Sarbanes-Oxley Provides Whistleblower Protection

Insights
7.07.03

The Sarbanes-Oxley Act of 2002 ("the Act") was signed into law by President Bush on July 30, 2002. The Act has broad and sweeping implications not only for attorneys who specialize in federal securities law, but also for employers and attorneys who represent or advise publicly-traded companies in employment matters.

Civil and Criminal Penalties Apply To Whistleblower Provisions

Section 806 of the Act (Protection For Employees Of Publicly Traded Companies Who Provide Evidence of Fraud) (18 U.S.C. § 1514A) creates a civil cause of action protecting employees who are discharged or adversely affected in their employment conditions because they "lawfully" provide information, cause information to be provided, or otherwise assist in any investigation of conduct of the employer which the employee "reasonably believes" to constitute a violation of the federal criminal statutes prohibiting mail, wire, bank or securities fraud (18 U.S.C. §§ 1341, 1343, 1344, 1348), any rule or regulation of the Securities and Exchange Commission ("SEC"), or any provision of federal law relating to fraud against shareholders. Employees are protected from such retaliation under the Act if they provide such information or assistance to (1) any federal regulatory or law enforcement agency, (2) any member of Congress or any Congressional committee, or (3) any person with "supervisory authority" over the employee (or any other such person working for the employer who has authority to "investigate, discover, or terminate misconduct").

Section 1107 of the Act amends 18 U.S.C. § 1513 to impose criminal penalties, including possible imprisonment for up to ten years, for retaliation against an employee for providing "truthful" information to a law enforcement officer relating to the commission or possible commission of any federal offense whether or not the offense is a violation of the Sarbanes-Oxley Act.

Supervisor Training Will Be Needed

An employer may be held liable under the Act even if the employee is incorrect in asserting that a violation of law has occurred, so long as the employee's belief that a violation has occurred is reasonably held. Further, the Act protects any employee who brings such information to the attention of a supervisor or any other person within the company who has authority to remedy misconduct. Employers therefore will need to train managers and supervisors to ensure that they are aware that retaliation against employees who provide such protected information is unlawful. Internal procedures should also be developed to ensure that protected information is properly reported to responsible officials of the company.

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The U.S. Department of Labor Has Enforcement Authority
Enforcement authority under the whistleblower provisions of Act is placed with the Secretary of Labor. The first step taken by an employee seeking to enforce the civil action provisions of the Act will be to file a complaint with the U.S. Department of Labor ("DOL"). If DOL has not issued a final decision on the case within 180 days of the filing of the complaint, and there is no showing that such delay is due to the bad faith of the claimant, the employee may bring an action for *de novo* review of the claim in federal district court.

The enforcement procedures to be utilized by the Department of Labor are those found in 49 U.S.C. § 42121(b), which provides whistleblower protection for airline employees who provide air safety information. Under 49 U.S.C. § 42121(b)(1), the employee's complaint must be filed with DOL within 90 days after the alleged retaliatory action occurs. DOL then conducts an investigation and must determine within 60 days after the complaint is filed whether there is "reasonable cause to believe" that the employee's complaint has merit. If the employee makes a *prima facie* showing that retaliatory conduct has occurred, the employer, to avoid the issuance of an adverse preliminary finding, must demonstrate, by "clear and convincing evidence," that it would have taken the "same unfavorable personnel action" in the absence of the protected conduct engaged in by the employee.

A Hearing On The Record Is Held Before Issuance of a Final Order
Within 30 days after notification of DOL's preliminary findings, either party may file objections to DOL's findings or any preliminary order issued by DOL, or both, and request a "hearing on the record" before an administrative law judge ("ALJ"). Following the ALJ hearing, the Secretary of Labor has 120 days in which to issue a final order sustaining the complaint (and ordering appropriate relief) or denying the complaint.

Any appeal from such a final order of the Secretary is to the United States Court of Appeals for the circuit in which the violation allegedly occurred, or the circuit in which the employee resided on the date of the violation. If an employer fails to comply with a final order under the Act, the Secretary has authority to seek enforcement in the United States District Court in which the violation was found to occur.

State Remedies Are Not Precluded
A prevailing employee is entitled under the Act to "all relief necessary to make the employee whole," specifically including reinstatement with seniority rights, back pay with interest, and any "special damages" sustained "as a result of the discrimination", to include litigation costs, expert witness fees and reasonable attorney fees. Sarbanes-Oxley specifically provides that nothing in the Act "shall be deemed to diminish the rights, privileges or remedies of any employee under Federal or State law, or any collective bargaining agreement." Thus, additional remedies beyond those provided for in Sarbanes-Oxley may be available under state law, e.g., tort remedies for retaliatory discharge.

A Preliminary Reinstatement Remedy Is Available Under the Act
If DOL finds in its initial investigation that there is reasonable cause to believe that the complaint has

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merit, a preliminary order will issue requiring the employer to reinstate the employee with back pay (and restore all other compensation and privileges), pay "compensatory damages" to the employee, take "affirmative action to abate the violation," and (if requested by the employee) pay all costs and expenses (including attorney and expert witness fees) reasonably incurred by the employee. By contrast, if the Secretary finds that a complaint is frivolous or brought in bad faith, the Secretary of Labor may award the prevailing employer a reasonable attorney's fee not exceeding $1,000.

Fifth Amendment Protections Are Available to Employers

The procedures to be utilized by DOL for investigating and making determinations under the Sarbanes-Oxley Act (i.e., those under 49 U.S.C. § 42121(b)) are similar to those used by DOL in making determinations under the whistleblower provisions relating to highway safety under Section 405 of the Surface Transportation Assistance Act ("STAA") (49 U.S.C. § 31105). Given the similarity of the Sarbanes-Oxley and the STAA procedures, the Supreme Court's holding in *Brock v. Roadway Express, Inc.*, 481 U.S. 252 (1987), an STAA case, would appear to require that DOL procedures for determining whether a pre-hearing reinstatement order should issue must include, at a minimum, (1) notice of employee's allegations, (2) notice of the substance of the relevant evidence supporting the employee's claim, (3) the opportunity to submit a written response, and (4) an opportunity to meet with the DOL investigator and present statements from rebuttal witnesses. Under the Court's holding in *Brock v. Roadway Express, Inc.* (in which the employer was represented by Fisher Phillips attorneys), any DOL procedures which do not include these features would fail to provide the employer with a meaningful opportunity to respond before deprivation of a "property interest" occurs, and therefore would fail to meet minimum requirements of procedural due process under the Fifth Amendment.

In-House Counsel Have Protection, But Also Obligations

Attorneys employed by publicly-traded companies, of course, are protected from retaliation under the whistleblower provisions of Section 806 of the Act (18 U.S.C. § 1514A), but now may be subject to federal Standards of Professional Conduct issued by the SEC pursuant to authority granted under Section 307 of Sarbanes-Oxley.

Under Final Rules adopted by the SEC on January 29, 2003 (17 C.F.R., Part 205), in-house attorneys and other attorneys having any business before the SEC, must report evidence of material violations of securities laws (or breaches of fiduciary duties or similar violations) by their companies "up the ladder" to the chief legal counsel or the chief executive officer (or the equivalent). If the chief legal counsel or chief executive officer of the company does not respond appropriately, the attorney must then report the evidence to the company's audit committee, another committee of independent directors, the full board of directors, or to a "qualified legal compliance committee" as defined in the Act (if created by the company).

The new SEC Rules apply to any attorney, whether inside or outside counsel, "appearing or practicing" before the SEC, including any attorney who (1) transacts any business with the Commission (including communications in any form), (2) represents a public company in any SEC

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proceeding or investigation (including a response to an SEC subpoena or information request), (3) provides advice on federal securities laws or SEC rules regarding any document (or any portion of a document) the attorney has notice will be filed with the SEC, or (4) advises a company as to whether under the federal securities laws any statement, opinion or other writing must be filed with or submitted to the SEC. 17 C.F.R. § 205.2. The SEC is still considering whether to require attorneys who withdraw from representation of public companies in certain circumstances to effect a so-called "noisy withdrawal", i.e., to notify the SEC that they are withdrawing for professional reasons. See SEC's Proposed Rule on Implementation of Standards of Professional Conduct for Attorneys (January 29, 2003).

Where the professional conduct standards of a state (or other federal jurisdiction) where the attorney is admitted or practices conflict with the 17 C.F.R., Part 205, the SEC rules govern. 17 C.F.R. § 205.1. Any violation of the SEC rules subjects the attorney to "the civil penalties and remedies for a violation of the federal securities laws available to the Commission" in an action brought by the SEC. 17 C.F.R. § 205.6(a). Sanctions for violations of the rules can include censure or temporary or permanent denial of the privilege of appearing or practicing before the SEC. 17 C.F.R. § 205.6(b).

The Act Imposes Restrictions On Compensation Plans

Employers should be aware not only of the whistleblower provisions of Section 806 of Sarbanes-Oxley (15 U.S.C. § 1514A), but also of the impact of the new law on executive compensation and retirement plans.

Under Section 306 of the Act (15 U.S.C. § 7244), it is now unlawful for a director or executive officer of the issuer of any equity security to buy or sell (or otherwise acquire or transfer) any equity security of the issuer (other than an exempted security) during any "blackout period" in which 50% or more of the participants and beneficiaries under the individual account plans maintained by the issuer are temporarily suspended from trading the issuer's securities for more than three consecutive business days. On January 24, 2003, the U.S. Department of Labor's Employee Benefits Security Administration (formerly the Pension and Welfare Benefits Administration) published Final Rules implementing the requirement of the Act that participants and beneficiaries be given a 30-day advance notice of a blackout period. These Rules also require notice be given to corporate insiders that they may not lawfully trade or exercise options during blackout periods.

Section 402 of the Act (15 U.S.C. § 78m) makes it unlawful for "issuers" (as defined in Section 3 of the Securities Exchange Act of 1934) to directly or indirectly extend or maintain credit, or to arrange for the extension of credit, in the form of a personal loan to or for any director or executive officer. This prohibition will likely extend to the "cashless" exercise of securities options which are equivalent to the extension of a short-term loan to the director or executive officer. Exceptions to the prohibition of Section 402 are home improvement loans, consumer credit, charge cards, certain broker/dealer loans other than for the purpose of buying stock of the company, and certain extensions of credit by FDIC-insured depository institutions. Section 402 does not apply to extensions of credit made prior

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to the July 30, 2003 effective date of the Act so long as there is no "material modification" of any term of the extension of credit (or any renewal of the extension of credit) after the Act's effective date.

Under Section 904 of Sarbanes-Oxley, Section 501 of the Employee Retirement Income Security Act of 1974 ("ERISA") (29 U.S.C. § 1131) is amended to increase the criminal penalties for willful violations of the Reporting and Disclosure requirements of ERISA. The limitation on criminal fines for individuals is increased from $5,000 to $100,000, the period of potential imprisonment is increased from one year to ten years, and the limitation on criminal fines against violators who are not individuals is increased from $100,000 to $500,000.

Employers therefore should take immediate steps to ensure that their executive compensation and retirement plans comply with and are administered in compliance with Sarbanes-Oxley, all SEC and DOL rules implementing the Act, and current Reporting and Disclosure requirements of ERISA.

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