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E-ALERT | Employment

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SUPREME COURT EXTENDS SOX WHISTLEBLOWER PROTECTION TO EMPLOYEES OF PRIVATE CONTRACTORS AND SUBCONTRACTORS OF PUBLIC COMPANIES

In *Lawson v. FMR LLC*, 134 S. Ct. 1158 (2014), the Supreme Court expanded the scope of Section 806, the whistleblower protection provision of the Sarbanes-Oxley Act of 2002 (SOX), by defining the protected class to include not only the employees of public companies but also the employees of any private employer providing services to a public company under a contract or subcontract.

In the wake of *Lawson*, many private companies that previously assumed they were beyond the reach of SOX now face potential liability under Section 806. Private employers of all sizes should implement procedures, or revisit existing procedures, to encourage internal reporting of concerns and prevent unlawful retaliation. In doing so, employers should also note recent comments from the Securities and Exchange Commission (SEC), which cautioned that employers may not incentivize employees for agreeing not to report their concerns to regulatory agencies.

SOX AND SECTION 806

Congress enacted SOX in the wake of the collapse of Enron Corporation, to "safeguard investors in public companies and restore trust in the financial markets," Section 806 protects whistleblowers who call attention to corporate fraud or securities violations:

> 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].

Although this language clearly prohibits contractors and subcontractors, as well as public companies, from engaging in retaliation, *Lawson* addressed the less well defined question of which *employees* are protected.

THE LAWSON DECISION

The two individual plaintiffs in *Lawson* worked for different subsidiaries of the same private company, FMR Corp. (FMR), which provided services to publicly traded Fidelity mutual funds. Both plaintiffs filed claims under Section 806 alleging their employers retaliated against them after they raised concerns about inappropriate cost accounting or reporting.

FMR argued that Section 806 covers "only the employees of the defined public company" and therefore did not protect plaintiffs. The district court declined to dismiss, but a split panel of the First Circuit reversed, relying heavily on the section's heading referring only to employees of public companies. The dissent pointed to the statute's "intentionally broad language."

On March 4, 2014, the Supreme Court reversed the First Circuit. The Court rejected FMR's arguments that the statute's reference to contractors and subcontractors is meant only to prohibit them "from retaliating against whistleblowers employed by the public company the contractor serves." The Court reasoned that "[c]ontractors are in control of their own employees, but are not ordinarily positioned to control someone else's workers." It pointed to the statute's remedial

provisions, which afford successful plaintiffs relief that an employer would ordinarily provide, such as reinstatement and back pay. The Court rejected the First Circuit's reliance on the statute's heading, which it dubbed "but a short-hand reference to the subject matter."

The majority opinion emphasized Congress's purpose in enacting SOX: to prevent the type of corporate fraud that Enron perpetuated against its shareholders. Because most mutual funds are structured as public companies with no employees of their own, the opinion concluded that a narrow reading of Section 806 would undermine this core objective by "insulating the entire mutual fund industry" from the statute's reach.

Acknowledging potential "overbreadth problems," the majority suggested that future cases could identify "limiting principles," but insisted that *Lawson* represents a "mainstream application" of Section 806. It rejected the dissent's "floodgate-opening concerns" as hypothetical.

WHAT THIS MEANS FOR EMPLOYERS

In the wake of *Lawson*, plaintiffs will no doubt test the bounds of Section 806. Defendants must articulate limiting principles that will persuade lower courts to restrain the floodgates where possible and to avoid the absurd results of which the dissent warned.

But the consequence of *Lawson* for all employers is potentially far-reaching, regardless of how the law's outer limits are ultimately defined, because *Lawson* considerably expands the universe of potential defendants and potential plaintiffs in Section 806 claims. Private companies of all sizes should anticipate an increase in SOX retaliation claims.

All employers should have in place internal policies and procedures designed to prevent liability from whistleblower claims. Employers who have not implemented whistleblower policies should do so. Others should consider revisiting existing policies to ensure they are comprehensive and operate as intended. At a minimum, these policies and procedures should (1) provide employees with means to report concerns internally; (2) ensure prompt and careful investigation of all reports; (3) establish a clear prohibition on all forms of unlawful retaliation; (4) ensure that the company does not incentivize employees not to complain to external agencies, as discussed below; (5) provide training at all levels of the company; and (6) establish internal controls to enforce these policies.

Finally, employers should take note of recent comments from the SEC's Office of the Whistleblower, which warned in strong terms that employers — and their in-house counsel — could face negative consequences if they offer incentives to employees for keeping whistleblower complaints internal. In other words, encouraging employees to report concerns is good practice, but employers also should not discourage employees from reporting concerns to regulators.

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