

June 5, 2014

Fourth Circuit Breathes Life into Summary Judgment for Employers Defending SOX Whistleblower Claims

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On May 12, 2014, the U.S. Court of Appeals for the Fourth Circuit issued a ruling upholding a grant of summary judgment in favor of the employer in *Feldman v. Law Enforcement Assocs. Corp.*,¹ a Sarbanes-Oxley (SOX) whistleblower retaliation case filed by the defendant employer's former president and chief executive officer. Section 806 of SOX² creates a federal cause of action in favor of employees who allege that their employers retaliated against them for reporting violations of federal securities laws. In affirming the lower court's decision, the circuit court concluded that the CEO failed to establish that his alleged protected activities were a "contributing factor" to the company's decision to fire him. In what is a rare case of a court finding an employee failed to make a *prima facie* showing under a SOX whistleblower statute, the court determined that the plaintiff's "light burden" was not satisfied due to the 20-month gap between his protected activities and his termination from employment and the existence of a "legitimate intervening event" that precipitated his firing.

This ruling may be viewed as a victory for employers in what is an emerging area of employment law.

Facts of the Case

The named plaintiff was president and CEO of a company that manufactures security and surveillance equipment. The plaintiff, along with his co-plaintiff, also served as an inside director on the company's board, which included three outside directors. In 2005, the company's founder pleaded guilty to criminal export violations involving another one of his companies and, as a result of that plea deal, was required to refrain from export activities for five years. The founder resigned from his position on the company's board of directors after the guilty plea, but he remained one of its major stockholders. He also closely followed the board's activities and apparently retained the loyalty of the board's remaining outside directors.

As early as 2007, there existed a deep divide between inside and outside directors, due in part to the founder's plan to sell the company without offering the plaintiff the first opportunity to buy it, and the board's refusal to approve the plaintiff's requested contract renewal and salary increase. In January 2008, nearly 20 months before the plaintiff was terminated, he and his co-plaintiff first reported concerns to the U.S. Department of Commerce that the company and one of the

1 2014 U.S. App. LEXIS 8833 (4th Cir. May 12, 2014).

2 18 U.S.C. § 1514A.

founder's other companies may have engaged in potentially illegal exports. That report resulted in a federal investigation of both companies and a raid on the founder's other company headquarters. The contentious relationship among the board members came to a head more than a year later, in April 2009, when the plaintiff told one of the company's major shareholders that he believed the board was not acting in the shareholders' best interests. Shortly thereafter, the plaintiffs filed another report with the Department of Commerce, this time revealing their suspicion that the company was involved in insider trading.

On August 29, 2009, the board of directors voted to fire the plaintiff. The following month, the company separated the co-plaintiff from employment when he failed to return from a medical leave of absence. The plaintiff later filed suit alleging, among other claims, that he was fired in retaliation for engaging in SOX-protected whistleblower activities. The U.S. District Court for the Eastern District of North Carolina concluded that the plaintiff's protected activities were not a "contributing factor" to his termination from employment and granted the company's summary judgment motion. The plaintiff appealed that decision to the Fourth Circuit.

The Court of Appeals Ruling

The Fourth Circuit, citing its previous decision in *Welch v. Chao*, 536 F.3d 269 (4th Cir. 2008), applied a burden-shifting framework.³ The burden-shifting framework requires the plaintiff to establish a *prima facie* case by a preponderance of the evidence. If the plaintiff is successful, then the burden shifts to the employer to rebut the *prima facie* case by demonstrating by clear and convincing evidence that it would have taken the same action in the absence of the alleged protected activity.

To satisfy his *prima facie* case, the plaintiff had to establish that: (1) he engaged in protected activity; (2) his employer knew that he engaged in the protected activity; (3) he suffered an unfavorable personnel action; and (4) the protected activity was a contributing factor in the unfavorable action.⁴ The court's opinion focused on the fourth element, known as the contributing factor test. A contributing factor is "any factor, which alone or in combination with other factors, tends to affect in any way the outcome of the decision." The test places a lesser burden on the plaintiff. The court described the element as "broad and forgiving," and agreed that the plaintiff need not show that the alleged protected activity was a primary or even a significant cause of the adverse action. That being said, the court also recognized that the causal connection may be severed by the passage of a significant amount of time, or a legitimate intervening event.

In reaching its decision in *Feldman*, the appellate court concluded that the 20-month period between the plaintiff's initial report to the Department of Commerce regarding potentially illegal exports and his firing weighed strongly against a finding that the plaintiff's alleged protected activities were a contributing factor in the company's decision to discharge him. More important than the span of time between the company's alleged protected activity and his firing, said the court, was his denouncement of the outside board members in meetings with a major shareholder. The plaintiff himself admitted that the outside board members viewed his actions in advising shareholders regarding their ability to sue the board and then advising the board to resign to avoid suit as "throw[ing] them under the bus." According to the Fourth Circuit, the plaintiff's actions created a "legitimate intervening event further undermining a finding that his long-past protected activities played any role in the termination."

The court also found it important that the plaintiff's fellow inside board member was not terminated as a result of his participation in the two whistleblower reports filed with the Department of Commerce. The plaintiff admitted that his co-plaintiff was initially asked to stay on at the company and was only separated from his employment after he failed to return from a medical leave of absence. According to the court, the co-plaintiff's retention undermined the plaintiff's claim that his protected activity was a contributing factor in his discharge.

3 The court began by addressing a threshold issue of whether it had jurisdiction over the claim based on the plaintiff's failure to wait the required 180 days to file suit after he filed his charge with the Occupation Safety and Health Administration (OSHA). The initial complaint filed by the plaintiff did not assert the SOX claim; instead, the plaintiff amended his initial complaint under Fed. R. Civ. Pro. 15(c) to add the SOX claim when it became ripe. The court of appeals noted that, although the SOX claim related back to the subject of the first complaint, "the filing of a supplemental pleading [pursuant to 15(d)] is [the] appropriate mechanism for curing numerous possible defects in a complaint." The court ultimately declined to apply the relation-back doctrine so literally as to "prevent the maintenance of the action in the first place." Instead, the court chose to construe the amended complaint as a supplemental pleading under Rule 15(d), thus curing the defect that would otherwise have deprived the district court of jurisdiction under Rule 15(c).

4 Notably, the court differentiated between the causation standard at the investigatory stage (circumstances sufficient to raise the inference that protected activity was a contributing factor) versus the evidentiary stage of summary judgment. See 29 C.F.R. § 1980.109(a).

Finally, the court gave no weight to the plaintiff's argument that he was a strong performer at work and that the company thrived under his direction. Instead, the court emphasized that a plaintiff's evaluation of his own performance was irrelevant to the court's determination and, regardless, that the courts do not "sit as a super-personnel department to second guess the Company's employment decisions." Ultimately, in affirming the district court's grant of summary judgment to the company, the court explained that, while the contributing factor standard in SOX cases is meant to be "broad and forgiving," the standard would be "toothless" if the court concluded that "these long-past activities affected [plaintiff]'s termination given the lengthy history of antagonism and the intervening events which caused the Outside Directors to view [the plaintiff] as insubordinate."

The Takeaway for Employers

Employers will find this opinion noteworthy for its in-depth consideration of the *prima facie* case in this evolving area of employment law. Also of note is that the court affirmed summary judgment without ever addressing whether the employer could show by clear and convincing evidence that it would have taken the same adverse action against the plaintiff in the absence of his protected activity.

Interestingly, the court did not address the question of whether the plaintiffs' reports to the Department of Commerce qualified as protected activities under the SOX statute. To be covered by SOX, the whistleblower needs to "reasonably" believe that the alleged corporate misdeed constitutes a violation of the mail fraud, wire fraud, bank fraud, or securities fraud statutes, any rule or regulation of the Securities and Exchange Commission, or any other provision of federal law relating to fraud against shareholders. The circuits remain split on how to define protected activity. Some courts rely on the management-friendly standard that requires the employee's complaint to relate "definitively and specifically" to a violation of any laws covered by Section 806. Other courts have adopted the Department of Labor's Administrative Review Board's controversial 2011 decision in *Sylvester v. Parexel, L.L.C.*, which rejected the "definitively and specifically" rule and dramatically broadened the scope of the term "protected activity." This split in authority should be watched closely and may ultimately impact the scope of potential claims.

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