ALERT MEMORANDUM

Jury Awards Ousted General Counsel Nearly $11 Million in Whistleblower Retaliation Action – Key Takeaways

February 21, 2017

Earlier this month, following three hours of deliberation, a federal jury in San Francisco, California found that Bio-Rad Laboratories, Inc. had violated the federal whistleblower provisions by unlawfully firing Sanford Wadler, its former general counsel, and awarded Wadler nearly $11 million in damages. Wadler had sued his former company under the Sarbanes-Oxley Act of 2002, the Dodd-Frank Act and California state law, asserting that he was wrongfully terminated in retaliation for investigating and reporting to senior management potential violations of the Foreign Corrupt Practices Act ("FCPA") in China. The pre-trial proceedings and three-week trial involved several whistleblower-friendly rulings that promise to generate additional litigation. Those legal determinations, as well as the jury's prompt finding of liability and imposition of a substantial award in the face of an aggressive corporate defense, could have implications for public companies – not the least of which is the precedent of a general counsel in the role of whistleblower.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or any of our partners and counsel listed under White Collar Defense and Investigations in the "Our Practice" section of our website.

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

Background

The Sarbanes-Oxley Act of 2002 prohibits publicly-traded companies and their officers, employees or agents from retaliating against whistleblowers who report potential violations of securities and anti-fraud provisions to regulatory or law enforcement agencies or supervisory authorities.[1] The Dodd-Frank Act passed by Congress in 2010 expands the whistleblower protections of Sarbanes-Oxley and introduces significant whistleblower incentives.[2]

The federal courts have considered a number of whistleblower-related lawsuits in recent years disputing the intended breadth of these statutes, with particular focus on who they protect, what kinds of conduct they prohibit and how they intersect with other legal rights or restrictions. The Court in *Wadler v. Bio-Rad Laboratories, Inc.* grappled with all of these important questions in dispositive and evidentiary motions and during trial, with a distinct bent in favor of broad whistleblower protections.

Wadler v. Bio-Rad Laboratories, Inc.

Factual Background

According to Wadler's complaint filed in the Northern District of California (the "Complaint"), Wadler served as Bio-Rad's general counsel and secretary for nearly 25 years.[3] Following Bio-Rad's discovery of potential FCPA violations in Russia, Thailand and Vietnam in 2009,[4] Bio-Rad hired an outside law firm to investigate whether the company or its agents had also been involved in corruption in China.[5] The internal investigation concluded in 2011 and found no evidence of corruption in China. Wadler had concerns with this determination, however, and independently pursued his suspicions of bribery and books-and-records violations. He ultimately reported his concerns to Bio-Rad's audit committee in February 2013, who again hired the same outside law firm to investigate Wadler's allegations, and concluded there was no evidence of FCPA violations in China.[6] Several months later, Bio-Rad's board of directors terminated Wadler.[7] Soon after, Bio-Rad self-reported conduct related to its China FCPA investigation to the SEC and DOJ, disclosing the concerns raised internally by Wadler as well as the investigative finding of no wrongdoing. Bio-Rad ultimately entered into a cease-and-desist order with the SEC in November 2014 as to the Russian, Thai and Vietnamese misconduct only, agreeing to pay over $40 million in disgorgement and prejudgment interest, and a settlement with the DOJ as to the Russian misconduct, agreeing to pay over $14 million in fines.

In November 2013, Wadler filed a complaint with the Department of Labor ("DOL") in accordance with the requirements of Sarbanes-Oxley. He subsequently filed suit in the Northern District of California in May 2015, availing himself of Sarbanes-Oxley's "kick-out" provisions. The Complaint alleged retaliation under Sarbanes-Oxley and Dodd-Frank as well as California state law wrongful termination in violation of public policy. Wadler named Bio-Rad and its individual directors as defendants in his Complaint.

In the DOL and federal court complaints, Wadler alleged that he was fired due to his efforts to investigate the potential FCPA violations in China and his "up the ladder" report to the audit committee.[8] He noted that six months before his termination, he had received a positive performance review and was promoted to executive vice president with a raise in salary.[9] Bio-Rad asserted in its DOL response that Wadler was terminated for general incompetence and deteriorating behavior, including acting abusively toward his colleagues, causing Bio-Rad to make

[1] 18 U.S.C. § 1514A(a)(1)(C).
[2] 15 U.S.C. § 78u-6(h)(1).
[3] Complaint ¶ 2, *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS) (N.D. Cal. May 27, 2015), ECF No. 1.
[4] *Id.* ¶ 14.
[5] *Id.* ¶¶ 16, 17.
[6] *Id.* ¶¶ 17, 18, 21, 29, 30, 32.
[7] *Id.* ¶ 35; *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS), 2016 WL 7369246, at *1 (N.D. Cal. Dec. 20, 2016).
[8] Complaint ¶¶ 1, 29, 35; Letter from Sanford Wadler to Whistleblower Investigation Program, Dep't of Labor OSHA Region 4-5, *Wadler v. Bio-Rad Labs., Inc.*, No. 9-3290-14-022 (Dep't of Labor Nov. 18, 2013).
[9] Complaint ¶ 37.

untimely SEC regulatory filings and deviating from management's terms in negotiating a large settlement.[10]

Motion to Dismiss

Protection for Internal Whistleblowers. While Sarbanes-Oxley expressly protects internal whistleblowers who report "up the ladder" to a supervisory authority, Dodd-Frank on its face only protects whistleblowers who provide information "to the Commission."[11] Courts are divided on the interpretation of this provision: the Fifth Circuit has held that the language unambiguously limits the statute to reports made to the SEC,[12] while the Second Circuit[13] and numerous district courts have concluded that Dodd-Frank's anti-retaliation provisions extend to internal reports of potential wrongdoing.[14]

In an October 2015 order granting in part and denying in part Bio-Rad's motion to dismiss, the Court accepted the latter interpretation. The Court acknowledged the ambiguity in the interplay between the Dodd-Frank definition of "whistleblower" and another provision in the statute which protects "disclosures that are required or protected under . . . Sarbanes-Oxley."[15] However, the Court reasoned that Dodd-Frank's reference to Sarbanes-Oxley would be ineffective if whistleblowers were only protected for direct reports to the SEC, and deferred to the SEC's interpretation that Dodd-Frank also protects internal whistleblowers.[16]

Individual Director Liability. In the same October 2015 order, the Court also broadened the scope of potential liability for defendants under Sarbanes-Oxley and Dodd-Frank. In a matter of first impression, the Court found that corporate directors of public companies can be held individually liable for retaliating against a whistleblower.[17]

With respect to Sarbanes-Oxley, the Court held that the Act's application to an "*agent* of such company," while ambiguous, should be read to include a non-officer, non-employee corporate director.[18] The Court noted that there is "scant case law" addressing the question and conceded that it was a "close call," but ultimately concluded that the context and broad purpose of Sarbanes-Oxley support an expanded view of liability.[19] As a practical matter, the Court found that Wadler's claim against the individual board members was untimely on notice grounds and dismissed the claim as to those defendants, with the exception of the CEO whom the Court deemed to have had sufficient notice of the DOL complaint.

Dodd-Frank, by contrast, merely proscribes an "employer" from retaliating against a whistleblower.[20] Nevertheless, the Court, after surveying use of the term "employer" in other statutes, found that its meaning was also ambiguous.[21] Turning again to legislative intent, the Court determined that Congress intended Dodd-Frank to be at least as extensive as Sarbanes-Oxley in protecting whistleblowers, and held that directors may also be individually liable under Dodd-Frank.[22] However, in a pre-trial stipulation, the parties agreed to dismiss all claims against the individual defendants except Bio-Rad's CEO.[23]

Motion to Exclude

Attorney-Client Privilege. In a significant pre-trial evidentiary ruling issued in December 2016, the Court

[10] *See Wadler*, 2016 WL 7369246, at *1, *2, *6, *8, *17, *18 (citing DOL response).
[11] 15 U.S.C. § 78u-6(a)(6).
[12] *See Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620, 621 (5th Cir. 2013).
[13] *See Berman v. Neo@Ogilvy LLC*, 801 F.3d 145, 146 (2d Cir. 2015).
[14] *See Wadler v. Bio-Rad Labs., Inc.*, 141 F. Supp. 3d 1005, 1024 (N.D. Cal. 2015), *motion to certify appeal denied*, No. 15-cv-2356 (JCS), 2015 WL 8753292 (N.D. Cal. Dec. 15, 2015).
[15] *See* 15 U.S.C. § 78u-6(h)(1)(A)(iii); *Wadler*, 141 F. Supp. 3d at 1024-25.
[16] *Wadler*, 141 F. Supp. 3d at 1024-27.
[17] *Id.* at 1019, 1024.
[18] 18 U.S.C. § 1514A(a) (emphasis added).
[19] *Wadler*, 141 F. Supp. 3d at 1015-16.
[20] *Id.* at 1022.
[21] *Id.* at 1022-23.
[22] *Id.* at 1024.
[23] Order Granting Stipulation Regarding Dismissals Pursuant To Fed. R. Civ. P. 41(a)(1)(A)(ii), *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS) (N.D. Cal. Dec. 28, 2016), ECF No. 142.

permitted Wadler to use attorney-client privileged information and documents as evidence at trial. On the eve of trial, Bio-Rad had moved to exclude nearly all of the evidence and testimony on which Wadler might rely, arguing that such information was learned in the course of his service as Bio-Rad's general counsel.[24] Bio-Rad further asserted that under California's stringent ethical and statutory rules, Wadler's claims and defenses would be "inextricabl[y] intertwined" with Bio-Rad's privileged and confidential information, and Wadler should therefore "accept that his case [could not] fairly proceed" unless he made an offer of proof showing that he could otherwise prove his claims without relying on such confidential material.[25]

In light of the broad relief sought by Bio-Rad, the Court deemed the motion to be a dispositive motion filed without leave after the deadline had passed, and denied the motion on that ground.[26] The Court nonetheless proceeded in dicta to reject Bio-Rad's substantive arguments and expressly permitted Wadler's use of a large number of privileged documents and communications at trial.

Applying federal law, the Court determined that the limited circuit court jurisprudence afforded significant latitude for whistleblowers to use privileged communications in retaliation actions.[27] As such, the Court concluded that Wadler may rely on privileged and confidential communications at trial that he "reasonably believes are necessary to prove his claims and defenses," [28] but emphasized that the Court should be "vigilant in ensuring that such evidence is admitted only when plaintiff's belief . . . is *reasonable*."[29]

The Court separately determined that Bio-Rad had waived its claim of privilege over a number of documents and communications due to its "open and aggressive approach" in litigating the case (including filing privileged communications in attachments to its motions on the public docket) and its disclosures in proceedings before the DOJ, SEC and DOL (including a PowerPoint presentation delivered by outside counsel for Bio-Rad to the DOJ and SEC addressing Wadler's concerns about the potential FCPA violations in China, as well as documents submitted to the DOL relating to Wadler's alleged misconduct and incompetence).[30]

Lastly, relying in part on an amicus brief submitted by the SEC, the Court concluded that the Standards of Professional Conduct for Attorneys, Part 205, enacted by the SEC pursuant to Sarbanes-Oxley, preempted California's ethical rules to the extent that the state ethical rules imposed stricter limits on the disclosure of privileged and confidential information than Part 205.[31]

Trial and Jury Verdict

Buttressed by this string of pre-trial legal victories, Wadler prevailed at trial against Bio-Rad and its CEO. This victory came in spite of the fact that Bio-Rad's counsel led an aggressive defense characterizing Wadler as an "FCPA slacker" under whose watch the company engaged in the FCPA violations that led to over $55 million in regulatory penalties and disgorgement, and who merely sought to protect his job and "reinvent" himself as an FCPA whistleblower with his allegations of misconduct in China. The defense counsel even called to the stand counsel from multiple outside law firms responsible for investigating and reporting the FCPA allegations in Russia, Thailand and Vietnam, one of whom testified that he advised the company to terminate Wadler back in 2011 for his failure to identify or address the violations sooner. The defense also put forth the testimony of numerous officers and employees who described Wadler's behavior as "erratic" and "out of control."

Nevertheless, after nearly three weeks of testimony and only three hours of deliberation, a jury found in favor of Wadler, awarding him nearly $11 million – among the highest jury awards to date under Sarbanes-

[24] *Wadler*, 2016 WL 7369246, at *1.
[25] *Id.* at *4, *9.
[26] *Id.* at *10.
[27] *Id.*
[28] *Id.* at *12.
[29] *Id.* at *14.
[30] *Id.* at *15-*18.
[31] *Id.* at *21.

Oxley's whistleblower provisions. The damages comprise $2.96 million in back pay, doubled under Dodd-Frank,[32] and $5 million in punitive damages.[33]

Punitive Damages. As to the wrongful termination claim, the jury found that Bio-Rad's wrongful conduct involved malice, oppression or fraud, entitling Wadler to punitive damages. This finding appears to be based on Bio-Rad's submission into evidence of a negative performance review for Wadler that, while dated April 2013 (prior to Wadler's termination), was shown in metadata to have been created in July 2013 (after his termination). The jury was apparently unpersuaded by the CEO's testimony that he handwrote the review in April and merely transcribed it electronically in July.

Key Takeaways

Many aspects of this case – including Wadler's sizeable recovery and the series of plaintiff-friendly decisions – bring to the forefront significant issues relevant to public companies, directors and other corporate stakeholders.

— ***Expanded Pool of Defendants.*** Corporate directors of public companies may be within the scope of the Sarbanes-Oxley and Dodd-Frank whistleblower provisions, and thus potentially subject to individual liability. The *Wadler* ruling, coupled with the DOJ's recent pronouncement about the need for individual accountability,[34] suggest directors should be mindful that they may be subject to personal liability for engaging in arguably retaliatory behavior toward a protected whistleblower. With this in mind, it may be prudent for companies and directors to revisit their indemnification agreements and directors and officers ("D&O") liability insurance in consultation with counsel to ensure that such actions would be covered under their policies.

— ***Potential Erosion of Privilege.*** Privileged communications between a whistleblower and the company's directors, officers, in-house counsel and even outside counsel may be both discoverable and admissible in a whistleblower retaliation action to the extent the whistleblower reasonably believes the communications are necessary to prove his or her claims and defenses. This is particularly significant where the plaintiff is a former general counsel or in-house counsel of the company – positions that are ordinarily precluded from reporting to the SEC as a result of their ethical obligations to their clients,[35] and typically viewed by employees and officers as confidential relationships in which to raise concerns and analyze solutions.

At the same time, the *Wadler* Court acknowledged its role as a vigilant gatekeeper in allowing the admission of privileged information. In fact, the Court admonished defense counsel for seeking such a broad blanket of privilege over all outside counsel communications, given that such a ruling would effectively allow a company to retaliate against a corporate counsel whistleblower while precluding the use of critical evidence in a retaliation lawsuit under the guise of privilege.[36] The Court may have considered credible a more targeted approach seeking to exclude specific communications unnecessary to prove Wadler's claims, or requesting confidential treatment of those deemed to be particularly sensitive.[37]

Moreover, *Wadler* provides a clear example of the collateral consequences of disclosing privileged communications in regulatory proceedings (here, through a PowerPoint presentation to the DOJ and SEC), thus waiving the privilege over those (and possibly related) communications in subsequent civil litigation.

— ***Whistleblower Policy.*** Companies should be vigilant in ensuring that sufficient policies,

[32] 15 U.S.C. § 78u-6(h)(1)(C)(ii).
[33] Final Verdict Form, *Wadler v. Bio–Rad Labs., Inc.*, No. 15-cv-2356 (JCS) (N.D. Cal. Feb. 6, 2017), ECF No. 223.
[34] *E.g.*, Deputy Att'y Gen. Sally Quillian Yates, *Individual Accountability for Corporate Wrongdoing* (Sept. 2015) ("Yates Memorandum").
[35] *See* 17 C.F.R. §205.3(d)(2); 15 U.S.C. §7245.
[36] *See Wadler*, 2016 WL 7369246, at *10, *12 (citations omitted).
[37] *Id.* at *14 n.6.

procedures and training exist to facilitate internal complaints of potential misconduct. The procedures should provide for a clear channel to report issues to senior management and in-house counsel, and a reasonable investigation of any whistleblower complaints with prompt documentation of those efforts. Critically, the policy should prohibit retaliation against whistleblowing employees, even when their claims seem to lack merit.

— ***Importance of Personnel Files.*** Companies should maintain timely and thorough personnel files, including by conducting regular performance evaluations with written documentation, and should record negative performance issues as they occur. If a company decides to terminate an employee who previously voiced concerns of potential misconduct, it is critical that the company has a clear record demonstrating that the discipline is unrelated to the whistleblowing activity.

— ***Risks of Trial.*** Finally, as *Wadler* demonstrates, there are substantial risks for a defendant company proceeding to a jury trial in a whistleblower retaliation case. This may be particularly true in the current climate of negative sentiment and distrust toward corporations. Wadler was subjected to aggressive cross-examination by sophisticated and experienced defense counsel, ranging from challenges to his competence to accusations that his report of misconduct was meritless and staged. Yet, the jury returned a prompt liability verdict in Wadler's favor that not only was he terminated wrongfully, but Bio-Rad's actions in doing so were malicious, fraudulent or oppressive. While this case is just one data point, companies should pay heed to the evidentiary rulings, broad interpretation of the whistleblower provisions and the jury's resounding verdict in favor of an attorney-defendant in weighing litigation risk in these kinds of cases.

…

CLEARY GOTTLIEB