



Employers Beware: Sarbanes-Oxley Requires Reinstatement for Real

By Daniel P. Westman

Three years after the whistleblower provisions of the Sarbanes-Oxley Act of 2002 were passed, it has become clear that litigation of Sarbanes-Oxley whistleblower cases differs in several critical respects from litigation of other employment disputes. This article will provide a brief overview of the Sarbanes-Oxley whistleblower provisions, and then discuss how unique features of those provisions have led to results that would be unusual in other types of employment litigation.

OVERVIEW OF THE SARBANES-OXLEY WHISTLEBLOWER PROVISIONS

The whistleblower provisions of Sarbanes-Oxley differ substantially from previous federal and state whistleblower laws. Until Sarbanes-Oxley, most federal and state whistleblower laws applicable to the private sector protected only employees who raised concerns about issues affecting public health or safety. Most such laws did not protect private sector employees who raised concerns about fraud against shareholders, because such issues were not perceived as affecting public health or safety.

In contrast, most federal and state laws covering government sector whistleblowers did protect government employees who raised concerns about waste of funds. The public interest in financial abuse in the public sector has always been clear, because

such abuse involves waste of taxpayer funds. However, until Sarbanes-Oxley the issue of financial fraud in the private sector was viewed as of concern only to shareholders.

With the failures of several major corporations, and the corresponding investment losses suffered by millions of employees and shareholders, Congress decreed in Sarbanes-Oxley that fraud against shareholders is an issue of public concern justifying significant new civil and criminal protections for private sector employees who raise concerns about financial fraud. For the first time, Sarbanes-Oxley creates a civil remedy for whistleblowers in the private sector who raise concerns about financial matters that implicate violations of federal securities laws. Section 806 of Sarbanes-Oxley creates a federal civil right of action on behalf of any employee of a publicly traded company, or any employee of a contractor of a publicly traded company, who is subject to discrimination in retaliation for reporting corporate fraud or accounting abuses. Section 806 prohibits publicly traded companies from discriminating against an employee in retaliation for any lawful act done by the employee to:

- (1) provide information or otherwise assist in any investigation regarding conduct which the employee reasonably believes constitutes a violation of federal securities fraud statutes or SEC rules, provided the investigation is conducted

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by a federal regulatory or law enforcement agency, any Member of Congress or Congressional Committee, or a person with managerial authority within the publicly traded corporation; or

(2) file, testify, participate in, or otherwise assist in any proceeding related to an alleged violation of corporate fraud laws or regulations.

Thus, the subject matter of protected disclosures has been significantly broadened beyond the categories of public health and safety.

In addition, the penalties for retaliation against whistleblowing have been greatly strengthened. The civil provisions of Sarbanes-Oxley allow for immediate reinstatement of whistleblowing employees, even before an evidentiary hearing on the merits. Even more drastically, Sarbanes-Oxley creates severe criminal penalties (including substantial fines, and up to 10 years in prison) for retaliation against whistleblowers who raise concerns about violation of *any* federal criminal statute, not simply laws limited to financial fraud.¹ These criminal penalties may apply to *any* employer, regardless of whether the employer is publicly traded or privately held, and may apply to individual managers as well as to corporate employers.

Sarbanes-Oxley also uses whistleblower protection as a key component of federal securities law enforcement. By 2002, the collapses of Enron, WorldCom, and numerous other companies demonstrated that the system of “oversight” created by the Securities Exchange Act of 1934 had

failed to prevent massive financial fraud by several issuers of publicly traded securities. During 2001 and 2002, numerous persons testified before Congress about the reasons for the Enron and WorldCom corporate collapses. The Report of the Senate Judiciary Committee on the bill that became Sarbanes-Oxley states: “In a variety of instances when corporate employees at both Enron and Andersen [the accounting firm which audited Enron’s books] attempted to report or ‘blow the whistle’ on fraud, but [sic] they were discouraged at nearly every turn.”²

Woven throughout Sarbanes-Oxley is the theme that protection of employees who report financial abuse may help to prevent future corporate collapses and securities frauds. Now, corporate insiders who see the daily operations of companies are protected by Sarbanes-Oxley if they report concerns about financial fraud. In addition to strengthening “oversight” by creation of the Public Company Accounting Oversight Board and other actions, Sarbanes-Oxley also added new “undersight” provisions protecting corporate insiders who witness and report about fraud. (“Undersight” is a term I have introduced in my writing to describe corporate insiders who report fraud they observe first-hand, in contrast with traditional “oversight” by which corporate outsiders attempt to detect fraud based on information filtered by others.) Protection for employees engaging in “undersight” is reflected in many facets of Sarbanes-Oxley:

- Section 806 creates new civil protection for employees who report concerns about alleged fraud upon shareholders, and Section 1107 creates new criminal penalties for retaliation which extend more broadly than does Section 806;
- Congress required the SEC to issue regulations setting forth minimum standards of practice applicable to attorneys who practice before the SEC. The rules issued by the SEC require attorneys who are aware of financial fraud by their clients to alert the issuers’ executive management, and then the issuers’ Boards of Directors if executive management does not respond appropriately;³
- Sarbanes-Oxley requires the SEC to promulgate rules that prohibit brokerage firms from retaliating against securities analysts because of an “unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report.” This new legal protection for securities analysts was driven by concerns that brokerage firms were pressuring securities analysts to write overly favorable evaluations of stocks in order to obtain additional investment banking business; and
- Congress required issuers of publicly traded securities to disclose whether they have Codes of Ethics applicable to senior financial officers. Both the New York Stock Exchange

and the National Association of Securities Dealers have gone further by requiring companies who wish to maintain their listings on those exchanges to implement Codes of Ethics not limited to executive management, and to include in such codes provisions that protect employees who report alleged violations from retaliation.⁴

Given Sarbanes-Oxley's pervasive concern for whistleblower protection, it is not surprising that the statute contains substantive and procedural elements that are favorable to employees.

BURDENS OF PROOF FAVORABLE TO EMPLOYEES

The Sarbanes-Oxley whistleblower provisions set forth different burdens of proof for plaintiffs and defendants in litigation before Administrative Law Judges (ALJ) employed by the U.S. Department of Labor (USDOL). In most civil litigation, both the plaintiff and the defendant must prove their cases by a "preponderance" of the evidence, meaning that the judge or jury finds that the evidence of one party is more likely to be true than the evidence of the other party.

Under the Sarbanes-Oxley whistleblower provisions, however, the relatively light "preponderance" of the evidence standard is applicable only to plaintiffs. In contrast, defendants must prove that they did not retaliate against plaintiffs by "clear and convincing" evidence, meaning evidence producing "a firm belief or conviction." This is a heavier burden than the "preponderance" standard, though not as difficult to satisfy as the "beyond a reasonable doubt" standard used in criminal cases.

Several decisions under the Sarbanes-Oxley whistleblower provisions have reached results in favor of employees which appear to have been driven by these differing burdens of proof. For example, in *Platone v. Atlantic Coast Airways*,⁵ and *Welch v. Cardinal Bankshares*,⁶ the employees were found to have met their burdens of proving by a preponderance of the evidence that they had a reasonable, good-faith belief that they had raised concerns about financial fraud, but the defendants were found not to have satisfied the "clear and convincing" standard.

The defendants argued that they had good reasons to terminate the plaintiffs. In *Platone*, the plaintiff's job was to represent management's position in dealings with the company's labor unions. The defendant argued that Ms. Platone was terminated because she had concealed from the defendant that she was having a romantic relationship with the representative of one of the company's unions. Perhaps the defendant would have persuaded the ALJ that concealing a potentially compromising relationship was the real reason for the plaintiff's discharge under the preponderance of the evidence standard. However, the ALJ ruled that the defendant had not proven by "clear and convincing" evidence that the romantic relationship was the true reason for the termination.

In *Welch v. Cardinal Bankshares*, the plaintiff was the Chief Financial Officer of a small bank who raised concerns about potential financial fraud. The bank terminated his employment when the plaintiff refused to talk with the bank about his own concerns unless his attorney was present. The ALJ ruled that the plaintiff had proved by a "preponderance" of the evidence that he had a good-faith belief in his

report, but that the defendant bank had not proved its defense of failure to cooperate in the bank's investigation by "clear and convincing" evidence.

REINSTATEMENT AS A REMEDY

Another unusual aspect of the Sarbanes-Oxley whistleblower provisions is the prominence of reinstatement as a remedy in the statutory scheme, which has resulted in reinstatement of employment in cases in which such relief would be unlikely in other types of employment litigation.

The USDOL has delegated investigation of complaints under Sarbanes-Oxley to OSHA, which has experience investigating retaliation complaints under the OSH Act. After the initial investigation, a *de novo* hearing on the merits before an ALJ may be requested by either party. Significantly, the statute allows OSHA to require reinstatement of the plaintiff's employment after the investigation by an OSHA investigator, but before the hearing on the merits before an ALJ, and provides that reinstatement is not stayed even if the defendant requests a *de novo* hearing. This provision is not surprising in the USDOL context because the USDOL enforces whistleblower statutes in the nuclear energy, aviation, and other safety-sensitive industries. Because the USDOL views employees as the front line of safety inspection inside the containment vessels of nuclear energy installations, or in airport hangars, the USDOL's traditional view has been that reinstating a whistleblower to a position from which additional safety problems might be reported is the best way to deter unsafe conditions. From this perspective, immediately reinstating a Sarbanes-Oxley whistleblower

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This newsletter addresses recent employment law developments. Because of its generality, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

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theoretically aids in deterring potential financial fraud.

However, reinstatement in other types of employment litigation is an unusual remedy where the relationship between the parties has become adversarial. Therefore, it was a surprise to the employers in two recent cases when the ALJs ordered reinstatement of the employees. In the *Welch v. Cardinal Bankshares* case, the small bank presented evidence to the ALJ that the bank's management, Board of Directors, and shareholders all did not wish the former Chief Financial Officer to return to his job. The ALJ considered those objections, but reinstated the employee notwithstanding.⁷ The bank has vowed to appeal. And, in *Bechtel v. Competitive Technologies, Inc.*, the ALJ ordered reinstatement of two Vice Presidents who alleged that they had been terminated for raising concerns about financial fraud.⁸ The employer objected strongly to the ALJ's order and delayed their reinstatement. The employees then sought an injunction in federal court compelling the employer to obey the ALJ's order. The federal court ruled that the statute clearly gave the ALJ authority to order reinstatement as a form of relief, and ordered the employer to comply with the ALJ's order.⁹

These decisions demonstrate the unique nature of Sarbanes-Oxley whistleblower litigation, and the need for counsel handling such cases to be familiar with the substantive and procedural aspects of litigating before the USDOL. For example, the USDOL requires that settlements be submitted to the USDOL for review because "the Secretary represents the public interest in keeping channels of information

open by assuring that settlements adequately protect whistleblowers."¹⁰ This and other USDOL requirements often surprise counsel unfamiliar with the USDOL's approach, but are second nature to those with experience litigating before the USDOL. Given the origins and purposes of Sarbanes-Oxley, and the USDOL's eye towards protecting the flow of information, it is likely that the Sarbanes-Oxley whistleblower provisions will continue to be applied in a manner which differs from interpretations of other employment laws. ■

¹ Section 1107 of Sarbanes-Oxley, entitled "Retaliation Against Informants," imposes criminal penalties on any individual who "knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense." This provision supplements the existing federal criminal penalties for witness intimidation. The penalties include a fine and/or imprisonment up to ten years.

² Senate Report No. 107-146, 107th Congress, 2d Sess., at 5.

³ See 17 C.F.R. Part 205.

⁴ See New York Stock Exchange Listed Company Manual, Section 303A, and National Association of Securities Dealers, Inc. Rule 4350(m), and Interpretive Memorandum.

⁵ 2003-SOX-27 (ALJ Apr. 30, 2004).

⁶ 2003-SOX-15 (ALJ Jan. 28, 2004).

⁷ 2003-SOX-15 (ALJ Feb. 15, 2005).

⁸ 2003-SOX-33 (ALJ Mar. 29, 2005).

⁹ No. 3-05CV629 (D. Conn. May 13, 2005).

¹⁰ *McCoy v. Utah Power*, 94-CAA-1 at 2 (Sec'y Mar. 22, 1994).

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