



Issue Date: 11 December 2007

In the Matter of

Case No. 2006-SOX-00044

MARK DIAMOND
Complainant

v.

SED INTERNATIONAL HOLDINGS, INC.
Respondent

Craig M. Frankel, Esq.
Robert P. Marcovitch, Esq.
Atlanta, Georgia
For the Complainant

L. Dale Owens, Esq.
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Atlanta, Georgia
For the Respondent

Before: JEFFREY TURECK
Administrative Law Judge

RECOMMENDED DECISION AND ORDER¹

This case arises out of a complaint of discrimination filed by Mark Diamond (“Complainant”) against SED Holdings International, Inc. (“Respondent”), pursuant to the employee protection (whistleblower) provisions of § 806 of the Corporate and Criminal Fraud Accountability Act of 2002, Title VIII of the Sarbanes-Oxley Act of 2002, 18U.S.C. § 1514A, (“the Act”) and the implementing regulations at 29 C.F.R. § 1980.² The Act prohibits publicly traded companies from discharging or otherwise discriminating against any employee with respect to compensation, terms, conditions, or privileges of employment because the employee provided to the employer, a federal agency, or Congress information relating to alleged violations of 18

¹ Citations to the record of this proceeding will be abbreviated as follows: CX – Complainant’s Exhibit; RX – Respondent’s Exhibit; and TR – Hearing Transcript.

² The Act incorporates the procedural provisions governing the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, found at 49 U.S.C. § 42121(b). See 18 U.S.C. § 1514A(b)(2)(B).

U.S.C. §§ 1341 (mail fraud and swindle), 1343 (fraud by wire, radio, or television), 1344 (bank fraud), 1348 (security fraud), any rule or regulation of the Securities and Exchange Commission (“SEC”), or any provision of federal law relating to fraud against shareholders. The Act, which extends such protection to employees³ of any company “with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. § 781) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. § 78o(d)),” provides the right to bring a civil action to protect against employee retaliation in these fraud cases. 18 U.S.C. § 1514A(b).⁴

A formal hearing was held October 31 through November 3, 2006, in Atlanta, GA. Post-hearing and reply briefs were received from Complainant and Respondent. Additionally, the parties submitted briefs on the applicability of *Welch v. Cardinal Bankshares Corp.*, ARB No. 05-064 (2007), which the Administrative Review Board (“the Board”) decided in May of 2007.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Background

Respondent, a Georgia corporation, is the sole shareholder of SED International, Inc. (“SED”), a Georgia corporation that distributes microcomputer products (CX 37). Complainant’s father, Gerald Diamond, founded SED’s predecessor and served as Respondent’s CEO until he committed suicide in 2003 (TR 423). Since 1987, Complainant has held a variety of positions with SED, working his way up the company ranks (TR 303-05). In July of 2003, Complainant was promoted to Respondent’s CEO, filling the vacancy left by his father’s death (TR 199-200). Complainant also sat on Respondent’s board of directors during the period relevant to this litigation (CX 23; CX 25; CX 51; CX 4). Complainant’s mother, Jean Diamond, has also held several positions at SED, including her current position of CEO (TR 197). She also continues to serve as chairperson of Respondent’s board of directors (TR 197).

Both sides agree that, in the years following Gerald Diamond’s death, Complainant’s relationship with his mother has deteriorated significantly. Witnesses testified that their

³ “Employees” include those individuals both currently and formerly working for a company. 29 C.F.R. § 1980.101.

⁴ In an order denying Respondent’s motion for summary decision, I found that Respondent “was required to file reports under § 15(d) of the Exchange Act” at the time of Complainant’s initial demotion. Despite the fact that it had filed a Form 15 certifying that it had fewer than 300 shareholders of record on September 30, 2004, I nevertheless found that, by operation of SEC rule 12h-3(c), Respondent’s § 15(d) reporting requirements remained in place from September 30, 2004, until June 30, 2005, the date on which Respondent’s fiscal year ended. Specifically, I found that Respondent was a company holding a “class of securities” for which a “registration statement relating to that class” was “required to be updated” under § 10(a)(3) of the Securities Act of 1933 during the balance of Respondent’s fiscal year. Accordingly, there was jurisdiction for Complainant’s complaint under § 806 of the Act. Although the parties have continued to brief on the issue, I will not revisit the question today.

fractured relationship negatively affected the morale at SED and even contributed to the ultimate decision to terminate Complainant (TR 66, 298). The struggle between Complainant and his mother for control of the company intensified at Respondent's June 1, 2005, board of directors meeting. Since Respondent's CFO resigned shortly beforehand, the meeting's agenda included discussing the retention of Larry Ayers as a temporary consultant to aid SED in closing out its books for fiscal year 2004-2005 (CX 23). Ayers previously served as SED's CFO for approximately 15 years (TR 458). He resigned in 2002 and left the company after serving in a consultant capacity while his successor, Michael Levine, transitioned into the CFO role (TR 311; CX 24). At the meeting, Complainant objected to retaining Ayers due to several "financial mishaps" that he claimed occurred while Ayers served as CFO (CX 23). Additionally, he indicated that he would not sign off on any financial documents prepared by Ayers if the company retained him (CX 23). In response, board chair Jean Diamond suggested that Complainant resign if he had such reservations (CX 23). Similarly, board member Melvyn Cohen asked Complainant whether he would risk termination by refusing to sign financials prepared by Ayers (CX 23). Complainant declined to resign at the time and voiced his desire to remain in his position and hire a qualified person upon whom the entire board could agree (CX 23). The day after the meeting, Complainant e-mailed board members Cohen and Stewart Aaron to state his desire "to continue the Board Meeting and take a vote on [the Ayers decision]" and his willingness to reconsider his position regarding signing financial documents prepared by Ayers (CX 24). He reiterated his opposition, however, by noting that "[t]he bottom line is that given his history, do we want him part of the company even as a consultant in any capacity?" (CX 24). Complainant also attached a copy of a document Levine had prepared at the start of his term as CFO (CX 24). The document, hereinafter referred to as the "Levine memo," included, *inter alia*, Levin's assessment of the state of SED's finance and accounting department upon his arrival, progress made in the first few months of Levine's tenure, and a particularly scathing review of Ayers (CX 24). Notably, the memo enumerates the "financial mishaps" to which Complainant would refer throughout his opposition to hiring Ayers (CX 24). The description of these issues, discussed *infra*, also constituted a significant amount of the hearing testimony.

On June 13, 2005, Respondent's board appointed Ayers over Complainant's objections; Complainant asked that the Levine memo be attached to the meeting's minutes to explain his vote (CX 25). Upon Cohen's motion, another special board meeting was scheduled to discuss Complainant's removal for cause as CEO and president (CX 25). When asked about his reasons for requesting the meeting, Cohen explained that "the Board was tired of the 'aggravation' of having to deal with the constant animosity and dissention between him and [Jean Diamond]" and that the conflict "was affecting morale within the company" (CX 25). On June 20, 2005, Complainant met with Jean Diamond; SED's Executive Vice President, Jonathan Elster; and SED's Vice President of Operations, Mark DiVito (TR 346). During the meeting, Jean Diamond, DiVito, and Elster counseled Complainant to consider the offer Cohen and Aaron would make to him the following day, while both Complainant and Jean Diamond expressed their shared wish that Complainant remain with the company (TR 346, 492).

Immediately prior to the June 21, 2005, board meeting, Aaron and Cohen met with Complainant to offer him a new contract that, among other things, would restore him to his prior post as company president and decrease his salary to the level he previously received as

president, which Complainant accepted (TR 347-50; CX 51; CX 68). On June 21, 2005, the board preliminarily approved the new contract (CX 51). Complainant's counsel at that time indicated that no agreement would be final until it was reduced to writing and signed (CX 51). After approving the terms of the contract, the board elevated Jean Diamond to CEO (CX 51). As agreed, Respondent's counsel sent the contract to Complainant's counsel upon drafting it (TR 499). During the following weeks, the sides did not discuss any disagreements regarding the terms of the contract (TR 500); but on July 21, 2005 Complainant rejected the offer (TR 502). Respondent's board then met on July 25, 2005, to terminate Complainant "for cause in all capacities as an officer of [Respondent] and [SED]" pursuant to Section 3(c) of his existing 2004 employment agreement (CX 4).

"Financial Mishaps"

The Levine memo discussed the three main issues that arose in SED's finance and accounting department while Ayers was CFO, which Ernst & Young auditor Gregory Heston explained in greater detail during his testimony. First, SED incurred significant escheatment liabilities to various states by retaining customer credits for periods of up to six years (CX 24; TR 149-52). Second, audits revealed inaccuracies in the financial reporting submitted by SED's Brazilian subsidiary to company headquarters in Tucker, GA (CX 24; TR 154-56). Third, SED lacked proper processes for filing IRS form 8300, which companies use to report certain cash transactions of over \$10,000 (CX 24; TR 159-60). Much of the testimony painstakingly explored the nature of these issues, particularly their financial impact on SED and the extent to which Ayers could fairly be blamed for them. Undisputed, however, is the fact that SED resolved all of these issues completely by the fall of 2003; indeed, Complainant referred to them as "old news" (TR 313-15, 429, 598). Furthermore, external auditors found no "material weaknesses" or "reportable conditions" during their annual audits of SED while Ayers was CFO (TR 824).

Complainant also made several relevant concessions regarding these issues during his hearing testimony. First, Complainant admitted that there is no "showing that Larry Ayers personally did anything wrong in connection with the re-aging [in] Brazil" (TR 636). For that matter, Complainant agreed that "the process of keeping those books and doing any re-aging was done by people who were not even reporting to and supervised by Mr. Ayers' subsidiaries anywhere in the United States" (TR 482-83). Complainant also conceded that he did not "tell the board in June or July 2005 that . . . the re-aging activities in Brazil violated any federal law relating to fraud on shareholders" (TR 483). Second, Complainant admitted that he had no "personal knowledge of what Larry Ayers personally did or did not do regarding escheat of unclaimed property in the years before he left the company" (TR 476). Complainant also conceded that he never told the board in 2005 that any action or inaction on the part of Ayers regarding the escheat issues violated any SEC rule or regulation or any federal law regarding fraud on shareholders (TR 477-78). Third, Complainant admitted that he did "not believe that Larry [Ayers] was personally involved in filing" or failing to file IRS 8300 forms (TR 478). Additionally, he admitted that he never personally told the board in 2005 that "Ayers was to blame for any problem with filing or not filing [the IRS 8300 forms]" (TR 479).

Whistleblower Protection Provisions

The Act's whistleblower protection provision prohibits Respondent from retaliating against employees who provide information or aid in investigations related to securities fraud:

- (a) Whistleblower protection for employees of publicly traded companies.--No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), or any officer, employee, contractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee--
 - (1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule of regulation of the Securities Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by--
 - (A) a Federal regulatory or law enforcement agency;
 - (B) any Member of Congress or any committee of Congress; or
 - (C) a person with supervisory authority over the employee (or other such person working for the employer who has the authority to investigate, discover, or terminate misconduct); or
 - (2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

18 U.S.C. § 1514A(a). To prevail on his whistleblower claim, Complainant must prove by a preponderance of the evidence that: (1) he engaged in a protected activity or conduct; (2) Respondent knew that he engaged in the protected activity or conduct; (3) Complainant suffered an unfavorable personnel action; and (4) the protected activity or conduct was a contributing factor in the unfavorable action. *Welch v. Cardinal Bankshares Corp.*, ARB No. 05-064, at 8 (2007) (citing 49 U.S.C.A. § 42121(b)(2)(B)(iii) (West Supp. 2006)). For the reasons that follow, I find that Complainant has failed to meet his burden with respect to the

“protected activity” element of his claim. Accordingly, I will and need not address the remaining elements.

To meet his burden for the “protected activity” element of his whistleblower claim, Complainant must prove by a preponderance of the evidence that he provided information to Respondent about conduct that he reasonably believed constituted a violation of 18 U.S.C. §§ 1341 (mail fraud), 1343 (wire, radio, or television fraud), 1344 (bank fraud), or 1348 (securities fraud), any SEC regulation or rule, or any provision of federal law relating to fraud against shareholders. *Welch*, ARB No. 05-064, at 8. Furthermore, Complainant must show that his communications related “definitively and specifically” to one of the listed federal laws, regulations, or rules. *Platone v. FLYi, Inc.*, ARB No. 04-154, at 17 (2006) (“In defining the scope of protected activity under other Federal whistleblower protection provisions, the Board has held that an employee’s protected communications must relate “definitively and specifically” to the subject matter of the particular statute under which protection is afforded. [The Act] does not provide whistleblower protection for all employee complaints about how a public company spends its money and pays its bills.”) (footnote omitted).

Discussion

This case has absolutely nothing to do with whistleblowing. Rather, it is simply a family squabble between the son and widow of SED’s founder for control of the corporation. It has pitted family members against family members and lifelong friends against each other. Ayers became a pawn in this internecine battle. Complainant did not want to hire Ayers; Jean Diamond did. Complainant lost this power struggle, and this action is his attempt to regain his former position with SED. That is not the purpose of the whistleblower provisions of the Act.

Generally, I find it difficult to envision a situation where the mere act of *hiring* an employee out of the concern that the employee would later violate the law would qualify as protected activity under the Act. The Act’s plain language requires that the employee reasonably believe that the complained-of conduct itself constituted a violation of a relevant law. Complainant has not shown how the act of hiring any employee could violate any such law. *Cf. Johnson v. Oak Ridge Operations Office*, ARB Case No. 97-057 (Sept. 30, 1999).

Even if a company’s hiring decision could under some circumstances be found to constitute fraud against shareholders, Complainant has not shown how Respondent’s proposal to rehire Ayers could possibly fall under the jurisdiction of SOX. Surely, rehiring Ayers could not constitute fraud in violation of §§ 1341, 1343, 1344, or 1348. Furthermore, Complainant has not alleged that hiring Ayers violated any SEC rule or regulation. Accordingly, Complainant must show that it would be reasonable to believe that hiring Ayers violated another provision of federal law relating to fraud against shareholders. To do so, Complainant essentially alleges that Ayers demonstrated a lack of competence⁵ during his tenure as CFO in preparing SED’s books and financial statements. Complainant contends that this lack of

⁵ Complainant has not alleged that Ayers knowingly falsified Respondent’s financial statements in the past.

competence could later cause Respondent to create inaccurate financial records and fail to maintain an adequate system of accounting controls in violation of §§ 13(b)(2)(A) and (B) of the Securities Exchange Act of 1934.⁶ Complainant insists that these provisions of the Securities Exchange Act of 1934 sufficiently relate to fraud against shareholders. Since I find it unreasonable to believe that the act of hiring a temporary consultant would violate these provisions, I need not address the question of whether they relate to fraud against shareholders.

Complainant alleges that his objections to retaining Ayers as a consultant to help close out Respondent's 2005 financials constituted "protected activity."⁷ Complainant has not satisfied the "reasonable belief" test, which requires the employee to demonstrate both that he actually believed that the complained-of conduct violated one of the enumerated categories of laws and that a reasonable person with his expertise and knowledge would have believed the same. *Welch*, ARB No. 05-064, at 10. Without having to address Complainant's actual beliefs, I find that no reasonable person with Complainant's expertise and knowledge would have believed that retaining Ayers violated any of the Act's enumerated laws. The connection

⁶ Section 13(b)(2)(A)-(B) of the Securities Exchange Act of 1934 provides that every qualifying securities issuer must:

(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that--

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences

15 U.S.C. § 78m(b)(2)(A)-(B).

⁷ Complainant's original complaint letter discussed two additional "protected activities." *Letter of Complaint*, at 1-3. Complainant withdrew those allegations at the hearing, and therefore I will not discuss them (TR 812-13).

between retaining Ayers and the violation of any such law is simply too tenuous and speculative to satisfy the test. In fact, in light of Ayers's history with Respondent, alleging that even a tenuous connection exists is baseless.

In *Johnson*, an environmental whistleblower case involving statutes that parallel the Act, the complainants claimed their superior retaliated against them for voicing concerns about the issuance of security clearances to employees with "questionable" backgrounds. *Johnson*, ARB Case No. 97-057, at 11-12. Specifically, the complainants argued that "people who have something questionable in their personal background are, *for that reason*, likely to engage in behavior at work which will endanger the environment." *Id.* Since the whistleblower provisions required the complainants to demonstrate that their expressed concerns were "grounded in conditions that reasonably could be concluded to relate to the CAA, SDWA, SWDA, or CERLA," the Board found that the complainants had not engaged in protected activity. *Id.* (internal quotation marks omitted). The Board noted that the complainants' theory that employees with questionable backgrounds who improperly receive security clearances would later violate various environmental laws amounted to "rank speculation of the sort that cannot support a claim of protected activity." *Id.* at 12.

In the instant case, Complainant's theory is much more tenuous than the one advanced in *Johnson*. Complainant argues that his objection to Respondent's retaining Ayers qualifies as protected activity because he believed Ayers performed poorly in the past and therefore would cause Respondent to violate a triggering securities law in the future. Complainant's speculation proves more rank than that of the *Johnson* complainants, who objected to "[v]esting security clearances in drug users, drug dealers[,] and convicted criminals." *See id.* at 3. Indeed, even if Complainant's legal theory did not require such an incredible stretch of the Act's language, his alleged beliefs about Ayers would be unreasonable. Complainant's counsel admitted that Complainant does not contend that anyone associated with Respondent, including Ayers, ever "knowingly signed off on financial statements that had inaccuracies in them" (TR 735). Why it would be reasonable for Complainant to assume Ayers would later do so in his temporary consultant capacity is unclear. Additionally, as noted *supra*, Complainant admitted that Ayers had nothing to do with the Brazilian subsidiary reporting issues, conceded that he did not believe that Ayers personally failed to file the IRS 8300 forms, and claimed no personal knowledge of Ayers' involvement with the escheat problems. Since Complainant had no foundation for believing that Ayers was actually responsible for the primary "financial mishaps" that occurred during his tenure as CFO, Complainant had no reasonable basis for believing that anything Ayers would later do in his temporary consultant capacity would violate §§ 13(b)(2)(A) or (B) of the Securities Exchange Act of 1934.

Accordingly, Complainant has failed to meet his burden to prove that a reasonable person with his knowledge and expertise would believe that retaining Ayers constituted a violation of a one of the enumerated provisions of law. Therefore, he did not engage in protected activity, and this case must be dismissed. Since Complainant did not engage in protected activity, there is no reason to discuss the other elements necessary to prove a whistleblower claim.

RECOMMENDED ORDER

IT IS RECOMMENDED that this complaint be DISMISSED.

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JEFFREY TURECK
Administrative Law Judge

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).