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Application Of SOX Whistleblower Rulings Inconsistent

By Paul J. Martinek — November 1, 2005

There has been confusion to date about whether non-publicly traded subsidiaries of publicly traded companies are subject to the whistleblower provisions of the Sarbanes-Oxley Act.

That conclusion—by two lawyers with Wilmer Culter Pickering Hale and Dorr in Washington—is based on a comprehensive analysis of every administrative ruling and federal court decision under Section 806 of Sarbanes-Oxley through September 2005. The research by Carrie Wofford and Thomas W. White will be summarized in a chapter on whistleblowers in the upcoming third volume of the American Bar Association's "Practitioner's Guide to the Sarbanes-Oxley Act."


Wofford

Wofford tells Compliance Week that she and White were not entirely surprised at the ALJs' differences in interpretation of SOX. "After all, the Sarbanes-Oxley Act introduced a whole new set of significant legal requirements that the legal community is still grappling to understand," she said. "Plus, it takes time for the cases to work their way up through the various levels of review where, presumably, binding rulings will ultimately be issued."

In light of differing interpretations of the SOX whistleblower provisions by administrative judges at the Department of Labor, "companies that face a retaliation claim should work closely with attorneys who are familiar with these trends and differences and who can tailor their guidance to the jurisprudential leanings of the individual judge overseeing the case," says Wofford.

Asked if inconsistencies in how SOX 806 has been applied suggests that the provision, or the statute as a whole, was sloppily or hastily drafted, White says "one might draw that conclusion." He notes that it is "well-known that SOX was enacted on an extraordinarily fast-track, and many provisions of the law raise issues that might have been clarified if the process had proceeded more deliberately."

Decisions Go Both Ways

One its face, the civil whistleblower provisions of Sarbanes-Oxley contained in Section 806 apply only to companies that file public reports with the Securities and Exchange Commission.

But what if the company has a non-publicly traded subsidiary?

According to Wofford, most administrative law judges ALJs who have reviewed SOX whistleblower cases will refuse to extend coverage to a private subsidiary if the complainant fails to name the parent company as a party in the complaint.

When the parent company is named as party, decisions vary as to the extent to which a strong tie must be shown between the parent and the subsidiary in order to cover retaliation by the subsidiary, Wofford notes. "Some ALJs—and one court—appear to find a subsidiary to be covered *per se* if the parent is publicly traded," says Wofford, citing a decision in which an administrative judge found that a publicly traded company, for SOX purposes, is "the sum of its constituent units."

Other cases approach the issue from the opposite end of the spectrum, requiring employees of a private subsidiary to "pierce the corporate veil" in order to recover under SOX 806. "For instance, one ALJ dismissed a claim because the complainant failed to name a publicly traded company and the ALJ found no indication that the parent companies were sufficiently involved in the management and employment relations of the subsidiary to justify piercing the corporate veil," says Wofford.

A few administrative judges have taken an intermediate view, looking to whether the parent and subsidiary "are so intertwined as to represent one entity," according to Wofford.

'Act As If Covered'


White

White notes that the legislative history of SOX "does not shed much light" on the question of whether the whistleblower provisions apply to subsidiaries of publicly traded companies. However, this does not necessarily imply that Congress meant to exclude subsidiaries of those companies, he says. "Indeed, given the broad scope of SOX and Congress' manifest intent to encourage internal reporting and to protect whistleblowers, one could conclude that Congress could not have meant to make a whistleblowing employee's rights turn on the vagaries of a public company's internal organizational structure."

Because of the uncertainty, it may be advisable for subsidiaries to assume that they're covered, Wofford notes.

"If a subsidiary retaliated against a whistleblower and happened to draw one of the ALJs who believe in broad coverage of subsidiaries, it would spell trouble for the subsidiary," she says. "It is plainly in the company's interest to act as if it is covered and respond appropriately to whistleblower complaints. In other words, don't retaliate. As SOX intends, companies should take whistleblower complaints seriously and investigate them as appropriate. If there are other reasons to discipline the whistleblower, such as a history of poor performance or insubordination, then those reasons should be documented and addressed as a separate matter from the whistleblowing."

White says there are some steps the subsidiary can take to decrease the possibility that an ALJ might find an employee of the subsidiary covered by the Act. "Maintaining strictly separate corporate identities should go a long way in the eyes of most ALJs, although there are some who seem to view a subsidiary as covered per se if the parent company is publicly traded. For other judges, it is significant if a subsidiary acts independently in employee relations, such as hiring, firing and supervising employees without input from the parent company. For others, the degree to which the corporate identities are intertwined is relevant."

In addition, "avoiding interrelated operations and common management and boards may help," says White. "The differences of opinion among ALJs may suggest the importance of consulting attorneys

familiar with the views of individual ALJs should a subsidiary face a complaint. In light of the decisions to date there can be no assurance that any company can absolutely insulate itself from liability for actions by a subsidiary, except perhaps a fully autonomous operating subsidiary. And, of course, in many companies full insulation may not be feasible."

Related coverage is available from the box above, right. Next week, we will look at what Wofford and White have discovered about how ALJs and federal judges have interpreted the whisteblower provisions of SOX when it comes to foreign-based workers of companies that are subject to the Securities Exchange Act.