Legal Backgrounder

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High Court Extends Federal Whistleblower Protection to Public Companies' Private Contractors

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On March 4, 2014, in a 6-3 decision, the U.S. Supreme Court held in *Lawson v. FMR, LLC*[1] that Section 806 of the Sarbanes-Oxley Act (SOX)[2] protects employees of a public company's private contractors and subcontractors. The Court determined that, to thwart another Enron-like debacle, outside professionals, even if not employees of the public company, should be protected by § 806 because they have a responsibility to report fraud without fear of retaliation. The Court's statutory interpretation of § 806 aligns with the current Department of Labor's (DOL) view that § 806 also protects employees of many private companies.

Section 806 is titled Whistleblower Protection For Employees of Publicly Traded Companies. This provision prohibits retaliation against an employee by public 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 Companies"), or any officer, employee, contractor, subcontractor, or agent of such companies. The question the *Lawson* Court had to answer was what Congress intended by the word "employee."

The two plaintiffs, Jackie Hosang Lawson and Jonathan Zang, worked for private subsidiaries of the Public Company, FMR, LLC. The subsidiaries provided investment advice to various Fidelity mutual funds. Zang alleged he was terminated in retaliation for raising concerns about an inaccurate registration statement, while Lawson alleged he was constructively discharged for questioning certain cost accounting methodologies that overstated expenses associated with operating the mutual funds. Because they were both employed by private companies, and not by FMR, LLC, they argued § 806 covers both employees of Public Companies and employees of private contractors that contract with Public Companies. The DOL dismissed the complaint, stating that employees of private companies were not covered employees under § 806. Before that decision became final, Lawson and Zang re-filed their whistleblower retaliation complaints in U.S. District Court for the District of Massachusetts.

The district court did not find the DOL's reasoning persuasive and denied the defendants' motions to dismiss. The district court held that § 806 protects employees of private contractors and subcontractors of Public Companies. On interlocutory appeal, a divided U.S. Court of Appeals for the First Circuit reversed the district court. The First Circuit held that employees covered by § 806 are ***only*** those who work for a Public

[1] 134 S. Ct. 1158 (2014).
[2] 18 U.S.C. § 1514A.

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Company.[3] In the interim between that decision and the Supreme Court's ruling, the DOL's Administrative Review Board (the highest DOL authority on whistleblower laws) issued a decision in an unrelated case, *Spinner v. David Landau & Assoc., LLC*, No. 10-111, ALJ No. 2010-SOX-029 (May 31, 2012), disagreeing with the First Circuit. The Court granted certiorari to resolve the split of authority on the question whether § 806 protects only employees of a Public Company, or whether it also protects employees of entities that contract with a Public Company.

In reversing the First Circuit, the Court looked to the text of § 806, the legislative history of SOX, other whistleblower statutes on which § 806 was modeled, and the "mischief to which Congress was responding" when it drafted SOX.

The Court initially looked to the statutory text, which states:

> No [public] company …, 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 or other protected activity] (emphasis added).

The Court noted that the provision boils down to "no …contractor …may discharge …an employee." According to the Court, the First Circuit's interpretation would require inserting "a public company" immediately following "employee." The Court observed that nothing in § 806 confines "employee[s]" to those of Public Companies, and if Congress wished to so confine it, Congress knew how. *See e.g.*, 12 U.S.C. § 780-6(a)(1)(C) (concerning "retaliat[ion] against any securities analyst *employed by that broker or dealer or its affiliates…*(emphasis added)). It was clear to the Court that § 806 was tied to an employer-employee relationship—meaning a contractor's employees as well.

If Congress did not intend to protect employees of private contractors, the inclusion of the term "contractors" in the provision would be virtually meaningless, the Court reasoned. The actions that § 806 prohibits are "common actions an employer takes against its *own* employees," not actions a private contractor generally could take against someone else's employee. The Court deemed it highly unlikely, and even impossible, for a contractor to terminate an individual who was not its employee. Finally, a plaintiff who was retaliated against is entitled under § 806 to job reinstatement and associated backpay. According to the Court, if "employee" is narrowly construed to cover only someone who works for a Public Company, a contractor would be forced to reinstate an individual who never worked for it.

The Court next examined the textual arguments regarding "employee." In contrast to the deference the First Circuit gave the statutory headings, the Court noted that reference to "employees of publicly traded companies" in § 806 carried little weight. The headings were not intended to take the place of the more detailed provisions that followed. Additionally, a strict reading of those headings would work against the clear protection provided by these provisions. First, § 806 applies to any company, public or private, that files a report with the Securities and Exchange Commission pursuant to § 15(d) of the Securities Exchange Act of 1934. A private company filing a § 15(d) report would not be included under the heading, but is clearly subject to the provisions of the text. Further, the types of activities that Section 806 protects are broader than just providing evidence of fraud, as they also include reporting violations of any SEC rules or regulations.

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[3] For a more detailed analysis of the First Circuit's holding, *see* Meindertsma and Scharnell, *Appeals Court Limits Reach of SOX Whistleblower Protection*, WLF Legal Backgrounder (Apr. 27, 2012), *available at* http://www.wlf.org/publishing/publication_detail.asp?id=2313.

The Court further reasoned that a broad interpretation of "employee" is consistent with the purpose of SOX whistleblower protection. It is well known that Congress enacted § 806 as a means to ward off another Enron-like "debacle" by encouraging employees who suspect fraud involving Public Companies to speak up. The Court found it clear that Congress understood that outside professionals (*e.g.*, law firms, accountants, contractors, and agents) bear significant responsibility for reporting fraud. Congress recognized that these outside professionals were the "gatekeepers who detect and deter fraud." Yet, in Enron, these same professionals were complicit in, and integral to, the shareholder fraud and cover-up. The contractors' employees' primary deterrent to reporting concerns about Enron's financial activities was the fear of retaliation, since the contractors who did speak up about the financial practices were demoted or terminated.

The Senate report accompanying § 806 also concluded that "Congress must reconsider the incentive system that has been set up that encourages accountants and lawyers who come across fraud in their work to remain silent." Congress could not stand pat and allow these integral outsiders to remain silent due to a lack of protection. By extending § 806 to include employees of private companies that contract with Public Companies, the Court protected those individuals Congress deemed "gatekeepers," and who ultimately could have thwarted the Enron scam early on. Although accountants and lawyers are already under a duty to investigate and report misconduct, the Court noted that none of the provisions provide any job protection—which is why an expansive reading of § 806 was vital.

The Court also said its interpretation of § 806 was supported by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which was passed after SOX was amended. Dodd-Frank extended protection of § 806 to include nationally recognized statistical rating organizations (NRSROs). The defendants in *Lawson* argued that this amendment demonstrated that Congress did not intend to protect employees of private companies when it enacted § 806, since Congress felt compelled to specifically add these individuals into its purview. However, the Court noted that not all NRSROs are private companies, and not all NRSROs contract with public companies. The Court also found it persuasive that when Congress passed Dodd-Frank, the regulations promulgated by the DOL already recognized that § 806 applied to employees of private companies.

Finally, the Court looked to the wording and interpretation of the whistleblower protections for aviation industry employees that Congress enacted in 2000, known as AIR21. 49 U.S.C. § 42121(a). The Court found AIR21 particularly instructive because § 806 was designed to track AIR21 "as closely as possible." In fact, § 806 incorporates many of AIR21's provisions by cross reference and the two whistleblower protection laws share nearly identical statutory text. The Court observed that AIR21 has been interpreted to protect employees of private contractors.

Turning to practicalities, the Court noted that if § 806 did not cover employees of contractors, the entire mutual fund industry would be insulated from SOX whistleblower protections; nearly every mutual fund is structured not to have employees, but to be advised by private investment advisors (like Lawson and Zang). Additionally, corporate disclosure statements are not generally written by the fund itself, but by private advisors.

Looking to the statutory text, textual arguments, purpose, legislative history, and AIR21, the Court held that both Lawson and Zang were employees under § 806 and could proceed with their claims.

This decision will not end debate over the scope of § 806, because the Court did not answer every question the statute's text raises. One open question is whether a broad reading of "employee" will allow what the Court deemed "household employees" (*e.g.*, private nannies, babysitters, gardeners) to rely on

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whistleblower protection. Under a literal reading of the Court's decision, an employee of an officer of a company, for example, is protected. The dissent noted that the Court's decision had a "stunning reach" that could extend protection far beyond that which Congress intended.

The Court artfully skirted a detailed discussion of this question by concluding it did not need to reach the issue because Lawson and Zang were not household employees. To the extent this issue arises in the future, the Court tipped its hand when it found that employees under § 806 must be in a position to "detect and report" the type of fraud and securities violations included in the statute. The vast majority of the time, household employees will not be in that type of position. If the broad reading of "employee" does become an issue, the Court suggested Congress was in the best position to address it by amending § 806.

The Court's expansive reading of § 806, combined with the ever-growing array of federal whistleblower protections, makes it as important as ever for employers to institute best practices to mitigate the risk of whistleblower litigation, including comprehensive training programs, programs and policies designed to foster a workplace culture where employees openly report concerns to management, and one where management effectively resolves those concerns.

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