

THE RECORDER

128TH YEAR NO. 78

www.therecorder.com

THURSDAY, APRIL 22, 2004

Fighting fraud or whistling Dixie?

What to do when slacker employees blow the whistle

By Alexei Oreskovic

RECORDER STAFF WRITER

Two-and-a-half years after the Enron Corp. accounting scandal, whistle-blowers are practically national heroes.

Time magazine crowned a trio of whistle-blowers its persons of the year in 2002, and the Sarbanes-Oxley Act, passed the same year, codified various protections for workers who blow the whistle.

But the rise of the whistle-blower has also created a new set of challenges for some employment lawyers. While whistle-blower protections have proven effective for uncovering corporate fraud, they're also an alluring cloak for poorly performing workers to drape over themselves when the going gets tough.

The delicate nature of these situations, and the high stakes involved — including stiff criminal and civil penalties — is forcing employment attorneys to revise some of their tactics and to widen the circle of lawyers involved.

"These things are so problematic because they involve not only the human resources issue of non-retaliation, but they now raise this much broader panorama of issues," says Victor Schachter, an employment partner at Fenwick & West.

In one recent incident, recalls Schachter, an employee whose job performance had increasingly come under criticism made allegations of accounting improprieties within the company.

The allegations set the wheels in motion for an accounting investigation, while at the same time threatening to halt an imminent evaluation of the employee's own performance — any adverse action could have been interpreted as evidence of retaliation for blowing the whistle.

Suddenly, intertwined in what traditionally has been an employment law situation were a knot of other concerns. In the incident, the whistle-blowing claim turned out to be legitimate, but the company still negotiated the employee's termination.

The situation has become increasingly common, says Schachter. "I've seen a mini-explosion of whistle-blower claims by people who are marginal performers, if not malingerers," he says.

Under Sarbanes-Oxley, an employee who provides information or assists in an investigation relating to a company's violation of federal fraud laws or Securities and Exchange Commission rules cannot be fired or discriminated against for coming forward. And



SHELLEY EADES

DAMAGE CONTROL: Fenwick & West partner Victor Schachter says a boom in whistle-blowing has created a "panorama" of problems for companies.

the allegation need not turn out to be legitimate so long as the employee "reasonably believes" it to be a violation.

Worker advocates say attempts to portray whistle-blowers as inept employees underscore the need for whistle-blower protections.

Jeffrey Ross, a plaintiffs attorney at Oakland's Dickson Ross, says his experience has been that "once high-performing, well-respected employees blow the whistle, suddenly they become, in retrospect, terrible, if not incompetent, employees."

"It's a very typical response," adds Ross, who says he's seen a

WHISTLE-BLOWERS

sharp rise in the number of whistleblower retaliation cases his firm handles.

But while the protections serve an important and necessary function, many management-side employment attorneys say they're also ripe for abuse by poor performers looking to inoculate themselves when they're on shaky ground.

"It's a natural place to go to protect your flank," says Fred Alvarez, the head of the employment law practice at Wilson Sonsini Goodrich & Rosati.

Dealing with the situation has forced employment attorneys to come up with new plays.

"It doesn't tie your hands," says Seyfarth Shaw partner Brian Ashe, but it does require slowing things down.

Otherwise, it could be costly to the company.

"If you are at all precipitous in significantly disciplining the employee," Ashe says, "then you're going to buy yourself a retaliation claim that's going to be expensive."

Managers must be trained to go out of their way to thank the worker for coming forward with the allegation, writes Paul Cane Jr., an employment partner at Paul, Hastings, Janofsky & Walker in a December article entitled "When the Whistle Blows and There Is No Foul: Managing the Misguided Whistle-blower."

And any pending disciplinary actions against the whistleblower for poor performance should be subjected to *de novo* review from an independent fact-finder who isn't tainted by retaliatory motivations, Cane advises. He also suggests assigning the employee a new manager that the worker gets

along with.

While employment lawyers have long helped corporate clients avoid retaliation claims involving sexual harassment and discrimination, a boom in whistle-blowing has changed the rules of the game.

For one thing, the stakes are higher. The Sarbanes-Oxley Act contains both criminal and civil penalties. Section

'From minute one it's both an HR issue and a securities law issue.'

— BORIS FELDMAN
Wilson Sonsini Goodrich & Rosati

1107 of the law imposes up to 10 years imprisonment for retaliating against an informant.

And a company's financial exposure isn't limited to fines. Reports that a company is cooking the books can have instant and disastrous consequences for its stock price.

"It raises the exposure of the claim from one plane to a complete other plane," says Wilson Sonsini's Alvarez. "The damage to the company is going to be in the market cap."

These extra considerations mean that a broader legal team is often called into action. Wilson Sonsini's Boris Feldman, a securities litigation partner in the firm's Palo Alto office, regularly pairs up with the firm's labor and employment group when whistleblower matters arise.

"From minute one it's both an HR issue and a securities law issue," says Feldman. It would be unusual, he notes, for only the employment group or the securities group to be involved.

The securities attorneys notify the company's audit committee of the allegation and spearhead an investigation to determine whether the fraud claim has any merit. In some cases, the financial investigation will even be farmed out to a separate law firm.

The whistle-blowing phenomenon is not limited to financial issues at public companies.

Although Sarbanes-Oxley affects only publicly traded corporations, employment attorneys in California are dealing with whistle-blowing claims at all types of companies. California common law prohibits retaliation in violation of public policy, which can cover whistle-blowing about anything from accounting fraud to pollution, and includes both public and private companies.

And unlike Sarbanes-Oxley, which routes whistle-blowing retaliation claims to the Department of Labor for an investigation and possibly a hearing in front of an administrative judge, state law means a trial by jury.

For plaintiffs, a jury trial is a much more attractive forum to bring whistleblower retaliation claims.

"If the jury starts to think, 'I've got a corporate criminal here because they're cooking the books,' it's a much easier sell for the plaintiffs," says Alvarez.

Reporter Alexei Oreskovic's e-mail address is aoreskovic@therecorder.com.