

THE SARBANES-OXLEY ACT OF 2002 –
ANOTHER OPPORTUNITY FOR ORGANIZATIONAL OMBUDS

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In the fall 2000 issue of Ombudsman News, I made several suggestions about how to document the creation and operations of an organizational ombuds office so that the ombuds' ability to assert a confidentiality privilege would be strengthened. The recent passage of the Sarbanes-Oxley Act of 2002 presents yet another opportunity to document the organizational ombuds' role and enhance the argument for confidentiality.

To understand why the Sarbanes-Oxley Act is helpful, however, we need to briefly review the grounds on which ombuds claim confidentiality. With the exception of some classical or governmental ombuds, there is no legislation that expressly creates a confidentiality privilege for organizational ombuds programs. Accordingly, recognition of a confidentiality privilege for these offices has often relied on two different arguments.

The first is that of implied contract. Organizational ombuds offices miss a valuable opportunity if they do not articulate in their brochures and other literature that they were created with the understanding or on the condition that communications with the ombuds are confidential. This contract argument can be very helpful in disputes over confidentiality outside of the United

States or in jurisdictions in which courts are not permitted to recognize privileges other than those that have been created legislatively.

The second basis for asserting a confidentiality privilege, and the one most relevant to the Sarbanes-Oxley Act, is Federal Rule of Evidence 501, which allows federal courts in the United States to recognize privileges as developed on a case-by-case basis under common law. Most federal courts use the Wigmore test to determine whether a privilege is appropriate. Under this test, a privilege is recognized if it meets the following four criteria:

1. the communication must be made in the belief that it will not be disclosed;
2. confidentiality must be essential to the maintenance of the relationship between the parties;
3. the relationship is one that society considers worthy of being fostered; and
4. the injury to the relationship incurred by the disclosure must be greater than the benefit gained in the correct disposal of the litigation.

Thus, in asserting a confidentiality privilege, lawyers representing organizational ombuds present *evidence* to demonstrate that these criteria have been met. (Remember the lesson of *Carman v. McDonnell Douglas*, 114 F.3d 790 (8th Cir. 1997), that a party invoking a privilege must present evidence to demonstrate entitlement to it.) It is particularly important to have evidence on the third criterion of the Wigmore test (“the relationship is one society considers worthy of being fostered”). Accordingly, I have urged organizational ombuds programs to document their benefit to the organization as an alternate means of resolving disputes and as an adjunct to the organization’s efforts to comply with the United States Sentencing Guidelines by permitting employees to raise concerns without fear of retribution. This issue is addressed at

length in a booklet that Tom Furtado and I wrote for TOA: “The United States Sentencing Guidelines, What an Organizational Ombuds Might Want to Know and Share with Management”. The adoption last year by the American Bar Association of the resolution on standards for ombuds likewise strengthens the argument that ombuds programs serve a purpose that society believes is important.

The Sarbanes-Oxley Act was the legislative response to corporate corruption scandals of the past year. Among its many features, it creates a Public Accounting Oversight Board and requires enhanced financial disclosures by both large companies and senior management. One of its provisions, however, presents an opportunity for organizational ombuds programs at publicly held companies both to solidify their reporting relationship and to bolster the claim that the ombuds office serves an important public purpose.¹

In particular, Section 301 of the Act amends Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78(f)) by adding a new subsection “m” to impose additional responsibilities on the audit committees of the board of directors of publicly held companies. Subsection m(4)(b) requires each such audit committee to establish procedures for: “*the confidential, anonymous*

¹ While outside the scope of this article, another opportunity to bolster the role of the organizational ombuds and the ombuds’ claim to a confidential privilege is also presented by the Report issued on June 6, 2002 by the New York Stock Exchange Corporate Accountability and Listing Standards Committee. The Report recommended that the NYSE Board of Directors “[r]equire listed companies to adopt and disclose a code of business conduct and ethics for directors, officers, and employees” The Report also recommends that NYSE listed companies adopt policies that encourage “the reporting of any illegal and unethical behavior.” In particular, the Report states: “The company should proactively promote ethical behavior. The company should encourage employees to talk to supervisors, managers, or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations, or code of business conduct to appropriate personnel. To encourage employees to report such violations, the company must ensure that employees know the company will not allow retaliation for reports made in good faith.” The recommendations in this article may also be applied to the recommendations in the NYSE Report or subsequent regulations promulgated by the NYSE for companies listed on that stock exchange.

*submissions by employees of the [company] of concerns regarding questionable accounting or auditing matters.*²

At first blush, this provision may seem inconsistent with the independence and neutrality of the organizational ombuds office -- it is not part of management and should not be regarded as a reporting channel that creates an obligation on them to report to management, except in the narrow exceptions recognized under the TOA Code of Ethics. Yet, both the need for employee reporting and employee fear of reporting is real. The 2000 National Business Ethics Survey (Vol. I) by the Ethics Resource Center reveals that employees still perceive misconduct in the work place at alarming levels and are afraid to report it:

- 31% of employees reported observing workplace misconduct within the previous year (p. 12)
- 37% of employees at organizations with fewer than 500 employees observed workplace misconduct within the previous year (p. 13)
- While lower than reported in a previous survey, 13% of employees at for-profit companies still reported a perception of pressure to compromise on their company's ethics standards
- For the employees who felt pressured, the sources of pressure were identified as co-workers (28%), supervisors (39%), and top management (36%) (p. 19)
- While also lower than in a previous survey, 43% of employees at for-profit

² Other provisions of the Sarbanes-Oxley Act may also be relevant and helpful. Section 806 prohibits adverse employment actions or discrimination against employees of publicly traded companies who assist in investigations or provide information relating to fraud against shareholders. Section 1107 makes it a federal criminal offense to retaliate against or interfere with the employment of a person who provides truthful information relating to possible federal crimes.

companies did NOT report their observation of misconduct to management or another appropriate person (p. 22)

- 31% of employees either strongly agree (7%) or agree (24%) that if they report ethics concerns, they will be seen as “troublemakers” by management (p. 24)
- Even among senior and middle managers, 19% fear being labeled as a troublemaker if they report ethics concerns (p. 24)

These statistics are consistent with the observation of Mary Rowe, Ombudsperson of MIT, that the more formidable the formal efforts are by an organization to achieve compliance with the law (and hence punishment for wrongdoers), the greater the barriers to reporting wrongdoing. These barriers include not only fear of punishment or organizational retribution, but loss of friendships, reputation, and other relationships.³

On the other hand, simply relying on a compliance officer or existing management as the only reporting channels is inadequate. The survey statistics demonstrate that more is needed. Presumably all of the employees in the 2000 National Business Ethics Survey could have reported misconduct to compliance officers or management, but many employees did not and many were afraid to do so. Moreover, designating a compliance officer as a “confidential” reporting channel is inconsistent with his or her role in management and the legal obligations to investigate

³ M. Rowe and C. Bendersky, “Workplace Justice, Zero Tolerance and Zero Barriers,” unpublished monograph, 2002, pp. 13-20.

complaints and to take appropriate corrective action. While a “hot line” may allow anonymous comments to be made, such an approach is too passive to be truly effective. It does not allow the interactive discussion or coaching on options or approaches that organizational ombuds, who presumably are intimately knowledgeable about the formal and informal systems of their organizations, can provide to employees who want to report wrongdoing but who need more information or reassurance in order to do so. Thus, given the other obligations of compliance officers and the limitations inherent in hot line numbers, some other approach is preferable.

One solution is for the ombuds office to be designated by the board or audit committee of the board as *part* of its efforts to comply with the Sarbanes-Oxley Act. While recognizing that the ombuds office can never be *the* official reporting channel for employees with concerns about questionable accounting or auditing matters, issues can be brought to the ombuds anonymously or on a confidential basis. Even though the organizational ombuds would not be required to break confidence or report such matters to the audit committee, these ombuds, working with an employee, almost always find a way to surface an issue even if the identity of the particular employee raising the issue is not revealed. An organizational ombuds program can be created with a promise of confidentiality and anonymity, whereas a compliance office cannot promise confidentiality or anonymity without compromising its essential legal obligations. Thus, from the perspective of the audit committee and the board, an organizational ombuds can serve a valuable role in assisting the company to comply with the Sarbanes-Oxley Act without compromising either the integrity, confidentiality, or neutrality of the ombuds office or the proper functioning and legal obligations of the compliance office. In addition, even where no confidential communications are

revealed, an ombuds can give the audit committee information on trends among the issues raised, which can also be of valuable assistance to the audit committee and the company.

The benefits to the organizational ombuds program of being identified as part of the company's efforts to comply with these new requirements are no less significant. By being designated by the audit committee as a means for employees to discuss concerns confidentially or anonymously and by being given reporting access to the audit committee, ombuds increase the options available to them and strengthen their role in the organization. Moreover, any reference to the ombuds program as part of the company's efforts to comply with the Sarbanes-Oxley Act becomes extremely powerful evidence that can be used by the organizational ombuds program to assert a confidentiality privilege. Even if an organizational ombuds office is not in a publicly held corporation to which the Sarbanes-Oxley Act applies directly, the organization and the ombuds office can choose to adopt policies that are consistent with the higher standards articulated in this legislation. Not only is the Sarbanes-Oxley Act the embodiment of significant national policy to deal with concerns over corporate corruption (and therefore evidence relevant to the third prong of the Wigmore test), it expressly requires that there be a means for *confidential* and *anonymous* communications. What better platform could there be for asserting a need for a confidentiality privilege?