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One Minute Memo®

Federal District Courts Issue Two SOX Whistleblower Decisions That Favor Employers

Although the U.S. Department of Labor's Administrative Review Board (ARB) has limited common defenses to whistleblower retaliation claims under Section 806 of the Sarbanes-Oxley Act of 2002 (SOX), and some federal courts have deferred to those decisions, federal district courts in Pennsylvania and Nevada recently handed down rulings that help level the playing field for employers. More specifically, the Eastern District of Pennsylvania strictly construed the scope of protected activity in *Wiest v. Lynch*, No. 10-cv-3288, 2011 U.S. Dist. LEXIS 79283 (E.D. Pa. July 21, 2011), and the District of Nevada directed that the prohibition on pre-dispute arbitration agreements covering SOX whistleblower claims in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) (signed July 21, 2010) is not retroactive in *Henderson v. Masco Framing Corp.*, No. 11-cv-00088, 2011 U.S. Dist. LEXIS 80494 (D. Nev. July 22, 2011).

Wiest v. Lynch

In *Wiest*, the plaintiff alleged that he refused to process certain event expenditures for his employer, Tyco Electronics Corp. (Tyco), because he believed they did not meet reimbursement or payment standards set by Tyco's accounting department, violated rules and regulations of the Securities and Exchange Commission or tax laws, and raised ethical concerns. He further contended that, in reaction to this refusal, Tyco retaliated against him by initiating an investigation into his purported misconduct. He brought suit under Section 806 of SOX against Tyco and individual employees. The court granted the defendants' motion to dismiss per Rule 12(b)(6) of the Federal Rules of Civil Procedure, holding that the plaintiff failed to plead that he engaged in protected activity.

In so ruling, the court stressed that Section 806 of SOX only protects an employee who has provided information to a supervisor regarding conduct he "reasonably believes" violates one of the laws enumerated in Section 806 of SOX, and that the complaint must "definitively and specifically" relate to such laws. The court further emphasized that an employee's complaint must convey an objectively reasonable belief that the company "intentionally misrepresented or omitted certain facts to investors, which were material and which risked loss." In addition, the court made it clear that a protected communication must provide information relating to an "existing" violation.

Applying this legal framework, the court determined that the plaintiff's allegations did not pass muster under Rule 12(b)(6), as he simply recommended in the communications at issue that the defendants review expenditures to ensure proper tax and accounting treatment and that the defendants comply with Tyco's expense approval process. Such communications, in the court's view, did not "definitively and specifically" relate to the laws referenced in Section 806 of SOX.

In addition, the court rejected the plaintiff's claim that his refusals to process payments constituted protected activity, noting that "a refusal to act without any explanation generally does not 'provide information' about a potential SOX violation." The court also found that complaints about "potential violations" of a company's internal policies do not constitute protected conduct.

The *Wiest* decision is noteworthy because it is at odds with the ARB's May 25, 2011 ruling in *Sylvester v. Parexel International LLC*, ARB No. 07-123. There, the ARB limited the scope of protected activity by ruling, among other things, that a complainant need not describe an "actual" violation of one of the categories of law in Section 806 of SOX (it simply could allege that a violation of law was imminent), the "definitively and specifically" standard is not appropriate, and a complaint need not involve a fraud on shareholders to be actionable.

Henderson v. Masco Framing Corp.

In *Henderson*, the plaintiff brought suit under Section 806 of SOX alleging he was discharged in retaliation for complaining that the company improperly withheld FICA Medicare taxes from his retention bonuses. Prior to July 2010 (when Dodd-Frank was signed), the plaintiff and the defendant–employer entered into a pre-dispute arbitration agreement governing all claims under federal law, including SOX whistleblower claims. The plaintiff moved to compel arbitration of the lawsuit, and the court focused on whether Dodd-Frank applies retroactively.

Dodd-Frank expressly prohibits pre-dispute arbitration agreements that cover SOX whistleblower claims, but does not indicate whether this ban is retroactive. The court recognized that there were "two non-binding, diametrically-opposed cases supporting [the parties'] respective positions" — *Riddle v. DynCorp Int'l Inc*., 733 F. Supp. 2d 743 (N.D. Tex. 2010) (denying retroactive application) and *Pezza v. Investors Capital Corp*., No. 10-cv-10113, 767 F. Supp. 2d 225 (D. Mass. Mar. 1, 2011) (giving retroactive application). The court rejected the approach taken in *Pezza*, and ruled that Dodd-Frank's ban on pre-dispute arbitration agreements covering SOX whistleblower claims does not apply retroactively. In so ruling, the court stressed that the presumption against retroactivity is particularly strong where, as in this case, a retroactive application would eliminate established contractual rights. Accordingly, the court granted the employee's motion to compel arbitration.

Implications

The *Wiest* and *Henderson* decisions illustrate how some federal courts are beginning to take an arguably balanced approach to SOX whistleblower claims (even though the *Henderson* court ruled in the plaintiff's favor). However, with increasing frequency, plaintiffs are opting to litigate SOX claims through the DOL's administrative regime rather than in federal courts, especially in cases where there are serious questions as to whether they engaged in protected activity. In addition, it remains to be seen whether the ARB will embrace the *Henderson* decision. Accordingly, employers should continue to proceed conservatively.

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