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Expert Analysis

3rd Circuit Adopts New Broader Standard for Defining Protected Activity for Whistle-Blowers

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Although the decision by the 3rd U.S. Circuit Court of Appeals in *Wiest v. Lynch*, 710 F.3d 121, *reh'g denied* (3d Cir. Apr. 23, 2013), was not an appeal arising from the administrative processes of the U.S. Department of Labor, it is best understood as the most significant success to date in the DOL's efforts to reinterpret and expand the whistle-blower protection provisions of the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1514A, through the administrative adjudication process.

Congress passed SOX in response to several highly publicized corporate financial scandals. The statute requires companies with stock that is publicly traded in the United States to adopt financial and accounting controls, and it requires the officers of those companies to certify as to the correctness of the financial statements they publish. Section 806 of the law contains employment protections for individuals who report financial misconduct to responsible company officials, law enforcement or Congress.

Specifically, employers are prohibited from retaliating against employees who complain of conduct they reasonably believe constitutes a violation of one of the six following sources of law: 18 U.S.C. § 1341 (mail fraud), § 1343 (wire fraud), § 1344 (bank fraud), § 1348 (securities fraud), any rule or regulation of the Securities and Exchange Commission, or any provision of federal law relating to fraud against shareholders.

The principal holding of *Wiest* is that to be protected under Section 806 of SOX, an employee who reports corporate wrongdoing "must have both a subjective and an objective belief that the conduct that is the subject of the communication relates to an existing or prospective violation of one of the federal laws referenced in Section 806."

The 3rd Circuit did not require the whistle-blower to "ring the bell on each element of one of the stated provisions of federal law" to obtain statutory protection. The court specifically rejected the body of case law holding that in order to be protected, the employee must make allegations that "definitively and specifically" relate to one or more of the sources of law set forth in Section 806.[1]

In relieving the whistle-blower of the burden of communicating facts that demonstrate violations of the elements of the laws specified in Section 806, the 3rd Circuit put itself in conflict with prior decisions of the 1st, 2nd, 4th, 5th, 6th, 7th, 8th, 9th and 11th circuits, and it may have set the stage for U.S. Supreme Court review of this most critical area of federal whistle-blower law.

In *Wiest*, the 2-1 appellate majority adopted, with relatively little in-depth analysis, an interpretation of Section 806 adopted by the DOL Administrative Review Board in *Sylvester v. Parexel International*, No. 07-123, 2011 WL 2165854 (U.S. Dep't of Labor, Admin. Rev. Bd. May 25, 2011).

Specifically, the ARB held in *Sylvester* that a SOX whistle-blower need not allege facts sufficient to make out a violation of one of the six sources of law set forth in Section 806; rather, the whistle-blower need only have an objectively and subjectively reasonable belief that what he or she alleges may violate one of those laws.

The 3rd Circuit afforded deference to the *Sylvester* decision under the principles announced in the Supreme Court's seminal administrative law decision, *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

The 3rd Circuit's decision in* Wiest v. Lynch *is the most significant success to date in the Labor Department's efforts to reinterpret and expand the whistle-blower protection provisions of Sarbanes-Oxley.

The key holding in *Chevron* is that when a congressional enactment is unclear or ambiguous and Congress has delegated enforcement authority to an agency within the executive branch of the government to enforce that enactment, the courts should defer to the interpretation of the enactment adopted by that agency unless the agency interpretation is arbitrary or capricious.

The result in *Wiest* is that an administrative board within the executive branch has succeeded in undoing federal circuit case law that accumulated over the course of many years.

FACTUAL BACKGROUND FOR THE LAWSUIT

Underlying the *Wiest* case are mundane tax and accounting issues that corporations face every day. Jeffrey Wiest was a tax accountant at Tyco Electronics Corp., a business with a significant corporate financial scandal in its rearview mirror. Wiest's job responsibilities included review and approval of the tax treatment of certain corporate expenses. The largest of the corporate expenses involved in the lawsuit was a $350,000 charge for Tyco employees to attend an event at the Atlantis Resort in the Bahamas.

In an email to his supervisor, Wiest contended that management planned to charge the expense inappropriately to advertising. His position was that because the expenses were so extravagant, they should be charged as imputed income to attending employees rather than to the advertising budget. After some discussion, management agreed with Wiest, proceeded with the event and compensated the attendees for the additional tax liability by grossing up their bonuses.

A second expense that Wiest challenged was the payment of $218,000 for a conference at the Venetian Resort in Las Vegas. His objection was that the incomplete agenda provided to him lacked both sufficient documentation for tax purposes and proper approval under Tyco's rules regarding delegation of authority. The Tyco tax department eventually obtained the entire agenda and concluded that the conference served a proper business purpose. Payment for the event was approved.

Several months after the Las Vegas event, Wiest made an objection to a $335,000 expenditure for a conference at the Wintergreen Resort in Virginia. According to Wiest, Tyco's policies regarding internal delegation of authority required that the

chief executive officer approve the event because the chief financial officer was scheduled to attend the event, and approval of an official one level up from the level of the highest-ranked "planned attendee of the event" was required. Wiest believed and alleged in his complaint that Tyco processed the payment for the Wintergreen event without the CEO's approval, in violation of Tyco's internal policies.

Other expenses Wiest questioned over a two-year period included a "relatively lavish holiday party," an audit team meeting and an employee baby shower. He also sent an email to management when he received an expense request from an employee that included duplicate entries, additional nights of hotel bills and undocumented expenses.

At some point after these transactions, Tyco terminated Wiest for issues that appeared to be unrelated to his questioning of expenditures.

3RD CIRCUIT ANALYSIS OF WIEST'S 'OBJECTIONS'

The 3rd Circuit incorporated the company's history into its opinion as support for the view that Wiest had a reasonable basis for his concerns about improper corporate conduct. Specifically, in applying the *Sylvester* standard to Wiest's objection to Tyco's initial treatment of the Atlantis event, the appellate panel leaned heavily on the prior Tyco scandal, finding it both objectively and subjectively reasonable for Wiest to think that the treatment of the event as an advertising expense violated one of the sources of law in Section 806 of SOX.

The appellate court did not identify which source of law it thought applied — an omission that drew considerable fire from the dissenting judge. The bottom line is that an accounting functionary's routine query about the tax treatment of a corporate expense now seems protected under SOX.

Following* Wiest*, Sarbanes-Oxley does not require a definitive and specific statement by the employee that one or more of the six sources of law set forth in Section 806 has been violated.

Wiest's "reporting" on the Wintergreen Resort event, which consisted of emails contending that the expenses for the event required, but did not have, the approval of the Tyco CEO, also garnered protection from the court. Again, approval for attendance at this event was necessitated by Tyco's internal control policies that required the authorization from an official one level up from the senior official attending the event.

The 3rd Circuit held it reasonable both objectively and subjectively for Wiest to believe that failure to obtain the CEO's approval was potential corporate looting in violation of one of the laws enumerated in Section 806 of SOX. Once again, the court mentioned the Tyco history but did not specify which law might be implicated by the lack of approval from the CEO.

However, the appellate court did not find that all of Wiest's queries were protected conduct.

The court was not supportive of Wiest's objections to the Venetian event. Wiest held up payment for that event until the tax department received a revised meeting agenda, which the tax department found sufficient to substantiate the event as a business expense. The 3rd Circuit held that it was not objectively reasonable for Wiest to believe that an "expense request that initially lacked a detailed agenda and breakdown of expenses would constitute a violation of one of the provisions listed in Section 806." The court did not explain why the incomplete agenda for a high-priced event in Las Vegas was not an objective basis for alarm given Wiest's prior experience with corporate scandals in exotic locations.

The appeals court also found that the "questions" Wiest raised about other expense reports and the baby shower were not sufficient to create an inference that Wiest believed subjectively that a provision of Section 806 was being violated. Accordingly, the court affirmed the District Court's decision that those actions — like those involving the Las Vegas trip — were not protected under Section 806.

From the appellate court's analysis of the issues raised by Wiest, it is possible to draw at least a wavy line between what is protected by Section 806 and what is not — at least in the view of the 3rd Circuit.

First, a communication to a supervisor that objects to a management decision is protected if the employee making the communication has most or all the facts necessary to understand the decision and expresses an opinion that the decision might be legally questionable — particularly if the corporate employer has a history of scandal. Alternatively, if the employee lacks sufficient facts to understand a management decision, it may not be reasonable for him or her to object to it, or if the employee's communication does not rise to the level of an objection, it will not be protected. It is noteworthy that the employee need not assert a violation of one of the specific sources of law enumerated in Section 806 and need not explain how or why the challenged corporate decision is unlawful. It seems likely that questions about an expense report raised by a knowledgeable administrative assistant or an accounts-payable clerk may now be protected in the 3rd Circuit.

Following the *Wiest* decision — at least in the 3rd Circuit — the law does not require a definitive and specific statement by the employee that one or more of the six sources of law set forth in Section 806 has been violated. Instead, SOX will protect routine internal corporate communications in which an employee disagrees with a management decision and has a good- faith belief that the decision might be unlawful.

THE ARB STRATEGY

The 2011 *Sylvester* decision was just the first in a series of ARB decisions designed to transform SOX from a focused statute protecting corporate insiders who raise shareholder fraud issues into federal whistle-blower protection of universal application. *Sylvester* eliminated the need for a definitive and specific allegation of fraud or an allegation of scienter or materiality, and the decision announced that a communication was protected if the employee had an objectively and subjectively reasonable belief that one of the Section 806 provisions of SOX might be violated in the present or the future.

In short order, the ARB then issued a series of transformative decisions built on *Sylvester*:

- *Menendez v. Halliburton*, Nos. 09-002 and 09-003, 2011 WL 4915750 (U.S. Dep't of Labor, Admin. Rev. Bd. Sept. 13, 2011), held that, notwithstanding statutory language limiting adverse actions to "terms and conditions of employment," the ARB would recognize "any non-trivial" employer act as retaliatory. In that case, the non-trivial act was identification of the whistle-blower within a corporate accounting group that seemed already to know who had gone to the SEC.
- *Vannoy v. Celanese Corp.*, No. 09-118, 2011 WL 4915757 (U.S. Dep't of Labor, Admin. Rev. Bd. Sept. 28, 2011), extended SOX protection to an Internal Revenue Service whistle-blower and appeared to sanction theft of confidential company documents as protected activity under Section 806.
- *Prioleau v. Sikorsky Aircraft Corp.*, No. 10-060, 2011 WL 6122422 (U.S. Dep't of

Labor, Admin. Rev. Bd. Nov. 9, 2011), held that a memorandum written by an information technology employee expressing concern that at some point in the future a certain computer application might interfere with the requirements of a legal "litigation hold" was protected.

- *Spinner v. David Landau & Associates*, Nos. 10-111, 10-115, 2012 WL 1999677 (U.S. Dep't of Labor, Admin. Rev. Bd. May 31, 2012), held that SOX protects not only employees of publicly traded companies, but also employees of contractors of publicly traded companies.[2]

The 3rd Circuit did not reach any of these issues in *Wiest*, but its holding that *Chevron* deference applies to *Sylvester* suggests that it is likely in each case to adopt the administrative interpretation of the statute as its own.

Barely a month after *Wiest*, in *Leshinsky v. Telvent GIT S.A.*, Civ. No. 10-4511, 2013 WL 1811877 (S.D.N.Y. May 1, 2013), a judge in the Southern District of New York disregarded the 2nd Circuit's decision in *Vodopia v. Koninklijke Philips Electronics,* 398 F. App'x 659 (2d Cir. 2010), and followed *Sylvester*.

The District Court, relying on *Wiest* as support for its position, held that the law had changed. In effect, the District Court found that the ARB had changed the "definitively and specifically" interpretation of Section 806 by administrative adjudication in the *Sylvester* case and that *Chevron* required the courts to accept that change.

Is this a question of administrative law or a conflict between the executive and judicial branches of the government?

Where does that leave all the appellate decisions holding the whistle-blower to a higher standard of clarity and precision, including the cases that did not afford *Chevron* deference to decisions of the Bush-era ARB? Are Article III judges bound to discard nearly 10 years of case law?

The answer to this question is not simple, and it should not be surprising that the majority and the dissent in the 3rd Circuit offered strikingly different answers. The majority was apparently unconcerned that the courts might defer to administrations that presented different — even contradictory — interpretations of a statute from time to time. The majority cited *National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005), for the proposition that an agency's inconsistency does not preclude analysis of the agency's position under the two-step *Chevron* framework.

Under that framework, more than one interpretation of a statute could be rational, and the Article III courts are bound to accept whichever policy the government agency chooses to advance at any given time, as long as the agency can explain its position rationally. Under this view, statutory interpretations can change when administrations change and the courts are bound to accept a shift in focus or position so long as the agency's decision is not irrational.

Dissenting, Judge Kent A. Jordan observed that it has traditionally been the role of the Article III courts to interpret the law and for the federal agencies to follow the law as the courts have interpreted it. He noted that under the majority's rationale of deferring to the administration's interpretation, nothing prevents the appointees of a later administration from reversing course and returning to the more restrictive interpretation of the statute in effect before *Sylvester*. In this latter respect, he sees the effects of *Chevron* exactly the way the majority does.

The SOX statutory scheme calls for both administrative and judicial adjudication of claims in the first instance. Under the DOL system, a complainant or a company dissatisfied with a decision by the Occupational Safety and Health Administration can appeal the decision to an administrative law judge and then to the ARB. After the ARB decision, the losing party can take the case to a federal court of appeals. However, a complainant has the option of removing the case from the DOL system after the DOL has had 180 days to resolve the case but has not done so.

In that event, the lawsuit proceeds like any other lawsuit in the federal court system, and the courts must interpret and apply the law as they do in thousands of cases each year. It is not clear what the rationale might be for supporting judicial deference to administrative agencies when the district courts have responsibility for adjudicating claims in the first instance. For the courts to afford *Chevron* deference in these circumstances allows the interpretation of an important federal anti-corruption statute to move with the political winds.

The *Wiest* decision created a distinct conflict among the circuits, although the only court of appeals decision cited in footnote 1 decided after *Sylvester* is the 6th Circuit's decision in *Riddle v. First Tennessee Bank*, 497 F. App'x 588 (6th Cir. 2012).

The Supreme Court is likely to decide what deference is due to the ARB in interpreting Section 806 when it decides the contractor case *Lawson v FMR LLC*, No. 12-3, *cert. granted* (U.S. May 20, 2013), which it agreed to hear on May 20. It is unlikely, however, that *Lawson* will decide the fundamental substantive question of what a whistle-blower must do to obtain the protection of the statute. This may require further Supreme Court action later.

NOTES

[1] *Day v. Staples Inc.*, 555 F.3d 42 (1st Cir. 2009); *Vodopia v. Koninklijke Philips Elecs., N.V.*, 398 F. App'x 659 (2d Cir. 2010); *Livingston v. Wyeth Inc.*, 520 F.3d 344 (4th Cir. 2008); *Welch v. Chao*, 536 F.3d 269 (4th Cir. 2008); *Allen v. Admin. Review Bd.*, 514 F.3d 468 (5th Cir. 2008); *Riddle v. First Tenn. Bank*, 497 F. App'x 588 (6th Cir. 2012); *Harp v. Charter Commc'ns*, 558 F. 3d 722 (7th Cir. 2009); *Pearl v. DST Sys.*, 359 F. App'x 680 (8th Cir. 2010); *Van Asdale v. Int'l Game Tech.*, 577 F.3d 989 (9th Cir. 2009); *Gale v. U.S. Dep't of Labor*, 384 F. App'x 926 (11th Cir. 2010).

[2] The ARB decision in *Spinner* expressly rejected the 1st Circuit's holding to the contrary in *Lawson v. FMR LLC*, No. 12-003, 670 F. 3d 61 (1st Cir. 2012), *cert. granted* (U.S. May 20, 2013).

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