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Expert Analysis

Availability of Arbitration for Sarbanes-Oxley Whistle-Blower Claims

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The Sarbanes-Oxley Act's whistle-blower provisions protect employees of publicly traded companies from retaliation for providing information in an investigation concerning conduct that the employee reasonably believes violates federal laws concerning fraud against shareholders.[1]

Companies have increasingly employed binding arbitration agreements to resolve SOX whistle-blower claims in a fair, expedient and cost-efficient manner. Many federal courts and administrative law judges have upheld such procedures absent an unconscionable agreement or waiver.

Employers therefore should consider the benefits and risks of arbitration agreements for SOX claims and review such agreements for enforceability as they would any arbitration agreement.

This article reviews the use of arbitration in SOX claims and provides tips for employers on structuring agreements and avoiding waiver.

Arbitration Has Benefits and Risks

Arbitration offers many benefits to employers. First, it often is less costly than litigation. Specifically, limited discovery, reduced pretrial preparation and the absence of costly motion practice may significantly reduce the legal costs associated with dispute resolution.

Second, arbitration may be less adversarial than litigation. According to a report by the U.S. Department of Labor, "Private arbitration may … allow even the most contentious disputes to be resolved in a manner which permits the complaining employee to raise the dispute without permanently fracturing the employee's working relationship with the employer."[2]

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Third, arbitration does not involve a jury. It is less likely that a neutral arbitrator will be swayed by emotion or anti-corporate sentiment. Accordingly, the decision-maker is more likely to base his or her decision on facts and less likely to award high compensatory or punitive damages to the complaining employee.

Fourth, arbitration is more expeditious than litigation. Most arbitration proceedings are closed within six to nine months, while a lawsuit may continue for years. Faster proceedings benefit both parties by reducing the legal fees and animosity that accompany extended trials.

Finally, arbitration is typically confidential and therefore protects the privacy of all parties. Employees may wish to avoid the questions of co-workers, neighbors and the press, and employers can avoid the unfavorable media attention and damage to workplace morale often associated with public litigation.

Arbitration also presents potential risks to employers, however. First, in some cases arbitration may be more expensive and time-consuming than court proceedings. Unlike courts, arbitrators rarely grant dismissals. Further, absent settlement, an arbitration almost always will go to a hearing. Employers also may have to incur additional costs to file motions in court to compel arbitration or defend against actions seeking to invalidate arbitration decisions.

Second, arbitration may be less predictable than court proceedings, in part because arbitration records are confidential.

Finally, arbitration procedures may prevent employers from conducting adequate discovery or appealing negative decisions. For example, arbitration agreements may prevent an employer from deposing the employee's witnesses or deposing third parties. Because of these potential benefits and risks, employers should consult with counsel to weigh the pros and cons of arbitration under specific circumstances.

SOX Claims May Be Arbitrated

Federal courts have consistently upheld mandatory arbitration of SOX whistle-blower claims, explaining that "[t]here is nothing in the text … or legislative history of the Sarbanes-Oxley Act evincing intent to preempt arbitration claims under the act."[3]

Former employees (and, in at least one case, an employer) have presented varied arguments against arbitration. Courts have uniformly refused, however, to limit the scope of SOX arbitration absent a waiver or unenforceable arbitration agreement.

Cases at the federal district and appellate levels have considered and upheld the general arbitrability of SOX claims.

In *Boss v. Salomon Smith Barney Inc.* an employee sued his former employer in federal court, seeking damages and reinstatement for retaliatory termination in violation of SOX.[4] The employer moved to stay the federal proceedings and compel arbitration. The employee argued that because SOX confers jurisdiction on the federal courts to hear whistle-blower claims, the claims could not be arbitrated.

Accordingly, the court upheld the arbitration agreement and granted the employer's motion to compel arbitration and stay the proceedings.

Similarly, in *Guyden v. Aetna Inc.* an employee filed a complaint against her former employer for retaliatory discharge in violation of SOX, and the employer moved to compel arbitration and dismiss or stay the federal proceedings.[5]

The employee argued that mandatory arbitration inherently conflicts with the statutory purpose of SOX because "arbitration thwarts the SOX's purpose of promoting corporate transparency."[6]

The court disagreed, ruling that arbitration does not explicitly or implicitly frustrate the statute's legislative purpose. The court found "no explicit directive against mandatory arbitration within the statutory text or legislative history."[7] In fact, Congress deliberately eliminated a SOX provision prohibiting binding arbitration agreements, it said.

The court further reasoned that arbitration did not implicitly frustrate the legislative purpose because arbitration fulfilled SOX's compensatory function by providing back pay, reinstatement and all other remedies available in traditional adjudication.

Courts have even been willing to defer to arbitration agreements when the agreements were crafted before the passage of SOX.[8] In *Kimpson v. Fannie Mae Corp.* an employee sued his former employer for wrongful

termination in violation of SOX, and the employer filed a motion to compel arbitration and dismiss or stay the federal proceedings.

The employee argued that he did not agree to arbitration of SOX claims by executing an employment agreement that included an arbitration clause because SOX did not exist when he entered the agreement.

The court disagreed, explaining that, "given the inclusive and comprehensive language of the policy, it clearly implicates [the employee's] claims related to Sarbanes-Oxley because they involve his exercise of a legally protected right that he alleges directly led to his termination."[9]

Accordingly, the court granted the employer's motion to compel arbitration and stay the proceedings.

Courts also have shown a strong commitment to arbitration by allowing the issue of arbitrability to be decided by the arbitration panel under certain circumstances. In *Alliance Bernstein Investment Research & Management v. Schaffran*[10] the employer sought a declaratory judgment that it was not required to arbitrate an employee's SOX claims before the National Association of Securities Dealers.

The employee moved to dismiss the complaint and compel arbitration. The federal court denied the employee's motion. On rehearing, the court dismissed the complaint, holding that the arbitration panel should decide the issue of arbitrability. The employer appealed to the 2nd Circuit.

On appeal, the employer argued that the parties were not required to arbitrate because the employee's SOX claim was a "discrimination" claim exempt from arbitration under the NASD arbitration code.[11]

The 2nd Circuit affirmed the District Court's order dismissing the complaint and held that the issue of arbitrability should be decided by the arbitration panel. Although the "general presumption [is] that arbitrability is a matter for the courts," the 2nd Circuit found that the presumption was overcome by "clear and unmistakable evidence" in the NASD arbitration code that the parties intended the arbitrators to resolve disputes over arbitrability.[12]

The arbitration panel subsequently ruled that the claim was subject to mandatory arbitration.

Effect of Arbitration Agreements on Labor Department Investigations

It is less clear whether the Department of Labor will defer to arbitration with respect to its investigation process. Under SOX, employees must file a complaint with the secretary of labor within 90 days of the alleged retaliatory act. The secretary has 180 days to issue a ruling before the employee may seek *de novo* review in the appropriate district court.

In *Equal Employment Opportunity Commission v. Waffle House*[13] the U.S. Supreme Court concluded that a private arbitration agreement did not preclude the EEOC from initiating an administrative investigation of a Title VII claim. Accordingly, it appears that an employer will not be able to force the government to defer to the arbitration agreement during investigative procedures before the DOL.

Language in *Sullivan v. Science Applications International Corp.*[14] may be used to support this conclusion.

In *Sullivan* an administrative law judge considered whether an employer waived its right to arbitration by cooperating with the DOL's investigation of a SOX whistle-blower claim. The judge explained, "An arbitration clause cannot limit or interfere with the secretary of labor's statutory obligation to investigate Sarbanes-Oxley complaints or bind the secretary, who is not a party to the arbitration agreement."[15]

Despite this precedent, however, the DOL has indicated that it often will choose to defer to arbitration under these circumstances.

In a 2002 memorandum the solicitor of labor explained that the Supreme Court's decision in *EEOC v. Waffle House* should be balanced against "what the Supreme Court has called our 'liberal federal policy favoring arbitration agreements.'"[16]

The memorandum outlined specific factors DOL lawyers must consider when deciding whether to defer to arbitration and emphasized that "[d]eferral [is] most appropriate in matters involving individual claims for relief in the form of back pay and reinstatement [such as] … whistle-blower statutes."[17]

The policy articulated in the 2002 memorandum is the most recent statement on deferral guidelines but is

subject to change based on internal policy decisions or administration changes.

Structuring the Arbitration Agreement Requires Care

Though SOX whistle-blower claims are arbitrable as a general matter, specific circumstances may render an agreement unenforceable or cause a waiver of the agreement.

Like all arbitration agreements, agreements governing the resolution of SOX whistle-blower claims may be invalid if "grounds … exist at law or in equity for the revocation of [the] contract."[18]

For example, in *Sullivan* an employee sued his former employer for retaliation under SOX. The employer moved to compel arbitration and stay the federal proceedings consistent with an arbitration agreement between the employee and the employer. The employee argued that the arbitration agreement was unconscionable and unenforceable.

Applying California law, the judge held that the agreement was not unconscionable because it:

- Provided for the selection of a neutral arbitrator;
- Offered sufficient discovery;
- Required a written award;
- Allowed back pay, reinstatement and other relief available in court; and
- Did not require the employee to pay unreasonable costs to participate.[19]

Accordingly, the judge granted the motion to compel arbitration.

Generally, arbitration agreements should be written in a clear and easily understood manner. They should bind the employer and the employee and identify the nature of the claims that will be covered.

Agreements also should specify the procedures, rules and arbitrators for the process. The procedures should provide for fair and adequate discovery, allow arbitrators to issue a written opinion, and afford the plaintiff the same relief available in court. In addition, because state contract law governs the validity of SOX arbitration agreements, more specific requirements for enforceable agreements will vary among states. Employers therefore should consult with counsel to ensure enforceable agreements.

Employers Must Avoid Waiver

A party also may lose its contractual right to an arbitral forum if it waives that right by taking action inconsistent with arbitration.

For example, in *Mozingo v. South Financial Group* the court held that an employee waived his right to arbitrate a SOX whistle-blower claim by engaging in federal proceedings.[20] He later moved to compel arbitration consistent with the parties' arbitration agreement.

The court said "the circumstances of this case taken as a whole" warranted waiver because the employee had "so substantially utiliz[ed] the litigation machinery that to subsequently permit arbitration would prejudice the party opposing the stay."[21]

The court emphasized in several instances, however, that "in light of the federal policy favoring arbitration, [circumstances giving rise to waiver] are not to be lightly inferred."[22]

More commonly, courts have refused to recognize waivers of arbitration rights in SOX whistle-blower cases.

In *Green v. Service Corporation International*,[23] for example, the employee removed his SOX claim to federal court, and the employer moved to compel arbitration and stay the proceedings. The employee argued that the employer had waived its right to compel arbitration by defending itself during administrative proceedings before the Department of Labor.

The court rejected the employee's argument and held that the employer's right to compel arbitration was not waived.

Similarly, in *Sullivan* the judge held that an employer did not waive its right to compel arbitration by engaging in discovery at the Occupational Health and Safety Administration before the case came before an administrative law judge.[24]

The judge reasoned that OSHA discovery was part of the investigation of the complaint, not the litigation, and that an arbitration agreement cannot restrict

the DOL's authority to investigate or bind the secretary of labor, who is not a party to the agreement.

Conclusion

As demonstrated by favorable case law, courts have been increasingly willing to enforce arbitration agreements in the SOX whistle-blower context absent unconscionability or waiver.

Therefore, employers should consider submitting to binding arbitration agreements for purposes of SOX whistle-blower claims. In deciding whether to submit to binding arbitration agreements, employers should consult with counsel to consider the pros and cons of arbitration under specific circumstances and to ensure an enforceable agreement.

Notes

1 18 U.S.C. § 1514A(a)(1).
2 Comm'n on the Future of Worker-Management Relations, U.S. Dep't of Labor and U.S. Dep't of Commerce, Report and Recommendations 30 (1994).
3 *Boss v. Salomon Smith Barney Inc.*, 263 F. Supp. 2d 684, 685 (S.D.N.Y. 2003); *see also Green v. Serv. Corp. Int'l*, 2008 WL 4056325 (S.D. Tex. Aug. 25, 2008); *Kimpson v. Fannie Mae Corp.*, 2007 WL 1020799 (D.D.C. Mar. 31, 2007); *Guyden v. Aetna Inc.*, 2006 WL 2772695 (D. Conn. Sept. 25, 2006), *aff'd*, 2008 WL 4426478 (2d Cir. Oct. 2, 2008).
4 *Boss*, 263 F. Supp. 2d at 684.
5 *Guyden*, 2006 WL 2772695, at *1.
6 *Id.* at *4.
7 *Id.*
8 *See, e.g., Kimpson,* 2007 WL 1020799.
9 *Id.* at *3.
10 *Alliance Bernstein Inv. Research & Mgmt. v. Schaffran*, 445 F.3d 121 (2d Cir. 2006).
11 *Id.* at 124.
12 *Id.* at 127, 125.
13 *EEOC v. Waffle House,* 534 U.S. 279 (2002).
14 *Sullivan v. Sci. Applications Int'l Corp.*, 2007-SOX-60 (Sept. 21, 2007).
15 *Id.* at 6 (discussed *supra*).
16 Memorandum from Eugene Scalia, Solicitor of Labor, to Regional and Associate Solicitors (Aug. 9, 2002), *available at* http://www.dol.gov/sol/media/memos/August9.htm (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24 [1983]).
17 *Id.*
18 Federal Arbitration Act, 9 U.S.C. § 2.
19 *Sullivan* at 5.
20 *Mozingo v. South Fin. Group,* 520 F. Supp. 2d 725, 729 (D.S.C. 2007).
21 *Id.* at 733, 729 (quoting *Patten Grading & Paving v. Skanska USA Bldg.,* 380 F.3d 200, 204 [4th Cir. 2004]).
22 *Id.* at 729.
23 *Green v. Service Corp. Int'l*, No. 4:06-CV-00833, *order compelling arbitration issued* (S.D. Tex. June 30, 2006), *available at* http://www.oalj.dol.gov/PUBLIC/WHISTLEBLOWER/DECISIONS/COURT_DECISIONS/06_00833.PDF.
24 *Sullivan* at 6.

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