SEYFARTH SHAW

MANAGEMENT ALERT

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# Sarbanes-Oxley and Discrimination Claims: A Disturbing Trend

> "I do not infer that there would never be a situation other than a class-action lawsuit where racial discrimination . . . detrimentally impacts shareholders. Fraudulent disclosures to shareholders about a company's diversity or opportunities for those within protected classes could very well impact a company's value on the public market."

## *Smith v. Hewlett Packard*, 2005-SOX-00088 (January 19, 2006).

When attorneys and others hear "Sarbanes-Oxley" or its common acronym "SOX", they typically think of securities regulations, corporate financial accountability to shareholders, and related compliance measures. However, a recent SOX decision serves as a reminder that SOX's reach may ultimately be interpreted to protect employees who make claims of racial and other discrimination. In *Smith v. Hewlett Packard*, the Department of Labor administrative law judge indicated that there *may* be circumstances when an employee's complaints of racial discrimination could be considered protected activity under SOX.

The *Smith* decision raises many more questions than it answers. And they are troubling questions, especially for publicly traded companies. *Smith* suggests that some single plaintiff discrimination claims could implicate Sarbanes-Oxley, or could at least be alleged to implicate Sarbanes-Oxley.

### Background facts

Complainant Smith was a diversity and employee relations consultant at Hewlett Packard. Among his responsibilities was to conduct "group sensing" studies, whereby he would interview employees at particular sites to assess employee morale. According to Smith, during one group sensing study he was conducting in Colorado, employees expressed concern about perceived racial discrimination and racial and sexual jokes. Around the same time, Smith also learned of, and became upset by, the results of an assessment HP had performed to determine whether its performance rating system had an adverse impact on minorities.

### Smith refuses to disclose specifics of investigation and accuses the company of systemic racism

When he submitted the results of his group sensing study to management, Smith declined to reveal the identities of those who had expressed concerns or to disclose the specifics of the complaints of perceived discrimination and other alleged harassment. This inhibited HP's ability to investigate and, if necessary, rectify the concerns and issues raised in those complaints. Additionally, Smith took it upon himself to create his own plan to address what he believed to be "systemic racism" and further proposed that he would oversee implementation of his plan, even after he left the company. Not surprisingly, tension thereafter developed between Smith and HP management, and their relationship deteriorated rapidly. Smith stated that he had met with some African-American employees who were discussing a class action and threatened that he would "take external action" under the Fair Labor Standards Act if his supervisors continued to ask him to detail the alleged concerns from the group sensing study. Additionally, Smith claimed that HP "purposely distorted" and "publicly lied" about the performance rating system and stated that if he "did not see an appreciable effort . . . to address these longstanding and institutional discriminatory practices," he would bring them to the attention of "the EEOC, the Department of Labor, and other appropriate agencies."

## Smith is terminated for insubordination and files a SOX complaint

Based on Smith's continued refusal to provide specifics regarding the group sensing report, he was terminated for insubordination. Smith filed a complaint with DOL alleging retaliation under SOX Section 806. In the SOX proceeding, Smith claimed that he had been terminated in retaliation for his attempts to remedy alleged systemic race discrimination, and that his refusal to turn over the detailed information from the studies, plus his statement that he would go to EEOC, DOL and other agencies, were protected activities under SOX.

## ALJ rejects Smith's theory under SOX, but includes troubling dicta

Following a hearing on the merits, the administrative law judge rejected Smith's claim under SOX, noting that SOX was designed "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws." (The judge also held that Smith unreasonably refused to disclose the details of the group sensing study, so that HP could assess them and take any needed corrective action.) However, the ALJ further stated that if a race discrimination lawsuit had in fact been filed, if HP had prevented information regarding the lawsuit from being revealed to shareholders, and if the employee had complained about *the company's preventing information regarding such a lawsuit from reaching the shareholders*, then the employee would have engaged in protected activity under SOX. Because Smith's complaint concerned more generalized issues of perceived discrimination (and other factors), rather than an allegation that HP had concealed from shareholders the existence of a race discrimination class action lawsuit, the ALJ held that Smith's complaint did not fall within the purview of protected activity under SOX. Moreover, the judge found that Smith's other conduct - such as developing his own plan for remedying discrimination and insisting that it be followed - was unreasonable behavior.

The ALJ rightly recognized that Section 806 is intended to protect employees who "blow the whistle" on their employer for engaging in conduct that defrauds shareholders or otherwise violates federal securities law. In a disconcerting final passage, however, the ALJ stated: "By reaching this conclusion, I do not infer that there would never be a situation other than a class-action lawsuit where racial discrimination . . . detrimentally impacts shareholders. Fraudulent disclosures to shareholders about a company's diversity or opportunities for those within protected classes could very well impact a company's value on the public market. Socially responsible investors may move their money upon learning of a company's discriminatory practices."

## Implications for future SOX claims

This concluding remark, albeit *dicta*, raises a number of troubling issues. For instance, suppose an employee believed that his employer was engaged in discriminatory practices and that the employer was hiding such practices from its shareholders while at the same time making public statements about its commitment to diversity. Suppose further that the employee complained that the employer was allegedly sweeping discrimination concerns under the rug, contrary to its publicly stated commitment to diversity, and that the employer thereby was intentionally misleading shareholders. The judge's comments in Smith suggest that such a complaint would be protected by SOX. Other decisions have likewise suggested that complaining of employment law violations could, under certain circumstances, be a protected activity under SOX. *See, e.g., Harvey v. Safeway, Inc.*, 2005 DOL SOX LEXIS 4 (February 11, 2005) (complaints of wage violations under the Fair Labor Standards Act could relate to a company's "under-compensation of its employees [which] could impermissibly alter the accuracy of its financial disclosures mandated by SOX"); *Harvey v. The Home Depot, Inc.*, 2004 DOL SOX LEXIS 56 (May 28, 2004) ("although racial discrimination is prohibited by a different federal law, its existence may also adversely affect the accuracy of corporate disclosures mandated by SOX").

Indeed, more and more plaintiffs' attorneys are bringing employment cases under SOX alleging, for instance, that an employee's complaints of ERISA, immigration, and wage/hour violations constitute complaints of fraud against shareholders and are thus SOX-protected. Given the high rate of case dismissals under SOX, one might wonder why plaintiffs are pursuing recourse under this statute, which allows reinstatement, backpay and compensatory damages, but not punitive damages which are recoverable under Title VII, Section 1981 and other anti-discrimination laws. One possible explanation could be the expedited procedures available to SOX complainants, including the possibility of preliminary reinstatement (prior to a DOL hearing on the merits). Another possibility is the prospect of threatening shareholder value (read, stock price) by bringing SOX claims against publicly traded companies, and the resultant leverage - or perceived leverage - to be gained by bringing discrimination or other non-securities-related employment claims under

Section 806. In any event, *Smith* appears to the latest development in a disturbing trend for publicly traded employers. Although the result in *Smith* was favorable for the employer, plaintiffs' attorneys will doubtless point to statements made by the ALJ therein as support for expanding SOX to protect conduct that is at most tangentially related to fraud against shareholders or securities law violations. At a minimum, publicly traded companies faced with internal or external discrimination claims should continue to monitor developments in this area.

*If you have any questions on this decision or any other SOX-related issues, please contact your Seyfarth Shaw attorney or any attorney on our website at www.seyfarth.com.*



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