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News & Types: Employment, Labor & Benefits Update

Terminated CEO's Complaints to the Board Not Protected "Whistleblowing" As No Requirement Under Federal Law to Report Every "Managerial Hiccup"

2/14/2018

By: Nancy E. Sasamoto

Practices: Employment, Labor & Benefits

EXECUTIVE SUMMARY

The Sarbanes-Oxley Act of 2002 forbids publically traded companies from retaliating against an employee for any lawful act done by the employee… to provide information… regarding any conduct which the employee reasonably believes constitutes a violations of section 1341 [mail fraud], 1343 [wire fraud], 1344 [bank fraud], or 1348 [securities fraud], and 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 government agency or to a person with supervisory authority." In the underlying case, the CEO's complaints about attorney overbilling, intellectual property disputes, and conflicts of interest are not "fraud" within the meaning of the statute.

Neal Verfuerth founded Orion Energy Systems in 1996 and took the company public in 2007. In early 2012, Verfuerth, who was CEO, announced that he was divorcing his wife. Rather than have Verfuerth sell his stock, the Board agreed to reimburse him for the attorneys' fee and costs he incurred due to the divorce proceeding. After several disputes between Verfuerth and Orion's board of directors over a variety of issues, Orion fired Verfuerth in November 2012. Verfuerth sued Orion alleging 14 causes of action including violation of two federal whistle-blower protection statutes. The District Court granted summary judgment for Orion and dismissed the claims brought under the Sarbanes-Oxley Act and the Dodd-Frank Act; the Seventh Circuit Court of Appeals affirmed.

According to Verfuerth, he complained to the Board multiple times between May and August 2012 about various issues including overbilling by outside counsel; a potential patent infringement by one of Orion's products and miscellaneous violations of internal company policy, such as consumption of alcohol at an "informal [board] meeting."

Around late September 2012, the Board began to investigate Verfuerth's divorce-expense reimbursements, which totaled more than $170,000 in attorney's fees. The Board discovered that Verfuerth had paid only about two-thirds of this sum to his divorce lawyer. Verfuerth said that he had withheld the remaining $60,000 from his lawyer because of a fee dispute, but did not return the money to Orion or otherwise to account for it.

On September 27, the Board removed Verfuerth as CEO and reassigned him to an advisory position. Verfuerth responded by informing the Board of his intent to resign. After the parties were unable to agree upon a severance package, the chairman of Orion's board notified all members (including Verfuerth) of a special meeting to consider terminating Verfuerth's employment for incurable cause. Less than an hour before this meeting, Verfuerth sent an email to the board in which he reiterated his many complaints about the board's managerial decisions and alleged that his impending termination was the result of a conspiracy against him. At the November 8 board meeting, the directors unanimously voted to dismiss Verfuerth for cause.

The Sarbanes-Oxley Act protects employees of public companies who reveal evidence of certain types of fraud, such as securities fraud or wire fraud. In rejecting Verfuerth's claims, the Court found that the practices about which he complained—attorney overbilling, intellectual property disputes, conflicts of interest, and violations of internal company protocol—are not "fraud" within the meaning of the statute. Moreover, a person does not become a whistleblower just by advising his colleagues about their own disclosure obligations and then doing nothing when they fail to follow his advice. The Court pointed out that Verfuerth never made a report to the Securities and Exchange Commission ("SEC") or any outside agency, and, in fact, as Orion's CEO, he signed SEC reports without mentioning any of these issues and certifying that he was not aware of any material undisclosed fact that could affect the value of Orion's stock.

Likewise, Verfuerth was not entitled to protection under the Dodd-Frank Act, which also protects a whistleblower, "who provides… information relating to a violation of the securities laws" to the SEC. Accordingly, the Court held that Verfuerth cannot use Dodd-Frank to salvage what is otherwise a meritless case.

Action Steps: Although the CEO's complaints were not considered fraud under the whistleblower statutes, many clients have implemented Corporate Codes of Conduct and "whistleblower" reporting options and hotlines to ensure early detection of potentially improper conduct.