The Global Impact of Sarbanes-Oxley Whistleblower Protections

BY ALLEN B. ROBERTS

Many global companies having debt or equity securities traded in United States markets or subject to filing obligations under the US Securities Exchange Act are technically within the reach of the Sarbanes-Oxley Act. Others may be affected only by its resonating aftershock. Whatever the current status or perceived exposure to Sarbanes-Oxley, the heightened awareness of businesses, their employees and plaintiffs' lawyers seeking new theories to explore the bounds of protections against dismissal and other unfavourable personnel actions has sharpened the focus on whistleblower protections of Sarbanes-Oxley.

The basics – protected whistleblower communications

As it relates to civil whistleblowers, the fundamental, although unstated, premise of Sarbanes-Oxley is that whistleblowers perform a valued service for their companies and possibly business at large, as well as the investor community. The legislation protects individuals from unfavourable personnel actions when they report a wrong relating to federal crimes involving mail fraud, wire fraud, bank fraud, securities fraud, fraud against shareholders or violation of Securities and Exchange Commission ("SEC") rules or regulations. Disclosures to three classes of recipients are protected: corporate management, a United States regulatory or law enforcement agency or a member or committee of Congress. No distinction among the three types of recipients is made, and the law does not favour or encourage internal reporting. There is no express protection for resort to other outlets, such as the media.

Protection is provided, additionally, to an employee disclosing information within the protected class of frauds, shareholder and regulatory interests in proceedings that the employee files or in which the employee participates. This measure of protection extends to employee participation in proceedings initiated by others – even if they have interests potentially adverse to the employer – including competitors or customers and vendors.

More than any other employee-protective legislation, the whistleblower protection of Sarbanes-Oxley carries the potential of being magnified beyond the business acts or practices alleged, attracting undesirable public, investor and media attention. The prospect of publicity, alone, is compelling reason for companies to have in place policies and procedures to avert whistleblower claims and to competently address a claim that cannot be avoided. For multinational businesses having securities traded in US markets, the contours of this broad legislation remain to be defined by litigation in administrative and judicial proceedings. Experience to date offers guidance for compliance and preparedness.

Sarbanes-Oxley whistleblower protections contrasted with other laws

Unexceptionally, prevailing whistleblower-employees are entitled to conventional "make whole" relief by way of job reinstatement with full seniority, together with back-pay, interest and compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees and reasonable attorneys' fees. But Sarbanes-Oxley has some features unique even in the mosaic of employee-protective legislation. In a major departure from mainstream legislation, a determination at any stage of administrative proceedings that is favourable to a dismissed Sarbanes-Oxley whistleblower results in a preliminary remedy of reinstatement, even while other hearing and review processes remain to run their course. At the earliest administrative stage of the proceedings, this means relief restoring the individual to employment may be directed by preliminary order ▸▸

before there has been an evidentiary hearing with an opportunity to hear testimony supporting the employee's claims, or to cross-examine or create a record or to have that record reviewed.

Anticipating extraterritorial reach

Of threshold importance to global companies is the prospect of extraterritorial reach attaching to the civil whistleblower protections of Sarbanes-Oxley. The question, certain to be addressed and refined by administrative and court decisions, is whether a whistleblower can obtain Sarbanes-Oxley protection for disclosure of activities occurring outside the US. An instinctive reaction is likely to be, "no." After all, Sarbanes-Oxley is uniquely an American creature.

Nevertheless, there are indications of challenges to that better view with assertions that any act impacting shareholders or the US trading or regulation of securities ought to be swept within Sarbanes-Oxley – wherever the allegedly wrongful activity occurred. A theory of extraterritorial reach may have particular appeal if the non-US business is subject to US internal controls or oversight by a US audit committee, or if it contributes information, directly or indirectly, to US financial reports or if the employee's activity is considered integral to the corporate structure of a company having publicly traded securities in the US.

As with matters not technically within the frauds and breaches at the heart of Sarbanes-Oxley's whistleblower provisions, the outcome may turn on the extent to which the US publicly traded entity and its securities are affected by the alleged wrong. If this construction prevails, care must be taken that Sarbanes-Oxley is not stretched beyond its intended jurisdiction. First, the civil whistleblower protections are not otherwise dependent on materiality of the alleged violation; Sarbanes-Oxley places no minimum dollar value on the protected activity covered. (In this regard, Sarbanes-Oxley's civil whistleblower provisions differ from the provisions requiring attorneys appearing and practicing before the SEC to report a material violation of securities law, breach of fiduciary duty or similar violation.) However, for an act outside the US or an act done by an affiliate whose securities are not traded in US markets to impact US securities, materiality would have to be a factor.

Second, the issue should not be the occurrence of an unlawful act disclosed by the whistleblower, but rather whether the act was so material that the company was obligated to disclose it to protect holders of its securities or the regulatory process. For example, even if a whistleblower disclosed a serious and material violation of the law of another country, that disclosure should have Sarbanes-Oxley consequences only to the extent the corporation then became obligated to disclose or address the act as a Sarbanes-Oxley matter, and it did not. By this reasoning, a whistleblower outside the US or citing an act occurring outside the US could invoke Sarbanes-Oxley whistleblower protections not for the wrongful act, but only for the failure of the US company to properly disclose. This could come into play with the required Sarbanes-Oxley certification by the Chief Executive Officer and Chief Financial Officer. Such certifications must state that reports filed with the SEC do not contain any untrue statement of a material fact or omit a material fact and the financial statements fairly present the financial condition and results of operations of the company and that the Chief Executive Officer and Chief Financial Officer have disclosed to the company's auditors and its audit committee all significant deficiencies in the design or operation of internal controls that could adversely affect financial data and any fraud involving employees having a significant role in the company's internal control.

Considerations for managing the inquiry and decision process

Whether or not Sarbanes-Oxley's whistleblower protections can be construed to have an extended global reach, its impact is likely to be reflected in best practices and increased attention in the legislative bodies and courts of other countries. For those companies directly or indirectly influenced by Sarbanes-Oxley's whistleblower provisions, preparedness for the diverse types of reports or complaints allowed, authorised, invited or required by Sarbanes-Oxley should be given high corporate priority.

Often missed in the analysis of whistleblower issues is the simple reality that two distinct inquiries and sets of business issues are presented in each case. First, there is the issue of the wrong allegedly discovered by the employee who "blows the whistle." Viewed most benignly and altruistically, a well-intentioned employee having no personal agenda dutifully illuminates an act inconsistent with company standards that the company would not allow or condone. Second, and completely separately, the disclosing employee complains of suffering a retaliatory unfavourable personnel action as a consequence of having made the disclosure.

While there may be circumstances where it is appropriate to combine the investigation of the distinct claims, the decision to do so should be the product of a purposeful election, and it should not occur by default. The issues are discrete, and the expertise to understand and investigate issues may not reside equally in the same individual or investigative team. Investigation and related analysis and decision-making should be performed by those best suited to address the substantive claim of alleged corporate wrongdoing, while those best suited to evaluate the personnel matter should address retaliation.

Apart from utilising the expertise of the individual assigned to the matter, separating the corporate and personnel functions has additional advantages. Combining functions may compromise the privilege from disclosure that otherwise would attach to ▸▸

attorney-client communications or attorney work-product. Furthermore, if investigative and/or decision functions were combined, there is the additional possibility that the strength of one aspect of a combined investigation could incorrectly influence the other.

A whistleblower disclosing information to a supervisor, Congressional member or committee or a federal agency obtains statutory protection only if there is an objective reasonable belief that disclosure comes within the express and limited wrongs specified in statute. Only if that initial fact is established need the inquiry proceed to whether the circumstances are sufficient to raise an inference that the protected activity was a contributing factor in the unfavorable personnel action. Moreover, the act of whistleblowing only protects against retaliation, it does not insulate the employee from all unfavorable personnel actions. This additional consideration and its ramifications may speak for the safeguard of coordinating the dual investigations of the distinct corporate and personnel matters, in preference to the designation of a single investigator or team. By treating the two elements of a whistleblower matter separately, the expertise and independence of those managing the investigation, its report and the decision process is best assured.

What Sarbanes-Oxley teaches concerning preparedness for whistleblower claims

Depending upon the type of disclosure by a whistleblower, a different measure of attention will be required at the board, executive, managerial or supervisory level of the company. Unless the employer creates and maintains an internal process for addressing such matters, a whistleblower believing that an internal procedure is unavailable or unavailing may be motivated to seek avenues having high visibility and a measure of exposure that curtails the ability to reach an early and effective resolution. Before a whistleblower complaint first arises, established procedures should give clear guidance to ensure appropriate business and legal awareness and control to protect against corporate exposure. Preparedness measures may include:

- Maintenance of a centralised log to note and control the receipt of a whistleblower report or complaint of retaliation.
- Designation of corporate representatives and/or attorneys for the receipt of reports or complaints.
- Restrictions on communications concerning the report or complaint.
- Limitations on access to information concerning the report or complaint.
- Adherence to established procedures for the investigation of the report or complaint.
- Preservation of the confidentiality of documents and communications.
- Restriction of access to electronic and print data.
- Maintenance of a control list of communicators and recipients of information.
- Control of distribution and duplication of intermediate reports.
- Creation of a single summary of factual conclusions.
- Control of each copy of the final report by numbering with a log showing the document number given to each recipient.

Depending upon the nature of the matter and the involvement of others, procedures should be established for communicating the decision to: (a) the board and/or management having a need to know, (b) the whistleblower, (c) investigators and interviewers and (d) witnesses providing information during the investigation. After the decision, procedures should be followed to:

- Control communication of the report, investigation and decision.
- Control relations with the whistleblower, whether that individual has continuing employee status or employee status has ended.
- Control relations with witnesses and other participants in the investigation or decision.
- Address media and third party inquiries.

Whatever the reach or impact of Sarbanes-Oxley's whistleblower protections, businesses have a legitimate interest in assuring that guidelines, policies and codes of conduct and ethical behavior are not disregarded. Development of procedures for receipt of whistleblower reports, preparedness for retaliation complaints and appropriate investigative measures are logical companions to the expectation that employees adhere to announced best practices.

This is a time when companies are searching for ways to enhance their corporate images and conserve their financial and human resources and costs of litigation. Encouraging internal whistleblower reporting – and being prepared with appropriate investigative and decision-making procedures – may come at an attractive price when the alternative possibilities are weighed. ■

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