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CLIENT ALERT

Third Circuit Upholds Reduced Pleading Requirements for SOX Whistleblowers

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It just got easier for alleged whistleblowers under the Sarbanes-Oxley Act (SOX) to avoid dismissal of their claims. At least in the Third Circuit, putative whistleblowers only need to allege that they informed management of their reasonable belief that the employer's practices constitute fraud in violation of at least one of SOX Section 806's enumerated statutes or regulations to sufficiently plead they engaged in protected activity. In *Weist v. Lynch*, No. 11-cv-4257, 2013 WL 1111784 (3d Cir. Mar. 19, 2013), the Third Circuit became the first appellate court to address and adopt the recent decision by the U.S. Department of Labor's Administrative Review Board (ARB) in *Sylvester v. Parexel Int'l,* ARB 07-123, 2011 WL 2165854 (Dep't of Labor May 25, 2011) (en banc),that specifically relaxed the pleading requirements for alleged SOX whistleblowers. This appellate adoption of the more lenient *Sylvester* standard likely means that more SOX whistleblower claims are on the horizon as the plaintiffs' bar is sure to seize on this decision in bringing new claims.

In *Weist,* the Third Circuit reversed the district court and adopted the "reasonable belief" standard for demonstrating protected activity. The district court had granted the motion to dismiss brought by Tyco Electronics Corp. and the individual defendants, finding that Mr. Weist had failed to allege that his internal communications to management regarding potential tax and accounting fraud "definitively and specifically related" to one of the statutes or rules listed in SOX Section 806. The Third Circuit found that the district court erroneously applied this higher standard of proof based on an earlier ARB decision, *Platone v. FLYI, Inc.*, ARB 04-154, 2006 WL 3246910 (Dep't of Labor Sept. 29, 2006), *aff'd,* 548 F.3d 322 (4th Cir. 2008). Instead, the Third Circuit concluded that the ARB's later rejection of the "definitively and specifically related" standard, and adoption of the "reasonable belief" standard, in *Sylvester* was entitled to *Chevron* deference.

The Third Circuit observed that the "reasonable belief" standard, unlike the "definitively and specifically related" standard, is in line with SOX Section 806, "which prohibits retaliation against employees for reporting information that he or she reasonably believes violates SOX." The Weist court agreed with the ARB's position that, in order to assert a "reasonable belief," plaintiffs must allege facts to show: (1) they have a subjective belief that the employer's actions violated one of the provisions listed in Section 806, and (2) that belief was objectively reasonable "based on the knowledge available to a reasonable person in the same factual circumstances with the same training and experience as the aggrieved employee." This "reasonable belief" standard is similar to that announced by courts reviewing whistleblower retaliation claims under other federal statutes, such as the False Claims Act.

According to the Third Circuit, a whistleblower does not need to be communicating concerns about a past violation in order to state a SOX claim. Employees are also protected from retaliation for communications regarding potential future violations if they reasonably believe that the violations are likely to happen. Consistent with that approach, the Third Circuit stated that claimants need not allege facts sufficient to sustain a fraud claim – such as those demonstrating scienter and materiality – in order to garner protection under the statute. Under this standard, employees must only put the employer on notice of potential fraudulent conduct through their communications to management.

With respect to Weist's claims, the Third Circuit concluded that his emails to his supervisors raising concerns about Tyco's treatment of costs related to an event at the Atlantis Resort in the Bahamas as a business expense, and not as income for employees, was sufficient to sustain his Section 806 claim. Furthermore, Weist's emails to his supervisors asserting the company's failure to follow its protocol when the CFO, an attendee, rather than the CEO, approved the expenses for another event, were sufficient to sustain his claim.

Weist's complaints to management regarding the lack of an agenda and detailed breakdown of expenses about a third event, both subsequently provided to him, were insufficient to meet the reasonable belief standard. In the same vein, Weist's allegations that he "raised questions" regarding the proper accounting treatment of other events also failed to state a claim that he had a reasonable belief of a violation of any of the laws referenced in Section 806. Thus, employers may still be successful in dismissing, even under the lowered SOX pleading standards, claims that lack sufficient factual detail regarding the plaintiff's communications to management regarding alleged violations of the laws and regulations cited in SOX Section 806.

The Third Circuit's decision is not unexpected given the recent trend of courts lessening the hurdles for whistleblowers to survive early dismissal of their claims. Yet it confirms the likelihood that employers will be facing more SOX whistleblower claims in the years to come. The decision also highlights the need to maintain a culture of compliance and internal reporting in order to minimize the potential exposure to these very public and very embarrassing whistleblower claims.

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