

District of Rhode Island Dismisses In-House Attorney's SOX Whistleblower Claim for Lack of Protected Activity

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On July 19, 2019, the U.S. District Court for the District of Rhode Island granted an employer's motion to dismiss a SOX whistleblower claim, holding that the Plaintiff—an in-house attorney—failed to allege sufficient facts to show he had an objectively reasonable belief that fraud had occurred. [Colesanti v. Dickinson](#), No. 18-491.

Background

Plaintiff was an in-house patent and trademark attorney, hired to advise the company regarding intellectual property rights. Between 2013 and 2016, the company allegedly asked Plaintiff four times to review royalty payments to a French physician patent holder pursuant to a patent license and advise when those payments no longer needed to be made. On April 16, 2014, in response to one of these requests, Plaintiff provided the expiration date of the patent, but did not calculate the date on which the company could cease making royalty payments. On February 25, 2016, Plaintiff informed the company that the obligation to pay royalties ended when the royalty agreement expired on March 1, 2014. Upon further review, the company allegedly discovered that this alleged oversight caused it to pay between \$800,000 and \$1,000,000 in overpayments. The company ultimately decided to permit the physician to keep the overpayments.

Plaintiff alleged that he engaged in his first act of protected whistleblowing in February 2016, when he informed his superiors of the overpayment. After discovering that these overpayments were made, the company hired an accounting firm to conduct an independent internal audit. With respect to what Plaintiff alleged to be his second act of protected whistleblowing, Plaintiff subsequently emailed several members of the company's senior management, including the general counsel, indicating that his original analysis of the royalty agreement was accurate and that the company had "misconstrued the termination date of the royalty payments." In these emails, Plaintiff also alleged that the company's contract management system had "become a significant risk to the business" and contributed to the oversight. For his third act of alleged whistleblowing, Plaintiff alleged that around late November 2016, he discussed the royalty overpayments with the company's compliance officer, and when the compliance officer indicated that he was not aware of any issues relating to royalty overpayments, Plaintiff sent him a copy of the auditor's draft report. Plaintiff's employment was terminated shortly thereafter.

Plaintiff filed suit alleging his employment was terminated in retaliation for the foregoing alleged whistleblowing in violation of SOX. In support, he asserted that the company's "failure to accurately and properly keep track of or pay royalties that were due and owing resulted in a material misrepresentation of such royalties to [the Company's] shareholders and in any Securities and Exchange Commission filings."

Ruling

The court dismissed Plaintiff's complaint pursuant to Rule 12(b)(6). At the outset, the court noted that the First Circuit has not yet addressed whether fraud allegations in a SOX whistleblower claim are subject to the heightened pleading standard under Federal Rule of Civil Procedure 9(b), but held that because SOX protects an employee's "reasonable subjective belief of fraud, and does not require proof of actual fraud," it would not apply the requirements of Rule 9(b).

The court then noted that courts routinely hold that activity is not protected by SOX “where it involves disclosure of conduct that is innocuous or trivial, or where it bears only a tenuous relationship to shareholder interests, even if the plaintiff reasonably believed the activity to be a violation of federal law dealing with fraud.” The court also noted that claims grounded in securities fraud have been rejected where the alleged fraud “does not rise to the level that would be material to the shareholders.”

The court ultimately held that Plaintiff’s complaint fell short of satisfying the pleading requirements under *Twombly* and *Iqbal* because a “plaintiff’s particular educational background and sophistication [is] relevant to the subjective component” and the complaint contained no facts that established or permitted an inference “that a person with [Plaintiff’s] legal training and experience could reasonably believe that the conduct he disclosed to his superiors involved ‘deceit or misrepresentation’ that approximates or implicates fraud or that the conduct is otherwise tethered to wrongdoing connected to ‘the fraud-prevention purposes of SOX.’”

Implications

This decision reaffirms the principle that sophisticated employees like in-house attorneys will be held to a higher standard in alleging that they had an objectively reasonable belief that fraud had occurred in light of their training and experience.

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