

Presenting a live 90-minute webinar with interactive Q&A

Private Employers and Expanded SOX Whistleblower Reach: Mitigating Risks after New Supreme Court Ruling

Structuring and Implementing Robust Compliance Programs,
Crafting Defense Theories to Dispute SOX Applicability

WEDNESDAY, MAY 21, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Private Employers May Be Subject to SOX Retaliation Provisions: Has the Supreme Court Put Your Clients in the Crosshairs?

MAY 21, 2014

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TOPICS

Supreme Court's decision in *Lawson v. FMR LLC*

SEC Actions

Recent SEC Awards

Recent SOX cases

Post *Lawson* open issues

SOX elements and defenses

Prevention and compliance

The *Lawson* Case

- *Lawson v. FMR LLC*, 571 U.S. _ (March 4, 2014)
Section 806 of the Sarbanes-Oxley Act of 2002 (“SOX”) reads:
 - Section 806 – titled “*Protection For Employees of Publicly Traded Companies*” – provides in part that:
No [public] company..., or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of [whistleblowing or other protected activity].
18 U.S.C. § 1514A(a).

Issue: Does Section 806 only protect employees of public company or contractors/subcontractors of that public company?

The *Lawson* Case - Plaintiffs

- Jackie Hosong Lawson, Senior Director of Finance for private advisory firm that provided services to Fidelity family of mutual funds.

Said constructively discharged after reporting cost accounting methods that led to overstated expenses.

- Jonathan Zang, portfolio manager for a different division of Fidelity.

Said fired after expressing concerns about draft SEC registration statement of several of the Fidelity mutual funds.

The *Lawson* Case - Defendants

- Two private companies that advise/manage mutual funds for a holding company, with no employees.

Common structure in mutual fund industry.

The *Lawson* Case - History

- Defendants moved to dismiss, arguing that SOX applies only to employees of public companies.
- District Court denied motion and certified issue to First Circuit.
- First Circuit ruled in favor of defendants.
- Supreme Court accepted case to resolve contrary decisions on issue.

The *Lawson* Case – Supreme Court

Supreme Court's Decision (Justice Ginsberg)

6-3 decision reversed in favor of Plaintiffs

- Based on statutory text and legislative history.
- Purpose of SOX to safeguard investors of public companies and restore trust after Enron.
- Outside professionals like accountants, lawyers, advisors must report fraud without fear of retaliation.
- Especially true for mutual fund industry.

The *Lawson* Case – Supreme Court

The Dissent (Justices Sotomayor, Kennedy and Alito)

- Absurd result/”stunning reach.”
- Costly new front of employment litigation against private employers.

The *Lawson* Case – Supreme Court

The Result

- Expansion of whistleblower claims against public and non-public companies.
 - DOL 2015 budget – stepped up enforcement thru OSHA

SEC Actions Also Growing

- In 2010, Dodd-Frank amended the Securities Exchange Act, adding whistleblower incentives and protection.
- SEC can award eligible whistleblowers who voluntarily provide original information that leads to successful SEC enforcement actions resulting in monetary sanctions over \$1 million.
- Awards are 10-30% of the monetary sanctions collected.
- Paid out of separate “Investor Protection Fund.”
- SEC Whistleblower Office receives 9-10 tips/day.

SEC Enforcement

- Final rules prohibit retaliation against whistleblowers who report possible wrongdoing based on a reasonable belief that a possible securities violation has or will occur.
- Rules provide incentives to report information internally before reporting to the SEC, but not required.
- FY2013 – SEC received 3,238 Whistleblower Tips potentially eligible for an award, involving:
 - Corporate Disclosures and Financials (17.2%)
 - Offering Fraud (17.1%) and
 - Manipulation (16.2%)

Recent SEC Awards

Whistleblower Awards

- SEC's first payment to whistleblower - \$50K to anonymous whistleblower for information on multi-million dollar fraud (09/21/12).
- \$1.9 million award to former CFO of Clean Diesel Technologies for firing him after warning board of directors about financial concerns raised by proposed merger (9/30/13).
- \$14 million by SEC to anonymous whistleblower for information leading to recovery of substantial investor funds (10/1/13).

Recent Sox Cases

Whistleblower Rulings

- NY court rules Dodd-Frank whistleblower protections do not apply outside the U.S. – *Liu v. Siemens A.G.*, No. 13-civ-217 (S.D.N.Y. Oct. 21, 2013).
- GA court decides whistleblowers have no right to jury trial under Dodd-Frank – *Pruett v. BlueLinx Holdings, Inc.*, No. 1:13-cv-02607 (N.D.Ga. Nov. 12, 2013).

Post – *Lawson* Open Issues

Scope of Protection

- Shareholder fraud only?
- SOX prohibits retaliation against employees who report what they “reasonably believe” to be a violation of federal mail, wire, bank, securities fraud and any SEC rule or regulation.
- *Lawson* dicta – covers not just reported fraud but also violations of SEC regulations/rules.
- Employers: argue purpose of SOX is to prevent fraud on shareholders (like Enron and WorldCom), need some link to shareholder fraud.

Post – *Lawson* Open Issues

SEC Complaint Required?

- Dodd-Frank Act defines “whistleblower” as person who provides information about securities laws to the commission.
- Fifth Circuit says employees must report to SEC, *Asadi v. G.E. Energy*, 720 F.3d 620, 625 (5th Cir. 2013), but SEC and district courts disagree (e.g., *Murray v. UBS Sec., LLC*, No. 12-civ-5914 (S.D.N.Y. May 21, 2013)).
- *Lawson* dicta: Dodd-Frank covers “primarily” reports to government.

Post – *Lawson* Open Issues

Requiring Internal Complaint First OK?

- Many employers require employees to make report internally prior to going outside the company.
- SEC opposes such policies.
- Dodd-Frank prohibits employers from requiring employees not to make reports with SEC.

Post – *Lawson* Open Issues

Defer to DOL Decisions?

- *Lawson*: Expressly declined to decide if DOL Administrative Law Board (“ARB”) decisions should be given deference.
- ARB: Number of recent pro-SOX plaintiff decisions.

Post – *Lawson* Open Issues

Does Whistleblower Misconduct Affect Ability to Make SOX Claim?

- Stealing proprietary information.
- Stealing information subject to security clearance.
- Providing such information to SEC.

Post – *Lawson* Open Issues

Settlement and Severance Agreements.

- Often contain promise not to sue or file claim.
- EEOC prohibits – must still allow statutory right to file charge even if employee waives right to personal recovery.
- Dodd-Frank similar.
- Suggested language:

This Agreement does not waive Employee's right to file a charge with the EEOC or a state anti-discrimination agency, or to file a whistleblower or other report with the U.S. or a state Department of Labor or other governmental administrative agency; provided Employee is waiving, however, any right to any monetary recovery if any administrative agency pursues any claim or claims on Employee's behalf. This Agreement also does not waive or impair Employee's right to participate in or cooperate with an investigation by a governmental administrative agency.

Post – *Lawson* Open Issues

Pre-Dispute Arbitration Agreements

- Dodd-Frank amended SOX to prohibit pre-dispute agreements to arbitrate whistleblower claims under SOX. 18 U.S.C. § 1514A(e).
- But did not add a similar provision invalidating pre-dispute arbitration agreements for whistleblower claims under the Securities Exchange Act. 15 U.S.C. § 78u-6.
- Two courts have recognized SOX's prohibition on pre-dispute arbitration agreements does not apply to Dodd-Frank whistleblower claims. See *Murry v. UBS Securities, LLC*, 2014 WL 285093 (S.D.N.Y. 2014); *Ruhe v. Masimo Corp.*, 2011 WL 4442790 (C.D. Cal. 2011).

SOX Elements and Defenses

- Short statute of limitations – 180 days to file complaint.
- Procedures:
 - Employee files complaint with OSHA
 - OSHA conducts detailed investigation
 - DOL makes initial determination
 - Either party files de novo appeal to ALJ within the DOL
 - Appeal to DOL Administrative Review Board, then Circuit Court
 - Employee may file suit in federal court if DOL does not complete process within 180 days

SOX Elements and Defenses

Elements:

- Employee engaged in protected activity.
- Employer knew about protected activity.
- Employee suffered unfavorable employment action.
- The protected activity was a “contributing factor” in the unfavorable action.

Defense:

- Employer must show by clear and convincing evidence that it would have taken the same action in the absence of the protected activity.

SOX Elements and Defenses

Protected activity:

- Providing information, causing information to be provided, or assisting in an investigation;
 - Information or report concerns conduct the employee “reasonably believes” is a violation of mail, wire, bank or securities fraud statutes, SEC rules or regulations, or federal laws concerning shareholder fraud; and
 - The information or assistance is provided to or the investigation is conducted by a federal agency, a member of Congress, or a person with supervisory authority over the employee.
-
- Generally does not include complaints about violations of internal policies.

SOX Elements and Defenses

Protected Activity:

- Can be mistaken, but done in good faith.
- Can be based on “reasonable concerns.”
- Must be known by employer, but ...
- Need not use words like “this is discrimination,” “this is fraud,” or “this is illegal.”

SOX Elements and Defenses

Relief available:

- “All relief necessary to make the employee whole.”
- Reinstatement is preferred remedy.
- Back pay with interest.
- Compensation for special damages, litigation costs, attorney fees, and expert fees.
- Unclear whether special damages includes emotional distress damages.

Prevention and Compliance

Growing out of the Federal Sentencing Guidelines, an effective ethics and compliance program must include 7 elements (plus one) (USSG Manual § 8B2.1(a)(2)) :

- 1. High level company personnel who exercise effective oversight;
- 2. Written policies and procedures;
- 3. Training and education;
- 4. Lines of communication;
- 5. Standards enforced through well-publicized disciplinary guidelines;
- 6. Internal compliance monitoring;
- 7. Response to detected offenses and corrective action plans; and
- 8. Periodic “risk assessments” (added by amendment to the original seven Guideline elements).

Prevention and Compliance

- Establish ethical and compliance oriented culture.
- High-ranking compliance officers – regular reports to the board.
- Detailed written policies – bribery, corruption, accounting practices, etc.
- Annual risk assessments.
- Update policies based on identified risks and enforcement trends.
- Screening procedures for business partners, vendors, etc.

Prevention and Compliance

- Background checks on employees and important business partners.
 - But: State laws may apply, e.g., Colorado bars credit checks when hiring many non-sensitive employees.
 - But: Controversial EEOC guidelines require individualized assessment.
- Internal controls and checks on accounting procedures.
- Train on ethics and compliance annually.
- Regular monitoring to ensure compliance with policies and procedures.
- Remediate problems quickly and appropriately.