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Issue Date: 01 April 2011

OALJ CASE NO.: **2011-SOX-00004**

In the Matter of:

JOE CUNNINGHAM
Complainant,
v.
LIVEDEAL, INC.; RAJASH NAVAR, JOHN EVANS, TOM CLARKE, and DOES 1 through 10, inclusive.
Respondents.

ORDER OF DISMISSAL

This case arises under the whistleblower provisions of Section 806 of the Sarbanes-Oxley Act of 2002 ("the Act" or "SOX"), 18 U.S.C. § 1514A, enacted on July 30, 2002. A former independent director of a publicly traded corporation, Joe Cunningham ("Complainant"), filed a complaint against LiveDeal, Inc., Rajash Navar, John Evans, and Tom Clarke ("Respondents") alleging that he was wrongfully demoted from his position as Chairman of the Board of Directors and Chairman of the Audit Committee after exposing managerial improprieties and fraud by certain board members and its Chief Executive Officer ("CEO"). Respondents filed this motion for summary judgment arguing that Complainant does not have standing to bring a claim because he is not an "employee" qualifying for protection under the Act. They also argue that the complaint against Navar, Clarke, and Evans should be dismissed for the independent reason that Section 806 does not list shareholders or directors as those who could violate the statute.[1] I grant summary judgment and conclude that an individual who represents himself as an "independent director" for the purpose of satisfying NASDAQ's corporate governance requirements is subsequently precluded from asserting that he is an "employee" who qualifies for protection under SOX.

FINDINGS OF FACT

LiveDeal, Inc., formerly known as YP Corp., is a publicly traded Nevada corporation.[2] On January 8, 2008, Complainant was elected to serve on the Board of Directors and to chair the company's Audit Committee. Cunningham Decl. ¶ 2. Thereafter, Complainant was also appointed as the Chairman of the Board and served in both capacities until he was removed from the positions on May 22, 2008. *Id*. at ¶ 3. Before joining the Board, Complainant was a

[1] Respondents argue that when Congress defined "company representative," it listed only "officer, employee, contractor, subcontractor, or agent of a company" as potential defendants and intentionally left out "directors." I do not address this argument and instead dismiss the complaint on other grounds as discussed in the decision.

[2] LiveDeal is publicly traded on the NASDAQ Stock Market ("NASDAQ").

practicing CPA with Price Waterhouse Coopers. *Id*. at ¶ 4. While performing his duties as an independent director of LiveDeal, he continued to serve as the President of Liberty Mortgage Acceptance Corporation. Resp. Mot. for Summary Decision EX 3 at 3.

At the time Complainant became a board member, LiveDeal was attempting to improve its image following several publicized scandals, including the imprisonment of former CEO Angelo Tullo, an enforcement action by the Federal Trade Commission, and several lawsuits. Compl. at 3-4. In his capacity as the Chairman of the Board, Complainant spent approximately 55 percent of his time working for the company. Cunningham Decl. at ¶ 5. According to Complainant he "regularly worked with operations, employees and management." *Id*. As part of his duties, he helped with investor meetings, attended trade conferences, worked in recruiting, conducted analyses of customer purchases, and assisted with mergers and acquisitions. *Id*. Complainant likewise had operating responsibility on a key marketing program and engaged the McClatchy Newspaper chain to create a revenue-sharing arrangement with LiveDeal. *Id*. Complainant received a salary of $6,000 per month for his services on the Board and was able to participate in the Employee Stock Option Plan ("ESOP"). *Id*. at ¶ 6.

In his capacity as Chairman of the Board and Chairman of the Audit Committee, Complainant initiated a series of investigations into the affairs of other board members and officers.[3] Notably, Complainant became suspicious of the expenses incurred by LiveDeal's CEO, Dan Coury, and instructed the company's Chief Financial Officer ("CFO"), Gary Perschbacher, to produce all of Coury's expense reports. Compl. at 4. The reports revealed that Coury incurred $222,650 in expenses in one year. *Id*. Complainant believed that a portion of these company expenses was incurred by Coury for his personal needs. *Id*. The reports also showed that an employee from Coury's company, Mesa Cold Storage, was on LiveDeal's payroll at $5,000 per month. *Id*. After learning these facts, Complainant asked the CFO to provide him with additional supporting documents and recommended Coury's termination. *Id*. The Board subsequently removed Coury from the position of CEO. *Id*.

Complainant also questioned John Evans' classification as an independent director. On May 13, 2008, he directed the CFO to review LiveDeal's NASDAQ filing to determine whether it complied with all securities laws. Compl. at 5. According to Complainant, Evans was not an "independent director" because he received $15,000 a month in consulting fees from LiveDeal and reported directly to LiveDeal's CEO. *Id*.

[3] Complainant notes that he investigated the following issues: (1) Evans' fraudulent representation that he was an independent director on a NASDAQ application in order to obtain a NASDAQ listing and secure bonuses for himself and Coury; (2) the Board's failure to press collection efforts on an over one-million dollar debt due to the conflict of interest of former CEO Angelo Tullo; (3) Navar's misrepresentations regarding the financial condition of LiveDeal in connection with its purchase of YP Corp.; 4) potential kickbacks to Coury and Evans in connection with the acquisition of Philippine telemarketing operation; (5) impairment of LiveDeal's intangible assets in connection with both the LiveDeal and the Philippine acquisition; (6) the possible breach of insider trading rules by Evans; (7) attempts by certain Board members to sell the Company at a low price for personal gain and to the detriment of shareholders; (8) the failure to reflect Board disagreements and discussions in corporate minutes; and (9) the forced resignation of Board member Benjamin Milk. Cunningham Decl. at ¶ 9.

Around this time, Complainant also revealed to the Board that he was planning to review the merger between LiveDeal and YP Corp. *Id*. at 6. YP Corp. purchased LiveDeal on June 6, 2007 and subsequently changed its name to LiveDeal. *Id*. Rajash Navar, a member of the Board, was also the founder of LiveDeal. *Id*. Complainant believed that Navar grossly misrepresented LiveDeal's financials, projected income, contracts and technology. *Id*. at 6-7. If his speculations were confirmed by financial statements, Complainant planned to propose that LiveDeal "clawback" a portion of the purchase price paid at acquisition. *Id*. at 7. Complainant likewise disagreed with Navar's vision for LiveDeal. Navar and John Evans were engaged in discussions with at least two outside companies to sell LiveDeal's stock. Complainant believed that it was not in the best interest of the stockholders to take the company private or sell the stock at the offered price. *Id*. at 8.

Complainant expected to become LiveDeal's CEO after Coury's termination was finalized. *Id*. at 11. In the spring of 2007, Complainant spoke with Board member Benjamin Milk, the Chairman of the Governance and Nominating Committee, regarding his placement as CEO. Opp'n to Motion For Summary Judgment at 10. Milk was responsible for vetting new board members, CEOs and other officers. *Id*. In the morning of May 19, 2008, Complainant was attending a LiveDeal management conference in Carlsbad, California and met with Gary Perschbacher and Mr. Raven, the Chief Operating Officer ("COO"), in order to discuss the plan to terminate Coury and have Complainant assume the CEO position. Cunningham Decl. at 4-5. According to Complainant, he terminated Coury's employment later that day and attended the rest of the management conference as interim CEO. *Id*. Coury's termination agreement was not signed until several days later.[4] Compl. at 9.

On May 22, 2008, the majority of the Board voted to remove Complainant from his position as Chairman of the Board and Chairman of the Audit Committee. *Id*. at 9. When the vote took place the following directors served on the Board: Complainant, Coury, Navar, Evans, Milk, Butler, and Clarke. Resp. Motion For Summary Decision EX 2 at 6; Resp. Motion For Leave To Reply EX 3 at 5. Coury, Navar, Evans, and Clarke voted to remove Complainant. Compl. at 9. Complainant, Milk, and Butler voted against the termination; however, Butler subsequently switched his vote. *Id*. Concurrently with Complainant's demotion, the Board elected Navar as the new Chairman of the Board. On June 3, 2008, the Board elected Mike Edelhart as the interim CEO and Gregory LeClair as the Chairman of the Audit Committee. *Id*. According to Complainant, Navar, Evans, and Clarke conspired to remove him in order to prevent further investigations. *Id*. Following the election, Milk resigned from the Board. *Id*.

After Complainant was removed from his roles as the Chairman of the Board and Chairman of the Audit Committee, he continued to serve as an independent director on the Board until February of 2009. Cunningham Decl. at ¶ 12. In February 2009, the Nominating Committee of LiveDeal's Board chose not to re-nominate Complainant for the position and stockholders did not vote for his reelection as director. *Id*.

[4] From the evidence on record, it is not clear whether Complainant had the authority to unilaterally remove Coury from the CEO position.

Complainant filed a Complaint with OSHA on July 16, 2008. Resp. Motion to File Reply at EX 2. On September 20, 2010, the U.S. Secretary of Labor dismissed the Complaint stating the following:

> As a former board member and allegedly prospective interim CEO, Complainant would not be considered an "employee" covered under 18 U.S.C. § 1514A. As a former board member, Complainant gave independent advice to LiveDeal, Inc., in exchange for some compensation. However, he neither worked for the company nor received employee benefits. As an alleged prospective interim CEO, Complainant's interactions with the company did not give rise to an employer-employee relationship, he was not an individual whose employment could be affected by LiveDeal, Inc., or a company representative, and Complainant would not be considered an applicant for employment because he failed to apply for the interim CEO position and because LiveDeal Inc. never formally offered the position for application.

Id.

LiveDeal's Bylaws

LiveDeal's bylaws set forth the powers and responsibilities of LiveDeal's Board of Directors, the Chairman of the Board, the Board Committees, officers of the corporation, and others. *See* Cunningham Decl. at EX A. Under the bylaws, LiveDeal's Board of Directors must consist of three to nine directors. *Id*. at §3.2(a). LiveDeal's management compiles a list of individuals that are recommended to serve as directors for a one year term.[5] Resp't Mot. For Leave to Reply at EX 3. This list is circulated to the shareholders who then elect the directors. *Id*. According to Complainant, shareholders have always followed the recommendations of management with regard to who should be elected to the board. *Id*. The Board of Directors could increase or decrease the authorized number of directors by a resolution amending the bylaws. Cunningham Decl. at EX A §3.2(a). A directorship to be filled by reason of an increase in the number of directors could be filled by a majority vote of directors in office for a term continuing only until the next annual meeting or the next election of directors by the stockholders at a special meeting of stockholders called for that purpose. *Id*. at §3.2(c). Any director could be removed from office only in accordance with LiveDeal's Articles of Incorporation.[6] *Id*.

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[5] According to Nasdaq Rule 5605-6, the director nominees must be selected, or recommended for the board's selection, either by a majority of the independent directors or by a Nominations Committee of only independent directors. Independent director oversight of director nominations does not apply in cases where the right to nominate a director legally belongs to a third party such as pursuant to a shareholder's agreement. Nasdaq Rule 5605-7; *see* NASDAQ, NASDAQ Rules, http://www.nasdaqtrader.com/trader.aspx?id=rules (last visited Mar. 28, 2011).

[6] Under LiveDeal's Articles of Incorporation, "[a] director may only be removed for cause upon the affirmative vote of at least 66 2/3% of the voting power of outstanding shares of capital stock entitled to vote; provided, however, that whenever the holders of any preferred stock shall have the right, voting separately as a class, to elect one of more directors, the foregoing removal provision shall not apply to the director or directors elected by such holders of preferred stock." LiveDeal's Form 8-A (Jan. 31, 2008), *available at* http://msnmoney.brand.edgar-

The Board of Directors could transact business if a quorum, or a majority of the total number of directors on the Board, was present at a particular meeting. *Id*. at §3.3(f). Actions of the majority of directors present at any such meeting constitute an act of the Board. *Id*. Any action required or permitted to be taken by the Board of Directors at any meeting could be taken without the meeting only if all members of the Board of Directors give consent in writing. *Id*. at §3.5

LiveDeal's Board of Directors has the authority to fix compensation of its directors. *Id*. at §3.6. Under the bylaws, receiving compensation for board services does not preclude any director from serving the company in any other capacity and receiving compensation for a different role. *Id*.

The Board of Directors could also, by resolution adopted by a majority of the whole Board, name two or more of its members as an Executive Committee. *Id*. at § 3.7(a). Subject to certain limitations, the Executive Committee has the authority to exercise the powers of the Board of Directors in the management of LiveDeal while the Board is not in session. *Id*. The Board could also, by resolution adopted by a majority of the whole Board, appoint other standing or temporary Committees consisting of at least one current member of the Board of Directors. *Id*. at §3.7(b).

The officers of LiveDeal are elected by the Board and included a Chairman of the Board of Directors, a President, Secretary and Treasurer. *Id*. at §4.1(a). The Chairman of the Board is a member of the Board of Directors who also serves as a "Non-Executive Officer" of the Corporation, presides at all meetings of the Board of Directors, and is vested with other duties and powers that the Board delegates to him. *Id*. at §4.2.

Any officer could be removed at any time, with or without cause, by a vote of the majority of the whole Board of Directors or by an officer upon whom such power of removal was conferred by the Board of Directors. *Id*. at §4.1(b). Officer vacancies are filled by the Board. *Id*.

SUMMARY DECISION

The court should grant the motion for summary disposition when the record (i.e., pleadings, affidavits and declarations offered with the motion and evidence developed in discovery) demonstrate that there are no genuine issues of material fact, and that the moving party is entitled to disposition as a matter of law." 29 C.F.R. § §18.40(d), 18.41(a); Fed. R. Civ. P. 56 (c); *see Townsend v. Big Dog Holdings, Inc*., 2006-SOX-28 (ALJ Feb. 14, 2006); *see also Richardson v. JP Morgan Chase & Co.*, 2006-SOX-82 (ALJ Jul. 7, 2006). In determining whether there is a triable dispute of material fact, a court must review all of the evidence and

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online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?ID=5683396&SessionID=1_RjWMJpzzfnEu9 (last visited Mar. 28, 2011). *See also* Nev. Rev. Stat. § 78.335 **(**"Any director or one or more of the incumbent directors may be removed from office by the vote of stockholders representing not less than two-thirds of the voting power of the issued and outstanding stock entitled to vote.").

construe all inferences in the light most favorable to the non-moving party. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986); *Adickes v. S.H. Kress & Co.*, 398 U.S. 144 (1970). However, a court should not make credibility determinations or weigh the evidence. *Reeves v. Sanderson Plumbing Prod., Inc.*, 530 U.S. 133, 150 (2000). The party who brings the motion for summary decision bears the burden of production to prove that the non-moving party cannot make a showing sufficient to establish an essential element of the case. *Rusick v. Merrill Lynch & Co.*, 2006-SOX-45 (ALJ Mar. 22, 2006). Once the moving party shows the absence of a genuine issue of material fact, the non-moving party cannot rest on his pleadings, but must present "specific facts showing that there is a genuine issue for trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986). A genuine issue of material fact exists when, based on the evidence, a reasonable fact-finder could rule for the non-moving party. *Anderson*, 477 U.S. at 242. However, granting a summary decision motion is not appropriate where the information submitted is insufficient to determine if material facts are at issue. *Id. at* 249.

ANALYSIS

A. Complainant Does Not Have Standing to Bring A Claim Under SOX in His Capacity as an Independent Director.

Complainant argues that he falls under the definition of "employee" as outlined in 29 CFR §1980.101 because he served as the Chairman of the Board, Chairman of the Audit Committee, and as an interim CEO from May 19, 2008 until May 22, 2008. He also asserts that he is covered by the Act because he was denied employment as an applicant for the permanent CEO position. Respondents counter argue that Complainant cannot fall under the definition of "employee" because he was an "independent director" of LiveDeal.

Section 806 of the Act prohibits any company with a class of securities registered under section 12 of the Securities Exchange Act of 1934, or required to file reports under section 15(d) of that Act, or any officer, employee, contractor, subcontractor, or agent of such company, from demoting, suspending, threatening, harassing, or in any other manner discriminating against an employee who reported alleged violations of any rule or regulation of the Securities and Exchange Commission ("SEC") or any provision of Federal law relating to fraud against shareholders. 18 U.S.C. § 1514A.

Federal Regulations implementing SOX at 29 C.F.R §1980.101 define "employee" as follows: 1) an individual presently or formerly working for a company or company representative; 2) an individual applying to work for a company or company representative; or 3) an individual whose employment could be affected by a company or company representative. The regulations also define "company representative" as any "officer, employee, contractor, subcontractor, or agent of a company." *See e.g.*, *Carnero v. Boston Scientific Corp.*, 433 F.3d 1, 6 (1st Cir. 2006) (explaining that the inclusion of the term "company representative" in the definition of "employee" allowed an employee to bring a claim for retaliation directly against the subsidiary of a publicly traded company).

Whether a director of a corporation qualifies for protection under the Act as an "employee" appears to be an issue of first impression. The Act and the regulations are silent on the issue, and I have found no precedent directly addressing the question. In *Vodicka v. DOBI*

Medical Int'l, Inc., the ALJ was faced with the issue at the summary judgment stage but was able to resolve the case on other grounds. *Vodicka v. DOBI Medical Int'l, Inc*., 2005-SOX-111, at *5 (ALJ Dec. 23, 2005) (noting that while there are "salutary policy reasons to protect the public by protecting directors" who blow the whistle, "directors are a different genus of corporate creatures than both officers and those who clearly are employees).

Respondents argue that if Congress had intended to enact protection for whistleblowing directors, it could have specifically named them in the Act. *See Estate of Bell v. Commissioner*, 928 F.2d 901, 904 (9th Cir. 1991) ("Congress is presumed to act intentionally and purposely when it includes language in one section but omits it in another."); *Arizona Elec. Power Co-op. v. United States*, 816 F.2d 1366, 1375 (9th Cir. 1987) ("When Congress includes a specific term in one section of a statute but omits it in another section of the same Act, it should not be implied where it is excluded."). Congress has specifically included the term "director" in other sections of the Act and has generally listed the term next to "officer." For example, section 402 contains a broad prohibition of personal loans by an issuer to any director or executive officer, stating: "It shall be unlawful for any issuer…to extend or maintain credit…in the form of a personal loan to or for any *director or executive officer*…" 15 U.S.C. § 78m(k) (emphasis added).[7] Similarly, section 306(a) prohibits directors and executive officers of public companies from directly or indirectly purchasing, selling or otherwise acquiring or transferring any equity security of such company during any pension plan blackout period. 15 U.S.C. § 7244. Although it is true that Congress has specifically singled out directors in other sections of the Act, these sections prohibit particular conduct by directors instead of giving them a cause of action. Furthermore, the statute does not specifically list other individuals who are protected; it merely singles out "employees." In its *Procedures for the Handling of Discrimination Complaints Under Section 806*, OSHA also does not shed light on the issue. *See* 69 FR 52105. It merely states that the definitions in the regulations accurately reflect the statutory language and do not broaden the class of employees that are protected under the plain language of the Act. *Id*.

When the definition of a term in the statute is uninstructive, courts turn to cases construing similar language to fill "the gap in statutory text." *Clackamas Gastroenterology Assoc. v. Wells*, 538 U.S. 440 (2003). Most courts consider the definition of "employee" to be uniform under federal statutes where it is not specifically defined. *See, e.g., Fichman v. Media Center*, 512 F.3d 1157, 1161 (9th Cir. 2008); *EEOC v. Johnson & Higgins, Inc*., 91 F.3d 1529, 1537-40 (2d Cir. 1996). The U.S. Supreme Court has previously held that when a statute contains the term "employee" but fails to define it adequately, there is a presumption that traditional agency-law criteria for identifying master-servant relationships apply. *See e.g., National Mutual Ins. Co. v. Darden*, 503 U.S. 318 (1992) (holding that "employee," as used in

[7] Similarly, section 303 of SOX generally prohibits an issuer's directors and officers, as well as certain other persons, from coercing or fraudulently influencing the auditor of the issuer's financial statements. The new rules adopted by the SEC under this section specifically apply to officers, directors and any other person acting under the direction of an officer or director. The SEC has defined the term "officer" to include a company's president, vice president, secretary, treasurer or principal financial officer, controller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization. In the adopting release, the SEC also stated that the new rules apply to "executive officers," a term that includes an issuer's chief executive officer and other officers who perform policy-making functions for the issuer. *See* Rule 13b2-2(b)-(c); Rule 13b2-2(a).

ERISA, incorporates traditional agency law criteria for identifying master-servant relationships); *Kelley v. Southern Pacific Co.*, 419 U.S. 318, 322-323 (1974) (interpreting the "while employed" language of the Federal Employers' Liability Act); *Baker v. Texas & Pacific R. Co.*, 359 U.S. 227, 228 (1959). Recently, in *Clackamas Gastroenterology Associates v. Wells*, the Supreme Court has reiterated that the "common-law element of control is the principal guidepost to be followed" in deciding whether a particular individual qualifies as an employee. *Clackamas*, 538 U.S. at 441.

In *Clackamas*, the Courts was faced with a question of whether physician-shareholders who owned a professional corporation that operated a medical clinic, and served on the corporation's board of directors were to be counted as "employees" under the Americans with Disabilities Act ("ADA"). [8] The ADA defines "employee" as "an individual employed by an employer." 42 U.S.C. §12111(4). In order to assist lower courts in applying this circular definition, the Supreme Court outlined six factors which are relevant to the inquiry: (1) whether the organization can hire or fire the individual or set the rules and regulations of the individual's work; 2) whether and if so, to what extent the organization supervises the individual's work; 3) whether the individual reports to someone higher in the organization; 4) whether and, if so, to what extent the individual is able to influence the organization; 5) whether the parties intended that the individual be an employee, as expressed in written agreements or contracts; 6) whether the individual shares in the profits, losses and liabilities of the organization. *Id*. at 449-50. The Court further noted that these factors are not exhaustive, and that whether an individual is an employee depends on "all of the incidents of the relationship[,] with no one factor being decisive." *Id*. at 450, fn. 10. After considering the facts of *Clackamas*, the Court concluded that the four director-shareholder physicians in the case were probably not "employees" of the clinic because they controlled the operation of the clinic, shared the profits, and were personally liable for malpractice claims. Nevertheless, the Court remanded the case and instructed the lower court to ascertain whether additional evidence in the record would support an opposite conclusion.[9] *Id*. at 452.

Although *Clackamas* is not precisely on point because the ADA and SOX have different underlying policy considerations, in light of the *Clackama*s factors, an independent director of a corporation like LiveDeal should not be considered an employee.[10] The directors of LiveDeal

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[8] "The meaning of the term 'employee' comes into play when determining whether an individual is an 'employee' who may invoke the ADA's protections against discrimination in 'hiring, advancement, or discharge,' 42 U.S.C. § 12112(a), as well as when determining whether an individual is an 'employee' for purposes of the 15-employee threshold." *Clackamas*, 538 U.S. at 447, fn. 6.

[9] Subsequently, the lower courts have adopted this test to determine whether various individuals should be classified as "employees" under other federal antidiscrimination statutes. *See Fichman v. Media Center*, 512 F.3d 1157 (2d Cir. 2008) (holding that members of board of directors for community access cable channel, which was operated by a nonprofit organization, were not "employees" under the ADA or the ADEA because the organization did not hire or fire its directors, the board selected its own members, directors each had full-time jobs independent of the organization, and the organization did not supervise or regulate their work).

[10] The ADA was designed to protect individuals against discrimination; however, Congress also had a countervailing interest in "easing entry into the market and preserving the competitive position of smaller firms" by limiting the legislation to firms with 15 or more employees. *Clackamas*, 538 U.S. at 447-48.

were not hired or fired by the company. Under the company's bylaws, they were elected by the shareholders based on the recommendations of management and could be removed from office only in accordance with the Articles of Incorporation by a vote of the shareholders. Directors did not report to anyone higher in the organization, and LiveDeal's Board operated as a democracy. Under the bylaws, the Board transacted business if the majority of the directors were present at a meeting and voted in favor of a particular transaction. At the time of his termination, Complainant was one of the seven board members and thus had a say in the governance of LiveDeal on equal footing with the other directors. *See* Restatement (Second) of Agency § 14C (1958) (When a director acts as "a member of the board, he does not act as an agent, but as one of the group which supervises the activities of the corporation.").

The Restatement Second of Agency is also instructive on the issue. It states that "[d]irectors, in the ordinary course of their service as directors, do not act as agents of the corporation. *Id*. "Neither the board of directors nor an individual director of a business is, as such, an agent of the corporation or its members." *Id*. Unlike an agent who acts under the control of the principal, "[a] board of directors, in fulfilling its fiduciary duty, controls the corporation, not visa versa." *Arnold v. Soc'y for Sav. Bancorp*, 678 A.2d 533, 539-40 (Del.1996); *see also Wharton v. Fidelity-Baltimore Nat. Bank*, 222 Md. 177, 158 A.2d 887 (1960) (holding that an individual "who remains a nominal officer or continues as a director after ceasing to be a regular corporate officer is no longer an "employee" entitled to rights under the corporation's employee stock option plan."). Nevertheless, under certain circumstances, directors may be appointed as agents of the corporation. The board may "exercise its express or implied power to confer authority upon [a director] to act for the corporation, or he may be appointed an executive officer, such as president, as well as director. In these cases, he is necessarily an agent, and normally a general agent, of the corporation, since he acts on its behalf and subject to its control through the board of directors." Restatement (Second) of Agency § 14C (1958).

Because certain corporate officers have been held to be employees under the Act, a director who also assumes a different role within the company could potentially qualify as an "employee." *See e.g., Guyden v. Aetna, Inc.*, 544 F.3d 376 (2d Cir. 2008) (director of internal audit has standing to sue under Sarbanes Oxley); *see also Bechtel v. Competitive Technologies, Inc.*, 2005-SOX-33 (ALJ Mar. 29, 2005) (ALJ ordered reinstatement of two vice presidents who alleged that they had been terminated for raising concerns about financial fraud).

However, in this case, Complainant only assumed additional roles on the Board. In his capacity as Chairman of the Board and Chairman of the Audit Committee, Complainant did not serve as an officer or employee of the corporation.[11] Individuals elected for these two positions had to be elected by the Board and serve as directors on the Board. LiveDeal's Bylaws § 4.1. The fact that Complainant received compensation for performing additional duties does not transform him into an employee. Complainant's salary was designed to compensate him for taking on additional board duties and risks. [12]

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[11] Complainant notes that LiveDeal's bylaws specifically classify the Chairman of the Board as an "officer" of the corporation. However, a particular title given to an individual's position is not dispositive, and the court must look to the individual's actual duties and status. *See Caruso v. Peat, Marwick, Mitchell & Co.*, 664 F. Supp. 144 (S.D.N.Y. 1987)

[12] Serving as a director of a public corporation has become less attractive and more risky due to many factors including: media attention on recent corporate scandals, increased risk of shareholder lawsuits, newly enacted legislation regulating officer and director conduct, heightened scrutiny of board decisions on matters such as executive compensation, stock options, and accounting procedures. Dan Bailey, *Creating the Ultimate Board in the*

Complainant himself points out that he took on many extra tasks as Chairman of the Board. Cunningham Decl. at ¶ 5. Granting coverage based on the type of committee a particular director serves on or drawing a distinction between executive and non-executive chairmen will create significant ambiguity in the case law and require courts to draw arbitrary distinctions.

Furthermore, Complainant could not have served as an officer or employee of LiveDeal because he represented himself as an "independent director" on LiveDeal's NASDAQ Listing Application dated May 2007. *See* Resp. Mot. For Summary Decision EX 2, EX 3. [13] In the *Questionnaire To Directors*, which was relied upon by the company to prepare its 2008 Proxy Statement and the Annual Report (Form 10-K), Complainant stated that he was not a LiveDeal "employee" or "executive officer." *Id*. at EX 3, p.17; Exhibit A. Complainant indicated that he received a fee of $6,000 for his services as Chairman of the Board but did not receive any other compensation from the company. *Id*. at p.6-8. Complainant also noted that he was not a party to any "employment agreement or contract or consulting agreement or contract with the Company or any of its subsidiaries." *Id*. at p.7.

As Respondents point out, Complainant cannot claim to be both an "employee" subject to corporations control and an "independent director" for the purposes of NASDAQ regulations. Independent directors have a special role under the SOX and NASDAQ regulatory scheme.[14] By listing the company on the NASDAQ, LiveDeal agreed to comply with its corporate governance rules. These rules set out specific requirements for the composition of a public company's audit committee, nominations committee and compensation committee. Before a public company is listed on the NASDAQ, the board of directors must identify which of its members are independent. A company must then disclose this determination in its proxy statement or in its Form 10-K.

The determination of director "independence" is relevant for several reasons. First, a majority of the board of directors of a NASDAQ publicly traded company must be comprised of Independent Directors as defined in Rule 5605(a)(2).[15] NASDAQ Rule 5605(b)(1). Second, independent directors are required to hold regularly scheduled meetings at which only independent directors are present. Third, under NASDAQ Rule 5605-4, the Audit Committee must have a minimum of three members who are all Independent Directors.[16]

Sarbanes-Oxley/Post Enron Era, Andrews Kurth LLP, Nov. 12, 2002, *available at* http://www.andrewskurth.com/pressroom-publications-CreatingtheUltimateBoardintheSarbanesOxley.html. After he was removed from these positions, Complainant's monthly salary was $3,000 instead of $6,000.

[13] Respondent's Exhibit 3 is titled "Questionnaire to Directors, Executive Officers, and Nominees of LiveDeal, Inc. in Connection with The Preparation Of The 2008 Proxy Statement And The 2007 Annual Report On Form 10-K" and is dated December 3, 2007. The separate Non-Management Director Independence and Committee Compliance Questionnaire is attached as Exhibit A.

[14] Nasdaq Rule 5605(a)(2) outlines the purpose for the requirement as follows: "It is important for investors to have confidence that individuals serving as Independent Directors do not have a relationship with the listed Company that would impair their independence. …These objective measures provide transparency to investors and Companies, facilitate uniform application of the rules, and ease administration."

[15] The NYSE listing rules have similar provisions. For example, under NYSE Rule 303A.01, the Board must have a majority of independent directors. Directors who are classified as independent may not be employees or officers of the company.

[16] Each Audit Committee member must satisfy the following requirements: 1) meet the Independent Director requirements under Rule 5605(a)(2); 2) satisfy the criteria for independence set forth in Rule 10A-3(b)(1) under the Securities Exchange Act of 1934 (15 U.S.C. 78f); 3) not have participated in the preparation of the financial statements of the company or any current subsidiary at any time during the past three years; and 4) be able to read and understand fundamental financial statements, including the companies balance sheets, income statement, and

Under Rule 5605, "Independent Director" means a "person other than an Executive Officer or *employee* of the Company or any other individual having a relationship, which in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of director." Nasdaq Rule 5605(a)(2) (emphasis added). The NASDAQ rules set forth various *per se* bars to independence. The following two are relevant in this case: 1) a director who is, or at any time during the past three years was, *employed* by the Company, and 2) a director who accepted any compensation from the Company in excess of $120,000 during any period of twelve consecutive months within the three years preceding the termination of independence (other than compensation for board or board committee service, payments arising solely from investments in the company's securities, compensation paid for immediate family members who are non-executive employees of the company or a parent or subsidiary of the company). *See* Rule 5605 (a)(2). Thus, classifying an independent director as an "employee" for the purposes of SOX protection will directly conflict with the definition of the term as it is used in the NASDAQ rules and other SEC filings.

The remedy of reinstatement afforded under SOX is also problematic when the whistleblower is an independent director. An employee who establishes a violation of Section 806 is entitled to recover "all relief necessary to make the employee whole." The "make whole" relief includes (1) "reinstatement with the same seniority status that the employee would have had, but for the discrimination," (2) "the amount of back pay, with interest," and (3) "compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees." 18 U.S.C. § 1514A(c) (2002); *see also* 29 C.F.R. § 1980.109(b) (2004). As under other whistleblower statutes administered by the DOL, reinstatement of the whistleblower is the preferred remedy under the Act.

Generally, directors of public companies are elected by the shareholders at annual shareholder meetings.[17] In order to reinstate a whistleblower director, the court will have to either remove a newly elected director or create a new opening on the board. Both of these alternatives get the court entangled in issues of corporate governance and contravene the choice made by the shareholders. *See MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1128 (Del. Supr., 2003) ("Maintaining a proper balance in the allocation of power between the

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cash flow statement. Nasdaq Rule 5605(c)(2)(A). Under exceptional and limited circumstances, one member who is not an independent director, but who is also not a current officer, employee or family member of an officer or employee, may serve on the Audit Committee for no longer than two years. However, this individual may not chair the audit committee. Nasdaq Rule 5605(c)(2)(B). If a Company fails to comply with the audit committee composition requirements under Rule 10A-3(b)(1) under the Act and Rule 5605(c)(2)(A), because an audit committee member ceased to be independent for reasons outside the member's reasonable control or because the company failed to fill a vacancy on the committee, the audit committee member may remain on the committee until the earlier of its next annual shareholder meeting or one year from the occurrence of the event that caused the non compliance. Rule 5605(c)(4)(A)-(B). A company that relies on either exemption must notify NASDAQ immediately upon learning of the event or circumstance that caused the non-compliance. *Id.*

[17] *See* Nev. Rev. Stat. §78.330; *Comac Partners, L.P. v. Ghaznavi*, 793 A.2d 372 (Del. Ch., 2001) (Statutory scheme governing corporations generally anticipates that the election of directors will be by the stockholders on an annual basis); *Stephenson v. Drever*, 16 Cal. 4th 1167, 1176 (1997) ("At shareholders meetings each shareholder is entitled to offer proposals to be voted on . . . and to nominate directors and to vote on the slate of directors nominated by management").

stockholders' right to elect directors and the board of directors' right to manage the corporation is dependent upon the stockholders' unimpeded right to vote effectively in an election of directors.") Allowing courts to reinstate directors will likewise create uncertainty for third parties dealing with the corporation. Prudent potential investors, shareholders and business partners always examine the company's management before deciding whether to transact business.[18] If the management situation remains uncertain for several years pending litigation, this will have a detrimental effect on the efficiency of the market. There is also no guarantee that a particular complainant would have been elected to the board even if he were placed on the ballot in the first place.

The remedy of reinstatement is especially problematic when the whisleblowing director also served as the chairman of the board. The chairman of the board is generally responsible for leading the board by "keeping the members focused on the objectives at hand, shaping meeting agendas, leading discussions and, occasionally serving as a board spokesperson."[19] In order to achieve this goal, the Chair must maintain regular communication with the other directors and management.[20] If there is significant personal animosity between the Chair and the other directors, the board's ability to constructively address problems becomes significantly impaired. This could potentially harm the corporation and the shareholders.

Furthermore, although courts deal with the issue of motive in every whistleblower case, determining whether a particular director was not nominated or elected because of his protected activities is a more challenging task.[21] Since directors are primarily responsible for engaging in oversight and ensuring compliance with corporate laws, courts will be forced to delve into details of multiple corporate transactions. Likewise, although many boards now conduct director evaluations, director elections generally do not boil down to credentials or experience. What makes someone a good fit for a position of director or Chair may vary from company to company. In most cases, there will also be a time lapse between the protected activity and the annual shareholder meeting where the new directors are appointed. Allowing directors to file lawsuits every time they don't get reelected will open the floodgates of litigation.

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[18] "A new cottage industry is being created to evaluate and compare the quality of companies' corporate governance and to assist companies in improving their government practices. Magazines such as Business Week are also rating companies on the quality of their boards and publishing lists of their picks for the best and worst examples of corporate governance." Bailey, *supra* note 12.

[19] Alexandra Daum, *Nonexecutive Chairman: Offering New Solutions Spencer,* Stuart Board Services Practice (2008), *available at* http://content.spencerstuart.com/sswebsite/pdf/lib/Cornerstone0108.pdf.

[20] *Id.*

[21] Under SOX, Complainant must show by a preponderance of the evidence that the protected activity was a contributing factor to the unfavorable personnel action. A "contributing factor" is "any factor, which alone or in combination with other factors, tends to affect in any way the outcome of the decision." *Morano v. Department of Justice*, 2 F.3d 1137, 1140 (Fed. Cir. 1993); *Kester v. Carolina Power & Light Co*., No. 02-007, 2003 WL 22312696, *8 (ARB Sept. 30, 2003); *Stone & Webster Eng'g Corp. v. Herman*, 115 F.3d 1568, 1573 (1997).

Respondents also point out that unlike employees, directors have a number of intra-corporate and extra-corporate avenues to disclose wrongdoing. For example, a director can raise any issue that he or she believes is necessary during any board meeting.

Based on the foregoing, I find that an independent director who serves on various board committees does not have a cause of action under SOX.

B. Complainant Does Not Qualify For Protection Under SOX As An Interim CEO Or Applicant For The CEO Position.

Complainant argues that even if he is not protected in his roles as Chairman of the Board and Chairman of the Audit Committee, he also acted as the Company's interim CEO from May 19, 2008 until May 22, 2008 and an applicant for the permanent CEO position. Opp'n to Motion for Summary Judgment at p.10.

Complainant asserts that he terminated Coury's employment in the morning of May 19, 2008, after discussing the issue with the CFO and the COO. *Id*. There is no evidence demonstrating that Complainant had the power to unilaterally terminate Coury's employment on May 19, 2008 and appoint himself as the interim CEO. Compl. at 2. According to LiveDeal's bylaws, any "officer may be removed at any time, with or without cause, by a vote of the majority of the whole Board of Directors or by an officer upon whom such power of removal may be conferred by the Board of Directors. Any vacancy occurring in any office may be filled by the Board of Directors." LiveDeal's Bylaws § 4.1(b). Furthermore, Complainant himself points out that Coury's official termination agreement was not signed until several days after he joined Navar, Evans, and Clarke in a vote to demote him on May 22, 2008. Compl. at 5.[22]

I also reject Complainant's argument that he was an applicant for the CEO position.[23] As Complainant points out, pursuant to Section 4.1(b) of LiveDeal's bylaws, "officers shall be elected annually by the Board of Directors at its regular meeting following the annual meeting of the shareholders and each officer shall hold office until the next annual election of officers and

[22] In the *Board and Senior Management Changes* form attached to the complaint, Complainant notes that Coury's resignation as CEO was not accepted by LiveDeal until May 23, 2008. Compl. at EX. A.

[23] I do not address the question of whether a CEO can sue under SOX as a corporate employee. In some cases, drawing a distinction between the role of the CEO and a chair of the board may be arbitrary because the two individuals perform the same duties within the corporation. Traditionally, the CEO of the company also assumed the additional title of board chair. Daum, *supra* note 19. In 2007, 65 percent of the S&P 500 companies operated under this model. *Id*. at p.2. The remaining 35 percent split the responsibility of chairman and CEO between two people. *Id*. There has been an on-going debate about the benefits of a nonexecutive chair model from a corporate governance perspective. Proponents of model say that "the task of the chair and CEO are different and, at times, they may conflict. The CEO runs the company; the chair runs the board. Among the board's responsibilities is to evaluate the CEO's performance and approve his compensation. Splitting the duties enables the CEO to focus on running the company, freeing him or her from potentially sensitive board leadership tasks such as evaluating and terminating board directors." *Id*. According to Harry Pearce, the chairman of the Independent Chairman Project mounted by the Millstein Center for Corporate Governance and Performance at the Yale School of Management, "in today's high risk business/legal regulatory environment, dividing the responsibilities seems a frank recognition of the increase and different demand on both positions. However, whether dividing the responsibilities in a given circumstance is indicated and workable remains a decision for individual boards." *Id*. at 3.

until such officer's successor is elected and qualified, or until such officer's death, resignation or removal." Complainant merely expressed his desire to serve as the CEO to Benjamin Milk, the Chairman of the Governance and Nominating Committee, Gary Perschbacher, the CFO, and Johan Raven, the COO. Opp'n to Motion for Summary Judgment at p.10. Since LiveDeal's CEO's are nominated and not selected through a formal application process, Complainant could not have applied for the position. There was also no vacancy for the CEO position at the time Complainant began expressing his interest because Coury was still the CEO. *Levi v. Anheuser Busch Co*., 2008 SOX 029 (Sep. 25, 2009) ("If the employer is not hiring for a position to which an applicant sends an unsolicited letter offering his services, the employee does not suffer an adverse action, if he is not hired.").

ORDER

Holding that an "independent director" is in a master-servant relationship with a corporation is inconsistent with the general agency principles, the common law definition of the term, and the NASDAQ rules. Thus, Respondent's Motion for Summary Decision is granted.

Accordingly, **IT IS HEREBY ORDERED** that the Complainant's complaint under the Sarbanes-Oxley Act is **DISMISSED**.

SO ORDERED.

A

Russell D. Pulver
Administrative Law Judge

NOTICE OF APPEAL RIGHTS: To appeal, you must file a Petition for Review 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, Suite S-5220, 200 Constitution Avenue, NW, Washington, DC 20210. In addition to filing your Petition for Review with the Board at the foregoing address, an electronic copy of the Petition may be filed by e-mail with the Board, to the attention of the Clerk of the Board, at the following e-mail address: ARBCorrespondence@dol.gov.

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. You must file an original and four copies of the petition for review with

the Board, together with one copy of this decision. In addition, within 30 calendar days of filing the petition for review you must file with the Board: (1) an original and four copies of a supporting legal brief of points and authorities, not to exceed thirty double-spaced typed pages, and (2) an appendix (one copy only) consisting of relevant excerpts of the record of the proceedings from which the appeal is taken, upon which you rely in support of your petition for review.

Any response in opposition to a petition for review must be filed with the Board within 30 calendar days from the date of filing of the petitioning party‘s supporting legal brief of points and authorities. The response in opposition to the petition for review must include: (1) an original and four copies of the responding party‘s legal brief of points and authorities in opposition to the petition, not to exceed thirty double-spaced typed pages, and (2) an appendix (one copy only) consisting of relevant excerpts of the record of the proceedings from which appeal has been taken, upon which the responding party relies, unless the responding party expressly stipulates in writing to the adequacy of the appendix submitted by the petitioning party.

Upon receipt of a legal brief filed in opposition to a petition for review, the petitioning party may file a reply brief (original and four copies), not to exceed ten double-spaced typed pages, within such time period as may be ordered by the Board.

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).