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SAFE TO BLOW WHISTLE: NEW LAW REQUIRES CORPORATIONS TO PAVE WAY FOR EMPLOYEES TO DISCLOSE MISCONDUCT AND PROHIBITS RETALIATION AGAINST THEM

By Sean Gallagher and Peter Walsh

``Alas! Say I, he has paid dear, very dear, for his whistle.''
Benjamin Franklin, The Whistle, November 1779

Recent widely publicized corporate scandals, from Enron to WorldCom, have given new prominence to the term whistle-blower and shaken the public's confidence in corporate America. Congress telegraphed its support for whistle-blowers recently when it enacted a far-reaching and highly publicized new law - the Sarbanes-Oxley Act - which imposes civil and criminal penalties on public companies that retaliate against employees who report certain corporate irregularities.

Sarbanes-Oxley not only creates a legal remedy for employees who lose their jobs because they report improprieties, it requires that public corporations create a mechanism to facilitate the reporting of questionable accounting or auditing practices. And, it subjects employers to criminal penalties for retaliating against whistle-blowers who report a potential violation of federal law to law enforcement agencies. So, the time is ripe for a discussion about the do's and dont's of responding to employee whistle-blowing.

Although Sarbanes-Oxley significantly expands the scope of legal remedies available to whistle-blowers, it builds on a long line of protections afforded by state and federal law. Indeed, many whistle-blowing activities are currently protected by law, such as reporting health, safety and welfare issues, fraud on the government, financial irregularities, criminal conduct, environmental violations, ethical lapses and failure to obtain software licenses.

Navigating this complex web of laws is a difficult task for many employers, large and small. While the Colorado legislature has not adopted a law to protect private-sector whistle-blowers, Colorado courts have prohibited retaliation against private-sector employees who report potentially illegal or fraudulent activity or who refuse to engage in illegal activity. Colorado law also prohibits retaliation against employees for exercising statutory rights, such as seeking workers

compensation benefits, or complying with statutory obligations, such as serving on a jury. Similarly, the federal False Claims Act prohibits employers from retaliating against employees who ``blow the whistle'' on false statements made to the federal government by their employers. Enacted during the height of the Civil War in 1863, the False Claims Act allows employees to sue government contractors if they believe that the contractor has defrauded the government and rewards them with a share of the proceeds if they win.

While there is no magic formula for avoiding whistle-blower lawsuits, employers can take several simple steps to minimize the risk of bad press, litigation and large damage awards. Creating an internal mechanism for the reporting of potential waste, fraud or abuse can go a long way toward ensuring that personnel decisions are not tainted by complaints about corporate misconduct. Creating a so-called corporate ombudsman position can also help develop a corporate culture that encourages the reporting of fraud and abuse, in turn reducing the likelihood that managers will punish employees for their disclosures.

Once reported, management should ensure that complaints are taken seriously and investigated, preferably by an impartial party. As we know from national politics, the way one responds to allegations of wrongdoing is often as important as whether the underlying allegations are true. Management should also pay close attention when disciplining or discharging someone who has blown the whistle. A short time frame between an employee's complaint and an adverse job consequence alone may create a presumption of illegal retaliation in the eyes of a court. Even where a temporal link is absent, management should carefully review any proposed discipline of whistle-blowers to ensure there is a legitimate and well-documented basis for any action taken.

Involving legal counsel at an early stage, especially where the company does not have the benefit of a well-staffed and experienced human resources department, may also reduce the chances of protracted litigation down the road. Experienced counsel can assist the client in conducting a thorough investigation of a whistle-blower's complaint and ensuring that appropriate action is taken. Similarly, the manner in which disciplinary actions unrelated to any such complaint are communicated to whistle-blowers may significantly reduce tensions if handled correctly. A thorough explanation of the reasons for the disciplinary action, communicated by a senior manager, may ease suspicions and convince the whistle-blower, or his or her lawyer, that the company's stated reasons are legitimate and have nothing to do with the whistle-blower's complaint. As we enter a new era of corporate oversight and regulation, whistle-blower litigation may pose an even greater threat to the reputation and goodwill of private and public companies. Timely and appropriate responsiveness to complaints of waste, fraud and abuse, however, may help rebuild confidence in corporate America, in addition to benefiting the bottom line.

KEY PROVISIONS OF THE SARBANES-OXLEY ACT

The act implements sweeping changes in corporate governance and disclosure for public companies and the accounting industry and imposes penalties for securities law violations. The act is designed to prevent deceptive

practices in management and accounting and to enhance financial reporting and disclosure by:

- Increasing criminal penalties for corporate wrongdoing;
- Increasing disclosure requirements for periodic reports filed pursuant
- to the Exchange Act, particularly with respect to off-balance sheet
- liabilities and pro forma financial statements;
- Increasing the authority and responsibilities of audit committees and
- raising independence standards for audit committee members;
- Creating a new Public Company Accounting Oversight Board;
- Creating professional responsibility standards for attorneys;
- Limiting the scope of services that auditors may perform for companies;
- Accelerating the disclosure of insider trading activities; and
- Eliminating loans by companies to officers and directors.

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