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TOP STORY—S. Ct.: SOX whistleblower provision extends to public company's private contractors

By James Hamilton, J.D., LL.M. and Joy P. Waltemath, J.D.

The U.S. Supreme Court has ruled that Sarbanes-Oxley Act Sec. 806 extends whistleblower protection to employees of privately held contractors and subcontractors who perform work for public companies. Writing for the Court, Justice Ginsburg said that nothing in the statutory language confines the class of employees protected to those of a designated employer. "Absent any textual qualification, we presume the operative language means what it appears to mean: A contractor may not retaliate against its own employee for engaging in protected whistleblowing activity" (Lawson v FMR LLC, March 4, 2014, Ginsburg, R).

Plurality. This was a plurality opinion in which Justice Ginsburg was joined by Chief Justice Roberts and Justices Breyer and Kagan. Justice Scalia filed a concurring opinion, joined by Justice Thomas, in which he agreed with the Court's conclusion that Sec. 806 protects employees of private contractors from retaliation when they report covered forms of fraud, which, as the Court carefully demonstrates, logically flows from the statutory text and broader context. But Justice Scalia did not endorse what he said were the Court's excursions "into the swamps of legislative history." Justice Sotomayor filed a dissenting opinion, joined by Justices Kennedy and Alito.

Mutual fund industry. The Court's reading of Sec. 806 avoids insulating the entire mutual fund industry from the whistleblower provision. Virtually all mutual funds are structured so that they have no employees of their own, noted the Court; rather they are managed by independent investment advisors. A narrow construction of Sec. 806 would have left the statute with no application to mutual funds. The Court's reading of the statute protects the employees of investment advisors, who are often the only first-hand witnesses to shareholder fraud involving mutual funds.

The petitioners here are former employees of private companies that contract to advise or manage mutual funds. One worked for FMR for 14 years, eventually serving as a Senior Director of Finance. She alleged that, after she raised concerns about certain cost accounting methodologies, believing that they overstated expenses associated with operating the mutual funds, she suffered a series of adverse actions, ultimately amounting to constructive discharge. The other was employed by FMR for eight years, most recently as a portfolio manager. He alleged that he was fired for raising concerns about inaccuracies in a draft SEC registration statement concerning certain funds.

The mutual funds, however, are public companies without employees. "Hence," reasoned the court, "if the whistle is to be blown on fraud detrimental to mutual fund investors, the whistleblowing employee must be on another company's payroll, most likely, the payroll of the fund's investment adviser or manager." Further, the Court rejected the argument that excluding the mutual fund industry from the SOX whistleblower provision is "tenable" because funds and their investment advisors are separately regulated under the Investment Company Act and the Investment Advisors Act. "But this separate regulation does not remove the problem," said the Court, "for nowhere else in these legislative measures are investment management employees afforded whistleblower protection."

Sec. 806 alone shields them from retaliation for bringing fraud to light, emphasized the Court. Indeed, affording whistleblower protection to mutual fund investment advisors is crucial to SOX's endeavor to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, continued the Court. These disclosures are written, not by anyone at the mutual funds themselves, but by employees of the investment advisors.

Another argument for the Court's interpretation was Sec. 806's purpose to ward off another Enron debacle. The legislative record shows Congress' understanding that outside professionals bear significant responsibility for reporting fraud by the public companies with whom they contract, and that fear of retaliation was the primary deterrent to such reporting by the employees of Enron's contractors. SOX contains numerous provisions designed to control the conduct of accountants, auditors, and lawyers who work with public companies, but only Sec. 806 affords such employees protection from retaliation by their employers for complying with the Act's reporting requirements.

Prohibited retaliation. More broadly, the Court viewed the application of the whistleblower provision to contractor employees as confirmed when the view is enlarged from the term "an employee" to the provision as a whole. The prohibited retaliatory measures enumerated in Sec. 806 – discharge, demotion, suspension, threats, harassment, or discrimination in the terms and conditions of employment – are commonly actions an employer takes against its own employees. Contractors are not ordinarily positioned to take adverse actions against employees of the public company with whom they contract. A narrow interpretation of Sec. 806 would, therefore, shrink to insignificance the provision's ban on retaliation by contractors.

DOL "floodgates." The majority found scant evidence that its decision would open any floodgates for whistleblowing suits outside Sec. 806's purposes. Department of Labor regulations have interpreted Sec. 806 as protecting contractor employees for almost a decade, yet the Court pointed out that FMR had not identified a single case in which the employee of a private contractor has asserted a Sec.806 claim based on allegations unrelated to shareholder fraud. Even FMR's "parade of horribles" was based on *Lockheed Martin Corp.* v. *ARB*, a Tenth Circuit case involving mail and wire fraud claims asserted by an employee of a *public* company—claims that would not be affected by the decision in this case. Fears that household employees and others, on learning of the Court's decision, would now pursue retaliation claims seemed, in the majority's view, unwarranted.

PCAOB and SEC. The Court also discounted the dissent's suggestion that the Public Company Accounting Oversight Board and the SEC's authority to sanction unprofessional conduct by accountants and lawyers, respectively, could provide a disincentive to retaliate against other accountants and lawyers. The possibility of such sanctions would be "cold comfort" to the accountants and lawyers who lose their jobs in retaliation for their efforts to comply with the Act's requirements if, as the dissent would have it, Sec. 806 does not enable them to seek reinstatement or back pay.

Commentary. In an email to *Employment Law Daily*, R. Scott Oswald, Managing Principal at The Employment Law Group, PC, said that "The Department of Labor has been applying SOX responsibly for years now; today the Court gave it permission to continue." He went on to note that he was pleased with the decision, which tracked "virtually all of the arguments we made in our amicus brief."

"Justice Ginsburg says she is simply applying 'common sense," said Oswald, "and I agree entirely: It would have been perverse to find that SOX does not protect – as the opinion says – the "legions of accountants and lawyers" and "countless professionals" who are best-equipped to report fraud at a public company. These are exactly the people who were punished for reporting wrongdoing at Enron; the whole point of SOX was to prevent another such cover-up."

Oswald also remarked that "I am surprised to find myself agreeing with some of Justice Sotomayor's dissent, too – especially her statement that Section 1514A now has "a stunning reach." I think that is true, but it is hardly a bad thing. Although most of the dissent's examples are "more theoretical than real," as Justice Ginsburg says, its overall point is well-taken: SOX *does* protect whistleblowers in a very wide

range of circumstances, *as well it should*. If someone reports fraud in good faith, the law should protect that person from reprisal."

David Wachtel of Washington, D.C.'s Bernabei & Wachtel, and *Employment Law Daily* Advisory Board Member, saw a 6-3 majority. "The Scalia partial concurrence, which Thomas joins, is only because of an objection, on principle, to the use of legislative history. He would decide the case exactly the same way."

Wachtel also emphasized, "The majority restores important protection for cases like Lawson – the public company had no employees. The only protection for the public, against fraud, could come from whistleblowing by contractors' employees."

He went on to note that "there is an interesting footnote in which the Court suggests that it would defer to the interpretation of SOX by OSHA, not the SEC. As the Court notes, OSHA is responsible for 20 whistleblower retaliation statutes. In many cases DOL is not the only source of subject matter expertise on the underlying issue: aviation and the FAA, nuclear power and the NRC, securities and the SEC, and so on. Deferring to OSHA may be a favorable development for whistleblowers because DOL may be more focused on whistleblowing principles and less on the concerns of the regulated industries.

As for the dissenting opinion, Wachtel commented that "The practical reason for the dissent is hard to discern. After discussing the headers [of the statute] – addressed by the majority – the dissenters go right into a baby-sitting hypothetical, and they also close with that hypothetical. My view is that the babysitting hypothetical is not the real world. SOX cases require at least a reasonable belief that the employer is engaged in fraud or violation of the securities laws. Although there are some SOX cases noting that the statute extends to mail and wire fraud not affecting shareholders, such as *Lockheed Martin v. ARB,* I do not foresee DOL or the courts overrun by SOX cases brought by babysitters or gardeners any time soon."

The case number is: 12-3.

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Companies: FMR, LLC

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