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Representing Whistleblowers in Sarbanes-Oxley Cases

**Jonathan Ben-Asher
Beranbaum Menken Ben-Asher & Bierman LLP
80 Pine Street – 32nd floor
New York, N.Y. 10005
Telephone: (212) 509-1616
Facsimile: (212) 509-8088
jb-a@bmbblaw.com**

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Jonathan Ben-Asher
Beranbaum Menken Ben-Asher & Bierman LLP

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Introduction

Five and a half years ago, Congress reacted to the multiplying corporate accounting scandals by enacting protections for employees of public companies who complain about or disclose fraud by their employers. In passing Sec. 806 of the Sarbanes-Oxley Act, Congress prohibited employers from retaliating against employees for a wide range of whistleblowing activities. Sec. 806 gave employees who suffer retaliation the ability to seek relief at the Department of Labor and, in many cases, to sue in federal court.¹

This was a significant advance for employees in the private sector, who, in many states, have limited protections if they protest or expose an employer's illegal financial practices. The whistleblowing provisions of other federal statutes cover discrete and limited classes of employees,² and the anti-retaliation provisions of the federal False Claims Act cover employees only if they investigate or disclose fraud on the federal government.³

In enacting Sarbanes-Oxley, Congress was well aware that the previous state of the law left corporate whistleblowers highly vulnerable. The Senate Judiciary Committee found that whistleblower protections were dependent on the "patchwork and vagaries" of varying state statutes, even though most publicly traded companies do business nationally. As it pointedly noted, "companies with a corporate culture that punishes whistleblowers for being 'disloyal' and 'litigation risks' often transcend state lines." As a result, "most corporate employers, with help from their lawyers, know exactly what they can do to a whistleblowing employee under the law." Congress therefore acted to protect employees who report fraudulent activity which could harm innocent investors.⁴

¹ Public L. No. 107-204, Sec. 806, codified at 18 U.S.C. Sec. 1514A.

² See, e.g., 12 U.S.C. Sec. 1831j (Employees of federally insured depositories); 31 U.S.C. Sec. 5328 (whistleblower protection for bank employees who disclose certain improprieties externally); Clean Water Act, 33 U.S.C. Sec. 1367(a); Clean Air Act, 42 U.S.C. Sec. 7622; Toxic Substances Control Act, 15 U.S.C. Sec. 2622; Energy Reorganization Act, 42 U.S.C. Sec. 5851.

³ 31 U.S.C. Sec. 3730(h).

⁴ S. Rep. No. 107-146, 107th Cong., 2d Session 19 (2002).

While Sarbanes-Oxley was an advance for most employees, it has become particularly nettlesome for employees who are lawyers, and for outside counsel. Sarbanes-Oxley required the SEC to promulgate regulations governing the conduct of lawyers who “appear and practice” before the SEC – in particular, governing what such lawyers should do when they become aware of a corporate client’s potentially fraudulent activity. Those regulations require lawyers to report fraud “up the ladder” of the company. In addition, one set of proposed regulations would require many lawyers who are not satisfied with the company’s response to make a “noisy” withdrawal from representation, by notifying the SEC directly that the withdrawal was for “professional” reasons, and by disaffirming any misleading representations made to the Commission. An alternative proposal would require withdrawal, but place the obligation to notify the SEC on the company itself.

This paper discusses Sarbanes-Oxley’s whistleblower provisions, and the legal and practical issues that have arisen under them. It first discusses which employers are subject to Sec. 806; what is protected activity under the statute; enforcement of the anti-retaliation protections at the Department of Labor; and litigation of these whistleblower claims in federal court. It then reviews the issues that arise when a lawyer learns of potential fraud by a corporate client, and concludes with some practical tips for representing Sarbanes-Oxley whistleblowers.

I. Developing issues in the coverage of employers under Sec. 806

The whistleblower protections of Sarbanes-Oxley are broad, covering the employees of all publicly traded companies. “Publicly traded companies” are defined as companies with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. Sec. 78l), or which are required to file reports under section 15(d) of the Act (15 U.S.C. Sec. 78o(d)).⁵

The mere filing of an application to register securities under Sec. 12 of the Act does not bring an employer within Sec. 806. Under Sec. 12, the SEC must first have received certification from exchange authorities that the securities have been approved for listing and registration, and thirty days must elapse from that certification. An employer which files a registration statement but withdraws it before that process is complete is not a covered employer under Sec. 806. *Roulett v. American Capital Access Service Corp.*, 2007 WL 747800 (S.D.N.Y. March 2, 2007)⁶

⁵ 18 U.S.C. Sec. 1514A(a).

⁶ In a similar vein, DOL has ruled that Sec. 806 does not provide protection for adverse

Section 806 of the Act, titled “Protection for Employees of Publicly Traded Companies who Provide Evidence of Fraud,” creates 18 U.S.C. Sec. 1514A, “Civil Action to protect against retaliation in fraud cases.” It prohibits a publicly traded company from engaging in a wide range of retaliatory actions: discharging, demoting, suspending, threatening, harassing or “in any other manner” discriminating against an employee in the terms and conditions of employment, because of the protected whistleblowing activities listed in the section.⁷ In enforcing Sec. 806, the Department of Labor has ruled that an employment action is unfavorable “if it is reasonably likely to deter employees from making protected disclosures.” A complainant does not have to prove termination, suspension or demotion.⁸

The statute prohibits retaliation by a broad range of actors. These include not only the employer, but any officer, contractor, subcontractor, employee or agent.⁹ However, the issue of which employers are proper parties in a claim under Sec. 806 is not a simple one, and while the courts and DOL have wrestled with it, the results are hardly consistent.

A. Subsidiaries of public companies

Sec. 806 does not specifically include non-publicly traded subsidiaries of publicly traded companies. The courts and DOL have issued conflicting decisions on whether those subsidiaries are governed by the statute. These decisions fall into three groups:

1. Congress intended to cover subsidiaries:

One frequently cited ALJ decision holds that Congress’ purpose in enacting Sec. 806 would be gravely compromised if a wide class of employers could be

employment actions which occurred before the effective date of the company’s registration. *Gallagher v. Granada Entertainment USA*. (2004 SOX 00074, April 1, 2005). See the Department of Labor’s website for decisions by its Administrative Law Judges and Administrative Review Board: www.oalj.dol.gov.

⁷ 18 U.S.C. Sec. 1514A(a).

⁸ *Halloum v. Intel Corporation*, 2003 SOX 0007, March 4, 2004.

⁹ 18 U.S.C. Sec. 1514A(a).

walled off from coverage by virtue of their subsidiary status. *Morefield v. Exelon Services, Inc.*, 2004 SOX 00002 (January 28, 2004). The ALJ ruled that it was “clear that Congress intended the term ‘employees of publicly traded companies’ in Section 806 to include the employees of the subsidiaries of publicly traded companies.”

The ALJ looked to the economic realities of the subsidiary-parent relationship, observing that subsidiaries “are an integral part of the publicly traded company, inseparable from it for the purposes of evaluating the integrity of its financial information, and they must be treated as such.” The ALJ noted that this view of the subsidiary-parent relationship was recognized in the provisions of the Act, which subjected subsidiaries to internal reporting controls without “heed to the technicalities of internal corporate veils.” He added that:

The publicly traded entity is not a free-floating apex. When its value and performance is based, in part, on the value and performance of component entities within its organization, the statute ensures that those entities are subject to internal controls applicable throughout the corporate structure, that they are subject to the oversight responsibility of the audit committee, and that the officers who sign the financials are aware of material information relating to the subsidiaries. A publicly traded corporation is, for Sarbanes-Oxley purposes, the sum of its constituent units; and Congress insisted upon accuracy and integrity in financial reporting at all levels of the corporate structure, including the non-publicly traded subsidiaries.¹⁰

See also *Gonzales v. Colonial Bank*, 2004 SOX 00039 (Aug. 20, 2004) (denying summary dismissal because “the parent company is a respondent in this case and it is determined that Congress intended to provide whistleblower protection to employees of subsidiaries of publicly traded companies.”)

2. Congress intended to exclude subsidiaries:

One significant ALJ decision, currently on appeal to the Administrative Review Board, holds, very simply, that subsidiaries can never be covered under Sec. 806. *Ambrose v. U.S. Foodservice, Inc.* 2005 SOX 105 (April 17, 2006). The ALJ’s fairly cursory ruling focused entirely on the fact that the title of Sec. 806 is “Whistleblower Protection for Employees of Publicly Traded Companies.” The National Employment Lawyers Association and the EEOC have filed *opposing* amicus briefs in this case, which could resolve the important issue, at least at

¹⁰ *Morefield v. Exelon Services, Inc.*, 2004 SOX 00002 (January 28, 2004)

DOL.

See also *Bothwell v. American Income Life*, 2005 SOX 00057 (Sept. 19, 2005); *Powers v. Pinnacle Airlines*, No. 2003 AIR 00012 (Mar. 5, 2003) (case under SOX and Aviation Investment and Reform Act). In both *Bothwell* and *Powers*, the ALJs also relied on the employee's failure to name the parent corporation in the charge.

3. Subsidiaries are covered when the parent and subsidiary are sufficiently intertwined:

These decisions look to the degree to which the parent exercises control over the subsidiary, including the extent to which the parent was involved in supervising the employee's employment or involved in the termination decision. See, for example, *Personalized Brokerage Services, LLC v. Lucius*, 2006 WL 2975308 (D. Minn. 2006) (Plaintiff did not plead that the parent "hired, supervised, exercised control over or terminated him"); *Teutsch v ING Group, N.V.*, 2005 SOX 00101 (Sept. 25, 2006) (Subsidiary not covered when parent had no control over the subsidiary's management and did not hire the employee or exercise any control over her activities, discipline, or termination); *Neuer v Bessellieu*, 2006 SOX 132 (December 5, 2006) (Subsidiary covered if parent and subsidiary "are so intertwined as to represent one entity," and where parent controls the work environment of, or termination decision about, the employee); *Dawkins v. Shell Chemical, LLP*, 2005 SOX 00041 (May 16, 2005) ("there is no indication the parent companies were sufficiently involved in the management and employment relations of Respondent to justify a piercing of the corporate veil").

One court has sustained a claim by an employee of a wholly-owned subsidiary of a public company, denying summary judgment, because the plaintiff alleged that her employment "could be affected" by officers of the parent company. *Collins v. Beazer Homes USA, Inc. et al*, 334 F. Supp. 1365 (N.D. Ga. 2004). The court reached this conclusion in a roundabout way, citing to the SOX regulations' definition of an employee as an individual "presently or formerly working for a company or company representative." Under DOL's regulations implementing Sec. 806, "company representative" includes any officer of a public company. 29 CFR 1980.101.

B. Agents and contractors

Some decisions have found liability for entities, including corporate subsidiaries, as the "contractor, subcontractor or agent" of a publicly held parent.

In one frequently cited decision, DOL's Administrative Review Board ruled that "whether a particular subsidiary or its employee is an agent of a public parent for purposes... [of SOX] should be determined according to principles of the general common law of agency." *Klopfenstein v. PCC Flow Technologies Holding, Inc.*, ARB Case 04-149 (May 31, 2006). This, the ARB explained, depends on whether the principal has manifested that the agent act for it, whether the agent accepted that authority, and the parties' understanding that the principal is to be in control (citing to the Restatement 2nd Agency, Sec. 1(1), comment b). The ARB remanded the case to the ALJ to make factual findings on this question.

In a S.D.N.Y. case, Judge Gerard Lynch found that the statute's bar against retaliation by employers' agents does not give whistleblowing protection to an employee of a non-public company merely because the non-public employer has business relations with a publicly traded company. The court noted that, in contrast, companies "that have acted as agents of publicly traded companies *with respect to their employment relationships*" could be liable under Sec. 806. *Brady v. Calyon Securities (USA) et al.*, 406 F. Supp.2d 307 (S.D.N.Y. 2005). In *Brady*, the defendant investment bank merely acted as the agent or underwriter in its investment banking relationship with the employer. The court noted that Sec. 806 "simply lists the various potential actors who are prohibited from engaging in discrimination on behalf of a covered employer," and that an employer's "agent or subcontractor" is one of those actors.

See also *Minkina v. Affiliated Physicians Group*, 2005 SOX 19 (February 22, 2005, appeal dismissed, ARB July 29, 2005) (same reasoning as *Brady*); *Goodman v. Decisive Analytics Corp.*, 2006 SOX 11 (January 10, 2006) (Contractor or agent "when discriminating against the employee must have been acting on *behalf* of the publicly traded company"); *Kalkunte v. DVI Financial Services*, 2004 SOX 00056 (July 18, 2005) (Contractor of publicly held company subject to liability where it took over management of employer through bankruptcy proceedings).

C. Foreign employers of foreign employees

In *Carnero v. Boston Scientific Corporation*, 433 F.3d 1 (3d Cir. 2006), cert. denied, 126 S.Ct. 2973, 165 L.Ed.2d 954, the Third Circuit ruled that a foreign employee of a foreign corporation is not covered by Sec. 806 concerning the foreign employer's misconduct abroad.

The court relied on the general presumption against extra-territorial

application of U.S. law; the existence of other provisions of SOX which explicitly provide for extra-territorial application; the absence of references in the legislative history to foreign application and what it characterized as Congress' "focus on problems within the United States;" the dangers of granting authority to DOL and U.S. courts to "delve into the employment relationship between foreign employers and their foreign employees;" Congress' failure to provide a means to enforce Sec. 806 against foreign employers; the absence of a venue provision governing foreign employers; prior ALJ decisions declining to enforce Sec. 806 extraterritorially; and the overall lack of Congressional intent to reach foreign employers.

One ALJ decision has distinguished *Carnero*, holding that Sec. 806 protected an American employee of a foreign company who, although employed abroad, engaged in protected activity in the US. *Penesso v LCC International, Inc.*, 2005 SOX 00016 (March 4, 2005).

II. Protected whistleblowing activity

An employee is protected from retaliation for engaging in any lawful act taken to provide information, cause information to be provided, or otherwise assist in an investigation, regarding any conduct which the employee "reasonably believes" constitutes a violation of the criminal provisions noted in the statute, any SEC rule or regulation, or any provision of federal law relating to fraud against shareholders. The criminal statutes noted are 18 U.S.C. Secs. 1341 (mail fraud), 1343 (wire fraud), 1344 (bank fraud) and 1348 (securities fraud).¹¹ In the view of the Department of Labor, whistleblowers are not limited to investigating or complaining about improprieties in financial statements which are disclosed to the public. Rather, they are protected if they look into conduct violating rules governing the application of accounting principles and the adequacy of internal accounting controls.¹²

Employees are protected when they provide information or assistance, either within the company or to an appropriate federal official. Within a company, employees can go to "a person with supervisory authority over the employee," or someone who has authority to "investigate, discover, or terminate misconduct."¹³

¹¹ 18 U.S.C. Sec. 1514A(a)(1).

¹² *Morefield v. Exelon Service, Inc.*, 2004 SOX 00002 (January 28, 2004) (Whistleblowers "may anticipate the deception buried in a draft report or internal document, which if not corrected, could eventually taint the public disclosure.")

Externally, they can provide information or help to a federal regulatory or law enforcement agency, or a congressperson or congressional committee.¹⁴

Employees are also protected from retaliation for filing, participating in, or assisting in a proceeding relating to the listed federal provisions, if the employer has “any knowledge” of the employee’s activity. The “proceeding” can be one which has been filed, or is “about to be filed.”¹⁵ The courts are likely to construe this to mean that an employee is protected while investigating potential fraud violations, even if the investigation does not lead to a formal proceeding. The “filed or about to be filed” language also appears in the anti-retaliation prohibition of the False Claims Act, and in that context protects employees who are collecting information about possible fraud “before they have put all the pieces of the puzzle together.”¹⁶

In a recent E.D.N.Y. case, the court held that for an employee to show protected activity, whether by providing information or assisting in an investigation, the employee “must point to point to affirmative acts which advance the investigation.” *Mahoney v. Keyspan Corp.*, 2007 WL 805813 (E.D.N.Y. March 12, 2007). “Merely expressing concern or support for a whistleblower” is not protected activity. The court held that plaintiff’s conversations with Keyspan’s in-house and outside counsel in support of a whistleblower did not qualify.

However, the court ruled that plaintiff did engage in protected activity by successfully urging the CEO to meet with the whistleblower and the company’s lawyers to “hear directly... the details of accounting frauds at the company.’” The court relied on plaintiff’s assistance in “opening a channel of communication with the CEO,” and held that Sec. 806 applies not only to “those who blow the whistle” but also those who “make the whistle audible.” A contrary interpretation, the court noted, would “lead to a point that isolates the whistleblower in a way that Congress could not have intended.”

¹³ 18 U.S.C. Sec. 1514A(a)(1)(C).

¹⁴ 18 U.S.C. Sec. 1514A(a)(1)(B) and (C).

¹⁵ 18 U.S.C. Sec. 1514A(a)(2).

¹⁶ See, e.g., *U.S. ex rel. Yesudian v. Howard University*, 153 F.3d 731, 739-40 (D.C. Cir. 1998).

While protected activity includes the “lawful acts” noted in Sec. 806, it may not include an employee’s refusal to engage in unlawful activity. In a case before DOL’s Administrative Review Board, the employee, an equity analyst at an investment advisory firm and broker-dealer, refused to change her rating of a stock, despite pressure from her superiors at a meeting, and said she would not sign a report that rated the stock more highly. After a hearing, the ALJ found that the complainant had engaged in protected activity, and that the employer had engaged in a pattern of pressuring its analysts to issue “strong buy” ratings on stocks and had retaliated against the complainant for refusing to do that.

The ARB reversed the ALJ’s decision, finding that the complainant’s refusal to sign the report was not protected activity, because disagreements over stock ratings were the normal course of the meeting in issue. Her “unspecified ‘refusal’ was not sufficient to ‘provide information’ to a person with supervisory authority relating to a violation.” The ARB found that the complainant would have engaged in protected activity if she had made clear that she believed the stock rating was a violation of law. “In drafting whistleblower protection laws, Congress...has drawn the distinction between notifying the employer of a violation and refusing to commit a violation.”¹⁷

To encourage whistleblowing, employers are required to set up audit committees, which must have procedures for employees to confidentially and anonymously report “concerns regarding questionable accounting or auditing matters.”¹⁸ Outside of civil litigation, Sarbanes-Oxley criminalizes retaliation against whistleblowers. These penalties apply even if the object of retaliation is not an employee.¹⁹

III. Enforcement

As introduced in the Senate, Sec. 806 permitted employees to sue employers directly in federal court, or, at their option, to file a complaint at the Department of Labor, with the possibility of subsequent federal court review.²⁰

¹⁷ *Getman v. Southwest Securities, Inc.*, ARB Case No. 04-059, 2005 DOL Ad. Rev. Bd. LEXIS 78 (July 29, 2005).

¹⁸ Public L. No. 107-204 at Sec. 301, amending 15 U.S.C. Sec. 78f.

¹⁹ 18 U.S.C. Sec. 1513(e).

²⁰ S. 2010, S. Rep. No. 107-146, 107th Cong., 2nd Sess. 9 (May 6, 2002) (Draft of Sec. 1514A(b)).

The Judiciary Committee significantly weakened this scheme, by requiring employees to participate in administrative proceedings at DOL, and by greatly limiting access to federal court.²¹

The Judiciary Committee also deleted a provision which would have barred mandatory arbitration of these claims.²² One case from the Southern District of New York case holds that an employer's mandatory arbitration agreement bars litigation of claims under Sec. 806.²³ And in an ironic twist, the Second Circuit has ruled that an employer's attempt to use the Federal Arbitration Act to preclude an employee from arbitrating his SOX claim and force the employee into federal court had to be resolved by the arbitrator, under the parties' arbitration agreement.²⁴ However, the Department of Labor's position appears to be that an arbitration agreement cannot preclude an employee from pursuing administrative remedies at DOL.

Employees must file a charge with the Department of Labor²⁵ within 90 days from when the violation occurred.²⁶ The 90 days runs from the date the employee receives "final, definitive, and unequivocal notice" of an adverse employment decision," and the time limit will be "equitably tolled" only in extraordinary circumstances.²⁷ Each discriminatory act starts a new 90 day clock for the filing of a charge (or at least the amendment of a prior charge.)²⁸

²¹ Id. at 22 [amended draft of Sec. 1514A(b)].

²² Id. at 11 [Draft of Sec.1514A(d)].

²³ *Boss v. Salomon Smith Barney Inc.*, 263 F. Supp. 2d 684 (S.D.N.Y. 2003).

²⁴ *Alliance Bernstein Investment Research and Management, Inc. v. Schaffran*, 445 F.3d 121 (2d Cir. 2006). In that case, the employee argued that the NASD's rules prohibiting mandatory arbitration of employment discrimination claims applied to claims under Sec. 806. The NASD's rules also provided that the arbitrator resolve disputes over the interpretation of those rules.

²⁵ 18 U.S.C. Sec. 1514A(b)(1).

²⁶ 18 U.S.C. Sec. 1514A(b)(2)(D).

²⁷ *Halpern v. XL Capital, Ltd.*, ARB Case No. 04-120, 2005 DOL Ad. Rev. Bd. LEXIS 98 (August 31, 2005).

²⁸ *McClendon v. Hewlett-Packard Company*, 2005 WL 2847224 (D. Idaho 2005); *Willis v. Vie Financial Group*, 2004 WL 1774575 (E.D. Pa. 2004)

The DOL is required to investigate the charge. If DOL does not issue a final decision (including a decision on an administrative appeal) within 180 days, the employee can bring an action “for de novo review” in federal court.²⁹ An employee cannot sue in federal court if his own “bad faith” caused DOL’s delay.³⁰

A. Administrative proceedings at the Department of Labor

Under Sarbanes-Oxley, administrative proceedings at DOL are governed by the procedures set out in the federal law, enacted in 2000, covering whistleblowing in the airline industry – Sec. 519 of the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, 49 U.S.C. Sec. 42121(b).³¹

Initially after the enactment of Sec. 806, the Department of Labor administered its Sarbanes-Oxley responsibilities under the regulations used in investigations under the Ford Aviation Act (29 CFR Sec. 1979.100 et seq.) In May, 2003, DOL issued final interim regulations specific to Sarbanes-Oxley proceedings. 68 Federal Register 102 at 31860 et seq. (May 28, 2003). DOL noted that in drafting the new regulations, it considered the regulations implementing the Ford Aviation Act, as well as other whistleblowing provisions DOL administers. 68 FR 102 at 31860. Those regulations are codified at 29 CFR Part 1980. DOL issued final regulations on August 24, 2004. 29 CFR Part 1980.

1. The employee’s prima facie case

At DOL, the complainant must make a prima facie showing that “protected activity” under Sarbanes-Oxley was a “contributing factor” to the unfavorable personnel action alleged in the complaint. More specifically, DOL’s regulations require that the charge, as supplemented by DOL’s interviews with the charging party, allege “the existence of facts and evidence to make a prima facie showing” (i) that the employee engaged in protected activity or conduct, (ii) that the named person knew or suspected, actually or constructively, that the employee engaged in the protected activity, (iii) that the employee suffered an unfavorable personnel action, and (iv) that there are circumstances sufficient to raise an inference that

²⁹ 18 U.S.C. Sec. 1514A(b)(1)(B).

³⁰ Id.

³¹ 18 U.S.C. Sec. 1514A(b)(2)(A).

protected activity was a contributing factor in the unfavorable action.³² The regulations state that the employee can normally prove the employer's knowledge and causation by showing, for example, that the adverse action took place shortly after the protected activity.³³

Without this *prima facie* showing, the charge will be dismissed, without an investigation.³⁴ Even if the employee makes the *prima facie* showing, the charge will also be dismissed if the employer demonstrates by "clear and convincing evidence" that it would have taken the same unfavorable action absent the employee's protected activity.³⁵ The employer has twenty days from receiving notice of the complaint to file a written statement, affidavits and documents in support of its position, and to request a meeting with DOL.³⁶

2. Department of Labor investigations

If the employee makes the required *prima facie* showing and it is not rebutted by the employer, DOL must conduct an investigation, and complete it within 60 days after the complaint is filed. The investigation is to determine if there is "reasonable cause" to believe that a violation occurred. DOL is supposed to investigate in a manner which protects the confidentiality of witnesses who provide information on a confidential basis.³⁷

DOL should also determine whether the information gathered initially warrants preliminary reinstatement while the charge is pending. If so, DOL gives the employer notice of the substance of the relevant evidence, including redacted or summarized witness statements, and the employer has ten business days (or more, if agreed upon with DOL) to respond in writing and meet with investigators to oppose preliminary relief.³⁸

³² 29 CFR Sec. 1980.104(b).

³³ 29 CFR 1980.104(b)(2).

³⁴ 29 CFR 1980.104(b)(2), 29 CFR 1980.104(d).

³⁵ 29 CFR Sec. 1980.104(c).

³⁶ *Id.*

³⁷ 29 CFR 1980.104(d), 1980 105(a).

³⁸ 29 CFR Sec. 1980.104(e).

After conducting the investigation, DOL issues written findings as to whether there is reasonable cause to believe the employer discriminated against the employee in violation of the Act.³⁹ If DOL does find in the employee's favor, it is supposed to order preliminary relief, which can include reinstatement, back pay, compensation for "special damages,"⁴⁰ and costs and expenses, including attorney's and expert witness fees.⁴¹ DOL's findings and preliminary order are effective within thirty days unless either party files timely objections and requests a hearing.⁴² The filing of objections stays all aspects of the order, *except* for an order of reinstatement.⁴³

If DOL has ordered reinstatement, it is effective immediately.⁴⁴ DOL will deem reinstatement "inappropriate" if the employer establishes that the complainant is a security risk, even if the information on which that contention is based was obtained after the employee's discharge. 29 CFR 1980.105(a)(1). DOL's summary of the interim regulations analogizes this issue to the after-acquired evidence rule created by the Supreme Court in *McKenon v. Nashville Banner Publishing Co.*, 513 U.S. 352 (1995). 68 Federal Register 102 at 31862 (May 28, 2003).

However, an employee's ability to obtain reinstatement has been impeded by the Second Circuit's decision in *Bechtel v. Competitive Technologies, Inc.* 448 F.3d 469 (2d Cir. 2006). In *Bechtel*, the Court of Appeals reversed the district court's preliminary injunction requiring the employer to reinstate the employee. The Court of Appeals held that a district court lacks jurisdiction to enforce a reinstatement order of the Department of Labor.

DOL's final 2004 regulations provide that there is no ALJ review of a decision by OSHA to either dismiss a complaint without completing an investigation, or to conduct an investigation. The regulations provide that if an

³⁹ 29 CFR Sec. 1980.105(a).

⁴⁰ "Special damages" are discussed in Sec. C below.

⁴¹ 29 CFR 1980.105(a)(1).

⁴² 29 CFR 1980.105(c), 1980.106(a).

⁴³ 29 CFR 1980.106(b)(1).

⁴⁴ 29 CFR 1980.105(c).

ALJ determines that the complaint was erroneously dismissed, the ALJ will hear the case on the merits, rather than remanding to OSHA for the completion of an investigation.⁴⁵

3. Department of Labor hearings

DOL's administrative hearings are conducted in accordance with the rules of practice and procedure of DOL's Office of Administrative Law Judges.⁴⁶ Hearings are *de novo* and on the record,⁴⁷ and formal rules of evidence do not apply.⁴⁸ The OALJ's rules incorporate the provisions of the Administrative Procedure Act (5 U.S.C. Sec. 554), which provide for, among other things, the issuance of subpoenas and taking of depositions, cross-examination, and other procedural protections.⁴⁹ DOL must conduct the hearing "expeditiously,"⁵⁰ and issue a final order within 120 days after it concludes.⁵¹

DOL apparently wants to minimize the likelihood that employees will take advantage of the Act's provision allowing them to sue an employer in federal court if DOL has not issued a final decision within 180 days of the complaint. For example, the summary of the regulations speaks of the need for hearings to be conducted as expeditiously as possible "particularly in light of the unique" 180 day rule, and an ALJ may order those limits extended unless the complaining party agrees to delay filing a federal court action for some period of time after the 180 days.⁵² Thus, ALJs are given "broad discretion" to limit discovery in order to expedite the hearing.⁵³

⁴⁵ 29 CFR 1980.109(a).

⁴⁶ 29 CFR 1980.107(a), referring to procedures codified at 29 CFR Part 18, Subpart A. See 29 CFR 18.1 through 29 CFR 18.59.

⁴⁷ 29 CFR 1980.107(b).

⁴⁸ 29 CFR 1980.107(d).

⁴⁹ 5 U.S.C. Sec. 554; 5 U.S.C. Sec. 556 (c) and (d).

⁵⁰ 49 U.S.C. § 42121(b)(2)(A).

⁵¹ 49 U.S.C. Sec. 42121(b)(3).

⁵² 68 FR 102 at 31862 (May 28, 2003).

⁵³ 29 CFR 1980.107(b).

DOL greatly limits its representation of employees in these hearings. While the regulations permit the Assistant Secretary to participate as a party or as an amicus,⁵⁴ DOL's summary of the interim regulations notes that "ordinarily" DOL does not expect to prosecute "meritorious" Sarbanes-Oxley claims, and that it believes that its limited role here is unlikely to discourage employees from filing charges. DOL may choose to prosecute cases involving significant legal issues, large numbers of employees, egregious violations or where the interests of justice require.⁵⁵ The SEC may also participate as an amicus at any time, in the SEC's discretion. Even if the SEC does not participate in the proceeding, the SEC may require that the parties provide it with copies of all pleadings.⁵⁶

DOL must issue a decision within 120 days after the hearing.⁵⁷ DOL may only determine that a violation occurred if the complainant demonstrates that the protected activity was a contributing factor in the challenged personnel action. If the employer shows by clear and convincing evidence that it would have taken the same action in the absence of the protected activity, DOL cannot order any relief.⁵⁸

If the ALJ concludes that the employer violated the law, the order will provide all relief necessary to make the employee whole, including reinstatement, back pay, "special damages," litigation costs, attorney's fees, and expert witness fees. If the employer shows that the complaint was frivolous or brought in bad faith, the ALJ may award a maximum of \$1,000 in attorney's fees to the employer.⁵⁹

⁵⁴ 29 CFR 1980.108(a)(1).

⁵⁵ 69 FR 102 at 31862 (May 28, 2003).

⁵⁶ 29 CFR 1980.108(b).

⁵⁷ 49 U.S.C. Sec. 42121(b)(3). This requirement is found in the Ford Aviation Investment and Reform Act, which governs proof and proceedings cases under Sec. 806. See 18 U.S.C. Sec. 11514(b)(2)(A).

⁵⁸ 29 CFR 1980.109(a).

⁵⁹ 29 CFR 1980.109(b).

4. Appeals from DOL hearing decisions

Either side may seek review of the ALJ's decision by filing a petition at DOL's Administrative Review Board (ARB) within ten business days. If the ARB accepts the case for review, the ALJ's decision becomes "inoperative," although the ALJ's reinstatement order will remain in effect. The ARB is to issue a final decision within 120 days after the hearing concludes.⁶⁰

Assuming DOL issues a final decision within 180 days after the charge was filed, the employee's access to court is limited to appealing that decision to the Court of Appeals for the circuit in which the violation occurred. (The employer has the same right.)⁶¹ The employee may also seek enforcement of the DOL's order in federal district court.⁶²

The Department of Labor's hearing decisions to date indicate that ALJs are reviewing the cases thoroughly, even if just the length of the decisions is considered. DOL has not shied away from looking at the securities law issues which arise, and appears to interpret the reach of the securities fraud statutes broadly. However, it is clear from reviewing DOL's decisions at all levels, that employees are faring poorly in these cases, with most cases being dismissed.

Congress' decision to require an administrative adjudication has created substantial hurdles for employees. First, employers are likely to be far less concerned with the threat of an administrative proceeding than with litigation. Second, although DOL has long administered a wide variety of whistleblowing statutes, its experience interpreting the securities and criminal prohibitions in issue here is still limited. Third, DOL's resources may not be suited to handling these cases. Its Office of Administrative Law Judges sits in only nine cities, with approximately forty ALJs to handle complaints arising under the many statutes it enforces.⁶³ Finally, while the availability of an administrative remedy may allow the filing of claims by pro se employees who could not afford counsel for

⁶⁰ 29 CFR 1980.110. The hearing is deemed to conclude ten business days after the ALJ's decision. 29 CFR 1980.110(c).

⁶¹ 49 U.S.C. Sec. 42121(b)(4).

⁶² 49 U.S.C. Sec. 42121(b)(6).

⁶³ In addition to its national office in Washington, D.C., OALJ has offices in Boston, Cherry Hill, N.J., Cincinnati, Metairie, LA, Newport News, VA, Pittsburgh and San Francisco. U.S. Department of Labor website at www.oalj.dol.gov.

litigation, it may also produce a flurry of unfounded cases to clog the system, to the detriment of stronger claims.

Resources regarding DOL decisions and appeals:

The Department of Labor publishes decisions of both Administrative Law Judges and the Administrative Review Board at www.oalj.dol.gov.

B. Federal court actions

If DOL does not issue a final decision within 180 days, the employee can bring an action “for de novo review” in federal court.⁶⁴ Once the federal action is filed, DOL loses jurisdiction over the case.⁶⁵

The burden of proof in these actions is, as at the Department of Labor, the construct used in administrative proceedings under the Ford Aviation Act. As detailed above, DOL is not permitted to conduct an investigation unless the employee makes a prima facie showing that the protected activity was a “contributing factor” in the employer’s actions.⁶⁶ Even if DOL finds this standard has been met, it still should not investigate if the employer shows, by clear and convincing evidence, that it would have taken the same action “in the absence of”

⁶⁴ 18 U.S.C. Sec. 1514A(b)(1)(B).

DOL’s regulations require that the federal court plaintiff give fifteen days notice to DOL and all other parties of the plaintiff’s intention to sue. 29 CFR 1980.114(b). This requirement does not appear in Sarbanes-Oxley or the Ford Aviation Investment Act, and should not be jurisdictional.

As noted above, DOL appears greatly concerned over the possibility that a plaintiff could sue in federal court while or after the ARB reviews an ALJ’s decision. Noting that duplicative litigation would waste the resources of the parties, DOL and the courts, DOL is encouraging courts to apply principles of issue preclusion and claim preclusion to some of these situations. 68 FR 102 at 31863 (May 28, 2003). See also *Stone v. Duke Energy Corp.*, 2004 WL 1834597 (W.D.N.C. 2004) (noting DOL’s position and declining to issue writ of mandamus compelling continued administrative proceedings, since DOL had only done an initial investigation and “this case should be resolved in the manner of a typical federal question case.”)

⁶⁵ *Stone v. Duke Energy Corp.*, 432 F.3d 320 (4th Cir. 2005)

⁶⁶ 49 U.S.C. Sec. 42121(b)(2)(B)(i).

the employee's conduct.⁶⁷ Ultimately, DOL can only find a violation if the employee proves retaliation by the "contributing factor" test; it cannot order relief if the employer shows it would have acted similarly in the absence of the employee's whistleblowing.⁶⁸

The application of this construct to federal court is not simple, since it was designed for a multi-step administrative process, rather than litigation. One court has ruled that federal court actions under Sec. 806 are not governed by the burden shifting rules traditionally used in employment discrimination litigation, but rather by the standards set out in DOL's regulations.⁶⁹ The contributing factor / motivating factor standards appear in other federal whistleblower provisions, and courts have applied DOL's burdens of proof in those matters.⁷⁰ If that rationale applies to Sarbanes-Oxley claims, a plaintiff could not prevail if the employer acted with dual motives for the challenged action – that is, for both retaliatory and permissible reasons. Precluding liability for mixed-motive cases can only chill whistleblowers from stepping forward.⁷¹

⁶⁷ 49 U.S.C. Sec. 42121(b)(2)(B)(ii).

⁶⁸ 49 U.S.C. Sec. 42121(b)(2)(B)(iii) and (iv).

⁶⁹ *Collins v. Beazer Homes USA, Inc.*, 334 F. Supp. 2d 1365 (N.D. Ga. 2004) ("The evidentiary framework to be applied in Sarbanes-Oxley is an analysis different from that of the general body of employment discrimination law," and referring to the burdens of proof set by DOL's SOX regulations).

⁷⁰ *Stone & Webster Engineering Corp. v. Herman*, 115 F.3d 1568, 1572 (11th Cir. 1997) (identical burden shifting provision of Energy Reorganization Act of 1974, as amended by the Energy Policy Act of 1992, "supplies its own free-standing evidentiary framework" regardless of "the sprawling body of general employment discrimination law."); *Trimmer v. U.S. Department of Labor*, 174 F.3d 1098, 1101 (10th Cir. 1999) (*McDonnell Douglas* burden shifting not applicable because Energy Reorganization Act's burdens of proof are designed to stem frivolous complaints).

⁷¹ In pleading Sarbanes-Oxley whistleblower claims, employees' counsel should consider the requirement of Fed. R. Civ. P. 9(b) that fraud claims be pleaded with particular specificity. One court has found that this rule applies in cases under Sec. 806. *Bishop v. PCS Administration (USA), Inc.*, 2006 WL 1460032 (N.D. Ill. 2006).

C. Available relief

A prevailing plaintiff is entitled to “all relief necessary to make the employee whole,” which “shall include” reinstatement with seniority, back pay with interest, and compensation for any “special damages sustained as a result of the discrimination,” including attorney’s fees and costs.⁷² The Senate Judiciary Committee eliminated a provision which would have permitted an award of double back pay. It also deleted a clause allowing punitive damage awards to employees whose whistleblowing involved substantial risks to the health, safety or welfare of the employer’s shareholders or the public.⁷³

Sarbanes-Oxley does not state whether a plaintiff can recover damages for emotional distress as part of the “special damages” authorized by Sec. 1514(A)(c)(2)(C). The legislative history only speaks of employees recovering “compensatory damages to make a victim whole,” including attorney’s fees and costs.⁷⁴

However, in a recent Eastern District of New York case, Judge Johnson held that “special damages” include damages for “reputational injury” which diminish a plaintiff’s future earning capacity. It is not clear from the opinion whether the court was referring to front pay, or damages to compensate plaintiff for the less tangible harm to his reputation and earning capacity. *Mahoney v. Keyspan Corp.*, 2007 WL 805813 (E.D.N.Y. March 12, 2007). The court in *Mahoney* relied on a similar decision from the Southern District of Florida, holding that “a successful Sarbanes-Oxley plaintiff cannot be made whole without being compensated for damages for reputational injury that diminished plaintiff’s future earning capacity.” *Hanna v. WCI Communities, Inc.*, 348 F.Supp.2d 1332 (S.D. Fl. 2004). But see *Murray v. TXU Corp.*, 2005 WL 1356444 (N.D. Tex. 2005) (Special damages limited to litigation costs, expert witness fees and reasonable attorney’s fees, based on text of Sec. 806, and analogizing to pre-1991 remedies of Title VII).

Some courts have construed the “special damages” permitted by the similarly-worded anti-retaliation provision of the False Claims Act to permit awards for emotional pain and suffering.⁷⁵ Whistleblowers are often ostracized

⁷² 18 U.S.C. Sec. 1514A(c).

⁷³ S. 2010, S. Rep. No. 107-146, 107th Cong. 2d Sess. 10-12 (May 6, 2002) (introduction of amended bill).

⁷⁴ S. Rep. No. 107-146, 107th Cong., 2d Sess. 13-14 (2002).

and ridiculed for raising potentially explosive issues, and experience the tremendous stress of isolation and career dislocation. They should be able to recover damages for these intangible harms, as well as their lost pay.

D. What is a “reasonable belief” that fraud has occurred?

A major question in these cases is the level of knowledge a plaintiff must have regarding an employer’s alleged fraud to qualify for whistleblower protection. Sec. 1514(a)(1) protects employees who provide information, cause information to be provided, or otherwise assist in an investigation regarding conduct which the employee “reasonably believes” constitutes a violation of the listed provisions.

The legislative history indicates that the reasonable belief standard should be liberally applied. Noting that retaliation cases should be subject to the “reasonable person” test, the Judiciary Committee cited to a whistleblower case under the Clean Water Act in which the Third Circuit spoke of protecting “good faith” and “non-frivolous” employee complaints.⁷⁶ *Passaic Valley Sewerage Commissioners v. United States Department of Labor*, 992 F.2d 474, 478-79 (3rd Cir. 1993).

In *Passaic Valley*, the Court of Appeals considered whether an intra-corporate complaint constituted protected activity under the Clean Water Act’s whistleblowing provision. That statute prohibits discrimination against any employee “by reason of the fact that such employee...has filed, instituted, or caused to be filed or instituted any proceeding under this chapter, or has testified or is about to testify in any proceeding resulting from the administration or enforcement” of the Clean Water Act. 33 U.S.C. Sec. 1367(a).

Finding that the whistleblower provision was enacted for the “broad remedial purpose” of protecting employees’ efforts to bring a company into compliance with the Clean Water Act, the court held that “good faith” assertions of corporate violations of the statute, whether made internally or externally, were protected. The court emphasized that employees should not be discouraged from pursuing internal remedies before publicizing “good faith allegations,” and seemed to include in that category situations where “perceived corporate oversights are a

⁷⁵ *Brandon v. Anesthesia & Pain Mngmt. Assoc., Ltd., et al.*, 277 F.3d 936 (7th Cir. 2002) (*in dicta*); *Hammond v. Northland Counseling Center, Inc.*, 218 F.3d 886 (8th Cir. 2000); *Neal v. Honeywell, Inc.*, 191 F.3d 827 (7th Cir. 1999).

⁷⁶ S. Rep. No. 107-146, 107th Cong., 2d Sess. 19 (2002).

matter of employee misunderstanding.” Significantly, the court stated that a “non-frivolous” complaint should not “have to be guaranteed to withstand the scrutiny of in-house or external review” to be protected.⁷⁷

Courts in SOX cases have largely adopted the *Passaic Valley* analysis, noting that “the threshold is intended to include all good faith and reasonable reporting of fraud, and there should be no presumption that reporting is otherwise, absent specific evidence.” See, e.g., *Collins v. Beezer Homes USA Inc.*, 334 F.Supp.2d 1365 (N.D. Ga. 2004); *Bishop v. PCS Administration (USA), Inc.*, 2006 WL 1460032 (N.D. Ill. 2006). As these cases noted, Sec. 806 does not require whistleblowers to identify the statutory provisions they believe are being violated. “If Congress had intended to limit the protection of Sarbanes Oxley...or to have required complainants to specifically identify the code section they believe was being violated, it would have done so.” *Id.*

The Southern District of New York has endorsed this view as well, although with a strong caution. *Fraser v. Fiduciary Trust Company International*, 417 F.Supp.2d 310, 322, 323-4 (S.D.N.Y. 2006). While noting that Congress did not intend to require the plaintiff to identify a specific code section he believes was violated, it has held that “general inquiries” are not sufficient. Rather, “the reported information must have a certain degree of specificity [and] must state particular concerns which, at the very least, reasonably identify a respondent’s conduct that the complainant believes is illegal.” Protected activity must “implicate the substantive law protected in Sarbanes-Oxley ‘definitely and specifically.’” (Plaintiff engaged in protected activity by drafting an email questioning the company’s failure to provide the same advice to all its clients concerning the advisability of selling WorldCom bonds to avoid losses, and by advising the defendant’s President that he had been told not to circulate the e-mail.) See also *Bozeman v. Per-Se Technologies*, 456 F.Supp.2d 1282, 1359 (N.D. Ga. 2006).

Citing DOL decisions, the Northern District of Illinois has required that the plaintiff’s belief be both subjectively and objectively reasonable, and that in determining reasonableness, the employee’s experience, background and access to information are relevant. *Bishop v. PCS Administration (USA), Inc.*, 2006 WL 1460032 (N.D. Ill. 2006).

A good faith, non-frivolous standard is consistent with the Department of Labor’s regulations. Under them, a complainant may be sanctioned only for filing

⁷⁷ *Passaic Valley Sewerage Commissioners*, 992 F.2d at 478-79.

a “frivolous” or “bad faith” charge.⁷⁸ DOL has interpreted the reasonable belief standard to protect employees who are completely mistaken in their evaluation of the employer’s alleged fraud. As one ALJ wrote in a decision under Sec. 806, “[a] belief that an activity was illegal may be reasonable even when subsequent investigation proves a complainant was entirely wrong. The accuracy of falsity of the allegations is immaterial....”⁷⁹

A “good faith” standard is also entirely sensible. Given the complexities of the violations that employees may complain about (e.g. mail fraud, bank fraud, wire fraud, securities fraud), an employee should not be required to have a professional’s sophisticated understanding of the intricacies of federal securities and criminal law to be protected from retaliation.

However, the courts have rejected whistleblower claims based on a whistleblower’s speculation that an employer’s non-fraudulent activity might, in the end, lead to financial losses and ultimate fraud on shareholders. These decisions have required that the employee’s belief that the company is engaged in misconduct be both subjectively and objectively reasonable. See, e.g., *Livingston v. Wyeth Inc.*, 2006 WL 2129794 (M.D.N.C. 2006) (Finding no reasonable belief for plaintiff’s complaints that pharmaceutical company would be unable to meet compliance and training deadlines of a consent decree regarding adulterated drugs and therefore would be fined \$15,000 a day by the FDA); *Bishop v. PCS Administration (USA), Inc.*, 2006 WL 1460032 (N.D. Ill. 2006) (“a reasonable belief that implementing certain procedures will be insufficient to prevent violations is not, by itself, a reasonable belief that a violation has occurred or been attempted.”)⁸⁰

⁷⁸ 29 CFR 1979.105(b).

⁷⁹ *Halloum v. Intel Corporation*, 2003 SOX 0007, March 4, 2004.

⁸⁰ The court in *Bishop* contrasted the plaintiff’s actions with those of the employee in *Morefield v. Exelon Services, Inc.*, 2004 SOX 2, 2004 WL 5030303 (January 28, 2004), discussed in Sec. II above. In *Morefield*, the DOL ALJ ruled that the employee had engaged in protected activity by reporting internal accounting deficiencies and efforts by top management to manipulate financial results. The employer argued that the company had not made false reports externally, that no outside party was deceived, and that Morefield had no basis for believing that his concerns were material. The ALJ ruled that a company’s financial manipulations do not have to appear in an external report. “The value of a whistleblower resides in his or her insider status,” and the ability to prevent deceptions which could “taint the public disclosure.” A whistleblower’s concerns may also address the inadequacy of internal controls which could lead to the violation of SEC rules or regulations or other mandates under SOX.

DOL has also dismissed claims based on an employee's speculation that an employer's non-fraudulent conduct might create financial losses. See, e.g., *Smith v. Hewlett Packard*, 2005 SOX 00088 (January 19, 2006) (no protected activity where employee complained about "systematic race discrimination" caused by allegedly discriminatory evaluation processes, and noting that the result might be different if plaintiff had complained about the employer's failure to disclose to shareholders the filing of a discrimination class action); *Minkina v. Affiliated Physician's Group*, 2005 SOX 19 (February 22, 2005) (employee did not engage in protected activity by reporting to OSHA what she believed to be dangerous air quality in the workplace, since the possibility that those conditions would lead to financial losses was mere speculation).

A recent decision of the Administrative Review Board shows how the reasonable belief standard may be increasingly difficult for employees to meet. *Welch v. Cardinal Bankshares Corporation*, ARB Case 05-064 (ARB, May 31, 2007). After an extended hearing, the ALJ below had ruled that Cardinal Bankshares violated Sec. 806 by terminating its CFO in retaliation for various complaints he had made about financial improprieties. The CFO, Welch, had a) complained about insider trading by Bank officers; b) refused to sign off on a quarterly financial statement overstating the company's income; c) refused to attest to the validity of financial statements because the company's auditor did not provide him with necessary information; and d) complained that Cardinal's internal controls improperly permitted employees outside the finance department to make journal entries without his knowledge.

The ALJ rejected Cardinal's argument that Welch had only been fired because he refused to meet, without counsel, with the company's auditors about the issues he had raised. The ALJ first considered the close temporal relationship between Welch's protected activity and his termination; he noted that Welch was fired only six weeks after his first complaint, and shortly after his later complaints. The ALJ noted that, in any event, Cardinal's management team engaged in a campaign to discredit and terminate him that began well before Welch refused to participate in the meeting without his lawyer, immediately after refusing to sign off on the disputed quarterly report. Finally, the ALJ ruled that Cardinal would not have terminated Welch but for his protected activity, rejecting the argument that the presence of Welch's counsel at the meeting was either unwarranted or prohibited by the company's rules.

As for remedies, the ALJ ordered that Welch be reinstated, and required further submissions on the calculation of an award of back pay, attorney's fees and costs. The ALJ did not address the issue of emotional distress damages, which, as

noted below, are arguably within the category of “special damages.”

On appeal, the ARB reversed the ALJ’s decision. It ruled that, as a matter of law, Welch could not have had a reasonable belief that Cardinal Bankshares was engaging in fraud. It held that Welch had to prove both that he actually believed there was fraud, and that a person with his expertise and knowledge would also have had that belief. As the CFO, the ARB found, should have known that no fraud occurred was actually occurring. The ARB also held that an employee’s belief that an employer is violating accounting standards, such as those in GAAP, is insufficient grounds for a SOX claim, because Congress sought to protect only employee complaints about violations of the statutory and regulatory provisions listed Sec. 806. Finally, Welch’s complaints about Cardinal’s lack of internal controls were also not protected activity, since “[a]lthough having a deficient internal control may make an institution more vulnerable to fraud, in itself it is not fraudulent.”

Cases under other federal anti-retaliation statutes are instructive on these issues, particularly whistleblower cases under the False Claims Act.

The False Claims Act, 31 U.S.C. Sec. 3729 and 3730, creates liability to the federal government for persons who knowingly present a “false or fraudulent claim for payment or approval” to the United States or a federal officer or employee. 31 U.S.C. Sec. 3729(a)(1). A “claim” is defined as any request or demand made to a contractor, grantee or other recipient, if the United States provides any portion of the money requested, or will reimburse the grantee or recipient for any portion of the money requested. 31 U.S.C. Sec. 3729(c). Either the United States Attorney General or a private “qui tam” plaintiff (“relator”) can bring a civil action under the False Claims Act based on a defendant’s submission of false claims.

The False Claims Act’s whistleblower provision bars employers from discriminating against any employee “because of lawful acts done by the employee... in furtherance of an action under this section, including investigation for, initiation of, testimony for, or assistance in an action filed or to be filed under this section.” 31 U.S.C. Sec. 3730(h).

While there is no parallel “reasonable belief” language in this section, courts have read a good faith or reasonable belief standard into the statute. The decisions interpret that standard liberally, to encourage internal complaints and corporate compliance, and in recognition of the fact that an employee who investigates or complains about impropriety may have only a basic, well-intended

sense that a wrong is being committed – without necessarily knowing what that wrong means technically or legally.

For instance, in *Field v. F&B Manufacturing Co.*,⁸¹ the court found that the plaintiff had a reasonable basis for believing that fraudulent activity had occurred, even though the government specifications in issue were never violated. Rejecting the employer’s contention that the employee had “imagined a fraud,” the court held that False Claims Act retaliation actions should be judged under a loose Rule 11 standard. It found that a reasonable employee could have believed that “something ‘fishy’ was afoot,” justifying the employee’s further inquiry. The employee’s “reasonable cause for suspicion and for initiating an inquiry into...potentially fraudulent conduct” was enough to protect him. In determining the employee’s reasonableness, what was relevant was the information he had at the time — not the fact that a later investigation revealed the absence of fraud.⁸²

In another FCA case, *U.S. ex rel Yesudian v. Howard University*, the D.C. Circuit minimized an employee’s burden in showing his “good faith” or reasonable belief that a fraud was occurring. The court held that an employee does not have to know that the investigation he was pursuing could lead to a FCA suit, or even have heard of the False Claims Act at the time. Otherwise, “only lawyers – or those versed in the law – would be protected.”⁸³

The same considerations should apply to Sarbanes-Oxley whistleblower cases. Requiring employees to have been “right” about an employer’s fraud would protect only those employees who were lucky enough to be prescient, and to have correctly predicted how a court might eventually apply securities and fraud laws to their employer’s conduct. Congress could hardly have intended that a “reasonable belief” in corporate wrongdoing require the employee to have been

⁸¹ *Field v. F&B Manufacturing Co.*, 1996 U.S. Dist. LEXIS 6014 (N.D. Ill. 1996).

⁸² 1996 U.S. Dist. LEXIS 6014 at *15 - *17.

⁸³ *U.S. ex rel Yesudian v. Howard University*, 153 F. 3d 731, 741 (D.C. Cir. 1998). *See also, Wilkins v. St. Louis Housing Authority*, 2002 U.S. App. LEXIS 27174 (8th Cir. Dec. 2002) (plaintiff engaged in protected activity based upon good-faith, objectively reasonable belief that company was committing fraud, generally, against the government); *Moore v. California Institute of Technology Jet Propulsion Laboratory*, 275 F.3d 838 (9th Cir. 2002) (rejecting requirement that plaintiff demonstrate that whistleblowing activity necessarily could have resulted in False Claims Act case, and holding that a reasonable jury could have concluded that plaintiff had good faith and objectively reasonable belief that an employee was attempting to defraud the government).

technically correct, and with the benefit of hindsight. Employees who have a “good faith” basis for looking into fraud or trying to correct it internally, but who do not correctly assess every element of a securities, mail, bank or wire fraud claim, are equally deserving of protection.

Similarly instructive on this question are decisions analyzing the anti-retaliation provisions of Title VII and the ADA, in which employees have been held to a “good faith, reasonable belief” that the actions complained about violated the law.⁸⁴ The courts have not required that a plaintiff establish that the conduct being opposed was in fact a violation of the law.⁸⁵

The Supreme Court’s interpretation of the reasonable, good faith belief standard in *Clark County School District v. Breeden* should not change this approach.⁸⁶ In *Breeden*, the Court declined to decide whether the Ninth Circuit acted properly in holding that an employee’s complaint is protected if the employee had a reasonable, good faith belief that the incident she complained about constituted unlawful conduct under Title VII. Instead, the Court held that even assuming that standard were correct, “no one could reasonably believe” that the incident in issue violated Title VII.

Breeden only requires the obvious: that an employee’s belief be a reasonable one. There is little difference between a court assessing whether “anyone” could have a reasonable belief that conduct was illegal, and whether the employee in question could have reasonably had that belief. Both questions judge reasonableness from the circumstances as they appeared at the time of the complaint. Under both formulations, a complaint which defies credulity will not pass muster, even if the employee believed in his heart of hearts that it was valid.

⁸⁴ *Manoharan v. Columbia University College of Physicians & Surgeons*, 842 F.2d 590 (2d Cir. 1988); *Brands-Kousaros v. Di Napoli*, 1997 U.S. Dist. LEXIS 20345 (S.D.N.Y. 1997).

⁸⁵ See, e.g., *Wilkins v. St. Louis Housing Authority*, 2002 U.S. App. LEXIS 27174 (8th Cir. 2002); *Little v. Windermere Relocation*, 301 F.3d 958 (9th Cir. 2001); *Foster v. Time Warner Entertainment Co.*, 250 F.3d 1189 (8th Cir. 2001); *McMenemy v. City of Rochester, et al.*, 241 F.3d 279 (2d Cir. 2001); *Manoharan v. Columbia University College of Physicians & Surgeons*, 842 F.2d 590 (2d Cir. 1988); *Spadola v. New York City Transit Authority*, 2003 U.S. Dist. LEXIS 306 (S.D.N.Y. 2003); *Brands-Kousaros v. Di Napoli*, 1997 U.S. Dist. LEXIS 20345 (S.D.N.Y. 1997), (citing *Cosgrove v. Sears, Roebuck & Co.*, 9 F.3d 1033, 1039 (2d Cir. 1993)).

⁸⁶ *Clark County School District v. Breeden*, 532 U.S. 268 (2001).

Even if *Breeden* articulates an “objectively reasonable” test, there is probably little difference between that and a “subjective” one.⁸⁷

In any event, many courts interpreting the anti-retaliation provisions of Title VII and the ADA since *Breeden* have continued to focus on the employee’s good faith, reasonable belief, under the totality of the circumstances.⁸⁸

Following the caselaw under the False Claims Act, Title VII and the ADA, courts should carry out Congress’ intent to deter employers from punishing employees who look into or complain about potential fraud claims, without requiring that those employees sift the intricacies of those claims with the expertise of securities lawyers. Employers’ interests are amply protected by a test that shields a well meaning employee who unwittingly misconstrues the facts or misinterprets the law. After all, employers have a strong interest in having employees come forward with their concerns about fraud, because some of those employees may turn out to be correct.

⁸⁷ *Breeden* can also be read as the Supreme Court’s reaction to the extreme thinness, to put it mildly, of the plaintiff’s sexual harassment complaint.

⁸⁸ See *Spadola v. New York City Transit Authority*, 2003 U.S. Dist. LEXIS 306 (S.D.N.Y. 2003) (Title VII case applying totality of circumstances test to assess reasonableness of employee’s belief, but finding plaintiff’s belief neither subjectively genuine nor objectively reasonable because plaintiff did not actually believe he was the victim of sexual harassment, and one comment at issue had no gender overtones and could not otherwise interfere with work); *Zappan v. Pennsylvania Bd. of Probation and Parole*, 2002 U.S. Dist. LEXIS 23424 (E.D. Pa. 2002) (in Title VII case, plaintiff acknowledged that employee subjects of adverse decision which he claimed was discriminatory were in fact in need of discipline and could point to no evidence that decision was discriminatory in any way, thus, opposing conduct not protected since no reasonable person could believe the actions violated Title VII); *Schatzman v. Martin Newark Dealership, Inc.*, 158 F. Supp. 2d 392 (D. Del. 2001) (distinguishing *Breeden*, and finding that the plaintiff’s complaints about comments he believed were racially derogatory constituted protected activity, even though African-American employees did not find them offensive); *Foster v. Time Warner Entertainment Co.*, 250 F.3d 1189 (8th Cir. 2001) (rejecting defendant’s argument that the plaintiff had not engaged in protected activity because the employee she was advocating for was not a qualified person with a disability under the ADA, and citing to the plaintiff’s good faith, reasonable belief that a legal violation was occurring).

V. Practical tips for lawyers representing Sarbanes-Oxley whistleblowers

1. Keep in mind your client's state of mind.

Many whistleblowing clients come to a lawyer in a state of great anxiety. They perceive that their careers hang in the balance, and that their superiors or peers are out to get them. This perception may well be accurate, or it may be exaggerated. You will have to do what you can to test this perception, since it will greatly affect your evaluation of the case and color your relationship with your client.

2. Do a thorough initial consultation and investigation.

Question your client closely and listen to him or her well. Whatever e-mails, memos and notes your client has will be crucial. Have your client draft a chronology of relevant events, and compare that chronology, and your client's answers during the initial meeting, with the e-mails and documents you have. Is your client truly in a position to know what the client says he knows, or is he really relying on rumor, assumptions and wishful thinking about the employer's conduct? If there are witnesses who could provide you with information, consider whether you can ethically speak with them,⁸⁹ or if talking with them might jeopardize your client's leverage and potential bargaining position.

3. Know your limits – consult with a securities lawyer.

Lawyers who specialize in securities fraud can help you understand the crucial questions of whether fraud occurred, whether your client's belief was a reasonable one, and, if your client is a lawyer, does your client have to report the fraud "up the ladder." In our firm, we have consulted with former federal prosecutors who are now in private practice.

4. Undertake the representation with a client-centered focus.

If your client is a current employee, does your client want to remain with the employer, keep his career on track and move on? Does your client want to negotiate a settlement or buy-out which will provide financial security and practical help with a career transition? Or does your client want to quickly proceed to the Department of Labor, and then perhaps into federal court, without regard for confidentiality, and aggressively pursue the employer?

⁸⁹ See *Niesig v. Team 1*, 76 N.Y.2d 363 (1990); *Merrill v. City of New York*, 2005 U.S. Dist. LEXIS 26693 (S.D.N.Y. November 4, 2005).

If your client is currently employed, the best help you may be able to provide at the outset is reviewing, editing or ghost-writing a complaint to the employer's HR department, or audit or compliance officer. Remember that for all practical purposes, if it's not written down, it doesn't exist and it didn't happen. So your client should preserve the record in the form of a specific, factual and detailed complaint, written in a serious and plain-spoken tone. Avoid charged-up adjectives and characterizations.

The employer is likely to respond to the complaint by seeking to interview your client. While of course your client will want you to be there, in many jurisdictions, you have no right to be present – unless your client is being interviewed by the employer's counsel. Prepare your client for this interview the way you'd prepare the client for a deposition, as the employer's notes and record of the interview may be crucial evidence if the case goes forward.

If the employer is truly concerned about what your client knows, then your client should consider entering into confidential negotiations with the employer's counsel. If the employer is not interested in talking with you, it may indicate that the issues your client sees are not as problematic for the employer as your client believes. (Or, it may simply indicate that the employer is in denial that serious issues exist.)

In all cases, keep in mind the 90 day limitations period for filing with the Department of Labor and the various deadlines for administrative filings.

5. Choose your forum wisely

While we may be tempted to assume that administrative agencies are inferior forums for resolution of these retaliation claims, that may not be true for Sarbanes-Oxley claims. While certainly a charging party at DOL has a reduced ability to conduct discovery, DOL proceedings may move along more quickly than litigation, and may end up being less expensive for the client. If you prevail at the hearing, the employer is likely to have a hard time obtaining a reversal from the Administrative Review Board (at least as compared with how many verdicts are overturned or reduced by federal court judges or appellate panels.) And if your client can be reinstated early on, that decision is likely to remain undisturbed and be a huge lever for settlement.

However, keep in mind that both discovery at DOL may be far more limited than what you need, and that you may be rushed along to a hearing well before you have had sufficient time to investigate your case.

One peculiarity of the Department of Labor's procedures may greatly affect your ability to settle a case. DOL requires that parties submit settlement agreements to it for approval.⁹⁰ As a result, a settlement agreement may be available for disclosure under the Freedom of Information Act. This may pose a major problem for those employers who are motivated to settle based on confidentiality considerations. To deal with this conundrum, employees can file an action in Federal court after 180 days, settle the federal court case, and then move at DOL to dismiss the administrative proceeding.

Conclusion

Sec. 806 certainly has its limits, and many issues about its application are still open. But it gives employees significant protections and remedies, and requires lawyers representing employers to carefully counsel their clients to avoid retaliation claims.

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⁹⁰ 29 CFR 1980.111. See also *Beliveau v. United States Department of Labor*, 170 F.3d 83, 88 (1st Cir. 1999) (in whistleblower proceeding under various environmental statutes, remanding case to DOL when parties did not seek DOL approval of settlement agreement).