

# Client Alert

A report  
for clients  
and friends  
of the firm

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## Sarbanes-Oxley Act Expands Protection for Whistleblowers

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the "Act"), which substantially impacts public companies and their professional advisors. The Act also has implications for human resources professionals and in-house employment counsel at public companies: it significantly expands federal protection for employees of publicly traded companies who report certain allegations of corporate misconduct.<sup>1</sup> Specifically, the Act prohibits discrimination against employees who engage in certain "whistleblowing" activities, gives whistleblowers a private right of action, and provides for the imposition of potential criminal penalties (including imprisonment) for retaliation against whistleblowers. Under these provisions of the Act, public companies may have significant exposure to monetary and criminal liability.

### Protection for Whistleblowers

The Act prohibits publicly traded companies, including officers, employees, contractors, subcontractors or agents of the company, from taking any adverse employment action against an employee because of his or her protected whistleblowing activities. The Act protects an employee of a public company who provides information or otherwise assists in an investigation or proceeding about conduct which he or she "reasonably believes" to be a violation of federal securities laws, the rules or regulations of the Securities and Exchange Commission ("SEC"), or "any provision of Federal law relating to fraud against shareholders."

To be protected by the Act, the employee must engage in one of two protected reporting activities: First, the employee must make the disclosures to a Federal regulatory or law enforcement agency, any member or committee of Congress, any person with supervisory authority over the employee, or any other person working for the company who has "the authority to investigate, dis-

cover, or terminate misconduct." Second, the employee must file, cause to be filed, testify, participate in, or otherwise assist in, a proceeding filed under the federal securities laws, the rules or regulations of the SEC, or "any provision of Federal law relating to fraud against shareholders." If an employee engages in any of this protected activity, then the company cannot discharge, demote, suspend, threaten, harass, or otherwise discriminate against him or her in the terms or conditions of employment *because of* that protected activity. Of course, nothing in the Act prevents public companies from taking adverse action against an employee for legitimate, non-discriminatory reasons.

### Procedures for Confidential and Anonymous Complaints

Under the Act, the public company's Audit Committee is required to establish procedures to permit employees to file internal, confidential and anonymous complaints concerning "questionable accounting or auditing matters." Therefore, companies may have to revise their existing employment policies to provide a mechanism for reporting such concerns.

### Administrative Procedure and Private Right of Action

In order to bring a claim of discrimination under the Act, a whistleblower initially must file a complaint with the U.S. Department of Labor ("DOL") within 90 days after the date on which the alleged retaliatory conduct occurred. The Secretary of Labor will investigate the complaint pursuant to the procedures set forth in 49 U.S.C. § 42121(b), which governs the investigation of whistleblower complaints in the air carrier industry, to determine if there is "reasonable cause" to believe that a violation occurred.

If the Secretary finds reasonable cause, the Secretary will issue a preliminary order providing for relief. Thereafter, either party may file written objections to that order and request a hearing on the record. The DOL must hold any such hearing as expeditiously as possible and render its final order within 120 days after the conclusion of the hearing. Any appeal from

<sup>1</sup> For purposes of the Act, a "publicly traded company" is a company with a class of securities registered under Section 12 of the Securities and Exchange Act of 1934, or that is required to file reports under Section 15(d).

that ruling must be filed with the appropriate U.S. Court of Appeals within 60 days after the date of issuance of the DOL's final order. If, however, the Secretary fails to issue a final decision within 180 days of the filing of the complaint, and there is no showing of bad faith by the employee, then the employee may commence an action for *de novo* review in U.S. District Court.

The Act also provides for the allocation of the burdens of proof in either the administrative or court proceeding. The employee has the burden of proving that his or her protected activity was "a contributing factor" -- and not the sole reason -- for the adverse employment action. If the employee meets this burden, the employer can avoid liability if it "demonstrates by clear and convincing evidence" that it "would have taken the same unfavorable personnel action in the absence of that behavior."

In either forum, a prevailing employee's potential remedies include reinstatement, back pay with interest, and compensation for any "special damages" such as litigation costs, reasonable attorneys' fees and expert witness fees. The Act does not specifically provide for the recovery of punitive damages or the right to trial by jury. Because the Act seems to limit recovery to equitable relief, there probably is no right to a jury trial.

### **Criminal Penalties For Retaliation Against Informants**

In addition to civil liability, the Act also provides for criminal penalties, including imprisonment, for individuals who retaliate against whistleblowers. Specifically, the Act prohibits any person from knowingly taking any "action harmful" to a person who has provided any truthful information relating to the commission (or possible commission) of a Federal offense to a law enforcement officer, including any interference with "the lawful employment or livelihood" of a whistleblower. Any individual who violates this provision may be subjected to fines and imprisonment of up to 10 years.

### **Conclusion**

In light of the Act's expansive protections provided to whistleblowers, publicly traded companies should review their employment policies and practices with respect to whistleblowers and take all steps necessary to prevent discrimination and protect the company from civil and criminal liability under the Act. For instance, companies should revise their anti-discrimination policies to prohibit discrimination and retaliation against whistleblowers; develop effective procedures for soliciting whistleblower complaints; educate and train managers about the Act; and investigate promptly and fully all claims of discrimination, and take immediate and appropriate remedial action which is necessary to end the alleged discrimination.

**NEW YORK LOS ANGELES  
WASHINGTON BOCA RATON  
NEWARK PARIS**

### **Labor and Employment Department**

Proskauer's Labor and Employment Department includes over 160 attorneys with significant and diverse labor and employment law experience. The individuals listed here serve as contact persons who would welcome any questions you might have:

#### **Edward Cerasia II**

973.274.3224 - [ecerasia@proskauer.com](mailto:ecerasia@proskauer.com)

#### **Laurie S. Leonard**

212.969.3102 - [lleonard@proskauer.com](mailto:lleonard@proskauer.com)

Proskauer is an international law firm with over 540 attorneys who handle a full spectrum of legal issues worldwide.

1585 Broadway  
New York, NY 10036-8299  
212.969.3000

2049 Century Park East  
32nd Floor  
Los Angeles, CA 90067-3206  
310.557.2900

1233 Twentieth Street, NW  
Suite 800  
Washington, DC 20036-2396  
202.416.6800

One Boca Place  
Suite 340 West  
2255 Glades Road  
Boca Raton, FL 33431-7383  
561.241.7400

One Newark Center  
18th Floor  
Newark, NJ 07102  
973.274.3200

68, rue du Faubourg Saint-Honore  
75008 Paris, France  
331.53.05.60.00

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