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OPINION

■ SARBANES-OXLEY ACT

Protect the whistleblower

By *Lynne Bernabei & Jason Zuckerman* SPECIAL TO THE NATIONAL LAW JOURNAL

SHERRON WATKINS, the lone whistleblower at Enron, is the one bright spot in the company's otherwise tawdry history of corruption and scandal. In August 2001, she warned Kenneth Lay that fraudulent off-the-books partnerships would cause the company to "implode in a wave of accounting scandals." Enron's senior officers ignored her concerns.

Recognizing the critical role that whistleblowers played in exposing some of the major accounting scandals, including Watkins' warnings to Lay, Congress included in the Sarbanes-Oxley Act of 2002 protection for whistleblowers who report fraud or violations of securities laws. Yet, even as the Enron trial revealed the critical role that whistleblowers play in protecting investors, some Department of Labor (DOL) administrative law judges (ALJs) and federal judges have diluted this protection to the point that it would not protect even Watkins.

Sarbanes-Oxley's whistleblower provision provides that an employee has engaged in "protected conduct" if the employee provides information to management, Congress or a federal regulatory or law enforcement agency about any conduct that the employee reasonably believes constitutes a violation of "any rule or regulation of the Securities and Exchange Commission [SEC], or any provision of Federal law relating to fraud against shareholders." It also protects employees who report a violation of federal fraud provisions, including those covering mail fraud; fraud by wire, radio or television; bank fraud; or securities fraud.

Limiting protected conduct

Contravening the plain meaning of the statute, some judges have held that an employee who has raised a concern to management about a violation of an SEC rule has not engaged in protected conduct unless the issue specifically implicates fraud against shareholders. See, e.g., *Bishop v. PCS Administration (USA) Inc.*, No. 05-C-5683, 2006 WL 1460032, at *9 (N.D. Ill. May 23, 2006); *Wengender v. Robert Half International Inc.*, 2005-SOX-59, at 15 (ALJ March 30, 2006). Cf. *Klopfenstein v. PCC Flow Technologies Holdings Inc.*, ARB No. 04-149, ALJ No. 2004-SOX-11 (ARB May 31, 2006). However, as DOL Associate Chief Judge Thomas M. Burke recently pointed out, requiring Sarbanes-Oxley complainants to plead fraud effectively removes the phrase "any rule or regulation of the [SEC]" from the act, and subsumes that phrase into the phrase "any provision of Federal law relating to fraud." *Walton v. Nova Information Systems and Bancorp*, 2005-SOX-107, at 3 (March 29, 2006).

Imposing this additional burden also substantially narrows the range of protected disclosures, since many SEC rules designed to prevent fraud do not expressly "prohibit" fraud. For example, § 404 requires publicly traded companies to maintain effective internal accounting controls. An employee who raises a concern about deficient internal controls should be protected from retaliation because these deficiencies can lead to false financial reporting. Under the narrow construction adopted by some judges, however, an employee who raises concerns about deficient internal controls would not be protected simply because the employee did not raise a concern about shareholder fraud. Indeed, Watkins' warning to Lay about fraudulent off-the-books partnerships would not have been protected because she did not allege fraud against shareholders.

If judges do not find that employees reporting violations of SEC rules are protected, then a whole range of financial and accounting failures may never be exposed, contravening Congress' intent.

Sarbanes-Oxley's whistleblower protection provision broadly defines retaliation to include discharge, demotion, suspension, harassment and even an employer's threat to take an adverse employment action. But some ALJ decisions have substantially narrowed the range of actionable retaliatory acts by importing from Title VII of the Civil Rights Act of 1964 jurisprudence the "tangible job consequence standard," under which a retaliatory act is actionable only if it results in concrete economic harm.

Title VII's prohibition against retaliation does not specify what types of adverse employment decisions are actionable. But Sarbanes-Oxley does. As Judge William Dorsey emphasized in *Halloum v. IntelZ Corp.*, 2003-SOX-7, at n.18 (ALJ March 4, 2004): "Whistleblower statutes are meant to encourage workers to disclose illegal and questionable activities, so their tests for unfavorable employment action encompass more than the adverse economic actions Title VII plaintiffs must prove; any action that would reasonably discourage a worker from making disclosures qualifies here."

The business lobby vociferously advocates a rollback of portions of Sarbanes-Oxley, on the ground that the law was an overreaction to the misdeeds of a few bad apples, and imposes too high a cost on publicly traded companies. As Congress and the agencies that enforce the act consider proposals to rescind portions of it, they should reflect on the costs of Enron's collapse, including $25 billion in losses to investors and 5,000 lost jobs. They should also recognize that in order to truly protect investors and improve the accuracy and reliability of corporate disclosures, whistleblowers such as Sherron Watkins need stronger, not weaker, protection. NLJ

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