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Passing The Integrated Employer Test

Law360, New York (August 31, 2009) -- When President Bush signed the Sarbanes-Oxley Act into law on July 30, 2002, he said it contained “the most far-reaching reforms of American business practices since the time of Franklin D. Roosevelt.”

As SOX enters its seventh anniversary, however, it has become clear that significant limitations exist where nonpublicly traded subsidiaries are concerned.

Indeed, it is now well-settled that the whistleblower protection provisions in Section 806 do not automatically apply to subsidiaries of publicly traded companies. But the exceptions to this rule have not been definitively established and remain a subject of debate.

Thus far, federal courts, the Administrative Review Board (ARB) and Administrative Law Judges, have applied traditional tests such “agency” and/or “piercing the corporate veil” to extend SOX coverage to employees of nonpublic subsidiaries.

But last fall the U.S. Department of Labor expressed its view that an “integrated employer” test should be used because the DOL considered the traditional tests too stringent.

Therefore, it behooves counsel for subsidiaries to become familiar with the contours of the integrated employer test so that they are prepared to pass it if it gains wider acceptance.

Section 806 and the DOL’s Perspective

Section 806 creates a cause of action for employees who suffer retaliation as a result of complaining about misconduct that they reasonably believe constitutes a fraud on shareholders.

Employers found to have violated Section 806 may be required to reinstate whistleblowers with back pay, interest and compensation for any special damages sustained as a result of the retaliation, including litigation costs, expert witness fees and reasonable attorneys' fees.

However, last September, Senators Leahy and Grassley, who drafted Section 806, wrote to then-U.S. DOL Secretary of Labor Elaine Chao to express their concern that too many SOX whistleblower claims were being dismissed because the DOL often concluded that Section 806 did not apply to nonpublicly traded companies.

Later that month, the DOL's Solicitor of Labor responded by pointing out that Section 806 only applies to a "company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, subcontractor or agent of such company ..." 18 U.S.C. §1514A(a).

The Solicitor likewise recognized that Congress may have deliberately omitted non-publicly traded subsidiaries from Section 806's coverage because, in contrast to Section 806, other sections of SOX expressly cover such entities.

Nevertheless, the Solicitor took the position that "the traditional tests of 'piercing the corporate veil' and agency to determine coverage of subsidiaries under Section 806," impose "an extremely heavy burden" on the employee seeking protection.

The Solicitor then stated that the DOL has adopted "the less restrictive integrated employer test ... to determine whether employees of subsidiaries of publicly traded companies are protected under Section 806."

The Solicitor added that the DOL filed amicus briefs on behalf of OSHA supporting adoption of this test in two cases before the ARB. One of those cases settled before the question was decided, *Ambrose v. U.S. Foodservices Inc.*, ARB Case No. 06-096, 2007 WL 2932053 (Sept. 28, 2007), and a decision has not yet been issued in the other case, *Johnson v. Siemens Bldg. Techs. Inc.*, ARB Case No. 08-032.

The Solicitor's letter to the Senators and the attached amicus briefs can be accessed at: www.osha.gov/dep/oia/whistleblower/Jacob_Reply.pdf.

Since the Solicitor's letter to the Senators last fall, Hilda Solis has replaced Elaine Chao as Secretary of Labor and she has the power to appoint new ARB members. President Obama has also nominated Mary Patricia Smith as the new Solicitor of Labor.

These changes may add some uncertainty as to whether the DOL will persist in endorsing the integrated employer test.

Further, whether the ARB, ALJs and federal courts will embrace this test remains to be seen, but it is probably just a matter of time before the issue is squarely decided. Cf. *Pik v. Goldman Sachs Grp.*, ARB Case No. 08-062 (June 30, 2009) (refusing to consider an integrated employer argument in a SOX claim where claimant failed to raise it in proceedings below).

Therefore, it is important to consider how the integrated employer test might be applied.

Understanding the Integrated Employer Test

The integrated employer test focuses on the following factors to determine if two entities should be treated as a single employer for purposes of liability: (1) interrelation of operations; (2) centralized control of labor relations; (3) common management; and (4) common ownership or financial control.

“No single factor is dispositive; rather, single employer status under this test ‘ultimately depends on all the circumstances of the case.’” *Pearson v. Component Tech. Corp.*, 247 F.3d 471, 486 (3d Cir. 2001) (applying these factors in the context of a WARN Act claim).

The following analyzes these factors with an eye towards illuminating the types of evidence subsidiaries may wish to proffer in an effort to pass the integrated employer test.

Interrelation of Operations

The interrelation of operations factor focuses on the degree to which the parent “excessively influenced or interfered with the business operations of the subsidiary ... beyond that found in the typical parent-subsidary relationship.” *Lusk v. Foxmeyer Health Corp.*, 129 F.3d 773, 778 (5th Cir. 1997).

In a case involving SOX claims, a district court applied a “joint employer” theory of liability, which includes an interrelation of operations factor. See *Hajela v. ING Groep*, 582 F. Supp. 2d 227, 236-37 (D. Conn. 2008).

After noting the absence of on-point authority in the context of SOX claims, the court found that the plaintiff made a sufficient showing of this factor to advance a joint employer theory, and pointed to the fact that the parent and subsidiary had an integrated e-mail system with a worldwide directory.

While the court concluded that this showing could withstand a motion to dismiss, it recognized the possibility that the plaintiff’s joint employer theory might not survive summary judgment. *Id.* at 237 n.14.

The First Circuit’s decision in *Englehardt v. S.P. Richards Co. Inc.*, 472 F.3d 1 (1st Cir. 2006), is also instructive in terms of identifying the type of evidence an employer may

rely upon in establishing a lack of interrelation of operations between a subsidiary and parent.

The court held that the interrelation of operations factor was not met in an FMLA case where the parent and subsidiary had “separate headquarters, human resources departments, records and record keeping, and separate work sites which fulfilled wholly distinct functions.” *Id.*

Centralized Control of Labor Relations

Some courts have held that “the most important factor in employment cases is control or influence over employment matters.” *Zang v. Fidelity Mgmt. Research Co.*, Case No. 2007 SOX 00027, 2008 DOLSOX LEXIS 20, **46-47 (ALJ Mar. 27, 2008).

This factor generally focuses on the power to hire, fire, supervise and schedule work. *Hukill v. Auto Care Inc.*, 192 F.3d 437, 444 (4th Cir. 1999).

“Courts have found centralized control where ‘entities share policies concerning hiring, firing, and training employees, and in developing and implementing personnel policies and procedures.’” *Id.*

In *Zang*, the ALJ held that this factor was not satisfied in a SOX claim where the employee’s work assignments and compensation and performance appraisals were handled by the subsidiary and the parent played no role in the decision to terminate the employee. *Id.* at **49-50.

By contrast, the court in *Hajela* noted that an Executive Board controlled six business lines and members of that board interviewed the claimant. *Hajela*, 582 F. Supp. 2d at 237.

The *Hajela* court also noted that the employment applications and job applications bore the parent logo and the claimant received his pay stubs, benefits and management training from the parent. *Id.*

Still, corporate formalities matter less than the economic realities under the integrated employer test, as the Solicitor noted in his letter to the Senators last fall.

Common Management

Separate management may be shown where there is no significant overlap between management and human resource functions at the two entities. *Sandoval v. City of Boulder*, 388 F.3d 1312, 1322 (10th Cir. 2004).

However, the mere fact that some individuals hold dual positions at the parent and subsidiary does not by itself satisfy this factor.

In fact, an employer may still prevail with respect to this factor by showing the parent did not make the allegedly retaliatory decisions. See Zang, 2008 DOLSOX LEXIS 20, at **52-53.

Common Ownership or Financial Control

Common ownership or financial control is often considered “the least important factor” because it is an ordinary aspect of the parent subsidiary relationship. *Int’l Brotherhood of Teamsters v. Am. Delivery Serv.*, 50 F.3d 770, 775 (9th Cir. 1995).

Subsidiaries may be able to demonstrate financial autonomy through various means such as separate payroll systems, separate tax returns and an ability to make basic financial decisions on their own.

Conclusion

The application of the integrated employer test to SOX whistleblower claims remains the subject of debate and it cannot be said with certainty that it will be applied by all courts, the ARB or all ALJs.

But, since the DOL espouses this test, employers need to be prepared to show how they will pass it when a letter from OSHA containing a SOX charge comes in the door.

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