

## Private Employers And Whistleblowing Post-Lawson



*Law360, New York (June 06, 2014, 10:58 AM ET)* -- Congress enacted the Sarbanes-Oxley Act in the wake of accounting scandals at Enron Corp. and Worldcom Inc. to “safeguard investors in public companies and restore trust in the financial markets.” SOX mandates strict reforms to improve financial disclosures and prevent fraudulent accounting practices. Section 806 prohibits employers from retaliating against whistleblowers who call attention to corporate fraud or securities violations.

Because SOX targets financial misbehavior at public companies, most privately held companies assumed, until recently, they had no reason to worry about SOX. The U.S. Supreme Court shattered this assumption with its decision in *Lawson v. FMR LLC*, which opened the door for Section 806 claims against a private company that is a contractor or subcontractor of a public company.

### Section 806 and Whistleblowing Laws

Dozens of federal laws provide different, occasionally overlapping, protections and incentives to whistleblowers who call attention to employer misconduct in various contexts, including environmental, food or consumer product safety, transportation and False Claims Act violations.

Recently, Congress passed two major expansions of whistleblower protections aimed at the financial services industry: under SOX and the Dodd-Frank Act. These two laws have distinct but overlapping whistleblower provisions.

Dodd-Frank includes multiple whistleblower protections and incentives, including a private right of action against an employer that retaliates and a bounty program that allows the U.S. Securities and Exchange Commission to grant a monetary award to a whistleblower whose tip leads to a successful enforcement action.

SOX protects whistleblowers under Section 806, which prohibits employers from retaliating against an employee who blows the whistle on what he or she “reasonably believes” is a violation of a securities rule or regulation or a violation of a federal law concerning securities fraud, mail fraud, wire fraud or

bank fraud. An employer may not “discharge, demote, suspend, threaten, harass or in any other manner discriminate against” a whistleblower. Aggrieved employees have a private right of action against an employer who violates Section 806.

### **Lawson v. FMR LLC**

Many observers historically understood Section 806 to protect only whistleblowing activity by the employees of public companies — FMR argued as much in the case.

FMR was a private company that provided services to publicly traded mutual funds. Two employees of FMR subsidiaries sued under Section 806, claiming they were fired for calling attention to the funds’ questionable cost accounting and reporting practices. The First Circuit sided with FMR. The Supreme Court reversed, holding that Section 806 protects whistleblowing activity by employees of a private contractor or subcontractor of a public company. The high court emphasized SOX’s legislative purpose of preventing Enron-style corporate fraud and noted a congressional finding that employees of a private accounting firm had tried to report Enron’s misconduct but were silenced by retaliation.

The Supreme Court declined to define the limits of Section 806’s coverage, prompting the dissent to charge that the court’s holding could “authorize a babysitter to bring a federal case against his employer — a parent who happens to work at the local Walmart (a public company) — if the parents stops employing the babysitter after he expresses concern that the parent’s teenage son may have participated in an Internet purchase fraud.” The court shrugged off this critique, suggesting that future cases will resolve any “overbreadth problems.”

### **What Companies Should Worry About SOX?**

The short answer? Everyone.

Lawson left many open questions about the scope of SOX whistleblower protections: What is a contractor or subcontractor for the purposes of Section 806? Is it every private employer who forms any contract with a public company or contractor of a public company, or are there limits based on the nature, scope and timing of the contract and the services provided? Is any and all whistleblowing protected, or is it limited to whistleblowing activity that relates to work being performed for the public company or involves financial or accounting practices?

Plaintiffs will no doubt test the bounds of Lawson’s holding. Private companies in the unfortunate position of defending these claims will attempt to persuade courts to adopt limiting principles. Employers seeking to minimize compliance risks in the future should take preemptive measures now to avoid potential exposure to such claims.

### **Prudent Employers Should Settle in for the Long Haul**

As future decisions shape Lawson’s limits, some private employers could be off the hook for SOX

liability. But for many companies, Section 806 is a new reality, barring congressional action. At the top of this list of employers are those that enter into long-term contracts to provide legal, accounting or other financial services to a public company. The Supreme Court included these examples on the first page of its Lawson decision and later described application of Section 806 to private financial services contractors as a “mainstream application” of the statute, insisting that excluding such employers from liability would undermine the central legislative purpose of Section 806.

### **In the Immediate Term, All Private Employers Should Think About SOX**

In the wake of Lawson, every private company should ask whether it has a business relationship that could qualify it as a contractor or subcontractor of a public company for the purposes of SOX. This determination will be straightforward in some cases and murky in others, given the lack of any defining criteria. On one end of the spectrum, a private company that enters a long-term contractual relationship with a public company to provide consulting services probably qualifies. On other end, a private employer that contracts to provide temporary cleaning services to a contractor of a public company may or may not qualify.

Until courts provide clearer guidance, prudent companies should act on the assumption that they will be subject to Section 806.

### **Basic Whistleblower Policies**

To mitigate the risk of liability under Section 806, all employers should implement formal whistleblower policies and procedures that include, at a minimum, the following:

- **Internal reporting mechanisms:** Provide accessible and discrete methods for employees to report concerns or suspicions about potentially unlawful activity internally. These policies should be well-publicized and offer multiple reporting avenues, to accommodate employees who may be uncomfortable with one avenue. For example, some employees might prefer to talk with a human resources representative who they feel will be objective and discrete, while other employees may be more comfortable sharing their concerns with a direct supervisor they know and trust. Properly implemented, internal reporting policies encourage would-be whistleblowers to complain internally before going outside the company, decreasing the likelihood the employer will be caught off guard. Such policies also help employers to learn about, monitor or stop illegal or questionable activity early, thus reducing or avoiding circumstances that invite whistleblowing or retaliation.
- **Procedures to ensure prompt and thorough investigation:** Identify the individuals who will be accountable for investigating internal reports and establish procedures for investigations. Procedures should define investigator roles and responsibilities, time frames, scope, confidentiality, internal and external notifications and require investigators to follow up to ensure that the whistleblowers do not suffer retaliation.

- Clear and explicit prohibition of all forms of unlawful retaliation: Most employers have policies prohibiting discrimination and harassment, but some may neglect to prohibit retaliation explicitly.
- Policy stating that employees may complain to external agencies: Employers can and should encourage internal reports of any potentially unlawful activity. However, employers must avoid doing anything that could be viewed as discouraging reports to external regulators. The SEC's Office of the Whistleblower has even warned employers against offering incentives to employees who agree to keep whistleblower complaints internal.
- Regular training at all levels of the company: All employees should know how to report concerns internally and that they will be protected from retaliation. Individuals who receive or investigate reports should be aware of SOX and be able to recognize potential SOX issues. These individuals should understand their roles in enforcing these policies and the legal consequences of their actions. Supervisors and managers should understand their obligation to refrain from retaliation and to prevent others from retaliating against employees who make internal or external reports. In particular, they should be aware that the prohibition on retaliation applies even if the whistleblower's allegations prove to be untrue.
- Establish internal controls to maintain and enforce whistleblower policies: Employers should regularly review the procedures for implementing the protection of whistleblowers, for example, as part of an established annual operations review process. This review process should include a holistic look at the policies themselves, how well they are understood and followed, their effectiveness in surfacing and mitigating potential risks and the sufficiency of staffing to fulfill the employer's responsibilities.
- Monitor terminations: Employers should develop procedures or systems to monitor involuntary terminations and "resignations" negotiated in lieu of involuntary terminations so that human resources or legal counsel has an advance opportunity to inquire whether the departing employee has lodged any complaints that might qualify as SOX or other types of whistleblower complaints. If so, the termination should be carefully vetted to confirm there are independent, legitimate grounds that support the termination.
- Incorporate protections in contracts with public companies: When forming a contract to provide services to a public company, include provisions that protect the private employer from risks arising from whistleblower activity related to the public company, including indemnification for the private employer and an agreement that neither company will retaliate against whistleblowers.

## **Beyond the Basics: What is Unique About SOX?**

Beyond the formal policies described above, private employers should be aware of certain distinctive aspects of SOX whistleblower provisions that may present risks and concerns different from those presented by other employment laws.

### ***Whistleblower Incentives***

Although Section 806 itself does not provide monetary awards for whistleblowers, the existence and recent growth of bounty programs for whistleblowers, most notably Dodd-Frank, raise the stakes for employers by increasing the likelihood that employees who observe financial fraud or securities violations will report their concerns externally, creating a challenge for employers who hope to identify and stop potentially unlawful activity early.

The financial incentives for whistleblowers can be substantial. The SEC may award a whistleblower between 10 and 30 percent of any monetary sanction imposed against the employer. A recent award to an anonymous whistleblower was \$14 million.

### ***Procedure for Filing a Section 806 Whistleblower Claim***

Whistleblower retaliation claims must be filed with the U.S. Occupational Safety and Health Administration within 180 days after the alleged retaliation, equitable tolling may apply. A plaintiff may file a claim in court if OSHA does not issue a final order within 180 days.

### ***No Predispute Agreements to Arbitrate***

Federal law does not allow predispute agreements to arbitrate Section 806 claims. (This is not the case with every type of whistleblower claim.) Also, an employee cannot waive the right to file a whistleblower claim, even if he or she waives the right to personal recovery.

Protected whistleblower activity and retaliation are defined broadly. A plaintiff in a Section 806 retaliation claim must establish a prima facie case that: (1) he or she engaged in protected activity; (2) the employer knew of the activity; (3) he or she suffered an adverse action; and (4) the circumstances warrant an inference that the protected activity was a contributing factor in the adverse action.

At first glance, these elements look similar to the elements of other retaliation claims. But Section 806 defines protected activity, adverse action and causation more broadly than some other retaliation laws do:

- Protected activity includes making internal or external reports, assisting in an investigation or participating in any proceeding concerning conduct the plaintiff reasonably believes constitutes a securities violation or shareholder fraud.
- Adverse action includes, among other acts, discharge, demotion, suspension, threats, harassment, intimidation, coercion, blacklisting, discipline or material downgrades in working conditions.

- Causation exists when the whistleblowing is a contributing factor in the employer’s decision to take adverse action.

Employers should understand that “contributing factor” proof is significantly less burdensome for plaintiffs than the “but-for” test applied in certain other employment claims.

### ***Damages***

Plaintiffs who prevail in Section 806 claims are entitled to all relief necessary to make them whole, including reinstatement, back pay with interest, attorney’s fees and costs and, in some cases, payment of special damages, including compensation for emotional distress.

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