ALERT MEMORANDUM

Third Circuit Holds That Employee Policies That Disregard Codes of Professional Conduct Can Violate the New Jersey Whistleblower Statute

July 28, 2017

On July 25, 2017, in a 2-1 decision, the Third Circuit Court of Appeals held in *Trzaska v. L'Oréal USA, Inc.*,[1] that the termination of an employee for refusing to follow a corporate policy that disregards obligatory professional standards can serve as the basis for a claim under New Jersey's whistleblower statute, the Conscientious Employee Protection Act ("CEPA").[2] This broad reading of the statute has implications for New Jersey employers in particular, but the court's analysis could be applied to cover employers elsewhere through similar state and federal statutes.

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[1] No. 15-3810, 2017 WL 3138371, at *6 (3d Cir. July 25, 2017).
[2] N.J. Stat. Ann. § 34:19-1.

Background

CEPA prohibits New Jersey companies from taking retaliatory actions against employees who object to or refuse to participate in any activity "which the employee reasonably believes: (1) is in violation of a law, or a rule or regulation promulgated pursuant to law . . . ; (2) is fraudulent or criminal . . . ; or (3) is incompatible with a clear mandate of public policy . . . ."[3]

CEPA is not unique. Other states have similar whistleblower statutes,[4] and there are also federal statutes establishing whistleblower protections for employees of publicly-traded companies in the Sarbanes-Oxley Act of 2002[5] and the Dodd-Frank Act of 2010.[6]

Trzaska v. L'Oréal USA, Inc.

Factual Background

Steven Trzaska was an in-house patent attorney and the head of a L'Oréal USA regional patent team in New Jersey from 2004 until his termination from the company in late 2014.[7] Mr. Trzaska's team was responsible for vetting proposals for new patents from L'Oréal inventors, and submitting applications for patents to the United States Patent and Trademark Office ("USPTO").[8]

As patent attorneys, Trzaska and his team members were obligated to follow both the rules of professional conduct governing attorneys in the states in which they were admitted to practice law—for Trzaska, Pennsylvania—and the professional rules of the USPTO. These rules (collectively, the "RPCs"), prohibited Trzaska and his team from "filing frivolous or bad-faith patent applications or from knowingly making false statements before a tribunal."[9]

L'Oréal had a policy requiring each regional patent team to meet a quota of filed patent applications for each year. In 2014, L'Oréal implemented a new quality-control program that resulted in fewer patent proposals being submitted to Trzaska's team for review before filing.[10] Nonetheless, according to Trzaska, his team was told that if it did not meet its required annual quota of 40 patent applications, "there would be consequences which would negatively impact their careers and/or continued employment."[11] As a result, Trzaska was concerned that his team would not receive enough viable patent proposals to meet its patent filing quota for 2014, and thus would be pressured to file applications for proposals that the team did not in good-faith believe were patentable.[12]

Trzaska explained this concern to his supervisors. When asked, he stated that he was not aware of any bad-faith application. He also stated that if he came across such an application he would refuse to submit it even if it prevented his team from meeting the quota.[13] Shortly after this discussion, Trzaska was offered the choice of two severance packages by L'Oréal, and, after refusing to accept either package, was ultimately fired, with L'Oréal stating that Trzaska's position was no longer needed.[14]

Trzaska brought suit in the United States District Court for the District of New Jersey alleging wrongful retaliatory termination in violation of CEPA.

The District Court Opinion

The district court dismissed Trzaska's suit for failure to state a claim upon which relief could be granted.[15] To survive a motion to dismiss under CEPA, a plaintiff is required, among other things, to sufficiently allege that "[he or] she had an objectively reasonable belief

[3] N.J. Stat. Ann. § 34:19-3.
[4] *See, e.g.*, Fla. Stat. Ann. § 448.102; Cal. Lab. Code § 1102.5; N.Y. Lab. Law § 740.
[5] 18 U.S.C. § 1514A(a)(1)(C).
[6] 15 U.S.C. § 78u-6(h)(1).
[7] *Trzaska*, 2017 WL 3138371, at *7.
[8] *Id.* at *1.
[9] *Id.* (citing RPCs).
[10] *Id.* at *2.
[11] *Id.* at *1.
[12] *Id.* at *2.
[13] *Id.*
[14] *Id.*
[15] *Trzaska v. L'Oréal USA, Inc.*, No. 215CV02713SDWSCM, 2015 WL 6687661, at *5 (D. N.J. Oct. 30, 2015).

that [his or] her employer's conduct violated a law, rule, regulation or public policy."[16]

The district court found that Trzaska failed to satisfy this element of CEPA for two reasons.

First, Trzaska failed to plead that L'Oréal's conduct violated any "law, rule, regulation or public policy" because L'Oréal was not bound by the RPCs, and the quota policy was a "business decision[] outside the RPCs' purview."[17]

Second, the court found that even if the RPCs were an adequate foundation for Trzaska's CEPA claims, Trzaska did not have an "objectively reasonable belief" of a violation based on his general concern that the quota policy might in the future cause a violation of the RPCs.[18] The district court concluded that "pressure from management to meet a quota is not equivalent to instructions to violate rules of attorney conduct, or other laws or regulations."[19]

The Third Circuit Decision

Stating that Trzaska's allegations were "more than skin-deep," the Third Circuit reversed the district court and remanded the case for further proceedings.[20]

The court explained that courts "construe [CEPA] flexibly," and concluded that Trzaska sufficiently alleged a violation of public policy: "an allegation that an employer instructed, coerced, or threatened its patent attorney employee to disregard the RPCs binding him violates a clear mandate of public policy within the meaning of CEPA."[21] The court reasoned that the public has a strong interest in maintaining a properly functioning patent system, and that New Jersey public policy supports an employee's right to refuse to violate the RPCs regulating that employee's profession.[22]

The Third Circuit disagreed with the district court's assessment that Trzaska was required to allege that L'Oréal violated a law or policy or that L'Oréal instructed him to commit a violation in order to state a claim under CEPA.[23] Instead, Trzaska's allegations that he and his colleagues were "implicitly instructed to disregard the RPCs in order to meet the [L'Oréal] quota and that his supervisors expressly rejected this concern" and "threatened to terminate his employment if he did not meet the quota" sufficiently stated a claim under CEPA at the pleading stage.[24]

Broadened Whistleblower Actions

The Third Circuit's decision is significant because it permitted a whistleblower action to advance in litigation based on a corporate policy that is in tension with—but does not on its face contradict—public policy mandates within the meaning of CEPA. The court's decision is also noteworthy because it did not require the plaintiff to allege that the company itself violated the law, or instructed an employee to disregard a law or regulation.

The *Trzaska* decision follows a steep increase, since Dodd-Frank, in whistleblower claims at state and federal government agencies—some leading to substantial awards—premised on both federal and state law. For example, the U.S. Securities and Exchange Commission recently awarded $61 million to two whistleblowers at JPMorgan Chase & Co. in connection with allegedly illegal sales practices at the bank.[25] And in *Wadler v. Bio-Rad Laboratories, Inc.*, a recent private action alleging retaliation in violation

[16] *Id.* at *3 (alteration in original) (quoting *Campbell v. County of Monmouth*, No. 11–cv–6210, 2015 WL 5722631, at *2 (D.N.J. Sept. 29, 2015)).
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Trzaska*, 2017 WL 3138371, at *6.
[21] *Id.* at *3.
[22] *Id.* at *4.
[23] *Id.* at *5.
[24] *Id.* Judge Chagares wrote a partially dissenting opinion agreeing that RPCs can support a claim under CEPA, but disagreeing that Trzaska had sufficiently alleged a reasonable belief of an RPC violation. *Id.* at *8.
[25] *See* Neil Weinberg, *JPMorgan Whistle-Blowers Set to Reap Record $61 Million Bounty*, Bloomberg (July 20, 2017 4:22 PM), https://www.bloomberg.com/news/articles/2017-07-20/jpmorgan-whistle-blowers-seen-reaping-record-61-million-bounty.

of federal and state law, a federal jury in the Northern District of California awarded substantial damages to a company's former general counsel for allegedly blowing the whistle on the company's failure to take seriously potential FCPA violations.[26]

Prior to the jury verdict in *Wadler*, the district court had issued a series of rulings that broadly applied a number of different state and federal whistleblower statutes at issue in the litigation. Most significant, the court held as a matter of first impression that corporate directors of public companies can be held individually liable for retaliating against a whistleblower, and that whistleblowers could rely on privileged communications in retaliation actions. These decisions likely assisted the plaintiff at trial, and the case culminated in a federal jury verdict awarding nearly $11 million in damages.[27] The plaintiff also received an additional $3.5 million in attorneys' fees and costs.[28]

Key Takeaways

- ***Potential Trend of Plaintiff-Friendly Federal Court Decisions.*** *Trzaska* provides another important data point that retaliation claims are finding legal footing in federal court actions. As the nearly $15 million award in *Wadler* demonstrated, these cases carry the potential for large damages awards against defendants.
- ***Whistleblower Policies.*** To help guard against potential whistleblower actions, companies should ensure that they have robust procedures to facilitate and evaluate internal complaints of potential misconduct. Companies should maintain protocols to report allegations of misconduct up to senior management and in-house counsel, as well as to ensure the thorough investigation of such allegations and documentation of the response. Even the strongest policies must be supplemented with training to minimize corporate risk by educating employees and executives about the various ways in which state and federal laws and policies could be implicated by their conduct. Most importantly, company policy should prohibit retaliation against whistleblowing employees, regardless of the merits of the whistleblowers' allegations, and companies should conduct specific training in this area as well.
- ***Attorney Whistleblowers.*** Both *Trzaska* and *Wadler* concerned suits brought by former in-house attorneys. Companies should be sensitive to the additional obligations that the RPCs may impose on such employees, as well as the increased protections for whistleblowers, including both attorneys and non-attorneys, under federal law.[29]
- ***General Company Policies.*** *Trzaska* shows that a company need not explicitly encourage violations of law to be liable under a whistleblower statute. Companies should carefully review all policies for potential inconsistency with any laws, rules, regulations, or public policies. [30]

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[26] Final Verdict Form, *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS) (N.D. Cal. Feb. 6, 2017), ECF No. 223.
[27] *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS), 2016 WL 7369246 (N.D. Cal. Dec. 20, 2016).
[28] Stipulation Regarding Attorneys' Fees and Costs, *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS) (N.D. Cal. Feb. 23, 2017), ECF No. 234.

[29] For example, whistleblowers, such as in-house counsel, who provide information "through a communication that was subject to the attorney-client privilege" are generally not entitled to receive a whistleblower award. *See* 17 C.F.R. § 240.21F–4(b)(4)(i) (2011). Nonetheless, such whistleblowers who provide such privileged information are still protected by the anti-relation provisions provided for by the Dodd-Frank Act. *See* 17 C.F.R. § 240.21F–2 (2011).
[30] For more information on the *Wadler* case as well as key takeaways in the whistleblower context, please see the Cleary Gottlieb Alert Memorandum entitled *Jury Awards Ousted General Counsel Nearly $11 Million in Whistleblower Retaliation Action – Key Takeaways*, published February 21, 2017.