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Whistleblower Litigation:
Dealing With SOX Allegations in the Current Economic Climate

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Overview of Program

- Summary of legal standard / procedure
- View from the inside
- Dealing with claims internally
- Legal trends
  - Recently-decided ALJ and federal court decisions
  - Potential impact of economic climate and new administration
- Q&A

Summary of Legal Standard / Procedure

Summary of Legal Standard: SOX §806 (18 USC §1514A)

- Covered employers may not "discharge, demote, suspend, threaten, harass, or in any other manner discriminate against" any employee who participates in a protected whistleblowing activity.
- Employees who suffer retaliation may file a complaint with the Department of Labor, and may later be able to file a civil action in federal court.
- Remedies are compensatory in nature, including:
  - Reinstatement to the same position / same seniority level
  - Back pay plus interest
  - Fees and costs
  - Potential damages for emotional distress or loss of reputation

Summary of Legal Standard: Covered Employers / Employees

- SOX only protects employees of publicly-traded companies.
  - Covered employers include all companies that have registered securities or that are required to file reports under the Securities Exchange Act of 1934.
  - Covered employees include current and former employees and applicants.

18 U.S.C. §1514A(a); CFR 1980.101

Summary of Legal Standard: Employee's Action for Retaliation

- The claimant must make a prima facie showing that:
  - The claimant engaged in a "protected activity;"
  - The employer knew or suspected that the claimant engaged in protected activity;
  - The claimant suffered an unfavorable personnel action; and
  - The protected activity was a contributing factor in the unfavorable action.
- The employer can rebut a prima facie case by showing that it would have taken the unfavorable action regardless of the claimant's participation in the protected activity.

29 CFR 1980.104(b)(1), (c)

Overview of Procedure: OSHA Investigation

- The claimant must file a written claim with DOL
  - Statute of Limitations – the complaint must be filed within 90 days after the alleged discrimination occurred (i.e., when the retaliatory action was both taken and communicated to the claimant)
- OSHA will investigate the claim
  - After investigation, the Assistant Secretary will issue findings and, if a violation occurred, will also issue a preliminary order providing relief to the claimant

18 USC §1514A(b)(2)(D); 29 CFR 1980.103(d), 105(a)

Overview of Procedure: DOL Appeals

- If either party objects to OSHA's findings, it may appeal to the DOL to have the case heard by an Administrative Law Judge
  - The appeal must be within 30 days of OSHA's ruling
  - The appointed ALJ will then conduct hearings, to be conducted *de novo* and on the record
- The ALJ's findings can be appealed to the DOL's Administrative Review Board

29 CFR 1980.105-110

Overview of Procedure: Federal Court

- If the Board has not issued a final decision within 180 days of the filing of the complaint, the complainant may file a civil action in federal district court.
  - A federal court action is often available, as final board decisions are rarely rendered within 180 days.
    - In 2005, the average initial OSHA investigation alone took a total of 127 days.
    - ALJ hearings often drag on for many more months or even years.
  - The district court reviews *de novo*.

29 CFR 1980.114;
Richard E. Moberly: *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 William & Mary L. Rev. 65 (2007)

View from the Inside

Hotline v. Helpline

What's in a Name?

Hotline = reporting hot issues, emergencies, attaches an image to the reported matter

Helpline = provides guidance, is a source of assistance, provides clarification

Some actual names used:

- Assist Line
- Alert Line
- Associate Help Line
- Compliance Line
- Help Line
- Concerns Helpline
- Report line
- Integrity Help Line
- Hot Line
- Abuse Line
- Care Line
- Values Line

BMC Ethics HelpLine - Microsoft Internet Explorer

File Edit View Favorites Tools Help

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Deutsch עברית

BMC Ethics HelpLine

At BMC we are committed to conducting business with integrity, trust and in accordance with the laws and regulations governing our activities. Ethical conduct is the right thing to do - and it's good business. Our Professional Conduct Policy and Code of Ethics (the "Code") sets out our values and standards of conduct for anyone representing BMC.

Whenever any situation threatens our values or our reputation, we rely on you to speak up. When you do, you provide us with the information necessary to correct the situation. Contact us 24 hours a day, seven days a week to report your concerns about:

- Accounting, internal control or auditing matters
- Conflicts of interest
- Insider stock trading
- Misuse of confidential information/intellectual property
- Harassment or discrimination
- Improper contact with government officials
- Contracting with third parties
- Environment, health and safety
- Substance abuse
- Theft, bribery or kickbacks
- Inappropriate gifts or gratuities
- Abuse of company resources
- Or any other violations of the BMC Code

Your report will be confidential and you will not be retaliated against or punished in anyway for reporting your concerns.

Submit a new report	Follow up on an existing report	Read the BMC Professional Conduct Policy and Code of Ethics

Start | 2 Microsoft Offi... | Microsoft PowerP... | G:\INVLOG | Microsoft Excel - ... | BMC Ethics Hel... | 2:17 PM

Helpline – Internal or Outsource?

- Internal
  - Pros
    - Potential cost savings
    - Control over all facets
  - Cons
    - Staffing considerations
    - Time
    - Perceived lack of confidentiality
- Outsourced
  - Pros
    - 24/7/365
    - Anonymity
    - Multilingual
    - On-demand analytics
  - Cons
    - Cost
    - Loss of some control

Report Lifecycle

- Report comes in
  - If through Helpline
    - Documented
    - Assigned an issue # for reference
    - Assigned a priority rating A-C
    - GC, Chair of Audit Committee, Director of C&E and Head of Internal Audit informed
    - GC, BOD Audit Chair, C&E and IA determine appropriate investigative team/approach, assigned by GC
  - If through any other channel (call to manager, HR, email to CEO, anonymous letter, etc.,)
    - Routed to Director of C&E
    - Director of C&E informs rest of team
    - Team assigns priority and appropriate investigative team/approach

Report Lifecycle *Cont'd*

- Investigation looping
  - Regardless of team investigating, it is assigned from Legal, looped back through Legal throughout the process, reported to Legal in the end.
- Process and conclusions documented in report to GC
- Matters tracked and records maintained by Compliance & Ethics

Report Priority

- Priority “A”
  - Critical, Urgent, Material
  - Notification by email and phone
  - 1-2 Day response time
- Priority “B”
  - Serious but less critical
  - 1-14 Day response time
- Priority “C”
  - Non-critical, Non-urgent
  - 1-21 Day response time

International Considerations

- Helpline vendors offer 24-7 global communication path
- Vendors can translate within an hour or two of the initial report
- Process is generally the same, but must consider:
  - Cultural issues
  - Local laws
  - Resource availability
  - Expense
  - Difficulty in getting information (due to all the above)

Discussion

- Responding to allegations
  - Gathering information related to the allegations
  - Process for investigating and responding to claims
  - Documenting investigations
  - Determining when the Board must be notified

Discussion

- Practical implications in the workplace once a whistleblower is no longer anonymous
  - How to evaluate and avoid potential retaliation claims
  - Does whistleblower status give the employee a “get out of jail free card?”
  - What to do when a purported whistleblower needs to be disciplined for other reasons
- Importance of the relationship with DOL investigator

Discussion

- Settlement attempts
  - Employers should be cautious if they request that a potential plaintiff sign a release of claims; such an attempt could be held to constitute an adverse action.
  - *Rzepiennik v. Archstone-Smith, Inc*, 2004-SOX 00026 (Feb. 23, 2007) – plaintiff argued that a severance offer with a bonus conditioned on his silence constituted an adverse action.
    - The ALJ ultimately rejected plaintiff's claim, but it was a close question:
      - "While there may be instances in which protracted negotiations culminating in a severance package could give rise to an adverse action under SOX, based upon a continuing violation analysis, the facts alleged here do not." *Id.*

Trends in the Law

Trends in the law: Interpretation of "reasonable belief"

- The "protected activity" element of a plaintiff's prima facie case requires a showing that the plaintiff "reasonably believed" the conduct complained of constituted a violation
- We have observed a recent dramatic uptick in the number of federal district court cases discussing the "reasonable belief" standard
  - Was the ground for dismissal in 62% of all dispositive federal district court decisions in 2008
  - By contrast, the issue was discussed in only 8% of dispositive federal decisions in 2007, and only around 14% of ALJ decisions in 2007-08

Trends in the law: Interpretation of "reasonable belief"

- What these recent decisions are saying:
  - Must be both an objective and subjective belief
  - Belief must pertain to an existing violation, i.e., not only "has happened" but is also "in progress"
  - Belief that violation is "about to happen" is insufficient
    - *See*, *e.g.*, *Livingston v. Wyeth, Inc.*, 520 F.3d 344 (4th Cir. 2008); *Walton v. Nova Information Systems*, 2008 WL 1751525 (E.D. Tenn. 2008); *Godfrey v. Union Pacific Railroad Co.*, 2008-SOX-5 (A.L.J. April 30, 2008) (citing *Livingston* for existing violation requirement).

Trends in the law:
Do plaintiffs have right to a jury trial?

- Recent federal decisions have concluded that section 1514A, by its terms, does not provide a right to jury trial
- Courts applied the three-part Seventh Amendment test, holding there is no Seventh Amendment right to jury trial:
  - Step One: Analogous Common Law Claim (weighs for jury trial)
  - Step Two: Remedy Sought (weighs against jury trial)
  - Step Three: Public Right (weighs against jury trial)
    - *See*, e.g., *Schmidt v. Levi Strauss & Co.*, 2008 WL 859705 (N.D. Cal. 2008); *Walton v. Nova Information Systems*, 514 F.Supp.2d 1031 (E.D. Tenn. 2007).

Trends in the law: What constitutes a "covered employer"?

- For plaintiff to sue under section 1514A whistleblower provisions, s/he must be a "protected employee" under the Act
- We have observed that the "no covered employer" rationale for dismissal is being discussed in fewer and fewer ALJ cases
  - 28.9% of decisions in 2002-06
  - 24.4% of decisions in 2007
  - 14.8% of decisions in 2008

Trends in the law: What constitutes a "covered employer"?

- Likely reason for this trend: in recent years, the law has become more clear re: subsidiaries of public entities
  - The A.R.B. explained in 2006 that subsidiaries of public companies were only covered employers when they act as agents of their parents.
    - *Klopfenstein v. PCC Flow Technologies Holdings*, A.R.B. No. 04-149 (A.R.B. May 31, 2006).
  - One federal court noted that by 2007, a "growing number" of ALJ opinions had concluded that employees of non-public subsidiaries are not covered under §1514A.
    - *Rao v. Daimler Chrysler Corp.*, 2007 WL 1424220 (E.D. Mich. 2007).
- With the "agent" rule in place, it is now more clear which of today's subsidiaries are likely to be covered employers, so many subsidiaries may not be raising the defense

Trends in the law: Are §1514A claims subject to arbitration?

- §1514A is silent regarding arbitration
- The Second and Fifth Circuits, district courts in the D.C. and Fourth Circuits, and ALJ decisions have all recently concluded that SOX whistleblower claims are arbitrable
  - *See Guyden v. Aetna, Inc.*, 544 F.3d 376 (2d Cir. 2008); *Green v. Service Corp. Int'l*, 2008 WL 4056325 (S.D. Tex. 2008), *aff'd*, 2007 WL 1577926 (5th Cir. May 30, 2007); *Kimpson v. Fannie Mae Corp.*, 2007 WL 1020799 (D.D.C. 2007); *Mozingo v. South Financial Group, Inc.*, 520 F.Supp.2d 725 (D.S.C. 2007) (plaintiff waived right to arbitrate by litigating claim, but stating that claim would have been arbitrable); *Bergman v. Chesapeake Energy Corp.*, 2008-SOX-9 (A.L.J. Dec. 19, 2007); *Sullivan v. Science Applications Int'l Corp.*, 2007-SOX-60 (A.L.J. Sept. 21, 2007).
- No DOL or federal authority to the contrary

Trends in the law:
Attorneys' Fees for Successful Claimants

- Recent Fourth Circuit case determines what constitutes a "prevailing party" entitled to attorneys' fees under 1514A
  - Held that the Supreme Court's decision in *Buckhannon* guides the determination
    - Court first considered whether the judgment created a "material alteration of the legal relationship between Plaintiff and Defendant"
    - Court next considered whether there was a "judicial imprimatur on that change"
  - Court held that a FRCP 68 judgment (offer of judgment by defendant) creates a material alteration and carries a judicial imprimatur
    - Because defendant made a Rule 68 judgment, plaintiff was entitled to attorneys' fees
      - *Grissom v. The Mills Corp.*, 2008 WL 5077824 (4th Cir. 2008)

Other observed trends: Employer rebuttal

- The number of dismissals by ALJs based on an employer's rebuttal of a prima facie case (i.e. by showing a legitimate ground for dismissal) is significantly decreasing:
  - 14.5% of ALJ decisions in 2002-06
  - 4.9% of ALJ decisions in 2007
  - 3.7% of ALJ decisions in 2008
- Does NOT mean that employers are finding it more difficult to make this showing – no 2007-08 ALJ decisions have *rejected* an employer's rebuttal argument either. The argument simply is not coming up.
  - It appears that ALJs are simply finding that every recent claimant fails to prove a prima facie case, so the rebuttal issue is usually moot.

Other observed trends: Sharp decline in withdrawals / settlements

- Withdrawal rates are declining significantly. Statistics of cases pending before ALJs shows recent decline in voluntary withdrawals:
  - 2002-06: 40.0%
  - 2007: 23.0%
  - 2008: 10.7%
- Possible reasons for this trend:
  - Perhaps fewer meritless claims are being filed, so today's plaintiffs have stronger claims and are refusing to withdraw their claims
  - Also implies a sharp decline in settlements
    - Although *reported* settlements are holding steady (18% in 2002-05, 16% since), many withdrawals occur prior to or following closed-door settlements. (*see* Moberly, 49 William & Mary L. Rev. 65.)

Potential Changes

Predictions: Low whistleblower success rates prompt calls for revisions to SOX

- With the new Congress and administration, there is the possibility that there may be some changes to the law
  - Congress could potentially revise SOX by relaxing some of its strict requirements plaintiffs must meet to prevail
- Whistleblower advocates cite statistics of low whistleblower success rates to critique SOX and call for greater protections for employees.
  - *See*, e.g., Jennifer Levitz, "Whistleblowers are Left Dangling," The Wall Street Journal (Sept. 4, 2008); Jeremy Grant, "US: Whistleblowers Remain in the Line of Fire," Financial Times (Sept.12, 2007); Moberly, 49 William & Mary L. Rev. 65.

Predictions:
Low whistleblower success rates prompt calls for revisions to SOX

- Win rates for plaintiffs are historically low, and are even decreasing.
- 2002 through 2006:
  - OSHA level: employees won only 3.6% of claims
  - ALJ level: employees won only 6.5% of claims
    - Moberly, 49 William & Mary L. Rev. 65
- 2007 through 2008:
  - OSHA level: by 9/2/08, the total historical dismissal rate (2002-08) had climbed to 98%
    - Jennifer Levitz, "Whistleblowers are Left Dangling," *The Wall Street Journal* (Sept.4, 2008)
  - ALJ level: *zero* of the decisions in 2007-08 posted on the DOL website found a retaliation violation
  - Federal district court: *zero* final decisions in favor of plaintiffs
    - BUT there have been some non-final dispositions in complainant's favor -- 5 denials of motions to dismiss and 5 denials of summary judgment (out of 38 potentially dispositive cases).

Predictions: Low whistleblower success rates prompt calls for revisions to SOX

- One revision frequently suggested: extending the statute of limitations.
  - Statistics show this to be the most common ground for dismissal – about 34% of all retaliation claims filed in the ALJ are dismissed for being untimely filed.
- Equitable tolling is possible, but rarely granted.
  - Courts may toll if the employer misled the plaintiff re: the filing of his complaint, the plaintiff was "extraordinarily prevented" from filing his claim, or the plaintiff raised the issue in the wrong forum. (*Avlon v. Am. Express*, 2008-SOX-51 (A.L.J. Sept. 8, 2008).
  - But *only one* DOL case has ever found equitable tolling, and only under extreme circumstances (missed the deadline by two days, after trying to file with various other agencies). *Getman v. Southwest Sec., Inc*., 2003-SOX-8 (A.L.J. Feb. 2, 2004).

Predictions:
Increased number of claims filed

- Despite low win rates, the number of SOX whistleblower claims filed in recent years has in fact *increased*.
  - *See* Jennifer Levitz, "Whistleblowers are Left Dangling," The Wall Street Journal (Sept. 4, 2008).
- Recent economic downturn may have a major impact
  - A dramatic increase in the number of terminated employees may result in many more potential plaintiffs.
  - Public perception of new administration may lead some potential plaintiffs to believe (perhaps erroneously) that the government may now be more sympathetic to employees.

Predictions:
Claims related to subprime mortgage crisis

- Widespread layoffs in the financial industry may lead former employees to claim they were laid off in retaliation for reporting violations
  - Sample case: Fieldstone Investment Corporation's general counsel accused senior management of illegal activity, was fired, filed SOX whistleblower claim alleging she was fired for reporting violations. (*The Baltimore Sun*, May 17, 2007)
- Law firms representing whistleblowers are advertising their services to subprime lending whistleblowers
  - "We have obtained significant outcomes for whistleblowers working in a wide range of industries, from **subprime lending** to pharmaceutical and manufacturing—anywhere companies engage in unlawful practices aimed at misleading investors or government regulators." (Web site of Katz, Marshall & Banks, LLP)

Predictions:
Possible impact of new whistleblower law

- The Consumer Product Safety Improvement Act of 2008 was signed into law by President Bush on August 14.
  - It provides whistleblower protection to employees in the consumer products industry who suffer retaliatory action for reporting violations of CPSC requirements.
- Public employers that are in the consumer products industry could now face both SOX or CPSC claims for the same alleged retaliation.
  - A CPSC claim may be a more appealing option to the plaintiff than a SOX claim
    - Longer statute of limitations period – 180 days
    - Statute expressly provides for a right to jury trial

Predictions: Extraterritorial application of SOX whistleblower provisions

- A 2008 S.D.N.Y. case held that SOX whistleblower provisions applied to a U.S. employee working overseas for a U.S. subsidiary of a foreign-based corporation.
  - *O'Mahony v. Accenture Ltd.*, 537 F.Supp.2d 506 (S.D.N.Y. 2008).
- News articles predict that the case will open the door for US employees working abroad to file litigation in the U.S.
  - *See*, *e.g.*, Melissa Klein Aguilar, "SOX Whistleblower Protections Grow Wider," Compliance Week (March 4, 2008); Frances Phillips Taft, "New Litigation Risk: Foreign-Based Employee Permitted to Sue Under Sarbanes-Oxley"(July 15, 2008).

Questions