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The Supreme Court Extends SOX Whistleblower Protections

July 28, 2014
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Connecticut Law Tribune

Protection to Employees of Privately-Held Companies

On its face, the Sarbanes-Oxley Act of 2002 ("SOX") is concerned with the conduct of publicly-traded, not privately-held, companies. SOX, after all, grew out of the scandalous and widely damaging failures of public companies like Enron, WorldCom, and Tyco. Its very name in the Senate – the Public Company Accounting Reform and Investor Protection Act – reflects a concern with transparency in publicly-traded firms. So it may have come as a surprise to some when the United States Supreme Court recently ruled, in *Lawson v. FMR, LLC*, 134 S.Ct. 1158 (2014), that SOX's provisions barring retaliation against "whistleblowers" who report on perceived fraud against shareholders can apply to privately held employers.

Under the new holding, such an application of the whistleblower law can arise when a private company is a contractor of a public company covered by SOX. The *Lawson* case presented an example of such an arrangement that is common in the financial industry, but that is by no means the only arrangement in which private-company liability for whistleblower retaliation can arise under SOX.

Understanding the *Lawson* case

In *Lawson*, the plaintiffs worked in the management of publicly-traded mutual funds, but were not employees of the mutual fund companies themselves. Rather, in an arrangement the Court characterized as typical of the mutual fund industry, they were employees of privately-held companies contracted to provide advising and management services to the funds. One of the plaintiffs alleged that after she raised objections to her employer's reporting procedures, she was forced to resign. The other plaintiff alleged that he was fired after objecting to a proposed filing with the Securities and Exchange Commission. Both alleged that their privately-held employers had violated section 806 of SOX (18 U.S.C. § 1514A(a)), which reads, in relevant part:

No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 ... or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 ..., or any officer, employee, contractor, subcontractor, 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 [whistleblowing activities].

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The courts below disagreed about whether the term "an employee" meant only an employee of a publicly-traded company, as distinct from an employee of a contractor or agent of the publicly-traded company in question. While the district court denied the defendants' motions to dismiss premised on the narrower reading of the term, the Court of Appeals for the First Circuit reversed. One reason the Supreme Court may have granted certiorari is that the First Circuit's decision created a potential split with the application of the statute in the remainder of circuits. While no other circuit court had yet weighed in, claims under section 1514A(a) can be tried before administrative law judges of the U.S. Department of Labor, and the department's Administrative Review Board had previously held, in *Spinner v. David Landau & Assoc., LLC*, ALJ No. 2010-SOX-029 (May 31, 2012), that an employee of a company providing contracted services to a publicly-traded firm is protected by section 1514A(a).

In a 6-3 decision authored by Justice Ginsburg, the Supreme Court resolved the question consistently with the Department of Labor's previous reading. Looking both to "the mischief to which Congress was responding" when it passed the bill, and to what the Court characterized as "the most sensible" reading of the text itself, the Court held that "the provision shelters employees of private contractors and subcontractors, just as it shelters employees of the public company served by the contractors and subcontractors." Citing extensively to passages of the Senate Report describing investigators' findings that outside accountants and lawyers had been thwarted or discouraged from calling attention to fraud at Enron, the majority reasoned that the broader reading of section 1514A(a) was necessary in order to achieve Congress's aim of removing such disincentives for all who might blow the whistle on public company fraud.

<u>Ground for future disputes – the "limiting principles"</u>

Among the objections raised by the defendants and various *amici curiae* to the Court's reading of "employee" was overbreadth – specifically, that the reading would "cast a wide net over employees who have no exposure to investor-related activities and thus could not possibly assist in detecting investor fraud." The dissent mentioned, for example, babysitters, checkout clerks, and day laborers removed from the financial reporting tasks with which SOX is concerned. The majority responded that the situation presented in *Lawson* was a "mainstream application" of the provision that did not raise such concerns, and that it would little advance the remedial aims of the statute to adopt a construction that in effect would exempt the entire mutual fund industry from the whistleblower protection provision.

The majority also called attention to two "limiting principles" suggested by the plaintiffs and the Solicitor General in response to the overbreadth arguments. The first would be to limit "contractors" to those "whose performance of a contract [with a covered public company] will take place over a significant period of time." The second would be to extend section 1514A(a)'s protection to employees of contractors "only to the extent that their whistleblowing relates to the contractor['s] ... fulfilling its role as a contractor for the public company, not the contractor in some other capacity."

Although the Court did not specifically adopt those limiting principles as part of the *Lawson* holding, one may fairly anticipate that they will play a role in future case law refining the application of the statute.

A new form of employment litigation?

An important question left largely unresolved in *Lawson* is whether SOX's definition of protected whistleblowing activities provides a further "limiting principle" on suits against privately-held employers, even without resorting to the definition of "employee." The statute only bars retaliation against a person who has provided information that he or she reasonably believes concerns a violation by a publicly-traded company of certain specific laws, or concerns fraud on the company's shareholders. One might suppose, therefore, that many potential suits under section 1514A(a) by employees of privately-held contractors would be ruled out not by the nature of the contractors' relationships with the publicly-traded firms with whom they do business, but simply by the fact that the employees lack information of the sort covered by the statute. But the dissent reasoned that this very enumeration of specific provisions of law actually is part of the overbreadth problem, because the statute "protects the reporting of a variety of frauds—not only securities fraud, but also mail, wire, and bank fraud." The dissent took the position, therefore, that applying the majority's broader reading of "employee" would "subject private companies to a costly new front of employment litigation."

Employment practice consequences

Given the newly-confirmed application of the SOX whistleblower provision to privately-held contractors, and especially given the apparent disagreement within the Court itself over the types of claims employees of such contractors may be able to fit into SOX, privately held companies who provide services to publicly-traded firms covered by SOX may be well advised to revisit their employee policies and assess whether they contain adequate whistleblower protection and anti-retaliation procedures.

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