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WHISTLEBLOWERS

A February 2009 decision by the Labor Department's Administrative Review Board in *Kalkunte v. DVI Financial Services* may signal the willingness of ARB members to adopt a broader construction of the Sarbanes-Oxley Act, according to this analysis by R. Scott Oswald and Jason M. Zuckerman, attorneys from the law firm that represents Sheila Kalkunte, who brought the whistleblower protection claim before the board.

DOL ARB Decision Reinvigorates Sarbanes-Oxley Whistleblower Protection

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When Section 806 of the Sarbanes-Oxley Act (SOX) was enacted in 2002, most employment law practitioners deemed it a robust whistleblower protection provision that would give corporate whistleblowers an unprecedented edge in pursing claims of retaliation. The empirical data, however, have revealed that the Department of Labor (DOL) has narrowly construed SOX, resulting in the dismissal of approximately 66 percent of whistleblower cases since 2002. See Jennifer Levitz, *Whistleblowers are Left Dangling*, Wall St. J., September 4, 2008, at A3. In particular, some administrative law judge decisions and some Administrative Review Board (ARB or board) decisions have narrowly construed coverage under SOX, thereby denying a remedy to employees that Congress intended to protect; imposed an unduly onerous burden on complainants to prove the objective reasonableness of their disclosures, a standard that almost requires proof of an actual violation that undermines Congress' intent to cover a broad range of disclosures; and in some cases, erroneously applied the Title VII burden-shifting framework rather than the more favorable burden of proof that Congress expressly applied to SOX.

Recently, however, the ARB issued a decision that signals a sharp reversal of this trend and highlights how SOX can be a potent remedy for whistleblowers. See *Kalkunte v. DVI Fin. Servs.*, ARB Nos. 05-139, 05-140, ALJ No. 2004-SOX-56 (ARB Feb. 27, 2009), 7 WLR 364, 3/13/09. This article discusses some of the key holdings in *Kalkunte*, including the scope of coverage, the ''rea-

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sonable belief'' standard, the burden of proof, and the meaning of ''special damages.''

Case Summary

Sheila Kalkunte began employment with DVI Financial Services Inc. (DVI) on a contract basis in June 2001 to serve as an attorney in its legal department. After working for DVI for about 19 months on a contract basis, Kalkunte was offered a full-time, in-house position as associate general counsel, which she accepted. Approximately six months later, Kalkunte's title changed to assistant general counsel and her duties included drafting opinion letters on behalf of DVI concerning securitizations. In June 2003, DVI's independent auditors abruptly resigned, causing a dramatic decline in the company's stock, and an inquiry from the Securities and Exchange Commission (SEC).

The case involved an in-house lawyer who complained that DVI's senior management gave improper delinquency reports to lenders and the Securities and Exchange Commission.

Months later, in August 2003, Kalkunte raised concerns about the company's accounting practices to audit committee members and outside counsel. Specifically, Kalkunte complained that DVI's senior management prepared and provided improper delinquency reports to lenders and the SEC in violation of securities laws. To address Kalkunte's concerns, the audit committee immediately appointed outside counsel to investigate Kalkunte's allegations of financial improprieties. Shortly after the investigation began, DVI declared bankruptcy and began a reduction in force (RIF), discharging more than 90 employees. Kalkunte was not discharged in this RIF and was assigned additional responsibilities, including working with auditors, managing the litigation section, and reviewing bankruptcy filings. In September 2003, AP Services LLC (AP) officials abruptly discharged Kalkunte when she inquired about the status of the investigation into her allegations. The purported reason for terminating Kalkunte's employment was that her position was no longer necessary. According to AP, a company that DVI retained to serve as bankruptcy specialists and ''turnaround consultants,'' the decision to terminate Kalkunte ''had nothing to do with [her] performance,'' but instead ''was a part of the continuing risk'' of the bankruptcy. Kalkunte filed a claim under SOX against both DVI and AP, and prevailed at a trial on the merits before an ALJ (3 WLR 976, 7/22/05). More than three years after AP appealed the ALJ's decision, the ARB affirmed the ALJ's decision.

Scope of Coverage

SOX prohibits any corporate ''officer, employee, contractor, subcontractor or agent'' of a publicly traded company from taking adverse employment action against an employee who complains of, or provides information regarding, any conduct that the employee reasonably believes violates federal law relating to fraud against shareholders. See 18 U.S.C. § 1514A(a). In *Kalkunte*, the ARB for the first time applied the contractor prong of coverage. DVI, a publicly traded company, retained AP, a private company, to supply employees to manage DVI through bankruptcy and dissolution. The contract granted AP authority to determine the best means for managing the bankrupt corporation and its assets, including the authority to hire and fire DVI employees. Finding that AP had decisionmaking authority and that ''Kalkunte was an employee whose employment could be (and was) affected by [AP Services],'' the ARB held AP was a covered employer under SOX.

By holding that employees of contractors of publicly traded companies are covered under Section 806, the ARB might be signaling a broader construction of the scope of SOX coverage.

The holding in *Kalkunte* on the scope of coverage is a significant development in that it is contrary to prior opinions narrowly construing SOX, including opinions holding that employees of subsidiaries of publicly traded companies are not covered and that SOX does not apply extraterritorially. See e.g., *Andrews v. ING N. Am. Ins. Corp.*, ARB No. 06-071 (ARB Aug. 29, 2008); *Ede v. The Swatch Group Ltd.*, ARB No. 05-053, ALJ Nos. 2004-SOX-68 and 69 (ARB June 27, 2007). Indeed, Senators Patrick J. Leahy (D-Vt.) and Charles E. Grassley (R-Iowa), the co-sponsors of Section 806, sent a letter to Labor Secretary Elaine L. Chao in September 2008 objecting to DOL's narrow construction of coverage. See Jennifer Levitz, ''Senators Protest Whistleblower Policy,'' Wall St. J., September 10, 2008, at A4. Moreover, in every SOX coverage case in which the solicitor of labor weighed in under Secretary Chao, the solicitor advocated the employer's position, i.e., narrow construction of SOX coverage. By holding that employees of contractors of publicly traded companies are covered under Section 806, the ARB might be signaling a broader construction of the scope of SOX coverage.

Reasonable Belief Standard

Under Section 806, a plaintiff need not prove that she disclosed an actual violation of an SEC rule or actual shareholder fraud, but instead merely that she disclosed what she ''reasonably believed'' to be a potential violation of an SEC rule or actual shareholder fraud. Some ARB and federal appeals court decisions, however, imposed an unduly onerous standard of objective reasonableness that nearly requires SOX complainants to prove that they disclosed actual violations of SEC rules. See, e.g., *Allen v. Admin. Review Bd.*, 514 F.3d 468 (5th Cir. 2008). In *Kalkunte*, the ARB clarified that a reasonable but mistaken belief is protected under SOX.

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The ARB clarifies that SOX complainants can recover damages for impairment of reputation, personal humiliation, mental anguish and suffering, and other non-economic harm resulting from retaliation.

Kalkunte's protected activities included disclosing DVI's filing of inaccurate delinquency reports with the SEC, and inquiring into the status of Arnold & Porter's investigation of her concerns, including her belief that Mr. Toney, an AP principal, was delaying the Arnold and Porter investigation. Noting that Kalkunte's conclusion that Toney was delaying the Arnold & Porter investigation may have been mistaken, the ARB still found that her concern was reasonable. Construing protected conduct to include more than just actual violations of SEC rules is critical, for as an ALJ pointed out, ''[t]o find otherwise would require that a whistleblower allow the violation to occur before reporting, [which] would defeat the intent of the Act and whistleblower law in general, which is to prevent the carrying out of the underlying crime.'' *Getman v. Sw. Sec., Inc.*, 2003-SOX-8, at 20 n.8 (ALJ Feb. 2, 2004), reversed on other grounds, 2005 WL 4888992 (ARB July 29, 2005).

Burden of Proof

Kalkunte demonstrates the extent to which the burden-shifting framework in Section 806, if properly interpreted, is very favorable to employees. A SOX complainant need not show that her protected conduct was a motivating or determinative factor in the decision to take an adverse action and instead can prevail by showing merely that protected conduct was a contributing factor, i.e., any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision. Although respondents had offered numerous reasons for the decision to terminate Kalkunte's employment, the ARB held that Kalkunte could still meet her burden because there was some evidence that her protected activity was a factor in her discharge, including evidence of retaliatory animus and temporal proximity.

Moreover, the decision shows how difficult it should be for an employer to prevail once the employee has proven by a preponderance of the evidence that the protected conduct is a contributing factor in the adverse action. At trial, AP officials testified that Kalkunte was discharged as part of RIF and that her position was no longer necessary. The ALJ concluded, however, that this justification was pretext in part because Kalkunte was the only employee discharged in September 2003. According to the ALJ, if AP and DVI truly intended to include Kalkunte in a RIF, they could have included her in one of the bona fide RIFs that took place in late 2003 and early 2004, rather than terminating her a few weeks after her inquiry into the status of the investigation about her disclosures. In other words, it should be very difficult for an employer to establish by clear and convincing evidence that it would have taken the same unfavorable personnel action in the absence of the employee's protected conduct.

Damages Recoverable Under SOX

Kalkunte is a significant ruling on damages in that it clarifies that ''special damages'' under SOX includes compensatory damages. Some federal court decisions have erroneously held that SOX does not permit recovery for reputational harm or pain and suffering. See, e.g., *Walton v. Nova Info. Sys.*, 514 F.Supp. 2d 1031 (E.D. Tenn. 2007); *Murray v. TXU Corp.*, 2005 WL 1356444 (N.D. Tex. 2005). By construing SOX consistent with analogous whistleblower retaliation laws that provide for compensatory damages, the ARB has clarified that SOX complainants can recover damages for impairment of reputation, personal humiliation, mental anguish and suffering, and other non-economic harm resulting from retaliation.

Conclusion

The current financial crisis demonstrates the importance of protecting corporate whistleblowers. In many of the large financial institutions that have collapsed, employees who warned of the consequences of fraudulent schemes often were subjected to retaliation or ignored. Although the whistleblower protection provision of SOX has been weakened in recent years, the *Kalkunte* decision signals that Section 806 of SOX can serve as a robust remedy for corporate whistleblowers.