Court of Appeals for the First Circuit Interprets The Whistleblower Provision of Sarbanes-Oxley

February 13, 2009

In a case of first impression, the Court of Appeals for the First Circuit limited the scope of the whistleblower protection provisions of the Sarbanes-Oxley Act of 2002 (SOX). Under that statute, publicly-traded companies are prohibited from retaliating against employees who complain to a supervisor about violation of (1) specified federal criminal fraud statutes (i.e., mail fraud, wire fraud, bank fraud or securities fraud); (2) a violation of any Securities and Exchange Commission (SEC) rule or regulation; or (3) federal law relating to fraud against shareholders. While the employee need not refer to a particular statute, he must have a reasonable belief that the conduct violates federal law. In *Day v. Staples, Inc.*, the First Circuit held that plaintiff Kevin Day was not protected under SOX because he failed to show that he reasonably believed that his internal complaints to Staples concerned shareholder fraud or a violation of federal securities laws.

Less than two months after being hired by Staples as an entry level analyst in the reverse logistic department, Day began complaining to supervisors about alleged fraud. His department was responsible for analyzing product returns and for coordinating returns from customers who ordered products in bulk. Day raised concerns about three department practices: (1) the issuance of credits to customers who returned products without documentation; (2) the withholding of credits from certain customers; and (3) the canceling and re-issuing of return requests, potentially resulting in overbilling by couriers. Day did not refer to specific violations of any of the securities laws, but rather generally alleged that Staples manipulated accounting data in a manner that negatively impacted shareholders. Over a series of meetings, management investigated Day's concerns and explained to him the business reasons for the practices. However, Day continued to press his complaints. Thereafter, Staples terminated Day's employment because of his inflexibility and poor job performance.

Day filed a complaint with the Occupational Safety and Health Administration (OSHA), alleging that he was fired in violation of SOX. After OSHA dismissed the complaint, Day brought suit in federal court. The district court granted summary judgment to Staples, and Day appealed to the First Circuit.

The issue on appeal was whether Day reasonably believed that the practices which were the subject of his complaints to management constituted a violation of any of the laws covered by SOX. The First Circuit held that he did not, and affirmed the decision of the district court. The Court explained that none of Day's complaints satisfied the elements of a securities fraud claim. Rather than claiming that Staples misrepresented information to shareholders, the gist of Day's complaints was that the practices did not maximize shareholder profits. While Day argued that the practices were contrary to generally accepted accounting principles (GAAP), the Court concluded that a generalized allegation of inaccurate accounting does not establish a reasonable belief of shareholder fraud.

Day makes clear that to be a whistleblower under SOX, the employee's complaints must, at a minimum, set forth facts that would satisfy the elements of a claim under the securities laws. A complaint that an internal practice is inefficient or does not maximize shareholder value is not enough. Notably, an employer's response to an employee's complaint is relevant to the analysis. The First Circuit explained that even if Day's complaints did initially reflect a reasonable concern, his complaints ceased to be reasonable after management explained the business rationales for the practices and assured Day that no fraud was being committed. Thus, the decision encourages employers to investigate and respond to employees' concerns. If the employee persists in his or her complaints, *Day* suggests that the employer's response can be used to demonstrate that the complaints became objectively unreasonable and thus outside of the protections of SOX.

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