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Wave of Whistleblower Claims on the Way

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Publicly traded companies and their subsidiaries and affiliates would be well-advised to start preparing now for the wave of Sarbanes-Oxley whistleblower claims that is currently sweeping the nation.

The federal government has effectively deputized employees of these companies to police their employers' conduct, providing generous monetary incentives to report any perceived financial misconduct without the fear of retaliation.

And the plaintiffs' bar is focusing substantial energy and resources to prepare for whistleblower litigation.

The threat of whistleblower claims is serious, the remedies seemingly limitless, and the stakes rising every day as the Department of Labor and the federal courts interpret this evolving area of law in an increasingly employee-friendly manner.

Like it or not, many publicly traded companies and their subsidiaries and affiliates are likely to face SOX whistleblower retaliation claims, regardless of their ultimate merit. And even if that day has not yet arrived, now is the time to begin preparing for it.

Sarbanes Oxley Act of 2002

Section 806 of the Sarbanes-Oxley Act of 2002 prohibits publicly traded companies from retaliating against employees who report financial misconduct within the company. To prevail on such a claim, the employee must show that he engaged in protected activity;

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that the employer knew or suspected, actually or constructively, that the employee engaged in protected activity; and that the employer took an unfavorable personnel action, the circumstances of which were sufficient to raise an inference that the protected activity was a contributing factor to the unfavorable personnel action.

The employer, in its defense, must prove by clear and convincing evidence that it would have taken the same action in the absence of the protected activity.

Protected activity in this context is defined as reporting information the employee reasonably believes constitutes a violation of federal mail, bank or securities fraud; federal laws relating to fraud against shareholders; or any rule or regulation of the Securities and Exchange Commission.

Notably, although SOX is, at bottom, a shareholder-protection statute, Section 806 does not require that the fraud alleged necessarily have been perpetrated against shareholders.

That said, reports about questionable personnel actions, racially discriminatory practices, executive decisions or corporate expenditures with which the employee disagrees, or even possible violations of other federal laws such as the Fair Labor Standards Act or Family Medical Leave Act, standing alone, are not protected by Section 806.

Further, the conduct reported must be material and must be a present, rather than a potential, future violation.

Finally, the employee making the report must have a reasonable belief at the time of the complaint that he is complaining of the type of fraud prohibited by the statute and that it is material. This belief is analyzed from both a subjective and objective perspective, meaning that the sophistication of the employee may alter the analysis of whether the complaint rises to the level of protected activity.

Employees initially must pursue SOX whistleblower claims through the DOL's adjudicative regime, by first filing a claim with the Occupational Safety and Health Administration, and then may proceed in the federal courts of appeals.

Alternatively, employees can "kick out" a claim to federal District Court for de novo review if the DOL does not issue a final order within 180 days. Employees who do not follow this procedure will have their claims dismissed for failure to exhaust administrative remedies.

Dodd-Frank Act of 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 raised the stakes even higher by significantly expanding the SOX whistleblower protections. Among other things, Dodd-Frank:

- Expanded coverage of Section 806 to private subsidiaries and affiliates of publicly traded companies whose financial information is included in the consolidated financial statements of such companies;
- Doubled the statute of limitations from 90 to 180 days;
- Provides a right to a jury trial in SOX actions removed to federal District Court; and

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• Prohibits pre-dispute arbitration agreements or any other "agreement, policy, form, or condition of employment" that require a waiver of rights under SOX.

In addition, Dodd-Frank provides that the SEC shall provide a monetary award to individuals who provide "original information" that results in an SEC settlement or judgment exceeding $1 million, with limited exceptions. The bounty, as it is called, can range from 10 to 30 percent of the total amount of the settlement or judgment and is determined at the sole discretion of the SEC.

Finally, Dodd-Frank affords employees who allege retaliation for filing a complaint with the SEC under its whistleblower program (as opposed to an internal complaint) a private right of action that may be pursued directly in federal District Court, without first filing a claim with OSHA.

Particularly noteworthy about that component of the statute is the lengthy statute of limitations. Employees must file a complaint within six years after the violation occurred or three years after the employee knew or reasonably should have known of facts material to the violation, provided the complaint is filed within 10 years of the violation. That is a significant departure from Section 806, which requires an exhaustion of administrative remedies and has a 180-day statute of limitations.

What should employers do?

Successful whistleblowers may obtain substantial remedies, including reinstatement without loss of seniority, back pay, reasonable attorneys' fees, costs, expert witness fees and emotional distress damages.

Indeed, the DOL and the federal District courts have shown a recent willingness to issue substantial monetary awards and to order reinstatement in response to pressure from the plaintiffs' bar and others. Seven-figure awards and reinstatement are not uncommon, and a recent decision upheld an additional compensatory award of $75,000.

In addition, SOX provides for potential criminal liability (including imprisonment of up to 10 years) and individual liability, and whistleblower cases can garner significant publicity, adversely impacting a company's public image and goodwill with its customers.

There are, however, means by which to avoid falling prey to SOX whistleblower claims, provided employers take affirmative steps to minimize the risks.

Perhaps most important, employers should ensure that, where practicable, whistleblower claims are resolved internally, as employees now have a unique incentive (in the form of a bounty) to report perceived misconduct to third parties, such as the SEC, even before an employer can adequately address their concerns and remedy any problems.

In addition, employers should implement complaint hotlines and provide multiple avenues through which employees can report perceived misconduct without fear of retaliation; promulgate appropriate codes of ethics and anti-retaliation policies; and train managers to be receptive and responsive to employee complaints.

On a broader scale, employers should adopt leadership models that foster a culture of disclosure, integrity and accountability throughout the organization with an eye toward encouraging employees to raise complaints internally rather than to third parties.

Finally, if and when an employee does report perceived misconduct, employers should take the matter seriously and conduct a thorough investigation. The employer should request that the employee document as many details as possible so that the investigation is focused on the actual complaint by the employee.

In addition, if the employee later claims retaliation, the employer will have a clearly documented record of the alleged reported conduct, which, if it is not covered conduct under the statute, cannot later be modified by the employee's counsel to "fit" within the categories of conduct protected under SOX.

Given the complexities and ever-evolving nature of the SOX whistleblower protections, the interplay between securities litigation, employment law and compliance issues, and the attractive incentives for employees to file whistleblower claims, it would be prudent for companies that are subject to Section 806 of SOX to retain counsel experienced with this area of the law to audit their existing policies and help create new policies and procedures.

Doing so before such a claim is filed will help avoid whistleblower claims or, at the very least, better position companies should such a claim arise in the future.