Third Circuit Sets "Reasonable Belief" Standard for Corporate Whistleblowers Bringing Claims under Sarbanes-Oxley

On March 20, 2013, the Third Circuit, in a split decision, established a more plaintiff-friendly pleading standard for whistleblower actions under the Sarbanes-Oxley Act ("SOX"). The Court held that corporate employees need only establish a "reasonable belief" one of the laws enumerated in Section 806 of SOX ("SOX 806") is being violated in order to invoke protections under SOX from retaliatory actions. The Court rejected arguments raised by the defendant corporation and the Chamber of Commerce that the SOX whistleblower law protected employees only if their disclosures "definitively and specifically" related to a "violation of a statute."

SOX 806

SOX 806 provides, in relevant part, that publicly traded companies and their employees are prohibited from retaliating against an employee who:

> "provide[s] information, cause[s] information to be provided, or otherwise assist[s] in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341[mail fraud], 1343 [wire, radio, or television fraud], 1344 [bank fraud], or 1348 [securities and commodities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information is provided to or the investigation is conducted by . . . a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct) . . . ."

The Opinion

Wiest v. Lynch, et al.[1] arose out of a wrongful termination case in which Tyco Electronics Corporation ("Tyco") conducted investigations on Jeffrey Wiest and ultimately dismissed Wiest from his position in Tyco's accounting department. Wiest brought an action under SOX 806 and state law, alleging that the investigation and termination were performed in retaliation for challenging the company's accounting treatment of expenditures for certain corporate events.[2] Citing the U.S. Department of Labor Administrative Review Board's (the "ARB") decision in *Platone v. FLYU, Inc.*,[3] the District Court found that Wiest's whistleblowing reports did not "definitively and specifically" relate to a violation a statute or rule listed in SOX 806 and dismissed the federal whistleblower claims on the basis that Wiest failed to establish a prima facie case.[4]

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1 No. 11-cv-4257 (3d Cir. Mar. 19, 2013) (the "Tyco Opinion"), available at http://www.ca3.uscourts.gov/opinarch/114257p.pdf.

2 In particular, Wiest raised concerns about requests to process payments for several resort events and parties that lacked proper approval and documentation, including a $350,000 event in the Bahamas that included expenses for costumed mermaids and pirates, tattoo artists and dancers.

3 ARB 04-154, 2006 WL 3246910 (Dep't of Labor Sept. 29, 2006).

4 To state a prima facie case under SOX 806, a plaintiff must allege that he or she (1) "engaged in protected activity;" (2) "[t]he respondent knew or suspected that the employee engaged in the protected activity;" (3) "[t]he employee suffered an adverse action;" and (4) "[t]he circumstances were sufficient to raise the inference that the protected activity was a contributing factor in the adverse action." 29 C.F.R. § 1980.104(e)(2)(i)-(iv) (2010).

On appeal, Wiest argued that the District Court, in determining that his communications did not constitute protected activities under the statute, incorrectly looked to *Platone* when it should have invoked the "reasonable belief" standard adopted in *Sylvester v. Parexel Int'l LLC*,[5] where the ARB discarded the "definitive and specific" test. The Third Circuit ruled in Wiest's favor, giving deference to the ARB's rejection of the *Platone* standard and reviving Wiest's action against Tyco.[6]

In abandoning the "definitive and specific" standard set in *Platone*, the Third Circuit recognized the distinction that the ARB drew between the whistleblower provisions in the Energy Reorganization Act (the "ERA") (the focus in *Platone*) and in SOX 806 (the focus in *Sylvester*). The Third Circuit stated:

> "[t]he ARB explained that, in addition to enumerating specific activities for which employers cannot retaliate against employees, the whistleblower provision of the ERA contains a catch-all provision to protect employees who "assist or participate in 'a proceeding ... or any other action [designed] to carry out the purposes of this chapter or the Atomic Energy Act of 1954, as amended." *Id.* (quoting 42 U.S.C. § 5851(a)(1)(F)). According to the ARB, because the ERA does not define "any other action to carry out the purposes of this chapter," courts interpreted that phrase to require that an employee's activity definitively and specifically implicate safety because of the ERA's purpose of protecting employee actions involving nuclear safety. *Id.*
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> "As the ARB recognized in *Sylvester*, the SOX whistleblower provision does not contain language similar to the ERA's catch-all provision. *Id.* Instead, it expressly enumerates the laws and rules to which it applies. Therefore, the ARB concluded that the importation of the definitive and specific standard is "inapposite to the question of what constitutes protected activity under SOX's whistleblower protection provision." *Id.* Moreover, the ARB determined that the definitive and specific standard potentially conflicts with the statutory language of [SOX] 806, which prohibits retaliation against employees for reporting information that he or she *reasonably believes* violates SOX. *Id.*[7] [emphasis in original]"

Applying *Sylvester* to Wiest's case, the Third Circuit decided that Wiest satisfied the "reasonable belief" test by establishing that he had a subjective, good faith belief that Tyco violated SOX and that this belief was "objectively reasonable."[8] Contrary to the District Court's decision, the Third Circuit noted that SOX 806 does not require a whistleblower's communication to establish the elements of fraud or an existing violation in order to constitute a protected activity under the statute. In keeping with the purpose of the whistleblower provisions, the

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5 ARB 07-123, 2011 WL 2165854 (Dep't of Labor May 25, 2011) (en banc).

6 Specifically, the Third Circuit reversed the District Court's Order denying Wiest's Motion for Reconsideration and Order granting Tyco's Motion to Dismiss as to some, but not all, of Wiest's communications relating to certain event-related expenses. The Third Circuit upheld the District Court's dismissal Order in connection with certain communications on the basis that Wiest's beliefs were not objectively reasonable. For instance, one such communication merely established that Wiest's department had requested additional review with respect to the expenses in question but that it "believe[d] the information provided substantiates [the event] as a business expense . . . ." Tyco Opinion at 29. The Third Circuit also affirmed the District Court's dismissal of other communications in which Wiest merely "raised questions" about proper accounting treatment of events but failed to allege any facts suggesting that he reasonably believed these events violated SOX 806. *Id.*

7 Tyco Opinion at 16-17. The Third Circuit also noted that in decisions issued subsequent to Sylvester, the ARB has asserted that the "definite and specific" standard does in fact conflict with the language of SOX 806.

8 "A belief is objectively reasonable when a reasonable person with the same training and experience as the employee would believe that the conduct implicated in the employee's communication could rise to the level of a violation of one of the enumerated provisions in [SOX] 806." Tyco Opinion at 21-22.

Third Circuit maintained that an employee who reported an imminent violation is also afforded protection under SOX. In other words, the fact that Wiest foresaw potentially fraudulent accounting irregularities did not preclude his belief from being objectively reasonable. Finally, the Third Circuit noted that a communication can qualify as a protected activity regardless of whether the employer had a reason to suspect that the communication was protected.

The Dissent

The dissent argued that the Third Circuit incorrectly applied *Sylvester* to the facts of the case. At the heart of *Platone* is "the imperative that the whistleblower sound off with clarity," the dissent stated, and the purpose of whistleblower statutes like SOX 806 is to protect employees "who have the courage to stand against institutional pressures and say plainly, 'what you are doing here is wrong' – not wrong in some abstract or philosophical way, but wrong in the particular way identified in the statute at issue."[9] The dissent went on to critique *Sylvester* stating: "Unfortunately, *Sylvester* provides no guidance as to what, if anything, a [SOX] 806 claimant is required to allege. In its efforts to lower the bar, the ARB has provided little more than a recitation of what is *not* required for an employee to allege protected conduct."[10]

Conclusion

The relaxed pleading standard set by this case should sensitize public companies to the increased likelihood of whistleblower claims and the related increased potential for litigation based on claims of retaliation under a broad range of circumstances arising from terminations of employment.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com; Diana Ni Hunter at 212.701.3140 or dhunter@cahill.com.

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9 Tyco dissent at 1.

10 Tyco dissent at 10 [emphasis in original].

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