

# Recent Developments in Whistleblower Law

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## Introduction

SEC Chair Mary Jo White recently lauded the invaluable public service whistleblower's provide while acknowledging that employers receive that service with "mixed feelings." This persistent dichotomy has caused the field of whistleblower law to be one of the most dynamic in the profession. Just two decades ago, whistleblower protections were few and far between. Now, especially within the past few years, laws protecting and rewarding whistleblowers have become widespread. Legislatures have passed new statutes, while rarely-used laws already on the books have found vitality, strengthened by statutory amendments or just a renewed understanding of the important role whistleblowers can play.

This proliferation of whistleblower protections and rewards has necessitated a quickly growing body of case law. Indeed, the legal landscape has shifted dramatically year-to-year as administrative tribunals and federal courts grapple with key issues such as the scope of protected conduct, the burden of proof, the causation standard. And though cases cut both ways, the unmistakable trend has been the broadening of protections for employees who blow the whistle. This paper surveys recent developments in whistleblower law from a whistleblower attorney's perspective.

## Sarbanes-Oxley Developments

### **Federal Courts Are Adopting the ARB's Broad Interpretation of SOX Protected Conduct**

Congress enacted SOX's whistleblower protection provision to combat a "corporate code of silence," a code that "discourage[d] employees from reporting fraudulent behavior not only to the proper authorities, such as the Federal Bureau of Investigation and the SEC, but even internally." S. Rep. No. 107-146, at 4-5 (2002). And to ensure that whistleblowers could serve as an effective early warning system for companies and prevent the next Enron, Congress specifically provided that whistleblowers need only complain about conduct that they "reasonably believe[]" violates one of the enumerated anti-fraud provisions in Section 806 (federal criminal prohibitions against bank fraud, mail fraud, and wire fraud; any rule or regulation of the SEC; or any provision of Federal law relating to fraud against shareholders). The plain meaning of the statute did not limit protected conduct to disclosures of actual shareholder fraud.

But less than four years after the enactment of SOX, the Department of Labor Administrative Review Board (ARB) appointed by Secretary of Labor Elaine Chao significantly weakened Section 806 of SOX by imposing onerous burdens on whistleblowers that were contrary to the statute's plain meaning and intent. In *Platone v. FLYi, Inc.*, ARB Case No. 04-154, 2006 WL 3246910 (Sept. 29, 2006), the ARB set forth the following requirements for SOX protected conduct:

1. A SOX complainant's disclosure must "definitively and specifically" relate to one of the six enumerated categories found in 18 U.S.C. § 1514A.
2. The disclosure must "approximate . . . the basic elements" of the kind of fraud or violation alleged. For example, a disclosure about securities fraud must allege "a material misrepresentation (or omission), scienter, a connection with the purchase, or sale of a security, reliance, economic loss, and loss causation."

Under *Platone*, SOX whistleblower protection was limited almost only to employees who were familiar with the intricacies of federal securities law, and many cases were dismissed on summary judgment based on the failure to meet the onerous *Platone* standard.

And to compound *Platone*, some federal courts imposed an unduly high standard of objective reasonableness. For example, a Fifth Circuit decision concluded that an internal complaint about a company overstating gross profits in violation of SEC Staff Accounting Bulletin 101 did not qualify as protected conduct because the company's financial reports had not yet been filed with the SEC. *See Allen v. Admin. Review Bd.*, 514 F.3d 468, 476 (5th Cir. 2008). The apparent logic of *Allen* is that the whistleblower should wait until shareholders have been defrauded before making an internal complaint. That reasoning, however, was contrary to the prophylactic purpose of Section 806.

In May of 2011, the ARB appointed by Secretary of Labor Hilda Solis issued a seminal decision in *Sylvester v. Parexel*, expressly abrogating *Platone* and adopting the following broad construction of SOX protected conduct:

- SOX complainants need only show that they reasonably believed the conduct complained about violated a relevant law. *Id.* at \*14.
- An employee need not wait until misconduct occurs to make a protected disclosure, so long as the employee "reasonably believes that the violation is likely to happen." *Id.* at \*16.
- A complainant need not allege shareholder fraud to receive SOX's protection. SOX was enacted to address "corporate fraud generally," and so a reasonable belief that a violation of "any rule or regulation of the Securities and Exchange Commission" could lead to fraud is protected, even if the violation itself is not fraudulent. For example, SOX would protect a disclosure about deficient internal controls over financial reporting, even though there is no allegation of actual fraud. *Id.* at \*19.
- The reasonable belief standard does not require complainants to tell management or the authorities why their beliefs are reasonable. *Id.* at \*42.
- SOX complainants no longer need to show that their disclosures "definitively and specifically" relate to the relevant laws. *Id.* at \*41.

- SOX complainants do not need to establish criminal fraud. Requiring a complainant to allege, prove or approximate the elements of fraud would be contrary to the whistleblower protection provision's purpose. *Id.* at \*47.

*Sylvester* also held that the *Platone* standard was in conflict with “the plain language of the SOX whistleblower protection provision, which protects ‘all good faith and reasonable reporting of fraud.’” *Id.* at \*14-15, 30 (quoting 148 Cong. Rec. S7418-01, S7420. When the ARB issued *Sylvester*, the key battleground in SOX litigation in federal court became whether federal courts would continue deferring to the prior ARB's *Platone* decision or would instead adopt the current ARB's *Sylvester* decision. Four years later, we now know the answer, and it is decisively positive for whistleblowers. In particular, the Second, Third, and Sixth Circuits and several district courts have adopted the *Sylvester* standard of SOX protected conduct, and no federal court has rejected the reasoning in *Sylvester*. See *Rhinehimer v. U.S. Bancorp Investments, Inc.*, No. 13-6641 (6th Cir. May 28, 2015); *Nielsen v. AECOM Tech. Corp.*, 762 F.3d 214, 220-21 (2d Cir. 2014) (granting *Skidmore* deference to *Sylvester*); *Wiest v. Lynch*, 710 F.3d 121 (3d Cir. 2013) (according *Chevron* deference to *Sylvester*); *Stewart v. Doral Fin. Corp.*, 997 F. Supp. 2d 129, 135-36 (D.P.R. 2014) (adopting the *Sylvester* standard); *Leshinsky v. Telvent GIT, S.A.*, 942 F. Supp. 2d 432, 443 (S.D.N.Y. 2013); *Stewart v. Doral Fin. Corp.*, CIV. 13-1349 DRD, 2014 WL 661587 (D.P.R. Feb. 21, 2014).

Recently the Sixth Circuit issued an opinion in *Rhinehimer v. U.S. Bancorp Investments, Inc.* adopting the *Sylvester* standard and affirming a jury verdict for a whistleblower who disclosed unsuitability fraud. *Rhinehimer* agrees with the ARB's observation in *Sylvester* “that an interpretation demanding a rigidly segmented factual showing justifying the employee's suspicion [referring to *Platone*] undermines this purpose and conflicts with the statutory design, which turns on employees' reasonable belief rather than requiring them to ultimately substantiate their allegations.” In addition, *Rhinehimer* suggests that the issue of objective reasonableness is rarely amenable to summary disposition:

The issue of objective reasonableness should be decided as a matter of law only when no reasonable person could have believed that the facts [known to the employee] amounted to a violation” or otherwise justified the employee's belief that illegal conduct was occurring. *Livingston v. Wyeth, Inc.*, 520 F.3d 344, 361 (4th Cir. 2008) (Michael, J., dissenting) *quoted in Sylvester*, 2011 WL 2165854 at \*12. If, on the other hand, “reasonable minds could disagree about whether the employee's belief was objectively reasonable, the issue cannot be decided as a matter of law.” *Id.*

*Rhinehimer v. U.S. Bancorp Investments, Inc.*, No. 13-6641, 2015 WL 3404658, at \*11 (6th Cir. May 28, 2015).

At trial, the jury found that Rhinehimer was disciplined and fired in retaliation for alerting one of his superiors to unsuitable trades made by a co-worker to the detriment of an elderly client of U.S. Bancorp Investments (USBII). Rhinehimer's manager expressly admitted that he gave Rhinehimer a written warning for opposing the unsuitable trades because Rhinehimer's complaint "prompted a FINRA investigation . . . and anybody associated with this was really feeling the heat." In addition, the manager warned Rhinehimer that if he were to sue the bank, his career in the city would be over. The bank placed Rhinehimer on a performance improvement plan requiring him to increase his revenue to \$40,000 per month, and shortly after placing him on the plan, the bank terminated his employment.

On appeal, USBII argued that under *Platone*, Rhinehimer was required to establish facts from which a reasonable person could infer each of the elements of an unsuitability fraud claim, including the misrepresentation or omission of material facts, and that the broker acted with intent or reckless disregard for the client's needs. The Sixth Circuit held that the evidence was more than sufficient to sustain the jury's finding that Rhinehimer reasonably believed that certain trades constituted unsuitability fraud. And the court noted the "employee's reasonable belief is a simple factual question requiring no subset of findings that the employee had a justifiable belief as to each of the legally-defined elements of the suspected fraud."

*Rhinehimer* is an important development for corporate whistleblower rights and protections in that it restores the original intent of SOX whistleblower protection. A whistleblower's reasonable belief is now assessed in a manner consistent with similar anti-retaliation statutes, *i.e.*, the employee must subjectively believe that there is a violation, and the belief must be objectively reasonable. And as federal courts continue to adopt or defer to the ARB's construction of SOX protected conduct as articulated in *Sylvester*, SOX whistleblowers are more likely to survive summary judgment.

### **DOL ARB Clarifies the "Contributing Factor" Causation Standard**

The ARB recently clarified the "contributing factor" standard and how it should be applied at an evidentiary hearing. *Fordham v. Fannie Mae*, ARB No. 12-061, 2014 WL 5511070 (Oct. 9, 2014); *Powers v. Union Pac. R.R.*, ARB No. 13-034, 2015 WL 1519813 (Mar. 19, 2015). In *Powers* and *Fordham*, the ARB articulated the "contributing factor" standard, explaining that: a whistleblower must prove by a preponderance of the evidence that his or her protected activity was a contributing factor in the employer's decision to take an adverse action. The ARB also explained that an employer's evidence that it took the challenged adverse action for a legitimate business reason will not be considered when determining whether a whistleblower has made his or her contributing factor showing.

The *Fordham* decision clarifies that a whistleblower must prove by a preponderance of the evidence that his or her protected activity was a contributing factor, not just raise an inference that it was. The ARB contemplated that its own inconsistent terminology, coupled with the

similarities between the “contributing factor” standard in whistleblower law and general employment discrimination law had generated confusion and lead to inconsistent applications of the standard. *Fordham*, 2014 WL 5511070 at \*12-13. Like the *McDonnell-Douglas* framework applicable to many discrimination claims, the “contributing factor” standard in the whistleblower context requires the employee to make out an initial showing known as a prima facie case. At the investigative stage before OSHA, a prima facie case under the “contributing factor” standard is similar to an employee’s burden under the *McDonnell-Douglas* framework – the whistleblower need only make allegations sufficient to raise an inference of reprisal. However, at an evidentiary hearing, the whistleblower must show by a preponderance of the evidence that his or her protected behavior was a “contributing factor.”

The ARB also clarified that an employer’s evidence that it took the challenged adverse action for a legitimate business reason will not be considered when determining whether a whistleblower has made his or her contributing factor showing. An ALJ may consider an employer’s evidence challenging whether the employee’s actions were protected or whether the employer’s action constituted an adverse action, as well the credibility of the complainant’s action and the evidence. But evidence supporting the employer’s affirmative defense must be measured by the tougher, clear and convincing metric. *Powers*, 2015 WL 1519813 at \*17-18.

These decisions give teeth to the recognition that the “contributing factor” standard is employee-friendly. *See, e.g., Araujo v. New Jersey Transit Rail Operations, Inc.*, 708 F.3d 152, 159 (3d Cir. 2013) (observing that “contributing factor” burden-shifting is “much easier for a plaintiff to satisfy than [Title VII’s] *McDonnell Douglas* standard.”); *Stone & Webster Eng’g Corp. v. Herman*, 115 F.3d 1568, 1572 (11th Cir. 1997) (“For employers, this is a tough standard, and not by accident.”). It is settled that a contributing factor is any factor, which alone or in combination with other factors, tends to affect the outcome of the decision. *E.g., Halliburton, Inc. v. Admin. Review Bd.*, 771 F.3d 254, 263 (5th Cir. 2014) (citing *Allen v. Admin. Review Bd.*, 514 F.3d 468, 476 n.3 (5th Cir. 2008)). But the evidentiary framework clarified in *Fordham* and *Powers* ensures that when the protected acts are closely intertwined with the adverse action taken, the respondent “bears the risk that the influence of legal and illegal motives cannot be separated.” *Powers*, 2015 WL 1519813 at 19 (citing *Abdur-Rahman v. Dekalb Cnty.*, ARB No. 08-003; ALJ No. 2006-WPC-002, slip op. at 12 (May 18, 2010)).

### **DOL ARB Sets a High Bar for Employers to Establish Same-Decision Defense**

The whistleblower provisions of SOX, the Energy Reorganization Act (“ERA”),<sup>1</sup> and several other whistleblower protection statutes enforced by OSHA employ a burden-shifting framework that is favorable to whistleblowers.

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<sup>1</sup> Section 211 of the ERA protects whistleblowers in the nuclear power industry. *See* 42 U.S.C. §5851.

Under the burden-shifting framework, once the complainant has demonstrated by a preponderance of the evidence that his or her protected conduct was a contributing factor<sup>2</sup> in the adverse action, the employer can avoid liability only by demonstrating by clear and convincing evidence that it would have taken the same adverse action in the absence of any protected activity. *See Menendez*, ARB Case Nos. 09-002, 09-003, ALJ Case No. 2007-SOX-05, at \*11 (ARB Sept. 13, 2011).

In 2014, the ARB issued a critical decision defining the burden an employer must meet to establish the mixed motive defense. In comparison to the burden-shifting framework of most other anti-discrimination laws, the ARB's explanation of the "clear and convincing evidence" standard in *Speegle v. Stone & Webster Construction*<sup>3</sup> places an onerous burden on employers.

Speegle worked as a journeyman painter for Stone & Webster ("S&W") repairing the paint at a nuclear power plant in Alabama. *Id.* at \*1. Speegle complained that many of the other employees hired by S&W for journeyman paint work were inexperienced apprentice painters, and that using apprentice painters was a safety risk and violates federal regulations. *Id.* S&W ignored Speegle's concerns, leading to a heated confrontation between Speegle and his supervisor. *Id.* at \*3. Two days after the confrontation, S&W terminated Speegle's employment for insubordination. *Id.*

Speegle filed a complaint with OSHA, alleging that he was fired in retaliation for raising nuclear safety concerns. *Id.* After a hearing, the ALJ held that Speegle had engaged in protected activity, but his protected activity was not a contributing factor to S&W's decision to terminate his employment. *Id.* On appeal, the ARB held that Speegle's protected conduct was a contributing factor in his termination. *Id.* S&W appealed to the Eleventh Circuit, which held that the ARB erred in its analysis of the ALJ's factual findings, and failed to consider additional arguments from Speegle that his termination was pretextual. *Id.* The case was remanded back to the ARB, which found that Speegle's protected conduct was a contributing factor in S&W's decision to fire him, and remanded the case to the ALJ to determine whether S&W had demonstrated, by clear and convincing evidence, that it would have terminated Speegle in the absence of his protected activity. *Id.* On remand, the ALJ again dismissed the complaint, and Speegle appealed to the ARB. *Id.*

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<sup>2</sup> The ARB defines a contributing factor as "any factor, which alone or in combination with other factors, tends to affect in any way the outcome of the decision." *Allen v. Stewart Enterprises, Inc.*, ARB No. 06-081, *slip op.* at 17 (July 27, 2006). This standard is "intended to overrule existing case law, which requires a whistleblower to prove that her protected conduct was a "significant," "motivating," "substantial," or "predominant" factor in a personnel action in order to overturn that action." *Id.*

<sup>3</sup> *Speegle v. Stone & Webster Construction*, ARB 13-074, 2005-ERA-006 (ARB Apr. 25, 2014).

In April 2014, the ARB issued a decision establishing a three-part framework that ALJs must apply in determining whether an employer can meet the mixed motive defense: (1) whether the employer’s evidence meets the plain meaning of “clear” and “convincing”; (2) whether the employer’s evidence indicates subjectively that the employer “would have” taken the same adverse action; and (3) whether facts that the employer relies on would change in the absence of the protected activity. *Id.* at \*7.

In the first prong of the analysis, the employer must present: (1) an unambiguous explanation for the adverse action in question, and (2) evidence demonstrating that a proposed fact is “highly probable.” *Id.* at \*8. Adopting a 1984 Supreme Court definition<sup>4</sup> of “clear and convincing evidence”, the ARB found that evidence is only clear and convincing if it “‘immediately tilts’ the evidentiary scales in one direction.” *Speegle*, ARB 13-074 at \*6.

In the second prong of the *Speegle* framework, an employer must prove that it would have taken the same action, as opposed to just proving that it could have taken the same action. *Id.* at \*8. For S&W, that meant proving that it would have fired Speegle solely due to one heated oral confrontation, as opposed to merely proving that a heated or insubordinate oral complaint by an employee can justify termination.

Finally, the ARB analyzed what is required for an employer to show that it would have acted similarly “in the absence of” the protected activity. *Id.* The ARB held that in assessing what would have happened in the absence of protected activity, the ALJ should consider how the facts would have been different in the absence of the that activity. *Id.* For example, Speegle’s repeated internal disclosures that using apprentice painters was unsafe engendered tension with management and therefore the ALJ erred by considering these tensions as evidence supporting the mixed motive defense (absent the protected conduct, Speegle would have had a better working relationship with management).

Consistent with the plain meaning and legislative history of SOX and similar statutes that employ a same-decision defense, the ARB clarified in *Speegle* that the defense can be established only when the protected activity had no influence on the employer’s decision to take the adverse action.

### ***Halliburton* Emphasizes the Broad Scope of SOX Adverse Actions and Remedies**

In November 2014, the Fifth Circuit held that: 1) “outing” a whistleblower is a prohibited adverse action; 2) the “contributing factor” causation standard does not require a showing of a retaliatory motive; and 3) SOX affords noneconomic compensatory damages, including

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<sup>4</sup> See *Colorado v. New Mexico*, 467 U.S. 310 (1984).

emotional distress and reputational harm. *Halliburton, Inc. v. Admin. Review Bd.*, 771 F.3d 254 (5th Cir. 2014).

Anthony Menendez raised concerns internally about questionable accounting practices while working as a director in Halliburton's Finance and Accounting department. *Id.* at 256. In particular, Menendez disclosed to his supervisor his belief that Halliburton's practices involving revenue recognition did not conform with generally accepted accounting principles. *Id.* The supervisor initially responded by telling Menendez that he was not a "team player" and should try harder to work with colleagues to resolve accounting issues. *Id.*

After Halliburton failed to address his concerns, Menendez filed a confidential disclosure with the SEC about Halliburton's accounting practices. *Id.* In addition, Menendez sent a memo to Halliburton's Board of Directors raising the same issues he disclosed to the SEC, and that memo was forwarded to Halliburton's General Counsel (GC). *Id.* When Halliburton received a notice of investigation from the SEC requiring Halliburton to retain documents, Halliburton's GC inferred from Menendez's internal disclosures that he was the source of the SEC inquiry. *See Halliburton, Inc.*, 771 F.3d at 257. The GC sent an email to Menendez's colleagues instructing them to retain certain documents because "the SEC has opened an inquiry into the allegations of Mr. Menendez." *Id.*

After the GC outed Menendez as a whistleblower, Menendez's colleagues began treating him differently, refusing to work and associate with him. *Id.* at 255. Menendez described the day that he saw the GC's email outing him as a whistleblower as one of the worst in his life. *Id.* at 257. Halliburton granted his request for paid administrative leave, and within a year, Menendez resigned. *Id.*

The main issue on appeal was whether Menendez suffered an "adverse action" when Halliburton disclosed his identity as a whistleblower. *See Halliburton, Inc.*, 771 F.3d at 259. Affirming the decision below, the Fifth Circuit applied the Supreme Court's *Burlington Northern* material-adversity standard, *i.e.*, whether a company's actions well might have dissuaded a reasonable worker from engaging in protected conduct, *Burlington Northern & Santa Fe Railway Co. v. White*, 548 U.S. 53 (2006). *See id.* 259-62.

The court reasoned Halliburton's outing Menendez to his colleagues and informing them that the whistleblower caused them to be the subject of an SEC investigation "created an environment of ostracism", which well might dissuade a reasonable employee from whistleblowing. *Id.* at 262. The court continued:

It is inevitable that such a disclosure would result in ostracism, and, unsurprisingly, that is exactly what happened to Menendez following the disclosure. Furthermore, when it is the boss that identifies one of his employees as the whistleblower who has brought an official investigation upon the department, as happened here, the boss could be read as sending a warning, granting his implied imprimatur on differential treatment of the employee, or

otherwise expressing a sort of discontent from on high . . . In an environment where insufficient collaboration constitutes deficient performance, the employer's disclosure of the whistleblower's identity and thus targeted creation of an environment in which the whistleblower is ostracized is not merely a matter of social concern, but is, in effect, a potential deprivation of opportunities for future advancement.

*Id.*

On appeal, Halliburton also asserted that a SOX whistleblower must prove a “*wrongfully-motivated*” causal connection.” The Fifth Circuit rejected this argument by relying on precedent that held a “contributing factor” is “*any* factor, which alone or in combination with other factors, tends to affect in any way the outcome of the decision.” *Halliburton, Inc.*, 771 F.3d at 263 (citing *Allen v. Admin. Review Bd.*, 514 F.3d 468, 476 n.3 (5th Cir. 2008)). In addition, the court relied on a Federal Circuit decision holding “a whistleblower *need not* demonstrate the existence of a retaliatory motive on the part of the [employer] in order to establish that his [protected conduct] was a contributing factor to the personnel action.” *Id.* at 263 (citing *Marano v. Dep’t of Justice*, 2 F.3d 1137, 1141 (Fed. Cir. 1993)).

The Fifth Circuit also rejected Halliburton's contention that SOX does not authorize noneconomic compensatory damages, *i.e.*, emotional distress and reputational harm. *Halliburton, Inc.*, 771 F.3d at 266. Relying on the statutory text (identifying “special damages” as a remedy for a prevailing SOX whistleblower), the Tenth Circuit's recent decision in *Lockheed Martin Corp. v. Admin. Review Bd.*, 717 F.3d 1121, 1138 (10th Cir. 2013), and cases construing “special damages” under the False Claims Act's anti-retaliation provision, the court concluded that SOX affords noneconomic compensatory damages. *Id.*

By clarifying the broad scope of actionable adverse actions and the low burden to establish causation, *Halliburton* establishes very helpful precedent for whistleblowers.

### **Implied Rights in SOX Whistleblower Policies Can Give Rise to Contract Liability**

A federal court recently held that an employer's anti-retaliation policy created legally enforceable rights. *See Leyden v. Am. Accreditation Healthcare Comm'n*, No. 1:14-CV-01118 (CRC), 2015 WL 1245976 (D.D.C. Mar. 18, 2015). In *Leyden*, the trial court held that the plaintiff had a valid claim based on the employer's alleged violation of its internal anti-retaliation policy. The court relied on law construing whether employee handbooks created implied contractual rights.

In *Leyden*, the plaintiff was the Chief Accreditation Officer at the American Accreditation Healthcare Commission, a non-profit offering accreditation and certification programs to healthcare entities. The defendant had an anti-retaliation policy, which stated: “No URAC employee who in good faith reports any Improper Activities in accordance with this policy shall suffer, and shall be protected from threats of harassment, retaliation, discharge, or

other types of discrimination.” The plaintiff voiced concerns that new management was mistreating female executives and that two board members were engaged in conduct that she thought jeopardized the organization's independence. The defendant then terminated the plaintiff's employment.

The defendant moved to dismiss the complaint, arguing in relevant part that the anti-retaliation policy did not create contractual rights. Even if it did, the defendant contended, it had disclaimed any such rights in its employee handbook.

However, the court held that the anti-retaliation policy created an implied contract. *Leyden*, 2015 WL 1245976, at \*3. The court began by reviewing *Strass v. Kaiser Found. Health Plan*, a case holding that an employee handbook created an implied contract. *Id.* (citing *Strass v. Kaiser Found. Health Plan*, 744 A.2d 1000, 1011 (D.C.2000)). The court discussed how a manual could create rights, and how an employer could effectively disclaim those rights. *Id.* The court also rejected the defendant's argument about the disclaimer, noting that a disclaimer that was “rationally at odds” with the other language in the document may not cut off an implied contract. *Id.*

In finding an implied contract, the court focused on the employer's invitation to report “Improper Activities” internally, and the language of the anti-retaliation policy. *Leyden*, 2015 WL 1245976, at \*3. The court also concluded that the employer's disclaimer, which was found in a different document, was rationally at odds with the anti-retaliation policy. *Id.* at \*4. The reasoning in *Leyden* could be persuasive in other jurisdictions and could provide an important remedy to whistleblowers that are not covered under federal or state whistleblower protection statutes.

### **SOX Whistleblowers Are Obtaining Substantial Jury Verdicts**

Although SOX was enacted twelve years ago, very few SOX claims have been tried before juries and until recently, SOX whistleblowers had not obtained large verdicts. This is due in part to the ambiguity that existed prior to 2010 as to whether SOX whistleblowers are entitled to a jury trial. The Dodd-Frank Act amendments to Section 806 of SOX clarify the right to try to a SOX whistleblower claim before a jury. *See* 18 U.S.C. 1514A(b)(2)(E) (“A party to an action brought under [Section 806] shall be entitled to trial by jury.”). Some recent verdicts suggest that SOX whistleblowers can obtain large damages, which may prompt more SOX whistleblowers to remove their claims from DOL to district court.

Most recently, in August 2015, a New York federal jury awarded \$1.6M in compensatory damages to a whistleblower in a SOX retaliation lawsuit. Progenics Pharmaceuticals employed Julio Perez as a Senior Manager of Pharmaceutical Chemistry. Perez worked with Progenics and Wyeth representatives to develop Relistor, a drug that treats post-operative bowel dysfunction and opioid-induced constipation.

Perez saw a confidential memo from Wyeth executives to Progenics executives. Contrary to the companies' public statements, the memo stated that Relistor underperformed during the second phase of clinical trials and did not warrant a third phase of trials. The Wyeth memo specifically stated: "Do not pursue immediate initiation of Phase 3 studies with either available oral tablets or capsule formulations."

On August 4, 2008, Perez disclosed his belief to Progenics executives that the company was "committing fraud against shareholders since representations made to the public were not consistent with the actual results of the relevant clinical trial, and [Plaintiff] think[s] this is illegal." The next day, Progenics' General Counsel questioned Perez about the confidential Wyeth memo. Progenics then terminated Perez's employment, claiming he had refused to reveal how he had obtained the Wyeth memorandum.

Perez brought suit under SOX. Progenics claimed that it terminated Perez's employment because he refused to explain how he got the memo, which Perez denied. Though the memo's intended recipients denied giving Perez a copy, Perez argued that the memo was distributed widely within Wyeth and that he had not "misappropriated" it.

After OSHA did not substantiate Perez's complaint, Perez removed his SOX claim to federal court in November 2010. The matter was hard fought, but the jury decided in favor of Perez, attributing the full amount of the \$1.6M verdict to compensatory damages. The jury's willingness to make a large award absent substantial economic loss is significant because the whistleblower provision of SOX places no cap on compensatory damages.

As another example, on March 5, 2014, a California jury awarded \$6 million to Catherine Zulfer in her SOX whistleblower retaliation against Playboy, Inc. ("Playboy").<sup>5</sup> Zulfer, a former accounting executive, alleged that Playboy had terminated her in retaliation for raising concerns about executive bonuses to Playboy's Chief Financial Officer and Chief Compliance Officer. *Zulfer v. Playboy Enterprises Inc.*, JVR No. 1405010041, 2014 WL 1891246 (C.D.Cal. 2014). She contended that she had been instructed by Playboy's CFO to set aside \$1 million for executive bonuses that had not been approved by the Board of Directors. *Id.* Zulfer refused to carry out this instruction, warning Playboy's General Counsel that the bonuses were contrary to Playboy's internal controls over financial reporting. *Id.* After Zulfer's disclosure, the CFO retaliated by ostracizing Zulfer, excluding her from meetings, forcing her to take on additional duties, and eventually terminating her employment. *Id.* After a short trial, a jury awarded Zulfer \$6 million in compensatory damages and also ruled that Zulfer was entitled to punitive damages. *Id.* Zulfer and Playboy reached a settlement before a determination of punitive damages. The \$6

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<sup>5</sup> Zulfer also brought claims for age discrimination under the California Fair Employment and Housing Act (Cal. Gov. Code §§ 12940(a)) and for wrongful termination in violation of public policy.

million compensatory damages award is the highest award to date in a SOX anti-retaliation case. *Id.*

The Ninth Circuit also recently affirmed a SOX jury verdict awarding \$2.2 million in damages, plus \$2.4 million in attorneys' fees, to two former in-house counsel. *Van Asdale v. Int'l Game Tech.*, 549 F. App'x 611, 614 (9th Cir. 2013). The plaintiffs, both former in-house counsel at International Game Technology, alleged that they had been terminated in retaliation for disclosing shareholder fraud related to International's merger with rival game company Anchor Gaming. *Id.* Specifically, plaintiffs alleged that Anchor had withheld important information about its value, causing International to commit shareholder fraud by paying above market value to acquire Anchor. *Van Asdale v. Int'l Game Tech.*, 577 F.3d 989, 992 (9th Cir. 2009). When the plaintiffs discovered the issue, they brought their concerns about the potential fraud to their boss, who had served as Anchor's general counsel prior to the merger. *Id.* at 993. International terminated both plaintiffs shortly thereafter. *Id.*

In addition, a former financial planner at Bancorp Investments, Inc. who alleged that he was terminated for disclosing trade unsuitability obtained a \$250,000 jury verdict in the Eastern District of Kentucky in late 2013.<sup>6</sup> *Rhinehimer v. Bancorp Investment, Inc.*, 2013 WL 9235343 (E.D.Ky. Dec. 27, 2013), *aff'd* 2015 WL 3404658 (6th Cir. 2014).

*Zulfer*, *Van Asdale*, and *Rhinehimer* highlight the importance of the removal or "kick out" provision in SOX that authorizes SOX whistleblowers to remove their claims from the Department of Labor ("DOL") to federal court for *de novo* review 180 days after filing the complaint with OSHA. Although SOX does not authorize punitive damages, a SOX complainant in federal court can add additional claims for which punitive damages can be recovered. For example, when Zulfer and the Van Asdales removed their SOX claims to district court, they added a common law claim of wrongful discharge in violation of public policy. While the ability to add claims can make a SOX claim more valuable after removal, that interest should be balanced against the increased time commitment and cost of litigating in the courts as opposed to the more streamlined DOL administrative process.

Prior to removing a SOX claim to federal court, plaintiff's counsel should carefully assess whether the jurisdiction to which the claim would be removed has adopted or deferred to the current ARB's broad construction of protected conduct as articulated in *Sylvester v. Parexel Int'l*, ARB 07-123, 2007-SOX-039, 2007-SOX-042 (ARB May 25, 2011). Not all circuits have

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<sup>6</sup> The plaintiff sent an email to Bancorp's Chief Compliance Officer raising concerns about a series of transactions that an executive had executed on the account of an elderly client. Plaintiff was worried that his boss, a Bancorp executive, had induced a wealthy man with diminished capacity to authorize transactions that were not in his interest. The plaintiff's email triggered a FINRA investigation into Bancorp.

adopted or deferred to *Sylvester* and instead may apply the decisions of the prior ARB narrowly construing SOX.

### **SOX Protects Post-Employment Whistleblowing**

A U.S. district court in New York recently adopted the ARB's view that former employees can engage in protected activity under SOX. *Kshetrapal v. Dish Network, LLC*, No. 14 Civ. 3527, 2015 WL 857911, at 3 (S.D.N.Y. Feb. 27, 2015).

In *Kshetrapal*, the court took the following allegations as true in deciding the defendant's motion to dismiss: The plaintiff worked as an associate director for Dish Network ("Dish"). 2015 WL 857911, at 1. He disclosed that a marketing agency that Dish had contracted with was submitting fraudulent bills. *Id.* The plaintiff disclosed the fraud, but initially his supervisors ignored him. When the plaintiff pressed the issue, Dish investigated and ultimately terminated the plaintiff's supervisor and its contract with the marketing agency. *Id.* The next month, Dish forced the plaintiff to resign. *Id.*

The marketing agency sued Dish for breach of contract. The plaintiff was deposed in that matter, and he testified that he had discussed the marketing agency's fraud with his supervisors who repeatedly dismissed his complaints. *Id.* at 2. Shortly after the deposition, the plaintiff began working for a music streaming service. *Id.* Dish had advertised with the streaming service, but Dish pulled its business after the plaintiff joined. *Id.* Sometime later, a potential employer rescinded an offer of employment to the plaintiff, explaining that Dish had instructed the new employer to do so. *Id.*

Based on these facts, the court held that SOX covered the plaintiff's protected activity, even though it occurred after the employment relationship ended. *Kshetrapal*, 2015 WL 857911, at 4. In reaching this conclusion, the court first looked at the statutory language and found it ambiguous. *Id.* at 3. Applying *Skidmore* deference, the court looked to the regulations and ARB precedent to resolve the ambiguity in favor of the plaintiff.

In holding that an employee's post-termination disclosures are protected by SOX, the court observed that a contrary holding would "discourage employees from exposing fraudulent activities of their former employers for fear of retaliation in the form of blacklisting or interference with subsequent employment," a result that would undercut the purpose of SOX. *Id.* at 4.

*Kshetrapal* indicates that the ARB's interpretations of SOX will continue to receive widespread support in the federal courts. Further, the case is a cautionary tale for any employer that contemplates an aggressive response to statements made by former employees.

## Duty Speech Defense Inapplicable to SOX Claims

A consensus is emerging that the duty speech doctrine does not apply to SOX whistleblower claims. The duty speech defense asserts that disclosures made while performing routine job duties are outside the ambit of protected conduct. The defense became increasingly popular in the wake of the Supreme Court's 2006 decision in *Garcetti v. Ceballos*, holding that government employees cannot bring First Amendment whistleblower retaliation claims based on work-related speech if the speech is part of their job duties. *Garcetti v. Ceballos*, 547 U.S. 410, 422 (2006).

Most DOL ALJs addressing this issue have declined to apply *Garcetti* to SOX claims. For example, Judge Lee Romero concluded that "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." *Deremer v. Gulfmark Offshore Inc.*, 2006-SOX-2, at 59-60 (ALJ June 29, 2007). The ARB has also declined to apply the duty speech defense to SOX claims. *See Robinson v. Morgan–Stanley*, Case No. 07–070, 2010 WL 348303, at \*8 (ARB Jan. 10, 2010) "[Section 1514A] does not indicate that an employee's report or complaint about a protected violation must involve actions outside the complainant's assigned duties").

Recently, a New York district court held that the "duty speech" defense is inapplicable to SOX claims. *See Yang v. Navigators Group, Inc.*, 2014 WL 1870802 (S.D.N.Y. May 8, 2014). Yang worked as the chief risk officer for Navigators Group, an insurance company. *Id.* at \*1. Yang alleged that Navigators terminated her employment for disclosing deficient risk management and control practices to her supervisor. *Id.* at \*4. Navigators moved to dismiss Yang's SOX claim in part on the basis that Yang's disclosures about "risk issues were 'part and parcel of her job.'" *Id.* at \*8. Judge Roman rejected the duty speech argument, relying on a 2012 district court decision holding that "whether plaintiff's activity was required by job description is irrelevant." *Barker v. UBS AG*, 888 F. Supp. 2d 291, 297 (D. Conn. 2012).

Another recent decision arising under New Jersey's robust whistleblower protection statute provides a detailed analysis of why the duty speech doctrine is contrary to the purpose of whistleblower protection laws. *See Lippman v. Ethicon, Inc.*, No. A-65 SEPT. TERM 2013, 2015 WL 4251063 (N.J. July 15, 2015).

Lippman worked at Ethicon, a manufacturer of medical devices used for surgical procedures, from July 2000 until his termination. Ethicon is a subsidiary of Johnson & Johnson (J&J). During the 10 years before he was transferred to Ethicon, Lippman worked at Ortho–McNeil Pharmaceutical (OMP), another J&J subsidiary, as director of medical services and then vice president of clinical trials.

At first, Lippman was vice president of medical affairs until Ethicon promoted him to worldwide vice president of medical affairs and chief medical officer in 2002. *Lippman*, No. A-

65 SEPT. TERM 2013, 2015 WL 4251063, at \*2. As vice president of medical affairs, Lippman “responsible for safety, ensuring that safe medical practices occurred in clinical trials of [Ethicon's] products; ... medical reviews, information from a medical standpoint; [and] medical writing.” *Id.* (*Lippman v. Ethicon, Inc.*, 432 N.J. Super. 378, 388 (App. Div. 2013)). Consistent with those responsibilities, Lippman served on multiple internal review boards for Ethicon. *Id.* Generally stated, those boards addressed strategic product activities and evaluated the health and safety risks of products. *Id.* As a member of those boards, plaintiff's function was to provide medical and clinical expertise and opinions. *Id.* (internal citation omitted). In short, Lippman was part of Ethicon's high-level policy decision making. *Id.*

The court noted that Lippman served on a quality board that assessed the health risks Ethicon's products posed and provided “medical input” regarding whether corrective measures were required for any products already in the field. *Lippman*, No. A-65 SEPT. TERM 2013, 2015 WL 4251063, at \*2 (internal citation omitted). The quality board could take various corrective actions. *Id.* And at times, a product recall became necessary because of regulatory requirements, Ethicon policy, and/or patient health and safety concerns. *Id.* Ethicon gave the quality board the final say in what, if any, corrective actions to take – even when there was no government directive. *Id.* Members of the quality board were “expected to express their view points from their” area of knowledge or expertise. *Id.*

During the course of his employment, Lippman made numerous objections and disclosures related to the safety and compliance of various pharmaceutical products, arguably within the course of his ordinary job duties. *See Lippman*, No. A-65 SEPT. TERM 2013, 2015 WL 4251063, at \*3. When he was terminated, the plaintiff brought suit under New Jersey's Conscientious Employee Protection Act (CEPA) alleging that he was fired for raising those concerns.

The trial court had granted summary judgment for the employer, holding *inter alia* that the law's protection did not extend to disclosures made pursuant to an employee's ordinary job duties. The appellate division reversed, basing its decision largely on an interpretation of the statutory text. *Lippman v. Ethicon, Inc.*, 432 N.J. Super. 378, 406-08 (App. Div. 2013) *aff'd as modified*, No. A-65 SEPT. TERM 2013, 2015 WL 4251063 (N.J. July 15, 2015).

The New Jersey Supreme Court affirmed the appellate division, concluding that based on the statute's purpose and text, that an employee is entitled to protection regardless of his duties or title, including compliance or “watchdog” employees. *Lippman v. Ethicon, Inc.*, No. A-65 SEPT. TERM 2013, 2015 WL 4251063, at \*10 (N.J. July 15, 2015). After stating that its primary goal was to implement legislative intent, the court emphasized CEPA's settled “public policy purpose to protect whistleblowers from retaliation by employers having been long recognized by the courts of this State.” *Id.* at \*8 (internal citations omitted). The court reiterated that “[a]fter nearly two decades of implementation, it is beyond dispute that the legislative purpose animating CEPA is...to ‘protect and encourage employees to report illegal or unethical workplace activities

and to discourage public and private sector employers from engaging in such conduct.” *Id.* (citing *Abbamont v. Piscataway Twp. Bd. of Educ.*, 138 N.J. 405, 431 (1994)).

Within that context, the statute’s plain meaning extends protection to all disclosures that otherwise meet the requirements for protection, regardless of the whistleblower’s job duties. *Lippman v. Ethicon, Inc.*, No. A-65 SEPT. TERM 2013, 2015 WL 4251063, at \*10 (N.J. July 15, 2015). Holding to the contrary would improperly “engraft language that the Legislature has not chosen to include” and deny the remedial legislation a liberal construction. *Id.* The court approvingly cited the appellate panel’s observation that “watchdog employees are the most vulnerable to retaliation because they are ‘uniquely positioned to know where the problem areas are and to speak out when corporate profits are put ahead of consumer safety.’” *Id.* (citing *Lippman*, 432 N.J. Super. at 406–07). But the New Jersey Supreme Court went even further than the appellate division and rejected any additional requirement on “watchdog” employees under the CEPA. *Id.* at \*14.

These recent decisions suggest that employers are unlikely to successfully assert a duty speech defense in statutory whistleblower retaliation cases.

### **SOX Authorizes Front Pay**

A prevailing SOX whistleblower can recover “all relief necessary to make the employee whole,” including reinstatement, back pay, attorney’s fees, and costs. 18 U.S.C. § 1514A(c). “Special damages” includes damages for impairment of reputation, personal humiliation, mental anguish and suffering, and other non-economic harm resulting from retaliation. *See Kalkunte v. DVI Fin. Servs.*, ARB Nos. 05-139, 05-140 at 11, ALJ No. 2004-SOX-56 at 11 (ARB Feb. 27, 2009). Although reinstatement is the preferred and presumptive remedy to make an employee whole, some ALJs have awarded front pay in lieu of reinstatement. *See, e.g., Hagman v. Washington Mutual Bank, Inc.*, 2005-SOX-00073, at 26-30 (ALJ Dec. 19, 2006), *appeal withdrawn by employer and dismissed*, 07-039 (ARB May 23, 2007) (awarding \$640,000 in front pay to a banker whose supervisor became verbally and physically threatening when Hagman disclosed concerns about the short funding of construction loans). But until recently, there was some ambiguity as to whether district courts would award front pay.

In October 2013, Judge Payne held that front pay is an appropriate remedy in lieu of reinstatement in SOX actions. *See Jones v. SouthPeak Interactive Corp. of Delaware*, 986 F. Supp. 2d 680 (E.D. Va. 2013), *aff’d* 777 F.3d 658 (4th Cir. 2015). Jones worked at SouthPeak as its CFO, and SouthPeak terminated his employment two days after he disclosed accounting irregularities to the SEC. *Id.* at 681. Following a four-day trial, a jury found for Jones and awarded nearly \$700,000 in damages. *Id.* at 682. Jones then filed a motion seeking front pay in lieu of reinstatement in addition to compensatory damages. Judge Payne’s decision to award front pay under SOX was based on DOL regulations implementing SOX that authorize the award of front pay in lieu of reinstatement and Fourth Circuit precedent affirming district court awards

of front pay in lieu of reinstatement under similar remedial statutes, such as the ADEA and FMLA.

SouthPeak appealed Judge Payne's decision and DOL has filed an *amicus curiae* brief arguing that front pay is an appropriate remedy under SOX. Assuming Jones prevails on appeal, other circuits will likely hold that SOX authorizes front pay in lieu of reinstatement. Although SOX does not authorize punitive damages, large awards of front pay to highly compensated employees, such as corporate officers, could result in very large recoveries under SOX.

### **Courts Are Affirming Large Compensatory Damage Awards in Whistleblower Retaliation Cases Based Solely on Whistleblower's Testimony**

Most of the whistleblower retaliation statutes adjudicated at the DOL, including SOX, authorize compensatory damages. Until recently, compensatory damages awards at DOL were fairly nominal absent expert witness testimony concerning the whistleblower's emotional distress damages or the whistleblower's diminished career prospects. However, two recent decisions, one from the Eighth Circuit and the other from the ARB, indicate that a whistleblower can obtain substantial compensatory damages based solely on his or her testimony.

In *Maverick Transportation v. U.S. Department of Labor*, the Eighth Circuit affirmed an ARB decision holding that Maverick, a trucking company, had retaliated against Canter, one of its drivers, for refusing to drive a truck that he believed was unsafe. *Maverick Transp., LLC v. U.S. Dep't of Labor, Admin. Review Bd.*, 739 F.3d 1149, 1157 (8th Cir. 2014). The truck in question had a chaffing brake hose and leaked steering fluid, conditions that substantially increased the likelihood of a catastrophic failure of the service brakes. *Id.*

Canter sued Maverick Transportation under the whistleblower protection provision of the Surface Transportation Assistance Act, which protects truck drivers who refuse to drive due to a reasonable apprehension that a vehicle is unsafe and may cause serious injury to himself or the public. *Id.* at 1152. The ALJ awarded Canter \$75,000 in compensatory damages for emotional distress, despite the fact that Canter offered no corroborating expert testimony, noting that "the ARB has awarded damages for emotional and mental distress where the claims were unsupported by medical evidence." *Canter v. Maverick Transp. LLC*, No. 2009-STA-054, slip op. at 15 (ALJ Oct. 28, 2010). The opinion indicates that Canter's testimony regarding his emotional distress was quite compelling:

- Canter experienced a loss of appetite and suicidal thoughts so severe that, on one occasion, he put a pistol to his head and, as he started pulling the trigger, moved his head out of the way and put a bullet hole through the ceiling and roof.
- Canter's receipt of debt collection notices and calls from collection agencies caused him great distress.

- His checking accounts were closed due to insufficient funds, and he owed bank fees and charges for overdrafts.
- Canter was forced to vacate his home in Alabama and move in with his sister in Colorado in July 2008
- He could not visit his stepchildren because he could not afford to travel.

*Id.*

On appeal, Maverick argued that the award of compensatory damages for emotional distress was excessive because it was supported only by Canter’s testimony. The court affirmed the ALJ, holding that “a plaintiff’s own testimony can be sufficient for a finding of emotional distress, and medical evidence is not necessary.” *Maverick*, 739 F.3d at 1157. In addition, the court held that the ARB properly awarded compensatory damages based on the severity of the harm, rather than the method by which the harm was proved. *Id.*

The ARB also recently affirmed a substantial compensatory damages award based solely on the whistleblower’s testimony. In *Fink v. R&L Transfer, Inc.*, the ARB affirmed the ALJ’s award of \$100,000 in compensatory damages and \$50,000 in punitive damages to a truck driver who was terminated for refusing to drive in unsafe winter weather conditions. *Fink v. R&L Transfer, Inc.*, No. 13-018 (ARB Mar. 19, 2014). In awarding compensatory damages, the ALJ relied on Fink’s testimony that:

- He had to seek public assistance to pay basic living expenses;
- His family ultimately lost their home;
- He had to borrow money from family members; and
- He had difficulty sleeping, wondering how he would be able to support his family.

*Id.* The ARB also affirmed the \$50,000 award of punitive damages, finding that “[a]n award of punitive damages may be warranted where there has been ‘reckless or callous disregard for the plaintiff’s rights, as well as intentional violations of federal law.’” *Id.*

In addition to obtaining large compensatory damages awards at the ALJ level and keeping those awards on appeal, some whistleblowers are also obtaining substantial compensatory damages awards from OSHA. For example, in September 2013, OSHA issued an order requiring Clean Diesel Technologies Inc. to pay \$1.9 million to its former CFO who was fired for warning the board of directors about ethical and financial concerns raised by a proposed merger. In addition to awarding \$486,000 in lost wages, bonuses, stock options and severance pay, OSHA awarded the complainant over \$1.4 million in compensatory damages for pain and suffering, damage to career and professional reputation, lost 401(k) employer matches and expenses.

## Supreme Court Holds that SOX Protects Employees of Privately-Held Contractors and Subcontractors of Publicly-Traded Companies

Section 806 of the Sarbanes-Oxley Act of 2002 (“SOX”), as amended by the Dodd-Frank Act, prohibits an “officer, employee, contractor, subcontractor or agency” of a publicly-traded company from retaliating against “an employee” for disclosing reasonably perceived potential or actual violations of the six enumerated categories of protected conduct in Section 806 (mail fraud, wire fraud, bank fraud, securities fraud, any rule or regulation of the SEC, or any provision of federal law relating to fraud against shareholders).<sup>7</sup> Until recently, there was a split of authority as to whether SOX protects employees of contractors providing services to public companies. In March 2014, the Supreme Court clarified that employees of contractors of public companies, including the attorneys and accountants that prepare the SEC filings of public companies, are covered under Section 806. *See Lawson v. FMR*, 134 S. Ct. 1158, 188 L. Ed. 2d 158 (2014).

Lawson worked for Fidelity Brokerage Services, a private subsidiary of the private company FMR Corp., which manages the day-to-day operations of publicly-traded Fidelity mutual funds.<sup>8</sup> *Id.* at 1159. As is common in the mutual industry, the Fidelity investment company that files reports with the SEC (and is covered under Section 806) does not direct the personnel that operate the funds on a day-to-day basis. She brought a SOX claim alleging retaliation for disclosing securities violations, including improper retention of advisory fees. *Id.* The district court held that Lawson is a covered employee under Section 806,<sup>9</sup> but the First Circuit reversed, holding that SOX protects only employees of publicly-traded companies. *See Lawson v. FMR LLC*, 670 F.3d 61 (1st Cir. 2012), *rev'd and remanded*, 134 S. Ct. 1158, 188 L. Ed. 2d 158 (U.S. 2014).

The First Circuit relied in part on the title and caption of Section 806, both of which refer to “employee of publicly traded companies,” and on references in the legislative history suggesting that Section 806 was intended to protect employees of public companies. In addition,

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<sup>7</sup> For purposes of SOX, a publicly-traded company is defined as a company that has securities registered under § 12 of the Securities Exchange Act or is required to file reports under section 15(d) of the same Act, or “any subsidiary whose financial information is included in the consolidated financial statements of such company.” *See* 18 U.S.C. § 1514A.

<sup>8</sup> Fidelity mutual funds are a collection of publicly-traded companies that have no employees. *Lawson*, S. Ct. at 1164. All operations of the funds are performed by FMR. *Id.*

<sup>9</sup> *Lawson v. FMR LLC*, 724 F. Supp. 2d 141 (D. Mass. 2010) *rev'd in part*, 670 F.3d 61 (1st Cir. 2012) *rev'd and remanded*, 134 S. Ct. 1158, 188 L. Ed. 2d 158 (U.S. 2014).

the First Circuit construed the plain meaning of Section 806 as prohibiting a contractor of a public company, such as FMR, from retaliating against an employee of a public company.

In a 6-3 decision, the Supreme Court reversed, holding that SOX protects employees of contractors, subcontractors, and agents of public companies. *Lawson*, 134 S. Ct. at 1176. The majority relied primarily on the plain meaning of the statute, but also based its decision on an extensive examination of the legislative history and purpose of SOX. In particular, the Court focused on references in the legislative history to outside auditors and attorneys who suffered retaliation after blowing the whistle on accounting fraud at Enron, and concluded that protecting employees of contractors of public companies is essential to preventing another Enron.

A recent ruling by the U.S. District Court for the Eastern District of Pennsylvania suggests a limiting principle for SOX coverage of employees of contractors and subcontractors. *See Gibney v. Evolution Mktg. Research, LLC*, 2014 WL 2611213 (E.D. Pa. June 11, 2014). Leo Gibney was employed by Evolution Marketing Research, a private consulting company that contracted its services out to many publicly-traded companies, including the pharmaceutical giant Merck. *Id.* at \*1. Evolution terminated Gibney's employment after he reported to his supervisor that Evolution was fraudulently overbilling Merck for its services. *Id.* at \*2. Gibney brought a SOX claim, and the district court held that even though Gibney was a protected employee and had reported securities fraud, SOX did not apply because it protects only disclosures aimed at preventing fraud perpetrated by, rather than against, publicly-traded companies. *Id.* The court expressed concern that permitting Gibney's claim to proceed would transform SOX into a general retaliation statute that would apply to any private company that transacts business with a public company. *Id.* While *Lawson* will probably generate an increase in SOX claims, *Gibney* suggests that courts will likely adopt limiting principles that narrow the scope of SOX coverage for employees of contractors and subcontractors of public companies.

### **OSHA Clarifies Investigative Standard for Reprisal Claims**

In spring 2015, OSHA issued a memo clarifying the investigative standard for OSHA whistleblower investigations. OSHA enforces more than twenty whistleblower protection laws, investigating reprisal complaints and issuing merit findings where there is reasonable cause to believe that retaliation has occurred. Under most of these laws, a merit finding typically includes a preliminary order of relief to make the employee whole. Such relief can include reinstatement, lost wages, compensatory damages, and attorney fees. Some statutes also provide for punitive damages.

The memo's essential message was that "the reasonable cause standard is somewhat lower than the preponderance of the evidence standard that applies following a hearing," and that OSHA can issue a merit finding where an investigation reveals that the complainant *could* succeed in proving a violation.

The memo provides the following clarification of the "reasonable cause" standard:

- “The threshold OSHA must meet to find reasonable cause that a complaint has merit requires evidence in support of each element of a violation and consideration of the evidence provided by both sides during the investigation, but does not generally require as much evidence as would be required at trial. Thus, after evaluating all of the evidence provided by the employer and the complainant, OSHA must believe that a reasonable judge could rule in favor of the complainant.”
- “OSHA’s investigation must reach an objective conclusion – after consideration of the relevant law and facts – that a reasonable judge could believe a violation occurred. The evidence does not need to establish conclusively that a violation did occur.”
- “OSHA’s responsibility to determine whether there is reasonable cause to believe a violation occurred is greater than the complainant’s initial burden to demonstrate a prima facie allegation that is enough to trigger the investigation.”
- “Although OSHA will need to make some credibility determinations to evaluate whether a reasonable judge could find in the complainant’s favor, OSHA does not necessarily need to resolve all possible conflicts in the evidence or make conclusive credibility determinations to find reasonable cause to believe that a violation occurred.”

OSHA’s clarification of the reasonable cause standard is consistent with the ARB’s precedent. *See Fordham v. Fannie Mae*, ARB No. 12-061, 2014 WL 5511070 (Oct. 9, 2014). And though the memo does not alter the law, it may increase the number of merit findings in that investigators will understand that they need not obtain “smoking gun” evidence of retaliation to issue a merit finding.

### **Dodd-Frank and SEC Whistleblower Reward Program Developments**

#### **SEC Whistleblower Reward Program Gains Traction**

Since its implementation in August 2011, the SEC’s Whistleblower Reward Program has steadily gained momentum. Under Section 922(a) of Dodd-Frank, a whistleblower that provides original information to the SEC that results in monetary sanctions exceeding \$1 million shall be paid an award of ten to thirty percent of the amount recouped. *See* 78 U.S.C. § 78u-6.

Initially, there was a great deal of skepticism about the SEC whistleblower program, including concerns that it would undermine corporate compliance programs (by causing whistleblowers to go directly to the SEC and bypass internal compliance programs) and would not yield useful tips. Five years later, however, the program is off to a strong start. In a recent speech titled “The SEC as the Whistleblower’s Advocate,” SEC Chair Mary Jo White characterized the program as a “game changer” and reported that the quality of tips has been very

high and spans the full spectrum of securities law violations, including market manipulation, offering fraud, and shareholder fraud. As the SEC confronts significant resource challenges in policing the financial markets, high quality tips that enable the SEC to quickly build a case are invaluable in helping the SEC protect investors.

The SEC whistleblower reward program has generated over 10,000 tips and has paid out approximately \$50 million in awards to whistleblowers. Some of these tips have enabled the SEC to halt ongoing fraud. Further, incentives for whistleblowers are forcing companies to strengthen their internal compliance programs. More than 80% of whistleblowers disclosed wrongdoing internally prior to blowing the whistle to the SEC. If a company fails to properly investigate and correct a disclosure of fraud or other securities violation, it is taking a significant risk that the whistleblower will disclose the wrongdoing to the SEC, requiring the company to explain why it failed to take corrective action.

Most recently, the SEC announced the Dodd-Frank whistleblower program's 18th award on July 15, 2015. The whistleblower disclosed a complex fraudulent scheme which otherwise would have been very difficult for investigators to detect. This resulted in an award of more than \$3 million – the third largest in the program's history.

In addition to providing strong financial incentives to whistleblowers, the SEC is enforcing Dodd-Frank's prohibition against whistleblower retaliation and is barring companies from using confidentiality agreements and policies to silence whistleblowers. While the whistleblower reward provisions are a small part of the Dodd-Frank Act, they might be the most effective new tool to protect investors and promote market integrity.

### **Dodd-Frank's Coverage of Internal Whistleblowing**

A split of authority has emerged regarding whether internal disclosures are protected under Section 922 of the Dodd-Frank Act, 15 U.S.C. § 78u-6(h) ("Section 922" or "Dodd-Frank"). The split stems from what appears to have been a drafting error. Under § 78u-6(a)(6), the term "whistleblower" means "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission." The anti-retaliation provision in Section 922, however, defines protected conduct as lawful actions taken by a whistleblower:

- (i) in providing information to the Commission in accordance with this section;
- (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or

(iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. § 7201 et seq.), this chapter, including section 78j-1(m) of this title, section 1513(e) of Title 18, and any other law, rule, or regulation subject to the jurisdiction of the Commission.

15 U.S.C. § 78u-6(h)(1)(A).

While the definition of “whistleblower” appears to require a disclosure to the SEC, the “catch-all” provision in Section 78u-6(h)(1)(A)(iii) encompasses conduct protected by Section 806 of SOX, which includes internal disclosures made to supervisory personnel irrespective of whether the employee separately reports the information to the SEC.

The SEC has adopted the position that Dodd-Frank whistleblower protections cover those who make internal disclosures. Most recently, on August 5, 2015, the SEC released new interpretive guidance reiterating that Dodd-Frank Act whistleblower protection is not limited only to disclosures made to the SEC in accordance with the procedures for obtaining a whistleblower award. Rather, protection also extends to whistleblowers who report potential securities law violations internally or to the SEC. This interpretive guidance is significant in that it provides additional support to federal courts rejecting *Asadi*'s narrow analysis.

The SEC offered three reasons not to limit Dodd-Frank whistleblower protection solely to disclosures to the SEC's Office of the Whistleblower.

First, the text of Rule 21F-2(b)(1) clarifies that Dodd-Frank whistleblower protection extends to the broad range of disclosures identified in Section 21F(h)(1)(A). That includes (i) providing information to the SEC through the whistleblower program; (ii) initiating, testifying in, or assisting in any investigation or judicial or administrative action of the SEC based upon or related to a whistleblower submission to the SEC; or (iii) making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 or “any other law, rule, or regulation subject to the jurisdiction of the Commission.” The whistleblower protection provision of SOX includes internal disclosures about a violation of any SEC rule or regulation.

Second, Rule 21F-2(b)(1)(iii) expressly provides that “[t]he anti-retaliation protections apply whether or not [an individual] satisf[ies] the requirements, procedures and conditions to qualify for an award.”

Third, the SEC's construction of Dodd-Frank whistleblower protection is driven by the policy goals and intent of the SEC whistleblower reward program:

Specifically, by providing employment retaliation protections for individuals who report internally first to a supervisor, compliance official, or other person working for the company that has authority to investigate, discover, or terminate misconduct, our

interpretive rule avoids a two-tiered structure of employment retaliation protection that might discourage some individuals from first reporting internally in appropriate circumstances and, thus, jeopardize the investor-protection and law-enforcement benefits that can result from internal reporting. Under our interpretation, an individual who reports internally and suffers employment retaliation will be no less protected than an individual who comes immediately to the Commission. Providing equivalent employment retaliation protection for both situations removes a potentially serious disincentive to internal reporting by employees in appropriate circumstances. A contrary interpretation would undermine the other incentives that were put in place through the Commission's whistleblower rules in order to encourage internal reporting.

U.S. SEC. AND EXCH. COMM'N, SEC RELEASE NO. 34-75592, INTERPRETATION OF THE SEC'S WHISTLEBLOWER RULES UNDER SECTION 21F OF THE SECURITIES EXCHANGE ACT OF 1934 (2015).

In September 2015, the U.S. Court of Appeals for the Second Circuit became the first federal appellate court to adopt the SEC's reasoning. *Berman v. Neo@Ogilvy LLC*, No. 14-4626, 2015 WL 5254916 (2d Cir. Sept. 10, 2015). The issue in *Berman* was whether the Dodd Frank Act's anti-retaliation protection extends to an employee's internal disclosures to his employer. The question arose from two seemingly-conflicting statutory provisions, one of which defines protected conduct to include internal disclosures protected under the whistleblower protection provision of the Sarbanes-Oxley Act and one of which defines the term whistleblower in a manner limiting protection to disclosures made to the SEC. In interpretive guidance issued in August 2015, the SEC reconciled these provisions and concluded that internal disclosures are covered. *Berman* focuses on whether the conflicting provisions create an ambiguity requiring the court to defer to the SEC's interpretation pursuant to *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* In *Berman*, the Second Circuit held that *Chevron* deference is warranted, and adopts SEC's position that internal disclosures constitute protected activity under the Dodd-Frank Act.

The court began its analysis by noting that the case was much closer than in past instances of statutory ambiguity requiring *Chevron* deference. But though the two provisions created no "absolute conflict," applying the law's definition of a whistleblower (which is limited to those who report violations to the SEC) to the anti-retaliation provision extending broader coverage would leave it with an "extremely limited scope." The court reasoned that except in rare cases where the employee reported internally and to the SEC at essentially the same time, there would be "virtually no situation" where the provision extending protection to more types of disclosures would apply.

The court examined the legislative history, the text, and other cases deciding the issue. It observed that only one other federal court of appeals has taken up the issue. *See Asadi v. G.E. Energy (USA), L.L.C., C.*, 720 F.3d 620 (5th Cir. 2013). In *Asadi*, the Fifth Circuit reached an

opposite result, holding that Dodd-Frank’s statutory language is not ambiguous and that Section 922 protects only disclosures to the SEC. *Asadi*, 720 F.3d at 627-31. However, the Second Circuit sided with the majority of district courts that have concluded it is unclear whether Congress intended the law’s anti-retaliation to have such a narrow scope. Because of this, a statutory ambiguity exists and deference to the SEC’s interpretation is appropriate.

As noted above, most of the district court opinions on this issue held that Section 922 protects internal disclosures. *See, e.g., Khazin v. TD Ameritrade Holding Corp.*, 2014 WL 940703, at \*6 (D.N.J. Mar. 11, 2014); *Yang v. Navigators Grp., Inc.*, 2014 WL 1870802, at \*13 (S.D.N.Y. May 8, 2014); *Ahmad v. Morgan Stanley & Co.*, 2014 WL 700339, at \*4 n.5 (S.D.N.Y. Feb. 21, 2014); *Rosenblum v. Thomson Reuters (Markets) LLC*, 984 F. Supp. 2d 141, 147-48 (S.D.N.Y. 2013); *Ellington v. Giacomakis*, 977 F. Supp. 2d 42, 45-46 (D. Mass. 2013); *Murray v. UBS Sec., LLC*, 2013 WL 2190084, at \*7 (S.D.N.Y. May 21, 2013); *Genberg v. Porter*, 935 F. Supp. 2d 1094, 1106-07 (D. Colo. 2013); *Nollner v. S. Baptist Convention, Inc.*, 852 F. Supp. 2d 986, 994 n.9 (M.D. Tenn. 2012); *Kramer v. Trans-Lux Corp.*, 2012 WL 4444820, at \*5-7 (D. Conn. Sept. 25, 2012). This cases have consistently rejected *Asadi*, found ambiguity in the provisions at issue, and held that internal disclosures are protected.

For example, in an October 2013 decision, the Southern District of New York disagreed with *Asadi* and found that the differing statutory definitions of “whistleblower” created an ambiguity that was best resolved by deferring to the SEC’s implementing regulations. *Rosenblum v. Thomson Reuters (Markets) LLC*, 984 F. Supp. 2d 141, 148 (S.D.N.Y. 2013). The U.S. District Court for the District of New Jersey took a similar approach in *Khazin v. TD Ameritrade Holding Corp.*, No. 13-4149, 2014 WL 940703 (D.N.J. Mar. 11, 2014). In that case, the employee, an investment oversight officer at a securities firm, was terminated after reporting a compliance violation to his supervisors. *Id.* at \*1. The court found that the statute was ambiguous, and it was therefore appropriate to defer to the SEC’s interpretive guidance. *Id.* at \*6. Most of the district court decisions have found an ambiguity in the statutory language and deferred to the SEC’s interpretive guidance. *See, e.g., Khazin*, 2014 WL 940703, at \*6; *Yang*, 2014 WL 1870802, at \*13; *Rosenblum*, 984 F. Supp. 2d at 147-48.

As another example, Judge Edward M. Chen recently issued an opinion concluding that *Asadi* is fatally flawed and that the SEC’s implementing regulations should be afforded *Chevron* deference. *Somers v. Digital Realty Trust, Inc.*, 2015 WL 2354807 (N.D. Cal. May 15, 2015). In *Somers*, the plaintiff was a Vice President at Digital Realty who was terminated after reporting to senior management that his supervisor had engaged in corporate actions in violation of SOX.

*Somers* brought suit under Dodd-Frank, alleging that he was terminated in retaliation for internally reporting securities law violations. Digital Realty filed a motion to dismiss arguing that since *Somers* only reported his concerns internally and not also to the SEC, he does not qualify as a “whistleblower” under Dodd-Frank. *Id.* at \*3. Judge Chen denied Digital Realty’s

motion, finding that SEC Rule 21F-2(b)(1) is entitled to *Chevron* deference and thus individuals like Somers who only report their suspicions internally are protected under Dodd-Frank.

Applying the surplus-usage and harmonious-reading canons of statutory interpretation, in conjunction with the legislative intent behind Dodd-Frank, *Somers* rejected the *Asadi* court's reasoning and concluded that the statutory language is ambiguous. *Id.* at \*6-12. In *Asadi*, the court determined that an expansive reading of Dodd-Frank would make the anti-retaliation provision of SOX moot. In contrast, *Somers* reasons that individuals might file claims under SOX in addition to or instead of Dodd-Frank because they might prefer an administrative forum and a prevailing plaintiff can recover monetary damages other than back pay, such as damages for non-economic harms. *Id.* at \*11-12.

After finding sufficient ambiguity to invoke *Chevron* deference, the *Somers* court decided that SEC Rule 21F-2(b)(1) eliminates the tension between the narrow definition of whistleblower and the broad language of (iii) and thus is a reasonable construction of the statute. In addition, the SEC's rule is consistent with purpose of Dodd-Frank to improve accountability and transparency, encourages the internal reporting of potential illegal activities, and enhances the SEC's ability to bring actions against employers who engage in retaliatory action. *Id.* at \*12-13.

Other district courts declining to follow the Fifth Circuit's decision in *Asadi* include the U.S. District Court for the District of Kansas (*Azim v. Tortoise Capital Advisors, LLC*, 2014 WL 707235 (D. Kan. Feb. 24, 2014)), and the U.S. District Court for the District of Nebraska (*Bussing v. COR Clearing, LLC*, 2014 WL 2111207 (D. Neb. May 21, 2014)).

In the wake of *Berman* and the [SEC's August 2015 interpretive guidance](#), more courts will likely be inclined to reject *Asadi*'s narrow construction of Dodd-Frank protected conduct. Still, the view expressed in *Asadi* has some support, and several district courts have expressly followed the Fifth Circuit's precedent in *Asadi*. For example, in *Englehart v. Career Educ. Corp.*, 2014 WL 2619501, at \*9 (M.D. Fla. May 12, 2014), the court held that an employee of an education services company who disclosed material misrepresentations in budget forecasts to her supervisor was not a whistleblower within Dodd-Frank's statutory definition. The court found that the restrictive statutory definition of whistleblower was unambiguous, and therefore gave no weight to the SEC's guidance, agreeing with *Asadi* that only an employee who complains to the SEC can be a whistleblower under the law. *Id.*

The U.S. District Court for the Northern District of California also followed the Fifth Circuit's lead in *Banko v. Apple Inc.*, 2013 WL 7394596 (N.D. Cal. Sept. 27, 2013). *Banko*, an Apple engineer, reported to his supervisors that a fellow engineer was embezzling money, an allegation that was allegedly later confirmed by an internal investigation. *Id.* at \*1. Apple then terminated *Banko*, who responded by bringing a claim for whistleblower retaliation under Dodd-Frank. *Id.* The district court granted Apple's motion for summary judgment on the Dodd-Frank

claim, citing *Asadi* and dismissing Banko's claim on the grounds that he never reported his concerns to the SEC. *Id.* at \*4-6.

The circuit split on this key issue will likely warrant Supreme Court review. But until a authoritative ruling comes, whistleblowers who have suffered retaliation for internal disclosures should consider bringing SOX claims within the 180-day statute of limitations.

### **Important Procedural Distinctions Between Dodd-Frank and SOX Emerge**

Assuming the holding in *Berman* becomes the law of the land, Section 922 of Dodd-Frank will likely provide a remedy that overlaps with SOX, but offers a much longer statute of limitations,<sup>10</sup> double back pay, and the opportunity to proceed directly in federal court without exhausting administrative remedies. Recent decisions about procedural aspects of Section 922 claims, however, suggest that Section 922 could be a weaker remedy than SOX in some respects. In particular, Section 922 claims are not exempt from mandatory arbitration agreements and Section 922 does not expressly provide the right to a jury trial.

In December 2014, the U.S. Court of Appeals for the Third Circuit held that whistleblower retaliation claims brought under Section 922 of the Dodd-Frank Act could be subject to mandatory arbitration. *Khazin v. TD Ameritrade Holding Corp.*, 773 F.3d 488 (3rd Cir. 2014). The Dodd-Frank Act bars employers and employees from agreeing to mandatory arbitration for three whistleblower protection provisions (Section 806 of the Sarbanes-Oxley Act, Section 1057 of Dodd-Frank, and Section 748 of the Dodd-Frank Act). However, the law failed to exempt Section 922 claims from mandatory arbitration. The Third Circuit reasoned that because Congress did not append an anti-arbitration provision to Section 922 while contemporaneously adding such provisions elsewhere, the omission was deliberate. *Id.*

*Khazin* is the first appellate decision holding that Section 922 Dodd-Frank Act whistleblower claims are subject to mandatory arbitration, but is consistent with prior district court decisions, including *Murray v. UBS Sec. LLC*, 2014 WL 285093, at \*8 (S.D.N.Y. Jan. 27, 2014) and *Ruhe v. Masimo Corp.*, SACV 11-00734-CJC(JCGx), 2011 WL 4442790, at \*4 (C.D. Cal. Sept. 16, 2011).

In January 2014, the Southern District of New York held in *Murray v. UBS Securities* that Section 922 claims are not exempt from mandatory arbitration agreements. *Murray v. UBS Sec.*,

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<sup>10</sup> SOX claims can be brought “not later than 180 days after the date on which the violation occurs, or after the date on which the employee became aware of the violation.” 18 U.S.C. § 1514A(b)(2)(D). Section 922 claims can be brought up to six years after the violation occurred or three years after the material facts become known to the employee, but never more than ten years after the date on which the violation occurred. 15 U.S.C. § 78u-6(h)(1)(B)(iii).

*LLC*, 2014 WL 285093 (S.D.N.Y. Jan. 27, 2014). Murray, a former mortgage analyst at UBS, alleged that UBS terminated his employment because he refused to modify his research to report more favorable market conditions for commercial mortgage-backed securities in which UBS was heavily invested. *Id.* at \*1. Murray filed a Dodd-Frank retaliation claim in federal court and also filed a SOX claim with OSHA.

Murray's employment agreement contained an arbitration clause covering any claim arising out of his employment. *Id.* Consistent with SOX, the arbitration clause had a carve-out for SOX claims. *See* 18 U.S.C. § 1514A(e)(2). UBS moved to compel arbitration of Murray's Dodd-Frank claim. *Murray*, 2014 WL at \*2. Murray argued that because his complaints to his supervisor were protected conduct under SOX, his claims arose under SOX and therefore his claim should proceed in court as a SOX claim. *Id.* at \*3. The court disagreed, holding that Section 922 claims are not exempt from mandatory arbitration, and therefore Murray could proceed with his Section 922 claim only through arbitration. *Id.* at \*14.

The availability of a jury trial is another important procedural distinction between SOX and Dodd-Frank whistleblower retaliation claims. As amended by Dodd-Frank, Section 806 of SOX includes an express right to a jury trial. 15 U.S.C. § 1514A(b)(2)(E). Section 922 of Dodd-Frank, however, does not contain an express right to jury trial. In late 2013, a Georgia district court held that Section 922 plaintiffs are not entitled to trial by jury. *Pruett v. BlueLinx Holdings, Inc.*, 2013 WL 6335887, slip op. at \*7 (N.D. Ga. Nov. 12, 2013).

When Congress enacted Section 922 approximately four years ago, Section 922 appeared at first glance to provide a stronger remedy than SOX. Recent decisions highlighting important procedural differences between the statutes, however, suggest that SOX might offer a stronger remedy than Section 922. And if courts apply "but for causation" to Section 922 claims, SOX will certainly be stronger remedy in that a SOX plaintiff can prevail by showing that protected conduct was a contributing factor to the adverse action. In light of the ambiguity about whether internal disclosures are protected under Section 922 and recent decisions highlighting important procedural distinctions between SOX and Section 922 claims, whistleblower counsel should be careful to comply with the short 180-day SOX statute of limitations.'

The following table summarizes key procedural distinctions between Section 806 of SOX and Section 922 of Dodd-Frank:

|  | SOX                         | Dodd-Frank                                    |
|--|-----------------------------|---|
| Administrative exhaustion                                  | Must file initially at OSHA | No administrative exhaustion requirement      |
| Statute of limitations                                     | 180 days                    | 3-10 years                                    |
| Right to jury trial  | Y                           | N   |
| Exempt from mandatory arbitration                          | Y                           | N   |
| Causation standard   | Contributing factor         | “but for” causation (although not sole cause) |
| Double back pay  | N                           | Y   |
| Special damages (emotional distress and reputational harm) | Y                           | N   |

### SEC Scrutinizes “Gag Clauses” in Settlement and Severance Agreements

In public remarks, including at ABA Labor and Employment conferences and webinars, Sean McKessy, Chief of the SEC’s Whistleblower Office, has warned that the SEC is identifying and investigating confidentiality agreements that attempt to impede employees from reporting securities violations to the SEC.<sup>11</sup> Recently the SEC made good on its promise and took administrative action against KBR, Inc. for requiring employees to sign confidentiality agreements that could impede employees from reporting violations. This is an important development for employment attorneys and warrants a thorough review of corporate confidentiality agreements and policies.

#### SEC Administrative Action

On April 1, 2015, the SEC took administrative action against KBR for requiring witnesses in certain internal investigations to sign confidentiality statements with language warning that they could face disciplinary action, including termination of employment, if they discussed the subject of the interview with outside parties without the KBR legal department’s prior approval. *See* Exchange Act Release No. 74619 (April 1, 2015). The SEC concluded that

<sup>11</sup> *See* 2014 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM at 8-9 (2014).

such agreements violate Rule 21F-17, which prohibits companies from using gag clauses in agreements or policies to prevent whistleblowers from providing information to the SEC: “No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications.” Rule 21F-17 is one of the regulations implementing the Dodd-Frank SEC whistleblower reward program.

Significantly, the SEC brought this action absent any evidence that the agreement prevented a KBR employee from communicating directly with SEC and without proof that KBR took any disciplinary action against an employee to enforce the form confidentiality agreement. Instead, the SEC found a violation because the threat of disciplinary action undermines the purpose of Rule 21F-17(a), which is to “encourage[e] individuals to report to the Commission.” *Id.*

To settle the charges, KBR agreed to pay a \$130,000 penalty and amend the confidentiality statement to clarify that employees are free to report possible violations to the SEC and other federal agencies without KBR’s approval. In announcing this enforcement action, Andrew J. Ceresney, Director of the SEC’s Division of Enforcement, pledged that the SEC “will vigorously enforce” Rule 21F-17 to ensure that whistleblowers are not silenced.<sup>12</sup>

#### Impact of the KBR Order

In light of the SEC’s demonstrated commitment to combat gag clauses that undermine the SEC Whistleblower Reward Program, employers should revise their agreements and policies to ensure that they do not dissuade current or former employees from making lawful disclosures to the SEC. The SEC Order suggests that a disclaimer similar to the following modification that KBR made to its confidentiality statement will likely suffice:

Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.

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<sup>12</sup> See Press Release from U.S. Securities Exchange Commission, “SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements” (April 1, 2015) (on file).

Note though that the SEC's action against KBR is not an attack on confidentiality agreements and policies serving legitimate business interests. As SEC Chair Mary Jo White pointed out in an April 30, 2015 speech, Rule 21F-17 is not "a sweeping prohibition on the use of confidentiality agreements . . . Companies may continue to protect their trade secrets or other confidential information through the use of properly drawn confidentiality and severance agreements."<sup>13</sup> The SEC Whistleblower Program is not a license to engage in unfair competition or use an employer's proprietary information to benefit a competitor. Instead, Rule 21F-17 is designed to ensure that whistleblowers can provide information to the SEC to enable the SEC to investigate and enforce violations of federal securities laws.

Although the SEC's administrative action against KBR stemmed from a specific prohibition against disclosure of information related to an internal investigation, the SEC might also target clauses in severance agreements that indirectly impede an individual from communicating with the SEC. For example, conditioning severance benefits on a certification that an employee has not made any disclosure to the SEC could be construed as interfering with an employee's right to make a confidential disclosure to the SEC.<sup>14</sup>

#### Gag Provisions Under Scrutiny at Other Agencies

The SEC is not alone in combatting gag provisions that restrict whistleblowing to law enforcement and regulatory agencies, or that interfere with National Labor Relations Act

("NLRA") concerted activity. Other agencies, including the EEOC, NLRB and DOL, are scrutinizing gag provisions in confidentiality agreements and policies. And Congress recently renewed a ban on government contractors using gag provisions in confidentiality agreements that bar disclosures about violations of law, gross mismanagement, a gross waste of funds, or an abuse of authority.

The NLRB has held that agreements barring employees from discussing ongoing internal investigations violates Section 7 of the NLRA. *Banner Health System*, 358 N.L.R.B. No. 93 (July 30, 2012). The Board reasoned that the employer's generalized concern in ensuring the integrity of its internal investigations did not outweigh employees' Section 7 rights. *Id.* at 2.

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<sup>13</sup> See Speech from Mary Jo White, "The SEC as the Whistleblower's Advocate" (April 30, 2015) (on file).

<sup>14</sup> In 2015, the ABA Journal of Labor and Employment Law published an article discussed *de facto* gag provisions that significantly reduce or eliminate the congressional incentives promoting SEC whistleblowing. See R Moberly, J Thomas, and J Zuckerman, "De Facto Gag Clauses- The Legality of Employment Agreements That Undermine Dodd-Frank's Whistleblower Provisions," ABA J. Labor & Employment Law, Vol. 30, No. 1, 2014.

OSHA's Whistleblower Investigations Manual prohibits investigators from approving settlement agreements that include gag clauses. And last month, OSHA obtained a preliminary injunction barring an auto parts company from telling any current or former employee not to speak to or cooperate with representatives of DOL, and enjoining the company from obstructing any OSHA investigation. In addition, the EEOC has issued guidance barring provisions in settlement agreements that interfere with an employee's right to file a charge or cooperate with an investigation, and has sued employers under Section 707 of Title VII of the Civil Rights Act of 1964 for conditioning the receipt of severance benefits on the waiver of the right to file discrimination charges and communicate with the SEC.

### **SEC Takes Enforcement Action for Whistleblower Retaliation**

A recent SEC enforcement order signals to companies that retaliating against a whistleblower can result not only in a private suit brought by the whistleblower, but can also result in a unilateral SEC enforcement action. On June 16, 2014, the SEC announced that it was taking enforcement action against Paradigm Capital Management, a hedge fund advisory firm, for engaging in prohibited principal transactions and for retaliating against the whistleblower that disclosed the unlawful trading activity to the SEC. This is the first case in which the SEC has exercised its authority under the Dodd-Frank Act to bring enforcement actions based on retaliation against whistleblowers.

According to the order, Paradigm retaliated against its head trader for disclosing internally and to the SEC prohibited principal transactions with an affiliated broker-dealer while trading on behalf of a hedge fund client. The transactions were a tax avoidance strategy under which realized losses were used to offset the hedge fund's realized gains.

When Paradigm learned that the head trader disclosed the unlawful principal transactions to the SEC, it retaliated against him by removing him from his head trader position, changing his job duties, placing him on administrative leave, and permitting him to return from administrative leave only in a compliance capacity (not as head trader). *See In the Matter of Paradigm Capital Mgmt., Inc.*, Exchange Act Release No. 72393 (June 16, 2014). The whistleblower ultimately resigned his position. *Id.*

Paradigm settled the SEC charges by consenting to the entry of an order finding that it violated the anti-retaliation provision of Dodd-Frank and committed other securities law violations, agreeing to pay over one million dollars to shareholders, agreeing to hire a compliance consultant to overhaul their internal procedures, and entering into a cease-and-desist order.

The SEC's press release accompanying the order includes the following statement by Andrew J. Ceresney, director of the SEC Enforcement Division: "Those who might consider punishing whistleblowers should realize that such retaliation, in any form, is unacceptable." The Paradigm enforcement action suggests that whistleblower retaliation can result in liability far

beyond the damages that a whistleblower can obtain in a retaliation action and that retaliation can invite or heighten SEC scrutiny.

### **Developments in Whistleblower Protection for Government Contractors**

#### **Government Contractor Employees Afforded Enhanced Whistleblower Protections**

The 2013 National Defense Authorization Act (“NDAA”) contains two robust whistleblower protection provisions that apply to employees of government contractors, excluding employee disclosures that relate to an activity of any element of the intelligence community. *See* 10 U.S.C. § 2409(e)(2)(A).

Section 827 of the NDAA protects employees of contractors and subcontractors of the Department of Defense (“DoD”) and National Aeronautics and Space Administration (“NASA”), while Section 828 applies to employees of contractors, subcontractors, and grantees of other agencies. Both provisions protect disclosures evidencing:

- gross mismanagement of a Federal contract or grant;
- a gross waste of Federal funds;
- an abuse of authority relating to a Federal contract or grant; or
- a substantial and specific danger to public health or safety, or a violation of law, rule, or regulation related to a Federal contract.

*See* 10 U.S.C. § 2409, National Defense Authorization Act for Fiscal Year 2013 § 827-28.

Disclosures are protected only if made to a Member of Congress or Congressional committee, an Inspector General, the GAO, a federal employee responsible for contract or grant oversight, management at the relevant agency, an authorized official of the DOJ or other law enforcement agency, a court or grand jury, or a management official or other employee of the contractor or subcontractor who has the responsibility to investigate, discover, or address misconduct. *See* 10 U.S.C. § 2409(a)(2); 41 U.S.C. § 4712(a)(2).

The burden of proof and causation standard in NDAA whistleblower cases is very favorable to employees. A complainant need only demonstrate that the protected disclosure was a contributing factor in the personnel action, which can often be met by showing knowledge and temporal proximity. Remedies include reinstatement, back pay, compensatory damages and attorney fees and costs. Compensatory damages are uncapped. *See* 10 U.S.C. § 2409(c)(1); 41 U.S.C. § 4712(c)(1).

An NDAA reprisal claim must be filed initially with the Office of Inspector of General of the agency that awarded the contract or grant about which the employee disclosed wrongdoing. The statute of limitations is three years after the date of the reprisal. The OIG will investigate the

complaint and make a recommendation to the agency head, who can order the contractor to provide relief to the NDAA complainant, including reinstatement. If the agency head fails to provide the requested relief within 210 days, the whistleblower may bring an action in federal district court and try the case before a jury.

Section 827 of the NDAA is a permanent amendment to 10 U.S.C. § 2409, which previously provided far narrower protections to employees of DoD contractors and did not protect internal disclosures. Section 828, however, is a pilot program that could expire in four years if it is not renewed by Congress.

The enactment of the 2013 NDAA has resulted in a substantial increase in whistleblower retaliation complaints brought by employees of government contractors. Before August 2013, the DoD averaged just four to six whistleblower complaints per month. Since the 2013 NDAA went into effect, those numbers have jumped considerably. Between January and July 2014, over 200 whistleblower complaints were filed.<sup>15</sup>

### **Courts Broadly Construing FCA Protected Conduct**

Due to relatively recent amendments to the anti-retaliation provision of the False Claims Act (FCA), courts are increasingly broadening their view of what constitutes protected activity under the FCA. In 2009, Congress passed the Fraud Enforcement and Recovery Act of 2009 (FERA), PL 111–21, May 20, 2009, 123 Stat 1617. Before the amendment, the FCA protected only “lawful acts done by the employee on behalf of the employee or others in furtherance of [a *qui tam* action], including investigation for, initiation of, testimony for, or assistance in an action filed or to be filed under this section.”

Now, the FCA protects “lawful acts done by the employee, contractor, agent, or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of this subchapter.” 31 U.S.C. § 3730(h)(1). And a series of recent decisions have shown the broad latitude courts are willing to give to employees under the newly amended FCA. The cases demonstrate that the FCA’s whistleblower retaliation provision protects:

- internal reporting of fraudulent activity to a supervisor,
- claims where the subject of the plaintiff’s disclosures would not necessarily have supported a full *qui tam*, and

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<sup>15</sup> See Aitoro, Jill, “New law drove whistleblower complaints against DOD contractors up”, WASHINGTON BUSINESS JOURNAL, (July 21, 2014), available at [http://www.bizjournals.com/washington/blog/fedbiz\\_daily/2014/07/new-law-drove-whistleblower-complaints-against.html](http://www.bizjournals.com/washington/blog/fedbiz_daily/2014/07/new-law-drove-whistleblower-complaints-against.html).

- steps taken in furtherance of a potential or actual qui tam action, and, separately, steps taken to remedy fraudulent activity or to stop an FCA violation.

In *Marbury v. Talladega Coll.*, Andrea Marbury sued her former employer Talladega College under the FCA’s whistleblower protection provision, alleging that Talladega terminated her employment because she opposed requests to use Title III funds for advertising expenses (an unlawful use of Title III funds). *Marbury*, No. 11 Civ. 03251, 2014 WL 234667, at 3 (N.D. Ala. Jan. 22, 2014). Talladega argued that Marbury did not engage in protected conduct under the FCA because she never took any concrete steps towards bringing a *qui tam* action, could not point to a specific false claim that Talladega submitted to the government, and only made internal complaints to her supervisor rather than filing a formal grievance or initiating a *qui tam* action. *Id.* at 6, 8, 10.

The court rejected Talladega’s narrow construction of the FCA’s whistleblower protection provision and instead found that Marbury’s internal opposition to using Title III funds for advertising and her refusal to complete requisition forms for unauthorized uses of Title III funds could qualify as protected whistleblowing. *Id.* at 8. The court also rejected Talladega’s argument that Marbury cannot be deemed to have engaged in protected conduct because she failed to show that Title III funds were misapplied. *Id.* at 10. The court noted that the whistleblower protection provision of the FCA does not require a showing that federal funds were actually expended for an unlawful purpose and that the whistleblower protection provision is “intended to prevent the filing of false claims and to discourage fraud.” *Id.* Had the court adopted Talladega’s argument, employees that stick their necks out to stop fraud would not be protected against reprisal.

*Marbury* is also a good illustration of how whistleblowers can use the cat’s paw doctrine to prove causation. Using a common tactic designed to shield employers against liability for whistleblower retaliation, Talladega assigned an official who was unaware of Marbury’s disclosures to make the decision whether to terminate her employment, and then argued in its motion for summary judgment that the decision to terminate Marbury’s employment could not have been motivated by retaliation. *Id.* at 11. Whistleblowers can surmount that tactic by using the “cat’s paw” theory, i.e., by showing that the decision-maker followed the biased recommendation of a subordinate without independently investigating the reason or justification for the proposed adverse personnel action. In this case, the supervisor who initiated the recommendation to terminate Marbury’s employment was aware of Marbury’s protected conduct and the decision-maker simply accepted that recommendation. *Id.* Applying the cat’s paw doctrine, the court concluded that there was sufficient evidence of causation to permit Marbury to prove to a jury that her whistleblowing motivated the decision to terminate her employment. *Id.*

In *Mikhaeil v. Walgreens Inc.*, the plaintiff had worked as a staff pharmacist at Walgreens in July 2012 and alleged that her employment was terminated for raising concerns about

potential Medicare fraud. *Mikhaeil*, No. 13 Civ. 14107, 2015 WL 778179 (E.D. Mich. Feb. 24, 2015). Walgreens moved for summary judgment, and in an opinion denying the motion in part, Judge Edmunds held that the FCA’s current retaliation provision “now protects two categories of conduct” - lawful acts taken in furtherance of an action under the FCA, and also “employees from being fired for undertaking other efforts to stop violations of the Act, such as reporting suspected misconduct to internal supervisors.” *Id.* at 7 (internal citations omitted). The judge observed that the “other efforts” language makes clear that internal reports therefore qualify as protected conduct. *Id.* at 7. Mikhaeil testified that she told her supervisor the relevant prescription numbers that she was concerned about, and therefore her disclosure about potential Medicare fraud was sufficiently specific to constitute an internal report alleging fraud on the government. *Id.* at \*8.

In *Young v. CHS Middle E., LLC*, a husband and wife team of surgical nurses working at a hospital in Iraq running on a State Department contract, made numerous complaints about the staffing levels on the installation leading to employees taking on assignments they were neither trained nor credentialed for, in violation of CHS’ contract with the State Department. *Young*, No. 13 Civ. 2342, 2015 WL 3396790, at \*2 (4th Cir. May 27, 2015). After the Youngs lodged several complaints with their supervisors, company executives, and a State Department official, CHS terminated them both. *Id.* The trial court granted CHS’s motion to dismiss, holding that the Youngs’ complaints about staffing did not amount to contract fraud, and were therefore not protected by the FCA. *Id.* The Fourth Circuit reversed on appeal.

In reversing, the Fourth Circuit noted that the FCA whistleblower provision as amended, “protect[s] employees while they are collecting information about a possible fraud, before they have put all the pieces of the puzzle together.” *Id.* (internal citations omitted). Critically, between the time the district court dismissed the Youngs’ claim and when the Fourth Circuit ruled on their appeal, the Fourth Circuit decided a key case involving FCA qui tam fraud claims - *United States ex rel. Omar Badr v. Triple Canopy, Inc.*, 775 F.3d 628 (4th Cir. 2015). In *Triple Canopy*, the government alleged that a security contractor responsible for base security in a combat zone had knowingly hired guards who were unable to pass contractually required marksmanship tests, yet presented claims to the government for payment on those unqualified guards. *Id.* at 632–633. The Fourth Circuit reversed the trial court’s dismissal of the claim, holding that a plaintiff successfully “pleads a false claim when it alleges that the contractor, with the requisite scienter, made a request for payment under a contract and withheld information about its noncompliance with material contractual requirements.” *Id.* at 636. The Fourth Circuit reasoned that if making “false implied staffing certifications” to the government constitutes an FCA violation, “acts undertaken to, for example, investigate, stop, or bring an action regarding such false implied staffing certifications can constitute protected activity for purposes of a retaliation claim.” *Young*, 2015 WL 3396790, at \*3.

The following table summarizes key distinctions between Section 3730(h) of the False Claims Act and Sections 827 and 828 of the NDAA:

|                           | FCA  | NDAAs  |
|---------------------------|--|--|
| Coverage                  | Employee, contractor, or agent   | Employee of a contractor, subcontractor, or grantee  |
| Protected Conduct         | Lawful acts done by the employee, contractor, agent or associated others 1) in furtherance of an action under the FCA or 2) other efforts to stop 1 or more violations | <ul style="list-style-type: none"> <li>-Violation of law, rule, or regulation related to a federal contract</li> <li>-Gross mismanagement of a federal contract or grant</li> <li>-Gross waste of federal funds</li> <li>-Abuse of authority relating to a federal contract or grant</li> <li>-Substantial and specific danger to public health or safety</li> </ul> |
| Administrative Exhaustion | File directly in federal court   | Must file initially at OSHA; can remove to federal court after 210 days  |
| Causation Standard        | “But for” causation  | Contributing Factor  |
| Jury Trial                | Y  | Y  |
| Damages                   | Double back pay, reinstatement, special damages (emotional distress damages and harm to reputation), attorney fees   | Back pay, reinstatement, special damages, attorney fees  |
| Stat. of Limitations      | 3 years  | 3 years  |

## **Conclusion**

The proliferation of whistleblower protection laws in conjunction with favorable administrative and judicial decisions construing SOX and similar remedial statutes provide whistleblowers with strong remedies to combat retaliation. But to effectively navigate the patchwork of claims available to whistleblowers, it is critical to focus on the significant differences in the scope of protected conduct, burden of proof, remedies, and procedural requirements. In addition, whistleblower counsel should carefully evaluate forum selection, potential whistleblower reward claims (and the impact of pursuing a retaliation claim while a reward claim is pending), and take steps to avoid potential counterclaims (including claims arising from “self-help discovery”).