SEYFARTH SHAW LLP
ATTORNEYS

SOX Whistleblower Team Management Alert

Top 10 SOX Whistleblower Cases of 2010

Litigation under the Sarbanes-Oxley Act's (SOX) whistleblower protection provisions in Section 806 is continuing to proliferate. The following are some of the most significant cases that federal courts and the U.S. Department of Labor (DOL) issued in 2010.

Number 10

You Blew The Statute Of Limitations, But We'll Excuse It

***Hyman v. KD Resources*, Case No. 09-076, 2010 DOLSOX LEXIS 27 (ARB March 31, 2010)**

The Administrative Review Board (ARB) ruled that a *pro se* plaintiff established a viable basis for tolling SOX's (then-applicable) 90-day limitations period (the Dodd-Frank Act recently doubled this period) based on a showing that his employer planned to return him to work or, alternatively, offer him a one-year consulting contract.

On June 5, 2008, the company terminated plaintiff's employment, and on November 11, 2008, he filed a complaint with OSHA. OSHA found that the complaint was untimely, as it was filed approximately 160 days after the discharge. The Administrative Law Judge (ALJ) then ordered plaintiff to show cause as to why his complaint was not time-barred. In response, he submitted documents related to his assertion that he was led to believe that he would be returned to his employment or given a one-year consulting contract, that he would be compensated for having been wrongfully terminated, and that the company would address the compliance issues that had been raised. On these bases, he argued that his failure to timely file his complaint should be excused on equitable estoppel grounds.

The ALJ disagreed with plaintiff, finding that he lacked necessary evidence to support an equitable tolling of the 90-day filing period, noting that he only asserted that he was promised a substantial severance in August 2008 and that settlement and re-employment terms were discussed in later e-mails.

Reversing the ALJ's decision, the ARB expansively found that equitable estoppel should be applied where, as it believed had occurred in this instance, an employer "lulled" a plaintiff into "foregoing prompt attempts to vindicate his rights." It then ruled that the documentation plaintiff submitted established that one or more of the company's officials and/or agents led him to reasonably believe that his discharge and SOX-related complaints would be resolved. Accordingly, the ARB allowed plaintiff to proceed with his claim. (Notably, his claim was subsequently dismissed on remand.)

Hyman shows that the ARB is apt to scrutinize and rely upon evidence showing that an employee has a reasonable basis for delaying in filing his complaint – particularly in *pro se* cases. Still, it should be remembered settlement negotiations will not stop the statute of limitations clock from ticking.

Number 9

You Blew The Statute Of Limitations … And There's No Excuse!

***Coppinger-Martin v. Nordstrom, Inc.*, Case No. 09-CV-73725, 2010 U.S. App. LEXIS 24433 (9th Cir. Nov. 3, 2010)**

In contrast to *Hyman*, the Ninth Circuit Court of Appeals recently refused to allow an employee to proceed with a time-barred

claim, rejecting her argument that her complaint was timely filed because she did not learn of the employer's retaliatory motive until months after she was discharged and refusing to accept her equitable tolling and estoppel arguments.

Plaintiff was a Chief Technical Architect in Nordstrom's Business Information Systems Strategic Planning Group. In the summer of 2005, she told her supervisors that she believed security vulnerabilities in Nordstrom's information systems exposed the company to potential violations of federal securities laws. Shortly thereafter, she received an unfavorable performance evaluation, and in November 2005, was told she would be discharged. Her last day of work was April 21, 2006. On May 22, 2006, her attorney contacted Nordstrom's counsel to discuss possible claims against the company. On October 13, 2006, she filed a SOX whistleblower complaint with OSHA, claiming Nordstrom fired her in retaliation for reporting potential securities law violations. After various administrative proceedings, in which her claims were dismissed as untimely, she appealed to the Ninth Circuit.

The Ninth Circuit held that the statute of limitations began to run when plaintiff learned that Nordstrom decided to terminate her employment, which was—at the latest—April 21, 2006, her last day of work. Since she did not file her complaint within 90 days of her last day of work, her claim was time-barred.

The court rejected plaintiff's argument that the statute of limitations was equitably tolled because she was not aware of Nordstrom's retaliatory motive until July of 2006, when she learned other employees were performing her former job duties. The court held that she had constructive knowledge of the law's requirements at least as of the time she retained counsel, before May 2006, and that she had sufficient information to make out a *prima facie* case of SOX retaliation as of her termination date in April 2006. It also rejected the argument that Nordstrom should be equitably estopped from asserting a statute of limitations defense because it fraudulently concealed its motive for her termination. The court reasoned that she had not pointed to any conduct by Nordstrom above and beyond the alleged retaliation that gave rise to the claim that prevented her from filing a timely complaint.

Number 8

Your Belief That The Company Assigned An Inflated Value To Worthless Patents Does Not Satisfy Rule 12(b)(6)'s Requirements

***Vodopia v. Koninklijke Philips Electronics, N.V.,* Case No. 09-CV-4767, 2010 U.S. App. LEXIS 22081 (2d Cir. Oct. 25, 2010)**

On October 25, 2010, the Second Circuit Court of Appeals affirmed the dismissal of a SOX whistleblower complaint for failure to state a claim. The court held that an in-house patent attorney's complaints of alleged fraud on the Patent Office, and potential invalidity of valuable patents owned by the employer, did not constitute protected activity because he lacked a reasonable belief that he was reporting fraud on shareholders.

More specifically, the court held that plaintiff's reports were not protected activity because they did not "definitively and specifically" relate to securities law violations or the categories of fraud exhaustively identified in Section 806. The court rejected plaintiff's argument that he engaged in protected activity when he alleged that the company committed a fraud on shareholders by "knowingly assigning an eight figure value to worthless patents." It reasoned that the complaint allegations focused on plaintiff's concern that the patents were invalid – not the value the company assigned to them. Moreover, plaintiff had not alleged that the $50 million value assigned to the patents was reported to the public or shareholders, or that this item would have been included in any public reporting that could have misled investors.

The court's willingness to find, at the motion to dismiss stage, that the employee did not adequately allege protected activity may encourage employers to seek early dismissals of SOX whistleblower claims.

Number 7

We'll Let You Amend Your OSHA Complaint And Quickly "Kick It Out" To Federal Court

***Trusz v. UBS Realty Investors, LLC,* Case No. 09-CV-268, 2010 U.S. Dist. LEXIS 30374 (D. Conn. March 30, 2010)**

Plaintiff supervised the company's valuation unit that was responsible for determining the market value of real estate and mortgage investments. In 2007, plaintiff told the company that several property values had been overstated, and in 2008 he continued to complain about staffing issues in the valuation unit and valuation errors. On April 10, 2008, he filed a complaint with OSHA, and he was discharged effective June 30, 2008. On September 30, 2008, plaintiff filed an amended complaint with OSHA alleging new instances of retaliation, including the termination of his employment.

Plaintiff requested that the DOL release jurisdiction over this claim so that he could file suit in federal court. Notably, an employee who alleges retaliation under Section 806 may file a case with a federal district court seeking a *de novo* review if the DOL has not issued a final decision within 180 days of the filing of the complaint and there is no showing that there has been delay due to bad faith of the complainant.

The company moved to dismiss the complaint, arguing that plaintiff jumped the gun by filing suit in federal court before 180 days elapsed from the date he filed his *amended* OSHA complaint. The company relied on decisions holding that all the facts raised in a SOX claim in federal court must first be presented to OSHA so that OSHA can adequately fulfill its obligations.

The court disagreed with the company, finding that plaintiff gave OSHA the opportunity to adjudicate his claims, including those included in the amended complaint, because he amended his initial complaint with facts and subsequent developments related to the conduct alleged in his original complaint. Further, the court noted that neither case law nor statutory or regulatory language requires a plaintiff to wait an additional 180 days after he amends his complaint before a federal court has jurisdiction. In this regard, the court noted that plaintiff did not include any facts that were omitted from his OSHA complaint in the federal complaint. Accordingly, the court rejected the motion to dismiss, holding that because plaintiff waited the requisite 180 days from the date he filed his initial OSHA complaint, and OSHA divested itself of jurisdiction over his claim, plaintiff fulfilled the jurisdictional prerequisites for the district court to adjudicate his claim.

Trusz affords leeway to plaintiffs seeking to augment allegations in their OSHA complaints and then remove them to federal court before the 180-day period following the amendment elapses. Employers may seek to limit the reach of this case, however, to situations where there is a clear nexus between the allegations in the original and amended OSHA complaints.

Number 6

Minor Internal Accounting Disputes Do Not Constitute Protected Activity (And SOX Whistleblowers Are Not Free To Assault Customers)

***Frederickson v. Home Depot USA, Inc.,* Case No. 07-100, 2010 DOLSOX LEXIS 47 (ARB May 27, 2010)**

The company employed plaintiff as a supervisor of its inside garden department. Plaintiff claimed that a service department supervisor told her, at the store manager's direction, to mark down a package of hooks as "damaged goods" rather than "for store use only." Plaintiff was not informed that damaged goods were charged to or paid for by the vendor, and he did not know first-hand if that was done. But he believed that the designation of the goods would result in falsification of company records and improper refunds from vendors. Plaintiff did not discuss the conversation where he was told to mark items as damaged good with his supervisor or the store manager. Nevertheless, plaintiff claimed that, after refusing to follow this

direction, he was subjected to unreasonable physical demands, which caused him to suffer a knee problem, and reassignment of some of his subordinates (which hindered his job performance). Plaintiff subsequently was discharged for violating the company's code of conduct due to his improper physical contact with a vendor (he struck a customer in the groin). He then filed a SOX complaint claiming he was retaliated against for refusing to engage in an unlawful mark-down.

The ARB affirmed the ALJ's decision granting the company summary judgment, finding that plaintiff did not engage in protected activity. It stressed that "[a] mere possibility that a challenged practice could adversely affect the financial condition of a corporation, and that the effect on the financial condition could in turn be intentionally withheld from investors, is not enough." More specifically, the ARB found that the challenged mark-down did not directly implicate the categories of fraud listed in the statute or securities violations, but at most constitutes an expenditure with which plaintiff disagreed; and the alleged conduct was confined to a single store and was not of a sufficient magnitude to support a reasonable belief that an investor would rely on the information or that it altered the total mix of information available to an investor. It also found that none of the employees who were aware of his complaint had supervisory authority over plaintiff or the authority to investigate, discover or terminate the misconduct, and that the company demonstrated it would have discharged plaintiff for his physical contact with a vendor regardless of whether he engaged in any protected activity.

Frederickson supports the argument that a plaintiff does not engage in protected activity when he complains of minor internal accounting-related matters that would not be material to shareholders and of which decision-makers are not aware.

Number 5

No, You *Can't* Complain To The Press!

***Tides v. Boeing Co.,* Case No. 08-CV-1736, 2010 WL 537639 (W.D. Wash. Feb. 9, 2010)**

The company discharged two internal auditors for leaking documents and information to a reporter regarding alleged deficiencies in its internal audit of its Information Technology control systems. The company convened an employee review board and determined that the leaks constituted grounds for termination of employment. Plaintiffs then filed a SOX whistleblower complaint in federal court, and cross-motions for summary judgment ensued.

The court granted defendant's summary judgment motion, holding that SOX does not prohibit termination for disclosures to the media. It explained that "Congress has made clear that while SOX was intended to protect whistleblowers, only certain types of whistleblowing would be afforded protection. Leaking documents to the media is not one of them." The court also rejected plaintiffs' contention that the company's reliance on the media leaks to fire them was a pretext for unlawful retaliation. In this regard, the court found that the fact that plaintiffs leaked confidential information to the media was undisputed and justified their discharges. It added that the plaintiffs only offered vague and unsupportable allegations of pretext.

In short, *Tides* supports the defense that making complaints or disclosures to the media does not qualify as protected activity under Section 806.

Number 4

The Eleventh Circuit Joins The First, Fourth, Seventh And Ninth Circuits in Strictly Applying The "Reasonable Belief" Requirement

***Gale v. U.S. DOL,* Case No. 08-CV-14232, 2010 U.S. App. LEXIS 13104 (11th Cir. June 25, 2010)**

Plaintiff was the Chief Executive Officer and a Director of a broker-dealer. In or about 2003, the company discharged plaintiff, and he subsequently filed a whistleblower complaint claiming he was discharged for raising concerns about a fee-payment

process and identifying a reimbursement that made him feel "really uncomfortable" and was a "moral hazard issue." Significantly, he testified that he "did not believe" defendant was engaging in illegal or fraudulent activities and admitted that he did not know whether certain information-sharing practices, about which he had expressed reservations, were actually prohibited.

Affirming the ALJ's dismissal of plaintiff's claim, the ARB found that plaintiff's "deposition testimony indicates that he did not believe WFG engaged in any illegal or fraudulent activity." Agreeing with the First, Fourth, Seventh and Ninth Circuits, the Eleventh Circuit affirmed, stressing that Section 806 "requires an employee to demonstrate both a subjective belief and an objectively reasonable belief that the company's conduct violated a law listed in that section." The court added that the "subjective belief" element of protected activity requires that the employee "actually believed the conduct complained of constituted a violation of pertinent law." It then concluded that plaintiff failed to create a genuine issue of material fact as to whether he engaged in protected activity because his testimony established that "he had no belief, let alone a reasonable belief that [the company] was engaging in any illegal or fraudulent conduct."

Gale is useful to employers, as it holds plaintiffs seeking to establish that they engaged in protected activity to a high standard, focusing on testimony and other evidence bearing on whether they actually believed an employer acted unlawfully, regardless of whether plaintiffs found the complained-of conduct unethical or otherwise unsavory.

Number 3

You Didn't Do Your Homework!

***Harkness v. C-Bass Diamond, LLC,* Case No. 08-CV-231, 2010 U.S. Dist. LEXIS 24380 (D. Md. March 16, 2010)**

Plaintiff was hired to serve as the company's general counsel and manage its legal department as it began its transition into being publicly traded. At the time of her hire, plaintiff had nearly twenty years of legal experience, much of which involved serving as in-house counsel for large domestic and international corporations. In April 2004, the company filed its application with the SEC to become publicly traded. In an effort to secure SEC approval, it voluntarily adopted an internal Code of Business Conduct that mirrored the rules and regulations applicable to publicly traded companies. The Code prohibited employees from disclosing material, non-public information about the company.

On or about January 14, 2005, plaintiff learned that the President and CEO disclosed to an outside investor that the company soon would be restating its earnings. Plaintiff decided that an investigation was necessary. As part of her investigation, she interviewed the President and CEO, who confirmed that he disclosed the private information to the investor.

At the conclusion of her investigation, plaintiff determined that the disclosure "might constitute a violation of Regulation FD." Thereafter, she shared her findings with the Chair of the company's Audit Committee. But she did so without investigating whether Regulation FD applied to the company – even though she knew the SEC had not yet approved its application to become a publicly traded company. Plaintiff also neglected to ask members of her legal staff or the company's outside counsel to research this issue. This was surprising since she submitted a report concluding that the disclosure of material, non-public information "likely would be deemed an 'intentional' disclosure under Regulation F, and then would have had an obligation to simultaneously publicly disclose this information."

Thereafter, plaintiff's relationship with the President and CEO deteriorated. Plaintiff claimed that he prohibited her from attending senior management meetings, refused to inform her of significant transactions and refused to allow her to accompany a transaction team on a due diligence trip. She attributed these events to retaliation prohibited by Section 806.

The company successfully moved for summary judgment, arguing that plaintiff failed to engage in protected activity. The court concluded that while the reporting of legal violations that are "only potential" constitutes protected activity, plaintiff's

uncertainty about the contours of the law itself when she reported the alleged violation made her conduct distinguishable and, therefore, unprotected. The court highlighted plaintiff's failure to research the threshold question of whether Regulation FD applied and, in this regard, emphasized plaintiff's substantial legal experience. Specifically, the court noted that, based on her twenty-plus years of legal experience, she should have been familiar with the value of performing legal research to ascertain the applicability of various laws, and stated that courts have "stressed the importance of a complainant's professional experience" when weighing the objective reasonableness of her belief that a law had been violated. Although the court determined that the regulation at issue may not have been particularly clear, plaintiff's "extensive experience serving as in-house counsel for corporations" indicated that she was familiar with researching the applicability of relevant statutes and regulations. What is more, the court pointed out plaintiff's access to outside counsel as well as an assistant general counsel "who could have advised her regarding the applicability of Regulation FD."

The lesson to be learned here is that whether a plaintiff's belief is reasonable under Section 806 will be evaluated in light of the plaintiff's personal experience and sophistication, and whether that plaintiff adequately investigated the complained-of conduct to determine if it is unlawful.

Number 2

Complaints About Internal Processes And Operations Are *Not* Protected Activity

***Robinson v. Morgan Stanley,* Case No. 07-070, 2010 DOLSOX LEXIS 7 (ARB Jan. 10, 2010), *petition denied*, Case No. 10-CV-1587 (7th Cir., Dec. 27, 2010)**

Plaintiff, a Senior Auditor in defendant's Internal Audit Division (IAD), first complained about potential bankruptcy charge-off violations and then lodged a variety of complaints, ranging from employee cell phone usage, the untimely reporting of audit results, computer security, the qualifications of IAD employees, the use of contractors, technology expenditures, and the same bankruptcy charge-off violations. The company discharged plaintiff for failing to meet performance standards and rejecting performance feedback, and her SOX complaint ensued.

The ALJ issued a 127-page decision rejecting plaintiff's claim, and she appealed to the ARB. The ARB affirmed the ALJ's dismissal of plaintiff's case. The ARB found that, with the exception of plaintiff's discussion of the bankruptcy charge-off issue, none of the information she provided in her February 2004 memorandum is entitled to protection under Section 806. It concluded that complaints to management about executive decisions and corporate expenditures with which a complainant disagrees are not protected activity unless they directly implicate the categories of fraud listed in the statute or securities violations. In this regard, the ARB reiterated (just as in *Fredrickson*, above) that "a mere possibility that a challenged practice could adversely affect the financial condition of a corporation, and that the effect on the financial condition could in turn be intentionally withheld from investors, is not enough."

The ARB did, however, disagree with the ALJ's conclusion that plaintiff did not engage in protected activity when she complained about the bankruptcy charge-off issue prior to her February 2004 memorandum. In support, the ARB referenced the language in Section 806 stating that an employee cannot be subjected to discrimination because he "provide[d] information … to … a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)" and noted that Section 806 does not indicate that an employee's report or complaint about a potential violation must involve actions outside assigned duties. But the ARB ultimately affirmed the ALJ's conclusion that plaintiff failed to prove that her protected activity was a contributing factor in her discharge. Instead, it found that she was discharged because she did not respond to performance feedback and failed to meet her performance standards.

The ARB's position that an employee may engage in protected activity even where she is simply performing her assigned duties raises questions. Why would an employer fire an employee for doing what she was required to do as part of her assigned job duties? While, going forward, an employer might not prevail before the ARB in arguing that such conduct is not "protected activity," it still may argue that it lacked a *motive* to discharge an employee for performing her assigned duties (*i.e.*, plaintiff's performance of her duties did not *contribute* to the decision to discharge her).

Number 1

You Can't Work Here … Period!

***Solis v. Tennessee Commerce Bancorp. Inc.,* Case No. 10-CV-5602, 2010 U.S. App. LEXIS 15302 (6th Cir. May 25, 2010)**

In a closely watched case, the Sixth Circuit reversed a district court's decision to enforce the DOL's preliminary order requiring an employer to reinstate a whistleblower, who happened to be the company's Chief Financial Officer (CFO). The case arose after the company discharged its CFO. The CFO filed a SOX whistleblower claim with OSHA, and OSHA found reasonable cause to believe he was retaliated against in violation of Section 806. OSHA ordered the company to pay the CFO over $1 million and, perhaps more importantly, to reinstate him to his former position.

The company, however, refused to reinstate the CFO, and the DOL sought to enforce its order by seeking a temporary restraining order and preliminary injunction in federal district court. The company's attorneys argued that the district court lacked the authority to enforce the DOL's preliminary reinstatement order under SOX, and that the DOL's procedures for ordering reinstatement did not comply with due process requirements. The district court acknowledged that prior to the this case, only the Second Circuit, in *Bechtel v. Competitive Technologies, Inc.*, had addressed the issue of whether the federal court had jurisdiction to enforce a DOL preliminary order. Two out of the three judges on the *Bechtel* panel declined to enforce the DOL's preliminary order, but there was no consensus regarding whether or not they actually had jurisdiction to do so. As such, in this case, the district court reviewed the decisions of the three Judges in *Bechtel* and adopted Judge Straub's minority view that SOX's statutory scheme confers jurisdiction on the court to enforce the DOL's preliminary reinstatement orders. The district court in this case then issued a preliminary injunction on May 19, 2010, requiring the company to immediately reinstate the CFO.

The company appealed to the Sixth Circuit and moved to stay the district court's decision. Like the Second Circuit in *Bechtel*, the Sixth Circuit in this case passed on the opportunity to definitively answer the question of whether federal courts have jurisdiction to enforce the DOL's preliminary remedial orders on SOX claims. But the Sixth Circuit overturned the DOL's reinstatement decision nonetheless, finding that the potential harm to the company if forced to temporarily reinstate the CFO outweighed the harm to him of not being immediately reinstated.

Whether federal courts have jurisdiction to enforce the DOL's preliminary remedial orders on SOX claims still remains unclear after this decision. But we can glean from this case that SOX whistleblowers will continue to face an uphill battle when asking courts to enforce DOL preliminary orders of reinstatement.

For further details, or if you have any questions regarding any of these decisions, contact your Seyfarth Shaw LLP attorney or any SOX Whistleblower Team member listed on the website at www.seyfarth.com/SOX.

SEYFARTH ATTORNEYS SHAW LLP

Breadth. Depth. **Results.**

www.seyfarth.com