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The Importance of Being Earnest: An Environmental Whistleblower’s Guide to Protection Under SOx § 806 and Dodd-Frank

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John J. Tollefsen¹

The Sarbanes Oxley Act of 2002 (“SOx”) § 806² protects certain employees who reasonably believe they are reporting a violation of a law, rules, or regulation listed in § 806. Their belief must be subjectively and objectively reasonable.³ The employee must earnestly and sincerely believe in good faith that there is a violation. The courts and administrative law judges (“ALJs”) have been generally hostile to § 806, adding additional barriers to recovery with the result that few claimants have been protected. This paper argues that claims under SOx § 806’s Securities Exchange Commission (“SEC”) rule or regulation violation provision, which has been almost ignored in the cases and by complainants, could provide increased whistleblower protection, particularly those who report violations of environmental laws.

The protection afforded by SOx § 806 should be of interest to environmental whistleblowers because it is considerably stronger than the protection offered by environmental statutes. In addition, there is a new civil cause of action under SOx § 806

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² SOx § 806 is codified as 18 U.S.C. § 1514A(a)(1).
³ E.g., Tuttle v. Johnson Controls Battery Div., 2004-SOX-76 (ALJ Jan. 3, 2005), an ALJ explained: “Protected activity is defined under SOX as reporting an employer’s conduct which the employee reasonably believes constitutes a violation of the laws and regulations related to fraud against shareholders. While the employee is not required to show the reported conduct actually caused a violation of the law, he must show that he reasonably believed the employer violated one of the laws or regulations enumerated in the Act. Thus, the employee’s belief ‘must be scrutinized under both subjective and objective standards.’ Melendez v. Exxon Chemicals Americas, 1993-ERA-6 (ARB July 14, 2000)”.

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in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”).\textsuperscript{4} This statutory action provides additional protections for whistleblowers and extends the statute of limitations.

The purpose of this paper is to provide some guidance and ideas to environmental whistleblowers who may want to seek the protection of SOx § 806 or Dodd-Frank by alleging a potential violation of a rule or regulation of the SEC.

I. Overview of SOx § 806

Enacted in response to the Enron and WorldCom scandals, President Bush signed SOx into law in 2002.\textsuperscript{5} SOx was intended to restore investor confidence in the nation’s financial markets by increasing management responsibility and reducing fraud through changes in corporate governance and accounting practices. Whistleblowing was seen as essential for bringing the scandals to light. Increased whistleblower protection was provided to employees of publicly traded companies who report corporate fraud and certain enumerated violations of law. SOx § 806 (a) (1) protected efforts of whistleblowers

\[\text{to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341 [mail fraud], 1343 [wire fraud], 1344 [bank fraud], or 1348 [securities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by . . . .} \]

There are six categories of protected activity 1) mail fraud; 2) wire fraud; 3) bank fraud; 4) securities fraud; 5) “any rule or regulation of the Securities and Exchange Commission” and 6) any provision of Federal law relating to fraud against

\textsuperscript{4} Pub. L. 111-203, H.R. 4173.
\textsuperscript{5} Pub. L. 107-204, 116 Stat. 802 (July 30, 2002).
shareholders.\(^6\)

SOx § 806(6) has become a minefield for whistleblowers because claimants have been poorly prepared to point out the type of fraud they identified and therefore their cases have been decided under the “catchall” provision of SOx § 806(6). The claimants are then required to prove all the elements of securities fraud including scienter.

Enforcement of SOx’s civil whistleblower protection provision is initially the exclusive jurisdiction of the Secretary of the Department of Labor (“DOL”). If the Secretary has not issued a final decision within 180 days of the filing of a complaint, and there has been no showing that the delay was due to the bad faith of the claimant, the claimant may bring a \textit{de novo} action in district court. The United States Courts of Appeals have jurisdiction to review the Secretary of Labor’s final decisions.\(^7\)

Proceedings under SOx § 806 are governed by the rules and procedures and by the burdens of proof of the aviation safety whistleblower provisions contained in the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (“AIR21”).\(^8\) As with AIR21, the Secretary of Labor has assigned responsibility for administering SOx § 806 to the Assistant Secretary for Occupational Safety and Health Administration (“OSHA”).\(^9\)

OSHA has issued a final rule establishing procedures and time frames for the handling of retaliation complaints under SOx § 806.\(^10\) The rule addresses complaints to OSHA, investigations by OSHA, appeals of OSHA determinations to a U.S. DOL

\(^6\) The six categories are referred to as “SOx § 806(1)” through “SOx § 806(6)” in this paper.

\(^7\) 18 U.S.C. § 1514A(b)(2).


\(^9\) Secretary’s Order 5-2002, 67 Fed. Reg. 65008 (Oct. 22, 2002). This is the same pattern as used for several other whistleblowing statutes and at least 14 whistleblowing statutes have been assigned to OSHA by the Secretary.

administrative law judge ("ALJ") for a *de novo* hearing, hearings by ALJs, and review of ALJ decisions by DOL’s Administrative Review Board ("ARB"), to which the Secretary has delegated authority to issue final agency decisions under SOx.¹¹

Regulations promulgated by DOL set forth four required elements of a prima facie case under SOx § 806: (1) “[t]he employee engaged in a protected activity or conduct”; (2) “[t]he named person knew or suspected, actually or constructively, that the employee engaged in the protected activity”; (3) “[t]he employee suffered an unfavorable personnel action”; and (4) “[t]he circumstances were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action.”¹²

In interpreting SOx § 806’s substantive requirements and burdens of proof, the DOL and the courts have looked to agency and judicial decisions under AIR21, as well as other OSHA-enforced whistleblower statutes, such as the Energy Reorganization Act ("ERA"),¹³ which provides protection to employees who report nuclear safety violations. As has happened with the other whistleblower statutes enforced by OSHA, the DOL and the courts borrow heavily from case law developed under Title VII and other discrimination statutes.

II. Summary of whistleblowing protection in environmental statutes

The environmental whistleblower statutes prohibit retaliation against employees for engaging in protected activities related to the enforcement of various environmental

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¹² 29 C.F.R. § 1980.104(b)(1)(i)-(iv). See *Van Asdale v. International Game Technology*, 577 F.3d 989, 996-997 (C.A.9 (Nev.), 2009). This paper does not cover all issues relevant to a SOx § 806 case but focuses on the reporting of SEC rule violations as protected activity. Practitioners new to SOx § 806 should consult other sources.
protection statutes. These statutes include the Water Pollution Control Act, the Clean Air Act, CERCLA, the Safe Drinking Water Act, the Solid Waste Disposal Act, and the Toxic Substances Control Act. Each of these statutes includes a 30-day statute of limitations. A 180-day statute of limitations is provided in the amended ERA which protects whistleblowers on nuclear safety matters under the Atomic Energy Act.

Whistleblowers can become confused by the complexity of statutes when they file their complaint with OSHA. In one case, the complaint alleged retaliation because the whistleblower had reported the wrongful release of “thousands of gallons of sludge water into the ground water system”. The complaint was filed with OSHA under SOx § 806 but did not mention any other statute. OSHA only considered the case under the SOx and denied relief.

III. Prepare to lose

As a practical matter, whistleblowing protection has not been favored by the judges or ALJs. This is to be expected. For many people, a “whistleblower” is a “snitch”. The advice the author gives to would-be whistleblowers who seek his advice is to avoid whistleblowing unless the employee wishes to risk ending her career. It is

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21 20 C.F.R. § 24.3(b).
22 42 U.S.C. 5851.
24 Hopkins v. ATK Tactical Systems, 2004-SOX-19 (ALJ May 27, 2004). In addition to statute of limitations problems, the complainant did not identify any SEC rule that was violated. As explained in this paper, several were likely available.
25 The English language is rife with pejorative terms for whistleblower like informer, fink, stoolpigeon, stoolie, sneak, blabbermouth, tattler, tattletale, squealer, mole, betrayer, rat, and rat fink. Even lawyers fight rules (like ABA proposed ethical rules) making reporting of other lawyer’s ethical violation mandatory.
safer to ignore the fraud and find another job than to engage in whistleblowing. Only those who desire to be persecuted for righteousness’ sake\textsuperscript{26} should become whistleblowers. Often employers, who have discovered a “snitch”, target the whistleblower and release her name to fellow employees. The environment at the workplace often is insufferable. The whistleblower will likely be persecuted until she quits or is fired on pretext. Then there will be years of expensive litigation before courts that tend to go out of their way to find for employers.\textsuperscript{27} If the employee is reinstated, she will be attempting to climb the corporate ladder at a company that despises her.\textsuperscript{28}

The triers-of-fact often find a way to find the employee did not engage in protected activity. There are many examples. The dishonesty reported will be seen as “immaterial”, the employee was not definite enough in her complaint, or countless other excuses will be used to favor the employer. A “mere suspicion” is not a reasonable belief;\textsuperscript{29} warning of possible violations is not protected activity.\textsuperscript{30} In addition, the report must be sufficient enough that a reasonable person with the similar education, training, and experience as the whistleblower would believe there was a violation.\textsuperscript{31} This

\textsuperscript{26} Matthew 5:10.
\textsuperscript{27} Perhaps the “termination at will” doctrine brought into American law during the 19\textsuperscript{th} century industrial revolution (in derogation of common law which provided one year contracts) is too deeply embedded in the mind of judges.
\textsuperscript{28} The author believes that only a seachange in attitude regarding business ethics in American culture or rigid enforcement of whistleblowing protection laws by the courts will make any difference.
\textsuperscript{29} E.g., \textit{Riedell v. Verizon Communications}, 2005-SOX-00077 (ALJ Aug. 14, 2006), an employee reported favoritism in procurement, a major breach of the mainframe network, and employee use of fake identities to access a large number of bank and credit agency records. The ALJ granted summary judgment in favor of the respondent, finding the complainant did not have sufficient facts to support his claims. The ALJ found that the complainant was suspicious but “a suspicion is simply speculation and cannot logically be regarded as a reasonable belief”.
\textsuperscript{30} E.g., \textit{Joy v. Robbins & Myers, Inc.}, 2007-SOX-74 (ALJ Jan. 30, 2008), the ALJ found that reporting (1) lack of export compliance procedure; (2) company’s failure to ensure compliance with Year II SOX certification; and (3) and possible premature revenue recognition by the employer was merely warning of possible violations not actual violations.
\textsuperscript{31} E.g., \textit{Grove v. EMC Corp.}, 2006-SOX-99 (ALJ July 2, 2007), the ALJ stated it “would not be unreasonable for a person with [the whistleblower’s] relatively low level of expertise and knowledge to believe that use of a new formula, . . . , presented potential advisors with a materially misleading picture of
objective standard has been praised for its avoidance of uncertainties and discrepancies\textsuperscript{32} even though it is designed to favor the employer. Occasionally the trier of fact applies the statute as written; there does not need to be a rule or regulation that covered the employer's behavior; there only needs to be a reasonable belief that there is a rule or regulation.\textsuperscript{33}

SOx § 806's short statute of limitations of 180 days (formerly 90 days) has proved troublesome to whistleblowers. Usually they believe the company wants to fix the problem and report the discrimination internally using the procedure in the employee manual. The investigation typically takes months. The whistleblower does not want to risk his career by filing with OSHA prematurely. Often Human Resources and Ethics departments reassure the whistleblower that if he is patient, they will fix the problem.\textsuperscript{34} Whistleblowers typically believe the internal investigation will vindicate him and may wait more than 180 days for resolution of the investigation.\textsuperscript{35}

A 2007 study found only 3.6% of SOx § 806 whistleblowers won relief through the initial administrative process that adjudicates such claims, and only 6.5% of
whistleblowers won appeals through the process.\textsuperscript{36} The author concluded:

“The results of this detailed analysis demonstrate that administrative decision makers strictly construed, and in some cases misapplied, Sarbanes-Oxley’s substantive protections to the significant disadvantage of employees. These data-based findings assist in identifying the provisions and procedures of the Act that do not work as Congress intended and suggest potential remedies for these statutory and administrative deficiencies.”\textsuperscript{37}

IV. Dodd-Frank’s new cause of action for whistleblowers

SOx § 806 provides that an employee subject to retaliation is “entitled to all relief necessary to make the employee whole.”\textsuperscript{38} This allows the employee to ask for relief like reinstatement, mental stress damages, loss of the employee’s future career earnings, and reputational damage.\textsuperscript{39} In contrast, Dodd-Frank provides limited remedies that may be the only remedy if the 180 day statute of limitations period of SOx § 806 has expired.

Dodd-Frank added additional provision to assist whistleblowers\textsuperscript{40} (like jury trials) by amending SOx § 806. It also added this new civil action:

No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—

(i) in providing information to the Commission in accordance with this section;

(ii) in initiating, testifying in, or assisting in any investigation or judicial or


\textsuperscript{38} 18 U.S.C. § 1514A(c)(1).

\textsuperscript{39} E.g., \textit{Hanna v. WCI Communities, Inc.}, 348 F. Supp. 2d 1332 (S.D. Fla. 2004) held that a successful plaintiff cannot be made whole without being compensated for reputational injury that diminishes the plaintiff’s future earning capacity but denied punitive damages under SOx § 806.

\textsuperscript{40} “Whistleblower” is a defined term that is more expansive than violation of SOx § 806 (17 CFR § 240.21F-2(a)). Courts have found that reporting to the SEC can be protected even if there is no claim under SOx § 806. See \textit{Nollner v. S. Baptist Convention, Inc.}, 2012 WL 1108923 (M.D.Tenn. Apr. 3, 2012); \textit{Egan v. Trading Screen, Inc.}, 2011 WL 1672066 (S.D.N.Y. May 4, 2011); and \textit{Kramer v Trans-Lux Corp.}, 2012 WL 4444820 (D.Conn., 2012). The SEC rule is in accord (17 CFR § 240.21F-2).
administrative action of the Commission based upon or related to such information; or
(iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), including section 10A(m) of such Act (15 U.S.C. 78f(m)), section 1513(e) of Title 18, and any other law, rule, or regulation subject to the jurisdiction of the Commission.

Actions for violations of this provision may be brought in United States’ district courts. The statute of limitations is 6 years after the date on which the violation occurred or 3 years after the date when facts material to the right of action are known or reasonably should have been known by the employee alleging a violation. The discovery rule is restricted to 10 years after the date on which the violation occurs.

Monetary damages are limited to 2 times the amount of back pay owed plus interest. The whistleblower is entitled to reinstatement with the same seniority status that would have existed but for the discrimination. Litigation costs, expert witness fees, and reasonable attorney fees are awarded to the successful whistleblower.

The whistleblower to the SEC is entitled to confidentiality except for public proceedings or disclosures allowed under federal law. The rights afforded whistleblowers cannot be waived and no predispute arbitration clause is enforceable.

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41 “(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.” 18 U.S.C.A. § 1513
42 15 U.S.C.A. § 78u-6(h)(1)(B)(i). “Subject to the jurisdiction” reaches rules of stock exchanges, FINRA, and other entities that need SEC approval. This is arguably broader than the language in SOx § 806.
43 15 U.S.C.A. § 78u-6(h)(1)(B)(i). Presumably the action can also be brought in state court since it was not preempted. Tafflin v. Levitt, 493 U.S. 455 (1990) (States have concurrent sovereignty with the Federal Government, limited only by the Supremacy Clause).
Dodd-Frank authorized jury trials under SOx § 806\textsuperscript{50} but no specific provision was made for a jury trial for this new cause of action.

V. Violation of rule of SEC

The premise of this paper is that courts should uphold SOx § 806 as written so that reporting any violation of a SEC rule would be protected activity. However there is language in some cases that seem to indicate that violation of a SEC rule is not enough unless there is proof of fraud on shareholders. If this is the intent, it is bad law. It is not the role of the ALJs or judges to determine whether a SEC rule is necessary to prevent fraud on shareholders. The SEC has decided the rule is necessary and SOx § 806 was written to protect those who report violations of SEC rules. Some examples of imprecise holdings include:

To be protected under the SOX, the whistleblower must ordinarily complain about a material misstatement of fact (or omission) concerning a corporation’s financial condition on which an investor would reasonably rely. The protected complaint must “definitively and specifically” relate to the SOX subject matter, be specific enough to permit compliance, and support a complainant’s reasonable belief.\textsuperscript{51}

While fraud under the Act is undoubtedly broader, an element of intentional deceit that would impact shareholders or investors is implicit.\textsuperscript{52}

Most SOx § 806 claimants have not identified a SEC rule that was violated and the cases have been analyzed under SOx § 806(6) (fraud on shareholders) using

\textsuperscript{50}18 U.S.C.A. § 1514(b)(2)(E).
\textsuperscript{52}Hopkins v. ATK Tactical Systems, 2004-SOX-19 (ALJ May 27, 2004). Hopefully this holding is limited to SOx § 806(6) (fraud on shareholders). Even if it is, it is an example of the extremes the courts will go to eliminate whistleblower protection. Consider the Enron case which was one of the impetuses behind SOx. Using opinions of numerous law firms and the expertise of Arthur Anderson, Enron hid liabilities in off-balance sheet entities. What whistleblower could be prepared to prove intentional deceive (scienter) in that situation? It could require proof that the lawyers issued their opinions with scienter. Even if the evidence could be found, how is the whistleblower to find the resources to battle with enormous law firms and accounting firms? Normally the whistleblower reports what appears to be wrongful conduct but is not highly enough placed in the organization to know whether the conduct is intentional or merely negligent.
securities fraud standards. For example, the Fourth and Fifth Circuits have required shareholder fraud in cases that did not involve violation of SEC rules.\textsuperscript{53} The law on whistleblower protection for reporting SEC rule violation remains to be developed.

Another tactic that has been used to reduce whistleblower protection is to assert that SOx § 806(6) (fraud on shareholders) is not a separate category but modifies the previous categories. In \textit{Reyna v. Conagra Foods, Inc.},\textsuperscript{54} the court noted that other courts are split as whether the phrase - “relating to fraud against shareholders” - should apply to all of the conduct listed in the statute. Based on the court’s reading of the plain meaning of the statute, the court concluded that “[t]he statute protects an employee against retaliation based upon that employee’s reporting of mail fraud regardless of whether that fraud involves a shareholder of the company.”\textsuperscript{55} This is the correct understanding of the law. Otherwise the court would be deciding which SEC rules relate to fraud on shareholders and which do not. SOx § 806 was not adopted so that a court could parse SEC rules between those that were necessary to prevent fraud on shareholders and those which were merely “proper”\textsuperscript{56}

\footnotesize{\textsuperscript{53} Compare Livingston v. Wyeth, Inc., No. 1:03CV00919, 2006 U.S. Dist. LEXIS 52978, at (M.D. N.C. July 28, 2006), aff’d, 520 F.3d 344 (4th Cir. 2008) (noting that the Fourth and Fifth Circuits and a number of ALJs have found that “[t]o be protected under Sarbanes-Oxley, an employee’s disclosures must be related to illegal activity that, at its core, involves shareholder fraud”); with O’Mahony v. Accenture Ltd., 537 F. Supp. 2d 506, 517 (S.D.N.Y. 2008) (noting that “[§ 806] clearly protects an employee against retaliation based upon the whistleblower’s reporting of fraud under any of the enumerated statutes regardless of whether the misconduct relates to ‘shareholder’ fraud”).


\textsuperscript{55} Contra Deremer v. Gulfmark Offshore, Inc., 2006-SOX-2 (ALJ June 29, 2007) (rejecting Reyna) (“[A]lllegations of ‘shareholder fraud’ is [sic] an essential element of a cause of action under SOX. Therefore, where the conduct complained of involves potential dissemination of false information to the investing public, not all intentionally fraudulent activity may support a cause of action under SOX. Rather, the alleged conduct must be sufficiently material to rise to the level of shareholder fraud.”).

\textsuperscript{56} Consider the rule requiring an 8K to be filed when the accounting firm is changed. \textit{See} the instructions to SEC Form 8-K. What tests and standards would a court use to make a determination whether the SEC rule was necessary to prevent fraud? Why should the whistleblower be required to prove that the SEC made the correct decision when it passed a rule?}
A. What is a SEC rule or regulation?

There does not seem to be a difference between the words “rule” or “regulation” as used in the statute.\(^{57}\) The Federal Register is the official daily publication where the SEC and other federal agencies first publish proposed regulations as well as adopted final regulations. Final regulations are arranged by subject into the Code of Federal Regulations ("C.F.R."). SEC rules are found in Chapter II of Title 17 – Commodity and Securities Exchanges. Chapters are divided into parts which cover particular topics. Parts are divided into sections (which correspond to rule numbers).\(^{58}\)

Consistent with the general tendency of courts and ALJs to strictly construe whistleblowing protection laws against the whistleblower, SEC Staff Accounting Bulletins (“SAB”) have been held to not have the force of law. Therefore if a whistleblower reasonably believes her employer is violating the SEC Accounting Bulletin, her report to the company does not qualify for protection under SOx 806(5) \textit{unless the trier of fact agrees with the SAB}.\(^{59}\) It may qualify for protection under SOx (6) as fraud if the numerous other requirements such as scienter are met. The reasoning has been explained:

\(^{57}\) See 15 U.S.C. § 78w(a) which enables the rule and regulation making authority of the SEC.


\(^{59}\) See e.g. \textit{Allen v. Administrative Review Bd.}, 514 F.3d 468, 478 (5th Cir.2008). “Staff Accounting Bulletins . . . represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws; they are not rules or interpretations of the Commission, nor do they bear official Commission approval. The Commission's staff issues SABs as a means of informing the financial community of its views on certain matters relating to accounting and disclosure practices.” \textit{Citing 46 Fed.Reg.} 11513 (Staff Accounting Bulletin No. 40) (Feb. 9, 1981).
Unlike, for example, a rule promulgated by the SEC pursuant to its rulemaking authority, see 15 U.S.C. § 78w(a), SAB No. 99 [defining “materiality”] does not carry with it the force of law. See, e.g., Christensen v. Harris County, 529 U.S. 576, 120 S.Ct. 1655, 1662-63, 146 L.Ed.2d 621 (2000) (explaining that interpretations contained in opinion letters, like those in policy statements, agency manuals, and enforcement guidelines, which are not, for example, the result of a formal adjudication or notice-and-comment process, lack the force of law); General Elec. Co. v. Gilbert, 429 U.S. 125, 141, 97 S.Ct. 401, 50 L.Ed.2d 343 (1976) (stating that courts may give less weight to guidelines than to administrative regulations which Congress has declared shall have the force of law or to regulations which, under the enabling statute, may themselves supply the basis for imposition of liability) (superseded by statute on other grounds). Nonetheless, because SEC staff accounting bulletins “constitute a body of experience and informed judgment,” Skidmore v. Swift & Co., 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944), and SAB No. 99 is thoroughly reasoned and consistent with existing law—is non-exhaustive list of factors is simply an application of the well-established Basic analysis to misrepresentations of financial results - we find it persuasive guidance for evaluating the materiality of an alleged misrepresentation. See Christensen, 529 U.S. 576, 120 S.Ct. at 1663 (quoting Skidmore, 323 U.S. at 140, 65 S.Ct. 161); Gilbert, 429 U.S. at 125, 97 S.Ct. 401.

In a later case where the SEC objected to the idea that its Staff Accounting Bulletins (“SABs”) were not legally binding, a court loosened the rule by seemingly equating SABs to the requirements of generally accepted accounting principles (“GAAP”):

However, courts have found SABs to provide, for example, “persuasive guidance for evaluating the materiality of an alleged misrepresentation.” Ganino, 228 F.3d at 163-164 (discussing SAB 99). Generally, “SEC regulations provide that financial statements are presumed misleading unless prepared in compliance with GAAP principles.” Romine v. Acxiom Corp., 296 F.3d 701, 705 (8th Cir.2002) (citing 17 C.F.R. § 210.4-01(a)(1)).

Even with this holding, the risk remains that courts or administrative hearings will hold that a violation of a SAB is not a violation of a rule or regulation of the SEC. The willingness of the courts to substitute their judgment for that of the staff of the SEC is baffling. What superior expertise does a court have that it should substitute its judgment on the meaning of a SEC rule for that of the SEC staff? The law should be that the SAB interpretation will be adopted by the court unless it is clearly erroneous.

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60 Ganino v. Citizens Utilities Co., 228 F.3d 154, 163-64 (2d Cir. 2000), emphasis added.
whistleblower should not be required to prove that the SAB is a correct interpretation of a SEC rule. Even if SABs are not rules and regulations of the SEC, the environmental whistleblower should be able to claim she reasonably believed violation of the SAB was a violation of the underlying SEC rule.

**B. The Whistleblower does not need to cite the SEC rule.**

SOx § 806 requires the whistleblower “provide information”. The cases require specific allegations. Merely complaining about “financial irregularities” is not sufficient.\(^{62}\) Voicing discontent and asking for explanations is insufficient.\(^{63}\) The cases require the information to be definite and specific:

> The “definitively and specifically” language in Bozeman comes from a case regarding whistleblowing in the Energy Reorganization Act context, American Nuclear Resources, Inc. v. U.S. Dept. Of Labor, 134 F.3d 1292, 1295 (6th Cir.1998). In American Nuclear the Sixth Circuit indicated that “an employee’s act must implicate safety definitively and specifically” in order to make a protected safety report. \(\text{Id.}\) at 1295 (emphasis added).\(^{64}\)

The cases do not require the whistleblower to cite the law that is violated but it is not clear how specific the complaint must be. Many of the SEC rules cited in this paper are unknown to most whistleblowers and even to most lawyers. Requiring identification of the rule as a precondition to protection would be unfair and violate the intent of SOx. The trend is to not require a specific citation of law:

> . . . as the Fourth Circuit has recognized, “[a]n employee need not cite a code section he believes was violated” to trigger the protections of § 1514A. Welch, 536 F.3d at 276.\(^{65}\)

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\(^{63}\) Grant v Dominion East Ohio Gas 2004-SOX-63 (ALJ Mar. 10. 2005).


C. What are the SEC environmental disclosure rules?

The SEC disclosure rules should be seen as a combination of specific SEC adopted rules and the rules of the Financial Accounting Standards Board (“FASB”)\(^\text{66}\) which are incorporated into the financial statements included in company filings with the SEC. The SEC rules are found in 1) Regulation S-K,\(^\text{67}\) 2) the antifraud provisions of the Securities Exchange Act of 1933,\(^\text{68}\) and the instructions to SEC Form 20-F covering foreign private issuers filing with the SEC.\(^\text{69}\) The environmental disclosure rules have generated controversy and interpretations vary among securities law professionals.\(^\text{70}\)

D. What is a “material fact”?

Companies are required to disclose facts if they are “material” facts. Information is “material” if there is a substantial likelihood that a reasonable investor would view the


\(^{67}\) 17 CFR, Part 229 - Regulation S-K.

\(^{68}\) See 15 U.S.C. § 78j(b) codifying SEC Rule 10b-5.


information as important in making an investment decision.\textsuperscript{71}

The SEC's general reporting rules require disclosure of \textit{any additional material information} necessary to make required statements not misleading even if the disclosure is not required by a specific SEC rule. In the context of its environmental releases, the Commission has interpreted these rules as requiring disclosure of "all other environmental information of which the average prudent investor might reasonably be informed".\textsuperscript{72}

The SEC has defined materiality in SAB 99.\textsuperscript{73} Since what is material to a financial statement is also material in SEC filings\textsuperscript{74} and what is material in a SEC filing is material in a financial statement.\textsuperscript{75} SAB applies to all aspects of preparing and auditing financial statements, including accruals for environmental loss contingencies and the estimation of environmental capital expenditures and operating expenses.

There is no percentage test for materiality (\textit{e.g.}, 10\% of revenue or 5\% of net worth). A quantitatively small misstatement may be material in these circumstances like

\begin{footnotesize}
\begin{enumerate}
\item Environmental Disclosure Requirements, Securities Act Release No. 6130, n.2 (Sept. 27, 1979) (citing Securities Act Rule 405, 17 C.F.R. § 230.405 (2008) and Exchange Act Rule 12b-2, 17 C.F.R. § 240.12b-2 (2008)). See also \textit{TSC Indus., Inc. v. Northway, Inc.}, 426 U.S. 438, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.").
\item \textit{In re Occidental Petroleum Corp.}, Exchange Act Release No. 16,950 (July 2, 1980).
\item SAB 99, although not technically a "SEC rule" has been adopted by courts as "persuasive" because it "constitute[s] a body of experience and informed judgment", \textit{Skidmore v. Swift & Co.}, 323 U.S. 134, 140 (1944).
\item "This formulation [of materiality] in the accounting literature is in substance identical to the formulation used by the courts in interpreting the federal securities laws" citing FASB\textsuperscript{2} "The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item". SAB 99 - Materiality (text at footnote 4).
\item "a) Financial statements should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." 17 C.F.R. § 210.4-01.
\end{enumerate}
\end{footnotesize}
these:

- . . . the misstatement arises from an item capable of precise measurement or whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate
- . . . the misstatement masks a change in earnings or other trends
- . . . the misstatement hides a failure to meet analysts’ consensus expectations for the enterprise
- . . . the misstatement changes a loss into income or vice versa
- . . . the misstatement concerns a segment or other portion of the registrant’s business that has been identified as playing a significant role in the registrant’s operations or profitability
- . . . the misstatement affects the registrant’s compliance with regulatory requirements
- . . . the misstatement affects the registrant’s compliance with loan covenants or other contractual requirements
- . . . the misstatement has the effect of increasing management’s compensation – for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation
- . . . the misstatement involves concealment of an unlawful transaction.\(^76\)

Quantitatively small misstatements have been held material in some SOx cases. In Morefield v. Exelon Servs., Inc.,\(^77\) an ALJ denied respondent’s motion to dismiss despite the fact that the amounts involved totaled less than .0001% of the annual revenues of the parent company. The ALJ reasoned that “[w]hether or not ‘materiality’ is a required element of a criminal fraud conviction as Respondents contend, we need be mindful that Sarbanes-Oxley is largely a prophylactic, not a punitive measure.”\(^78\)

Therefore, “[t]he mere existence of alleged manipulation, if contrary to a regulatory standard, might not be criminal in nature, but it very well might reveal flaws in the internal controls that could implicate whistleblower coverage for seemingly paltry

\(^76\) SAB 99 (text at footnote 14). The Staff clarifies that immaterial deviations from GAAP which are intentional may be unlawful under Section 13(b)(2) of the Exchange Act and therefore material. The auditor has a duty to report these deviations to the audit committee.


\(^78\) Id. at 5.
In contrast, in *Deremer v. Gulfmark Offshore, Inc.* an ALJ noted that where respondent had revenues of $139 million and a loss of $4.63 million in 2004, a potential financial impact from allegedly fraudulent activity of an additional $200,000 expense was arguably immaterial. There was no mention of SAB 99 in this case.

The burden of proof of materiality has been placed on the whistleblower in SOx § 806(6) cases. In *Kaser v. A.G. Edwards and Sons, Inc.* the complainant argued that her refusal to shred documents she believed should have been retained under NASD (now FINRA) regulations comprised protected activity. The ALJ dismissed her claim because she did not prove the documents improperly designated for shredding were material to shareholders. The ALJ stated, “[n]ot all fraud is actionable under SOX. Fraud is not significant to the ‘total mix’ of information if it is not material to the company, and does not impact shareholders.” The case was argued under SOx § 806(6) and no mention was made of the fact that the FINRA rules must be approved by the SEC.

In contrast, materiality but should not be required under § 806(5) unless the rule alleged to be violated *separately requires materiality.*

Possible SEC rules and regulations that could be used by whistleblowers

What follows is a list of some of the rules and regulations environment

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79 Id.
82 As argued in this paper, the complainant could win under SOx § 806(5).
83 In *Welch v. Chao*, 536 F.3d 269, 276 (C.A.4, 2008), the court stated “nothing in § 1514A (nor in Livingston) indicates that § 1514A contains an independent materiality requirement”, *citing Livingston v. Wyeth, Inc.*, 520 F.3d 344, 351 (4th Cir.2008). Livingston (at 356) points out that a omitted fact must be “material” to violate securities laws and concludes, “Thus, Livingston has failed to produce evidence that he provided information or made a complaint to Wyeth about conduct which a reasonable employee in his position could have believed at the time constituted a violation of the securities laws”. Presumably the outcome would have been different if Livingston had identified SEC rules that had been violated.
whistleblowers could allege they reasonable believed were violated under § 806(5).

VI. Possible SEC rules that could be cited by an environmental whistleblower

There are many SEC rules that are potentially impacted when an environmental whistleblower reports a violation. A few are cited in the following paragraphs.

A. Climate change disclosure

Regulation S-K and accounting guidance require companies to disclose a variety of climate change matters, including:

- **S-K Item 101 – Business**: Material capital or operating costs incurred to comply with climate change regulations, such as purchasing emissions allowances, paying carbon taxes or installing new technology to reduce greenhouse gas (“GHG”) emissions.\(^{84}\)
- **S-K Item 103 – Legal Proceedings**: Legal proceedings to which a company or its properties are involved related to or involving climate change which are (i) material, (ii) involve amounts greater than 10% of current consolidated assets or (iii) involve monetary sanctions of $100,000 or more (i.e. lawsuits against the company by public interest groups).\(^{85}\)
- **S-K Item 303 – MD&A**: Known trends, demands, commitments, events, or uncertainties related to climate change, unless the company can conclude that the trends, demands, commitments, events or uncertainties (i) are not “reasonably likely” to occur or (ii) if they occur are not “reasonably likely” to have a material effect on the company’s liquidity, capital resources or results of operations. Climate change is arguably a known “uncertainty”. Proposed climate change regulation may also be a known “uncertainty” that must be disclosed.\(^{86}\)
- **S-K Item 503(c) – Risk Factors**: Significant risks including regulatory and litigation risks as well as reduced demand for certain products of the company due to public protest because of their perceived climate impact (“non-green” products).\(^ {87}\)
- **FAS 5 – Financial Statements**: Material loss contingencies that are more than remote, such as physical impacts on the company from the changing environment (e.g., rising sea levels or potential water shortages).\(^ {88}\)

While the existing SEC disclosure rules do not per se require companies to collect additional information to assess their climate change risks, companies clearly need to be collecting whatever information or doing whatever research is required to

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\(^{84}\) 17 C.F.R. § 229.101.
\(^{85}\) 17 C.F.R. § 229.103.
\(^{86}\) 17 C.F.R. § 229.303.
\(^{87}\) 17 C.F.R. § 229.503(c).
\(^{88}\) Financial Accounting Standards No. 5 (1975) FASB. See section below on financial statements.
comply with the actual climate change laws to which they are subject. For example, certain companies or industries are currently required to measure their greenhouse gas ("GHG") emissions while others are not. For those companies that are not currently subject to these laws, these companies should, at a minimum, stay abreast of applicable or relevant laws and litigation (even if they are not a party) and carefully track any facts required to determine whether climate change risks are material to them.

On January 27, 2010, after several months of consideration, the SEC approved, in a 3-2 vote, an interpretive release entitled “Commission Guidance Regarding Disclosure Related to Climate Change” (“Climate Change Release”). Chairman Mary Schapiro noted that the Climate Change Release does not create new legal requirements or modify existing ones. She explained the Climate Change Release does not redefine longstanding interpretations of what is “material”, i.e., whether there is a substantial likelihood that a reasonable investor would consider that information important in deciding how to invest. She stated that the Release is intended to provide clarity and enhance consistency in climate change disclosure.

The Release cautions companies that information they report to others may also need to be disclosed in their SEC filings. As SEC Commissioner Louis Aguilar emphasized in his comments to the Release, companies should ensure that they have sufficient information regarding their GHG emissions to understand whether related regulation could have a material effect.

89 17 CFR Parts 211, 231 and 241 (Release Nos. 33-9106; 34-61469; FR-82).
90 The Release identifies disclosures outside of SEC filings, in most cases voluntarily, regarding GHG emissions and how climate change impacts their businesses including The Climate Registry, The Carbon Disclosure Project, and the Global Reporting Initiative. Non-SEC mandatory climate change reporting includes the National Association of Insurance Commissioners’ Model Climate Change Risk Disclosure Rule which, as adopted by some states like California, will require insurance companies that collect $500 million or more in insurance premiums annually to complete and submit a publicly available climate risk survey each year starting after May 2010.
Potentially negative and positive consequences of pending climate change legislation and regulation may be material:

Costs to purchase, or profits from sales of, allowances or credits under a “cap and trade” system; Costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a “cap and trade” regime; and Changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.91

The Climate Change Release offers examples of consequences like damage to a company’s reputation due to the public’s perception of publicly disclosed information relating to its GHG emissions and decreased demand for carbon intensive goods.92 International accords should also be evaluated for material impact on the company.93

Indirect and direct consequences of regulation or business trends should be evaluated for disclosure including:

Decreased demand for goods that produce significant greenhouse gas emissions; Increased demand for goods that result in lower emissions than competing products; Increased competition to develop innovative new products; Increased demand for generation and transmission of energy from alternative energy sources; and Decreased demand for services related to carbon based energy sources, such as drilling services or equipment maintenance services.94

The Climate Change Release also states companies should consider the actual and potential physical impacts of climate change on their operations and financial results for disclosure. This includes possible consequences of severe weather resulting from climate change such as:

For registrants with operations concentrated on coastlines, property damage or business disruption for companies with coastal operations; Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods; Increased claims and

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91 Climate Change Release at 24.
92 Id. at 26.
93 Id.
94 Id. at 25.
liabilities for insurance and reinsurance companies; Decreased agricultural production capacity in areas affected by drought or other weather-related changes; and Increased insurance premiums and deductibles, or a decrease in the availability of coverage, for registrants with plants or operations in areas subject to severe weather.\(^95\)

B. Environmental protection disclosure

Item 101 of Regulation S-K - Description of business requires:

(xii) Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries.\(^96\)

C. Financial statements disclosure

Since 1975 there have been numerous standards and guidance for disclosure promulgated by the accounting regulators (the SEC, FASB\(^97\) and AICPA\(^98\)) defining what constitutes GAAP for environmental issues. Environmental risks can be “loss contingencies” that must be disclosed on financial statements in certain circumstances. The ongoing “mark to market” trend\(^99\) could eventually require disclosure of all (not just material) environmental loss contingencies\(^100\) because minor ones will be revealed as reductions in asset value. The process is ongoing and the final outcome is uncertain due to industry objections to recent proposals.

\(^{95}\) Id. at 27.
\(^{96}\) 17 C.F.R. § 229.101(c)(1)(xii).
\(^{97}\) “FASB” is the acronym for The Financial Accounting Standards Board of the Financial Accounting Foundation (see FASB.org).
\(^{98}\) The American Institute of CPAs (“AICPA”) is the national professional association of CPAs in the United States.
\(^{100}\) E.g., The FASB Exposure Draft of “Contingencies (Topic 450); Disclosure of Certain Loss Contingencies” issued July 20, 2010 proposed adoption of Subtopic 410-30 which would have required detailed disclosure of environmental loss contingencies, including disclosure of all remote loss contingencies that may have a potentially severe impact, regardless of when they are expected to be resolved. After receipt of numerous negative comment letters, The FASB voted to remove the project from its technical agenda on July 9, 2012.
One ongoing area of difficulty is the desire of companies to reduce any loss contingency from environmental risks by offsetting the liability with estimates of third party contributions and insurance policy coverages. This is difficult under FASB Interpretation No. 39 which does not allow offsetting except where a “right of setoff exists” which is enforceable at law.\textsuperscript{101}

**D. Foreign private issuers disclosure**

“Foreign private issuers”\textsuperscript{102} are companies whose equity securities and assets are beneficially owned primarily by non-U.S. persons or which are located outside of the United States. Foreign private issuers report on Form 20-F and, in some filings with the SEC, are permitted to incorporate by reference the disclosure contained in their 20-F filings.

Item 4.D of Form 20-F requires the foreign private issuer to provide “information regarding any material tangible fixed assets, including leased properties”, with a description of “any environmental issues that may affect the company's utilization of the assets”. There is no limitation to “material” issues so apparently all environmental issues which relate to any material asset must be disclosed regardless whether the issues are material or immaterial. Other Items in Form 20-F have disclosure requirements similar to Regulation S-K.\textsuperscript{103} Financial statements must contain information content substantially similar to financial statements that comply with U.S. GAAP and Regulation S-X.\textsuperscript{104}


\textsuperscript{102} “Foreign private issuer” is defined in Rule 3b-4 of the Exchange Act (17 C.F.R. § 240.3b-4).

\textsuperscript{103} See the sections of this paper that discuss various Regulation S-K disclosures.

\textsuperscript{104} Item 17, Form 20-F. S-X is 17 C.F.R, Part 210 and is available at http://ecfr.gpoaccess.gov/cgi/t/text-textidx?c=ecfr&sid=c7cbe9b63d85903d1fcfc7fc748ffb17&tpl=/ecfrbrowse/Title17/17cfr210_main_02.tpl. See the section of this paper on Financial Statements for more details.
E. Legal proceedings disclosure

Item 103 of Regulation S-K requires a public company to disclose material legal actions that have actually been brought or that are known by the company to be contemplated by governmental authorities or private parties for violations of environmental law or the existence of conditions that could give rise to liability. It does not require disclosure of potential actions which could be brought which are not known to be contemplated against the company.

Item 103 and the instructions set out three tests for determining materiality: 1) the proceeding is material to the business or financial condition of the company; 2) the amount involved exceeds ten percent of current consolidated assets of the company; or 3) any governmental entity (foreign or domestic) is a party or expected to be a party and monetary sanctions will be $100,000 or more. The judgment whether the $100,000 threshold will be reached must be subjectively and objectively reasonable. Separate proceedings do not need to be aggregated to calculate $100,000.

A “legal proceeding” includes “all administrative orders relating to environmental matters, whether or not those orders literally follow a ‘proceeding’.” In Wielgos, the courts assumed the application for a license to operate a nuclear power plant was a legal proceeding.

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105 17 C.F.R. § 229.103.
106 Determining what is “material” is fact specific. For example, disclosure of the identity of the specific division of the Nuclear Regulatory Commission that was considering an operator’s license for a nuclear power plant application was not required by Item 103. Wielgos v. Commonwealth Edison Company, 892 F.2d 509 (7th Cir. 1989).
107 The company must aggregate all proceedings arising out of the same facts to make the 10% calculation. 17 C.F.R. § 229.103 Instruction 5(B) (2008).
“proceeding”.111

F. MD&A Disclosure

Item 303 of Regulation S-K112, management’s discussion and analysis of financial condition and results of operations, has at least three disclosure categories that could be helpful to environmental whistleblowers.113

1) Trends or uncertainties. § 229.303 (3) Results of Operations (ii) provides:

Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.

In its MD&A Release, the SEC states that if management cannot determine if an event is reasonably likely to occur, disclosure is required if the event would be material to the company’s financial condition or results of operations. “Materiality” is a lower standard for MD&A disclosure than for securities fraud. The SEC defines “reasonably likely” as lower than “more likely than not”.114

Item 303 requires a company to evaluate the maximum Superfund liability it might incur under joint and several liability offset115 by its known ability to obtain contribution or indemnification from other potentially responsible persons (“PRPs”) and its undisputed insurance coverage.116 Disclosure is required even if there has not been accounting

111 Supra, 892 F.2d 509.
112 17 C.F.R. § 229.303.
115 SAB 92, note 11. See section of paper on financial statements.
recognition of the loss contingency.\textsuperscript{117}

2) Off-balance sheet arrangements. § 229.303(4) (i) requires the company disclosure to:

\ldots discuss the registrant's off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Off-balance sheet arrangements include guarantees, certain indemnification agreements, retained or contingent interest in assets, and actual or contingent obligations from an entity which provides financing, liquidity, market, or credit risk support to the company, or engages in leasing services with the company.\textsuperscript{118}

3) Risk Factors. § 229.503(c) requires disclosure of material risk factors.

Although environmental risks are not mentioned in the item, they must be disclosed if they could have a material effect on company financial results or operations.

G. Mine safety

Mine safety disclosures (Item 104 of Regulation S-K)\textsuperscript{119} requires the following disclosures:

i) The total number of violations of mandatory health or safety standards that could significantly and substantially contribute to the cause and effect of a coal or other mine safety or health hazard under section 104 of the Federal Mine Safety and Health Act of 1977 i) . . . .

(iv) The total number of flagrant violations under section 110(b)(2) of such Act (30 U.S.C. 820(b)(2)).

\textsuperscript{118} Item 303(a)(4)(ii). There are additional details in this part of the rule that are not relevant to this paper but could arise in a whistleblower case and could be helpful in some cases.
\textsuperscript{119} 17 C.F.R. § 229.104.
(vii) The total number of mining-related fatalities.\textsuperscript{120}
(2) A list of coal or other mines, of which the registrant or a subsidiary of the registrant is an operator, that receive written notice from the Mine Safety and Health Administration of:
   (i) A pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal or other mine health or safety hazards under section 104(e) of such Act (30 U.S.C. 814(e)); or
   (ii) The potential to have such a pattern.

Environmental mine safety whistleblowers could be protected under SOx § 806(5) for reasonably believing there is a significant violation of the Federal Mine Safety Act or there is the potential for a pattern of significant violations of mandatory health or safety standards to arise.

H. Violation of GAAP

If a company is not complying fully with GAAP, it is violating a SEC rule:

(1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided.\textsuperscript{121}

I. Internal audit controls

The Securities Exchange Act of 1934 requires that reporting companies maintain a system of accurate internal accounting controls.\textsuperscript{122} If there is an environmental violation, there may also a failure of internal controls.

J. Circumvention of controls or false record

A possible environmental violation could be illegal dumping. It is likely that a public company would have written internal controls to prevent the dumping. If illegal

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\textsuperscript{120} The instructions state: "Instruction to Item 104(a)(1)(vii): Registrants must report all fatalities occurring at a coal or other mine during the period covered by the report unless the fatality has been determined by MSHA to be unrelated to mining activity."

\textsuperscript{121} 17 C.F.R. § 210.4-01.

\textsuperscript{122} 15 U.S.C. §78m(b)(2)(B).

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dumping occurs, it is likely the internal controls were circumvented. The SEC has a rule which reads, “No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2)”.

Paragraph (2) describes all annual and quarterly reports prescribed by the SEC.

K. Failed control environment

The company is required to have documentation that reasonably support its assessments of its control environment (including human resource policies) and confirm its test of internal controls were appropriately designed, planned, and performed, and results of tests were appropriately considered. In environmental cases, the whistleblower should consider whether controls could have been designed to prevent the violation. It is possible the relevant internal controls were not appropriately designed, planned, performed, and tested.

L. Missing management documentation of controls

Management documentation is required by the PCAOB Auditing Standard No. 2: An Audit of Internal Control Over Financial Reporting Performed in Conjunction With

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126 The Public Company Accounting Oversight Board ("PCAOB") is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection. Its constitutionality was mostly upheld in Free Enterprise Fund v. Public Company Accounting Oversight Board, 130 S.Ct. 3138 (2010).
an Audit of Financial Statements.\textsuperscript{127} The standard details management’s duties in respect to documentation of controls and states inadequate documentation is a deficiency.

M. Negligently misleading external auditors

SOX § 303 prohibits officers and directors of an issuer, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate, mislead, or fraudulently influence the auditor of the issuer's financial statements if that person knew or should have known that such action, if successful, could result in rendering the financial statements materially misleading. The SEC rule implementing SOX § 303 makes even negligent misleading of external auditors a violation.\textsuperscript{128} For example, if the external auditors do not know of a potential environmental loss contingency through a negligent failure to report, a SEC rule has been violated. Disagreeing with commentators who claimed this was a new concept, the Release states, “To the contrary, for many years we have initiated enforcement actions against those who, by negligently providing misleading confirmations to auditors, cause an issuer to violate the financial reporting or books and records provisions of the Securities Exchange Act of 1934”.\textsuperscript{129} The release justifies the lack of a scienter requirement by explaining:

\ldots a primary purpose for enactment of the Sarbanes-Oxley Act is the restoration of investor confidence in the integrity of financial reports. Such a purpose would not be served by imposing what would amount to a new scienter requirement on the pre-existing provision prohibiting officers and directors from causing misleading


\textsuperscript{129} Id. at 4.
statements or omissions to be made to auditors.\textsuperscript{130}

The SEC noted in footnote 41:

\begin{quote}
It is the act of coercing, manipulating, misleading, or fraudulently influencing the auditor, for the purpose of rendering misleading financial statements, that is unlawful. There is no requirement in section 303(a) of the Act that the purpose be achieved.
\end{quote}

The release justified the low standard of liability because there is no private right of action under SOX § 303. It explained in footnote 95:

\begin{quote}
We believe that the mental state requirements of the rules generally should be construed consistently with the existing rules in Regulation 13B-2. Because there is no private right of action, among other reasons, the Commission believes that a lesser standard of liability is appropriate. See Release No. 34-15570 (February 15, 1979); 44 Federal Register 10970. See also, Report of the Committee on Banking, Housing, and Urban Affairs, To Accompany S. 2673, “Public Company Accounting Reform and Investor Protection Act of 2002,” 107\textsuperscript{th} Cong., 2d Sess., (S.R. 107-205), at 26 (Comm. Print, July 3, 2002), which cites as a reason for enacting section 303 the testimony of witnesses who were concerned with addressing fraud and other “misconduct in the audit process.”
\end{quote}

\textbf{VII. Conclusion}

Sox SOx § 806 and the Dodd-Frank whistleblower protection provisions protect an environmental whistleblower in certain circumstances who provide information regarding violation of SEC rules. Although protection of whistleblowers under SOx § 806 has resulted in \textit{de minimis} protection, most cases were argued under SOx § 806(6) (fraud on shareholders). The courts have grafted into SOx § 806(6) some of the provisions of federal securities fraud holdings like scienter. Federal securities law is trending toward protecting employers over investors\textsuperscript{131} and the trend is likely to continue. If whistleblowers continue to concentrate their claims on SOx § 806(6), the results will probably not improve.

On the other hand, if whistleblowers would focus on claims under SOx § 806(6),

\textsuperscript{130} Id. at 5.
\textsuperscript{131} For example, the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67 increased pleading standards and added other restrictions due to Congress’ displeasure with securities class actions.
violation of any rule or regulation of the Securities and Exchange Commission, there is likely to be increased protection due the breadth and depth of the rules. The SEC has rules that cover almost any situation that could give rise to corporate fraud. It has numerous rules that cover environmental risks and disclosures.

An environmental whistleblower who has an objectively reasonable belief of a violation of a SEC rule by his employer and who remembers the importance of being earnest\textsuperscript{132} (a subjectively reasonable belief) should be able to cite a SEC rule violation and prevail.

\textsuperscript{132} The Importance of Being Earnest, A Trivial Comedy for Serious People by Oscar Wilde was first performed on February 14, 1895 at St. James’ Theater in London.