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Sarbanes Oxley Whistleblower Cases

By Philip M. Berkowitz

The Sarbanes-Oxley Act (“SOX”) prohibits retaliation against certain corporate whistleblowers. In the two years since its enactment, most whistleblower cases have gone the employer’s way. However, this may provide false comfort to employers.

At last count, there are only a handful of substantive court decisions on SOX whistleblower cases. But SOX whistleblower enforcement cases are still in their infancy. Two very recent cases—one in federal district court and the other before an administrative law judge—found that plaintiffs had presented sufficient evidence of unlawful activity to preclude the defendants’ motions for summary judgment.

Most recently, the United States senators who authored the SOX whistleblower provision have urged the Securities and Exchange Commission (“SEC”) to enforce criminal prosecution of companies who unlawfully retaliate against whistleblowers.

Background on SOX Whistleblowing

SOX was enacted on July 30, 2002. Title VIII is designated as the Corporate and Criminal Fraud Accountability Act of 2002.¹ Section 806 provides a cause of action to employees of public companies who allege that they were retaliated against for disclosing any conduct that the employee reasonably believes violates “any provision of Federal law relating to fraud against shareholders.”

1. 18 USC 1514A.



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Any employee who makes such a disclosure to any *supervisor* or *any other person working for the employer* who has “authority to investigate, discover, or terminate misconduct” is protected. Also protected is disclosure of allegedly fraudulent conduct to a federal regulatory or law enforcement agency, a member of Congress, or any committee thereof.²

Thus, SOX’s whistleblower provisions provide extremely broad protection to employees of public companies for internal complaints of allegedly fraudulent conduct.

OSHA Regulations: Employer’s Burden of Proof

The Department of Labor (“DOL”) delegated to the Occupational Safety and Health Administration (“OSHA”) enforcement authority over SOX’s whistleblower provisions. This summer, OSHA issued final regulations detailing the procedures for handling these cases.³

Under the regulations, the employee must first establish a *prima facie* case of retaliation. This is similar to the burden under Title VII of the Civil Rights Act⁴ (“Title VII”)—the employee must show that he or she engaged in a protected activity or conduct; that the employer knew “actually or constructively” that the conduct occurred; that the employee suffered an unfavorable personnel action; and that the circumstances “were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action.”⁵

However, when a SOX whistleblower claim proceeds to a formal hearing before an administrative law judge (“ALJ”), a complainant must demonstrate by a preponderance of the evidence that protected activity was a contributing factor in the unfavorable action alleged in the complaint.⁶ Thus, to shift the burden of proof to the defendant, something more than a “*prima facie* showing” is required.⁷

Once the employee meets that burden, the burden shifts to the employer—not, as under Title VII, merely to articulate a nondiscriminatory reason for its conduct, but to *prove*, “*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.”⁸

Complainants may bring an action in district court for *de novo* review of an ALJ’s decision if there has been no final decision of the DOL within 180 days of the filing of the complaint and there is no delay due to the complainant’s bad faith.

2. Id. Section 1514A(a)(1).

3. 29 CFR Part 1980, 69 Fed. Reg. 52104 (Aug. 24, 2004).

4. 42 USC § 2000e et seq.

5. 69 Fed. Reg. 52114.

6. 29 CFR § 1980.109(a).

7. Collins, 2004 U.S. Dist. LEXIS *24, n. 13.

8. 29 CFR § 1980.104(c).

Recent Decisions

Collins v. Beazer Homes

Two recent SOX decisions, *Collins v. Beazer Homes USA Inc.*⁹ and *Richards v. Lexmark International, Inc.*,¹⁰ show quite clearly the danger that these cases continue to pose for employers. In *Collins*, the plaintiff, a newly hired director of marketing, was terminated after complaining about various marketing and other decisions. Typical of many of these cases, she also secretly tape-recorded various conversations.

Specifically, almost immediately after her hire, Collins began having conflicts with her manager, the division president, and her coworker, the director of sales. Collins felt that these individuals were inappropriately favoring a particular advertising agency. Within two months of her hire, she signed a contract with a new agency.

Collins complained to the vice president of sales and marketing that she was having problems implementing her marketing decisions. She objected to the division president's management style. She objected to how the company was paying the prior advertising agency, and about how marketing costs were being categorized. She also generally complained about other alleged inappropriate allegations.

Secret Tape-Recording

Collins secretly tape-recorded a meeting with the company's vice president of human resources, Jennifer Jones. Collins also sent an e-mail letter to Beazer's CEO, making further claims about the existence of a "cover-up/corruption." She did not, however, indicate any specifics. In another e-mail, Collins said that she suspected kickbacks in the company's business practices and that, in order to hide information, marketing costs were not being properly allocated.

Jones met with Marty Shaffer, a vice president, and discussed terminating Collins's employment. Shaffer then met with Collins, who again tape-recorded *their* conversation. Collins made a number of complaints, but did not specifically say that illegal activity was taking place.

Shaffer told Collins that he would have to let her go, since the two individuals about whom she was complaining had been with the company for some time, and since it did not appear that the conflict was going to end.

Collins filed a SOX whistleblower complaint with OSHA. When OSHA failed to issue a final administrative decision within 180 days, she filed in federal court. Beazer moved for summary judgment.

The court analyzed SOX's special evidentiary framework for establishing whether the plaintiff proves her case and noted that, if the plaintiff makes her preliminary showing, that the employer can avoid liability only if it can demonstrate *by clear and convincing evidence* that it would have taken the same unfavorable personnel action in the absence of protected behavior.

9. 334 F. Supp. 2d 1365, 2004 U.S. Dist. LEXIS 18374 (ND Ga. Sept. 2, 2004).

10. DOL ALJ No. 2004-SOX-00049 (Oct. 1, 2004).

“Reasonable Belief” of Violation of Law

The court rejected Beazer’s arguments in favor of summary judgment. Beazer argued that Collins didn’t engage in protected activity, because she failed to show an actual violation of the law. But the court noted Collins “reasonably believed” that there was a violation of a law or regulation that was protected by SOX, and that the standard is one of a reasonable person, even if the employee is mistaken or misunderstands the requirements of law.

The court also rejected Beazer’s argument that because Collins never specifically alleged securities or accounting fraud, and because her complaints were “vague” and amounted only to “personality conflicts” and “differences in marketing strategies,” she did not state a claim. Given the “broad remedial purposes” behind SOX, the court found that genuine issues of fact precluded a finding as a matter of law that the plaintiff did not engage in protected activity.

Beazer’s claims that Collins’s allegations were vague or not serious were contradicted, the court held, by the company’s investigation of the matter by various senior executives, and the seriousness with which it treated these allegations.

The court rejected Beazer’s additional argument that, because Shaffer was not fully aware of the nature of Collins’s allegations, and since Shaffer was the “sole decision maker” in her discharge, the company was unaware of plaintiff’s protected activity as a matter of law. Accepting this argument, the court said, would permit an employer to avoid SOX liability simply by bringing in a manager unaware of the employee’s claims in order to fire her.

Temporal Proximity

Finally, the court held that the temporal proximity between the time of plaintiff’s complaints and her discharge was more than adequate to establish circumstances suggesting that the protected activity was a contributing factor to her termination. The court concluded that Beazer could not establish by clear and convincing evidence as a matter of law that they would have fired her even absent her protected activity.

Richards v. Lexmark International, Inc.

In *Richards*, the employer had come close to a decision to terminate the plaintiff, who had been with the company for just over two years, after a long history of well-documented performance problems and difficulties getting along with his coworkers. The company had generated numerous memoranda indicating that it would likely fire him in January 2003, after the holiday season.

Important Assignment Prior to Discharge

However, in December 2002, Richards was given an assignment to assess the company’s inflated levels of inventory over the preceding two years. He provided his preliminary analysis on January 3, 2003, asserting that the company’s methods would lead to erroneous inventory management reporting. The following business day, Richards was discharged.

Lexmark argued that ample evidence proved that it would have fired Richards notwithstanding this report. However, construing the evidence in Richards’s favor, the ALJ held that the *proximity in time* between his protected activity and his discharge was more than sufficient to raise an inference of causation, and that Lexmark failed to show by clear and convincing evidence that it would have fired him even in the absence of this conduct.

The exact date of the decision to terminate Richards was, the ALJ held, unclear and contradictory.

Senators Urge Criminal Enforcement

Recently, the U.S. senators who authored the whistleblower provision in SOX have urged the SEC to vigorously enforce the provision permitting criminal enforcement of SOX, in order to deter retaliation against corporate whistleblowers. In a letter to Chairman William Donaldson, Senators Charles Grassley (R-IA) and Patrick Leahy (D-VT) encouraged aggressive enforcement of section 806.

The senators asked the SEC to respond to a number of questions, including whether a violation of section 806 can subject a company to fines and other penalties under the SEC’s enforcement. The SEC was further asked to provide the number of criminal and civil enforcement investigations that have been initiated as a direct result of suspected willful violations of SOX, including its whistleblowing provision.¹¹

Clearly, guarding against SOX whistleblower liability requires strengthening internal compliance policies and carefully documenting performance problems. But it also requires that employers watch for warning signs of whistleblower claims—complaints that someone isn’t a team player or has a personality dispute with her supervisor may be key. By all means, companies should beware of employees bearing hidden digital recording devices.

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11. J. Hamilton, “Senators Urge Vigorous Enforcement of Sarbanes-Oxley Whistleblower Statute,” SEC Today (CCH) (Vol. 2004-232) at 1 (Dec. 23, 2004).

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