Hofstra Labor and Employment Law Journal

Volume 24 | Issue 1 Article 5

2006

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THE WHISTLEBLOWER PROVISION OF SARBANES-OXLEY: DISCERNING THE SCOPE OF "PROTECTED ACTIVITY"

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I. INTRODUCTION

In response to Enron and numerous other corporate business scandals, Congress enacted the Sarbanes-Oxley Act of 2002 ("SOX")[1] to combat fraudulent accounting practices and other conduct defrauding shareholders. The stated purpose of SOX is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws," and SOX mandates corporate responsibility, public disclosure, and improved methods of auditing and financial reporting to effectuate this goal.[2]

This article focuses on section 806 of SOX, the "whistleblower provision," which protects employees of publicly traded companies from retaliation for bringing certain perceived corporate wrongdoings to light, thereby encouraging disclosure of such information and serving SOX's overarching goal of protecting shareholder assets. Specifically, this article attempts to analyze the trends that are emerging as courts and administrative tribunals consider what types of employee actions constitute activities protected under section 806 and seeks to discern the boundaries of what constitutes protected activity under current law. In performing this exercise, the ultimate goal is to arm employers with the information necessary to avoid potential whistleblower claims under Sarbanes-Oxley in the future, and to discourage unfounded claims that can cause substantial harm despite the absence of legal merit.

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1. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).
2. *Id.* at 745.

II. SECTION 806—NUTS AND BOLTS

Section 806 prohibits covered employers from dismissing or discriminating against an employee who files, causes to be filed, testifies, participates in, provides information, or assists in an investigation regarding employer conduct that the employee reasonably believes constitutes a violation of (1) mail, bank, wire, or securities law; (2) any rule or regulation of the Securities and Exchange Commission ("SEC"); or (3) any provision of Federal law relating to fraud against shareholders.[3] To qualify as an employer, the company must be publicly traded.[4] That is, the prohibition of section 806 only applies to companies that either hold a class of securities registered under section 12 or are required to file reports under section 15(d) of the Securities Exchange Act of 1934, as well as "any officer, employee, contractor, subcontractor, or agent of such company."[5] If a plaintiff can successfully mount a whistleblower claim, both civil and criminal penalties may be sought.[6]

An employee wishing to initiate a civil enforcement action under section 806 must file a complaint with the Secretary of Labor within ninety days of the alleged violation.[7] The Secretary has designated the Occupational Safety and Health Administration ("OSHA") as the agency responsible for initially investigating the complaints, and thus OSHA performs any necessary investigation and works to issue written findings within sixty days of the complaint being filed.[8] Either party can file objections to the written findings and request a de novo hearing with an Administrative Law Judge ("ALJ").[9] After the ALJ renders a decision, the parties can seek review by the Administrative Review Board ("ARB").[10] If still unsatisfied, a party can file a petition for review with the United States Court of Appeals.[11] While this is the normal course of

3. 18 U.S.C. §§ 1514A(a)(1)-(2) (Supp. 2006).

4. 18 U.S.C. § 1514A(a).

5. *Id.*

6. 18 U.S.C. §§ 1514A(b), 1513(e); *see also* John F. Fatino, *The Sarbanes-Oxley Act of 2002 and the New Prohibition on Employer Retaliation Against Whistleblowers: For Whom the Bell Tolls or Tooting One's Own Horn?*, 51 S.D. L. REV. 450, 450-54 (2006) (discussing the Act's civil and criminal remedies).

7. 18 U.S.C. § 1514A(b)(2)(D).

8. 29 C.F.R. §§ 1980.104-.105 (2005); Delegation of Authority and Assignment of Responsibility to the Assistant Secretary for Occupational Safety and Health, 67 Fed. Reg. 65008 (Dep't of Labor Oct. 22, 2002).

9. 29 C.F.R. § 1980.106 (2005).

10. 29 C.F.R. §§ 1980.109-.110 (2005).

11. 29 C.F.R. § 1980.112 (2005).

complaints under section 806, a complainant can obtain de novo review of his claim in federal district court if the Secretary fails to issue a final decision within 180 days of the filing of the complaint and there is no showing that the delay is due to the complainant's bad faith.[12]

Whether the employee's civil enforcement claim is heard through the administrative channel or by a district court under the 180-day rule, the elements of proof are the same. The plaintiff must make a prima facie case by establishing by a preponderance of the evidence that: (1) the employee engaged in protected activity as defined by SOX; (2) the employer was aware of the protected activity; (3) the employee suffered an adverse employment action; and (4) circumstances exist which are sufficient to raise an inference that the protected activity was likely a contributing factor in the unfavorable action.[13] Once the employee meets this burden, he is entitled to relief unless the employer can show by clear and convincing evidence that it would have taken the same unfavorable personnel action even in the absence of such protected activity.[14]

III. PROTECTED ACTIVITY LITIGATION

Although there has been litigation over many aspects of SOX whistleblower claims, including the 180-day rule,[15] the exhaustion requirement,[16] the ninety-day time period for filing complaints,[17] and the "contributing factor" element,[18] this article zeroes in on litigation over the question of what exactly constitutes a protected activity. Unfortunately, it is impossible to glean any bright-line rule from the existing decisional authority. Nonetheless, guiding principles are developing, and construing "protected activity" narrowly, and thus favorably to employers, certainly seems to be the current trend.

a. The Basics

While there is clearly some uncertainty as to the scope of protected activity under section 806 of SOX, the statute itself sets forth the basic

12. 18 U.S.C. § 1514A(b) (Supp. 2006).

13. Collins v. Beazer Homes USA, Inc., 334 F. Supp. 2d 1365, 1375-76 (N.D. Ga. 2004).

14. *Id.* at 1376.

15. *See, e.g.*, Murray v. TXU Corp., 279 F. Supp. 2d 799, 802 (N.D. Tex. 2003).

16. *See, e.g.*, Zhu v. Fed. Hous. Fin. Bd., 389 F. Supp. 2d 1253, 1272 (D. Kan. 2005).

17. *See, e.g.*, Halpern v. XL Capital, Ltd., 2005 DOL Ad. Rev. Bd. LEXIS 98, at *5, ARB No. 04-120, ALJ No. 2004-SOX-00054 (ARB Aug. 31, 2005).

18. *See, e.g.*, *Collins*, 334 F. Supp. 2d at 1376.

definition of what employee actions will be covered. Section 806 protects an employee who provides information that the employee "reasonably believes constitutes a violation" of the enumerated laws to (1) a federal law enforcement agency or regulatory agency, (2) a committee or member of Congress, (3) a person with supervisory authority over the employee, or (4) a person working for the employer who has the authority to investigate, discover, or terminate misconduct.[19] This definition has been further expounded in both administrative and federal court decisions.[20]

The ARB elaborated on what qualifies as "providing information" in the context of determining whether an employee's conduct is a protected activity in *Getman v. Southwest Securities, Inc.*[21] In *Getman*, a stock analyst for a broker-dealer/investment adviser claimed that she engaged in a protected activity when she refused to raise a stock rating under pressure from her employer's Review Committee.[22] Reversing the ALJ, the ARB held that the refusal to change a rating did not, by itself, constitute a protected activity.[23] In so holding, the ARB explained that "[i]n drafting whistleblower protection laws, Congress . . . has drawn the distinction between notifying the employer of a violation and refusing to commit a violation."[24] The ARB explained that to qualify as a protected activity, an employee must actually communicate a concern that the employer's conduct constitutes one of the enumerated violations.[25] The

19. 18 U.S.C. § 1514A(a)(1) (Supp. 2006).

20. Jeffrey S. Klein and Nicholas J. Pappas, *Defining 'Whistleblower' Under the Sarbanes-Oxley Act*, N.Y.L.J. Aug. 7, 2006 at 3 (discussing Fraser v. Fiduciary Trust Co., 417 F. Supp. 2d 310 (S.D.N.Y 2006) and Bishop v. PCS Admin., No. 5 C. 5683, 2006 WL 1460032 (N.D. Ill. May 23, 2006)).

21. ARB Case No. 04-059, 2005 DOLSOX LEXIS 18 (Dep't of Labor July 29, 2005).

22. *Id.* at *9-10.

23. *Id.* at *19.

24. *Id.* at *18-19.

25. *Id.* at *18. In the recent decision of *Platone v. FLYI, Inc.*, 2006 DOL Ad. Rev. Bd. LEXIS 89, ARB No. 04-154, ALJ No. 2003-SOX-27 (ARB Sept. 29, 2006), the ARB again analyzed the communication aspect of SOX whistleblower claims. The ARB explained the principle that "an employee's protected communications must relate 'definitively and specifically' to the subject matter of the particular statute under which protection is afforded." *Id.* at *32. Indeed, the Board stated that "the relevant inquiry is not what [an employee alleges in her complaint], but what she actually communicated to her employer . . . prior to the termination." *Id.* at *34. In *Platone*, the employee had sent a series of emails and engaged in conversations with her superior and others addressing a potential billing issue between her company and the Air Line Pilots Association (ALPA). *Id.* at *11-16, *33. The court found that none of these communications "include[d] any specific revelations about fraudulent activity affecting shareholder interests." *Id.* at *39. Thus, contrary to what she alleged in her complaint, she had not informed her superior that the company had either created or acquiesced in a scheme to funnel improper payments to members of ALPA's master executive counsel. *Id.* at *43. Accordingly, there was no protected activity. *Id.* at *45.

ARB did note that "[t]here may be times where only refusal is sufficient to provide information," but found that Getman's refusal did not do so.[26]

A more difficult question than what constitutes "provid[ing] information"—and the key to adequately defining the scope of protected activity under SOX—is the question of what types of conduct employees can "reasonably believe[] constitute[]" violations of the enumerated laws.[27] As is clear from the statute and as has been repeatedly emphasized by ALJs, the ARB, and the courts, "[a]n employee can engage in §1514A protected activity even if the reported conduct did not actually constitute a violation of one of the laws or regulations enumerated" so long as he or she reasonably believed a violation occurred.[28] Thus, we know that an employee's communication can qualify as a protected activity only if it communicates either (1) an actual violation of one of the enumerated laws or (2) some other conduct that one could reasonably believe was a violation of one of the enumerated laws.[29] Accordingly, the key to gaining an understanding of the scope of protected activity under section 806 is to familiarize oneself with the conduct that decision-makers have thus far concluded is of the type one could "reasonably believe" to be a violation.[30]

b. Beyond the Basics—Decisions Reigning in the Scope of Protected Activity

As a starting point in analyzing what decision-makers have found (and will in the future find) to be conduct that one could reasonably believe to be a violation, it should be noted that Congress "intended to impose the normal reasonable person standard used and interpreted in a wide variety of legal contexts."[31] Additionally, it is clear that "[t]he

26. *Getman*, 2005 DOLSOX Lexis 18, at *18.

27. 18 U.S.C. § 1514A(a)(1) (Supp. 2006).

28. Bishop v. PCS Admin., No. 05 C. 5683, 2006 WL 1460032, at *5 (N.D. Ill. May 23, 2006) (citing Collins v. Beazer Homes USA, Inc., 334 F. Supp. 2d 1365, 1376 (N.D. Ga. 2004)).

29. *Id.* at *5, *8.

30. While it is necessary for a complainant to have both a subjective and an objective belief that the reported conduct was a violation, *see id.* at *5; *see also* Livingston v. Wyeth Inc., No. 1:03CV00919, 2006 WL 2129794, at *9 (M.D.N.C. July 28, 2006) (noting a whistleblower must "not only subjectively believe that the reported conduct . . . constitute[s] fraud on shareholders," but that "there must also be a reasonable, objective basis for suspecting such fraud"), as a practical matter, it is the decisions analyzing the objective-belief requirement that create the boundaries of what may be considered a protected activity in the future. Accordingly, the objective standard is the focus of this article.

31. *Collins*, 334 F. Supp. 2d, at 1376 (quoting Legislative History of Title VIII of H.R. 2673: The Sarbanes-Oxley Act of 2002, Cong. Rec. S7418, S7420 (daily ed. July 26, 2002), *available at* 2002 WL 32054527).

employee's access to information, experience, and background are considerations in determining whether he or she had a reasonable belief."[32] With these considerations in mind, this article will now consider several recent administrative and district court decisions that are instructive as to the range of conduct that constitutes a protected activity.

1. Complaints Over Internal Policy

Several recent cases support the proposition that raising complaints about internal policy is not protected under SOX. In *Bishop v. PCS Administration (USA), Inc.*,[33] the plaintiff, who was the former in-house attorney for PCS Administration, claimed that she was terminated for notifying her employer that its compliance program was deficient under sentencing guidelines regarding corporate compliance and ethics and that this deficiency put the company at risk for liability of future violations.[34] Plaintiff argued that simply "raising the specter of potential fraud" constituted protected activity, but the district court disagreed.[35] The district court explained that the statute's plain language refers to providing information that is reasonably believed to "constitute a violation" of one of the enumerated statutes or regulations and that "[t]he word 'constitute' should be understood to mean an actual violation has occurred, which could include an attempt (in the criminal sense)."[36] Thus, "[t]o the extent there is a reasonable (but incorrect) belief, it must be a reasonable belief that an actual violation has occurred or is being attempted."[37] The court held that it was not reasonable for the plaintiff, as an attorney, to believe that simply because the company's compliance program was legally deficient and an increased potential and risk of violations or penalties was thus present, an actual violation had occurred or was being attempted.[38]

Admittedly, the court clearly considered the fact that the plaintiff was an attorney when it concluded that her subjective belief was not objectively reasonable.[39] Thus, practitioners would likely be challenged

32. *Bishop*, 2006 WL 1460032, at *5.
33. 2006 WL 1460032 (N.D. Ill. May 23, 2006).
34. *Id.* at *1, *3.
35. *Id.* at *6.
36. *Id.* at *8.
37. *Id.*
38. *Id.*
39. *Id.* "If the law itself does not establish that a deficient compliance program is a violation of the pertinent statutes or regulations concerning fraud, then the subjective belief of plaintiff (an

in an attempt to rely on *Bishop* in situations where the reporting employee does not have such specialized knowledge. Nonetheless, *Bishop* lends at least some support to the proposition that complaints regarding deficiencies or noncompliance with purely internal safeguards will not constitute a protected activity when failure to comply with those safeguards does not itself violate statutes or regulations relating to fraud on shareholders (or any other rule or regulation of the SEC).[40] Other cases lend support to this proposition as well. In *Marshall v. Northrop Grumman Synoptics*,[41] the ALJ held that complaints about internal controls being inconsistent with general accounting principles and complaints that financial records for the internal use of a department were incorrect could not constitute a protected activity when such errors did not affect any public report or other document that could be the basis of actual fraud on shareholders.[42] The ALJ explained that "raising a concern about a violation of an ethics policy is not a protected activity. The fact that the concerns involved accounting and finances in some way does not automatically mean or imply that fraud or any other illegal

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attorney practicing before the SEC) was not objectively reasonable." *Id.*

40. A tangential issue that is currently developing is whether reports of innocent violations of SEC laws constitute protected activity. The *Bishop* court explained that "[a]ll the statutes and regulations referenced in § 1514(a)(1) are ones setting forth fraud" and "[t]he phrase 'relating to fraud against shareholders' in this provision must be read as modifying each item in the series, including 'rule or regulation' of the [SEC]." *Bishop*, 2006 WL 1460032, at *9 (quoting 18 U.S.C. § 1514A(a)(1) (Supp. 2006)). The majority of decisions are in accord with the proposition that "fraud is an integral element of a whistleblower cause of action" under SOX. Livingston v. Wyeth Inc., No. 1:03CV00919, 2006 WL 2129794, at *9 (M.D.N.C. July 28, 2006); *see also* Smith v. Hewlett Packard, No. 2005-SOX-00088, 2006 WL 468045 (Dep't of Labor Jan. 19, 2006) ("The legislative history of the Act explains that fraud is an essential element of a claim brought under the whistleblower provision."). However, in the recent case of *Klopfenstein v. PCC Flow Technologies Holdings, Inc.*, ARB Case No. 04-149, 2006 DOLSOX LEXIS 59 (Dep't of Labor May 31, 2006), the ARB suggested that an innocent violation of an SEC rule may give rise to jurisdiction under SOX if an employee were retaliated against for reporting it. *Id.* at *35. While it was merely dicta, the ARB stated that "we do not believe that activity is protected only when . . . the complainant believes he is reporting fraud." *Id.* The court further noted that "[i]t certainly is possible that [the complainant] engaged in protected activity" when he reported certain accounting discrepancies even if he did not believe that the discrepancies amounted to fraud. *Id.* at *36. This issue is beyond the scope of this article because it will only be raised in a small number of situations, but it is a development worth noting and watching in the future. On a related note, and assuming, contrary to the suggestion in *Klopfenstein*, that fraud is an essential element of a whistleblower claim under SOX, the recent district court case of *Fraser v. Fiduciary Trust Co.*, 417 F. Supp. 2d 310, 323 (S.D.N.Y. 2006), held that a report about an employer's conduct can qualify as a protected activity even if the statement does not expressly indicate that the employer was acting fraudulently as long as it describes conduct that constitutes fraud. *Id.*

41. Marshall v. Northrop Grumman Synoptics, No. 2005-SOX-0008, 2005 DOLSOX LEXIS 63 (Dep't of Labor June 22, 2005).

42. *Id.* at *12.

conduct took place."[43]

Likewise, in *Richards v. Lexmark International, Inc.*,[44] the ALJ held that a complaint that the "Days of Inventory" calculation used by the employer had potential to misrepresent and understate the number of days that items remained in inventory, which could potentially result in misrepresentations in management's reports, did not constitute a protected activity.[45] The ALJ explained that it was not reasonable for the complainant, who had a Masters of Business Administration and over thirty years of supply chain management experience, to think this constituted fraud on shareholders.[46] This was because there was no evidence that the methods used were not in accordance with generally accepted accounting principles ("GAAP") or contrary to any other SEC requirements, certified public accountants were involved, and write-offs were footnoted in the financial statements.[47] Thus, the court concluded that "[n]o facts [had] been adduced that would cause a reasonable person with Complainant's training and experience to determine that there was any potential securities fraud or violation of any laws or SEC rules and regulations."[48]

Again, like *Bishop*, the complainant's expertise in *Lexmark* played at least some role in the decision.[49] Furthermore, the ALJs in both *Lexmark* and *Marshall* doubted the respective complainant's subjective belief,[50] which provides another way in which complainants could distinguish these cases in the future. Nonetheless, it seems that *Bishop*, *Marshall*, and *Lexmark*, taken together, support the conclusion that complaints about purely internal reporting matters or internal controls that do not directly violate a law enumerated in section 806 will not be deemed protected activity under SOX.[51] This is in line with the notion that "[p]rotected activity must implicate the substantive law protected in Sarbanes-Oxley definitively and specifically."[52] However, it is critical to note that while complaints about purely internal accounting and

43. *Id.*
44. No. 2004-SOX-00049, 2006 DOLSOX LEXIS 71 (Dep't of Labor June 20, 2006).
45. *Id.* at *91.
46. *See id.* at *90, *92.
47. *See id.* at *42,*91-92.
48. *Id.* at *92.
49. *See id.* at *90; Bishop v. PCS Admin., No. 05 C. 5683, 2006 WL 1460032, at *5 (N.D. Ill. May 23, 2006).
50. *See Lexmark*, 2006 DOLSOX LEXIS 71, at *92; Marshall v. Northrop Grumman Synoptics, No. 2005-SOX-0008, 2005 DOLSOX LEXIS 63, at *11 (Dep't of Labor June 22, 2005).
51. *See Bishop*, 2006 WL 1460032, at *6; *Marshall*, 2005 DOLSOX LEXIS 63, at *10-11; *Lexmark*, 2006 DOLSOX LEXIS 71, at *92.
52. Fraser v. Fiduciary Trust Co., 417 F. Supp. 2d 310, 322 (S.D.N.Y. 2006).

ethical matters might fall safely outside the scope of protected activity, such is not the case when the complaint involves noncompliance with internal accounting controls promulgated in compliance with Sarbanes-Oxley mandates or SEC rules and regulations. In that case, the noncompliance itself would indeed be a violation of one of the laws enumerated in section 806.[53]

2. Complaints that Wrongdoing Would Result in Fraudulent Misstatement

The following cases differ from *Bishop*, *Lexmark*, and *Marshall* in that the conduct complained of is more than simply noncompliance with internal policy. In these cases, complainants allege that some wrongdoing by the employer could constitute or eventually lead to fraudulent misstatements in the financial statements. These decisions infuse the notion of materiality into the mix of factors to consider when trying to determine whether conduct is of the type that one could "reasonably believe"[54] constitutes a violation of the statutes and regulations enumerated in section 806. In doing so, these cases serve to limit the potential range of what constitutes a protected activity.

In the case of *Harvey v. Home Depot, Inc.*,[55] the complainant brought a claim under section 806 alleging that he was retaliated against for reporting racial discrimination and additional behavior that reflected an overall bias, prejudice, and abuse of power by the company executives.[56] The ALJ explained that the complainant engaged in a protected activity only if the conduct he complained of could "reasonably be considered to fall within the six SOX specified categories of protected activities."[57] Because none of the complainant's allegations related to mail fraud, wire fraud, bank fraud, securities fraud, or any violation of SEC rules, the case turned on whether the complainant reported something that could reasonably be believed to constitute a violation of federal law relating to fraud against shareholders.[58]

The ALJ noted that "an implicit argument may be made that a company which permits discriminatory practices despite its public policy

53. *See, e.g.*, Morefield v. Exelon Servs., Inc., No. 2004-SOX-00002, 2004 WL 3567255, at *3, *4 (Dep't of Labor Jan. 28, 2004); Collins v. Beazer Homes USA, Inc., 334 F. Supp. 2d 1365, 1377 (N.D. Ga. 2004).

54. 18 U.S.C.A. § 1514A(a)(1) (Supp. 2006).

55. No. 2004-SOX-20, 2004 DOLSOX LEXIS 56 (Dep't of Labor May 28, 2004).

56. *Id.* at *5-7, *15.

57. *Id.* at *35.

58. *See id.* at *35-36.

of equal opportunity is acting contrary to the best interests of its share holders," but explained that this argument fails because a protected activity under SOX "must involve an alleged violation of a federal law directly related to fraud against share holders."[59] "[T]he federal law actually prohibiting individual employment discriminatory practices, Title VII, is based on individual rights and establishes procedures to address illegal employment discrimination; it was not enacted to preclude fraud against shareholders."[60] The ALJ went on to consider the argument that because "SOX mandates the accuracy of corporate disclosures, a reported incident of racial discrimination within a publicly traded company that represents itself to be non-discriminatory may amount to a violation of a SOX disclosure requirement and thus involve a federal law related to fraud against shareholders."[61] The ALJ concluded that despite the logical appeal of this argument, the link between the discrimination at issue and SOX was too tenuous.[62] The provisions of SOX requiring accuracy of corporate disclosures reflect Congress' intent to protect shareholders by requiring accurate reporting of a corporation's financial condition.[63] Whether an employer's acts of individual discrimination comply with the company's stated equal opportunity standards has a very marginal connection to accurate accounting and financial condition.[64] Accordingly, the ALJ found that the complainant's report did not constitute a protected activity.[65] The ALJ left a door open, however, when he noted that the reporting of an employer's "failure to disclose a class action lawsuit based on systemic racial discrimination with the potential to sufficiently affect the financial condition of a corporation might [constitute] SOX protected activity if an individual complained about the failure to disclose that situation."[66]

The case of *Harvey v. Safeway, Inc.*,[67] involving the same complainant and ALJ as the *Home Depot* case, reiterates the principles established in *Home Depot*[68] and applies them in a slightly different context. In *Safeway*, the complainant alleged that his complaints of wage violations under the Fair Labor Standards Act ("FLSA")

59. *Id.* at *37-38.
60. *Id.* at *38.
61. *Id.* at *38-39.
62. *Id.* at *39.
63. *See id.*
64. *See id.*
65. *Id.* at *43.
66. *Id.* at *39-40.
67. No. 2004-SOX-21, 2005 DOLSOX LEXIS 4 (Dep't of Labor Feb. 11, 2005).
68. *See supra* text accompanying notes 53-63.

constituted a protected activity under section 806.[69] The ALJ explained that complaints of systemic violations of FLSA could potentially "reach the necessary magnitude to effectively perpetrate a fraud on shareholders," but ultimately held that the complainant's reports of discrepancies in his weekly paychecks did not fall within this category and thus did not constitute a protected activity.[70] In reaching this conclusion, the ALJ noted that FLSA is focused on employee compensation and not the prevention of fraud against shareholders.[71] The ALJ reasoned that while it could be argued that the employer's "under-compensation of its employees could impermissibly alter the accuracy of its financial disclosures mandated by SOX," the connection between an individual FLSA violation and SOX is too tenuous.[72] The ALJ explained that even if uncorrected, the underpayment of the complainant's wages would have only a "microscopic" effect on any financial report prepared by the employer for the benefit of the shareholders.[73] The ALJ concluded that the complainant's reports simply failed to reach "the requisite level of materiality."[74] To tie his ultimate decision in with the objective reasonableness standard, the ALJ simply stated that the complainant's report "did not include an objectively reasonable complaint that [the employer] was also engaged in a significant, material and company-wide underpayment of its employees to the extent a fraud was being perpetrated on its shareholders."[75]

Thus, from *Home Depot* and *Safeway*, we see that materiality is the key to a successful whistleblower complaint when the claimed protected activity is a report of some wrongdoing that is not closely linked with shareholder communications.[76] Stated another way, "a complainant could only reasonably believe that perceived conduct was a fraudulent misstatement of corporate financial condition if that conduct was material toward the representation of that condition."[77] The case of *Minkina v. Affiliated Physician's Group* is consistent with this

69. *See Safeway*, 2005 DOLSOX LEXIS 4, at *1-2, *4.

70. *Id.* at *78.

71. *Id.* at *79.

72. *Id.* at *80.

73. *Id.* at *80-81.

74. *Id.* at *80.

75. *Id.* at *83.

76. *Id.* at *80; Harvey v. Home Depot, Inc., No. 2004-SOX-20, 2004 DOLSOX LEXIS 56, at *42 (Dep't of Labor May 28, 2004).

77. Tice v. Bristol-Myers Squibb Co., No. 2006-SOX-20, 2006 WL 2616393, at *18 (Dep't of Labor Apr. 26, 2006).

proposition.[78] In *Minkina*, the complainant alleged that she was retaliated against for reports she made to OSHA as well as her employer concerning what she believed to be dangerous air quality conditions at the workplace.[79] The ALJ held that the complainant's reports did not constitute protected activity.[80] The ALJ explained that:

> Quite simply, while the Complainant may have had a valid claim of poor air quality, Sarbanes-Oxley . . . was enacted to address the specific problem of fraud in the realm of publicly traded companies and not the resolution of air quality issues, even if there is a possibility that poor air quality might ultimately result in financial loss.[81]

Admittedly, the ALJ in *Minkina* ends his analysis without discussion of materiality.[82] However, the conclusion is consistent with the rule that can be gleaned from *Home Depot* and *Safeway*—reports of violations of laws or regulations unrelated to shareholder fraud will not be deemed protected activity unless the effect of such would be material to a shareholder.[83] *Minkina* may very well have had a different result if the evidence showed that the conduct complained of did indeed constitute an environmental violation, the government was stepping in to impose fines, and those fines would have a material effect on the financial statements.

The principles developed by *Home Depot* and *Safeway* were recently endorsed—and arguably expanded in a way that is favorable to employers—by a federal court in *Livingston v. Wyeth Inc.*[84] In *Livingston*, the employer company was a developer and manufacturer of pharmaceutical, consumer health, and animal health products, and was regulated pursuant to the Federal Food, Drug, and Cosmetic Act and regulations thereunder.[85] These regulations require current good manufacturing practices ("GMPs") by all manufacturers of

78. Minkina v. Affiliated Physician's Group, No. 2005-SOX-00019, 2005 DOLSOX LEXIS 41, at *16-17 (Dep't of Labor Feb. 22, 2005).

79. *Id.* at *1.

80. *Id.* at *15. This was just one alternative holding in the case; the ALJ also concluded that the complainant's former employer did not qualify as a covered employer under SOX. *Id.* at *14.

81. *Id.* at *17.

82. *See id.* (ending the discussion by reiterating that the former employer, a privately held company, is not covered by Sarbanes-Oxley).

83. *See* Harvey v. Home Depot, Inc., No. 2004-SOX-20, 2004 DOLSOX LEXIS 56, at *31, *33, *37-38 (Dep't of Labor May 28, 2004); Harvey v. Safeway, Inc., No. 2004-SOX-21, 2005 DOLSOX LEXIS 4, at *76-77, *80 (Dep't of Labor Feb. 11, 2005).

84. Livingston v. Wyeth Inc., No. 1:03CV00919, 2006 WL 2129794, at *10 (M.D.N.C. July 28, 2006).

85. *Id.* at *1.

pharmaceutical vaccine products, including a GMP for training all employees engaged in the drug manufacturing process.[86] The Food and Drug Administration ("FDA") had detected various GMP violations in two of the employer's facilities, and as a result the employer entered into a consent decree with the FDA which required it to address compliance issues in all of its facilities.[87] The facility in which the complainant worked told the FDA that it would revise its quality system guidance documents and set a target date of "September 30, 2002 implementing the revisions and verifying compliance."[88] Even if the required training curricula was not fully developed and implemented by this date, however, the facility would be deemed compliant provided that a satisfactory "legacy plan" was adopted.[89]

The plaintiff, who was the team leader of the group set up to ensure site-wide compliance with the GMP training system, alleges that he was retaliated against for making repeated internal complaints about training deficiencies and a perceived cover-up of those deficiencies.[90] The plaintiff argued that he had a reasonably objective basis for believing that if his office went forward with compliance verification as scheduled, it would be providing false and misleading information to the FDA, thereby subjecting it to fines and penalties.[91] The court disagreed, and held that the plaintiff had not engaged in a protected activity.[92] First, the court found that there was not an actual violation of any of the laws enumerated in section 806.[93] There was nothing in the record to indicate that the employer "made false or misleading statements, or omitted relevant information, in any documents provided to its shareholders."[94]

Next, the court explained why there was also no objectively reasonable basis for the plaintiff to equate the perceived training deficiencies with a violation.[95] The court stated that it was "entirely speculative to say that because Defendants disagreed with Livingston's belief that the facility could not meet the September 30, 2002 deadline,

86. *Id.*
87. *Id.* at *2.
88. *Id.*
89. *Id.* at *3 (explaining that a legacy plan is simply a way to close compliance gaps after the compliance date passes).
90. *Id.* at *2, *5-6, *9.
91. *Id.* at *9.
92. *Id.* at *10.
93. *Id.*
94. *Id.*
95. *Id.*

this meant that management planned to conceal critical information."[96] The complainant admitted that "even if compliance concerns persisted on that date, a legacy plan could be created for purposes of avoiding penalties," and the court found that this "concession [was] fatal" to his SOX claim because no reasonable employee knowing that fact could believe the employer was intending to conceal training deficiencies.[97]

While the complainant contended that the potential financial impact of non-compliance would be significant and thus the concerns about the state of the training program should be reported, the court disagreed.[98] The court explained that:

> Information must be sufficiently material to a company's financial picture before it will form the basis for securities fraud. Under Supreme Court authority, for information to be material, there must be "a substantial likelihood that a reasonable shareholder would consider [the matter] important to his decision to invest." Given the importance of "materiality" under the securities laws, Administrative Law Judges have rejected whistleblower retaliation claims where the information disclosed would not be sufficiently material to shareholders.[99]

The court found that even if it were reasonable for the complainant to believe that the FDA might take some type of enforcement action because of compliance issues in the future, it would not necessarily follow that the employer would be obligated to report the alleged violations before the FDA actually took any action.[100] This is presumably because at such a premature and speculative time, such information would not be material to a reasonable investor.

Interestingly, the *Livingston* court does not discuss the complainant's allegations that the potential fines and penalties would be quite substantial. This article proposes that this is because the materiality requirement of the reasonable-belief standard has two elements: (1) the likelihood that the negative event affecting the financial reporting will actually materialize within a reasonable timeframe, and (2) the potential financial impact that would result if and when that event occurred. If we view these two elements as a sliding scale—the stronger the likelihood that the event will occur, the less financial impact will be required, and vice versa—then we will have a

96. *Id.* at *10-11.
97. *Id.* at *10.
98. *Id.*
99. *Id.* (citations omitted).
100. *Id.*

useful test for predicting whether or not an employee's communications regarding a perceived violation would be deemed a protected activity.

This strategy proves helpful in explaining the outcomes that have been reached to date. In *Smith v. Hewlett Packard*,[101] the complainant argued that he was retaliated against for reporting to the EEOC that his employer failed to make appreciable efforts to remedy alleged race discrimination.[102] In analyzing whether this report constituted a protected activity, the ALJ looked to the *Home Depot* case for guidance and ultimately concluded that it did not.[103] The ALJ reiterated the proposition announced in *Home Depot* that reporting an employer's failure to disclose a class-action lawsuit based on systemic racial discrimination with the potential to sufficiently affect the financial condition of a corporation would likely constitute a protected activity, but such was not the case before him.[104] The ALJ held that although there was a vague rumor of a class-action lawsuit, there was no such litigation and thus there was nothing material for the employer to disclose to its shareholders.[105] Viewing this outcome on the sliding scale, we see that although the financial effect of a class action based on systematic race discrimination would undoubtedly have a significant negative financial effect, the likelihood in *Smith* that such event would actually occur anytime in the near future was too low for the situation to be deemed material. Similarly, in *Reed v. MCI, Inc.*,[106] the complainant alleged that he was terminated because he reported the misuse of unlicensed computer software.[107] The complainant argued that this was a protected activity because there could be substantial fines and loss of goodwill associated with such use, thus negatively impacting the financial health of the company.[108] The complainant noted that the penalty per incident could be as high as $150,000 and that thousands of incidents could have occurred.[109] Nonetheless, the ALJ held that the complainant could not reasonably believe that the company had committed a violation of any of the enumerated security laws or that it

101. Smith v. Hewlett Packard, No. 2005-SOX-00088, 2006 WL 468045 (Dep't of Labor Jan. 19, 2006).

102. *Id.* at *2.

103. *Id.* at *7, *9.

104. *Id.* at *7-8 (citing Harvey v. Home Depot, Inc., 2004-SOX-20, 2004 DOLSOX LEXIS 56, at *14-15 (Dep't of Labor May 28, 2004)).

105. *Id.*

106. No. 2006-SOX-00071, 2006 DOLSOX LEXIS 74 (Dep't of Labor June 20, 2006).

107. *Id.* at *6.

108. *Id.* at *7.

109. *Id.*

had committed a fraud on its shareholders.[110] Arguably, the ALJ came to this result because even though the financial impact to the company would be very significant, there was no evidence that any fines were actually on the horizon.

IV. CONCLUSION

While the boundaries of what constitutes a protected activity under SOX are still being drawn, the recent decisions outlined above give practitioners guidance for future situations. The materiality requirement for claims involving alleged shareholder fraud, as opposed to those involving an alleged violation of one of the specifically enumerated statutes or regulations, places an effective limitation on a law that could otherwise be construed to protect virtually all conduct that might eventually have some effect on shareholder reports, no matter how remote the chances. Understanding what will be deemed material, and thus what can form the basis for a reasonable belief that a fraud on shareholders has occurred or is being attempted, is necessary in order to discern the scope of protected activity. Fortunately, *Livingston* and other recent cases are starting to give us direction in that regard, and future cases will certainly continue to elaborate on the standard.

110. *Id.* at *7-8.