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Supreme court confirms whistleblowing protections for employees of private companies acting as contractors or subcontractors of U.S. public companies.

by Michael Sussman, March 2014

SOX was adopted in the wake of the Enron scandal in which Enron officials were accused of perpetrating fraud on the shareholders of a major U.S. public company. While its provisions largely apply to U.S. public companies, including companies with securities publicly traded in the Unites States, foreign companies that are registered with the Securities and Exchange Commission ("SEC") and those with U.S. public reporting obligations, Section 806 (18 U.S.C. § 1514A) provides protection from retaliation for officers and employees of such public companies who engage in whistleblowing activity in relation to securities and other alleged fraud. The provision also protects contractors, subcontractors and agents ("Contractors") of such public companies, but does not explicitly cover retaliation against officers and employees of private Contractors. The provision is administered primarily by the U.S. Department of Labor (the "DOL"), which has consistently taken the view that the officers and employees of Contractors of public companies benefit from the protections.

In Lawson v. FMR LLC, No. 12-3, 571 U.S. ___ (2014), the decision in which was handed down on March 4, 2014, the U.S. Supreme Court has confirmed that the provision does apply to officers and employees of private Contractors. For private companies that act as Contractors to U.S. public companies but have not focused on this issue, this may be a good time to consider policies and procedures to handle any whistleblowing that might result from the information that becomes available to their officers and employees as a result of the consulting relationship.

The Lawson Decision

The Lawson case involved an action brought for relief under SOX by employees of certain FMR subsidiaries. FMR (Fidelity) is one of the largest fund managers that manages publicly traded funds. The employees were terminated after raising questions about the information provided on certain funds that FMR managed. Like most publicly traded funds, the funds themselves had no employees and were managed entirely by the external manager under contract. FMR's defense included the assertion that the language of SOX § 806 should be read to mean that its protections apply only to officers and employees of the relevant public companies (in this case the funds, which had no employees), and not officers and employees of private Contractors to the public companies. The federal District Court disagreed, denying FMR's motion to dismiss the suit, but the decision was overturned on appeal by the First Circuit Court of Appeals. The Supreme Court has now reversed the First Circuit.

The majority opinion, written by Justice Ginsburg and joined by five of the other justices in whole or in primary part, was based on the plain meaning of the words, an analysis

of the purpose of the statute after Enron, and the conviction that not to extend whistleblower protection to officers and employees of private Contractors would lead to the unintended result of shielding fund managers, as well as employers of professionals such as lawyers and accountants, from the protections that would otherwise be available to their officers and employees. Nevertheless, the opinion did not set the outer bounds of who would be covered.

A main line of attack from the three-justice minority opinion, written by Justice Sotomayor, was that the language of the statute is in fact ambiguous as to whether the officers and employees of private Contractors are covered, but that the intent of the statute to limit coverage to officers and employees of public companies can be inferred from a number of factors including the headings used in the statute, the statutory context and the absurd result that could arise from the majority's view. In particular, with respect to the asserted absurdity, the minority suggested that the majority view would allow a babysitter to bring a federal suit against an employer (such as a parent who is an employee of Walmart, a public company) "if the parent stops employing the babysitter after he expresses concern that the parent's teenage son may have participated in Internet fraud." The majority rejected this on the grounds that the scenario is highly unlikely, and, if Congress wants to prevent such suits, it can do so by explicitly exempting such domestic employment. The majority also rejected the contention of the minority that the amendments made by the Dodd-Frank legislation in 2010 that expand the scope of the provision suggest that it had a more limited scope prior to the amendments, noting that there were other reasons for the amendments.

Despite the contentious opinions, there seems little likelihood that the key element of the decision, i.e., that the officers and employees of private Contractors to public companies are covered by Section 806 of SOX, will be materially narrowed or overturned in the near future. Nor is there any apparent desire in Congress to narrow the scope of the law. Private Contractors that work for public companies subject to SOX should therefore operate on the basis that their officers and employees (and agents) are covered by the whistleblower protections.

What Are the Protections Available for Whistleblower Under SOX?

Section 806 provides that no company covered by the law, "… may discharge, demote, suspend, threaten, harass or discriminate against an employee in the terms and conditions of employment because of [whistleblowing activity]."

Procedurally, the primary enforcement mechanism is a complaint to the DOL. The DOL decision can be appealed to an administrative law judge, and then to the DOL's Administrative Review Board (the "ARB"). Final decisions of the ARB can be appealed to federal district court on the same basis as other administrative decisions. Alternatively, if the DOL does not issue a final decision within six months of the filing (other than due to bad faith of the complainant), a suit may be filed directly in federal district court.

Remedies that can be granted include reinstatement, back pay with interest and compensation for special damages, including litigation costs and attorney fees.

Who is Protected?

The Supreme Court majority did not define the outer limits of who may be covered by the whistleblower protections in Section 806. But it did make clear the kind of people that are protected.

(i) Officers and Employees of Fund Managers for Publicly Traded Funds.

These were of course the actual class of people covered by the Supreme Court decision. Any similar third-party private manager of a public fund or other entity is likely subject to the same analysis.

(ii) Officers and Employees of Private Contractors Engaged by Public Companies.

If your company acts as a contractor or subcontractor with a Public Company, then you should consider whether there is any significant chance that the work could lead to information that could differ from what shareholders understand of the public company.

For example:

a. *Does your contract incorporate, or have you been required to sign separately, a non-disclosure or confidentiality agreement, so that it is recognized that you may receive material information that is not available to shareholders or investors?*

b. *Is the nature of the work such that it will develop new information that could be material to shareholders? For example, are you preparing a report on assets or liabilities of the public company, such as a reserves report for a mining or drilling company?*

c. *Will your staff be physically located at the public company's premises or other places where they may overhear or inadvertently obtain information that is non-public?*

Needless to say, unless there is clear evidence otherwise, it may be wise to presume that there is a risk of obtaining non-public information that could differ from what is in the public domain.

(iii) Lawyers, Accountants and Other Similar Professionals.

The majority made clear that empowering the staff of law firms, accounting firms and other similar professional firms was a key intention of SOX, given the role of such professionals in the Enron scandal. In this context, this may include some or all partners of the firm as well; it seems likely that partners who felt they were removed from the partnership for reasons prohibited under SOX would claim that they are covered. In any event, the intimate and confidential relationship of such professionals with their clients suggests that they should be fully prepared with appropriate policies and procedures for dealing with SOX-based complaints.

What Should a Private Contractor Do if It Already has a Whistleblowing Policy?

Some private Contractors that work with public companies may already have a set of whistleblowing policies and procedures. For example, those that are in regulated industries, such as financial services, and law and accounting firms, may already have such policies and procedures in place. Government Contractors may also already have procedures, and of course those that practice before the SEC (who are covered by separate whistleblowing requirements).

These policies and procedures should be re-examined in any event, unless they are already based on SOX § 806. The policies and procedures to deal with internal whistleblowing may be focused on giving staff a safe route for raising internal issues that will avoid requiring them to raise the issues with the senior managers who may be seen as the cause of the issues in the first place. Where the issue involves the behavior of a client or customer, there may be additional and/or different approaches required. For example, raising an issue with a client may implicate legal or professional obligations owed to the client that must be considered, and it may be difficult for such issues to be raised without involving senior managers at the Contractor. Thus, consideration should be given to a parallel process for SOX whistleblowing, or to a process that will allow those to whom the complaint is initially made to make a determination to handle the issue differently than if the complaint involved solely internal personnel. In either case, of course, the goal needs to be to ensure that prohibited retaliatory behavior is avoided.

What Should a Private Contractor Do If It Has No Whistleblowing Policy?

For a private Contractor that has no current whistleblowing policy or procedures, now would be a good time to consider the need for them.

(i) Given the nature of the Contractor's relationships with its public company clients, is there any significant possibility that staff would obtain information that could lead to whistleblowing?

Certainly if the Contractor generally agrees to a non-disclosure or confidentiality arrangement with its public company clients, there is some risk of this. There may be significant risk in any case where the Contractor prepares new non-public information for the public company, has access to material non-public information to carry out its work, or has physical access to the workplace or records of the public company client that could give it access to material non-public information.

(ii) What kind of policy and procedures will be appropriate for the Contractor?

Among other things, they should (a) give staff a safe route for whistleblowing in relation to the public company client; (b) reduce or eliminate the possibility that any supervisor or senior manager would be able to act in a retaliatory manner in relation to a whistleblower; and (c) create a process for determining whether and how to raise the issue with the client.

Training; Specific Situations

As with any new or amended policy or procedures, the private Contractor should arrange for training for its staff and senior managers.

Where a private Contractor is uncertain how to handle specific situations, consideration should be given to obtaining more specific legal and/or other professional advice.

FOR MORE INFORMATION

For further insights or to engage us for advice, please feel free contact us.

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