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SOX: A Robust Remedy For Whistleblowers

Law360, New York (August 25, 2009) -- The Ninth Circuit recently issued a seminal decision construing the whistleblower provision of the Sarbanes Oxley Act[1] ("SOX" or "Section 806"), clarifying that an employee can engage in protected conduct merely by suggesting the need for an employer to investigate potential fraud.

Reversing the district court's entry of summary judgment, the Ninth Circuit held in Van Asdale v. Int'l Game Tech.[2] that the success or failure of a SOX retaliation action does not depend on the plaintiff's "ability to show any actual fraud, only that they reasonably believed that fraud had occurred."[3]

The plaintiffs in Van Asdale are two former in-house attorneys who were initially hired by International Game Technology ("IGT"), a Nevada-based gaming machine company, for the positions of associate general counsel.

During the Van Asdales' employment, IGT merged with Anchor Gaming, a gaming machine manufacturer that held a valuable "wheel" patent.

After the merger and in preparation for litigation against Anchor's former competitor, Bally Technologies, Shawn Van Asdale determined that the benefits of the merger may have been overvalued because Anchor's "wheel" patent was invalidated by prior art, i.e., a machine manufactured by Bally that predated Anchor's "wheel" patent.

Suspecting that IGT shareholders had been misled about the value of IGT's acquisition of Anchor's "wheel" patent, Shawn raised concerns to his supervisors, including IGT's general counsel. Shortly thereafter, IGT terminated Shawn and his wife Lena.

The Van Asdales brought a SOX retaliation claim against IGT, alleging that the company terminated them in retaliation for reporting possible shareholder fraud.[4]

The district court granted IGT's motion for summary judgment, concluding that the attorneys did not engage in protected conduct because they "hadn't reached a conclusion" that IGT engaged in actual shareholder fraud.[5]

The Ninth Circuit rejected the district court's narrow interpretation of SOX, holding that "[r]equiring an employee to essentially prove the existence of fraud before suggesting the need for an investigation would hardly be consistent with Congress's goal of encouraging disclosure."[6]

Noting that the legislative history of Section 806 of SOX makes clear that it protects "all good faith and reasonable reporting of fraud," the Ninth Circuit concluded that the appropriate standard for determining whether an employee engaged in protected conduct is not whether an employee can prove that her employer actually engaged in actual fraud but rather whether the employee "reasonably believed that there might have been fraud."[7]

In particular, the Van Asdales' request for IGT to conduct an investigation and their "subjective belief that the conduct that they were reporting violated a listed law" was sufficient evidence of protected conduct to avoid summary judgment.[8]

In addition to rejecting the district court's narrow construction of the scope of protected conduct under SOX, the Ninth Circuit rejected IGT's position that the Van Asdales could not proceed with their SOX claims because proving their alleged protected conduct would require the disclosure of attorney-client privileged information.[9]

Relying on SOX's express authorization for any "person" to file a whistleblower complaint and the purpose of Section 806, the court found that "Congress plainly considered the role [in-house] attorneys might play in reporting possible securities fraud," and thus, to the extent that a suit may implicate confidentiality-related concerns, a court must use "equitable measures at its disposal to minimize the possibility of harmful disclosures, not dismiss the suit altogether."[10]

The Scope of SOX Whistleblower Protection Seven Years After Congress Enacted SOX

This month marks the seventh year anniversary of the enactment of SOX.

While decisions construing the scope of SOX's whistleblower provision were all over the map for several years, Federal Circuit Court opinions and U.S. Department of Labor Administrative Review Board ("ARB"') decisions have now clarified the scope of SOX whistleblower protection and have rejected most of the efforts of employers to narrow SOX.

1) Protected Conduct is Not Limited to Disclosures About Shareholder Fraud

Employers have tried to limit the scope of protected conduct to disclosures about shareholder fraud.[11]

Applying the plain meaning of section 806, the ARB has held that protected conduct is not limited to providing information to management about "just fraud, but also [the] 'violation of ... any rule or regulation of the Securities and Exchange Commission."[12]

The First, Fourth, Fifth, Seventh and Ninth Circuits have also held that SOX protects disclosures about a reasonably perceived violation of any SEC rule,[13] any provision of Federal law related to shareholder fraud against shareholders, bank fraud, mail fraud and wire fraud.

Indeed, as the SEC noted in an amicus brief it filed in the leading Fourth Circuit decision on the scope of protected conduct under SOX, [14] raising a concern about noncompliance with generally accepted accounting principles, including a misclassification of items in a financial statement that do not affect the bottom line, may constitute protected conduct.

In sum, SOX protects not only concerns about shareholder fraud, but also a broad range of conduct that could lead to shareholder fraud.

2) A Reasonable but Mistaken Belief is Protected

Employers have achieved some headway in weakening Section 806 by persuading courts to require SOX retaliation plaintiffs to demonstrate that they had an objectively reasonable belief that the conduct about which they complained violated one of the six enumerated categories of protected conduct.

SOX plaintiffs, however, need not demonstrate that they raised a concern about an actual violation. A reasonable but mistaken belief is protected.[15]

Moreover, a layperson will not be expected to know the intricacies of securities law in forming a reasonable belief that the employer is violating an SEC rule.

Instead, objective reasonableness "is evaluated based on the knowledge available to a reasonable person in the same factual circumstances with the same training and experience as the aggrieved employee."[16]

3) Duty Speech Doctrine Does Not Apply to SOX

In the wake of the Supreme Court's decision in Garcetti v. Ceballos,[17] employers have tried to apply the "duty speech" doctrine to SOX, excluding from the ambit of SOX protected conduct disclosures made in the course of an employee performing her ordinary job duties.

Applying the plain meaning of SOX and case precedent construing analogous whistleblower protection statutes, U.S. Department of Labor administrative law judges have held that SOX "specifically protect[s] reports employees make to their supervisors."[18]

As an ALJ explained, "one's job duties may broadly encompass reporting of illegal conduct, for which retaliation results" and "[t]herefore, restricting protected activity to place one's job duties beyond the reach of the Act would be contrary to congressional intent."[19]

The Senate report on SOX notes that Sherron Watkins, Enron's vice president for corporate development, blew the whistle on accounting irregularities in the course of performing her job duties.[20]

As the “duty speech” defense cannot be reconciled with the plain meaning and legislative history of Section 806, it is a very weak defense in SOX retaliation cases.

4) The Burden of Proof is Very Favorable to Employees

The burden-shifting framework in Section 806 is favorable to employees. To establish liability, an employee need only show that her protected conduct was a “contributing factor” in the decision to take an adverse action.

A “contributing factor” is any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision.[21] This is a lower burden than the “motivating factor” causation standard in Title VII.

Indeed, as the Ninth Circuit held in Van Asdale, “causation [in a SOX retaliation action] can be inferred from timing alone where an adverse employment action follows on the heels of protected activity.”[22]

As described by a management-side attorney who has litigated SOX whistleblower retaliation claims, “even a legitimate business reason will not save a corporate defendant from major liability and injunction penalties if the judge concludes that retaliation against the whistleblower played any role in the decision to take the challenged employment action.”[23]

Once the employee proves the elements of a Section 806 claim by a preponderance of the evidence, the employer can avoid liability only if it proves by “clear and convincing” evidence that it “would have taken the same unfavorable personnel action in the absence of the complainant's protected behavior or conduct.”[24]

Clear and convincing evidence is “[e]vidence indicating that the thing to be proved is highly probable or reasonably certain.”[25]

The “clear and convincing evidence” standard is “an extremely difficult burden, at a minimum requiring proof of documented poor performance and disciplinary intent that predates the protected activity.”[26]

5) SOX Prohibits a Broad Range of Retaliatory Conduct

The text of Section 806 prohibits a broad range of retaliatory adverse actions, including discharging, demoting, suspending, threatening, harassing, or in any other manner discriminating against a whistleblower.

About one year ago, the ARB clarified that the Burlington Northern[27] deterrence standard applies to SOX whistleblower claims.[28]

Therefore, in addition to the enumerated adverse actions in the statutory text, SOX also prohibits an employer action that could dissuade a reasonable worker from engaging in protected activity.

6) Whistleblower's Motive is Irrelevant

Faced with a whistleblower retaliation lawsuit, some employers have a knee-jerk reaction to attack the plaintiff's motive for blowing the whistle.

This tactic typically backfires in that it highlights the lengths to which the employer will go to "shoot the messenger." Moreover, as a matter of law, the whistleblower's motive is irrelevant.

In a recent ARB decision construing the analogous whistleblower protection provision of the Safe Drinking Water Act, the ARB rejected the employer's argument that the complainant should not be deemed to have engaged in protected conduct because his disclosure was motivated by personal animus against his supervisors.[29]

The ARB expressly rejected this argument, concluding that "even if [a complainant] were motivated by a retaliatory intent in making [a disclosure] ... a complainant's motivation in making a safety complaint has no bearing on whether the complaint is protected."[30]

7) "Definitively and Specifically" Does Not Require an Employee to Cite Securities Law Chapter and Verse

In one of its early decisions construing SOX's whistleblower provision, the ARB held that in order to constitute protected conduct, a complainant's protected communications "must relate 'definitively and specifically' to the subject matter of the particular statute under which protection is afforded."[31]

The terms "definitively and specifically," however, do not appear in Section 806, and this heightened burden to establish protected conduct finds no support in the legislative history.

Although the ARB's amendment of Section 806 has been widely adopted by federal courts, the "definitively and specifically" requirement does not require an employee to cite securities law chapter and verse.[32] Moreover, an employee need not use the words "SOX," "fraud," "fraud on shareholders" or "stock fraud."[33]

8) Objective Reasonableness is a Mixed Question of Fact and Law

In an effort to prevent SOX whistleblower claims from proceeding to trial, employers have asserted that the objective reasonableness of an employee's alleged protected disclosure is always a question of law.

The Fourth Circuit categorically rejected this position, holding in Welch that "objective reasonableness is a mixed question of law and fact."[34]

Similarly, the Fifth Circuit held in Allen that while the objective reasonableness of an employee's belief can be decided as a matter of law in some cases, "the objective reasonableness of an employee's belief cannot be decided as a matter of law if there is a genuine issue of

material fact ... [and if] reasonable minds could disagree on the issue, the objective reasonableness of an employee's belief should not be decided as a matter of law."[35]

Accordingly, the "objective reasonableness" of an employee's protected disclosure will seldom result in summary dismissal of the claim.

Conclusion

In sum, the Ninth Circuit's recent Van Asdale decision and other leading decisions on Section 806 of SOX from both federal Circuit Court of Appeals and the DOL's ARB clarify that SOX can afford robust protection to whistleblowers and attempts to create loopholes in SOX have generally failed.

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[1] See 18 U.S.C. § 1514A.

[2] 2009 WL 2461906 (9th Cir. 2009).

[3] Id. at *1.

[4] Id. at *1.

[5] Id. at *12.

[6] Id. at *12.

[7] Id. at *11; see also Jayaraj v. Pro-Pharmaceuticals Inc., 2003-S0X-32 at 16-17 (Feb. 11, 2005) ("The statute is clear that the complainant is not required to show that the reported conduct actually constituted a violation of the law, but only that she reasonably believed that the employer violated one of the enumerated statutes or regulations ...").

[8] Van Asdale, at *11 ("although [plaintiff] acknowledged that she 'hadn't reached a conclusion' as to whether fraud had occurred, the context of this statement was [plaintiff's] discussion of the need for an investigation.").

[9] Id. at *5.

[10] Id.

[11] Grant v. Dominion E. Ohio Gas, 2004-S0X-63 (Mar. 10, 2005) (employer alleged that complainant did not engage in protected conduct because none of his expressed concerns "contained any reference to fraud or implication that the company had acted intentionally to mislead shareholders or misstate the company's bottom line.").

[12] Klopfenstein v. PCC Flow Techs Holdings Inc., ARB No. 04-149, ALJ No. 2004-SOX-11, at 17 (ARB May 31, 2006).

[13] See Van Asdale, 2009 WL 2461906; Day v. Staples Inc., 555 F.3d 42 (1st Cir. 2009); Harp v. Charters Comms., 558 F.3d 722 (7th Cir. 2009); Welch v. Chao, 536 F.3d 269 (4th Cir. 2008); Allen v. Admin. Review Bd., 514 F.3d 468 (5th Cir. 2008).

[14] Welch, 536 F.3d at 269.

[15] See Van Asdale, at *11 ("to encourage disclosure, Congress chose statutory language which ensures that an employee's reasonable but mistaken belief that an employer engaged in conduct that constitutes a violation of one of the six enumerated categories is protected."); Kalkunte v. DVI Fin. Serv. Inc., ARB Nos. 05-139, 05-140, ALJ No. 2004-SOX-56 (ARB Feb. 27, 2009) (clarifying that a reasonable but mistaken belief is protected under SOX); Allen, 514 F.3d at 477 ("Importantly, an employee's reasonable but mistaken belief that an employer engaged in conduct that constitutes a violation of one of the six enumerated categories is protected.").

[16] Allen, 514 F.3d at 477.

[17] Garcetti v. Ceballos, 547 U.S. 410 (2006).

[18] See Leznik v. Nektar Therapeutics, 2006-SOX-93, at 7 (ALJ Nov. 16, 2007). The Employment Law Group PC was counsel for complainant in this action.

[19] Deremer v. Gulfmark Offshore Inc., 2006-SOX-2, at 59-60 (ALJ June 29, 2007).

[20] Id. (citing Senate Comm. on the Judiciary, The Corporate and Criminal Fraud Accountability Act of 2002 (The Sarbanes-Oxley Act of 2002), S. Rep. No. 146, 107th Cong., 2nd Sess., 2002 WL 863249 (May 6, 2002)).

[21] Kalkunte, ARB Nos. 05-139, 05-140, ALJ No. 2004-SOX-56 (ARB Feb. 27, 2009). The Employment Law Group PC represented Kalkunte.

[22] Van Asdale, at *13.

[23] Mary E. Pivec, "Whistleblower Protection Pitfalls," Legal Times, Vol. XXVIII, No. 16 (April 18, 2005).

[24] 29 C.F.R. § 1980.109(a).

[25] Peck v. Safe Air Int'l Inc., ARB No. 02-028 at 6, ALJ No. 2001-AIR-3 (ARB Jan. 30, 2004).

[26] Pivec, "Whistleblower Protection Pitfalls."

[27] See Burlington Northern & Santa Fe Ry. Co. v. White, 548 U.S. 53 (2006).

[28] Melton v. Yellow Transp. Inc., ARB No. 06-052, ALJ No. 2005-STA-02 (ARB Sept. 30, 2008).

[29] Collins v. Vill. of Lynchburg, Ohio, ARB No. 07-079, ALJ No. 2006-SDW-03 (ARB March 30, 2009).

[30] Id.

[31] Platone v. FLYi Inc., ARB No, 04-154, ALJ No. 2003-50X-27, at 17 (ARB Sept, 29, 2006).

[32] See Welch, 514 F.3d at 276.

[33] Van Asdale, at *7.

[34] Welch, 536 F.3d at 278.

[35] Allen, 514 F.3d at 477.