A Timely Analysis of Legal Developments

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In This Issue:

August 2011

A recent federal court decision imposes highly significant pleading limitations on claims under the Sarbanes-Oxley Act. The decision, which is at odds with the far looser standards imposed in a recent federal Administrative Review Board decision, should provide much needed relief to employers charged with generalized and non-specific claims of financial wrongdoing.

Critical New Court Decision Limits Sarbanes-Oxley Claims

By Ken O'Brien and Gregory Keating

In a significant victory for the employer in a decision under the whistleblower provisions of the Sarbanes-Oxley Act of 2002 (SOX), the United States District Court for the Eastern District of Pennsylvania has dismissed for the moment a lawsuit brought against Tyco Electronics by a former accounts payable employee. In *Wiest v. Lynch*, Case No. 2:10-cv-03288-GP (July 21, 2011), the court made clear that an employee who attempts to sue his employer under SOX's anti-retaliation provision, 18 U.S.C. § 1514A, must allege significantly more than merely "that wrongdoing has occurred." Rather, the employee must allege that his or her communication to the employer "definitively and specifically" related to one of the statutes or rules listed in SOX and conveyed "an objectively reasonable belief that the company intentionally misrepresented or omitted certain facts to investors, which were material and risked loss."

Factual Background

Plaintiff worked for 31 years in his employer's accounts payable department. He consistently received high ratings, especially in the areas of "integrity" and "ethics and values." In fact, in 2008, he received a bonus for "his significant achievements and continuing focus on 'doing the right thing.'" Plaintiff alleged, however, that his situation changed for the worse after he refused to process certain expenses for company events in the Bahamas and Las Vegas because he believed they were improper, did not meet the company's standards, violated regulations issued by the Securities and Exchange Commission and tax regulations, and raised ethical concerns. Ultimately, the company's tax department undertook the additional review he requested and determined that one of the events had been improperly classified as business expenses. Consequently, the company treated the costs of that event as "award income" to the persons who attended the event while grossing up their bonuses to cover the additional income tax due. The company's tax department determined that the second event had been properly treated as a business expense. In addition, plaintiff refused to process expenses incurred at a third event because it was unclear to him whether a certain company officer had personally approved the expenses.

Plaintiff also alleged that he expressed concerns about other company expenses and

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suspected that company managers were frustrated by his challenges of these expenses. He claimed that, as a result, he was told that the company's human resources department was conducting an investigation into concerns that he had improperly failed to report basketball tickets he had received, that he had made sexually suggestive remarks to coworkers, and that he had had an improper relationship with another employee ten years earlier. He alleged that he was told that the investigation was at a "very serious stage" and that he "should not bother with a scheduled performance review." He then went on medical leave and claimed he was terminated seven months later.

Procedural Background

Plaintiff filed an administrative complaint with the federal Occupational Safety and Health Administration (OSHA), alleging that his employer and supervisors retaliated against him for engaging in activities protected under SOX. Under relevant procedures, such administrative complaints are directed to the United States Secretary of Labor. If the Secretary fails to issue a final decision on such complaints within 180 days, then the employee is free to bring a lawsuit in federal district court. After the Secretary took no action within 180 days, plaintiff filed suit alleging: constructive discharge in violation of the anti-retaliation provisions of SOX, intentional infliction of emotional distress, and wrongful termination. The company moved to dismiss the complaint, arguing that, even if everything plaintiff alleged was true, his suit should be dismissed because he failed to allege: (1) he engaged in protected activity under SOX; (2) his employer knew, actually or constructively, of the protected activity; (3) he suffered an unfavorable personnel action; and (4) the protected activity was a contributing factor to the unfavorable personnel action.[1]

The Court's Decision

The court began its analysis by noting that SOX protects employees who provide information to supervisors regarding conduct that the employee reasonably believes violates one of the statutes or rules enumerated in 18 U.S.C. § 1514A, which relate generally to mail fraud, wire fraud, bank fraud, securities fraud, or fraud against shareholders. The court determined that, when an employee invokes the whistleblower provisions of SOX, the employee's communication "must '*definitively and specifically*' relate to one of these" provisions of law, and the "employee's communication must express 'an *objectively reasonable belief there has been shareholder fraud*." (emphasis added) It is not enough, said the court, for the employee to generally and "merely allege that wrongdoing has occurred." Instead, the allegedly protected communication from the employee to his or her supervisor must relate to "an *objectively reasonable belief that the company intentionally misrepresented or omitted certain facts to investors, which were material and which risked loss*." (emphasis added) Finally, the court determined that the employee's communications must provide information that reflects a "reasonable belief of an *existing* violation." These holdings in *Wiest* are consistent with the holdings of other courts, including the First Circuit (*Day v. Staples*, Inc., 555 F.3d 42, 55 (1st Cir. 2009)) and the Fifth Circuit (*Allen v. Admin. Review Bd.*, 514 F.3d 468, 476 (5th Cir. 2008)).

The court examined each of the emails that the plaintiff alleged constituted his protected activity.[2] The court initially examined the email from plaintiff regarding the relevant corporate events as to which he set forth his concern that some of the expenses incurred might be excessive and that perhaps they should be further reviewed by the employer's tax department. The court determined that this communication did not "definitively and specifically" convey a reasonable belief that shareholder fraud either had taken place or was in progress and noted that the company had conducted an additional review of the expenses. The court cited with approval other court holdings that "SOX does not apply to generic allegations of accounting violations, . . . violations of IRS regulations, or general allegations of fraud that are not definitive and specific."

Next, the court turned to plaintiff's allegation that, with respect to one of the events in question, he "refused to process the payment for the event." The court held that this alleged refusal to act, which was *unaccompanied by any communications* from plaintiff, did not satisfy the general SOX requirement that the alleged whistleblower "provide information about a SOX violation" because he had not alleged that he explained to his supervisors that his refusal to process the payment was related to a concern about fraud on shareholders. The court concluded that a refusal or failure to act does not generally, standing alone, constitute a protected communication under SOX. The court then turned to plaintiff's claim that, with regard to another event, the employer violated a purely internal procedure and held that "raising a complaint about a violation of an internal procedure is not considered protected activity" under SOX.

Finally, the court turned to plaintiff's communication regarding another employee receiving reimbursement for expenses that may have

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been purely personal and could not properly be taken as a business tax deduction. Again, the court held that this email simply provided information about the potential tax consequence of failing to obtain reimbursement from the employee for the expenses and was not linked to shareholder fraud.

The court granted defendant's motion to dismiss, but gave plaintiff leave until August 20, 2011, to amend his complaint to try to cure these defects, expressing skepticism that he would be able to do so.

Implications and Concerns for Employers

The *Wiest* decision is welcome news for employers who are concerned that the number and type of employee "communications" that may subsequently be found to form the basis of a SOX whistleblower lawsuit are exploding. The requirement that the communication from the employee "specifically and definitively" relate to particular unlawful conduct will make such communications potentially more readily apparent and distinguishable from other, more routine communications concerning general corporate activities and compliance issues.

The decision, however, is not yet "the law of the land," and, as noted, the court gave plaintiff leave to amend to try to strengthen his claims. If he succeeds, this will render the employer's success short-lived.

Far more significant, however, is the fact that the holding in *Wiest* differs *dramatically* from the approach taken in the most recent holding of the Department of Labor Administrative Review Board (ARB). The ARB is empowered to hear appeals from and render decisions regarding SOX complaints that remain in the Department of Labor's administrative law judge trial system and do not proceed to court as the *Wiest* case did. On May 25, 2011, the ARB issued its decision in *Sylvester v. Parexel International LLC*, Case No. 07-123. As noted in a prior Littler ASAP publication by the authors, the ARB expressly rejected many of the principles embraced by the court in *Wiest*. Of particular importance, the ARB in Parexel rejected the requirement laid out in Wiest that the employee plead more than just generalized corporate fraud and rejected the argument that the employee must plead "definitively and specifically" that the matters about which he or she complains work a fraud on shareholders. Thus, it is possible that an employer that finds itself in court on such claims may prevail on arguments that the ARB would reject. This leaves open the possibility that employees pursuing such claims may wish to leave cases in the administrative system, rather than opt for a jury trial in federal court. In such event, the employer will have to persuade the ARB to overrule its prior holding in *Parexel* – not an easy task. It is worth noting that the parties filed their briefs in *Wiest* before the ARB issued its holding in *Parexel*, and that case is not mentioned by the court.

Conclusion

Even under the more favorable standard followed by the court in *Wiest*, managers and supervisors who receive employee communications related to possible corporate wrongdoing or fraud on corporate shareholders must ensure that any adverse action against the employee rests on separate and unrelated concerns, such as performance, staff requirements, and other neutral factors. If any concerns arise regarding navigating these treacherous areas of liability, experienced counsel should be contacted for advice.

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[1] This formulation is derived directly from federal regulations governing administrative complaints under SOX at 29 C.F.R. § 1908.104(b)(1)(i)-(iv). The employer also moved to dismiss the case on the grounds that it was not a publicly traded company. However, the court declined to rule on this issue, which would have turned on determining the retroactivity of certain amendments to SOX made by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[2] In this case, the only communications that were alleged to have constituted protected activity were emails from plaintiff regarding the company events discussed above. In other settings, of course, protected communications could take other forms.

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