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EMPLOYMENT LAW ALERT

JUNE 8, 2011

New ARB Decision Erodes Employer-Friendly Precedents under SOX

On May 25, 2011, an en banc panel of the Obama administration's newly appointed Administrative Review Board ("ARB") reversed an Administrative Law Judge's ("ALJ's") decision dismissing the SOX complaints of two drug testing company employees. In *Sylvester v. Parexel International LLC*, No. 07-123 (ARB May 25, 2011), the ARB determined that:

- The heightened pleading standards set forth by the U.S. Supreme Court in *Bell Atlantic Corp. v. Twombly* and *Ashcroft v. Iqbal* do not apply to SOX whistleblower claims before the DOL; and
- The ALJ erred by requiring the complainants to show that:
    1. an actual violation of the laws under SOX occurred,
    2. their protected activity "definitively and specifically" related to one or more of SOX's enumerated violations,
    3. the claimed violations related to shareholder fraud, and
    4. they had specifically alleged the elements of a criminal securities fraud claim in order to qualify for SOX protection.

Background[1]

Parexel is a publicly-traded company that tests drugs for drug manufacturers and other clients. Sylvester worked as a Case Report Forms Department Manager for Parexel, and was responsible for reporting data and related research results from clinical studies conducted by Parexel. Neuschafer worked as a Clinical Research Nurse, and was responsible for reporting accurate clinical data according to the Food and Drug Administration ("FDA") Good Clinical Practice ("GCP") Standards.

On two occasions (in March and May 2006), Sylvester and Neuschafer reported the false reporting of clinical data (a GCP violation) to a manager, a supervisor, and other employees who were also working on the study, but no corrective action was taken by Parexel. Within a week of the complainants' accusations, Parexel issued letters of warning to Sylvester and Neuschafer. Sylvester protested to management that her letter was issued in retaliation for reporting the GCP violations.

On June 15, 2006, Parexel discharged Sylvester, allegedly because she was a not a "team player." On August 10, 2006, Parexel discharged Neuschafer allegedly because her "personality did not fit in."

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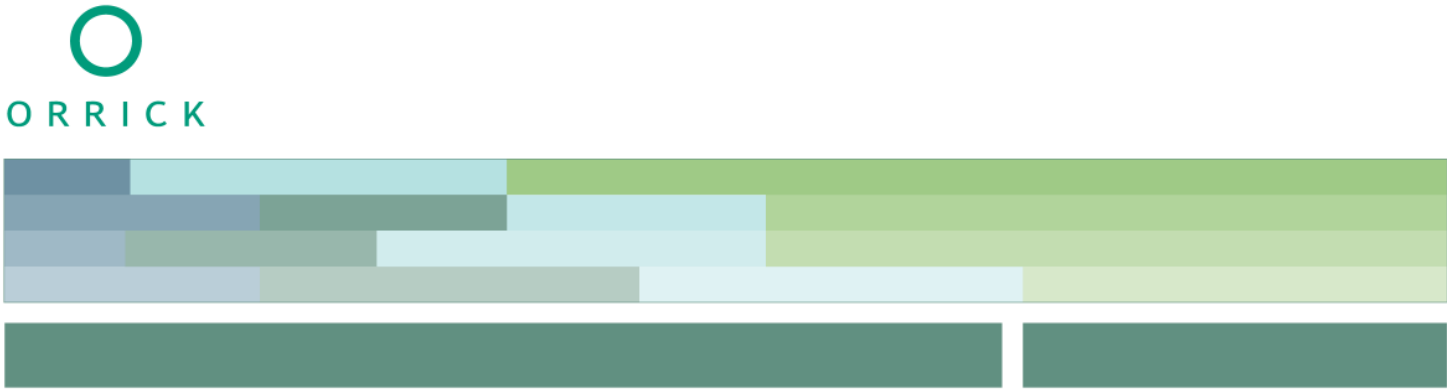


Parexel's Motions to Dismiss

Sylvester and Neuschafer filed SOX whistleblower complaints claiming that Parexel terminated their employment in retaliation for providing information to managers about the GCP violations. The complaints alleged that the fraudulent acts constituted actual or potential mail or wire fraud, and fraud against shareholders, and also stated that "[v]iolation[s] of GCP could constitute a violation of Federal law including…18 U.S.C. 1344 (financial institution fraud) or other federal or state law."

Parexel moved to dismiss the claims on the ground that the complaints did not adequately allege protected activity under SOX Section 806. The ALJ granted Parexel's motion and dismissed the complaints, holding that the complainants failed to establish that their expressed concerns (1) "definitively and specifically" related to a violation of any of the laws covered by SOX Section 806, (2) involved an actual violation by Parexel of any of the laws enumerated in Section 806, (3) involved shareholder fraud, fraud generally, or were otherwise adverse to shareholders' interests, or (4) constituted reasonable concerns about SOX violations. The complainants appealed.

The ARB's Analysis and Decision

The ARB determined that the ALJ had erred on several grounds in dismissing the complaint.

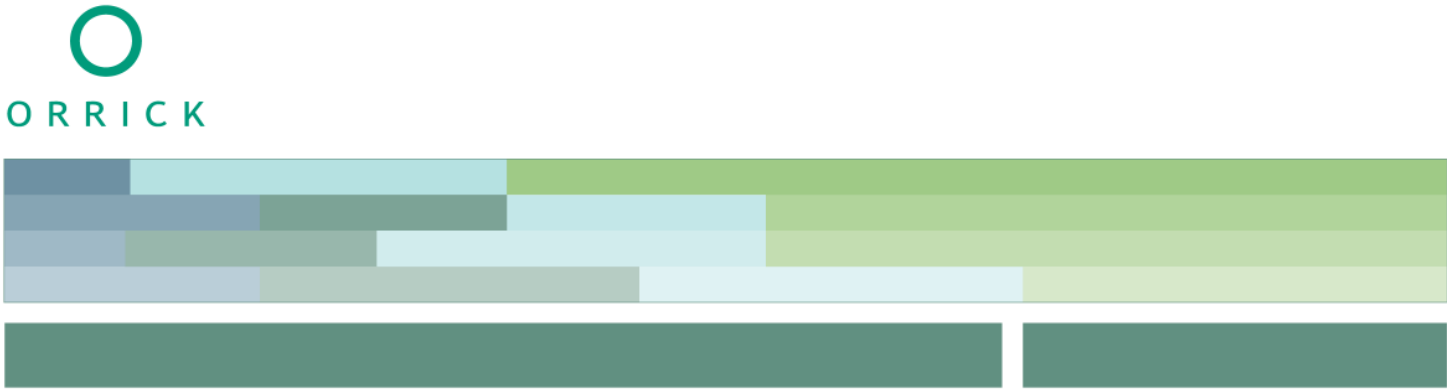
Pleading Standard For SOX Claims Initiated with OSHA

First, the ARB held that the heightened *Twombly*[2] and *Iqbal*[3] pleading standard, which had been used by the ALJ, are inappropriate for SOX whistleblower claims. The ARB explained that, unlike federal court complaints, SOX claims to OSHA require "no particular form of complaint," except that they must be in writing and "should contain a full statement of the acts and omissions, with pertinent dates, which are believed to constitute the violations."[4] OSHA is then required, when appropriate, to interview the complainant *to supplement a complaint* that lacks a prima facie claim.[5] A plaintiff's complaint in federal court is measured against the requirements of Rules 8 and 9 of the Federal Rules of Civil Procedure, and immediately subject to challenge by the defendant based on the sufficiency of the pleadings under Rule 12. Therefore, the Board determined, requiring SOX claimants to file the equivalent of a federal court complaint when they initiate contact with OSHA would "contravene the expressed duty that OSHA has to interview the complainant and attempt to supplement the complaint."

The Board opined that although ALJs are entitled to manage their case loads and decide whether a particular case is so meritless on its face that it should be dismissed in the interests of justice, "SOX claims are rarely suited for Rule 12 dismissals."

"Reasonable Belief" of a Violation

SOX complainants are only required to show that they "reasonably believe" that the conduct complained of constitutes a violation to sustain a complaint of having engaged in SOX-protected activity. The reasonable belief standard requires an examination of whether complainant actually believed the complained of activity was a



violation as well as whether that belief was reasonable for an individual in the employee's circumstances having her training and experience. Complainants are not required to show, however, that they actually communicated the reasonableness of those beliefs to management. A whistleblower complaint concerning a violation about to be committed is also protected as long as the employee reasonably believes that the violation is likely to happen.

Because a determination regarding the reasonableness of the complainants' alleged protected activities required an examination of these facts, the Board determined that it was inappropriate for the ALJ to rule on that activity on a motion to dismiss.

"Definitive and Specific" Evidentiary Standard

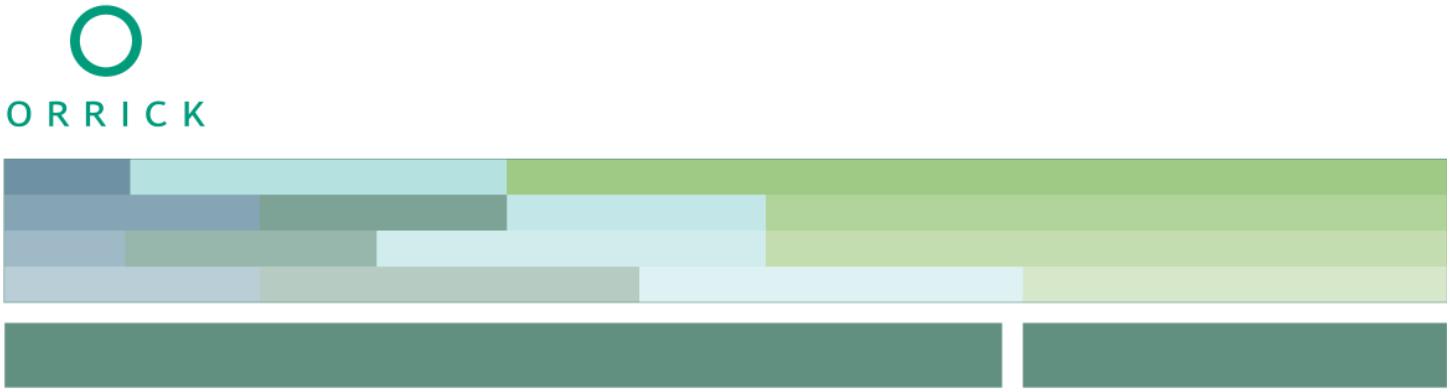
In relying on prior cases using the words "definitive and specific" or "definitively and specifically" in determining whether a complainant engaged in SOX-protected activity, the ALJ held that the complainants' allegedly protected activities did not have a sufficiently definitive and specific relationship to any of the listed categories of fraud or securities violations. The Board disagreed and held that the ALJ failed to focus on the plain language of the SOX whistleblower protection provision, which protects "all good faith and reasonable reporting of fraud."

The Board opined that the "definitive and specific" evidentiary standard had been imported from prior precedent under the Energy Reorganization Act ("ERA"), and that the standard had developed in those cases because the statute contained an ambiguous "catch-all" employee protection provision. SOX's whistleblower protection, however, does not include similar "catch-all" language and instead "expressly identifies" the laws to which the statute applies. According to the Board, although the "definitive and specific" test has been followed in "a number of ARB decisions" and deferred to by several circuit courts of appeals, here the Board held that the standard "has evolved into an inappropriate test and is often applied too strictly." According to the Board, "the critical focus is on whether the employee reported conduct that he or she *reasonably believes* constituted a violation of federal law." Therefore, the ALJ should have considered whether the complainants provided information to Parexel that they reasonably believed related to one of the violations listed in Section 806, and not whether that information "definitively and specifically" described one or more of those violations.

Allegations of Shareholder Fraud

The Board held that the ALJ also erred in concluding that the Complainants were required to allege in their pleadings that they expressly referred to "fraud, shareholders, securities, statements to the SEC, or SOX in their reports of false reporting of clinical data" to their supervisors and other employees. SOX's legislative history indicates that the Act was implemented to address not only securities fraud, but also corporate fraud generally. Of the six enumerated categories listed in Section 806, only one of them refers to fraud against shareholders.

According to the Board, and "[i]n examining the SOX's language, it is clear that a complainant may be afforded protection for complaining about infractions that do not relate to shareholder fraud. On their face, mail fraud, fraud by wire, radio, or television, and bank fraud are not limited to frauds against shareholders," and when an



entity engages in any of the six enumerated categories of violations, it does not necessarily engage in immediate shareholder fraud.

A reasonable belief about a violation of "any rule or regulation of the Securities and Exchange Commission" could encompass a situation in which the violation, if committed, is "completely devoid of any type of fraud." Therefore, "an allegation of shareholder fraud is not a necessary component of protected activity under SOX Section 806."

Pleading Standard for Fraud

Citing *Platone v. FLYi Inc.*, ARB No. 04-154, ALJ No. 2033-SOX-27 (ARB Sept. 29, 2006), the ALJ held that "the alleged fraudulent conduct must 'at least be of a type that would be adverse to investors' interests' and meet the standards for materiality under the securities laws such that a reasonable shareholder would consider it important in deciding how to vote."[6] The ARB, however, held that some courts have misinterpreted the *Platone* analysis as a requirement that SOX complainants must allege the elements of a securities fraud claim to qualify for protection. According to the ARB, "requiring a complainant to prove or approximate the specific elements of a securities law violation contradicts [SOX's] requirement that an employee have a reasonable belief of a violation of the enumerated statutes." Therefore, according to the ARB, complainants need not plead or prove the elements of a violation of the substantive laws to sufficiently allege that they were engaged in protected activity under Section 806.

Implications for Employers

The ARB's decision in *Sylvester* has clearly lowered the bar for survival of whistleblower complaints adjudicated before OSHA and made it considerably more difficult for employers to get early relief from non-meritorious claims. In light of this decision and other recent developments under SOX and the Dodd-Frank Act, employers should prepare for a significant increase in whistleblower claims brought under both Acts.

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[1] The facts presented here are those reported in the ARB's decision. The ARB accepted as true the facts in the complaints for purposes of reviewing the ALJ's order granting Parexel's Motions to Dismiss.

[2] 550 U.S. 544 (2007).

[3] 129 S. Ct. 1937 (2009).

[4] 29 C.F.R. § 1980.103(b).

[5] 29 C.F.R. § 1980.104(b)(1).

[6] In *Platone*, the ARB described a violation of Section 806 by referencing a violation of securities laws. In analyzing Platone's claim that 10b-5 had been violated, the ARB commented that Platone's whistleblower complaint failed because, among other things, the complaint did not "approximate any of the basic elements of a claim of securities fraud."