

## A Year For Whistleblower Rewards And Protections

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Time magazine dubbed 2002 the “Year of the Whistleblower” based in part on the role of Cynthia Cooper and Sherron Watkins played in exposing fraud at Enron Corp. and WorldCom Inc. Their disclosures prompted Congress to pass the Sarbanes-Oxley Act, which includes a whistleblower protection provision. But until recently, there was little incentive for corporate whistleblowers to risk their careers to disclose fraud and inadequate protection against retaliation.

Fortunately, 2014 has been a transformative year for the development of whistleblower law. Whistleblowers have obtained record recoveries: roughly \$435 million under the False Claims Act and more than \$31 million from the U.S. Securities and Exchange Commission’s Whistleblower Rewards Program. Also, recent administrative and judicial interpretations of SOX have rendered it a potent remedy to combat whistleblower retaliation.



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### Whistleblower Rewards Programs Gain Momentum

This year the SEC paid \$31 million in awards to whistleblowers, more than double the total paid in 2013. And, the SEC gave awards to nine whistleblowers in 2014, more than all other years combined. Moreover, the U.S. Department of Justice recovered a record \$5.69 billion under the False Claims Act and total whistleblower recoveries increased more than 25 percent year over year.

Significantly, in 2014, the SEC exercised for the first time its authority under the Dodd-Frank Act to protect whistleblowers from retaliation. On June 16, 2014, the SEC announced an enforcement action against Paradigm Capital Management Inc., a hedge fund advisory firm, in part for retaliating against a whistleblower who disclosed unlawful trading activity to the SEC. According to the order, Paradigm retaliated against its head trader for reporting that the hedge fund was engaging in a prohibited tax avoidance strategy.

When Paradigm learned that the head trader had disclosed the misconduct to the SEC, it changed his job duties, placed him on administrative leave and let him return only in a different position. See *In the Matter of Paradigm Capital Mgmt. Inc.*, Exchange Act Release No. 72393 (June 16, 2014). The whistleblower ultimately resigned. *Id.*

Paradigm settled the SEC charges for \$2.2 million. It consented to an order finding that it violated Dodd-Frank's anti-retaliation provision and committed other securities law violations. Paradigm also agreed to hire a compliance consultant to overhaul its internal procedures. Taking enforcement action for whistleblower retaliation is a critical step in building the SEC's Whistleblower Program because it signals that SEC's Office of the Whistleblower intends to vigorously protect whistleblowers.

### **SOX Whistleblower Protection Strengthened**

2014 also witnessed substantial strengthening of the whistleblower protection provision of SOX, including: a U.S. Supreme Court decision clarifying that SOX protects employees of privately held contractors and subcontractors of publicly traded companies; record SOX jury verdicts; federal appellate decision deferring to the U.S. Department of Labor's broad interpretation of SOX protected whistleblowing; and an administrative review board decision articulating an onerous same decision affirmative defense.

### **Supreme Court Clarifies that SOX Protects Employees of Private Contractors and Subcontractors of Publicly Traded Companies**

In a 6-3 decision, the Supreme Court held that SOX protects employees of contractors, subcontractors and agents of public companies. See *Lawson v. FMR*, 134 S. Ct. 1158 (2014). The court relied on the plain meaning and legislative history of SOX, including testimony at congressional hearings about the retaliation that Arthur Anderson LLP employees suffered when they opposed Enron's fraudulent accounting.

Lawson could have a substantial impact on law firms and audit firms that prepare public company financial statements and disclosures relied upon by the SEC and shareholders. While law firms and audit firms servicing public companies ostensibly act as gatekeepers and exercise independent professional judgment, they are also under intense competitive pressure to please clients and generate new business. As employees of contractors of publicly traded companies are likely to have first-hand knowledge of fraudulent schemes at public companies, providing them SOX whistleblower protection will go a long way to preventing fraud.

### **SOX Whistleblowers Obtain Large Verdicts**

Although Congress enacted Section 806 of SOX more than a decade ago, few SOX claims were tried before juries. But recently, SOX whistleblowers have been obtaining substantial verdicts. In 2013, the Ninth Circuit affirmed a SOX jury verdict awarding \$2.2 million, plus \$2.4 million for attorneys' fees,<sup>[1]</sup> and on March 5, 2014, a jury awarded \$6 million to Catherine Zulfer — the largest award to date in a SOX retaliation claim.

Zulfer alleged that her employer, Playboy Enterprises Inc., terminated her employment in retaliation for refusing the CFO's instruction to set aside \$1 million for discretionary executive bonuses that the board of directors had not approved. Most of the bonuses would have been paid to the CEO and CFO. Zulfer warned Playboy's general counsel that the bonus accrual could violate SEC rules prohibiting the circumvention of internal accounting controls. Following Zulfer's internal whistleblowing, the CFO retaliated against her by excluding her from meetings, forcing her to take on additional duties and eventually terminating her employment. After a short trial, the jury awarded Zulfer \$6 million in compensatory damages and ruled that Zulfer was entitled to additional punitive damages. *Id.* Zulfer and Playboy reached a settlement before a determination of punitive damages.

This record verdict will likely spur SOX whistleblowers to exercise the removal option in SOX and try their claims before juries.

### **Federal Courts Defer to ARB's Broad Interpretation of SOX-Protected Whistleblowing**

During 2014, several federal appellate courts adopted or deferred to the ARB's broad construction of SOX, as articulated in its May 2011 decision in *Sylvester v. Parexel*.<sup>[2]</sup> This development is a sharp reversal of the trend of federal courts establishing loopholes in SOX that were contrary to the plain meaning and intent of the statute, such as limiting protected conduct solely to disclosures of actual shareholder fraud or requiring whistleblowers to possess the knowledge and experience of a securities lawyer to engage in protected conduct.

In particular, the ARB held in *Sylvester* that:

- 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 complaint 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 have told 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.
- The *Iqbal/Twombly* pleading standard does not apply to SOX claims. *Id.* at \*10. Instead, a SOX complainant must simply provide "a full statement of the acts and omissions ... which are believed to constitute the violations." *Id.* at \*9.

Employers have argued that federal courts should reject *Sylvester* and continue to apply ARB's prior *Platone* decision requiring that a SOX complainant's disclosure "definitively and specifically" relate to one of the six enumerated categories found in 18 U.S.C. § 1514A. That effort has been largely unsuccessful, with some notable exceptions. See, e.g., *Lockheed Martin Corp. v. Admin. Review Bd.*, 717 F.3d 1121, 1132 n.7 (10th Cir. 2013); *Wiest v. Lynch*, 710 F.3d 121 (3d Cir. 2013) (holding that *Sylvester* is entitled to Chevron deference); *Leshinsky v. Telvent GIT SA*, 942 F. Supp. 2d 432, 443 (S.D.N.Y. 2013); *Stewart v.*

Doral Fin. Corp. (D.P.R. Feb. 21, 2014). But see, e.g., Riddle v. First Tenn. Bank (6th Cir. Aug. 31, 2012) (“an employee’s complaint must ‘definitively and specifically relate’ to one of the six enumerated categories found in 18 U.S.C. § 1514A.”); Gauthier v. Shaw Group Inc. (W.D.N.C. Dec. 4, 2012).

And, in August 2014, the Second Circuit held that Sylvester is entitled “at least” to Skidmore deference. See Nielsen v. AECOM Tech. Corp. (2d Cir. Aug. 8, 2014). The widespread adoption or deferral to Sylvester effectuates congressional intent to protect a wide range of disclosure designed to prevent fraud and significantly increases the odds of SOX whistleblowers surviving motions for summary judgment.

### **ARB Sets a High Bar to Establish Same Decision Affirmative Defense**

Under various whistleblower protection provisions enforced by OSHA, including SOX, once a complainant has demonstrated that protected conduct was more likely than not a contributing factor<sup>[3]</sup> in an 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 defined in detail the standard that an employer must meet to establish the same decision affirmative defense. See Speegle v. Stone & Webster Construction, ARB 13-074, 2005-ERA-006 (ARB Apr. 25, 2014). The standard is high, especially in comparison to the burden-shifting framework employed under most other anti-discrimination laws. In Speegle, the ARB established a three-part test to determine whether an employer can prove the same decision 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.

Under Speegle, evidence is clear and convincing only if it “‘immediately tilts’ the evidentiary scales in one direction.” Speegle, ARB 13-074 at \*6. In addition, Speegle requires the employer to prove that it would have taken the same decision in the absence of protected whistleblowing, as opposed to just proving that it could have taken the same decision. Id. at \*8. Speegle will be a powerful tool for whistleblowers to combat employer’s use of post-hoc justifications for a retaliatory adverse action.

### **Fifth Circuit Clarifies the Broad Scope of Actionable Adverse Actions**

Last month, the Fifth Circuit held that outing a whistleblower is a prohibited adverse action, even where the whistleblower has not suffered economic damages. Halliburton Inc. v. ARB, No. 13-60323 (5th Cir., Nov. 12, 2014).

While working as Director of Technical Accounting Research and Training in the finance and accounting department at Halliburton, Anthony Menendez raised concerns internally about questionable accounting practices. In particular, Menendez disclosed to his supervisor his belief that Halliburton’s practices involving revenue recognition did not conform with generally accepted accounting principles. Menendez’s 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.

After Halliburton failed to address his concerns, Menendez filed a confidential disclosure with the SEC about Halliburton’s accounting practices. 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. When Halliburton received a notice of investigation from the SEC requiring Halliburton to

retain documents, the company's general counsel inferred from Menendez's internal disclosures that he was the source of the SEC inquiry. The general counsel 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."

Subsequent to the general counsel outing Menendez as a whistleblower, Menendez's colleagues began treating him differently, refusing to work and associate with him. Menendez described the day that he saw the general counsel's email outing him as a whistleblower as one of the worst in his life. Halliburton granted his request for paid administrative leave and, within a year, Menendez resigned.

Affirming the ABR's decision, the Fifth Circuit applied the Supreme Court's Burlington Northern material-adversity standard to SOX (i.e., the inquiry is 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). Halliburton's outing of a whistleblower to his colleagues and informing them that the whistleblower caused them to be the subject of an SEC investigation "created an environment of ostracism" for the whistleblower, which well might dissuade a reasonable employee from whistleblowing.

### **Combating the Corporate Code of Silence**

The legislative history of SOX reveals that Enron succeeded in perpetuating fraud against shareholders in large part due to 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).

While corporate whistleblowers continue to face substantial retaliation, the recent success of the SEC Whistleblower Program and the recent strengthening of the whistleblower provision of SOX should go a long way in combating the corporate code of silence.

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[1] *Van Asdale v. Intl Game Tech.*, 549 F. App'x 611, 614 (9th Circ. 2013).

[2] See *Sylvester v. Parexel Int'l LLC*, ARB 07-123, 2007-SOX-039, 2007-SOX-042 (ARB May 25, 2011).

[3] 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).