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WHISTLEBLOWERS MAY BE PROTECTED UNDER SARBANES-OXLEY ACT WHEN REPORTING FRAUD UNRELATED TO SHAREHOLDERS

The U.S. Court of Appeals for the Third Circuit recently shed light on a current split in the lower federal courts on whether the whistleblower provision in the Sarbanes-Oxley Act ("SOX") protects employees from retaliation for disclosing fraudulent activity that does not directly relate to fraud against shareholders. To state a valid whistleblower claim under SOX, employees must allege they engaged in protected activity by providing information or assisting in an investigation regarding conduct which the employee reasonably believes constitutes:

> (i) mail fraud; (ii) wire fraud; (iii) bank fraud; (iv) securities fraud; (v) a SEC rule or regulation violation; or (vi) a federal law violation relating to fraud against shareholders.

18 U.S.C. § 1514A(a)(1). While the reporting of the last two (2) categories – SEC violations or federal law violations relating to shareholder fraud – explicitly links an employee's protected activity to the underlying purpose of SOX, the same is not necessarily true for reporting violations under any of the first four (4) categories. Violations of mail, wire, bank or securities fraud statutes may, but do not always, involve fraud against shareholders. A split of authority currently exists as to whether reporting mail, wire, bank or securities fraud constitutes protected activity under SOX, where the reported fraud does not relate to fraud against shareholders.

Split of Authority in Lower Courts

Lower courts within the Fourth and Seventh Circuits, including the Northern District of Illinois, have taken a narrower view of SOX's whistleblower provision, holding that the phrase "fraud against shareholders" should be read to modify the protection extended to the mail, wire, bank or securities fraud statutes; therefore, reporting violations of these statutes is only protected activity if the violation involves shareholder fraud. See e.g., Bishop v. PCS Administration (USA), Inc., 2006 U.S. Dist. LEXIS 37230, *30-31 (N.D. Ill. May 23, 2006) (in-house attorney terminated after reporting deficiencies in company's corporate compliance program was not protected by SOX whistleblower provision because "[t]he phrase 'relating to fraud against shareholders' in this provision must be read as modifying each item in the series"); Livingston v. Wyeth, Inc., 2006 U.S. Dist. LEXIS 52978, *30 (M.D.N.C. July 28, 2006), aff'd, 520 F.3d 344 (4th Cir. 2008) (terminated employee who internally reported employer's non-compliance with manufacturing practices training did not state a valid whistleblower claim under SOX: "[t]o be protected under [SOX], an employee's disclosures must be related to illegal activity that, at its core, involves shareholder fraud"). These decisions focus on SOX's underlying purpose, which aims to address corporate fraud on shareholders.

Finding to the contrary, lower courts within the Second and Eleventh Circuits take a broad view of SOX's whistleblower provision and hold that reported fraud need not relate to shareholders in order to constitute protected activity. See e.g., O'Mahony v. Accenture Ltd., 537 F. Supp. 2d 506, 517 (S.D.N.Y. 2008) (employee who objected to employer's scheme of tax evasion was protected under SOX, even if the violations did not involve fraud against shareholders); Reyna v. ConAgra Foods, Inc., 506 F. Supp. 2d 1363, 1381 (M.D. Ga. 2007) ("[SOX] clearly protects an employee against retaliation based upon that employee's reporting of mail fraud or wire fraud regardless of whether that fraud involves a shareholder of the company.").

Third Circuit's Recent Ruling on March 19, 2013

In the first appellate decision to rule on this issue, the U.S. Court of Appeals for the Third Circuit recently joined lower courts in the Second and Eleventh Circuits in broadly interpreting protected activity under SOX. In Wiest v. Lynch, the Third Circuit reversed a decision by the Eastern District of Pennsylvania and held that an employee's activity may be protected under SOX even where it does not relate to shareholders. 2013 U.S. App. LEXIS 5345, *44 (3d Cir. Mar. 19, 2013). In Wiest, Tyco Electronics Corporation terminated the employment of an employee who questioned the company's reimbursement of certain event expenditures. The District Court dismissed the employee's SOX retaliation claim for failure to allege protected activity because the employee's multiple e-mails addressing possible tax and accounting fraud were not reasonably connected to a concern about shareholder fraud. Wiest v. Lynch, 2011 U.S. Dist. LEXIS 79283, *18, 29-30 (E.D. Pa. July 21, 2011). Relying on administrative decisions from the Department of Labor's Administrative Review Board ("ARB"), the Third Circuit reversed and held that "requiring a complainant to prove or approximate the specific elements of a securities law violation contradicts the statute's requirement that an employee have a reasonable belief of a violation of the enumerated statutes." 2013 U.S. App. LEXIS 5345, at *30 (internal citation omitted).

Tenth Circuit Soon to Rule

Soon to shed further light on this federal court split, the U.S. Court of Appeals for the Tenth Circuit will decide a case involving the scope of protected activity under SOX – specifically, whether a terminated employee was engaged in protected activity by disclosing that a supervisor was using company funds for inappropriate personal relationships. Lockheed Martin Corp. v. Department of Labor, (Case No. 11-cv-9524) (oral argument heard on Sept. 19, 2012). The underlying ARB decision, which was appealed directly to the Tenth Circuit, found that the employee engaged in protected activity because SOX "does not require that the mail fraud or wire fraud pertain to fraud against shareholders." ARB Case No. 10-050, slip op. at 5 (ARB Feb. 28, 2011). It is anticipated that the Tenth Circuit will issue its opinion in the very near future.

Implications for Employers

- The Tenth Circuit's pending decision will further inform the protective scope of SOX. If the Tenth Circuit joins the Third Circuit in holding that fraud violations unrelated to shareholders are protected under SOX, a trend in broadly interpreting SOX will be apparent. However, if the Tenth Circuit takes a narrower position and rules contrary to the Third Circuit, the split in authority will extend to the appellate level and the case could likely go to the United States Supreme Court.

- Recent ARB decisions have trended towards broadly interpreting SOX's whistleblower provision, holding that reported fraud need not relate to shareholders to constitute protected activity. See e.g., Brown v. Lockheed Martin Corp., ARB Case No. 10-050 (Feb. 28, 2011); Sylvester v. Paraxel Int'l LLC, ARB Case No. 07-123 (May 25, 2011). Publicly-held companies should be alert that some courts have begun to follow the ARB's recent trend of making it substantially easier for plaintiffs to receive protection from retaliation under SOX.

- In addition to dividing on what type of reported violations constitute protected activity under SOX, federal courts are also divided on a whistleblower's burden in showing that these violations actually occurred. Some courts, including the Northern District of Illinois, have narrowed SOX's protective scope by holding that a plaintiff must show a "definitive and specific" violation. See e.g., Xie v. Hospira, Inc., 2011 U.S. Dist. LEXIS 100537, *9 (N.D. Ill. Sept. 2, 2011) (no protected activity where employee "has not offered evidence 'definitively and specifically' tying [employer's] alleged actions to one of the laws enumerated in *section 1514A(a)(1)*"). In contrast, the ARB and other courts, including the U.S. Court of Appeals for the Third Circuit, have taken a broader approach and held that plaintiffs need only show that they had a "reasonable belief" that a violation occurred. Wiest, 2013 U.S. App. LEXIS 5345, at *44.

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April 15, 2013