Sarbanes-Oxley and Whistleblowers: What Happens When Employees Bring Retaliation Claims?

Patricia A. Kinaga

Companies facing whistleblower lawsuits under Sarbanes-Oxley are recognizing the high stakes involved with these complaints: employers found guilty of retaliation against whistleblowers may be required to pay damages, reinstate terminated employees to their former positions, and pay for the complainant’s legal fees. Criminal sanctions may also be levied. This article focuses on the nuts and bolts of what happens when employees file whistleblower retaliation actions under Section 806 of the Sarbanes-Oxley Act, and includes an overview of some important whistleblower decisions.

Under the Sarbanes-Oxley Act (SOX), no company or company representative may retaliate against an employee who has provided information, caused information to be provided, or otherwise assisted in an investigation of certain types of alleged fraudulent conduct. The ramifications, of which most employers are now aware, may include civil penalties under Section 806, as well as criminal penalties of up to ten years in prison under Section 1107.1

It has been over three years since SOX was passed. While criminal filings by the US Attorney’s Offices largely remain uncharted territory, over 450 complaints have been filed under Section 806. The administrative law and federal court decisions covering this first three year’s of experience with SOX and accompanying regulations2 provide guidance for employers facing this new breed of discrimination claims.

COVERED RESPONDENTS

Section 806 applies only to publicly traded companies.3 Employees of non-publicly traded subsidiaries of publicly traded companies may also be protected, provided that the complainant names the parent company.4

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SOX does not specifically state whether it applies to US citizens overseas who work for a publicly traded foreign company, or for a privately held foreign subsidiaries of a publicly traded US company. 5

At least one court has held that SOX does not preempt a mandatory arbitration provision. 6

Individuals may be liable. SOX bars retaliatory conduct by not only companies, but also any officer, employee, contractor, subcontractor, or agent of such company. 7

PROTECTED ACTIVITY

Employees are protected under SOX as long as they held a reasonable belief that particular types of unlawful activity was occurring, regardless of whether such activity was actually occurring. Such employees are protected if they reported suspected violations to a supervisor or employee with authority to discover, investigate, or halt the alleged misconduct, 8 of any federal regulatory agency, law enforcement agency, or any member of Congress. 9

Section 806 requires that the offense reported involve company activities that violate specific federal laws related to mail, 10 wire, 11 bank, 12 and securities 13 fraud, any rule or regulation of the SEC, or any federal law related to fraud against shareholders.

RETAILIATORY CONDUCT BY RESPONDENT

The scope of employer actions considered retaliatory under SOX is quite broad. Employers may not “discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment.” 14 The broad definition has been held to cover negative performance evaluation coupled with diminished job responsibilities. 15

REMEDIES

Employees who prevail in SOX whistleblower lawsuits are entitled to restitution, including compensatory damages, and “all relief necessary to make the employee whole.” 16 This can include reinstatement at the employee’s former position, 17 attorney’s fees, and back pay (with interest). 18 An administrative law judge (ALJ) who finds a complaint frivolous or brought in bad faith may award reasonable attorney’s fees up to $1,000.

Illustrative of the ALJ’s remedial arsenal is Welch v. Cardinal Bankshares Corp. 19 Welch was fired as Cardinal’s chief financial officer not long after complaining to the CEO about the bank’s accounting practices. An ALJ, finding that Cardinal had in fact violated SOX’s whistleblower provisions by retaliating against Welch, ordered Cardinal to pay
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Welch over $65,000 in back pay and special damages (plus prejudgment interest), and more than $108,000 in attorney’s fees. The judge also ordered Cardinal to reinstate Welch to his position as chief financial officer, with the same seniority, status, and benefits he would have had but for the bank’s unlawful retaliation. Welch’s reinstatement was ordered despite the bank’s arguments that its relationship with Welch was one of “enmity and distrust,” not to mention that reinstatement would necessitate removal of Welch’s replacement.

“Reinstatement is a drastic remedy and will frequently pose difficulties,” wrote the judge, “but reinstatement as a remedy is generally appropriate to further the stated remedial goal of Sarbanes-Oxley, i.e., to make complainants whole. Indeed, despite the inherent problems posed by reinstatement, it is the default or presumptive remedy in wrongful termination cases.”

INITIAL STAGES: FILING AND INVESTIGATION

Authority to investigate SOX whistleblowing complaints has been delegated by the Department of Labor to the Occupational Safety and Health Administration (OSHA). According to recent reports, between July 2002 and April 2005, 485 whistleblower complaints were filed with OSHA, and investigations had been completed in 386 of those cases. Employers generally fared well: 282 cases were dismissed, and 58 were withdrawn. Of the cases dismissed, many were dismissed at the administrative level on legal grounds, including failure to timely file a complaint.

1. Preliminary Disposition by the Department of Labor/OSHA

Initial Review

An employee must file a complaint with the Department of Labor within 90 days of the alleged retaliatory act. OSHA will then notify the employer of the complaint. It is critical to note that the employer has only 20 days from the receipt of such notice to file a response with OSHA. An OSHA investigator then reviews the complaint, and determines whether the employee has made a prima facie case. This requires the employee to allege the existence of evidence showing he or she engaged in activity protected under SOX; the employer knew or suspected the employee had engaged in that activity; the employee was subjected to an unfavorable personnel action; and circumstances that raise an inference the protected activity was a contributing factor in the unfavorable action.

Even if the employee has made a prima facie case, OSHA will not conduct an investigation if the employer shows by clear and convincing evidence that it would have taken the same unfavorable personnel action in the absence of the protected behavior or conduct.
Investigation

If OSHA proceeds with an investigation, it will do so protecting the confidentiality of witnesses other than the complainant. Prior to the issuance of findings and a preliminary order, if the investigator concludes there is reasonable cause to believe a violation has occurred and that preliminary reinstatement of the complainant is warranted, OSHA will again contact the respondent and disclose the evidence supporting the complainant’s allegations including witness statements redacted with identifiers where statements were given in confidence. Within ten business days after so being contacted by the investigator, the respondent may submit another written response, meet with investigator to present witness statements, and present legal and factual arguments.27

Issuance of Findings and Preliminary Orders

The Assistant Secretary of Labor will then issue a written finding within 60 days of the initial filing of the complaint.28 The written finding will be accompanied by a preliminary order providing relief to the complainant, which may include reinstatement (unless there is a finding that complainant is a security risk), back pay with interest, litigation costs, expert witness fees, and reasonable attorney’s fees.29

2. Appeal of the Preliminary Order

After OSHA has issued its preliminary order, either party may file an objection and request a hearing before an ALJ.30 Objections must be filed within 30 days after receipt of the preliminary order.31 If no objections are filed, then the order becomes final, and is not subject to judicial review.32

If an objection is filed within the 30-day period, then the preliminary order from OSHA will be stayed (with the exception of any part requiring reinstatement of the employee to their former position),33 and a hearing scheduled. There is no discretion to choose whether to grant or deny these hearing requests—if a hearing is requested, it will be scheduled. In order to stay a reinstatement provision, the employer must file a separate motion to stay the reinstatement with the Office of Administrative Law Judges.34

3. Hearing Before the ALJ

Procedure

Hearings are conducted in accordance with the procedure set forth in 29 C.F.R., subpart A, part 18. The ALJ hears the case de novo.35 Both parties may make pre-hearing discovery requests, including the taking
of depositions. The ALJ, however, has broad discretion to grant or deny these requests. Extensive discovery may be limited in order to expedite the process. The formal rules of evidence do not apply. Both the Assistant Secretary of Labor and the SEC may participate as amicus curiae at any stage of the proceedings.

**Standard and Remedies**

A violation will only be found if the complainant has demonstrated that the protected conduct was a contributing factor in the unfavorable personnel action; additionally, relief will be not be granted if the employer demonstrates by clear and convincing evidence that it would have taken the same personnel action even in the absence of the protected conduct.

An ALJ who finds a violation may provide the same types of relief available to the Assistant Secretary (reinstatement, back pay with interest, special damages); the statute and regulations are silent as to whether reinstatement may be precluded if there is a showing the complainant is a security risk. A judge who determines the complaint was frivolous or brought in bad faith may award reasonable attorney’s fees no exceeding $1,000.

4. **Appealing the Decision of the ALJ**

Once the ALJ has issued a decision, the parties have ten business days to file a petition for review with the Department of Labor’s Administrative Review Board (Board). The Board has the discretion to accept or deny petitions for review, and the ALJ’s decision becomes final if the Board does not accept the case within 30 days. If the Board accepts the petition, it reviews the factual determinations of the administrative law judge using the substantial evidence standard. The Board is required to issue a decision within 120 days after the conclusion of the hearing before the ALJ. If the Board concludes there has been a violation, the final order will include the same remedies available to be ordered by the ALJ. If the Board has not issued a final decision within 180 days of the filing of the complaint, and there has been no delay due to the bad faith of the complainant, the complainant may file an action at law or equity for de novo review in federal district court, regardless of the amount in controversy. The statute and regulations are silent as to whether the complainant would be entitled to a jury trial at the district court level.

5. **Appealing the Decision of the Board**

The Board’s decision can be appealed by either party to a Court of Appeals located either in the jurisdiction where the alleged violation occurred, or where the complainant resided at the time of that violation.
Any such appeal must be filed within 60 days of the issuance of the Board’s final order.52

6. Settlement Procedures

There are two types of settlements available under Section 806: investigatory and adjudicatory.

Investigative settlements can only be entered after the filing of a complaint, but before the parties have made any objections to official findings or orders (or before issued findings become final and thus can no longer be objected to by law).53 The complainant, employer, and Assistant Secretary of the Department of Labor must agree to the terms of any investigative settlement.54 **Note:** since the statute and regulations do not address pre-charge settlements, employers may consider holding settlement proceeds until after the 90 SOX charge filing period has expired.

The parties may enter into an adjudicatory settlement if objections have already been made to an official finding or order.55 If the case is currently in front of an ALJ, then the ALJ and both parties must approve the settlement; if a petition for review has timely been filed with the Board, then the Board and both parties must approve the settlement.56

Once an investigative or adjudicatory settlement has been submitted and approved, it constitutes the final agreement between the parties.57

A REMINDER ABOUT PRACTICAL POINTERS—REDUCING THE RISKS

Employers may be reminded about the following recommendations to help reduce the risks:

- Ensure that your company has properly implemented SOX reporting and compliance requirements;
- Create a formal, written corporate ethics policy that requires employees to report known or suspected fraud, theft, and other illegal activities, and which includes a clearly stated anti-retaliation component;
- Document all interactions with employees who lodge such complaints;
- Create an anonymous reporting system, perhaps utilizing an independent third party to take anonymous complaints to augment the company’s internal intake procedure;
- Promptly investigate complaints/reports; and
- Avoid unnecessary lag times once a decision is made to implement an unfavorable personnel action.
NOTES

1. Codified at 18 U.S.C. §§ 1513(e) and 1514.


3. By contrast, § 1107 applies to employees at both publicly and privately held companies.


5. Further, see Carnero v. Boston Scientific Corp., 2000 U.S. LEXIS 135 (1st Cir. Jan. 5, 2006), where an Argentine citizen, residing in Brazil, and employed by a foreign subsidiary of publicly traded Boston Scientific Corporation was held to lack standing under SOX.


8. Anonymous disclosures to a corporate audit committee may also be covered, although not specifically addressed in the regulations.

9. By contrast, § 1107 only applies when an employee has provided truthful information about a violation to a law enforcement officer.


17. Reinstatement may not be appropriate if the complainant is a security risk. 29 C.F.R. § 1980.105(a)(1).


20. Id.


22. 29 C.F.R. § 1980.103(d).


24. 29 C.F.R. § 1980.104(c).


27. 29 C.F.R. § 1980.104(e).
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31. Id.
32. 29 C.F.R. § 1980.106(b)(2).
33. 29 C.F.R. § 1980.105(c); 29 C.F.R. § 1980.106(b)(1).
34. 29 C.F.R. § 1980.106(b)(1).
35. 29 C.F.R. § 1980.107(b).
37. 29 C.F.R. § 1980.107(b).
38. Id.
40. 29 C.F.R. § 1980.108.
41. 29 C.F.R. § 1980.109(a).
42. 29 C.F.R. § 1980.109(b).
43. 29 C.F.R. § 1980.110.
44. Id.
45. Id.
46. 29 C.F.R. § 1980.110(b).
47. 29 C.F.R. § 1980.110(c).
48. 29 C.F.R. § 1980.110(d) and (e).
51. 29 C.F.R. § 1980.112(a).
52. Id.
54. Id.
56. Id.
57. 29 C.F.R. 1980.111(e).