

Whistleblower Protection, It's Complicated

When Congress included a whistleblower provision with the Sarbanes-Oxley Act, 18 U.S.C. Section 1514A, it was responding to a "culture" of wrongdoing that discouraged employees "from reporting fraudulent behavior." (Cal. Att'y Gen. Op. 00 1203, 84 Ops. Cal. Att'y Gen. 71 (May 23, 2001)). This "code of silence" hampered investigations and created a "climate" where wrongdoing could occur "with virtual impunity." The whistleblower provision was designed to encourage and protect employees who report misconduct. Whether it has succeeded remains to be seen. According to one report, of the 361 complaints of retaliation resolved by the Occupational Safety and Health Administration in the statute's first three years, it found for the employee only 13 times. (See Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 Wm. & Mary L. Rev. 65 (2007).)



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Whistleblowers recently had more luck in *Van Asdale v. Int'l Game Tech.*, 577 F.3d 989 (9th Cir. 2009), the 9th Circuit's first analysis of the Sarbanes-Oxley Act's whistleblower provision. The plaintiffs were in-house counsel for International Game Technology and were involved with the company's 2001 merger negotiations with Anchor Gaming. The crown jewel of Anchor Gaming's intellectual property portfolio was a slot machine "wheel" patent, which a competitor claimed was invalid, a claim that could have had a significant effect on the merger's value. International Game Technology satisfied itself the patent was valid, and the merger was completed.

The plaintiffs subsequently found themselves working at International Game Technology under a new chief executive officer and a new general counsel - both of whom had occupied those same positions at Anchor during the merger. In 2003, the plaintiffs discovered a document containing information seriously undermining the validity of the wheel patent. The information and the document were in the possession of Anchor Gaming - and possibly known to Anchor Gaming's then-CEO and



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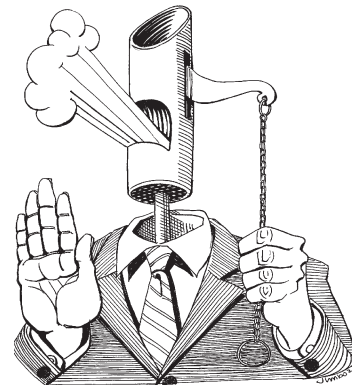
general counsel - at the time of the merger but had not been disclosed to International Game Technology. The plaintiffs took their concerns to their new boss. While the parties disputed what transpired at the meeting, there was no dispute that within several months of that encounter, and despite previously positive reviews, both plaintiffs were fired.

The plaintiffs brought a lawsuit alleging that their terminations violated the Sarbanes-Oxley Act's whistleblower provision. The district court granted summary judgment for International Game Technology and the plaintiffs appealed, setting the stage for the 9th Circuit to interpret the Sarbanes-Oxley Act's whistleblower provision for the first time. While the most obvious practical aspect of the decision may be the Court's recitation of the elements needed to establish a prima facie case, plaintiffs' status as attorneys presents more nuanced issues.

International Game Technology initially contended that the action should be dismissed because plaintiffs could not establish their claim without using privileged attorney-client communications. The 9th Circuit first rejected International Game Technology's argument that state rules of professional responsibility (here, Illinois, where the plaintiffs were licensed) could preclude claims based on federal law. It then rejected the more general argument that federal common law precluded the use of such privileged information, determining that "confidentiality concerns alone do not warrant dismissal." The Court did not explain what additional concerns would warrant dismissal. Instead, it determined that "the appropriate remedy is for the district court to use the many 'equitable measures at its disposal' to minimize the possibility of harmful disclosures." (*Kachmar v. SunGard Data Systems, Inc.*, 109 F.3d 173, 182 (3d Cir. 1997)). The one measure mentioned was limiting testimony to the plaintiffs' fraud allegations and avoiding any concurrent litigation-related discussions. The Court also looked to the language of the Sarbanes-Oxley Act itself, finding that "even though Congress plainly considered the role attorneys might play in reporting possible securities fraud," it had not limited the language of the statute authorizing any "person" to file a whistleblower complaint (15 U.S.C. Section 7245).

For whistle-blowing California lawyers, however, this may not be the only, or even most significant, analysis. There remains the state bar. California rules require attorneys to keep client confidences except in the face of death or substantial bodily harm. (See California Rules of Professional Conduct 3-600; California Business & Professions Code Section 6068(e) regarding why there is no exception for whistleblowers; California Bar Ethics Alert, *The New SEC Attorney Conduct Rules v. California Duty of Confidentiality* (Spring 2004); and 84 Ops. Cal. Att'y Gen. 71 regarding why California whistleblower statutes are not intended to supersede or impair privilege). The professional impact on an attorney whistleblower can be significant, even if the bar ultimately decides to take no action. (See Charles S. Doskow, *The Government Attorney and the Right to Blow the Whistle: The Cindy Ossias Case and Its Aftermath (A Two-Year Journey to Nowhere)*, 25 Whittier L. Rev. 21 (2003).)

Ironically, it may be lawyers who are best positioned to satisfy the substantive elements required to maintain a Sarbanes-Oxley Act whistleblower suit. The statute prohibits discrimination against an employee for providing information "regarding any conduct which the employee reasonably believes constitutes" mail, wire, bank, securities, or "shareholder" fraud or violates a Securities and Exchange Commission rule or regulation. The 9th Circuit also requires that the whistle-blower belief be objectively reasonable and that the whistle-blowing communication



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"definitively and specifically" "relate to" one of the enumerated frauds. Does that mean that the whistleblower must know the legal elements of fraud? If two employees report the same conduct, one because she believes it is unethical and violates a company policy and the other because he believes it defrauds shareholders, does only the latter recover as an aggrieved whistleblower?

The answer appears to be "yes." Had the plaintiffs told management that they believed Anchor Gaming had committed merely fraud on the Patent Office (International Game Technology's version of the facts), their claims would have failed. Moreover, not only must the plaintiff actually believe the requisite fraud may have occurred, but for that belief to be objectively reasonable the plaintiff's theory of fraud "must at least approximate the basic elements of a claim of securities fraud." (*Day v. Staples, Inc.*, 555 F.3d 42, 55 (1st Cir. 2009)). While "an employee need not have cited a code section he believes was violated," it nevertheless appears that familiarity with the basic principles of corporate fraud would be a big help. Thus for better or worse, attorneys seem to be prime candidates for the Sarbanes-Oxley Act's whistleblower protection, even if that protection may go only so far.

The Ins and Outs of E-discovery

On June 29, 2009, Governor Arnold Schwarzenegger signed the California Electronic Discovery Act into law. The Act closely tracks the 2006 amendments to the Federal Rules of Civil Procedure, and, like the Federal Rules, will have a significant impact on discovery of electronically stored information. Given the sheer volume of electronically stored information in commercial and class action lawsuits these days, electronic discovery can be a minefield for litigants if not carefully navigated. But if properly and thoroughly understood, the Act can provide the tools for managing the costs and burdens of discovery.

The Act, like the Federal Rules, broadly defines electronically stored information as "information that is stored in an electronic medium." California Civil Code of Procedure Section 2016.020(e). If applied similarly to the Federal Rule, it will encompass all data stored on computers or other digital media. Despite this broad definition, though, the Act does place some limits on the discovery of electronically stored information.

For example, if the electronically stored information "is from a source that is not reasonably accessible because of undue burden or expense," the producing party may avoid production on that basis, but must state which sources it will not search. California Civil Code of Procedure Section 1985.8(d). However, unlike the Federal Rules, under the Act, the producing party has the burden of demonstrating that the requested information is not reasonably accessible. Nonetheless, subject to any limitations set by the court, a requesting party may still obtain an order requiring production of some or all of the electronically stored information sought if good cause is shown-even if the producing party has established the information is not reasonably accessible.

The court may also limit production where the information is unreasonably cumulative or duplicative, it is available from less expensive or more easily accessible sources, or the likely benefit is outweighed by the burden and expense of production. These exceptions are based on the idea that the cost of discovery should be proportionate to the overall case. It is worth noting, however, that objections to discovery based on the burden and expense of production generally have not been successful under the Federal Rules unless substantiated with specific facts and evidence of the burden. The California Act will likely be similarly applied.

Another significant change found in the Act is the so-called "Safe Harbor" provision. Prior to the Act, courts had the power to impose sanctions against a party for failing to maintain relevant evidence. Now under the Act, courts may not impose sanctions against a party for electronic discovery information that is lost "as a result of the routine, good faith operation of an electronic information system." California Civil Code of Procedure Section 1985.8(k)(1). A similar safe harbor clause is found in the Federal Rules, which protects parties using systems that automatically alter and overwrite electronic information. Based on the Federal Rule, the Act, if interpreted similarly, should protect against sanctions for the inadvertent loss of ephemeral data such as temporary caches, system logs, and other information that is routinely deleted for the efficient operation of a computer system. It is important to note, however, that the protection of the safe harbor provision only extends to the deletion of such data up to the point at which a legal duty to preserve is triggered. After preservation, or "legal hold," obligations are triggered, parties must take measures to suspend the automatic deletion of all relevant information and the failure to do so may subject them to sanctions for spoliation.

Because the amount of electronically stored information available is often voluminous, its discovery greatly increases the risk of inadvertently producing privileged information. In an apparent attempt to address this issue, the Act includes a clawback provision that allows a party to seek the return of any privileged electronically stored information inadvertently produced by notifying the receiving party. California Civil Code of

Procedure Section 2031.285(a). Based on the text of the Act, however, the clawback provision appears only to apply to the physical return of the inadvertently produced documents, but does not address whether there has been a privilege waiver. Under the Federal Rules and the recently amended Federal Rule of Evidence 502, inadvertent disclosure is generally not a waiver of privilege as long as reasonable steps have been taken to prevent disclosure or the parties have an agreement entered by the court to such effect. Unfortunately, California does not have an analogous rule of evidence to clarify this issue. It remains to be seen how California courts will interpret this new rule, but it is important for parties to understand the limitations of the clawback provision.

Under prior California law, parties were already generally required to meet and confer regarding discovery disputes in connection with discovery motions. Despite this general requirement, though, many anticipated the Act would amend California Rule of Court 3.724 to include specific meet and confer requirements relating to electronic discovery; however, it did not. Recognizing this omission, the Judicial Council has now amended Rule 3.724 (effective Aug. 14, 2009).

Under the amended Rule 3.724, parties must engage in the meet and confer conference at least 30 days prior to the initial case management conference. Among other things, parties will now be required to discuss issues relating to preservation of electronically stored information, the form in which it will be produced, when it will be produced, the scope of discovery of electronically stored information, the method by which parties will be able to make claims of privilege or confidentiality, and - most importantly - how the costs of production will be borne or shared by the parties. Parties and their attorneys should be cognizant that this change to Rule 3.724 now means that parties must understand their information technology systems and capabilities much earlier in the case. They will need to be prepared to discuss those capabilities with the opposing side to flesh out any related discovery issues before they are in front of the judge at the case management conference. Under the new rule, parties cannot simply delay addressing issues relating to electronic discovery until they have a discovery demand in front of them or it is raised at a hearing. This rule forces parties to be proactive, not just reactive.

Electronic discovery can be expensive and burdensome. This is especially true in light of the new Act, which makes it clear that the scope of discovery includes all forms of electronically stored information. At the same time, though, the Act provides a framework for litigants and the courts to cope with the ever-increasing amount of electronically stored information. Companies that embrace the new rules and take steps to understand their information systems will be best positioned to reap the Act's benefits.

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