

Fifth Circuit Provides Guidance on Whistleblower Claims Under Sarbanes-Oxley Act

When most people think of the Sarbanes-Oxley Act of 2002, they think of a law regulating corporate governance, accounting, and financial disclosure. But public and private companies should remember that Sarbanes-Oxley is also an important employment statute.

The “Whistleblower Protection” provisions of Sarbanes-Oxley shield employees from retaliation when they provide information about real or perceived violations of federal securities laws. Further, the Act requires public companies to set up internal systems to solicit and review employee reports. It features an elaborate enforcement scheme including administrative, civil *and* criminal provisions, and provides for both corporate *and* individual liability. Although most of the Act’s provisions apply to publicly-held companies, private companies can also be liable for retaliation, where a whistleblower reports violations to a law enforcement officer. In short, employers ignore the whistleblower provisions of Sarbanes-Oxley at their peril.

Until recently, the United States Court of Appeals for the Fifth Circuit—which encompasses Texas, Louisiana, and Mississippi—had not considered any cases under the whistleblower provisions. Then, on January 22, 2008, the court handed down its decision in *Allen v. Administrative Review Board*, No. 06-60849.

In *Allen*, three employees brought retaliation claims against their employer, Stewart Enterprises, under Sarbanes-Oxley. They alleged that they had raised various concerns about accounting and computer problems at the company. Specifically, they said that the company’s computer system had made faulty interest calculations, that untimely refunds had been issued, and that the billing system was preventing the company from collecting certain balances. After raising these complaints, the employees claimed that they were subjected to a hostile work environment, including exclusion from meetings, undue scrutiny on expense reports, and reassignment to undesirable workspaces. Ultimately, all three employees lost their jobs in a reduction in force.

A Department of Labor administrative law judge reviewed the case and found no merit to the complaints. The employees ultimately appealed to the Fifth Circuit. The appeals court agreed with DOL, and dismissed the claims. The court said that one of the employees, who was an accountant, should have known the errors she alleged did not violate federal securities laws. Further, the court said:

Considering the fact that Stewart [Enterprises] did not intentionally cause the [computer] problem, did not conceal it, and attempted to correct it, a reasonable person could conclude that Stewart’s conduct ... did not violate some provision of federal law relating to fraud against shareholders.

Perhaps most importantly, the Court said that—going forward—it would use “both a subjective and an objective standard” to determine whether an

employee’s mistaken belief that an action violates securities laws is “reasonable.”

While *Allen* was a win for the employer, it demonstrates why compliance with Sarbanes-Oxley’s whistleblower provisions can be difficult. Under most employment statutes, an employee will claim he was retaliated against for reporting prior discrimination on the basis of race, sex, or some other protected status. Through common sense and the advice of counsel, an employer can usually tell whether unlawful discrimination or harassment really has occurred.

Under Sarbanes-Oxley, however, common sense is not enough. The question is whether the reported action violates federal securities laws or SEC rules. This is often a complex legal question. Complicating things further, an employer will be liable even if the reported act *does not* violate the law, provided the employee *reasonably believed* it was unlawful. And now, under *Allen*, whether an employee’s incorrect belief was “reasonable” depends on the “subjective and objective” knowledge and expertise of the particular employee. In other words, what might be reasonable for a file clerk might not be reasonable for an accountant.

Employers sometimes forget that Sarbanes-Oxley has an important employment law component. *Allen* reminds us that this not the case, and that all employers—both public and private—should pay careful attention to reports by employees that even remotely implicate securities laws.

eLABORate

Inquiries concerning topics addressed in the eLABORate may be directed to any of our Employment Law attorneys:

Jackson, Mississippi

Joseph L. Adams	adamsjo@phelps.com	(601) 360-9708
Deborah Shelby Dees	deesd@phelps.com	(601) 360-9334
Gary E. Friedman	friedmag@phelps.com	(601) 360-9355
Paul O. Miller, III	millerp@phelps.com	(601) 360-9350
W. Thomas Siler, Jr.	silertt@phelps.com	(601) 360-9357
Mark Fijman	fijmanm@phelps.com	(601) 360-9716
Kenneth G. Fairly	fairlyk@phelps.com	(601) 360-9705
W. Brett Harvey*	brett.harvey@phelps.com	(601) 360-9721
LaToya C. Merritt	merrittl@phelps.com	(601) 360-9749
Seale Pylate	pylates@phelps.com	(601) 360-9342
Sandra Brown Strong	browns@phelps.com	(601) 360-9729
Tori L. Winfield	winfielt@phelps.com	(601) 360-9366

Baton Rouge, Louisiana

Susan W. Furr	furrs@phelps.com	(225) 376-0230
Karleen J. Green	greenk@phelps.com	(225) 376-0244
Thomas H. Kiggans	kigganst@phelps.com	(225) 376-0247
Jessica Coco	jessica.coco@phelps.com	(225) 376-7954
Mimi Flowers Plauché	plauchem@phelps.com	(225) 376-0279
Betty Burke Uzee	betty.uzee@phelps.com	(225) 376-0235

New Orleans, Louisiana

M. Nan Alessandra	alessann@phelps.com	(504) 584-9297
Jane E. Armstrong	armstroj@phelps.com	(504) 584-9244
Kim M. Boyle	boylek@phelps.com	(504) 679-5790
David M. Korn	kornd@phelps.com	(504) 584-9374
Brandon Davis	brandon.davis@phelps.com	(504) 584-9312
Taryn Southon Nunes	nunest@phelps.com	(504) 584-9383
MaryJo Roberts	maryjo.roberts@phelps.com	(504) 584-9262

Tampa, Florida

Jolee Land	jolee.land@phelps.com	(813) 472-7857
Dennis M. McClelland	dennis.mcclelland@phelps.com	(813) 472-7865
John David Mullen	john.mullen@phelps.com	(813) 472-7867
John E. Phillips	john.phillips@phelps.com	(813) 472-7863
Meredith A. Phipps	phippsm@phelps.com	(813) 472-7577

Houston, Texas

Sandra B. Jacobson	sandra.jacobson@phelps.com	(713) 877-5553
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*Contributing Author

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