Legal Backgrounder

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APPEALS COURT LIMITS REACH OF SOX WHISTLEBLOWER PROTECTION

by
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On February 3, 2012, the United States Court of Appeals for the First Circuit concluded in *Lawson v. FMR LLC*[1] that the employee whistleblower protections found in Section 806 of the Sarbanes-Oxley Act ("SOX")[2] do not cover employees of most non-public companies. The decision is significant not only because it is the first federal appellate decision to address the issue, but also because it limits the reach of Section 806 and, in so doing, conflicts with the U.S. Department of Labor's ("DOL") view that Section 806 protects employees of many private companies.

Section 806 defines employers subject to the whistleblower provisions, but much debate has taken place over whether those provisions apply only to publicly traded companies or to both public companies and their private subsidiaries and/or entities that contract with them. Section 806, as enacted in 2002, prohibited retaliation against whistleblowers by companies "with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 or those companies required to file reports under Section 15(d) of the Securities Exchange Act of 1934" (referred to herein for convenience as "Public Company"). This would seem clear enough—neither subsidiaries nor contractors of publicly traded companies are covered. But Section 806 also states that no "officer, employee, contractor, subcontractor, or agent of" a Public Company may retaliate against "an employee."

Lawson put to the test whether (a) contractors, agents, and the like were prohibited from retaliating against *an employee of a Public Company*, and (b) whether they were also prohibited from retaliating against their own employees. The case involved two separate retaliation lawsuits brought against private companies that provide advising or management services by contract to the

[1]No. 10-2240, 2012 WL 335647 (1st Cir. Feb. 3, 2012).

[2]18 U.S.C. §1514A.

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Fidelity family of mutual funds. The mutual funds were not parties to the lawsuits but qualify as Public Companies under SOX because they are investment companies organized under the Investment Company Act of 1940 and are required to file reports under Section 15(d) of the Securities and Exchange Act of 1934.

The two plaintiffs worked for private companies and therefore had to establish that Section 806 does more than protect employees of Public Companies. Plaintiff Zang worked for a subsidiary of Fidelity Management & Research Co. ("Fidelity Management companies"). The Fidelity Management companies contracted with various Fidelity mutual funds as investment advisers to the funds. They were also subsidiaries of FMR LLC, a Public Company. Zang alleged he was terminated "in retaliation for raising concerns about inaccuracies in a draft revised registration statement for certain Fidelity funds" in violation of Section 806. As required by the procedures set out in the statute, Zang initially filed his complaint with the DOL, but an administrative law judge dismissed his complaint on the ground that he was not a covered employee. Before the DOL decision became final, Zang exercised his right to re-file his complaint in federal district court, in Massachusetts.

The other plaintiff, Lawson, also worked for a private subsidiary of FMR LLC, Fidelity Brokerage Services. She claimed that she was retaliated against, and eventually forced to resign, after she raised concerns about cost accounting methodologies. Her case ended up in the same federal district court as Zang's.

The defendants in both cases—all private companies—filed motions to dismiss the complaints on the basis that Section 806 did not apply to them. The district court denied the motions, reasoning that Section 806 protects employees of private contractors and subcontractors of Public Companies. It is that ruling that the defendants brought to the First Circuit.

The court in *Lawson* focused on the precise language of Section 806, including the title of the provision and the captions included in the subsections. For example, the title is "Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud," and the heading for the first subsection is "Whistleblower protection for employees of publicly traded companies." Those references are clear in limiting the protections to employees of Public Companies. In concluding that Section 806 does not cover employees of contractors and subcontractors, the court stated: "[T]he clause 'officer, employee, contractor, subcontractor, or agent of such company' goes to who is prohibited from retaliating or discriminating, not to who is a covered employee." The court reasoned that Section 806 "first identifies covered employers" as Public Companies, "which may not retaliate against their own employees." The section then enumerates those parties that will be considered a part of the public company, and are thus also "barred from retaliating against employees of the covered public-company." According to the court, Section 806 includes contractors and subcontractors as parties that may not retaliate, but the *employees* covered by Section 806 are only those who work for a Public Company.

The First Circuit noted that if Congress wanted to provide broad protection to additional employees, including employees of contractors and subcontractors of public companies, it knew how to do so. For example, the title of the other whistleblower protection provision Congress included in SOX, Section 1107, is "Retaliation Against Informants." The language of that section "requires neither a public company, nor an employment relationship, nor a securities violation" to apply, whereas Section 806 "is by contrast, conspicuously narrow." "Congress has been clear in SOX when it intends to regulate private entities and has been explicit," and Congress neither clearly nor explicitly protected employees of private contractors or subsidiaries in Section 806.

The court also looked to legislative history to determine Congress' intent. Statements in congressional committee reports indicate that the Corporate and Criminal Fraud Accountability Act of 2002 (which included Section 806 and was incorporated into SOX) refers to protections concerning publically traded companies. Additionally, "Senator Leahy stated that [Section 806] 'would provide whistleblower protection to employees of publically traded companies who report acts of fraud.'" Finally, after Congress enacted SOX, legislation was proposed to expand Section 806 to include employees of investment advisers to mutual funds, but that proposal failed. The Court reasoned that if Section 806 was originally intended to include such employees Congress had no reason to attempt to amend the statute. In fact, Congress did amend Section 806 in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to encompass subsidiaries and employees of statistical rating organizations of public companies. The amendments also extended Section 806 protections to employees of "any subsidiary or affiliate [of a Public Company] whose financial information is included in the consolidated financial statements of such company."[3]

Although the DOL and SEC supported the plaintiffs' argument that Section 806 covered them, the *Lawson* court gave no deference to the agencies' arguments. According to the court, (1) Congress gave no authority to the DOL or SEC to interpret the term "employee," and (2) even if Congress had permitted the agencies to interpret the statute, no deference would be due to their interpretations because the statute is not ambiguous and would not support a different interpretation.

The *Lawson* decision thus draws a relatively clear line as to what employees Section 806 protects. The decision contrasts with the DOL's interpretation of the scope of the statute, which has been developing over the years and has been leading to a more expansive reading of the law. First, DOL (through OSHA) promulgated regulations under Section 806 adopting the broader interpretation of covered employees advocated by the plaintiffs in *Lawson*.[4] Second, in its decisions in Section 806 cases, the DOL held that a SOX complainant need not name a publically held company as a respondent in the complaint, so long as the complainant names an officer or agent of the company.[5] Thus, if a private company acted as an agent of a public company, it could be a proper respondent in a SOX case.

More recently, the DOL has determined that Section 806 should be broadly interpreted to further the goal of the statute to protect whistleblowers. One recent decision opines that "Congress intended to enact robust whistleblower protections for more than employees of publically traded companies" and that Congress wanted to expand protection to "employees of certain private firms that work with, or contract with, publicly traded companies."[6] Under that approach, the Labor Department's Administrative Review Board concluded that an employee of a private subsidiary "whose financial information is included in a publically traded parent company's consolidated financial statements" is a protected employee under Section 806, and made clear that it would have

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[3]15 U.S.C. § 78c.

[4]29 C.F.R. § 1980.101 (2009) defines an employee as "an individual presently or formerly working for a company or company representative, an individual applying for work for a company or company representative, or an individual whose employment could be affected by a company or company representative." A company representative is defined as "any officer, employee, contractor, subcontractor, or agent of a company."

[5]*Klopfenstein v, PCC Flow Technologies Holdings, Inc.*, ARB Nos. 07-021, -022, ALJ No. 2004-SOX-11 (2009), *aff'd, Klopfenstein v. Administrative Review Bd.*, No. 10-60144 (5th Cir. 2010).

[6]*Johnson v. Siemens Building Tech.*, ARB No. 08-032, ALJ No. 2005-SOX-15 (2011).

reached that decision even if Congress had not explicitly amended the law to include such employees. The court in *Lawson* explicitly rejected the DOL's statement that Congress intended to cover more than employees of publically traded companies as "dicta to which no deference could be owed."

Future cases under Section 806 will determine whether other federal courts concur with the First Circuit's analysis and holding. In addition, the DOL will at some point be required to decide whether to adhere to the *Lawson* conclusion or whether it will attempt to interpret Section 806 more broadly.

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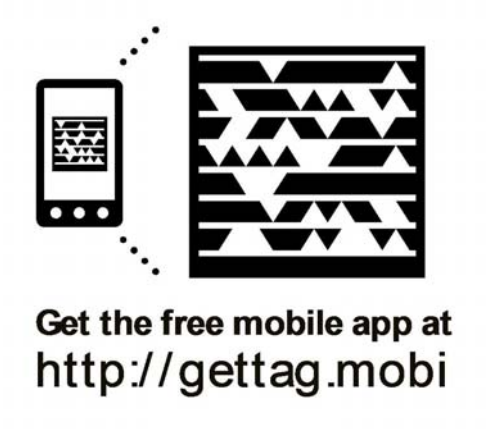

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