRAUD LEGISLATION AND WHISTLEBLOWER PROTECTION IN CHINA

In recent years, China has had its fair share of corrupt corporate scandals. The frequency and severity of these incidents of corporate fraud reveal China's need for legal mechanisms that will increase discovery and encourage reporting of such malfeasance.[17] Increased reporting will increase the risk of detection and punishment, and thereby deter corrupt business practices and lead to improved corporate governance. However, as the discussion in this section will suggest, employee whistleblowing is likely the mechanism that will be most effective in reducing corporate fraud in China, as regulation by government agencies and financial auditors has thus far proven highly ineffective.

A. *CAO Scandal and Other Examples of Rampant Corporate Fraud in China*

One of the most prominent examples of corporate fraud in China from the recent past is the China Aviation Oil (CAO) scandal, a speculative oil trading debacle that surfaced in late 2004 as the CAO corporation neared collapse and faced a loss of more than US$550 million. CAO, a Chinese state-owned enterprise, was regarded as a leading Chinese firm listed in Singapore and was thought to have possessed some of the best corporate governance practices in Asia. The discovery of its corrupt business practices and the failure of its internal control mechanisms at virtually every level of management was therefore a huge shock to the business world.[18] Senior management used company funds to place high risk bets on the

17. *See* Jing Leng, *The Interaction Between Domestic and Overseas Capital Markets and Corporate Governance of Chinese Listed Companies*, in CORPORATE GOVERNANCE POST-ENRON: Comparative and International Perspectives 273, 297-301 (Joseph J. Norton et al., eds. 2006); Peter Humphrey, *China's Booming Fraud Industry*, CHAMBER EYE (Guangdong), Aug. 2008, at 26, 29, *available at* http://www.chinawhys.com/img/Chamber%20Eye%20article%20on%20booming%20fraud%202008-08.pdf.

18. Kevin T. Jackson, *The China Aviation Oil Scandal*, *in* HANDBOOK OF FRAUDS, SCAMS, AND SWINDLES: FAILURES OF ETHICS IN LEADERSHIP 151, 159-60 (Serge Matulich & David M. Currie eds., 2009).

price of oil futures, which involved using options to speculate on the direction of oil prices instead of volatility and ignoring the impact of volatility and other factors on the mark-to-market value of the option portfolio.[19] This fraud was able to continue and go undetected because of shortfalls in CAO's internal control and corporate governance. The internal audit division failed to report the internal control deficiencies regularly and correctly to the audit committee, and the risk management committee also failed to set any trading limits on option trading. Furthermore, the CEO and the board of directors of CAO overrode internal controls by taking an excessive amount of risk in order to avoid realizing losses. However, instead of leaving the market and accepting losses of only several million dollars, the company raised its bets and continued its derivative trading until it was ultimately faced with the realization of an even greater amount of losses that it could not meet.[20]

The CAO scandal led many to question why the corporation's board had not stopped management from going ahead with the derivatives trades. Jamie Allen, the secretary-general of the Asian Corporate Governance Association based in Hong Kong, believes that "if there was a strong audit committee, this all would have been shut down before any trouble. It's more a question of corporate culture."[21] Also missing from CAO's corporate culture was encouragement of employee whistleblowers, who may have come forward with reports of fraud had they had adequate means and protection to do so. Employee whistleblowers could have possibly shed light on this failure of corporate governance and brought an end to this corrupt practice long before CAO amassed a US$550 million dollar loss.

Corporate fraud severely plagues many industries within China. For instance, in China's pharmaceutical industry, kickbacks for pharmaceuticals alone approach RMB772 million

19. *Dissolve Mystery of China Aviation Oil Incident*, PEOPLE'S DAILY ONLINE, Dec. 10, 2004, http://english.people.com.cn/200412/10/eng20041210_166900.html.

20. Cao Desheng, *Costly Lessons from the CAO Scandal*, CHINA DAILY, Dec. 23, 2004, *available at* http://www.chinadaily.com.cn/english/doc/2004-12/23/content_402605.htm.

21. James Rose, *China Aviation Oil Scandal Puts Governance in the Spotlight*, ETHICAL CORP., Dec. 17, 2004, *available at* http://www.ethicalcorp.com/content.asp?ContentID=3309.

(US$110 million) of state assets every year, an amount equivalent to approximately 16% of the tax revenue for the whole pharmaceutical industry.[22] Foreign investors have also encountered significant problems with their Chinese joint venture partners concerning corporate governance and fraud, which in the words of one consulting group, "can vary from outright criminal activity to serious non-compliance issues."[23] Similarly, corporate fraud is also a serious concern to US-based companies doing business in China.[24] In 2003, the American company Lucent Technologies Inc. had to dismiss four senior management staff of its Chinese subsidiary because they were suspected of offering bribes to foreign government officials in exchange for favorable treatment.[25] In 2005 a public report by the US Department of Justice (US DOJ) claimed that a Chinese subsidiary of the US-based Diagnostic Products Corporation (DPC Tianjin) had paid approximately US$1.6 million in bribes in the form of illegal 'commissions' to physicians and laboratory staff employed by China's state-owned hospitals.[26] As a result, the US-based DPC was forced to pay approximately US$2.8 million to the US SEC, and DPC Tianjin was forced to pay a criminal penalty of US$2 million to the US DOJ.[27] Although the corrupt business practices of DPC were discovered and punished by the US DOJ, most of the incidences of corporate fraud in China go undetected by the government authorities in China and abroad. The operation of employee whistleblowers in China may therefore be necessary to make

22. Feng Jing, *Combating Commercial Bribery*, BEIJING REV., May 25, 2006, http://www.bjreview.cn/EN/06-21-e/bus-1.htm.

23. Klaus Koehler, *Fraud and Corporate Governance in Foreign Invested Enterprises in China*, CHINA INVEST NEWSLETTER (Klako Group), Mar. 2005, *available at* http://www.klakogroup.com/en/china-invest-monthly-newsletter/fraud-and-corporate-governance-in-foreign-invested-enterprises-in-china.

24. AMERICAN CHAMBER OF COMMERCE PEOPLES REPUBLIC OF CHINA, 2005 WHITE PAPER (2006), *available at* http://www.amcham-china.org.cn/amcham/upload/wysiwyg/20060214111508.pdf; *see also* David Finn, *Peering Over the Great Wall: Extraterritorial Securities Regulation and U.S. Investment in China's State Owned-Banks*, 7 U.C. DAVIS BUS. L.J. 277, 286-87 (2006).

25. Stephen Taub, *Lucent Fires Four on Bribery Suspicions*, CFO, Apr. 7, 2004, http://www.cfo.com/article.cfm/3013085.

26. US Department of Justice, *DPC (Tianjin) Ltd. Charged with Violating the Foreign Corrupt Practices Act*, Press Release No. 05-282, May 20, 2005, *available at* http://www.justice.gov/opa/pr/2005/May/05_crm_282.htm.

27. *Id.* (explaining that Diagnostic Products Corp. was made to pay fines as a result of violating the Foreign Corrupt Practices Act of 1977).

up for the ineffectiveness of government regulation and other corporate fraud detection mechanisms.

B. *Despite Rampant Corporate Fraud, the Chinese Government Has Done Little to Investigate and Prevent Corporate Wrongdoing*

As the above examples demonstrate, China has been suffering from a virulent strain of corporate fraud in the last decade. Although the Chinese government has attempted to control and reduce this outbreak of corporate wrongdoing and improve corporate governance in China, no significant progress has been made.

> [Chinese governmental] authorities have worked hard to impose a framework of rules for listed companies, including a requirement to produce quarterly results. But the gap between theory and practice is wide. There is no effective enforcement and corporate governance is poor. Chinese companies, which are state companies run by political fiat or private firms controlled by entrepreneurs or family members, have little experience in looking after minority shareholders and only a partial understanding of such concepts as board independence, independent auditing of results and the need for proper risk control.[28]

The ineffectiveness of government regulation was initially caused by China's sole emphasis on fighting the "demand side of corruption," which involved close regulation of public officials but ignored the actions of the private sector "suppliers of corruption."[29] Unfortunately, the result was that the corruption being committed by private sector corporations did not receive adequate attention and scrutiny. Although bribery in the private business sector is a common occurrence in China, among all of the cases of economic crime on file for investigation by the Chinese police, business bribery cases amounted to less than 1% between 2000 and 2005.[30] Moreover, China's government has not only failed to discover and investigate cor-

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28. *Fools Rush in: The CAO Derivatives Fiasco,* ECONOMIST, Dec. 11, 2004, at 78, 78; *see also* Stanley Lubman, *Looking for Law in China,* 20 COLUM. J. ASIAN L. 1, 82-83 (2006).

29. TRANSPARENCY INT'L, GLOBAL CORRUPTION REPORT 2009: CORRUPTION AND THE PRIVATE SECTOR 254 (2009).

30. Feng Jing, *Combating Commercial Bribery,* BEIJING REV., May 25, 2006, http://www.bjreview.cn/EN/06-21-e/bus-1.htm.

porate wrongdoing, but even when such wrongdoing is uncovered the government has failed to prosecute and punish such conduct. As an example, between 1998 and 2002 the Chinese government prosecuted only 6,440 cases of business/corporate bribery, an amount far below the actual 207,103 crimes of business bribery that were investigated and could have been prosecuted.[31]

In more recent years, China has begun to focus on the investigation and regulation of the "suppliers of corruption," the corporations themselves, by creating and increasing the powers of the Chinese Securities Regulation Commission (CSRC).[32] The CSRC is basically the Chinese analogue of the SEC in the US. The CSRC is a government agency entrusted to take administrative actions to enforce the securities law in China. However, the amount of resources allocated to the CSRC for the investigation of violations of securities law is severely insufficient.[33] Moreover, the CSRC lacks substantial investigatory powers: it does not have the same power of subpoena as that of the SEC, and until recently it had to apply for a court order before it was able to freeze bank accounts or seize evidence in connection with its investigations.[34] As with many Chinese government agencies, there is also significant corruption and fraudulent wrongdoing within the CSRC itself, further inhibiting its ability to effectively reduce corporate fraud and improve corporate governance.[35] The investigatory and enforcement powers of the CSRC with respect to insider

31. Report on the Work of the Supreme People's Procuratorate to the Tenth National People's Congress Standing Committee of the People's Republic of China, SUP. PEOPLE'S PROC. COMMUNIQUE, Mar. 2003, *available at* http://www.china.org.cn/english/2003/Mar/57964.htm.

32. Han Shen, *A Comparative Study of Insider Trading Regulation Enforcement in the U.S. and China*, 9 J. BUS. & SEC. L. 41, 45-48 (2008).

33. Zhong Zhang, *Legal Deterrence: The Foundation of Corporate Governance – Evidence from China*, 15 CORP. GOVERNANCE: AN INT'L REV. 741, 758 (2007), *available at* http://ssrn.com/abstract=1017406; Christopher M. Zoeller, *Corporate Scandals: Global Recognition of Securities Regulation – How Is China Faring?*, 41 U. TOL. L. REV. 213, 252-53 (2009).

34. *See* Zhang, *supra* note 33, at 758. Although the new Securities Law provides the CSRC with the power to seize evidence, etc. without requiring that it first obtain a court order, the new law still requires that strict conditions be satisfied before this power can be exercised.

35. *See* Guoping Li, *China's Stock Market: Inefficiencies and Institutional Implications*, 16 CHINA & WORLD ECON. 81, 89-90 (2008).

trading are a case in point. Before June 2004, only eleven insider trading cases in total were reported and prosecuted in the Chinese courts, and in recent years the number has increased only slightly.[36]

Apart from regulation by government agencies, the Chinese government has also recently opened the door of the courts to civil lawsuits that are brought against companies committing corporate fraud, including shareholder derivative suits. Although the threat of civil litigation in the US has served to improve corporate governance, in China civil lawsuits against companies are a very recent development and there have been very few successful prosecutions.[37] Furthermore, such civil lawsuits can only be brought after a CSRC investigation has taken place, thereby severely limiting the opportunities when such litigation can be brought.[38] Even if investors succeed in getting their shareholder derivative suit heard in a Chinese court, the severe lack of clear substantive legal provisions and procedural rules render these lawsuits almost meaningless.[39] Courts in China will almost always request that shareholder derivative suits be settled and will do whatever they can to avoid ruling upon the merits of these complicated cases.[40] As a result, the threat of civil litigation brought by investors is not yet an effective deterrent of corporate fraud in China. Until Chinese legislators and judicial authorities create a more investor-friendly shareholder derivative suit system that entails clearer substantive and procedural rules, the risk of suffering from such lawsuits will not be seriously feared by Chinese corporations. The misconduct of corporate management and directors in China therefore requires

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36. HUI HUANG, INTERNATIONAL SECURITIES MARKETS: INSIDER TRADING LAW IN CHINA 28 (2006); *see also* Bjorn Sorenson, *Is a Growing China a Threat to United States IPO Market Dominance? Comparative Securities Laws and Competition in the Market for Markets*, BUS. L. BRIEF, Spring 2008, at 25, *available at* http://ssrn.com/abstract=1112319; Shen, *supra* note 32, at 63-64.

37. GONGMENG CHEN ET AL., DO OWNERSHIP STRUCTURE AND GOVERNANCE MECHANISMS HAVE AN EFFECT ON CORPORATE FRAUD IN CHINA'S LISTED FIRMS? 9 (2005), *available at* http://ssrn.com/abstract=728945.

38. *Id.*

39. Jiong Deng, *Building an Investor-Friendly Shareholder Derivative Lawsuit System in China*, 46 HARV. INT'L L.J. 347, 364-65, 375 (2005).

40. *Id.*

another type of deterrent which can compensate for the shortfalls of government regulation and civil litigation.[41]

Auditing as part of an internal control system is also unable to adequately fulfill the role of deterring corporate wrongdoing in China. The lack of auditor independence, the shortage of well-qualified auditors, and an environment of massive corruption within China's audit market all render the auditing of a company's financial records an ineffective means of improving corporate governance.[42] China lacks qualified accountants and its accounting rules deviate greatly from long-standing international standards.[43] Therefore, until managers and professional accountants in China can be trained to produce accurate and honest audits and to adequately disclose information to the public, another type of fraud detection mechanism must be relied upon. Encouraging whistleblowing by employees can make up for the inadequacy of internal auditing of Chinese corporations.[44]

The Chinese government has been unsuccessful in reducing corporate fraud by means of both a regulatory agency (CSRC) and shareholder derivative suits. Internal fraud detection mechanisms operate within the corporation itself rather than as a function of the government. However, the corruption and incompetency of China's auditing profession prevent internal auditing from serving as an effective deterrent.[45] This places whistleblowing, another type of internal fraud detection mechanism, in a crucial role in the quest to improve corporate

41. *See* Peng Sun & Yi Zhang, *Is There Penalty for Crime: Corporate Scandal and Management Turnover in China*, 32 (SSRN, Working Paper No. 891096, 2006), *available at* http://ssrn.com/abstract=891096.

42. The inadequacies of China's auditing profession affect not only internal auditing, but external auditing as well. In light of China's corrupt and incompetent auditor market, auditing as part of an internal control system, as well as external auditing that is conducted by an auditor outside the company, are both ineffective methods to control corporate fraud in China. Thomas W. Lin, *Corporate Governance in China: Recent Developments, Key Problems, and Solutions*, 1 J. ACCT. & CORP. GOVERNANCE 1, 13-14 (2004).

43. Jason Zezhong Xiao et al., *The Making of Independent Auditing Standards in China*, 14 ACCT. HORIZONS 69 (2000).

44. Philippa Jane Trant, An Overview of Contemporary Corporate Governance in China: An Interpretation and Analysis, 65-66 (2006) (unpublished M.A. dissertation, University of Nottingham), http://edissertations.nottingham.ac.uk/329/1/06MAlixpt7.pdf.pdf.

45. *Id.* at 46-47.

governance in China. In order for whistleblowing to adequately fulfill this role, however, employees in Chinese corporations must be protected and feel safe in their ability to report corporate wrongdoing without incurring punishment.

C. *Whistleblowers in China Are Reverely Punished: Examples from the Public Sector*

Within China there is a strong tradition of punishing those who reveal the wrongdoing of others. Examples of this tradition within the corporate sector are rare because most incidences of corporate fraud in China either go undetected or are possibly discovered internally by company employees and are then withheld from public disclosure. However, many demonstrations of this tradition of punishing whistleblowers exist within China's public sector, where citizens report the misconduct of government officials. The punishment of Wu Lihong[46] and Dr. Jiang Yanyong[47] are cases in point. Perhaps

46. In 2007 Wu Lihong, an environmental activist, reported the wrongdoing of five government officials responsible for allowing the pollution of Taihu Lake in Jiangsu province to reach levels that left the tap water undrinkable. Some of the five officials received administrative demerits while others were dismissed from their positions. Soon after the revelation of the pollution and official misconduct, the whistleblower Wu Lihong was violently arrested and charged with blackmail. He was made to stand trial and was then sentenced to three years in prison. It is likely that this criminal charge was fabricated by angry government officials seeking revenge, and seeking to deter other potential whistleblowers. *See* Agnes Crane, *China Punishes Five Officials for Lake Pollution*, REUTERS, June 11, 2007, *available at* http://www.reuters.com/article/2007/06/11/us-china-pollution-idUSPEK7180220070611; Simon Montlake, *Whistle-Blower in China Faces Prison*, CHRISTIAN SCI. MONITOR, Aug. 14, 2007, *available at* http://www.csmonitor.com/2007/0814/p01s03-woap.html; Joseph Kahn, *In China, a Lake's Champion Imperils Himself*, N.Y. TIMES, Oct. 14, 2007, *available at* http://www.nytimes.com/2007/10/14/world/asia/14china.html.

47. The whistleblower, Dr. Jiang Yanyong, who exposed to the global community China's secretive approach to dealing with the outbreak of SARS in 2003, was detained in military custody for 45 days, then put under house arrest and close surveillance, and was banned from leaving the country to receive an international human rights award. Perhaps the most frequently occurring cases of punished whistleblowers are those involving citizens who report illegal land seizures. *China: Release Whistleblowing Doctor*, HUMAN RIGHTS WATCH, June 10, 2004, *available at* http://www.hrw.org/en/news/2004/06/09/china-release-whistleblowing-doctor; *see also* Joseph Kahn, *China Releases the SARS Whistle-Blower*, N.Y. TIMES, July 21, 2004, *available at* http://www.nytimes.com/2004/07/21/international/asia/21chin.html.

the most frequently occurring cases of punished whistleblowers are those involving citizens who report illegal land seizures. Most of these citizen whistleblowers are arrested on fabricated criminal charges, such as embezzlement, and are often sentenced to several years in prison, while the government officials and other high-status entities that are guilty of illegally seizing the citizens' land are left unpunished.[48]

The harsh punishment of whistleblowers has led many Chinese law experts to call for new legislation to protect individuals from retaliation and unjust treatment for disclosing the misconduct by officials and other prominent people.[49] However, legislative protection of whistleblowers who reveal fraud in the corporate sector is also necessary. The publicized punishment of whistleblowers in the public sector not only serves to deter future public sector whistleblowing but also discourages whistleblowing in the private sector. The result is the creation of a tradition that dissuades the reporting of others' fraudulent activity and which therefore fails to take advantage of one of the most effective mechanisms of fraud detection and prevention. Legal protection of whistleblowers is therefore necessary to provide Chinese company employees with the confidence and courage to report corporate fraud and thereby create a real risk of detection that will deter fraud from being committed in the first place.

D. *The Whistleblower Protection Provision of the US Sarbanes-Oxley Act Generally Does Not Apply to Chinese Companies Listed on US Exchanges*

The whistleblower protection provided by US securities law does not apply to Chinese whistleblowers, whether or not the company is listed on a US stock exchange.[50] Therefore, even though a large portion of Chinese companies are listed on US stock exchanges, there is still a need for China to have its own whistleblower protection legislation. International law standards and judicial opinions have ruled that US jurisdiction

48. *See Experts Call for Legislation to Protect Whistleblowers*, XINHUA NEWS AGENCY, Dec. 23, 2006, http://www.china.org.cn/english/MATERIAL/193633.htm.

49. *Id.*

50. Terry Morehead Dworkin, *SOX and Whistleblowing*, 105 MICH. L. REV. 1757, 1774-79 (2007).

over foreign companies under US securities laws, such as the Sarbanes-Oxley Act, is limited to issues that are clearly concerned with securities regulation.[51] As a result, it has been argued that section 806 of US SOX does not provide whistleblower protection to employees in foreign companies because such protection concerns matters of labor and employment relations rather than securities regulation.[52] There is also a federal appellate court case, *Carnero v. Boston Scientific Corp.*, which has directly held that US SOX section 806 does not apply extraterritorially to protect foreign employee whistleblowers working abroad for foreign companies listed on a US exchange.[53] It is therefore critical that China create and

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51. Ian L. Schaffer, *An International Train Wreck Caused in Part by a Defective Whistle: When the Extraterritorial Application of SOX Conflicts with Foreign Laws*, 75 FORDHAM L. REV. 1829, 1834 (2006). The US does not have the power to regulate all aspects of the foreign companies that are listed on US exchanges. Rather, US securities laws "have been construed to apply only to areas and transactions in which American law would be considered operative under prevalent doctrines of international law." Lauritzen v. Larsen, 345 U.S. 571, 577 (1953).

52. *See generally* Minodora D. Vancea, *Exporting U.S. Corporate Governance Standards Through the Sarbanes-Oxley Act: Unilateralism or Cooperation?*, 53 DUKE L.J. 833, 843 (2003). Furthermore, since "labor conditions . . . are the primary concern of a foreign country," American law is not considered operative in the regulation of labor conditions and the protection of employee whistleblowers within foreign companies. Foley Bros. v. Filardo, 336 U.S. 281, 286 (1949).

53. Carnero v. Boston Scientific Corp., No. Civ.A.04-10031, 2004 WL 1922132, at *2 (D. Mass. Aug. 27, 2004), aff'd, 433 F.3d 1 (1st Cir. 2006); Matt A. Vega, *The Sarbanes-Oxley Act and the Culture of Bribery: Expanding the Scope of Private Whistleblower Suits to Overseas Employees*, 46 HARV. J. ON LEGIS. 425, 487-88, 494-95 (2009); James W. Nagle & Leslie S. Blickenstaff, *Foreign Workers Cannot Sue Under "SOX" Whistleblower Provisions*, WASH. LEGAL FOUND., Feb. 24, 2006, at 2, *available at* http://www.goodwinprocter.com/~/media/Files/Publications/Attorney%20Articles/2006/Foreign_Workers_Cannot_Sue_Under_Sox_Whistleblower_Provisions.pdf; Brad Levy, *Pretty New SOX, but Plenty of Holes: An Analysis of the Government's Inability to Apply Section 806 of the Sarbanes-Oxley Act of 2002 Extraterritorially*, 40 TEX. TECH. L. REV. 225, 239-40 (2007); *see also* Mary K. Ramirez, *Just in Crime: Guiding Economic Crime Reform After the Sarbanes-Oxley Act of 2002*, 34 LOY. U. CHI. L.J. 359, 386 (2003).

In *Carnero*, the plaintiff was an Argentinean citizen who brought an action against the US parent company of his foreign employer, alleging that he was discharged for disclosing his employer's allegedly fraudulent accounting practices (which were unrelated to the Foreign Corrupt Practices Act). The First Circuit held that section 806 did not provide a cause of action for for-

enforce its own whistleblower protection legislation, rather than rely on US securities law to encourage better corporate governance in China.

II.
DESCRIPTION OF CHINA SOX AND ITS WHISTLEBLOWER PROTECTION PROVISION

In May of 2008, the Chinese government finally promulgated a securities regulation law that provides protection of whistleblowing employees. The new law is considered the Chinese-analogue of US SOX and is therefore commonly referred to as China SOX. The law's official translated name is *The Basic Internal Control Norms for Enterprises*,[54] and it was passed by China's Ministry of Finance, the National Audit Office, and

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eign employees and relied upon the following to support its holding: (1) other sections of US SOX contain express provisions for extraterritorial jurisdiction while section 806 does not; (2) nothing in the legislative history of section 806 provides any evidence of congressional intent to apply the whistleblower provisions extraterritorially; (3) if section 806 were given extraterritorial reach, it would empower U.S. courts and agencies to interfere with the employment relationship between foreign employers and their foreign employees, likely violating long-standing doctrines of international law; (4) also, Congress did not provide the Department of Labor (DOL), which is the agency responsible for enforcing section 806, with extraterritorial investigatory powers, interpreters, or foreign personnel which are all necessary to protect foreign whistleblower employees. The court also noted that the DOL has issued at least three preliminary rulings that section 806 does not apply extraterritorially to employees working outside of the U.S., and that since the DOL is the agency designated by Congress to interpret and enforce section 806, these determinations are entitled to some weight.

However, there are a few situations where the holding of *Carnero* is inapplicable such that foreign employees may in fact bring a cause of action in the U.S. under section 806. *See* Vega, *supra* note 53, at 494-95. There are at least two scenarios in which the *Carnero* court's decision need not be followed. The first situation is when part or all of the whistleblowing conduct giving rise to a case occurs within the U.S. Though rigidly territorial, this "conduct" test would afford some protection to the extent there is some connection to the U.S. The second circumstance is when the adverse effects of conduct abroad are felt within the United States. This "effects" test reflects a presumption in favor of extraterritorial application when U.S interests are affected in antitrust and securities cases. Both the "conduct" and "effects" tests were recently discussed in the context of a SOX whistleblower claim by the federal court in the Southern District of New York. O'Mahony v. Accenture Ltd., 537 F. Supp. 2d 506 (S.D.N.Y. 2008).

54. An alternative translation of the law's title that is often used is *The Basic Standard for Enterprise Internal Control.*

the three major regulators of the financial sector: the Chinese Securities Regulatory Commission (CSRC), the China Banking Regulatory Commission (CBRC), and the China Insurance Regulatory Commission (CIRC).[55] Even though China SOX is a ministry-level law and is therefore subordinate to the national laws enacted by the National People's Congress (including the Corporate Law and Securities Law),[56] it is still intended to strongly influence the actions of Chinese corporations. China SOX is primarily a risk management regulation that aims to improve corporations' internal fraud detection measures and prevent corporate fraud.[57] All large and medium-sized listed companies established within the territory of mainland China have been required to comply with China SOX as of July 1, 2009, the law's effective date.[58] The remaining non-listed large and medium-sized Chinese companies are still encouraged, although not mandated, to comply with the China SOX provisions.[59] China SOX, therefore, will have a direct impact on over 900 companies listed on the Shanghai Stock Exchange and about 800 companies listed on the Shenzhen Stock Exchange.[60] The Ministry of Finance, together with other relevant departments of the State Council, holds the power to interpret China SOX and issue supplementary measures.[61]

Article 43 of China SOX is the provision that provides whistleblower protection and requires that all listed Chinese companies:

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55. The Basic Internal Control Norms for Enterprises (promulgated by the Ministry of Finance, the Chinese Securities Regulatory Commission (CSRC), the National Audit Office, and the China Insurance Regulatory Commission (CIRC)), May 22, 2008, (effective July 1, 2009), *translation provided by* Wu Jiahua, Associate, O'Melveny & Myers LLP, Shanghai (copy on file with author) [hereinafter China SOX].

56. *See* Guiguo Wang & Priscilla M. F. Leung, *One Country, Two Systems: Theory into Practice*, 7 PAC. RIM L. & POL'Y J. 279, 299-300 (1998).

57. Alex Raymond, *China SOX: The Importance of the Whistleblower Mechanism*, July 31, 2009, http://www.articlesbase.com/regulatory-compliance-articles/china-sox-the-importance-of-the-whistleblower-mechanism-1084710.html.

58. China SOX art. 3.

59. *Id.*

60. KPMG HUAZHEN, CHINA BOARDROOM UPDATE: INTERNAL CONTROL REGULATORY DEVELOPMENTS (Aug. 18, 2008), http://www.kpmg.com.cn/en/virtual_library/Risk_advisory_services/China_Boardroom/CBU0801.pdf.

61. China SOX arts. 48 & 49.

> [S]hall set up an exposing and complaining system and a whistleblower protection system, set up a special telephone line for exposing offenses, set down the procedures, time limit and requirements for handling reported offenses and complaints, and ensure that exposure and complaining are an important channel for the enterprise to efficiently get information. All staff shall be informed of the exposing and complaining system and the whistleblower protection system [in a timely manner].[62]

The basic purpose of the China SOX whistleblower mechanism is to alert a company to risks, fraud, or corruption and to provide an opportunity to employees to report suspicious activities, malfeasance, or fraud to management.[63]

Article 43 of China SOX establishes both a whistleblower protection system as well as a structural mechanism through which whistleblowers can safely disclose their findings. The law is not specific about what the whistleblower protection system must entail and it is not clear whether there is a statutory cause of action that whistleblowers may bring against their retaliating employers. In addition, the structural provision calling for the creation of a whistleblower disclosure channel also fails to specify certain essential elements. While the provision specifically calls for the creation of a telephone hotline, it then uses only broad language to require that "procedures" for disclosing and responding to reports of corporate fraud be created. The form these procedures are to take and other essential issues, such as who shall receive and investigate the reports of fraud, are not specified. However, the relatively broad language of article 43 provides Chinese companies with discretion that will likely help to successfully implement this new law and effectively encourage and protect whistleblowers.[64] This discretion can enable Chinese companies to find the adequate form of whistleblower protection that can overcome the great-

62. China SOX art. 43.

63. Raymond, *supra* note 57.

64. Similar to China, the Japanese government has also promulgated an analogue of US SOX (referred to as J-SOX), and has drafted the J-SOX rules in a loose way so corporations can interpret the rules as needed and adapt it to its own needs. *See* Yuriko Nagano, *Japanese Look to Implement 'J-SOX' Rules*, COMPLIANCE WK., Feb. 21, 2007, *available at* http://www.complianceweek.com/article/3100/japanese-look-to-implement-j-sox-rules.

est disincentive to blowing the whistle: employer retaliation. Such discretion can also enable the development of disclosure channels that will be most successful in encouraging whistleblowing and ensuring that the findings of fraud are properly addressed.

The broad language requiring a whistleblower protection system can enable whistleblowing employees to seek recourse through a variety of means. Whether or not China SOX is interpreted as providing a statutory cause of action for whistleblowers alleging employer retaliation, the broad language leaves open the possibility that a breach of labor contract action may serve as a system of whistleblower protection.[65] As will be discussed below in Part 2, section III.B, China's Labor Contract Law and Labor Dispute Resolution Law establish clear procedures and substantive rules,[66] and have the ability to provide more robust protection of whistleblowers than a statutory cause of action could provide.[67] Additionally, the discretion in creating whistleblowing disclosure channels may enable Chinese companies to experiment with different structures until they find those that work best within their particular corporate environment. The entities that will be most effective in investigating reports of fraud and eradicating the malfeasance rather than corruptly covering it up, will differ from company to company. Therefore, a whistleblower disclosure channel may operate most successfully in one company when the recipient end consists of the board of directors, while in another company the managers or internal auditors or perhaps another entity will be most effective.[68] Allowing such experimentation and discretion to tailor whistleblower reporting mechanisms to the features of the particular company will substantially further the goal to improve corporate governance and reduce corporate fraud.

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65. *See* Richard Moberly, *Protecting Whistleblowers by Contract*, 79 U. COLO. L. REV. 975, 986-88 (2008).

66. *See* discussion *infra* Part 2.III.B.

67. The inadequacies of a federal statutory cause of action for whistleblowers are demonstrated by the implementation of US SOX section 806. *See* discussion *infra* Part 2.II.A; *see also* Ramirez, *supra* note 53.

68. Richard E. Moberly, *Sarbanes-Oxley's Structural Model to Encourage Corporate Whistleblowers*, 2006 B.Y.U. L. REV. 1107, 1161-67 (2006).

III.
CRITICISMS OF CHINA SOX AND PREDICTED SUCCESSES/ DIFFICULTIES WITH THE IMPLEMENTATION AND ENFORCEMENT OF THE WHISTLEBLOWER PROTECTION PROVISION

Although China SOX has only very recently become effective, there are already numerous criticisms regarding the new law's implementation and enforcement. Many of the criticisms focus on the over-generality of the whistleblower protection provision, the willingness of the Chinese government to support the enforcement of the new law, and the incompatibility between whistleblowing and China's corporate and societal culture.

Critics argue that the whistleblower protection provision (article 43) is too general and vague, and therefore without supplemental requirements, Chinese corporations might easily develop a whistleblowing system that looks acceptable on paper, but then implement a system which in fact is not functional, or never actually implement a system at all.[69] Although the vagueness of the provision provides useful discretion to Chinese companies as described above, this vagueness may also entail dangers of non-compliance. Since China SOX became effective in July 2009, Chinese corporate attorneys have not taken any significant steps to implement the whistleblower protection provision, or any other provisions, within the corporations they represent.[70] As a result, in order to effectively enforce article 43 and create greater incentives for companies to implement a fully developed and effective whistleblower reporting mechanism, there must be serious legal consequences

69. China SOX is "[u]nlike Sarbanes-Oxley in the United States and Japan, both of which threaten serious legal implications against boards and managers for non-compliance . . . [T]he vast majority of [Chinese] companies will likely take a 'form over substance' approach and only act as if they are meeting the rules. . . . If at the end of the day, there are no consequences, people may just do with issuing a bit of paper. . . . Chinese companies are evaluating that option now." Richard Meyer, *China's SOX: A Pipe Dream at Best*, COMPLIANCE WK., Sept. 30, 2008, http://www.complianceweek.com/article/5074.

70. E-mail from Wu Jiahua, Assoc., O'Melveny & Myers Shanghai, to author (Oct. 12, 2009) (on file with author). In Ms. Wu's personal opinion, China SOX is a very weak attempt to regulate the internal control mechanisms of Chinese listed companies. She has found the new statute to be too general and not as sophisticated as the US Sarbanes-Oxley Act.

for those companies who do not comply and "safe harbors" from such consequences for those companies that do comply.[71]

China SOX currently does not contain any specific provisions laying out punishments, such as monetary fines, for those companies who do not fully comply in creating effective whistleblower protection and disclosure channels. However, China's Ministry of Finance has the power to issue supporting measures of the new law that will in fact penalize such non-compliant companies.[72] Additionally, to enable the discovery of non-compliant companies, the Ministry of Finance could promulgate supplemental requirements that mandate companies to disclose both a description of the structure of their whistleblowing disclosure channels (such as who reviews whistleblowing complaints, etc.) as well as a summary of the performance and results of these disclosure systems (such as the number of complaints received by the system, the types of complaints, whether the complaints were substantiated or without merit, how complaints were resolved, and the current employment status of the employees who submitted the complaints).[73] The Chinese government therefore has the ability to successfully enforce the whistleblower protection regime of China SOX, and the only question is whether the government (and the Ministry of Finance in particular) will choose to effectively use its enforcement powers.

Many critics argue that these enforcement powers will not be exercised and that the Chinese government is not yet willing to support such whistleblower systems through additional laws or due judicial consideration of whistleblower retaliation

71. The "safe harbors" for compliant companies under China SOX can take a similar form as those provided by the US Organizational Sentencing Guidelines, which provide a substantial reduction in penalties for US corporations with effective compliance and ethics programs. *See* U.S. SENTENCING GUIDELINES MANUAL §§ 8B2.1, 8C2.5 (2004).

72. China SOX art. 49.

73. *Cf.* Elletta Sangrey Callahan et al., *Integrating Trends in Whistleblowing and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment*, 40 AM. BUS. L.J. 177, 210 (2002) (proposing that ombudsmen prepare summaries of complaints received, the investigation, and any actions taken).

cases.[74] As a result these critics conclude that the corporate whistleblower regime called for by China SOX cannot succeed. However, the Chinese government has in fact already embraced whistleblowing as an important and crucial tool in detecting and reducing fraudulent activity. For example, in the context of workplace safety, China's senior safety inspector (who heads the State Administration of Work Safety) publicly announced in 2008 that whistleblowing provides crucial clues for investigators often frustrated by cover-ups made by both local government officials and entities within the companies, and he therefore officially called on rank-and-file employees to expose workplace accidents and inadequate safety measures.[75] This is evidence of the likelihood that, in the context of corporate fraud, the Chinese government will similarly place a strong emphasis on China SOX's whistleblower regime and will likely take the necessary steps to ensure its proper enforcement. Moreover, with respect to opening up the courts to hear whistleblower retaliation claims, the Chinese government has already made huge strides in providing the substantive and procedural rules required for courts to effectively handle such cases (which are further described below in terms of China's Labor Contract Law and Labor Dispute Resolution Law).[76]

Other criticisms focus on China's corporate culture and the argument that it greatly conflicts with the practice of whistleblowing. These critics believe that the management of Chinese companies are not committed to risk management and will not openly support China SOX and its whistleblowing regime.[77] They argue that these are irreconcilable conflicts that will indefinitely interfere with the implementation and operation of whistleblower reporting schemes.[78] While these critics may be correct that changes in China's corporate cul-

74. *See, e.g.*, James Rose, *Now Blow That Whistle*, STANDARD, July 16, 2007, http://www.thestandard.com.hk/news_detail.asp?pp_cat=15&art_id=49042&sid=14478549&con_type=1.

75. Charles Hutzler, *China's Top Safety Inspector Calls for Public Whistle-Blowing to Reduce Accidents*, FOX NEWS, Jan. 22, 2008, *available at* http://www.foxnews.com/wires/2008Jan22/0,4670,ChinaWorkSafety,00.html.

76. *See* discussion *infra* Part 2.III.B.

77. *See, e.g.*, Alex Raymond, *The Most Important Criteria for "China SOX" Success*, June 8, 2009, http://www.articlesbase.com/regulatory-compliance-articles/the-most-important-criteria-for-china-sox-success-958975.html.

78. *See id.*

ture are important criteria for China SOX's success, they are too pessimistic and likely inaccurate in characterizing China's corporate culture as being impossible or highly unlikely to change. The significant rewards a corporation can reap from an effective whistleblowing regime has, and will likely continue to, encourage China's corporate culture to change in the ways necessary to support such fraud disclosure systems.[79] Apart from better overall corporate governance, the benefits a corporation is to enjoy from effective whistleblowing mechanisms include a lower overall risk profile, more predictable business, increased trust from the market, a higher stock price, motivated employees, lower employee turnover, improved supplier relationships, quicker decision-making by the company, and more customers.[80] These financial advantages are of enough significance that the management of Chinese companies will likely be persuaded to overcome the institutional resistance to change and will bring about a corporate culture that is in harmony with the practice of whistleblowing.

In addition to corporate culture, there are some who argue that the more deeply ingrained traditional culture of Chinese society will also permanently block the development of effective corporate whistleblowing systems:

> Whistleblowing also runs into some very ingrained cultural prejudices, which tends to aid malfeasance. Notions of superiors as father/mother figures and therefore not to be disagreed with or, heaven forbid, put in hot water, are common and deep-rooted in China as much as elsewhere in Asia and this clearly hinders the development of an appropriate commercial whistleblowing mechanism. Attempts by foreign multinationals to set up whistleblowing systems in China have generally been flops, largely because the idea has never properly taken root among the local rank and file staff.[81]

79. *See* Alex Raymond, *China SOX Compliance: Top 10 Business Benefits*, June 24, 2009, http://www.articlesbase.com/business-articles/top-10-business-benefits-of-china-sox-compliance-990370.html.

80. *Id.*

81. Rose, *supra* note 74.

These Confucian cultural traditions promote obeying one's superiors, including one's employer,[82] and may logically be viewed as perpetually interfering with the practice of whistleblowing in China. However, events within China's history seem to demonstrate otherwise. China's experiences during the Cultural Revolution (1966-1976) reveal that the Chinese people can overcome the traditional cultural disfavor of whistleblowing and zealously take part in the reporting of wrongdoing by their neighbors and superiors.[83] During this period of Chinese history, there were countless incidents of Chinese citizens publicly denouncing and persecuting those they accused of being "counter-revolutionaries," which often included government officials, employers, and other superior figures.[84] Also, the examples of whistleblowers in the public sector described above further demonstrate that the Chinese people have both the ability and willingness to come forward to report misconduct committed by the public officials and other superior figures who govern them.[85] Furthermore, in recent years both employees and non-employee citizens have been actively blowing the whistle on corporate violations of environmental laws and pollution regulations.[86] In the eastern provinces of China especially, people from the local communities and rank-and-file employees have been instrumental in monitoring local industries for violations of environmental law.[87]

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82. *See* WM. THEODORE DE BARY & IRENE BLOOM, SOURCES OF CHINESE TRADITION: FROM EARLIEST TIMES TO 1600, 41-46 (2d ed. 1999).

83. *See* CONRAD SCHIROKAUER, A BRIEF HISTORY OF CHINESE AND JAPANESE CIVILIZATIONS 612-16 (2d ed. 1989).

84. *See* JOHN E. SCHRECKER, THE CHINESE REVOLUTION IN HISTORICAL PERSPECTIVE 228-32 (2d ed. 2004); *see also* CRAIG DIETRICH, PEOPLE'S CHINA: A BRIEF HISTORY 228-31 (3d ed. 1998).

85. *See* discussion *supra* Part 1.I.C.

86. Benjamin van Rooij, *Greening Industry Without Enforcement: An Assessment of the World Bank's Pollution Regulation Model for Developing Countries*, 32 L. & POL'Y 127, 144 (2010).

87. However, local government regulators within these eastern provinces have been offering rewards of up to RMB5000 (US$730) to citizens/employees who make accurate complaints about genuine industry violations of environmental regulations. *See id.* It is possible that such rewards provide incentives which are necessary for Chinese people to overcome the cultural obstacles to whistleblowing. If this is the case, then monetary rewards in addition to legal protection against retaliation must be provided in order to encourage whistleblowing to the extent necessary to improve corporate govern-

As these historical and more recent examples demonstrate, China's cultural traditions have not held back the whistleblowing activity of the Chinese people, and there is no indication that China's societal culture will now impair the corporate whistleblowing regime established under China SOX. It is also possible that China's Confucian-based culture can, or has already been reconciled with the act of whistleblowing. After all, a popular Confucian proverb states that "If you see broken glass on the floor of your home, you would take action to protect your family," implying that the reporting of wrongdoing can in fact be beneficial to the public interest in a way that complies with Confucian ethics.[88]

While the prevalent criticisms of China SOX's whistleblower protection provision may in part be based on misconceived notions about China's culture and its capacity for change, much of the criticism concerning China's ability to adequately enforce China SOX is valid and holds merit. China, however, can look beyond its borders to analyze the experiences of other nations, such as the US, which can assist the Chinese government in more effectively enforcing a whistleblowing regime within China's companies.

PART 2: WHISTLEBLOWING IN THE UNITED STATES

The development of China's securities regulation laws, including China SOX, has not occurred within a vacuum but has been influenced by the securities regulation laws operating within other countries. The Chinese government has the ability to learn from the experiences and mistakes of the US and other countries, and to then use these lessons to more effectively implement and enforce its own laws. With respect to laws establishing and regulating corporate whistleblower fraud detection systems, China has a great deal to learn from the US in particular. However, whether the Chinese government will choose to acknowledge and take advantage of these international lessons is still a matter of speculation.

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ance. *See* discussion *infra* Part 2.II.C & III.D (discussing *qui tam* incentive systems).

88. CONFUCIUS, THE ANALECTS, quoted in James Rose, *Now Blow That Whistle*, STANDARD, July 16, 2007, http://www.thestandard.com.hk/news_detail.asp?pp_cat=15&art_id=49042&sid=14478549&con_type=1.

I.
DESCRIPTION OF US SOX WHISTLEBLOWER PROTECTION PROVISION

A. *SEC Adequately Investigates and Punishes Corporate Malfeasance, but Whistleblowers Are Still Needed to Combat Corporate Fraud*

Unlike the Chinese Securities Regulation Commission, the Securities and Exchange Commission (SEC) of the US has been much more effective in investigating and penalizing corporations that have violated securities laws and committed fraud. To note a few examples, the SEC successfully used its superior investigatory and enforcement powers to require WorldCom to pay a $2.25 billion penalty for its 2002 accounting scandal, Bristol-Meyers to pay $150 million penalty for its fraudulent earnings management scheme, Royal Dutch Shell to pay $120 million penalty in connection with its misstatements of oil reserves, and to impose very large penalties against a number of mutual fund complexes for their roles in the mutual fund market timing scandal.[89] However, despite the effectiveness of the SEC and its severe punishments, whistleblowers are still a necessary part of fraud detection mechanisms in US companies because it is often the whistleblower employees who bring the incidents of corporate wrongdoing to the attention of the SEC.[90] Moreover, an in-

89. Stephen M. Cutler, Director, Div. of Enforcement, Sec. & Exch. Comm'n, The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program, Address at UCLA School of Law (Sept. 20, 2004) (transcript available at http://www.sec.gov/news/speech/spch092004smc.htm).

90. For example, corporate fraud committed by Symbol Technologies and Kmart was revealed by anonymous employee whistleblowers who sent letters directly to the SEC and other government regulators. *See* Steve Lohr, *Ex-Executives at Symbol Are Indicted*, N.Y. TIMES, June 4, 2004, http://www.nytimes.com/2004/06/04/business/ex-executives-at-symbol-are-indicted.html (describing that the investigation leading to eight indictments started when the SEC received anonymous letter); Constance L. Hays, *2 Ex-Officials at Kmart Face Fraud Charges*, N.Y. TIMES, Feb. 7, 2003, http://www.nytimes.com/2003/02/27/business/2-ex-officials-at-kmart-face-fraud-charges.html (describing that the investigation into fraud by Kmart executives commenced with an anonymous letter that was sent both to the Kmart board and to government officials). In addition, the mutual fund industry paid hundreds of millions of dollars to settle charges of fraud arising out of allegations made by employee whistleblowers to government investigators re-

creased threat of employees blowing the whistle on corporate malfeasance changes the climate within boards of directors and management, such that there is more personal accountability, more loyalty to fiduciary duties, and more deterrence of illegal activities.[91] Therefore even in the US where there is more adequate government regulation and punishment of corporate fraud, encouragement of employee whistleblowing is still crucial to the goal of improving corporate governance. As a result, legal protection of employee whistleblowers is just as important in the US as it is in China.

B. *The Application and Enforcement of Section 806 of US SOX*

Recognizing the importance of employee whistleblowing, especially in light of the scandals at Enron,[92] WorldCom,[93] and Tyco International,[94] the US promulgated the Sarbanes-Oxley Act of 2002 and its section 806 whistleblower protection provision.[95] The Sarbanes-Oxley whistleblower provision prohibits companies from retaliating against employees who report cor-

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garding improper practices in the industry. *See* Jayne O'Donnell, *The Guy Who Blew the Whistle on Putnam*, USA TODAY, Nov. 20, 2003, http://www.usatoday.com/money/perfi/funds/2003-11-20-whistleblower-1a-cover_x.htm.

91. *Sarbanes-Oxley Lowers Corporate Fraud Lawsuits*, Interview by Renee Montagne with Christopher Cox, Chairman, Securities & Exchange Commission (Aug. 7, 2007) (transcript available at http://www.npr.org/templates/story/story.php?storyId=12555895).

92. Dan Ackman, *Sherron Watkins Had Whistle, but Blew It*, FORBES, Feb. 14, 2002, http://www.forbes.com/2002/02/14/0214watkins.html.

93. David M. Katz & Julia Homer, *WorldCom Whistle-Blower Cynthia Cooper*, CFO MAG., Feb. 1, 2008, http://www.cfo.com/article.cfm/10590507/c_10598910?f=insidecfo.

94. Andrew Ross Sorkin & Alex Berenson, *Corporate Conduct: The Overview; Tyco Admits Using Accounting Tricks to Inflate Earnings*, N.Y. TIMES, Dec. 31, 2002, http://www.nytimes.com/2002/12/31/business/corporate-conduct-overview-tyco-admits-using-accounting-tricks-inflate-earnings.html.

95. US SOX also contains other provisions to encourage employee disclosure of corporate fraud. Section 1107, US SOX's criminal whistleblower provision, is in Title XI of the Act, entitled the Corporate Fraud Accountability Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. Section 1107 makes it a felony for anyone to knowingly retaliate against or take any action "harmful" to any person, including interfering with his employment, for providing truthful information to a law enforcement officer relating to the commission or possible commission of a federal offense. *See* 18 U.S.C. § 1513(e). As part of a criminal obstruction of justice statute, section 1107 is enforced by the U.S. Department of Justice.

porate wrongdoing. If a listed public company retaliates against such an employee (whether in the form of termination, demotion, etc.), it may be liable under section 806 for any damages caused to the employee because of the unlawful discrimination.[96] An employer may not retaliate in any manner that is likely to stifle precisely the sort of behavior Congress intended to encourage. A company will be held liable under SOX section 806 for responding to an employee's disclosure with disciplinary or retaliatory actions if such actions will dissuade potential whistleblowers from engaging in protected activity in the future.[97] If held liable, the company will have to make the employee whole, and may therefore be required to reinstate the whistleblowing employee to his former position and to compensate the employee for back pay, mental pain and suffering, loss of professional reputation, and/or other types of losses.[98]

US SOX extends its protection to the employees of contractors, subcontractors, agents, and subsidiaries of listed public companies, and therefore, a whistleblower does not need to have been employed directly by a publicly traded company in order to have a statutory cause of action under Sarbanes-Oxley section 806.[99] When bringing a statutory civil claim under section 806, employee whistleblowers must file their complaints with the Secretary of Labor within 90 days of the alleged retaliatory act.[100] The employees will then have their cases reviewed and investigated by the Occupational Safety and Health Administration (OSHA), and OSHA's rulings may subsequently

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In addition to these civil and criminal whistleblower provisions, SOX contains two other mechanisms to encourage the disclosure of corporate fraud. Section 301 of the Act, which creates 15 U.S.C. § 78f(m)(4), requires that the audit committees of publicly traded companies establish procedures for the receipt, handling, and retention of anonymous complaints from employees relating to accounting or auditing matters.

96. Sarbanes-Oxley Act of 2002, § 806, Pub. L. No. 107-204, 116 Stat. 745 (codified as 18 U.S.C. § 1514A (2002)).

97. Dworkin, supra note 50, at 1761-63.

98. Section 806 provides that an employee subject to retaliation is "entitled to all relief necessary to make the employee whole." 18 U.S.C. § 1514A(c)(1) (2002).

99. *Id.* § 1514A(a).

100. *Id.* § 1514A(b)(2)(D). However, the Dodd-Frank Act has increased the time in which an employee may file a complaint with the Secretary of Labor from 90 days to 180 days. *See* discussion *infra* Part 2.II.E.

be appealed to a Department of Labor Administrative Law Judge who will review the claims de novo.[101]

In order to benefit from section 806 protection and be entitled to bring a cause of action against a retaliating employer, whistleblowers must make their disclosures, reports, or complaints of corporate fraud to either a federal regulatory or law enforcement agency, any member or committee of Congress, or a person with supervisory authority over the employee (or other persons working for the employer who have the authority to investigate, discover, or terminate misconduct).[102]

US SOX section 806 protects employees against discrimination if they provide information, cause information to be provided, or assist in an investigation regarding fraudulent activity by the public company. A covered disclosure for which US SOX provides protection is a report or complaint about any of the following three types of violations: (1) fraud in general, where a company engages in a scheme to defraud individuals, another company or the government; (2) securities fraud, where a company engages in practices illegal for securities issuers, brokers and/or dealers (such as failing to disclose accurate financial statements to investors); and/or (3) violation of any federal law that relates to fraud against shareholders.[103]

The Department of Labor (DOL) has the power to interpret and enforce section 806, and the Secretary of Labor has issued implementing regulations to assist in its effective enforcement.[104] These implementing regulations provide that section 806 broadly protects employees reporting what they

101. If OSHA (the government agency to which the Department of Labor has delegated its section 806 investigatory and enforcement powers) has not issued a final decision within 180 days of the filing of the complaint, and there is no showing that such delay is due to the bad faith of the claimant, then the claimant may then bring an action for de novo review in the appropriate federal district court. *Id.* § 1514A(b)(1)(B).

102. *Id.* § 1514A(a)(1).

103. *See* Eden P. Sholeen & Rebecca L. Baker, *Unlocking the Mysteries of SOX Whistleblower Claims*, 44 HOUS. LAW. 10 (Jan./Feb. 2007); *see also* Beverley H. Earle & Gerald A. Madek, *The Mirage of Whistleblower Protection Under Sarbanes-Oxley: A Proposal for Change*, 44 AM. BUS. L.J. 1, 5 (2007).

104. *See* Procedures for the Handling of Discrimination Complaints Under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, Title VIII of the Sarbanes-Oxley Act of 2002, 29 C.F.R. Part 1980 (2004).

objectively believe to be illegal or questionable activities, and this protection applies even if it is later determined that the employer's conduct did not fall strictly within one of US SOX's prohibited types of corporate fraud.[105] Accordingly, an employee who is incorrect with respect to his belief of illegal practices by the company nonetheless will be protected from discrimination if the employee's complaint was based on a "reasonable belief."[106] The justification behind this broad application of protection for complaining employees is that requiring certainty on the employee's part before protection will be granted would negate section 806's purpose, which is to encourage employees to raise their concerns over questionable corporate practices.[107]

In order to receive protection under section 806, employee disclosures of corporate fraud must satisfy certain requirements established by the statute itself and by the DOL. Case law from the DOL indicate that in order to make a protected disclosure, a complainant must articulate with specificity the allegedly illegal activity, as mere inquiries about company practices will not suffice.[108] Moreover, the activity outlined in the complaint must relate to one of US SOX's enumerated frauds, e.g., securities fraud, bank fraud, wire fraud, or violation of any rule or regulation of the SEC, or any

105. Thomas G. Eron, *2002-2003 Survey of New York Law: Employment Law*, 54 SYRACUSE L. REV. 991, 1031-32 (2004).

106. William Dorsey, *Materiality in Sarbanes-Oxley Act Employee Protection Claims*, 27 J. NAT'L ASS'N L. JUD. 339, 390, 400-01 (2007). However, section 922 of the Dodd-Frank Act has created a new private right of action for whistleblowing employees who believe they have been retaliated against. Unlike US SOX section 806, this new cause of action does not require employees to "reasonably believe" that the reported conduct violates an enumerated law. *See* discussion *infra* Part 2.II.E.

107. *See* 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, 1064-66 (2004).

108. Lerbs v. Buca Di Beppo, Inc., No. 2004-SOX-8, 2004 WL 5030304 (Dep't of Labor June 15, 2004). In this case, the Department of Labor's Administrative Law Judge held that because the complainant "'did not think that [the company's accounting practice] was right and that it was misleading'" was not sufficiently specific to qualify as protected activity because it failed to outline the objectionable practice. *Id.* at *2. "Instead, in order to be protected, a whistleblower must state particular concerns which, at the very least, reasonably identify a respondent's conduct that the complainant believes to be illegal." *Id.* at *11 (emphasis added).

provision of federal law relating to fraud against shareholders.[109] Further, the complainant also must have a reasonable belief that the activity complained of is illegal and not merely immoral or contrary to industry practice.[110] Finally, when making a disclosure relating to fraud against the shareholders the complainant must articulate and actually believe that the company practice will have a material effect on the shareholders.[111]

While the existence and enforcement of these specific rules, procedures, and implementing regulations may seem more beneficial to the protection of whistleblowers as compared to the vagueness and discretion left by China SOX, there are actually substantial problems with the implementation of US SOX's section 806 whistleblower protection.[112]

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109. *See* 18 U.S.C. § 1514A(a)(1) (2006); Minkina v. Affiliated Physician's Group, No. 2005-SOX-19, 2005 DOLSOX LEXIS 41 (Dep't of Labor Feb. 22, 2005). This case held that if the activity about which the employee complains does not qualify as securities fraud, bank fraud, or wire fraud, then the disclosure will not constitute protected activity absent a reasonable belief that the activity will have an adverse material effect on the company shareholders. Accordingly, the ALJ granted the respondent's motion to dismiss after finding none of the above frauds applicable, and noted that "while the complainant may have had a valid claim of poor air quality, Sarbanes-Oxley . . . was enacted to address the specific problem of fraud in the realm of publicly traded companies and not the resolution of air quality issues, even if there is a possibility that poor air quality might ultimately result in financial loss." *Minkina*, 2005 DOLSOX LEXIS 41, at *16-17.

110. *See Lerbs*, 2004 WL 5030304. The ALJ reasoned that the employee's subsequent concession that in fact he did not believe the company's accounting practice to be illegal removed the employee's disclosure from the protection of section 806, as the employee must believe that the practice over which he or she is complaining is illegal and not merely contrary to industry practice.

111. Harvey v. Safeway, Inc., No. 2004-SOX-21, 2005 WL 4889073 (Dep't of Labor Feb. 11, 2005). In this case, the complainant reported to officers at Safeway that his work hours were not accurately calculated and that he was therefore underpaid in violation of the Fair Labor Standards Act. He further claimed that the withholding of his wages by Safeway constituted fraud against the shareholders because the wages were wrongly labeled as profits, thereby misleading the shareholders with respect to the company's value. In granting Safeway's motion to dismiss, the ALJ concluded that the employee's disclosure of discrepancies in his weekly paycheck did not amount to protected activity because he failed to demonstrate that the company practice in question had a material impact on the company's financial reports.

112. *See* SEYFARTH SHAW LLP, SOX WHISTLEBLOWER TEAM MANAGEMENT ALERT: TOP 10 SOX WHISTLEBLOWER CASES OF 2010 (2010), http://

II.
PROBLEMS WITH ENFORCING THE US SOX WHISTLEBLOWER PROTECTION PROVISION

A. *The US Department of Labor Has Too Narrowly Interpreted Section 806*

The Department of Labor (DOL) is responsible for interpreting the whistleblower protection and anti-retaliation provisions of US SOX to determine the law's scope of protection, forum availability, application of the rules, relief afforded, and timing.[113] However, the DOL has interpreted section 806 in such a narrow manner that the purpose of US SOX to encourage and protect corporate whistleblowers has been seriously undermined.[114] According to the comprehensive list of statistics on US SOX cases that the DOL compiled as of June 2005, of the 393 cases that had been completed by OSHA, OSHA had dismissed 289 of those for lack of merit.[115] Thus, as of June 2005, OSHA had dismissed almost 82% of the cases that it had before it under US SOX prior to a hearing. The Office of Administrative Law Judges reported that, as of April 2005, it had docketed 155 total cases under US SOX and decided 119 of those cases.[116] As of June 2005, only four out of the 119 total whistleblower cases decided under US SOX were

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www.seyfarth.com/dir_docs/news_item/cba16d27-b72e-4faa-ad03-1e4670a2230d_documentupload.pdf (summarizing significant US SOX whistleblower cases decided in 2010 by U.S. federal courts and the Department of Labor).

113. *See* 18 U.S.C. § 1514A(b)(2)(D) (2002); Procedures for the Handling of Discrimination Complaints Under Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, Title VIII of the Sarbanes-Oxley Act of 2002, 29 C.F.R. pt. 1980 (2004).

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

115. Valerie J. Watnick, *Whistleblower Protections Under the Sarbanes-Oxley Act: A Primer and a Critique*, 12 FORDHAM J. CORP. & FIN. L. 831, 861-62 (2007).

116. *See id.*; Office of Administrative Law Judges, USDOL/OALJ Reporter: Whistleblower Decisions Sarbanes-Oxley Act, § 806 2003 and 2004-SOX, http://www.oalj.dol.gov/PUBLIC/WHISTLEBLOWER/REFERENCES/CASELISTS/SOX1LIST.HTM [hereinafter 2003 & 2004 USDOL/OALJ Reporter]; Office of Administrative Law Judges, USDOL/OALJ Reporter: Whistleblower Decisions Sarbanes-Oxley Act, § 806 2005-SOX, http://www.oalj.dol.gov/PUBLIC/WHISTLEBLOWER/REFERENCES/CASELISTS/SOX2LIST.HTM [hereinafter 2005 USDOL/OALJ Reporter].

decided in favor of the employee whistleblower.[117] It appears that employee whistleblowers have a very small statistical chance of success both at the investigative and at the hearing stages of US SOX section 806 proceedings. As a result, many employees expecting protection by US SOX are not actually enjoying such protection, and without such protection Congress' goal of using the threat of whistleblowers to compel corporations to root out fraud cannot be accomplished to the fullest extent.[118]

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117. *See* 2003 & 2004 USDOL/OALJ Reporter, *supra* note 116; 2005 USDOL/OALJ Reporter, *supra* note 116; Watnick, *supra* note 115, at 861-62.

118. *See* Watnick, *supra* note 115, at 833-34; 18 U.S.C. § 1514A(a)(1) (2002). *See also* Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 WM. & MARY L. REV. 65, 106-20 (2007); Beverley H. Earle & Gerald A. Madek, *The Mirage of Whistleblower Protection Under Sarbanes-Oxley: A Proposal for Change*, 44 AM. BUS. L.J. 1 (2007); 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 (2004); John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 318-31 (2004); 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, 884-86 (2002); Mary Kreiner Ramirez, *Blowing the Whistle on Whistleblower Protection: A Tale of Reform Versus Power*, 76 U. CIN. L. REV. 183, 199-208 (2007).

The DOL has narrowly interpreted section 806 to apply only when whistleblowers provide information to statutorily defined categories of persons, and therefore the DOL does not extend protection to whistleblowers providing information to state or local authorities, co-workers who are not supervisors nor charged with authority to investigate the misconduct, or the press. Since most employees likely do not know nor have the expertise to review the exact statutory language and limits of section 806 prior to their blowing the whistle, many employees make disclosures to entities outside this statutory coverage and are thereby left without protection. The DOL has also interpreted US SOX section 806 in such a limited way that it applies only to publicly traded companies where the employer is not a government entity, and does not apply to foreign companies or the foreign subsidiaries of a US company.

Moreover, the DOL has narrowed the definition of "employees" and usually excludes independent professionals and in-house counsel from section 806 whistleblower protection. These "gatekeepers" (lawyers, securities analysts, public accountants, securities brokers, and bankers) and the oversight of corporate activities that they provide often have a large impact on public confidence in corporations, but if there is uncertainty as to the legal protection of their employment these gatekeepers will be less willing to blow the whistle on corporate fraud.

The effects of this narrow interpretation are so severe that several U.S. senators have gone as far as to publicly accuse the DOL of violating the "spirit and goals" of US SOX and have called on the DOL to stop dismissing claims based on these overly restrictive interpretations of section 806.[119] Although US SOX does provide some protection to employee whistleblowers, its narrow application results in inadequate protection that leaves whistleblowers feeling vulnerable. This vulnerability makes employees much less likely to report corporate malfeasance and improve corporate governance, which thereby also increases the vulnerability of investors and the public interest.[120] It is therefore crucial that China, a country where people often face harsh punishment for blowing the whistle, attempt to avoid such narrow interpretation and application of its new China SOX whistleblower protection provision.

B. *Confidential Arbitrations*

Another feature of the implementation of section 806 that interferes with the purpose of US SOX to reduce corporate fraud and improve corporate governance is the allowance of whistleblower retaliation cases to be heard through confidential arbitrations, rather than public ALJ proceedings. The Second Circuit Court of Appeals recently ruled that the confi-

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Furthermore, the DOL has interpreted that the release of "sensitive information" by a whistleblowing employee is not likely protected under section 806 because it could be viewed as breaching the employee's duty to the employer which thereby warrants the employee's termination. However, this interpretation may too often prevent an employee from reporting serious suspicions of corporate fraud simply due to fear of disclosing related sensitive information; instead, section 806 should be applied in a way that more effectively balances the employer's concern to protect confidential information against the need to protect the whistleblower. Also, since US SOX is limited to violations of particular statutes as discussed above, employees of publicly traded companies are not covered if they report on violations of law that fall outside the specified financial fraud provisions. As these examples all demonstrate, US SOX section 806 is narrowly drawn and interpreted such that it limits protection to whistleblowers.

119. Jennifer Levitz, *Senators Protest Whistleblower Policy*, WALL ST. J., Sept. 10, 2008, http://online.wsj.com/article/SB122101918024118495.html.

120. *See* Cheryl L. Wade, *The Sarbanes-Oxley Act and Ethical Corporate Climates: What the Media Reports; What the General Public Knows*, 2 BROOK. J. CORP. FIN. & COM. L. 421, 432-433 (2008).

dential arbitration of a whistleblower claim satisfies the purposes of section 806 because it still provides whistleblowers with the opportunity to fully vindicate their rights and be made whole.[121] However, without the threat of a corporation's fraudulent activity becoming public knowledge and negatively affecting investor confidence and share price, there is less incentive for corporations to comply with US SOX.[122] The consequences of confidential arbitration of whistleblower claims and this proposed resolution is an important lesson for China to acknowledge and address in its implementation of China SOX.[123]

C. *A* Qui Tam *Incentive System, Similar to That of the False Claims Act, Can Encourage Whistleblowing*

Another fault of US SOX section 806 is its failure to account for the psychological, emotional, and economic risks involved in whistleblowing. In addition to employer retaliation, social ostracism as well as blacklisting and psychological strain are also significant disincentives to blowing the whistle.[124] Even if a whistleblower is able to vindicate her rights and regain her employment position, the psychological toll of being treated differently by one's co-workers and supervisors, and often even by one's family and friends, is yet another serious negative consequence of whistleblowing that must be reconciled.[125]

The only way to motivate whistleblowers to brave these obstacles and expose major corporate fraud is to use the old-fashioned "carrot." A significant financial bounty would - at some level - outweigh the pecuniary and non-pecuniary drawbacks of whistleblowing. The FCA [Federal False Claims Act] demon-

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121. Guyden v. Aetna Inc., 544 F.3d 376, 384-85 (2d Cir. 2008).

122. *See* John Paul Lucci, *Enron - The Bankruptcy Heard Around the World and the International Ricochet Of Sarbanes-Oxley*, 67 ALB. L. REV. 211, 221-33 (2003); Nicholas E. Eckelkamp, *Confidential Arbitration of Whistleblower Actions: A Loophole That Could Effectively Undo the Sarbanes-Oxley Act of 2002*, 2009 J. DISP. RESOL. 239, 252-54 (2009).

123. *See* discussion *infra* Part 2.III.B.

124. C. FRED ALFORD, WHISTLEBLOWERS: BROKEN LIVES AND ORGANIZATIONAL POWER 52-54 (2001).

125. *See* Sonja L. Faulkner, After the Whistle Is Blown: The Aversive Impact of Ostracism (Aug. 1998) (unpublished Ph.D. dissertation, University of Toledo), *available at* http://psycnet.apa.org/psycinfo/1999-95002-216.

strates that bounty schemes can be effectively integrated into anti-fraud regimes.[126]

Congress has therefore recently reformed US SOX, and created a reward system under the Dodd-Frank Act similar to that in the FCA: employees who observe corporate malfeasance are allowed to inform the SEC, and if the information is novel and leads to a successful case, the employee whistleblowers are then entitled to receive a significant reward.[127] Insulating whistleblowers from employer retaliation is, by itself, likely not enough to encourage whistleblowing to the level necessary to effectively reduce corporate fraud. Especially in a country like China, where there are long-held cultural traditions that disfavor blowing the whistle against one's superiors,[128] a *qui tam* incentive system can go a long way in helping employees overcome the many disincentives to reporting the fraudulent activities of their corporate employers.[129]

D. *Other Recommended Improvements to Section 806*

Other changes to the statute and implementing regulations of US SOX section 806 may provide for even greater protection and encouragement of employee whistleblowers. Some of the recommended changes include extending the statute of limitations for section 806 whistleblower claims from 90 days to 300 days, amending the regulations in a way that makes it easier for OSHA to grant preliminary reinstatement of terminated whistleblowers more regularly, and requiring disclosure in annual reports to shareholders and to the IRS of all section 806 whistleblower complaints that are filed by employees of the company.[130] Each of these changes can significantly improve the effectiveness of whistleblower protection

126. Geoffrey Christopher Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 87 B.U. L. REV. 91, 154 (2007).

127. *See* discussion *infra* Part 2.II.E (discussing the reforms the Dodd-Frank Act has made to US SOX section 806); Dworkin, supra note 50, at 1773-74.

128. *See* discussion *supra* Part 1.III.

129. *See* discussion *infra* Part 2.III.D (analyzing how a *qui tam* incentive system can encourage greater whistleblowing in China).

130. Beverley H. Earle & Gerald A. Madek, *The Mirage of Whistleblower Protection Under Sarbanes-Oxley: A Proposal for Change*, 44 AM. BUS. L.J. 1, 52-54 (2007).

statutes not only in the US, but also in China because they serve to increase the general level of protection provided to all employees. Also, since US SOX whistleblowers are disclosing violations of securities laws and accounting practices, another suggested change is moving enforcement of the whistleblower protection provision from the DOL to the SEC which has more expertise with respect to these issues.[131] However, an analogous change in China SOX's whistleblower protection provision would not be beneficial since the CSRC (the Chinese equivalent of the SEC) does not have effective investigatory or enforcement powers and is also heavily plagued by corruption.[132]

Additionally, US SOX and its implementing regulations can be revised to require companies to appoint a permanent ombudsman or business practices officer who will be responsible for receiving and investigating all whistleblower complaints.[133] Companies should also be required to develop a formal intake process that provides employee whistleblowers with the chance to maintain their anonymity,[134] to inform and educate their employees of the corporation's whistleblowing regime and disclosure channel (through the positing of notices, sending letters, and holding mandatory training programs),[135] and to maintain documentation of the reasons for any disciplinary action or termination made with respect to any employee.[136]

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131. *See id.*

132. *See* discussion *supra* Part 1.I.B.

133. Douglas M. Branson, *Too Many Bells? Too Many Whistles? Corporate Governance in the Post-Enron, Post-WorldCom Era*, 58 S.C. L. REV. 65, 106-107 (2006).

134. Ethan D. Wohl, *Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure*, 12 FORDHAM J. CORP. & FIN. L. 551, 556-58 (2007).

135. 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, 461 (2005).

136. *See* Victoria L. Donati & William J. Tarnow, *Key Issues and Analysis Relating to Retaliation and Whistleblower Claims*, *in* PRACTISING LAW INSTITUTE, Litigation and Administrative Practice Course Handbook Series: Litigation 665–66 (2006), *available at* 745 PLI/LIT 619, 665–66 (Westlaw). This documentation will ensure that in the event of a section 806 retaliation claim, evidence will be available to actually demonstrate, or tending to demonstrate, whether or not the employer took such adverse action against the employee for reasons other than the employee's whistleblowing activities.

Each of these discussed changes can provide more robust protection of whistleblowers both in the US and in China, and can more effectively make use of the superior ability of employee whistleblowers to serve as monitors of corporate fraud.

E. *The Dodd-Frank Act and Its Reforms of US SOX Section 806*

The Dodd-Frank Act was signed into law on July 21, 2010, and in addition to its reforms aimed at Wall Street, it has also expanded whistleblower protection and resolved some of the problems of US SOX section 806.[137] The Dodd-Frank Act explicitly amends US SOX section 806 to cover all subsidiaries of a publicly traded company, including privately held subsidiaries, thereby eliminating the often-used defense that publicly traded companies are not liable for the actions of their non-publicly traded subsidiaries.[138] The Act also increases the time in which an employee may file a complaint with the Secretary of Labor from 90 days to 180 days.[139] Section 922 of the Dodd-Frank Act creates a new private right of action for whistleblowing employees who believe they have been retaliated against.[140] This new cause of action enables whistleblowers to bypass the administrative review process and bring a retaliation claim directly to the appropriate U.S. District Court.[141] Moreover, unlike US SOX section 806, this new cause of action does not require employees to reasonably believe that the reported conduct violates an enumerated law.[142] The lack of a "reasonable belief" requirement under this new cause of action will likely enable more whistleblower claims to progress further in litigation than occurred under US SOX section 806.[143] Additionally, section 922 of the Dodd-Frank Act creates a "whistleblower bounty program" (similar to a *qui tam* in-

137. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act]. Section 922 of the Dodd-Frank Act, which is the primary section that establishes a new whistleblower program, amends the Securities Exchange Act of 1934 by adding Section 21F.

138. Dodd-Frank Act § 929A.

139. *Id.* § 1057(a).

140. *Id.* § 922(a) (amending the Securities Exchange Act of 1934, § 21F(h)).

141. *Id.*

142. *Id.*

143. *See* discussion *supra* Part 2.I.B.

centive system) which provides a monetary award to individuals who disclose original information to the SEC and meet certain criteria.[144] If the original information a whistleblower provides to the SEC leads to a successful judicial or administrative action brought by the SEC under the securities laws that results in monetary sanctions exceeding $1 million, the whistleblower is entitled to an award of between 10 and 30 percent of the monetary sanctions imposed.[145]

However, the sweeping reforms made by the Dodd-Frank Act have brought on a new slate of problems. Most significantly, these reforms, especially the new bounty program, discourage internal reporting and instead create strong incentives for employees to report any violations immediately to the SEC. As a result, the Dodd-Frank whistleblower program seems to be at odds with the objective of US SOX to strengthen internal corporate compliance programs. The SEC has attempted to address such tensions in its proposed implementing rules.[146] However, we will have to wait and see whether the final promulgated rules will effectively encourage

144. Dodd-Frank Act § 922(a) (amending the Securities Exchange Act of 1934, § 21F(a)(1), (b)).

145. *Id.*

146. *See* Proposed Rule 21F-4(b)(7), Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 75 Fed. Reg. 70,488, 70,495 to 97, 70,519 (proposed Nov. 17, 2010) (to be codified at 17 C.F.R. pts. 240 and 249), *available at* http://www.sec.gov/rules/proposed/2010/34-63237.pdf.

The SEC has used its proposed implementing rules to attempt to balance the competing interests in motivating whistleblowers to disclose information to the SEC and in encouraging companies to maintain strong internal compliance programs. Proposed Rule 21F-4(b)(7) provides that if an employee elects to first report potential wrongdoing internally before going to the SEC, the employee will receive the benefit of a 90-day "look back" period. Pursuant to this look back provision, if a whistleblower reports a potential violation to either (1) an authority other than the SEC (e.g., Congress) or (2) internal legal, compliance, or audit personnel at the company, and, within 90 days thereafter, reports the potential violation to the SEC, the SEC will deem the information to have been provided to the SEC as of the date of the whistleblower's earlier report. The 90-day look back period can be criticized as not doing enough to promote internal reporting to a company's a compliance program. The look back period does provide a measure of comfort to potential whistleblowing employees who may otherwise be disinclined to report internally for fear of losing their eligibility to receive a monetary award under the bounty program. However, the provision does nothing to actually create an incentive for internal reporting.

whistleblowing to the SEC while still also encouraging employees to begin with an internal report to their company's own compliance program.[147] Whatever the outcome, the reforms to US SOX section 806 made by the Dodd-Frank Act provide important lessons for China to apply in the implementation of the China SOX whistleblower program.

III.
COMBINING CHINA'S UNIQUE LEGAL SYSTEM AND LESSONS LEARNED FROM ABROAD WILL ENABLE EFFECTIVE ENFORCEMENT OF CHINA SOX WHISTLEBLOWER PROTECTION

A. *China's Lack of an Independent Judiciary and the Judiciary's Weak Role in Enforcing Legislation*

Courts within China are far from independent and are instead subject to constant corruption and pressure from the ruling Communist Party.[148]

Courts remain subject to Party oversight and control, and are subject to a wide range of external pressures, including pressure from officials, from the Chinese media, and even from individual protesters. Intervention into cases by Party officials continues to be legitimate. Court finances — and judges' positions — remain subject to local government control, making it difficult for courts to rule against local governments. And the authority of court decisions is undermined by a lack of finality in the Chinese legal system; cases can be reexamined at any time.[149]

All of the leading officers of the courts in China are Party members who serve on political-legal committees that must report directly to the government.[150] These leading judicial of-

147. The SEC explicitly invited comments on the proposed rules implementing the Dodd-Frank whistleblower program. The comment period officially ended on December 17, 2010. Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, 75 Fed. Reg. at 70,488.

148. Jerome A. Cohen, *China's Hollow 'Rule of Law,'* CNN, Dec. 31, 2009, http://www.cnn.com/2009/OPINION/12/31/cohen.china.dissidents/index.html.

149. Benjamin L. Liebman, *Legitimacy Through Law in China?*, WIDE ANGLE, June 1, 2009, *available at* http://www.pbs.org/wnet/wideangle/lessons/the-peoples-court/legitimacy-through-law-in-china/4332/.

150. Bradley L. Milkwick, *Feeling for Rocks While Crossing the River: The Gradual Evolution of Chinese Law*, 14 J. TRANSNAT'L L. & POL'Y 289, 302-304 (2005).

ficers influence the decisions of the court by serving on both the collegiate panels that decide cases and on the adjudication committee that reviews the court's decisions.[151] Additionally, the Chinese government and ruling Communist Party exercise continuing oversight of the courts through the appointment of particular judges and judicial personnel.[152]

Furthermore, not only are Chinese courts plagued by government interference and corruption, but they also suffer from weak enforcement powers, especially with respect to judgments in civil cases. Although parties are required by law to abide by all court judgments, recent reports indicate that 25 to 40% of all civil judgments made by Chinese courts are not effectively enforced.[153]

As a result of this weak and corrupt judicial system, many argue that China cannot improve its corporate governance regime and develop a more efficient and robust stock market until it first improves the independence and enforcement powers of its judiciary.[154] Government officials' constant interference with the decisions of the courts ruins the predictability of and creates a severe lack of transparency in the application of Chinese laws.[155] With such an unjust and ineffective judicial system, persons seeking vindication of their rights within Chinese courts are unlikely to feel confident in their ability to succeed on their claim. And even if successful, they are unlikely to feel confident in the ability of the courts to enforce the judgment. Therefore, if Chinese whistleblowers of corporate fraud are made to rely on the courts to protect them from retaliation by their employers, the purpose of China SOX article 43 to encourage whistleblowers in the corporate sector will likely be unfulfilled. However, until China's judicial system

151. Chris X. Lin, *A Quiet Revolution: An Overview of China's Judicial Reform*, 4 ASIAN-PAC. L. & POL'Y J. 255, 262 (2003)

152. *See* Kim Newby, *Doing Business in China: How the State of 1.3 Million Can Tap the Nation of 1.3 Billion*, 19 MAINE BAR J. 238, 239, 242 (2004).

153. DANIEL C.K. CHOW, THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA: IN A NUTSHELL, 197-205, 217-24 (2003).

154. Yi Zhang, Law, Corporate Governance, and Corporate Scandal in an Emerging Economy: Insights from China 27 (Nov. 7, 2006), *available at* http://ssrn.com/abstract= 957549.

155. David Finn, *Peering over the Great Wall: Extraterritorial Securities Regulation and U.S. Investment in China's State Owned-Banks*, 7 U.C. DAVIS BUS. L.J. 277, 286-87 (2006).

undergoes serious reform, the availability of mediation and arbitration to handle whistleblowers' retaliation claims can ensure the successful implementation of China SOX's whistleblower protection provision.

B. *How the Chinese Labor Contract Law and Labor Dispute Resolution Law Can be Used to Successfully Implement China SOX Whistleblower Protection*

Not only can the use of arbitration and mediation to hear whistleblower retaliation claims avoid the problems inherent in having such claims heard in China's corrupt courts, but it can also resolve the statutory vagueness of China SOX article 43 and avoid the narrow interpretations suffered by the US in its implementation of US SOX section 806. The problems incurred by the US in interpreting US SOX and the inadequacy of its statutory cause of action for whistleblower retaliation claims[156] can be easily avoided in the implementation of China SOX by simply requiring whistleblowers to bring their retaliation claims as breach of contract claims under China's Labor Contract Law.[157] These breach of contract claims will then secure the benefit of the clear substantive and procedural rules laid out in China's Labor Dispute Resolution Law (aka Labor Mediation and Arbitration Law).[158]

The Labor Contract Law (LCL) was promulgated to promote "harmonious" relationships between employers and workers and protect "the lawful rights and interests" of workers.[159] Pursuant to the LCL, Chinese employers are required

156. *See* discussion *supra* Part 2.II.

157. *See* Labor Contract Law of the People's Republic of China (2007), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?Article =1022&context=lawfirms [hereinafter LCL] (unofficial translation provided by Baker & McKenzie LLP).

158. *See* Labor Dispute Resolution Law of the People's Republic of China (2007) (on file with author) [hereinafter LDR] (unofficial translation provided by Baker & McKenzie LLP).

159. LCL art. 1; *see also* Li Jing, *China's New Labor Contract Law and Protection of Workers*, 32 FORDHAM INT'L L.J. 1083, 1110-11 (2008); Jovita T. Wang, *Article 14 of China's New Labor Contract Law: Using Open-Term Contracts to Appropriately Balance Worker Protection and Employer Flexibility*, 18 PAC. RIM L. & POL'Y 433 (2009).

to have labor contracts with all of their employees,[160] and if the employer does not sign a written labor contract within one year after employment begins, the employer is deemed to have signed an open-ended labor contract with the employee.[161] Moreover, the LCL applies to all employers doing business in China, regardless of the number of persons employed.[162] Therefore, employees of Chinese companies are parties to a labor contract with their corporate employer, and if they are terminated or otherwise disciplined without cause they are entitled to bring a breach of contract lawsuit in order to vindicate their rights.[163] In accordance with China SOX article 43, reporting corporate malfeasance does not warrant discipline or termination of the whistleblowing employee, and therefore such adverse action against a whistleblower can constitute a breach of the labor contract.[164]

Even if a corporate employer successfully argues that the whistleblower is simply an employee at will and not subject to a labor contract, whistleblowers can still likely bring a breach of contract claim based on the corporation's "Code of Ethics" or "Code of Business Conduct," which promise protection from retaliation for any employee who reports any illegal activity in good faith.[165] Almost all major stock exchanges require publicly-traded companies to publish such Codes and promise broad whistleblower protection, including the majority of Chinese listed companies.[166]

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160. *See* LCL art. 16. "An employment contract shall become effective when the Employer and the worker have reached a negotiated consensus thereon and each of them has signed or sealed the text of such contract."

161. *See* LCL art. 14. "An 'open-ended employment contract' is an employment contract for which the Employer and the worker have agreed not to stipulate a definite ending date. . . . If an Employer fails to conclude a written employment contract with a worker within one year from the date on which it starts using the worker, the Employer and the worker shall be deemed to have concluded an open-ended employment contract."

162. *See* LCL art. 2.

163. *See* LCL art. 77.

164. *See id.*; China SOX art. 43.

165. Richard Moberly, *Protecting Whistleblowers by Contract*, 79 U. COLO. L. REV. 975, 988-96 (2008).

166. First, the two major stock exchanges, NYSE and NASDAQ, require their listing issuers to adopt a Code that applies to all employees. *See* NYSE LISTED COMPANY MANUAL § 303A.10 (2009), *available at* http://nysemanual.nyse.com/lcm/ ("Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees

The Labor Dispute Resolution Law (LDR), and the Regulations for the Handling of Enterprise Labor Disputes (HELDR) that supplement the LDR, establish a clear procedure for handling breach of labor contract claims in China.[167] The parties to the dispute first have the opportunity to find a solution through negotiations and/or mediation.[168] If the negotiations and/or mediation fail, the case may be referred to a labor arbitration commission for arbitration.[169] However, the parties may also petition directly to the labor arbitration commission for arbitration and bypass negotiations and mediation altogether.[170] Only when one of the parties or both parties refuse to accept the arbitration award, he or they may bring a lawsuit before the People's court where the case will be heard de novo.[171] Therefore, while negotiations and mediation are completely voluntary, arbitration is mandatory as a necessary step preceding litigation.[172]

The LDR enables Chinese whistleblowers to avoid the Chinese courts and provides them with a more independent decision-maker who can better protect whistleblowers from unjust employer retaliation. Labor arbitration commissions, in comparison to China's courts, can more adequately fulfill the goal of China SOX article 43 to encourage whistleblowing and thereby reduce corporate fraud. The reasons for this dif-

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. . . ."); NASDAQ STOCK MARKET RULES § 5610 (2011), *available at* http://nasdaq.cchwallstreet.com. Second, the Code must provide for an enforcement mechanism to encourage prompt, internal reporting of violations of the Code. *See* NYSE LISTED COMPANY MANUAL § 303A.10; NASDAQ STOCK MARKET RULES § 5610. The NYSE and NASDAQ listing requirements specifically mandate that the Code include corporate assurances that it will not retaliate against an employee for reporting violations of the Code. *See* NYSE LISTED COMPANY MANUAL § 303A.10; NASDAQ STOCK MARKET RULES § IM-5610. The NYSE also requires that companies protect employees who make reports in "good faith," while the NASDAQ requires protection of those reporting "questionable behavior." *See* NYSE LISTED COMPANY MANUAL § 303A.10; NASDAQ STOCK MARKET RULES § IM-5610.

167. Jiefeng Lu, *Employment Discrimination in China: The Current Situation and Principle Challenges*, 32 HAMLINE L. REV. 133, 179-180 (2009).

168. *See* LDR arts. 4 & 5.

169. *See* LDR arts. 5, 14, & 15.

170. *See id.*

171. *See id.*

172. Haina Lu, *New Developments in China's Labor Law Dispute Resolution System: Better Protection for Workers' Rights?*, 29 COMP. LAB. L. & POL'Y J. 247, 249, 259 (2008).

ference are that labor dispute arbitration committees are not heavily dominated by the government nor plagued by corruption, but are instead characterized by a relatively high degree of independence and fair play, and possess effective power to enforce arbitration awards.[173] Therefore, whistleblowers have a better chance of succeeding on the merits and escaping employer retaliation when it is an arbitration commission, rather than a court, that handles their case.[174] However, it is also important that the regulations implementing the China SOX whistleblower protection provision prevent confidential arbitrations of whistleblower retaliation claims. Confidential arbitrations must be avoided in order to more highly encourage whistleblowing and to impose a greater threat to corporate wrongdoers that their fraudulent activity will be publicly revealed and harm the performance of the company's stock.[175]

The use of the LCL and the LDR also avoids the potential problems associated with the narrow interpretation and inadequate application of a statutory cause of action under China SOX article 43. If the substantive and procedural rules established in the LCL and LDR are applied to China SOX whistleblower claims, the Ministry of Finance (the entity with the authority to interpret and enforce China SOX)[176] will not have the need to interpret the vague language of article 43 but

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173. RONALD C. BROWN, UNDERSTANDING LABOR AND EMPLOYMENT LAW IN CHINA 172-83 (2009). Although labor arbitration commissions are established by the Chinese government, see LDR art. 17, they still exercise substantial independence and operate free from government interference relative to Chinese courts. Moreover, employees can feel confident that their labor disputes will be presided over by arbitrators who are in fact qualified and experienced. In order for a person to become an arbitrator in any labor dispute arbitration, he or she must meet one of the following minimum requirements: (1) have prior experience as a judge; (2) have prior experience as a senior legal researcher or as a senior lecturer of law; (3) have legal knowledge regarding, and more than five years of experience in, human resource (or labor union) management; or (4) have more than three years of experience practicing law. *See* LDR art. 20.

174. *Cf.* CHINA LABOUR BULLETIN, HELP OR HINDRANCE TO WORKERS: CHINA'S INSTITUTIONS OF PUBLIC REDRESS (2008), *available at* http://www.clb.org.hk/en/files/share/File/research_reports/Help_or_Hindrance.pdf (suggesting that China should establish an independent supervisory system composed of trade unions and NGOs to monitor arbitration committee and court adjudication procedures in labor dispute cases).

175. *See* discussion *supra* Part 2.II.B.

176. *See* China SOX art. 49.

can simply defer to the scope of protection and procedural rules of the LCL and LDR. The substantive coverage and procedural rules of these laws have already been greatly successful in providing necessary protection of the rights of Chinese employees. While many Chinese labor laws have largely gone unenforced in the past, the LCL and LDR have instead been relatively strongly enforced since their passage and have led to genuine improvements in labor rights for Chinese workers, made dispute resolution channels more accessible, and have promoted more harmonious relations between employers and their employees.[177] Therefore, applying these already successful rules to whistleblowers' retaliation claims provides an advantage over the potentially inadequate interpretations and implementing regulations of China SOX that may be issued by the Ministry of Finance.

There are also several major features of the LCL and LDR that act to significantly improve the protection of employee rights. These features include an extended statute of limitations period that lasts for one year from the occurrence of the dispute and breach of contract, and clear procedural rules that serve to relieve employees from the burden of proof.[178]

All in all, using the LCL and LDR to enforce the whistleblower protection called for by China SOX article 43 can cure the vagueness created by China SOX's lack of clear procedural and substantive rules, can avoid future narrow interpretations of such protection, and can also circumvent the problematic Chinese courts by imposing mandatory arbitration as a precondition to litigation of retaliation claims. Therefore, many of the issues that may potentially interfere with the effective protection of Chinese corporate whistleblowers and their quest to improve corporate govern-

177. However, full compliance by employers with all the provisions of the LCL and LDR still has yet to be achieved. *See* JEFFREY BECKER & MANFRED ELFSTROM, INT'L LABOR RIGHTS FORUM, THE IMPACT OF CHINA'S LABOR CONTRACT LAW ON WORKERS 7 (2010), http://www.laborrights.org/sites/default/files/publications-and-resources/ChinaLaborContractLaw2010_0.pdf; GLOBAL LABOR STRATEGIES, WHY CHINA MATTERS: LABOR RIGHTS IN THE ERA OF GLOBALIZATION 50 (2008), http://laborstrategies.blogs.com/global_labor_strategies/files/why_china_matters_gls_report.pdf.

178. Yun Zhao, *Labor Law Developments in China: China's New Labor Dispute Resolution Law: A Catalyst for the Establishment of Harmonious Labor Relationship?*, 30 COMP. LAB. L. & POL'Y J. 409, 424 (2009).

ance may be resolved by simply applying China's already successful procedures for handling labor disputes.

C. *There Are Great Benefits to Reap from Using US SOX as a Model, but Will China Be Willing to Learn from the US Experience?*

In addition to using the Labor Contract Law and Labor Dispute Resolution Law to successfully enforce whistleblower protection, China can also further improve this protection and the ability of employees to serve as effective corporate monitors by learning from the American experience with US SOX section 806 and the Dodd Frank reforms. There are several procedural advantages provided to employees bringing US SOX whistleblower claims[179] that China can learn from and employ in its own labor dispute resolution of Chinese whistleblower retaliation cases. First, US SOX section 806 benefits whistleblowing employees by allowing for their immediate reinstatement. Even before an evidentiary hearing on the merits is conducted by the DOL, an employee may be reinstated to his former position immediately following an investigation by OSHA.[180] Second, under US SOX section 806 whistleblowing employees need only "reasonably believe" that they are reporting violations of securities fraud statutes or other securities regulation rules, and need not satisfy a "materiality" standard and prove that the corporate activity was in fact fraudulent.[181] In a US SOX whistleblower claim, the employee plaintiff must only prove his or her "reasonable belief" by a preponderance of the evidence;[182] and under the new cause of action created by section 922 of the Dodd-Frank Act, employee plaintiffs have no burden at all to prove their "reasonable belief" that the reported conduct violates an enumer-

179. Matt A. Vega, *The Sarbanes-Oxley Act and the Culture of Bribery: Expanding the Scope of Private Whistleblower Suits to Overseas Employees*, 46 HARV. J. ON LEGIS. 425, 484-87 (2009).

180. 18 U.S.C. §§ 1514A(b)(2)(A), (c)(2)(A) (2002); *see also* discussion *supra* Part 2.I.B.

181. *See* Welch v. Chao, 536 F.3d 269, 277 (4th Cir. 2008) (holding that US SOX section 806 does not require an actual violation of federal securities law; a reasonable but mistaken belief is enough); *see also* discussion *supra* Part 2.I.B.

182. *See* 18 U.S.C. § 1514A(a)(1) (2009).

ated law.[183] In addition, the defendant employers in US SOX whistleblower cases are subject to a very stringent burden of proof, increasing the likelihood of success for the plaintiff whistleblowing employees. The defendant employer must prove that he or she did not retaliate against the plaintiff by "clear and convincing" evidence, which usually requires evidence that produces "a firm belief or conviction."[184]

However, it is uncertain whether China will take note of the American experience and adopt the advantageous features of US SOX section 806 and the Dodd-Frank reforms that have been and will be beneficial in encouraging whistleblowers to reveal corporate fraud in the US. Although US SOX section 806 (and the Dodd-Frank reforms) does not apply to foreign companies,[185] other provisions of US SOX do apply extraterritorially and many Chinese companies listed on American stock exchanges have made great efforts to ensure their compliance.[186] This enthusiasm to comply with other provisions of US SOX may foreshadow China's future adoption of whistleblower protection procedures similar to those used in enforcing US SOX section 806 and the Dodd-Frank reforms.

In addition, analogies to other areas of securities regulation indicate that China has been willing in the past to learn from the US model. For example, the US SEC was instrumental in assisting China in its development of a securities regulation regime.[187] Shortly after the establishment of the Shang-

183. Dodd-Frank Act, § 922(a) (amending the Securities Exchange Act of 1934, § 21F(h)); *see* discussion *supra* Part 2.II.E.

184. *See* Nixon v. Stewart & Stevenson Services, Inc., No. 05-066, 2007 WL 2932043 (Dep't of Labor Sept. 28, 2007); 18 U.S.C. § 1514A. This "clear and convincing" evidence standard is a much heavier burden than the "preponderance of the evidence" standard that is usually applied in most other employment cases. *See* Lebo v. Piedmont-Hawthorne, No. 04-020, 2005 DOL Ad Rev Bd LEXIS 92 (Dep't of Labor Aug. 30, 2005); 49 U.S.C. § 42121 (b)(2)(B)(i)-(ii) (2009).

185. *See* discussion *supra* Part 1.I.D.

186. "Wang Xiaochu, chairman and chief executive of blue-chip company China Mobile in Hong Kong, listed in the United States, has committed to compliance with Sarbanes-Oxley. 'Our accounts are very transparent and accurate,' observed Mr. Xiaochu, 'me [sic] and our chief financial officer Xue Taohai will be happy to sign the document and bear the legal responsibility.'" *China Mobile Throws Weight Behind Responsibility Drive,* S. CHINA MORNING POST (H.K.), Aug. 15, 2002, at 3, *available at* 2002 WLNR 4478783.

187. *See* Han Shen, *A Comparative Study of Insider Trading Regulation Enforcement in the U.S. and China,* 9 J. BUS. & SEC. L. 41, 43, 74 (2008). *See generally*

hai and Shenzen stock exchanges, China established the China Securities Regulatory Commission (CSRC), using the SEC as a model.[188] However, as compared to the SEC, the CSRC has played a very inadequate role in securities regulation in China,[189] and this may demonstrate that blind adoption of US legal and governance models is not appropriate for China. The Chinese government must learn from the US while still taking into account China's unique characteristics.

Instead of following the exact path taken by the US in implementing section 806 and the Dodd-Frank reforms, the Chinese government should adapt the US model to the particular attributes of China's society and legal system.[190] In accordance with this reasoning, China must account for its inadequate, corrupt judicial system, which differs greatly from the judicial regime of the US, and emphasize the use of arbitration over litigation with respect to China SOX whistleblower retaliation claims. The need to emphasize arbitration over litigation provides further justification for the use of the LCL and LDR in enforcing China SOX whistleblower protection. Furthermore, there are other unique features of China's legal culture and society that should also be considered in developing

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Yuwa Wei, *The Development of the Securities Market and Regulation in China*, 27 LOY. L.A. INT'L & COMP. L. REV. 479, 488-500 (2005).

188. Patrick Harverson, *U.S. SEC Offers to Advise Beijing Securities Regulators*, FIN. TIMES, Apr. 29, 1994, at 10-11.

189. *See* discussion *supra* Part I.I.B.

190. *Cf.* Frances H. Foster, *American Trust Law in a Chinese Mirror*, 94 MINN. L. REV. 602, 636-51 (2010). In discussing China's adoption of American trust law, "one Chinese drafter observed, 'regardless of whether the system is transplanted or adopted by another nation, it must go through a process of nativization and integration with the particular features of its host nation. These national features consist of . . . the legal customs and norms . . . [and] the societal, economic, and cultural environment.'" *Id.* at 636 (quoting Zhou Xiaoming, Xintuo Zhidu de Bijiao Fa Yanjiu [Comparative Law Research of Trust Systems] at 108-09 (1996)).

Furthermore, "the most telling lessons may be found in what China rejected rather than what China adopted. China's critique of American trust law provides a mirror for us to see our own system more clearly. And, as is so often true in life, the image in the mirror turns out to be less attractive than expected." *Id.* at 650. Under this reasoning, not only can China learn from US SOX, but the US can also learn from China ways in which it should reform the US SOX legislation. The US should therefore pay close attention to the inadequacies that China finds within US SOX, and the new provisions and/or implementing regulations that China promulgates to avoid such shortfalls in the implementation of China SOX.

a successful plan of implementation for the whistleblower protection provision of China SOX.

D. *Other Features of Whistleblower Protection Systems that Will Improve the Operation and Enforcement of Such Systems Within China*

In formulating an effective whistleblower protection system, China should attempt to reconcile certain aspects of its culture with the acts of whistleblowing and bringing suit against one's employer. The primary school of thought that has shaped Chinese society and Chinese traditional culture is Confucianism.[191] The hallmarks of Confucianism are its emphasis on humaneness, goodness, and benevolence, and also its focus on maintaining an hierarchy of relationships.[192] Another unique feature of Chinese culture that shapes social and personal behavior is the concept of "guanxi," which constitutes "social connections" and an unwritten understanding between individuals that represents a personalized network of influence.[193] Moreover, the concept of "face," which is the symbol representing respectability, reputation and pride, is another important element of Chinese culture.[194] Chinese people will go to great lengths to avoid the disastrous consequences of losing face, as demonstrated by several empirical studies.[195] Furthermore, Chinese employees tend to be highly bound to their group of co-workers and superiors due to China's collectivist

191. *See* WM. THEODORE DE BARY & IRENE BLOOM, SOURCES OF CHINESE TRADITION: FROM EARLIEST TIMES TO 1600, 41-46 (2d ed. 1999).

192. *See* CONRAD SCHIROKAUER, A BRIEF HISTORY OF CHINESE AND JAPANESE CIVILIZATIONS 612-16 (2d ed. 1989); Wm. Theodore de Bary, *Individualism and Humanitarianism in Late Ming Thought, in* SELF AND SOCIETY IN MING THOUGHT 149 (de Barry ed., 1970).

193. Udo C. Braendle, Tanja Gasser, & Juergen Noll, *Corporate Governance in China - Is Economic Growth Potential Hindered by Guanxi?*, 110 BUS. & SOC'Y REV. 389, 393 (2005); Jerome A. Cohen, *Network Solutions*, S. CHINA MORNING POST, Mar. 4, 2010, at A13, *available at* http://www.usasialaw.org/wp-content/uploads/2010/03/2010-3-4-SCMP-Network-solutions_A13.pdf.

194. Qiumin Dong & Yu-Feng L. Lee, *The Chinese Concept of Face: A Perspective for Business Communicators* 402-403 (2007), *available at* http://www.swdsi.org/swdsi07/2007_proceedings/papers/401.pdf (discussing the results of an empirical study); *see also* T. K. P. Leung & Ricky Yee-kwong Chan, *Face, Favour and Positioning - a Chinese Power Game*, 37 EUR. J. MKTG. 1575, 1575-1598 (2003) (discussing the results of an empirical study).

195. *See* Dong & Lee, *supra* note 194; Leung & Chan, *supra* note 194.

culture, which emphasizes interdependence and discourages taking individual action that would harm another member of the group.[196] As a result of these characteristics of Chinese society, the business culture within China's corporations is largely relationship-driven and centered around a desire to avoid conflict.[197] Whistleblowing and taking action against one's superiors is therefore largely discouraged by China's traditional and corporate culture. Although China has already shown signs of rising above the traditional distaste of whistleblowing,[198] certain mechanisms can be included within China's whistleblower protection regime to help corporate employees more fully overcome these cultural impediments.

Maintaining the anonymity of Chinese whistleblowers will be important in encouraging the reporting of corporate fraud.

Anonymity is an essential prerequisite to safe guard confidentiality and to encourage healthy whistleblowing behaviors. Unlike people from individualist societies, Chinese employees may not be 'bold' enough to conduct whistleblowing behaviors, simply because of their cultural orientation and personality traits.[199]

Additionally, *qui tam* legislation that provides monetary rewards to whistleblowers (and which has already been officially adopted in the context of US SOX whistleblower protection)[200] can go a long way in helping Chinese employees overcome their culture-driven hesitance to report the wrongdoing of their employers.[201] To overcome the collectivist mentality of Chinese employees, it is important that China SOX also encourage the development of a corporate culture that supports the disclosure of fraud. China SOX can achieve this through the issuance of implementing regulations that require Chinese

196. Mailynn B. Brewer & Ya-Ru Chen, *Where (Who) Are Collectives in Collectivism? Toward Conceptual Clarification of Individualism and Collectivism*, 114 PSYCHOL. REV. 133, 133-51 (2007).

197. Trant, *supra* note 44, at 65-66.

198. *See* discussion *supra* Part 1.III.

199. Julia Zhang et al., *Decision-Making Process of Internal Whistleblowing Behavior in China: Empirical Evidence and Implications*, 88 J. BUS. ETHICS 25, 37-38 (2008).

200. *See* discussion *supra* Part 2.II.C & E; Dodd-Frank Act, § 922(a) (amending the Securities Exchange Act of 1934, § 21F(a)(1), (b)).

201. Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?* 5, 31 (Nat'l Bureau of Econ. Research, Working Paper No. 12882), *available at* http://www.nber.org/papers/w12882.pdf.

companies to establish a formal organizational system (whether in the form of an ethical standards committee, a code of conduct, an ethics officer, and/or an internal disclosure policy) that encourages the reporting of malfeasance and characterizes whistleblowing as positive and healthy employee behavior.[202] Finally, as already suggested with respect to US SOX whistleblower protection,[203] Chinese corporations should be required to adequately train and educate their employees about the details of the company's whistleblower protection regime, the available disclosure channels, and the response and investigations that will be made in response to whistleblower disclosures. This training will notify employees of their options and can also provide the confidence necessary for Chinese employees to overcome such disincentives as employer retaliation and the belief that their disclosures will go unacknowledged.

IV.
CONCLUSION

The discovery and deterrence of corporate fraud in the US, China, and elsewhere depends largely on employees blowing the whistle on the malfeasance of their corporate employers. The passage of China SOX and its whistleblower protection provision therefore represents a huge step by the Chinese government toward alleviating China's corporate fraud epidemic and improving the corporate governance within Chinese companies. However, the promulgation of a statute is only one part of the battle. The Chinese government must also take additional steps to ensure the proper implementation and successful enforcement of its whistleblower protection legislation.

Acknowledging China's unique characteristics while also learning from the experiences of the US (a pioneer in whistleblower protection), can lead the way to effective enforcement of China SOX article 43. By adequately taking into account China's Confucian culture, its weak government securities regulatory agency, and its lack of an independent judiciary, an effective plan of implementation for China SOX

202. Gerald Vinten, *Whistleblowing: Corporate Help or Hindrance?*, 30 MGMT. DECISION 44, 48 (1992).

203. *See* discussion *supra* Part 2.II.D.

whistleblower protection can be developed. This effective plan includes employing China's Labor Contract Law and Labor Dispute Resolution Law to handle China SOX whistleblower retaliation cases in ways that circumvent China's corrupt courts. The use of these laws can also enable China to cure the vagueness of China SOX's whistleblower protection provision and to avoid the problem of narrow interpretation that has plagued the enforcement of US SOX section 806. Additional lessons learned from abroad include preventing confidential arbitration of retaliation claims, guaranteeing anonymous reporting, establishing a *qui tam* incentive system, and requiring companies to educate their employees about the whistleblower reporting system. If China takes advantage of these lessons, it will not only help employees conquer the fear of retaliation and the cultural disincentives to blowing the whistle, but it will also more fully ensure that whistleblower protection fulfills its role in reducing corporate fraud and improving corporate governance in Chinese companies.

The Chinese government certainly has the ability to effectively enforce China SOX whistleblower protection. But whether the Chinese government will take all the necessary steps to complete this successful implementation is uncertain. Only time will tell if the Chinese government will recognize the essential need of proper enforcement of its whistleblower protection legislation in the fight against corporate fraud and the quest to improve corporate governance in China's companies.