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# TRENDS<sup>TM</sup> IN LITIGATION



**BRIDGING THE GAP BETWEEN ENFORCEMENT AND  
REGULATION: CHARTING THE CHANGING SECURITIES  
ENFORCEMENT LANDSCAPE**

*An Interview of Jerry Isenberg by Dennis O. Garris*

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**A CULTURE OF WAIVER: COMPELLED “VOLUNTARY”  
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*By William H. Jordan and T.C. Spencer Pryor*

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*W*e are pleased to present this issue of TRENDS, and we are confident you will find of interest the critically important current issues that are addressed.

The first piece in this edition is an interview of Jerry Isenberg by Dennis Garris. Jerry spent twenty-five years working in the Division of Enforcement of the SEC, and he is universally regarded as one of the nation's leading experts in SEC practice. His interviewer, Dennis Garris, is similarly a star in the SEC universe, having spent many years in the SEC's Division of Corporation Finance as the Chief of the Office of Mergers and Acquisitions.

The next two articles deal with hot topics in the evolving world of government investigations and legislative reform in the wake of the Enron era. Bill Jordan and Spencer Pryor summarize the evolution of the concept of "voluntary" waiver of the attorney client privilege in the context of government investigations. Bob Riordan and Leslie Wood provide key guidance on the whistleblower provisions of Sarbanes-Oxley. Both articles provide guidance for anyone who has or may be faced with a government inquiry.

Also of interest is the article Bob Mowrey and Dave Meezan have written regarding climate change litigation. They provide an excellent analysis of the Supreme Court's recent decision in *Massachusetts v. EPA* as well as an overview of related air quality litigation.

We trust you will enjoy this edition of TRENDS. As always, we welcome any feedback on these articles or suggestions you may have for future editions.

Peter Kontio  
Todd R. David



*Peter Kontio*  
*Co-Chair*  
*Litigation Groups*  
*peter.kontio@alston.com*



*Todd R. David*  
*Co-Chair*  
*Litigation Groups*  
*todd.david@alston.com*



## BRIDGING THE GAP BETWEEN ENFORCEMENT AND REGULATION: CHARTING THE CHANGING SECURITIES ENFORCEMENT LANDSCAPE



*Jerry Isenberg, Partner  
Securities Litigation  
jerry.isenberg@alston.com*

*Jerry Isenberg served at the Securities and Exchange Commission for 25 years, working in the Division of Enforcement. While at the Commission, Jerry worked on some of the SEC's most significant cases – from financial and accounting fraud, market manipulation, insider trading to proxy contests and hostile takeovers. Now a member of Alston & Bird's Securities Litigation Group in Washington, he brings an enforcement perspective to the defense and regulatory needs of clients. Dennis Garris, an alumnus of the SEC's Division of Corporation Finance, recently talked with him about moving from one side of the enforcement table to the other.*

*Dennis:*

After so many years in the Commission's enforcement division, it must be a bit strange to be on the other side of the table. How are you developing your private practice?

*Jerry:*

I was at the SEC for 25 years and left as the Principal Assistant Director. As a result, I saw the full gamut of SEC investigations – financial fraud, market manipulations, insider trading and broker-dealer matters. I've translated that experience into the private sector, and now my practice focuses on defending clients in investigations conducted by the SEC, the Department of Justice, state regulatory agencies and self-regulatory agencies.

*Dennis:*

How do you bridge the gap between enforcement and a regulatory practice?

*Jerry:*

My enforcement background is very helpful to my regulatory work because it has given me insight and a good sense of what could



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get a client into trouble! I can help design or review procedures to keep them out of the government's sights.

*Dennis:*

Your SEC experience differs from most enforcement lawyers because you worked with the office of mergers and acquisitions. How was that?

*Jerry:*

We tried to achieve a balance that allowed the big guys to fight it out amongst themselves on a level playing field. But when somebody did cross the line, we were right on top of it, working closely with the Division of Corporation Finance. We brought several cases involving the Williams Act, including tender offer and proxy cases and cases involving ownership reporting on Schedule 13D.

*Dennis:*

Jerry, you did a little rulemaking at the Commission as well. I recall your work on an antifraud rule under 14(e), a tender offer rule that says that you can't commence a tender offer unless you have the financing.

*Jerry:*

Yes, that was very interesting. The rulemaking resulted from several cases in which parties had commenced tender offers that generated substantial interest in the market, but then it became clear they didn't have the wherewithal to follow through on the tender offer. In some cases, the tender offer was simply a fraud. Of course the market is very sensitive to that kind of announcement because it can cause major disruptions. We spent a lot of time thinking through the various ramifications and unintended consequences to the market when drafting the rule and then worked closely with the Division of Corporation Finance to finalize it. It was an exciting and effective process.

*Dennis:*

What are you most proud of from your days at the SEC?



*Dennis O. Garris, Partner  
Corporate Transactions  
and Securities  
dennis.garris@alston.com*



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*Jerry:*

I worked on a lot of cases, so that's tough! The biggest impact may have come from a case we brought relating to the sale by a major broker-dealer of limited partnership interests to the public without any notion of suitability. We designed a settlement mechanism that distributed almost a billion dollars to the aggrieved limited partnership investors. It was an important case with a satisfying result.

*Dennis:*

You are part of the SEC enforcement network in Washington. What enforcement environment are we in right now and do you see that changing?

*Jerry:*

I think the pendulum has swung back a bit – not all the way – from the period immediately following the debacles created by Enron and WorldCom. The Commission is still aggressive, but it is a little more tempered than five years ago. While it isn't clear yet the direction the Commission will take under Chairman Cox, it is clear that the SEC retains significant influence over corporate America, and any SEC investigation requires serious attention. Another change is that the SEC much more quickly involves criminal prosecutors in its cases. That wasn't true a few years ago. Now, a securities law violation is potentially a much more serious matter because there is a greater likelihood that a criminal prosecutor could become involved.

*Dennis:*

Has the pendulum swung too far or do you think the SEC and the Justice Department should always run in tandem?

*Jerry:*

Most prosecutors like headlines, and the SEC has generated enormous headlines since the major cases that arose after 2000. Prosecutors have also learned a lesson from Eliot Spitzer. Whether it's the lesson we would like them to learn is another question! But you see the impact. The options backdating cases are a good example. Some years ago these would be considered civil in nature, but they are now considered major criminal matters. I expect that



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trend to continue and to grow. Whether it's a good or bad trend, it is a fact of life that modern corporate America must respect and respond to accordingly.

*Dennis:*

Is the SEC overdoing it? Do these cases involve intentional wrongdoing or just poor recordkeeping or poor corporate processes? What's your view?

*Jerry:*

There's a mix of conduct. Much of it can be traced to simply sloppy recordkeeping. On the other hand, there have been significant problems and a certain amount of intentional misconduct. Where companies want to have it both ways – they want to have competitive compensation, but they don't want to take the accounting consequences – that's serious conduct, and the SEC and prosecutors treat it seriously.

Another priority right now is insider trading. The SEC has recently brought a record number of cases against both market professionals and officers of public companies. It is noteworthy that the SEC recently imposed control person liability on a broker-dealer for failing to have adequate policies and procedures to prevent insider trading. Any client in possession of material non-public information – whether it's a public company, a hedge fund advisor, or broker-dealer – needs a compliance program that polices insider trading.

*Dennis:*

How often should clients review their compliance programs?

*Jerry:*

The enforcement environment changes constantly. Clients always need to be on top of developments, particularly at the SEC. They need a real-time and ongoing effort to assess their programs to see if they're adequate.

Many regulated entities use off-the-shelf compliance programs that they believe are tailored to their particular business. But sometimes, these don't match up to the way they really do business. For example, a hedge fund advisor may have an off-the-shelf



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investment advisor compliance manual. The right approach is to assess a client's business and then review its compliance procedures with respect to the way that business actually works. A carelessly applied off-the-shelf compliance approach can be penny wise, but pound foolish.

*Dennis:*

What do you miss most from your days at the Division of Enforcement?

*Jerry:*

I find private practice to be extremely interesting and very rewarding. It's really wonderful to serve a client, get a great result, and receive a thank-you from the client. The SEC didn't provide much in the way of client gratitude, but it did provide the excitement of being part of a mission and doing the job for the public interest. I miss my former colleagues, too.

*Dennis:*

So what message would you send back to your friends and former colleagues at the Commission? How do you think they've been doing since you've been gone?

*Jerry:*

Of course, everyone that has left the SEC believes that the Commission's golden age was the time when they were there on the staff! Seriously, I'm not critical – it's a very difficult job. I suppose if I had to take a message back, it would be that in the aftermath of Enron, WorldCom, and the other huge corporate scandals of the early 2000s, to keep working for balance, and to remember that not all matters are the same. Not all accounting irregularities are accounting fraud – every case is different, every case deserves to be assessed individually.



## A CULTURE OF WAIVER: COMPELLED “VOLUNTARY” WAIVER OF THE ATTORNEY- CLIENT AND WORK PRODUCT PRIVILEGES IN GOVERNMENT INVESTIGATIONS



The aggressive policies implemented by federal prosecutors investigating potential corporate fraud in the wake of the Enron, WorldCom and Tyco scandals have come under increasing attack from a variety of unlikely bedfellows. In particular, the federal government’s policy (whether perceived or actual) of encouraging companies to waive the protections of the attorney-client privilege and work product doctrine as a condition of cooperation has been loudly criticized by groups as diverse from one another as the ACLU, the American Bar Association, the U.S. Chamber of Commerce, the National Association of Criminal Defense Lawyers and former attorneys general from both Democratic and Republican administrations.

In 2004, *TRENDS* reported on the government’s relatively new “cooperate . . . or else” attitude in corporate fraud investigations.<sup>1</sup> Since that time the outcry over the government’s enforcement strategies and “compelled” yet “voluntary” privilege waiver requests has escalated to the point that Congress has even threatened to pass legislation forbidding the government from conditioning a prosecution decision with respect to a company, even in part, on whether the corporation waived its legal privileges.<sup>2</sup> In response to the potential legislation, the Department of Justice (“DOJ”) in December 2006 revised its policies and procedures regarding corporate investigations and prosecutions and issued new guidance to criminal prosecutors. This article discusses what has occurred since our last article in 2004 and what companies can do to address the government’s views on the applicability of important legal privileges.

### *The Government’s Pre-Enron View*

In 1999, then-Deputy Attorney General Eric Holder provided the first official endorsement of a corporate privilege waiver



*William H. Jordan, Partner  
Litigation and Trial Practice  
bill.jordan@alston.com*



*T.C. Spencer Pryor, Associate  
Litigation and Trial Practice  
spence.pryor@alston.com*



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in a memorandum that set forth the guidelines for “Bringing Criminal Charges Against Corporations,” which became known as the Holder Memorandum.<sup>3</sup> The memorandum stated that the DOJ would consider a company’s “willingness to cooperate in the government’s investigation ... including, if necessary, a waiver of the [attorney-client privilege]” in determining whether to bring charges.<sup>4</sup> Although DOJ would not “consider waiver of a corporation’s privileges an absolute requirement, . . . prosecutors should consider the willingness of the corporation to waive the privileges when necessary to provide timely and complete information *as only one factor* in evaluating the corporation’s cooperation.”<sup>5</sup>

### ***Post-Enron: Waiver Requests Become Institutionalized***

Following Enron and the other corporate scandals in 2000-2001, President Bush created the Corporate Fraud Task Force, led by then-Deputy Attorney General Larry D. Thompson. The Task Force revised DOJ’s earlier policies announced in 1999 and issued what has become known as the Thompson Memorandum.<sup>6</sup> Included in this memorandum were seemingly insignificant changes to the provisions regarding privilege waivers such as deleting the word “*only*” from the Holder Memo’s guidance so that it read: “prosecutors should consider the willingness of the corporation to waive privileges when necessary to provide timely and complete information **as one factor** in evaluating the corporation’s cooperation.”<sup>7</sup> Some commentators (including Alston & Bird alumnus and now UGA law professor Lonnie Brown) stated that this seemingly insignificant change was indicative of DOJ’s intent to place greater emphasis on these waivers and conveyed a subtle message to corporations and their counsel that waiver of the privilege is now a more significant consideration in the eyes of DOJ.<sup>8</sup>

Similarly, the Securities and Exchange Commission issued its “Seaboard Report” to guide it in evaluating when a company will receive “credit for cooperative behavior.”<sup>9</sup> One of these factors was whether the company made available to the Commission the results of its internal review of the wrongdoing and provided “sufficient documentation” regarding its response. The U.S. Sentencing Commission also included in its 2004 amendments language stating that to receive “credit” for cooperating under the guidelines a company did not need to waive its privileges “unless such waiver



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is **necessary** in order to provide timely and thorough disclosure of all pertinent information known to the organization.”<sup>10</sup> Although couched in language stating that waiver should be made in only exceptional cases, this statement was quickly used by prosecutors to justify why a company should waive its legal privileges if it wanted to receive credit for cooperating. (In the face of intense criticism, the Sentencing Commission deleted this language in 2006.)

In practice, these changes created a “culture of waiver” in government investigations. A 2006 survey conducted by the Business Roundtable and the U.S. Chamber of Commerce found that a majority of the outside counsel who responded indicated that they had been pressured by federal enforcement officials to waive the privilege in connection with a government investigation.<sup>11</sup> Moreover, the respondents stated that those officials most frequently cited the Thompson Memorandum and the Sentencing Guidelines waiver language as the reasons the corporation should disclose confidential attorney-client communications and attorney work product. Anecdotal evidence from our own investigations in which the Alston & Bird Government Investigations Group has represented clients has shown that privilege waiver requests are not only increasingly common in federal criminal investigations, but are also being made with greater frequency in civil health care fraud investigations as conditions of settlement or by state attorneys general in investigations they are conducting.

### ***DOJ Attempts to Address Waiver Requests and the Perception of the Culture of Waiver***

In October 2004, then-Acting Deputy Attorney General (and former Alston & Bird partner) Robert D. McCallum Jr. issued the McCallum Memorandum, which sought to address growing concerns regarding DOJ’s waiver policy.<sup>12</sup> The memorandum directed each individual department head and U.S. Attorney’s office to establish a written waiver review process for their respective department or district. This directive arguably limited individual prosecutorial discretion, but many opponents argued that it failed to alleviate the government-coerced waiver promulgated by the Thompson Memorandum.<sup>13</sup>

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of cooperation.<sup>14</sup> A “culture of waiver” has arisen because even companies that may have fully complied with government regulations are more likely to waive privilege in order to assert their innocence in the context of a government investigation given that the alternative – indictment and the possibility of the corporate death penalty – is not an option. Indeed, the consequences of indictment may be severe: Arthur Andersen ultimately prevailed in the United States Supreme Court but, by the time the company’s conviction had been reversed, it had disintegrated as a going concern. Accordingly, many of our clients involved in government investigations feel that they have no choice but to waive privileges (regardless of whether it is specifically requested) given the government’s perceived expectation that waiver should occur.

In September 2006, a bipartisan group of ten former high-ranking DOJ officials wrote U.S. Attorney General Alberto R. Gonzales asking him to drop attorney-client privilege and attorney work product waivers as measures of corporate cooperation.<sup>15</sup> They suggested that the waiver requests amount to compulsory waiver because “the threat of being labeled ‘uncooperative’ simply poses too great a risk of indictment to do otherwise.”<sup>16</sup> They also contended that corporations face a compounded dilemma when one considers the likelihood that waiver constitutes a waiver to potential third-party plaintiffs.<sup>17</sup> Accordingly, companies are faced with the real possibility that by cooperating (*i.e.*, waiving privilege and providing privileged and confidential information to the government) they are also delivering potentially damaging information to third-party civil litigants and their lawyers.

In addition, the DOJ’s policy may erode the attorney-client privilege by undermining its principal justification – encouraging candid communication between corporate employees and attorneys. The “chilling effect” of routine waiver requests may very well discourage employees and executives from consulting corporate attorneys, thereby reducing, rather than increasing, corporate compliance objectives, if employees view their company’s attorneys merely as conduits of information to relevant government agencies.<sup>18</sup> Moreover, the usefulness of internal investigations largely depends on an open channel of communication between the individual employees and counsel. Compelled waivers may serve the interests of a particular criminal or regulatory investigation, but it sacrifices the long-term public interests associated with the privilege.<sup>19</sup>



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### *DOJ Issues Additional Policy Guidance in December 2006*

In the face of criticism regarding its policies from companies, attorneys, commentators and Congress (which threatened to change DOJ's policy by legislation), current Deputy Attorney General Paul McNulty issued the McNulty Memorandum in December 2006.<sup>20</sup> The new DOJ policy now states that prosecutors can seek a privilege waiver only "when there is a legitimate need for privileged information to fulfill their law enforcement obligations. A legitimate need for the information is not established by concluding it is merely desirable or convenient." A "legitimate need" will depend on:

- the likelihood and degree to which the privileged information will benefit the government's investigation;
- whether the information sought can be obtained in a timely and complete fashion through alternative means that do not require waiver;
- the completeness of the voluntary disclosure already provided; and
- the collateral consequences to a corporation of a waiver.<sup>21</sup>

The memorandum then divides privileged material into two categories. "Category I" material is factual and includes "key documents, witness statements, or purely factual interview memoranda regarding the underlying misconduct, . . . factual summaries, or reports containing investigative facts documented by counsel." Also included is legal advice contemporaneous to the underlying misconduct when the corporation was relying upon it. In order to request a waiver of this information, a prosecutor must obtain written authorization from the U.S. Attorney for that district, who must also provide a copy of the request to and consult with the Assistant Attorney General for the Criminal Division in Washington, D.C., before granting or denying the request. If the request is authorized, the corporation's response to the request may then be used as a consideration in determining whether it has cooperated in the investigation.<sup>22</sup>

"Category II" includes attorney-client communications and non-factual work product, including legal advice given to the corporation, attorney notes and documents containing counsel's mental impressions and conclusions. This material requires a



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heightened level of scrutiny and can be requested only where Category I material provides “an incomplete basis for a thorough investigation” and should be made “only in rare circumstances.” Approval must not only be obtained from the U.S. Attorney, but also from the Deputy Attorney General. Even if requested, however, the memorandum states that a prosecutor *may not consider* a corporation’s decision not to provide this information when making a charging decision, although the prosecutor can favorably consider a decision to acquiesce to the government’s request.<sup>23</sup>

Finally, the McNulty Memorandum notes that a company’s decision to provide privileged information to the government voluntarily and without a formal request does not require any of the procedures outlined above. Thus, even without a formal request, the government states that waiver may help expedite the government investigation and enable it to verify the “completeness and accuracy” of a company’s voluntary disclosures.<sup>24</sup>

### ***What Does This New Policy Mean for the “Culture of Waiver” In Government Investigations?***

The McNulty Memorandum, like the McCallum Memorandum before it, adds additional levels of oversight and process to privilege waiver requests, but it is unlikely to have much, if any, effect on the government’s desire for privileged documents or on a company’s decision whether to waive its privileges. DOJ continues to express its strong interest in maintaining material sufficient for a “full and complete” disclosure by the company of potential wrongdoing – regardless of whether this information is privileged.

Companies and their counsel must carefully evaluate how best to provide information to the government and may attempt to find creative ways through attorney proffers or other means to get the government what it needs short of a waiver. Counsel may also conduct their internal investigation and draft their report in a manner that provides the company with more flexibility in arguing which category of information is implicated by a waiver request.

The delicate dance required to navigate a company through an internal investigation, voluntary disclosure and potential collateral civil litigation remains complex. The government’s amended procedures regarding privilege requests may very well have some effect on the frequency of formal requests, but the difficult decisions that confront companies involved in these reviews still remain.



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## Endnotes

- <sup>1</sup> William H. Jordan, “Cooperate . . . Or Else: Corporate Cooperation in Government Criminal Investigations,” *Trends In Litigation* (Fall 2004) available at <http://www.alston.com>.
- <sup>2</sup> See SB 30, entitled the Attorney-Client Privilege Protection Act of 2005.
- <sup>3</sup> See Memorandum from Deputy Attorney General Eric H. Holder, Jr. to Component Heads and U.S. Attorneys on Bringing Criminal Charges Against Corporations (June 16, 1999), available at <http://www.usdoj.gov/criminal/fraud/policy/Chargingcorps.html>.
- <sup>4</sup> *Id.*
- <sup>5</sup> *Id.* (emphasis added).
- <sup>6</sup> Memorandum from Deputy Attorney General Larry D. Thompson to Heads of Department Components and U.S. Attorneys, Principles of Federal Prosecution of Business Organizations (January 20, 2003), available at [http://www.usdoj.gov/dag/cftf/business\\_organizations.pdf](http://www.usdoj.gov/dag/cftf/business_organizations.pdf).
- <sup>7</sup> *Id.* (emphasis added).
- <sup>8</sup> See Lonnie T. Brown, Jr., *Reconsidering the Corporate Attorney-Client Privilege: A Response to the Compelled-Voluntary Waiver Paradox*, 34 Hofstra L. Rev. 897, 937 (2006).
- <sup>9</sup> Discussed in more detail in *Trends In Litigation* (Fall 2004).
- <sup>10</sup> See U.S. Sentencing Comm’n Guidelines Manual § 8C2.5, cmt. 12 (2004), available at [http://www.ussc.gov/2004guid/8c2\\_5.htm](http://www.ussc.gov/2004guid/8c2_5.htm).
- <sup>11</sup> The detailed Survey Results are available online at [www.acca.com/Surveys/attyclient2.pdf](http://www.acca.com/Surveys/attyclient2.pdf)
- <sup>12</sup> See Memorandum from Acting Deputy Attorney General Robert D. McCallum, Jr., to Department Heads and U.S. Attorneys (October 21, 2005), available at [http://www.usdoj.gov/dag/speech/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf).
- <sup>13</sup> See The Thompson Memorandum’s Effects on the Right to Counsel in Corporate Investigations: Before the Senate Committee on The Judiciary, 109th Cong. 109-112 (2006) (statement of Karen J. Mathis, president of the American Bar Association).
- <sup>14</sup> *Id.*
- <sup>15</sup> See Letter from Former High-Ranking DOJ Officials to Attorney General Alberto R. Gonzales on Proposed Revisions to Department of Justice Policy Regarding Waiver of the Attorney-Client Privilege and Work Product Doctrine (September 5, 2006), available at <http://www.acca.com/public/attyclientpriv/agsept52006.pdf>.
- <sup>16</sup> *Id.*
- <sup>17</sup> *Id.*



<sup>18</sup> R. William Ide III, American Bar Association Task Force on Attorney-Client Privilege: Report to the House of Delegates (2005).

<sup>19</sup> *Id.* at 20.

<sup>20</sup> Available at [http://www.usdoj.gov/dag/speech/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf).

<sup>21</sup> *Id.* at pp. 8-9.

<sup>22</sup> *Id.* at pp. 9-10.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

## ABOUT THE AUTHORS



Bill Jordan concentrates his practice on complex commercial litigation, government and internal corporate investigations, corporate ethics and compliance matters and antitrust law. From 2001 to 2003 Bill served as a senior official at the Department of Justice where he supervised offensive and defensive litigation. Bill received a J.D. from Emory University School of Law and his B.A. from Rhodes College.

Spence Pryor concentrates his practice in the areas of white collar criminal defense, corporate compliance, health care, government investigations and internal corporate investigations. From 2001 to 2005, Spence served as a federal prosecutor in the criminal division of the U.S. Attorney's Office for the Eastern District of Virginia and also as a counsel to the Deputy Attorney General at the Department of Justice. Spence received his J.D. and his B.A. from the University of Georgia.



## THE WHISTLEBLOWER PROVISION OF SARBANES-OXLEY: DISCERNING THE SCOPE OF “PROTECTED ACTIVITY”



In response to Enron and numerous other corporate business scandals, Congress enacted the Sarbanes-Oxley Act of 2002 (“SOX”) to combat fraudulent accounting practices and other conduct defrauding shareholders. The stated purpose of SOX is “to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws.” SOX mandates corporate responsibility, public disclosure and improved methods of auditing and financial reporting to effectuate this goal.

Section 806 of SOX, the “whistleblower provision,” protects employees of publicly traded companies from retaliation for bringing certain perceived corporate wrongdoings to light, thereby encouraging disclosure of such information and serving SOX’s overarching goal of protecting shareholder assets. While SOX is still a relatively young law, trends are emerging already as courts and administrative tribunals consider what types of employee actions constitute activities protected under section 806. Identifying the evolving contours of protected conduct will help employers to avoid the time, expense and potential liability associated with whistleblower claims.

### *Protected Activity Litigation*

Section 806 prohibits employers of publicly traded companies from taking adverse action against an employee who files, causes to be filed, testifies, participates in, provides information or assists in an investigation regarding employer conduct that the employee reasonably believes constitutes a violation of mail, bank, wire or securities law, SEC rules or regulations or federal laws protecting shareholders from fraud. A plaintiff who has engaged in protected activity and subsequently suffers an adverse employment action can establish a whistleblower claim if the employer was aware of the protected activity and the adverse action can be connected to it.

An often recurring question in SOX whistleblower claims is what exactly constitutes “protected activity.” The SOX statute expressly



*Robert P. Riordan, Partner  
Labor and Employment  
bob.riordan@alston.com*



*Leslie E. Wood, Associate  
Labor and Employment  
leslie.wood@alston.com*



protects an employee who provides information that the employee “reasonably believes constitutes a violation” of the enumerated laws to a government official, supervisor or appropriate agent of the employer. Yet not all disclosures of improper, or even illegal, conduct are sufficient to constitute protected activity under SOX. Indeed, the emerging trend is to define protected activity narrowly, and thus favorably to employers.

### *Complaints Regarding Internal Policy or Requests*

Several recent cases support the proposition that merely raising complaints about internal policy is not protected under SOX when the failure to comply with those safeguards does not itself violate statutes or regulations relating to fraud on shareholders (or any other rule or regulation of the SEC). In *Bishop v. PCS Administration (USA), Inc.*,<sup>1</sup> the plaintiff, a former in-house attorney for PCS Administration, claimed that she was terminated for notifying her employer that its compliance program was deficient and that this deficiency put the company at risk for liability. The plaintiff argued that simply “raising the specter of potential fraud” constituted protected activity, but the court disagreed. “To the extent there is a reasonable (but incorrect) belief, it must be a reasonable belief that an actual violation has occurred or is being attempted.”

Likewise, in *Marshall v. Northrop Grumman Synoptics*,<sup>2</sup> the ALJ held that complaints about internal accounting controls and financials do not constitute protected activity when such errors do not affect any public report that could be the basis of actual fraud on shareholders. “The fact that the concerns involved accounting and finances in some way does not automatically mean or imply that fraud or any other illegal conduct took place.”<sup>3</sup> In *Getman v. Southwest Securities, Inc.*,<sup>4</sup> a stock analyst for a broker-dealer/investment adviser claimed that she engaged in a protected activity when she refused to raise a stock rating under pressure from her employer’s review committee. This claim, however, was rejected by the administrative review board hearing the case: “[i]n drafting whistleblower protection laws, Congress . . . has drawn the distinction between notifying the employer of a violation and refusing to commit a violation.”

These cases support the conclusion that complaints about purely internal reporting matters, policies or requests that do not directly violate a law enumerated in section 806 will not be deemed

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protected activity under SOX. However, it is critical to note that while complaints about purely internal accounting and ethical matters might fall safely outside the scope of protected activity, such is not the case when the complaint involves noncompliance with internal accounting controls promulgated in compliance with SOX mandates or SEC rules and regulations. In that case, the noncompliance itself would indeed be a violation of one of the laws enumerated in section 806.<sup>5</sup>

***Complaints that Wrongdoing Would Result in Fraudulent Misstatement***

Other cases, however, present more challenging issues, where complainants allege that some wrongdoing by the employer could constitute or eventually lead to fraudulent misstatements in the financial statements. These cases infuse the notion of *materiality* into the mix of factors to consider when trying to determine whether conduct is of the type that one could “reasonably believe” constitutes whistleblower activity under SOX.

In the case of *Harvey v. Home Depot, Inc.*,<sup>6</sup> the complainant brought a claim under section 806 alleging that he was retaliated against for reporting racial and other employment discrimination. The case turns on whether the complainant reported something that could reasonably be believed to constitute a violation of federal law relating to fraud against shareholders. The ALJ found that reporting an incident of employment discrimination did not constitute protected activity. Only if the report involved an employer’s “failure to disclose a class action lawsuit based on systemic racial discrimination with the potential to sufficiently affect the financial condition of a corporation” might such a complaint constitute SOX protected activity.

Likewise in *Harvey v. Safeway, Inc.*,<sup>7</sup> the complainant alleged that his complaints of wage violations under the Fair Labor Standards Act (“FLSA”) constituted a protected activity under section 806. The ALJ explained that complaints of systemic violations of FLSA could potentially “reach the necessary magnitude to effectively perpetrate a fraud on shareholders,” but concluded that the complainant’s reports simply failed to reach “the requisite level of materiality.”

The lesson is that materiality is the key to a successful whistleblower complaint when the claimed protected activity is a report of



*The ALJ found that reporting an incident of employment discrimination did not constitute protected activity.*



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Information must be  
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some wrongdoing that is not closely linked with shareholder communications.

Information must be sufficiently material to a company's financial picture before it will form the basis for securities fraud. Under Supreme Court authority, for information to be material, there must be "a substantial likelihood that a reasonable shareholder would consider [the matter] important to his decision to invest." Given the importance of "materiality" under the securities laws, Administrative Law Judges have rejected whistleblower retaliation claims where the information disclosed would not be sufficiently material to shareholders. *Livingston v. Wyeth Inc.*<sup>8</sup>

### **Conclusion**

While the boundaries of what constitutes a protected activity under SOX are still being drawn, recent decisions give practitioners guidance for future situations. Complaints about improper policies or procedures alone may be insufficient to warrant whistleblower protection. The materiality requirement for claims involving alleged shareholder fraud places an effective limitation on a law that could otherwise be construed with wild over-breadth. Understanding what will be deemed material, and thus what can form the basis for a reasonable belief that a fraud on shareholders has occurred or is being attempted, is necessary in order to discern the scope of protected activity.

### **Endnotes**

- <sup>1</sup> 2006 WL 1460032 (N.D. Ill. May 23, 2006).
- <sup>2</sup> *Marshall v. Northrop Grumman Synoptics*, No. 2005-SOX-0008, 2005 DOLSOX LEXIS 63 (Dep't of Labor June 22, 2005).
- <sup>3</sup> *Id.*
- <sup>4</sup> ARB Case No. 04-059, 2005 DOLSOX LEXIS 18 (Dep't of Labor July 29, 2005).
- <sup>5</sup> *See, e.g., Morefield v. Exelon Servs., Inc.*, No. 2004-SOX-00002, 2004 WL 3567255, at \*3, \*4 (Dep't of Labor Jan. 28, 2004); *Collins v. Beazer Homes USA, Inc.*, 334 F. Supp. 2d 1365, 1377 (N.D. Ga. 2004).
- <sup>6</sup> No. 2004-SOX-20, 2004 DOLSOX LEXIS 56 (Dep't of Labor May 28, 2004).
- <sup>7</sup> No. 2004-SOX-21, 2005 DOLSOX LEXIS 4 (Dep't of Labor Feb. 11, 2005).
- <sup>8</sup> *Livingston v. Wyeth Inc.*, No. 1:03CV00919, 2006 WL 2129794, at \*10 (M.D.N.C. July 28, 2006).



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## ABOUT THE AUTHORS



Robert Riordan focuses his practice on litigation relating to employment, business torts and unfair competition. He has extensive experience in defending Sarbanes-Oxley whistleblower claims, and his practice regularly involves defending companies against claims of all varieties of discrimination and retaliation. Mr. Riordan received his J.D. degree in 1984 and his A.B. degree in 1980 from Duke University.

Leslie Wood is a member of the firm's Labor & Employment Group. She received her J.D. in 2005 from Washington & Lee University School of Law and her B.S. in commerce with a concentration in accounting in 2002 from the University of Virginia's McIntire School of Commerce.



## CLIMATE CHANGE LITIGATION HEATS UP WITH *MASSACHUSETTS V. EPA*



*Robert D. Mowrey, Partner  
Environmental and Land Use  
bob.mowrey@alston.com*



*David M. Meezan, Partner  
Environmental and Land Use  
david.meezan@alston.com*

On April 2, 2007, the U.S. Supreme Court weighed into an increasingly intense debate concerning global climate change with a decision under the federal Clean Air Act (CAA) having significance far beyond the precise legal issues raised by the case. In *Massachusetts v. EPA*, the Supreme Court held that the U.S. Environmental Protection Agency (EPA) had improperly denied a petition requesting that the agency regulate greenhouse gas (GHG) emissions by new motor vehicles. The Court recognized for the first time that carbon dioxide (CO<sub>2</sub>) and other GHGs can be subject to regulation as “air pollutants” under the CAA. In so doing, the Court flatly rejected EPA’s position that the CAA could not reach GHGs.

The Court, clearly cognizant of the impact its pronouncements could have on the overall climate change debate, opened its opinion as follows:

A well documented rise in global temperatures has coincided with a significant increase in the concentration of carbon dioxide in the atmosphere. Respected scientists believe the two trends are related. For when carbon dioxide is released into the atmosphere, it acts like the ceiling of a greenhouse, trapping solar energy and retarding the escape of reflected heat. It is therefore a species – the most important species – of a greenhouse gas. . . .

127 S.Ct. 1438 at 1440.

*Massachusetts v. EPA* is likely to spur increasingly intense regulatory, legislative and litigation activity over GHGs and their potential to cause global climate change. For example, in *New York v. EPA*, a coalition of states and environmental groups have challenged EPA’s refusal to regulate CO<sub>2</sub> emissions from power plants under Section 111 of the CAA. EPA based its refusal to regulate such emissions on the same rationale rejected by the Supreme Court in *Massachusetts v. EPA* – that CO<sub>2</sub> is not an “air pollutant” under the CAA. The trial court had stayed the *New York* case pending resolution of *Massachusetts v. EPA*, and that case now will likely move forward.



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Other litigation pending in New York and California alleges that GHG emissions amount to a “public nuisance,” a theory surely helped by the Supreme Court’s declaration that GHGs are “air pollutants” under the CAA. Administrative appeals have been filed seeking to stop regulatory permitting of power plants including in Georgia. Litigation also has been brought to stop energy-intensive projects on the theory that environmental impact statements under the National Environmental Policy Act must be performed to assess the projects’ potential contributions to global warming. And, a lawsuit has been filed in Mississippi on behalf of Hurricane Katrina victims claiming that industries’ GHG emissions contributed to global warming that intensified Katrina’s effects.

The existing GHG cases are the tip of an enormous iceberg of GHG litigation to come. A deluge of litigation is likely as to any EPA rulemakings to address GHGs under the various CAA provisions, and there will be ever-more aggressive attempts by environmental groups and others to impose liabilities on industries for GHG emissions. Business-versus-business suits also are foreseeable, as some industries adversely impacted by climate change may seek compensation from other businesses allegedly causing it.

The potential for expanded climate change litigation has not escaped the attention of major liability insurers. Lloyds of London has expressed concern over the possibility of courts assigning liability and awarding compensation for climate change-related claims. And some insurers are making inquiries as to corporate strategies for addressing climate change. These developments also have caught the attention of corporate shareholders. Shareholder resolutions requiring corporate assessments of the rising regulatory and litigation risks posed by GHG emissions are at an all-time high, and corporations are increasingly assessing whether SEC-related reporting obligations may be triggered by the potential costs and liabilities that may be associated with climate change.

### ***The Decision***

In *Massachusetts v. EPA*, a collection of state and municipal governments plus certain environmental organizations challenged EPA’s rejection of a 1999 petition asking EPA to regulate vehicle emissions of GHGs, including CO<sub>2</sub>. Section 202 of the CAA requires the EPA administrator to prescribe “standards applicable to the emission of any air pollutant from any class or classes of new

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*The existing GHG cases are the tip of an enormous iceberg of GHG litigation to come.*  
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*EPA concluded that it lacked authority under the Clean Air Act to regulate GHGs as air pollutants and determined even if it had authority, would be unwise to do so.*  
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motor vehicles or new motor vehicle engines, which in his judgment cause, or contribute to, air pollution which may reasonably be anticipated to endanger public health or welfare.” The CAA defines the term “air pollutant” to include “any air pollution agent or combination of such agents, including any physical, chemical, biological, radioactive . . . substance or matter which is emitted into or otherwise enters the ambient air.” The petitioners alleged that heat-trapping GHGs, including CO<sub>2</sub>, methane, nitrous oxide and hydrofluorocarbons, had already accelerated global climate change, and would have adverse effects on human health and the environment in the future.

EPA denied the petition on two grounds. First, EPA concluded that it lacked authority under the CAA to regulate GHGs as air pollutants. Second, EPA determined that even if it had authority to regulate GHGs, it would be unwise to do so. The petitioners sought review of EPA’s determination in the U.S. Court of Appeals for the District of Columbia Circuit. A divided panel of that court rejected the petitioners’ challenge and affirmed EPA’s determination. The petitioners filed a petition for certiorari, and the U.S. Supreme Court agreed to hear the case.

By a 5-4 margin, the Supreme Court reversed the D.C. Circuit. The Court first addressed the threshold issue of whether the plaintiffs had Article III standing to pursue their claims. Finding they did, the Court focused particularly on the alleged injury to the State of Massachusetts. The State claimed that climate change caused by GHGs was contributing to a rise in global sea levels, resulting in current and future loss of Massachusetts’ coastal lands. Rejecting EPA’s argument that Massachusetts’ alleged injury was both remote and unlikely to be addressed by the regulation sought by the petitioners, the Court emphasized “the special position and interest of Massachusetts” as a sovereign state, the severity of the injury to Massachusetts’ land, and the fact that the CAA expressly created a procedural vehicle for challenging an EPA denial of a rulemaking petition. The Court also observed that, although the requested rulemaking would not completely redress Massachusetts’ injury by halting global warming, the potential for rulemaking to *slow* the pace of climate change was sufficient for standing purposes.

Having determined the case was justiciable, the Court turned to the merits. The Court first held that it “ha[d] little trouble concluding” that GHG emissions fit within the CAA’s expansive definition of “air pollutants,” thoroughly rejecting the EPA’s various



legal positions on this point. The Court also rejected arguments that EPA lacked authority to regulate GHGs because Congress had not sought to regulate GHG emissions directly through legislation passed *after* the CAA's original enactment. The Court was similarly not persuaded by EPA's argument that regulating fuel economy standards (the only practical way to regulate GHG emissions from automobiles) would impermissibly interfere with the Department of Transportation's regulation of such standards. The Court next rejected EPA's alternative basis for denying the rulemaking petition – that it would be “unwise” to regulate GHG emissions from motor vehicles at this time. EPA relied on several grounds for this conclusion, including: (1) existing, voluntary executive branch programs already provided an effective response to climate change; (2) regulating GHGs would impair the President's ability to negotiate with developing nations over reductions in their GHG emissions; and (3) regulating vehicle emissions would be an inefficient, piecemeal approach to addressing climate change. The Court rejected each of these justifications, stating that, although the EPA administrator has considerable discretion to decide whether to regulate air pollutants, any decision not to regulate must be based on factors that “relate to whether an air pollutant ‘causes, or contributes to, air pollution which may reasonably be anticipated to endanger public health or welfare.’” Finding the EPA's reasons did not relate to the “endangerment” determination called for by the CAA, the Court held EPA's rejection of the rulemaking petition to be arbitrary and capricious, and remanded the case back to the D.C. Circuit for further proceedings.

Although *Massachusetts v. EPA* decided a narrow statutory issue, the decision plainly has broader implications. In addition to the decision's potential to unleash a new wave of climate change litigation, the direct effect of *Massachusetts v. EPA* is that the EPA must now make a definitive finding as to whether GHGs “may reasonably be anticipated to endanger public health or welfare,” and thus require regulation under the CAA. In testimony given before the Senate Environment and Public Works Committee on April 24, 2007, EPA Administrator Steven Johnson declined to offer a timetable for regulation of GHGs. Administrator Johnson suggested that, although the Supreme Court has rejected EPA's proffered policy considerations in the context of deciding *whether* to regulate GHGs, EPA might nonetheless take these factors into account in deciding *how* to regulate them.



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• • •  
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In further testimony, however, Administrator Johnson announced that, in part because of the Court's decision, EPA was dropping its opposition to considering California's 16-month-old request to implement its own state limitations on GHG emissions from vehicles. Eleven other states have announced their intention to move forward with similar regulations if California obtains permission from EPA.

*Massachusetts v. EPA* represents a clear victory for advocates of regulating GHG emissions from motor vehicles. However, its impact over time may be felt far more broadly, in the form of increased legislation, regulation and litigation across the whole spectrum of GHG activities. Any company that provides or uses energy in any significant quantity – that is, virtually the entire range of industries in the United States – needs to be alert to these trends.

## ABOUT THE AUTHORS

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Bob Mowrey chairs the firm's Environmental and Land Use Group. His practice focuses on toxic tort and environmental litigation, state and federal hazardous waste matters, Clean Water Act issues, hazardous materials issues, carbon management issues and corporate compliance and counseling matters. Bob earned his J.D. from the University of Chicago Law School and his B.A. from Wittenberg University in Springfield, Ohio.

David Meezan is a partner in the firm's Environmental and Land Use Group and concentrates his practice on complex environmental, toxic tort and land use litigation and advises clients on greenhouse gas emission regulations. He received his J.D. and M.S.E.L. from Vermont Law School and his B. A. from Emory University.



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