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Corporate Governance Group
Client Alert

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FEDERAL DISTRICT COURT GIVES EXPANDED READING TO PROTECTED WHISTLEBLOWER ACTIVITY UNDER SARBANES-OXLEY

Determines that employer retaliation following report of client misconduct by whistleblower can support a claim under SOX

In *Sharkey v. J.P. Morgan Chase & Co.,*[1] the U.S. District Court for the Southern District of New York recently determined that section 806 of the Sarbanes-Oxley Act of 2002 ("SOX") protects whistleblowers who report fraudulent conduct by third parties and, as a result, suffer retaliation by their employers. In a matter of first impression, the Court rejected defendant's contention that SOX section 806 is operative only when the reported misconduct is engaged in by the whistleblower's employer, not by a third party. Although the Court dismissed the whistleblower's claim (with leave to replead) because she failed to allege illegal conduct with the degree of specificity necessary to support a whistleblower claim, the decision is in contrast with previous federal court decisions that have narrowed the scope of the SOX whistleblower protection statute in various respects.[2]

Background of Whistleblower Statute

Under section 806 of SOX:

"No [publicly traded company] . . . may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee . . . to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes

[1] No. 10 Civ. 3824 (S.D.N.Y. 2011).

[2] *See* our previous Client Alerts recording this trend: "First Circuit Requires 'Objective Reasonable Belief' Of Fraudulent Conduct in Order for Terminated Employee to Obtain Sarbanes- Oxley Whistleblower Protection," dated February 25, 2009; and "Seventh Circuit Adopts 'Objective Reasonable Belief' Test in Denying Sarbanes Oxley Whistleblower Protection to Terminated Employee," dated March 31, 2009.

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constitutes a violation of … [Federal statutes relating to mail fraud, wire fraud, bank fraud or securities fraud], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to . . . a person with supervisory authority over the employee . . . .” [emphasis added]

As discussed in previous Client Alerts, this provision, adopted as part of the sweeping SOX legislation adopted in reaction to the corporate accounting scandals that surfaced in 2002, was designed to protect so-called “whistleblowers” at publicly-traded companies “by prohibiting employers from retaliating against employees because they provided information about specified potentially unlawful conduct.” In providing this protection to corporate whistleblowers, Congress sought to combat a perceived “corporate code of silence” that damages investors in publicly-traded companies by both “hamper[ing] investigations” of corporate wrongdoing and “creat[ing] a climate where wrongdoing can occur with virtual impunity.”

Factual Background

Until her employment was terminated in August 2009, Jennifer Sharkey was an apparently productive employee of J.P. Morgan Chase & Co. (“JPMC”). In her capacity as a Vice President and Wealth Manager in JPMC’s Private Wealth Management department, in January 2009 Sharkey was assigned to manage a long-term, large fee-generating client. However, JPMC’s risk management department soon contacted Sharkey to express concern that the client was involved in various illegal activities, including allegations of mail fraud, bank fraud and money laundering. Sharkey promptly conveyed these concerns to her supervisor. After conducting her own research and communicating further with the risk management department, Sharkey concluded that the client indeed was involved in the alleged illegal activities and recommended to her supervisor and others “up the line” that JPMC terminate the relationship. Sharkey’s recommendation apparently was ignored.

When Sharkey refused to back down from her recommendation, JPMC allegedly retaliated “by removing her from several client accounts, excluding her from meetings involving her own clients, refusing to pay her a bonus for 2009 and ultimately terminating her employment with JPMC.” At the time of her firing, Sharkey was informed by a JPMC human resources officer that her termination “has nothing to do with your performance,” but instead was initiated by her supervisor “because she feels she cannot trust you anymore.”

In response, Sharkey filed a complaint with the Occupational Safety and Health Administration (“OSHA”) alleging violations of SOX section 806. After OSHA issued a (presumably unfavorable) preliminary order, Sharkey sought *de novo* review in the Southern District. JPMC countered with a motion to dismiss, arguing that Sharkey failed to state a claim because she had “reported illegal activities in which a JPMC client was engaged, not illegal activities on the part of JPMC,” and thus was not engaged in “‘protected activity’ under SOX.” Moreover, JPMC claimed, even if Sharkey’s activities were protected, her complaint failed to allege specific violation “of any of the statutes or regulations enumerated in the SOX statute.”

The Court’s Analysis

The Court began by explaining that to survive JPMC’s motion to dismiss, Sharkey’s “complaint must contain sufficient factual matter, accepted as true, to ‘state a claim to relief that is plausible on its face.’”

For this purpose, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice."

Further, the Court noted that to successfully state a claim under SOX section 806, Sharkey must make a prima facie showing that (1) "she engaged in a protected activity;" (2) the defendants "knew or suspected that [she] engaged in protected activity;" (3) she "suffered an unfavorable employment action;" and (4) "the protected activity contributed to the unfavorable employment action."

Next, the Court rejected JPMC's argument that Sharkey was not engaged in SOX "protected activity" because she alleged illegal conduct on the part of a JPMC client, not by JPMC. In so ruling, the Court cited the congressional record to demonstrate lawmakers' intention that the statute "sweep broadly." The Court also looked to the text of the statute, which states that employees are protected from retaliation if reporting "any conduct which the employee reasonably believes constitutes a violation of" the laws or regulations enumerated in the statute. In the Court's view, "[t]he statute by its terms does not require that the fraudulent conduct or violation of federal securities law be committed directly by the employer that takes the retaliatory action."

On the other hand, the Court agreed with JPMC that Sharkey's allegations of illegal conduct were not sufficiently specific. While "[a] whistleblower 'need not cite a code section he believes was violated,'" the Court noted that "[f]or the whistleblower to be protected by [SOX], the reported information must have a certain degree of specificity **[**and**]** must state particular concerns which, at the very least, reasonably identify a respondent's conduct that the complainant believes to be illegal." Because Sharkey did not identify with specificity "the allegedly illegal conduct that forms the basis of her whistleblower complaint," the Court found that her complaint "fails to state a SOX claim" and therefore granted JPMC's motion to dismiss. The Court did, however, grant Sharkey leave to replead her complaint.

Conclusion

The *Sharkey* decision reflects an interesting contrast that has developed in the manner in which the federal courts address SOX whistleblower complaints. On the one hand, the Court ruled against Sharkey (while giving her the opportunity to replead) because her complaint did not set forth the allegedly illegal conduct with sufficient specificity to clearly fall within "one of the six enumerated categories of misconduct contained in SOX section 806." At the same time, however, the Court supported a broader reading of SOX section 806 by clarifying that the reporting by a purported whistleblower of illegal third party conduct qualifies as "protected activity," even though the whistleblower's employer itself does not engage in, or even have knowledge of, the allegedly illegal conduct.

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