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Sarbanes-Oxley Helps Firms Cut Off Frivolous Allegations

by John S. Adler

The first federal court challenge to the constitutionality of the Sarbanes-Oxley Act of 2002 has been heard and decided, leaving the statute intact. In a ruling in late November, a federal judge in Birmingham, Ala., rejected arguments that the act is unconstitutionally vague in a case arising within the context of a pending corporate fraud criminal prosecution.

Further challenges are certain but are unlikely to alter the dramatic impact of the statute on publicly traded corporations and those that serve them. By their nature, challenges within the criminal prosecution context will likely be decided well before challenges to the civil enforcement provisions.

Nevertheless, the unwillingness of at least one federal court to disturb essential elements of the statute and conclude that jurors will be entrusted with applying the act alerts all concerned that the effects of the statute will remain far-reaching, in both a civil and a criminal context.

Thus, the enforcing regulations issued by the federal government in August 2004 demand a significant change in a publicly traded entity's approach to, at a minimum, the provisions of Sarbanes-Oxley, granting statutory protection for whistle-blowers.

For California employment attorneys, the litigation of whistleblower complaints is nothing new. In claims brought under specific statutory authority as well as in claims brought under theories of retaliatory discharge in violation of fundamental public policy, employers large and small, public and private, have been held accountable for retaliatory conduct since at least *Petermann v. International Brotherhood of Teamsters*, 174 Cal.App.2d 184 (1959).

Petermann, however, was decided within the context of a breach-of-contract action and was characterized as an exception to the employment at-will statute found in state Labor Code Section 2922.

Twenty-one years later, the state Supreme Court found a retaliatory-discharge claim to be a tort cause of action in *Tameny v. Atlantic Richfield Company*, 27 Cal.3d 167 (1980), finding that an employment termination under such circumstances violated "a basic duty imposed by law upon all employers."

Since that decision, California courts have debated and analyzed the sources from which public policy can be derived, but the fundamental right to bring such a claim, surrounding in tort, remains consistent and unchanged.

What Sarbanes-Oxley did is provide an express right of action, within Section 806 of the act, for any employee of a publicly traded company to challenge a discharge, demotion, suspension, threat, harassment, or any other form of discrimination cause by "any lawful act done by the employee."

Arguably, conduct by the employee that is not lawful, leading to his or her discharge or other adverse action, is not actionable regardless of the employee's intent. Thus, issues of motivation, intent and the employer's investigation and characterization of the events continue to remain paramount, as always, in retaliatory-discharge litigation.

But unlike traditional retaliatory-discharge litigation, Sarbanes-Oxley puts in motion an administrative process that presents opportunities and obstacles for both the employee and the accused employer or employee.

The statute requires a complaint to be filed with the Department of Labor no later than 90 days after the date of violation. Thus, the employment law practitioner faces a short window of time to evaluate and present the whistle-blower's complaint.

Yet the burden placed on the employee is minimal compared to the challenges presented to the employer. Before the employer examines the challenges, the question presented is, Should the employer care? After all, Sarbanes-Oxley requires the Department of Labor, through the Occupational Safety and Health Administration, to investigate and render findings.

That decision can be appealed to a Department of Labor administrative law judge for de novo review. Then, the administrative law judge's decision can be appealed to a Department of Labor administrative review board, with those findings subject to judicial review by a federal appeals court.

Given this multilevel process, why shouldn't the employer just delay, try to avoid the issuance of a final decision by the Labor Department within 180 days of the filing of the complaint — and then meet the complaining party in federal court, unencumbered by the administrative process?

From a review of the administrative regulations and in light of litigation statistics, in the current post-Enron environment it would be unwise for an employer to choose such a passive course of action.

With limited experience under the statute thus far, of the first 317 employee complaints to the Labor Department under Sarbanes-Oxley, 253 have been decided with only 38 (15 percent) resulting in findings for the employee.

On last report, two dozen cases initially filed with the Department of Labor are pending in the federal courts. Of the 30 cases reported to have settled for the aggregate of $3 million, these cases, arguably presenting some merit, have resulted in an average award of $100,000.

The results from Jury Verdict Research of Horsham, Penn., show that whistle-blowers suits resulted in the highest median employment law trial awards within both state and federal courts for the period 1997 through 2003. The median award in such whistle-blower actions exceeded $300,000, compared to much lower median awards for traditional discrimination or wrongful-termination cases.

Thus, the financial exposure to employers in whistle-blower actions mandates closer attention and the use of all legal processes to obtain a fast analysis and cost-effective resolution to any such complaints. The Sarbanes-Oxley Act regulations provide such a mechanism.

These regulations are intended for the "expeditious handling of discrimination complaints." Following the complainant making a prima facie showing of retaliation (known protected activity, unfavorable personnel action and the protected activity being "a contributing factor in the unfavorable action"), the employer has only 20 days following receipt of the notice of filling of the complaint to present facts demonstrating "by clear and convincing evidence" that the employer "would have taken the same unfavorable personnel action in the absence of the complainant's protected behavior or conduct."

The showing is to be presented through written statements and sworn affidavits, plus documentary evidence, substantiating the employer's position.

All must be presented within the 20-day period; similarly, within the same 20-days, the "named person may request a meeting" to present its position. 29 C.F.R. Section 1980.104. On such a showing, no investigation will be conducted.

If the employer fails to so demonstrate, the investigation will go forward. However, before the issuance of any findings and preliminary order (regulations at Section 1980.105), if there is reason to believe that a violation of the act has occurred and that preliminary reinstatement of the complaining part is warranted, the "named person" is again contacted by the agency and given notice of the substance of the relevant evidence supporting the allegations.

The employer is to be provided with any witness statements, appropriately redacted, and given the opportunity to submit a written response within 10 business days of the notification. Again, a personal meeting with investigators to present this information is available but must be accomplished within the same 10-business-day window.

The Department of Labor then — within 60 days of the filing of the complaint — must issue both written findings that conclude whether there is reasonable cause to believe a violation has occurred and a preliminary order (when appropriate) that includes "all relief necessary to make the employee whole."

This remedy can include reinstatement, back pay with interest, compensation for special damages, and reasonable attorney fees and costs, including expert-witness fees.

Thereafter, the findings and preliminary order become effective 30 days after receipt by the named person, unless an objection and request for hearing has been filed as set forth in 29 C.F.R. Section 1980.106.

Nevertheless, any reinstatement directive set forth in the preliminary order becomes effective immediately, with some exception for security-risk issues.

Thus, the regulations provide a mixed bag of challenges and opportunities for the publicly traded employer. Statistically, its chances of success at the administrative level are good. Logistically, the very short windows of time to react and respond mandate careful, lawful human resources practices and an acceptance of an administrative process that delivers what it claims: a speedy analysis and determination of a potentially costly legal dispute.

Employers, often believing they have been wrongfully sued by disgruntled employees, have long lamented the absence of a process by which they could quickly eliminate frivolous allegations of retaliation. The Sarbanes-Oxley Act provides such a mechanism.

Employers should embrace and applaud this expedited process and only hope that it serves as a model for the adoption of other administrative processes that will promptly eliminate claims without merits.