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Sarbanes-Oxley Augments Whistleblower Protection

The Sarbanes-Oxley Act (SOX) of 2002 was enacted by Congress primarily to improve corporate governance and accounting practices. However, it also includes whistleblower provisions, which require audit committees to establish procedures for handling whistleblower complaints and provide protection to employees who make whistleblower complaints. The SOX whistleblower provisions apply to all public companies. In addition, one of the SOX whistleblower provisions applies to private companies as well. Taken together, the SOX whistleblower provisions add to the existing patchwork of state and federal laws protecting employees from retaliation by employers for reporting corporate wrongdoing. This Management Alert summarizes the three sections of SOX that contain whistleblower provisions, and briefly summarizes other whistleblower laws.

Section 301

Section 301 instructs the SEC to direct the national securities exchanges and associations to require each listed company's audit committee to establish formal procedures for addressing complaints relating to accounting and auditing matters, including an anonymous channel for employee complaints. Pursuant to Rule 10A-3 of the Exchange Act, the SEC has directed the national securities exchanges and associations to issue rules that prohibit the listing of companies that do not establish procedures to deal with both internal and external complaints, specifically providing for: (1) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (2) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters. Most companies must establish such procedures by the earlier of the first annual meeting after January 15, 2004, or October 31, 2004.

Rule 10A-3 does not mandate a specific set of procedures. Instead, in its final rule release, the SEC stated that it expected each audit committee to develop procedures that work best consistent with its company's individual circumstances. In formulating its procedures, the audit committee has some decisions to make:

1. To whom should complaints be channeled? Although The Audit Committee is charged with establishing the procedure, it does not have to administer it.
2. How will employee complaints be delivered "anonymously"? Telephone hotlines, administered internally or external-

ly, or a web-based approach are the most obvious choices. Anonymous paper submissions are also possible.

3. How is the procedure to be disseminated and communicated within the company? Without appropriate communication, education and management support, the procedure will not work.

Section 806

SOX provides substantial protection to employee whistleblowers who (1) provide information or assist in an investigation regarding conduct that the employee "reasonably believes" constitutes a violation of federal criminal law relating to mail fraud, wire fraud, bank fraud or securities fraud, SEC rules or regulations, or federal law relating to fraud against shareholders; or (2) file, testify, participate in or otherwise assist in a proceeding relating to an alleged violation of federal criminal law relating to such activities. Employees are protected when the information or assistance is provided to, or the investigation conducted by, a federal regulatory or law enforcement agency, any member or committee of Congress, a person with supervisory authority over the employee, or any other person who has authority to investigate, discover or terminate misconduct. Employees cannot be discharged, demoted, suspended, threatened, harassed or discriminated against as a result of such activity. Section 806 became effective upon enactment of SOX on July 30, 2002.

An employee alleging a Section 806 violation must file a complaint with the Assistant Secretary for OSHA (to whom the Secretary of Labor has delegated authority for enforcement of Section 806) within 90 days of the alleged violation. OSHA will commence an investigation if the employee makes a prima facie showing that the prohibited behavior was a contributing factor in the alleged unfavorable personnel action, unless the employer demonstrates, by clear and convincing evidence, that it would have taken the same unfavorable personnel action regardless of that behavior.

While an OSHA decision can be appealed, OSHA has the authority to reinstate a discharged employee immediately notwithstanding the appeal. An employee prevailing in a Section 806 claim is entitled to all relief necessary to make the employee whole, including reinstatement, back pay with interest, and special damages covering litigation costs, expert witness fees and attorney fees. Note that Section 806 does not diminish any rights or remedies that an employee may have

under any other federal or state law, or under any collective bargaining agreement. As noted below, both public and private companies are already subject to numerous federal and state laws protecting those who engage in whistleblower activity.

Section 1107

Section 1107 provides criminal penalties for both public and private employers for retaliating or otherwise interfering with the lawful employment or livelihood of any person who provides to a law enforcement officer any truthful information relating to the commission or possible commission of any federal offense. Section 1107 is currently effective. Criminal penalties include fines and up to ten years in prison.

Other Federal Whistleblower Laws

In addition to the SOX whistleblower provisions, there are a number of other federal whistleblower statutes, many of which apply only to federal employees for reporting violations by government agencies or employees. The federal defense contractor statute also covers employees of civilian defense contractors, providing special whistleblower protection for reporting contract-related violations to the government. The False Claims Act prohibits discrimination against employees who report or participate in the investigation of false claims under the Act. This Act allows private persons to sue on behalf of the government, and collect a bounty of 15-30% of the recovery. It is most often used by employees of government contractors who are claiming their employers have defrauded the government and who seek to recover money damages on behalf of the government. In addition, most federal employment laws also contain express provisions prohibiting employers from retaliating against employees who exercise their rights under these laws by reporting violations or participating in investigations of violations.

Illinois Whistleblower Act

The Illinois legislature recently passed The Illinois Whistleblower Act (S.B. 1872), which, once signed into law, will create various new whistleblower protections for Illinois private sector employees. It prohibits Illinois employers from enforcing any rule or policy that prevents an employee from disclosing information to a government or law enforcement agency, if the employee has reasonable cause to believe that the information discloses a violation of any state or federal law, rule or regulation. It also prohibits an employer from retaliating against an employee for such conduct. Violations constitute Class A misdemeanors and can result in damages, including back pay, litigation costs and attorney's fees.

State Whistleblower Statutes

Most other states have also passed laws protecting employees from retaliation by employers for disclosing information to the government or law enforcement authorities concerning violation of the law. Many state employment-related statutes also expressly prohibit retaliation against employees who exercise their rights under those statutes. Many states also have state versions of the federal False Claims Act. These laws are pervasive, but not uniform. Where statutory prohibitions are lacking, states courts sometimes step in by recognizing common law tort claims for retaliatory discharge.

Summary

Any time an employee is to be discharged or involuntarily separated, employers need to be very careful that there is no element of whistleblowing or retaliation involved. SOX and other new laws have raised the stakes and aimed a spotlight at this area by adding to the bases on which whistleblower claims may be made, requiring that public companies develop procedures for handling whistleblower complaints and increasing the penalties for getting it wrong.

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This Management Alert is intended only as a summary of the SOX whistleblower and related provisions. If we can answer any questions about how the SOX whistleblower protections may affect your company, please contact the Seyfarth Shaw attorney with whom you regularly work.

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