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Sweeping Changes Made to Labor and Employment Whistleblower Protections

Financial reform legislation, if signed, will—among other changes—allow employee whistleblowers to bypass Sarbanes-Oxley administrative proceedings and its 90-day statute of limitations for bringing retaliation claims.

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While there has been no shortage of controversy surrounding the policy and politics of the "Restoring American Financial Stability Act of 2010" (RAFSA), important changes to the Corporate and Criminal Fraud Accountability Act of 2002 (Sarbanes-Oxley or SOX), 18 U.S.C. § 1514A, and additional new whistleblower provisions in the legislation have received virtually no attention—despite their significant and substantive impact on how public company employers handle corporate compliance and whistleblower complaints moving forward.

Assuming that the legislation passed by the U.S. Senate last night is signed into law as expected in early July, public company employers should be aware of the following changes:

- **Avoidance of SOX Administrative Proceedings.** With the creation of a new Whistleblower Program (WP) administered by the Securities and Exchange Commission (SEC), a whistleblower who gives information to the SEC's WP about a violation of securities law can thereafter assert any claim of retaliation by his or her employer directly in federal court, bypassing SOX's administrative proceedings before the Occupational Safety and Health Administration (OSHA) of the U.S. Department of Labor (DOL).

- **Avoidance of SOX's 90-Day Limitations Period Under SEC-WP's Six- to Ten-Year Statute of Limitation.** Whistleblowers who are protected under the RAFSA amendments will have six to ten years to bring retaliation claims against employers in federal court, completely outside of the SOX framework; SOX provides them only 90 days to bring claims.

- **Increased Monetary Incentives for SEC-WP Whistleblowers.** In addition to providing a new, double-back-pay remedy, which is not allowed under SOX, RAFSA allows SEC-WP claimants to share in any government recovery (for example, by way of sanctions) against employers for providing "original" information about shareholder fraud.

- **Coverage of SOX Expanded to Subsidiaries and Nationally Recognized Statistical Rating Organizations.** RAFSA expands SOX coverage to subsidiaries and other related entities that are consolidated on the company's financial reports and to nationally recognized statistical rating organizations.

While the SEC will be required to issue regulations to implement WP within 270 days of RAFSA's enactment (approximately April 2011) if the legislation is signed into law as expected in July, RAFSA undeniably expands a whistleblower's incentives to report fraud by creating the possibility of a lucrative payout and by providing more lenient legal standards relating to retaliation for employees who report wrongdoing to the SEC rather than through internal compliance channels.

A more detailed discussion of RAFSA's substantive whistleblower provisions follows.

Bypass of Administrative Procedure Created

Under current law, SOX claims cannot be filed directly in federal court. Rather, complainants are required first to file a complaint with the DOL (through OSHA). 18 U.S.C. § 1514A(b). Although OSHA's jurisdiction includes the vast majority of federal whistleblower statutes, according to its critics the agency has proved ill-equipped handle the volume of SOX complaints that it has received over the past eight years. Beginning in February 2009, when the Government Accounting Office (GAO) published a scathing review of OSHA's SOX administration and complaint management, OSHA came under fire by Congress to reform its whistleblower program. OSHA is moving toward reform in this regard.

RAFSA, however, creates a "second choice" for would-be whistleblowers who have information about alleged fraud relating to the securities laws. Under the new WP, these whistleblowers can provide information directly to the SEC. In the event of retaliation, the whistleblower may file a retaliation claim against their employer directly in federal court without implicating SOX at all, as RAFSA creates a private cause of action separate and apart from an employee's rights under SOX.

This option to "bypass" SOX's administrative proceedings will undoubtedly result in an increase in litigation for public company employers, as it provides a new avenue for would-be whistleblowers who, at least from a statistical perspective, stood little chance of prevailing before OSHA. Employers also need to be prepared for the increased government and media attention—and, just as likely, "spin off" securities and other lawsuits—that often come with public allegations of corporate fraud.

Extended Statute of Limitations for SEC-WP Whistleblowers

Under the current law, a SOX claim must be filed "not later than 90 days after the date on which the violation occurs," 18 U.S.C. § 1514A(b)(2)(D), an arguably short filing window in comparison with a number of other federal statutes.

RAFSA moves SEC-WP whistleblower complaints in an entirely different direction, extending the time to file by almost 25 times the original SOX limitations period, and well beyond the limitations periods of other employment statutes. The legislation will allow SEC-WP complainants to file retaliation claims (in federal court, rather than before OSHA, as described above) up to *six years* after the date on which the violation occurred or *three years* from the date when facts material to the complaint are known or reasonably should have been known by the employee (whichever is later), but in no event beyond 10 years.

This expansion may cause significant problems for employers. Putting aside the more obvious liability issues (i.e., that more claims may work their way through the system as a result of the expanded limitations period), many employers, as a matter of general practice, do not keep employment, payroll, or other records for 10 years.

Expanded Coverage to Subsidiaries Under SOX

Since SOX's passage in 2002, the DOL has taken the position that employees of subsidiaries of public companies generally are not covered under the statute, at least absent significant nexus between the management and employment relations of the parent and subsidiary. That position has not proved popular, with Congress and other critics challenging the DOL's interpretation of SOX in this regard.

To that end, Congress included in RAFSA an amendment to SOX that adds to the definition of "publicly traded company" any "subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company." According to the Senate Banking Committee review of an earlier version of the legislation, "this clarification would eliminate a defense now raised in a substantial number of actions brought by whistleblowers under the statute."

The policy shift is not surprising, and even without the passage of RAFSA, appears to be on the DOL's regulatory agenda. As recently as last week, Dr. David Michaels, the Assistant Secretary of Labor for OSHA, made his first public remarks about his plans for SOX, and openly expressed disbelief at the DOL's position on the statute's coverage of subsidiaries. The DOL's Administrative Review Board (ARB) also issued an order last month inviting all interested persons to submit briefs on whether employees of subsidiaries are protected by SOX.

An amendment to RAFSA also extends SOX coverage to nationally recognized statistical rating organizations.

Increased Relief for Prevailing Whistleblowers

Under the current version of SOX, a prevailing employee is "entitled to all relief necessary to make the employee whole." 18 U.S.C. § 1514A(c). That relief "shall include" reinstatement, back pay, and "compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees." *Id.* at § 1514A(c)(2).

RAFSA allows a prevailing SEC-WP whistleblower *twice* the amount of back pay otherwise owed to the individual, with interest—more than SOX would otherwise provide. RAFSA also allows the SEC to provide monetary rewards to those who contribute original information through the WP program that leads to recoveries of monetary sanctions of $1,000,000 or more in criminal and civil proceedings. According to the Banking Committee, and in "recogni[tion] that whistleblowers often face the difficult choice between telling the truth and . . . committing career suicide," the WP would provide for rewards between 10% and 30% of any monetary sanctions that are collected based on the original information offered by the whistleblower.

These amendments, therefore, give whistleblowers significant enhanced incentives to make a report to the WP and, in any event, claim retaliation.

Conclusion

While the legislation still needs to be vetted in congressional conference, expected to occur by early July, the House of Representatives passed a nearly identical provision as part of the Wall Street Reform and Consumer Protection Act (H.R. 4173) on December 11, 2009. Accordingly, employers should expect few, if any, substantive changes to RAFSA's whistleblower provisions before it becomes law.

In short, and in preparation for changes that loom ahead, public company employers should consider:

- **Finding New Ways to Encourage Internal Reporting.** To compete with increased financial incentives to whistleblowers who provide original information to the government, employers need to consider how best to encourage would-be whistleblowers to raise compliance concerns internally, ensuring that they have the opportunity to investigate and correct any problems in a timely manner, thereby reducing the risk of liability.

- **Auditing Subsidiary Compliance.** While public companies are now well versed in the "compliance culture" created by SOX in 2002, companies must be mindful to extend the same corporate compliance structures to subsidiaries and other related entities. In anticipation of SOX's expansion to include subsidiaries or other related entities that are consolidated on the company's books, employers need to audit existing compliance structures and develop ways to extend them to umbrella organizations.

We will continue to monitor the continuing developments of Financial Regulatory Reform. If you have any questions or would like more information on the issues discussed in this LawFlash, please contact the authors, **Sarah Bouchard** (215.963.5077; sbouchard@morganlewis.com) and **Tom Linthorst** (609.919.6642; tlinthorst@morganlewis.com), or any of the following Morgan Lewis attorneys:

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