

CAN'T YOU HEAR THE WHISTLE BLOWING

ARE YOUR EMPLOYEES NOW PROTECTED
UNDER THE SARBANES-OXLEY
WHISTLEBLOWER PROVISIONS?

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In March 2014, the Supreme Court issued its decision in *Lawson v. FMR LLC*,¹ which has the potential to greatly expand the number of employees who may bring lawsuits under the “whistleblower” provision of the Sarbanes-Oxley Act. This decision is the first to interpret the whistleblower provision of the Sarbanes-Oxley Act. In *Lawson*, the Court held by a 6-3 margin that Sarbanes-Oxley creates a cause of action not only for employees of public companies, but also for employees of non-public companies that perform work for public companies.

AN INTRODUCTION TO WHISTLEBLOWER PROTECTION

In response to the catastrophic collapse of Enron Corp., Congress passed the Sarbanes-Oxley Act of 2002, which included a provision protecting whistleblowers who work for public companies, including law firms, accountants, and auditors. The law provides that:

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].²

The term “protected activity” is defined broadly to include reports made to federal regulatory and law enforcement agencies, Congress, an employee’s supervisor, and internal corporate investigators. The employee must be reporting alleged mail fraud, wire fraud, bank fraud, securities fraud, or a violation of any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

Employees who prevail under this law may be entitled to reinstatement, back pay with interest, “make-whole” compensation (including restoration of seniority, vacation/sick leave), “special damages” for emotional distress and loss of professional reputation, attorney’s fees and costs, and “affirmative relief” such as a letter of apology or formal posting of the decision.

As a result, before a company delves into any factual allegations a whistleblowing employee might make, they could raise the defense that the employee is not covered by the whistleblower statute because the company is not public.

THE SUPREME COURT’S RECENT DECISION IN *LAWSON V. FMR LLC*

In *Lawson*, the Plaintiffs were former employees of a private company that contracted to advise publicly traded mutual funds. The Plaintiffs alleged that their employer, FMR LLC, unlawfully terminated them for reporting alleged shareholder fraud. Each employee sued FMR under the Sarbanes-Oxley whistleblower provision.

In a wide-ranging decision, the Supreme Court held that the Sarbanes-Oxley whistleblower provision does protect employees of privately held companies that are contractors or subcontractors who perform work for public companies. The Court reached this conclusion based on the text of the statute and the intent of Congress, which the majority explained was to “ward off another Enron debacle.” Despite this, the Court did not limit whistleblower protections to the kind of harm which led to the Enron collapse. In short, the Court declined to define the scope of Sarbanes-Oxley’s whistleblower protection, while expanding the class of persons who would be eligible for such protection.

Writing for the dissent, Justice Sotomayor (joined by Justice Kennedy and Justice Alito) explained that the decision had far-reaching and potentially absurd results. Justice Sotomayor argued that the Court’s decision would now allow an employee of a small, privately owned business that, for example, contracts to clean the local Starbucks, to sue the company if the employee is demoted or fired after reporting that another client has mailed the cleaning company a fraudulent invoice.

Thus, under *Lawson*, the Sarbanes-Oxley whistleblower protections may now extend to (1) employees of public companies; (2) household employees of individuals who work for public companies; (3) employees of private companies that contract with public companies; (4) employees of any private company that subcontracts with a private company that contracts with a public company; and (5) employees of any agent of a public company.

The consequences for extending whistleblower protections may be severe. According to the Department of Labor’s statistics from 2005, public companies hired 10 million independent contractors and 11 million contract workers, all of whom potentially could now fall within the protection of Sarbanes-Oxley.

Justice Sotomayor concluded by noting that a flood of litigation could result from this decision, and that the whistleblower provision protects reporting not only of securities fraud, but also mail, wire, and bank fraud. By interpreting a statute that protects an expansive class of conduct to now cover a large and more expansive class of employees, Justice Sotomayor concluded that “today’s opinion threatens to subject private companies to a costly new front of employment litigation.”

DECISIONS AFTER LAWSON

While it is still too soon to tell whether *Lawson* will have the sweeping effects anticipated by the dissent, it has been applied in at least two cases since March. In *Safarian v. American DG Energy, Inc.*,³ the Defendant was a publicly traded company in the utility business, and the Plaintiff was an engineer who serviced and installed Defendant’s machines. However, Plaintiff admitted that he was not an employee of American DG Energy, and instead he was an employee of a company owned by DG Energy called Multiservice. The Plaintiff was eventually terminated for disclosing and threatening to disclose alleged acts and omissions to Defendant’s employees and customers. Plaintiff repeatedly objected to what he perceived as overbilling, improper construction, and a failure to obtain permits.

As an initial matter, the District Court for the District of New Jersey concluded that the Plaintiff was an independent contractor, but based on *Lawson*, the court held that his independent contractor status did not bar him from bringing a whistleblower claim under Sarbanes-Oxley. While the Court ultimately concluded that Plaintiff had not stated a claim for protection under those acts, he was eligible for such under *Lawson* despite his independent contractor status.

Similarly, in *Wiest v. Thomas J. Lynch*,⁴ the Plaintiff sued Tyco Electronics Corporation and four individual defendants under the whistleblower protections in Sarbanes-Oxley. Wiest worked for Tyco until his termination in 2010 after he began rejecting and questioning certain expenses that he believed violated accounting standards or securities and tax laws. The Defendants argued, among other things, that Mr. Wiest was not covered under Sarbanes-Oxley because Tyco was a non-publicly traded subsidiary of Tyco Electronics Limited. The District Court for the Eastern District of Pennsylvania stated that “[t]here is no reason to think that the Supreme Court’s holding in *Lawson* does not also apply, beyond contractors of public companies, to agents of public companies and those agents’ employees.” The court went further and explained that agency could be established by the fact that Tyco performed accounting and tax services for Tyco Limited. The Court concluded that Mr. Wiest had established that Tyco acted as an agent for Tyco Limited, and under *Lawson*, his Sarbanes-Oxley claims could proceed.

Wiest and Safarian illustrate that

Lawson has weakened or eliminated this gatekeeping defense to whistleblower claims, with the result that courts will reach the merits of many more such claims raised by employees.

PRACTICE TIPS

After *Lawson* it is clear that privately held companies can no longer assume that they are immune from liability under the Sarbanes-Oxley whistleblower provision. Directors of Human Resources and other corporate officers should consider the following steps:

First, review your relationships with public companies. Consider whether your private company contracts or subcontracts with a public company, whether any employees may also work for public companies, or whether any employees may also be agents of public companies.

Second, consider what activity is protected under Sarbanes-Oxley. Train your supervisors and managerial employees to understand what activity is protected and to ensure that they appropriately address conduct that may be protected. Also consider instituting internal procedures for employees to complain about alleged violations which could be protected, and ensure that sufficient procedures are in place to prevent retaliatory conduct against such employees.

Third, private companies now need to consider revising or preparing policies that prohibit retaliation to include the protected activities set forth in Sarbanes-Oxley.

Finally, remain cautious in making adverse personnel decisions. Many companies have problem employees, and the Supreme Court may have opened the door for those employees to claim whistleblower protection. Take care to ensure that you understand whether these individuals are now covered under Sarbanes-Oxley, and that you are taking the necessary precautions to prevent retaliation for protected activity. Be proactive, and get ahead of this potential flood of employment litigation.



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¹ *Lawson v. FMR, LLC*, 134 S. Ct. 1158, 188 L.Ed. 2d 158 (2014).

² 18 U.S.C. § 1514A(a).

³ 2014 U.S. Dist. LEXIS 59684.

⁴ 2014 U.S. Dist. LEXIS 52472; 38 I.E.R. Cas. (BNA) 1.