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Issue Date: 09 June 2006

Case No.: **2006-SOX-0019**

In the Matter of:

JACQUE JOHNSON,
Claimant,
v.
MECHANICS AND FARMERS BANK,
Respondent.

Before: **RICHARD K. MALAMPHY**
Administrative Law Judge

RECOMMENDED DECISION AND ORDER GRANTING RESPONDENT'S MOTION FOR SUMMARY DECISION

Complainant, Jacque Johnson, filed a complaint with the Occupational Safety and Health Administration (OSHA) of the United States Department of Labor on July 20, 2005 alleging that Respondent terminated his employment in violation of Section 806 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. §1514A (2003) (hereinafter "the Act" or "SOX").

The Act provides protection from discrimination or retaliation to whistleblower employees of publicly traded companies when those employees provide information to their employer, a federal agency, or a member of Congress regarding what the employee reasonably believes are violations of U.S. Security and Exchange Commission rules and regulations and other laws relating to preventing fraud against shareholders. *Id.*

The Act allows the Complainant Employee to file a complaint with the Secretary of the Department of Labor, and furthermore allows removal for *de novo* review in the appropriate United States District Court if the Secretary has not issued a decision within 180 days after the complaint is filed provided "there is no showing that such delay is due to the bad faith of the claimant . . . ." 18 U.S.C. §1514A(b)(1)(B).

All actions brought under Section 806 of the Sarbanes-Oxley Act are governed by 29 C.F.R. § 1980 (2005). According to 29 C.F.R. §1980.107, "proceedings will be conducted in accordance with the rules of practice and procedure for administrative hearings before the Office of Administrative Law Judges," 29 C.F.R. § 18.1 *et seq.*
Id.

Factual History

Respondent Mechanics and Farmers Bank is a state-chartered commercial bank, which is wholly-owned by a publicly traded holding company, M&F Bankcorp, Inc. The OSHA investigation revealed that the Respondent and M&F Bankcorp share common Officers and Directors.

Complainant worked for Mechanics and Farmers Bank as a Senior Vice President and City Executive for Respondent's Charlotte operations from March 15, 1998 through May 23, 2005. Complainant had a somewhat contentious relationship with his employer from September 2004 and continuing, as detailed in Respondent's Brief in Support of its Motion to Dismiss.

On April 20, 2005 and April 29, 2005, Complainant expressed his concerns with questionable loan applications to the bank's Audit and Risk Manager, Anthony Powell. Complainant reported that Kevin Price, a fellow bank officer and a local business developer, had been involved in three questionable loan applications. Complainant believed Mr. Price had a conflict of interest. In the course of the OSHA investigation, Mr. Powell confirmed that he recommended Mr. Price either divest himself from doing business with the companies performing work on a project related to one of the loan applications or resign from his position at the bank. Mr. Powell did not, however, believe Complainant's concerns rose to the level of fraud. While Respondent addresses several potentially problematic banking transactions in its brief, Complainant focuses on his allegation of bank fraud in a loan application completed by Kosmos, LLC.[1]

Complainant explained that he did not believe at the time of his complaint to Mr. Powell regarding Kosmos, LLC that the bank had done anything illegal; rather: "I perceiv[ed] that there was a need for investigation to see if there was anything illegal because of the cloudiness of the loan . . . . So, at that particular point I didn't know if there was any fraudulent activity by an employee of the bank, but I suspected there could be." Deposition Tr., 160-61. The Bank did investigate the loan application and found that Kosmos, LLC had submitted fraudulent documents in support of its application. The Bank did not make the loan and another bank involved in the transaction filed a suspicious activity report with the Treasury Department. Respondent's Brief at 12.

The OSHA investigator also found that two of Complainant's subordinates, Lori Corpening and Leslie Cato, argued and engaged in a physical confrontation while at work. Respondent's Chief Executive Officer, Lee Johnson, sent an investigator to the Charlotte office to determine the cause of that disruption. The investigator determined that Cato was the aggressor and recommended she be terminated and criticized Complainant's handling of the matter. On May 3, 2005, the Bank's Senior Vice President, Wesley Christopher, sent Complainant an e-mail telling him to terminate Cato effective May 6, 2005 and to transfer Corpening to another area. Complainant did not do so, and, on May 6, 2005, demanded to review the investigator's report of the employee confrontation. On May 9, 2005, Complainant sent Christopher another email calling the investigation "scandalous" and referring to the

[1] As Respondent noted in its brief, the parties have referred to this entity as Kozmo, Kosmos, and Kozmos. I will be using Kosmos to refer to this entity hereinafter.

investigator as "a hired gun." Christopher repeated his instructions to Complainant regarding terminating Cato's employment and transferring Corpening. Complainant continued to refuse to do so and continued to write e-mails critical of the investigation on May 13 and May 16, 2005. On May 23, 2005, Christopher terminated Complainant's employment, citing insubordination and "continuing performance issues."

Procedural History

The Complainant filed his Sarbanes-Oxley complaint on July 20, 2006. OSHA completed its investigation and dismissed the claim after finding Complainant was terminated for reasons other than his involvement in any possible protected activity on October 4, 2005. Complainant filed this appeal on October 31, 2005.

Respondent filed two Motions to Dismiss, arguing first, that Mechanics and Farmers Bank is not an entity covered under the Act and second, that Complainant failed to state a claim upon which relief can be granted. Respondent also filed a Motion for Summary Judgment, contending that it is entitled to judgment as a matter of law.

DISCUSSION

First Motion to Dismiss

While the Rules of Practice and Procedure before Administrative Law Judges do not specifically address motions to dismiss, 29 C.F.R. § 18.1(a) provides that "the Rules of Civil Procedure for the District Courts of the United States shall be applied in any situation not provided for or controlled by these rules . . . ." *Id.* Thus, the Respondent's Motions will be analyzed under Fed. R. Civ. P. 12(b).

1. Coverage

Respondent argues that this case must be dismissed since it is not a publicly-traded entity and thus is not covered under the Act. Respondent is, however, the wholly-owned subsidiary of a publicly-traded company, M&F Bankcorp, Inc. Since I find, based on the following discussion, that this area of the law is unsettled, I deny Respondent's First Motion to Dismiss.

The question of Sarbanes-Oxley coverage for wholly owned subsidiaries of publicly traded companies has proven difficult. No United States District or Circuit Court has directly addressed this issue nor has the Administrative Review Board. On the Administrative Law Judge level, there is a difference of opinion among my colleagues. While the Decision and Order of another Administrative Law Judge is not precedent, I may be persuaded or aided by it.

Some cases have taken a narrow view of the Act, limiting coverage to only publicly traded companies and their immediate employees. Thus, if a complainant were not directly employed and later retaliated against by the parent corporation, these cases hold that there is no SOX whistleblower cause of action. *See*, *e.g.*, *Bothwell v. American Income Life*, 2005 SOX 00057 (ALJ Sept.19, 2005) (granting respondent's motion for summary judgment when

complainant was employed by a subsidiary of a non-publicly traded company and reasoning that allowing subsidiaries to be covered under the Act would "widen the scope of the Act beyond the intentions of Congress." *Id.* at 6); *Powers v. Pinnacle Airlines, Inc.*, 2003 AIR 12 (ALJ Mar. 5, 2003) (dismissing SOX claim and holding, the employee of a subsidiary cannot invoke the Act merely because the parent company is publicly traded; and explaining that to do so "ignores the general principle of corporate law that a parent corporation is not liable for the acts of its subsidiaries. . . . Nor has the Complainant even alleged any facts that would justify piercing the corporate veil and ignoring the separate corporate entities." *Id.* at 4; *but see Morefield v. Exelon Services, Inc.*, 2004 SOX 2 (ALJ Jan. 28, 2004) at 4.)

Other Administrative Law Judges have, however, applied the Act more broadly, allowing parent companies to be held responsible for the acts of their subsidiaries under certain circumstances. *See*, *e.g., O'Keefe v. TIAA-CREF*, 2005-SOX-0086 (ALJ Oct. 19, 2005) *slip op.*(denying Respondent's Motion to Dismiss and Motion for Summary Decision since a question of fact existed as to whether "the high degree of intermingling between TIAA and its subsidiaries, between TIAA and CREF and the presentation of TIAA-CREF as one company to its customers, employees and the public" should result in TIAA-CREF's treatment as one publicly traded entity under the Act. *Id.*, *slip op*. at 10); *Mann v. United Space Alliance, LLC et al.*, 2004 SOX 15 (ALJ Feb. 18, 2005) (holding parent companies liable under the act where there was evidence of shared management and control of operations. *Id.* at 9.); *Morefield v. Exelon Services, Inc.*, 2004 SOX 2 (ALJ Jan. 28, 2004) (holding, "[T]he term 'employee of publicly traded company,' within the meaning of Sarbanes-Oxley, includes all employees of every constituent part of the publicly traded company" including employees of wholly owned subsidiaries. *Id.* at 4);

Based on the record before me and construing the facts in the light most favorable to the Complainant and making all reasonable favorable inferences therefrom, I cannot dismiss this case based on the coverage issue. Whether the Respondent in this case is outside the bounds of the Sarbanes-Oxley Act is an unsettled question; therefore, dismissal is inappropriate.

By denying the Respondent's First Motion to Dismiss, I explicitly do not find that Mechanics and Farmers Bank is subject to the Sarbanes-Oxley Act. Rather, I find that that issue must be litigated on its merits.

2. Failure To State A Claim / Motion for Summary Judgment

A motion to dismiss for failure to state a claim for relief only tests the legal sufficiency of a claim; it does not involve a discussion of the facts or merits of the case at hand. *Rutman Wine Co. v. E. & J. Gallo Winery*, 829 F.2d 729 (1987); *see also* Fed. R. Civ. P. 12(b)(6). In analyzing such a motion, the court is limited to the content of the complaint, and tests whether Complainant has made "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). It is well-settled that the motion to dismiss for failure to state a claim is viewed with disfavor and is rarely granted. *Kaiser Aluminum & Chem. Sales, Inc. v. Avondale Shipyards, Inc.*, 677 F.2d 1045 (5th Cir. 1950).

In this case, the record includes not only the original complaint, but also the OSHA investigative report and preliminary order, as well as briefs from the parties on the issues herein. I believe, given the short tenure of the Act and the relative novelty of the issues involved in this case, the full record should be considered in this instance. Thus, according to Rule 12(b)(6), this motion will be "treated as one for summary judgment" since "matters outside the pleadings are presented. . . ." *Id.*

The regulations at 29 C.F.R. § 18.40 and Federal Rule 56 set forth the standard to be used in deciding a Motion for Summary Judgment: "A Motion for Summary Judgment will be granted when there is no genuine issue as to any material fact and [when the record indicates] that a party is entitled to summary decision." 29 C.F.R. §18.40(d); *see also* Fed. R. Civ. P. 56. The evidence is to be construed in favor of the nonmoving party, and the nonmoving party is to be given the benefit of all favorable inferences that can be drawn from the evidence. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). The party moving for summary judgment has the burden of establishing the "absence of evidence to support the nonmoving party's case." *Celotex Corp. v. Zenith Radio*, 475 U.S. 574, 587 (1986).

Here, I find Complainant failed to state a *prima facie* case of retaliatory discharge, and grant Respondent's Motion to Dismiss for failure to state a claim upon which relief may be granted. Since I so find, it is not necessary to consider Respondent's Motion for Summary Judgment as well.

It is evident on both the face of the statute and in decisions made by my fellow Administrative Law Judges that complainants seeking whistleblower protection under the Act must have a reasonable belief that the employer in question has been involved in fraudulent activity. *Grant v. Dominion East Ohio Gas*, 2004 SOX 00063 (ALJ Mar. 10, 2005) at 36 (holding, complainant must believe his employer violated applicable laws); *Tuttle v. Johnson Controls*, 2004 SOX 00076 (ALJ Jan. 3, 2005) at 3 (stating, protected activity exists when complainant reports an employer's violative conduct.). Moreover, the reasonableness of Complainant's belief must be evaluated both subjectively and objectively. *Id.*

Here, Complainant's cause must fail because Complainant did not have a reasonable belief that Respondent bank was involved in fraudulent activity. Rather, Complainant reported his suspicion that loan applications which the Bank subsequently investigated and did not fund might have been fraudulent. Complainant does not dispute that the Bank investigated and denied the applications due to the loan applicant's fraudulent behavior. Two other loan applications that were questioned by the Complainant were not funded by the Respondent.

Thus, even assuming the validity of Complainant's factual assertions, there is no cause of action herein under the Sarbanes-Oxley Act.

ORDER

Based on the foregoing discussion, Respondent's First Motion to Dismiss is DENIED. Respondent's Second Motion to Dismiss is GRANTED. Complainant's complaint is DISMISSED with prejudice.

A

RICHARD K. MALAMPHY
Administrative Law Judge

RKM/vlj
Newport News, Virginia

NOTICE OF APPEAL RIGHTS: To appeal, you must file a Petition for Review ("Petition") with the Administrative Review Board ("Board") within ten (10) business days of the date of the administrative law judge's decision. *See* 29 C.F.R. § 1980.110(a). The Board's address is: Administrative Review Board, U.S. Department of Labor, Room S-4309, 200 Constitution Avenue, NW, Washington, DC 20210. Your Petition is considered filed on the date of its postmark, facsimile transmittal, or e-mail communication; but if you file it in person, by hand-delivery or other means, it is filed when the Board receives it. *See* 29 C.F.R. § 1980.110(c). Your Petition must specifically identify the findings, conclusions or orders to which you object. Generally, you waive any objections you do not raise specifically. *See* 29 C.F.R. § 1980.110(a).

At the time you file the Petition with the Board, you must serve it on all parties as well as the Chief Administrative Law Judge, U.S. Department of Labor, Office of Administrative Law Judges, 800 K Street, NW, Suite 400-North, Washington, DC 20001-8002. The Petition must also be served on the Assistant Secretary, Occupational Safety and Health Administration and the Associate Solicitor, Division of Fair Labor Standards, U.S. Department of Labor, Washington, DC 20210.

If no Petition is timely filed, the administrative law judge's decision becomes the final order of the Secretary of Labor pursuant to 29 C.F.R. § 1980.109(c). Even if you do file a Petition, the administrative law judge's decision becomes the final order of the Secretary of Labor unless the Board issues an order within thirty (30) days after the Petition is filed notifying the parties that it has accepted the case for review. *See* 29 C.F.R. §§ 1980.109(c) and 1980.110(a) and (b).