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The Supreme Court Considers Whether SOX Protects Employees of Private Companies From Retaliation for Blowing the Whistle

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Yesterday, the Supreme Court heard oral arguments in *Lawson v. FMR LLC*, a case in which the Court is expected to clarify whether the whistleblower protections of the Sarbanes-Oxley Act ("SOX") cover employees of private companies that contract with public companies. Section 806 of SOX prohibits a publicly-traded company—or any officer, employee, contractor, subcontractor, or agent of a publicly-traded company—from retaliating against an "employee" who reports suspected violations of Securities and Exchange Commission rules or federal fraud laws. The word "employee" in the statute is not defined. The issue before the Court is whether the whistleblower protections are limited to employees of public companies or extend as well to employees of privately held contractors and subcontractors of public companies.

THE LAWSON CASE

The defendants are privately-held companies that, by contract, provide advisory and management services to the Fidelity family of mutual funds. The Fidelity Funds are publicly-held entities organized under the Investment Company Act of 1940. The Fidelity Funds have no employees of their own but rather are overseen by a board of trustees that rely on private companies such as the defendants to provide advisory and management services. Plaintiffs are two putative whistleblowers who were employees of the defendant advisors and managers. After plaintiffs raised concerns about the management of Fidelity Funds, one plaintiff was terminated and the other plaintiff resigned claiming a constructive discharge of their employment.

Both plaintiffs filed complaints with the Occupational Safety & Health Administration of the Department of Labor alleging unlawful retaliation under the SOX whistleblower protections. Regulations issued by the OSHA—in its capacity as the agency with delegated authority to enforce such whistleblower protections—defined "employee" to include employees of private contractors and subcontractors of public companies. Before the agency issued a final decision in the administrative review process, Plaintiffs filed complaints in Boston federal court.

At the district court level, the defendants moved to dismiss the complaints, arguing that the SOX whistleblower protections cover only employees of public companies. The district court disagreed, concluding that the provisions cover both employees of public companies as well as employees of private contractors and subcontractors of public companies. To protect against the potentially sweeping scope of

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this interpretation, the district court imposed a limitation (not found in the express text of the statute) that the employees must be reporting violations relating to fraud against shareholders. The defendants appealed to the First Circuit.

In a 2-to-1 decision, the First Circuit reversed. The majority, while acknowledging that different readings may be given to the word "employee" in the statute, found that "the more natural reading is the one advanced by the defendants." The majority pointed to the fact that the relevant title and sub-title of the statute expressly refers to "protections for employees of publicly traded companies." The majority also worried that plaintiffs' position "creates anomalies and provides very broad coverage." The majority concluded: "If we are wrong and Congress intended the term 'employee' … to have a broader meaning than the one we have arrived at, it can amend the statute."

In dissent, Judge Thompson embraced the interpretation advocated by plaintiffs: "Because my colleagues impose an unwarranted restriction on the intentionally broad language of the Sarbanes-Oxley Act, employ a method of statutory construction diametrically opposed to the analysis this same panel employed just weeks ago, take pains to avoid paying any heed to considered agency views to which circuit precedent compels deference, and as a result bar a significant class of potential securities-fraud whistleblowers from any legal protection, I dissent."

"So a company that let's say is a publicly traded company, they … hire a gardener. And the gardener is a gardening company and it has three employees … and then they fire one of the three employees. And he gets annoyed and says it was because of fraud. Now, the fraud has nothing to do with the company that they're cutting the lawn for. … I don't think the statute intends to get that."

- Justice Breyer

HIGHLIGHTS FROM SUPREME COURT ORAL ARGUMENT

At oral argument yesterday, plaintiffs' counsel went first, insisting on a broad interpretation—one that covers employees of private companies who raise "garden variety fraud" and not just securities-related fraud. The Court immediately questioned plaintiffs about the absurdities that could arise if the Court were to adopt plaintiffs' interpretation.

Justice Breyer presented a hypothetical: "So a company that let's say is a publicly traded company, they … hire a gardener. And the gardener is a gardening company and it has three employees … and then they fire one of the three employees. And he gets annoyed and says it was because of fraud. Now, the fraud has nothing to do with the company that they're cutting the lawn for. … I don't think the statute intends to get that."

In response, plaintiffs did accept one limitation: "'Contractor' in the ordinary parlance refers to an ongoing relationship" and thus "someone from a private firm [who] goes down to Walmart [and] buys a box of rubber bands" would be excluded. However, plaintiffs refused to accept any other limitations, including any interpretation that excluded lawyers and accountants. Plaintiffs sought to turn the discussion of absurdities to the absurdities that result from the First Circuit's position: "The core problem with the interpretation of the Court of Appeals is that it really renders almost meaningless the decision of Congress to prohibit retaliation by contractors and subcontractors."

The Assistant Solicitor General, though agreeing with plaintiffs that employees of private companies are covered, immediately offered several limiting principles. "The first is that it has to be a person who is in a position to detect and report the types of fraud and securities violations that are included in the statute. Second, we think that 'the contractor of such company' refers to the contractor in that role, working for the public company." The Assistant Solicitor General asked the Court not to interpret the statute simply to protect against "far-fetched" applications.

But Justice Kennedy seemed to doubt this approach: "We still have to give a rule. Do we write in the opinion, this is a mainstream application case and therefore it is so confined? That doesn't make any sense."

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- Justice Kennedy

In response, the Assistant Solicitor General noted that, as an empirical matter, "no floodgates have been opened" despite the fact that the OSHA regulation has existed since the beginning of SOX, and asked that any extreme examples be handled by OSHA in the first instance. "You'll find on OSHA's website that it's only 150 or maybe 200 complaints per year that are filed with the agency." The Assistant Solicitor General also advocated for deference to be paid to the OSHA regulation. When Chief Justice Roberts asked why deference should be given to OSHA when Congress delegated rule-making authority under SOX to the SEC, the Assistant Solicitor General clarified that the SEC has no such authority under the statute. "Not for this provision. For other parts of SOX, yes. But the anti-retaliation provision in SOX, like about twenty other anti-retaliation provisions, is entirely handled by the Department of Labor."

When defendants got their turn, Justice Scalia asked: "If the statute does not cover contractors' [or] subcontractors' … firing of their own people, what … coverage does it have? A subcontractor usually cannot fire somebody from the principal company that's traded on the exchange." Defendants cited an example from a 2009 decision by the Department of Labor's Administrative Review Board, where a bankrupt company hired a private contractor to wind down the affairs of the company, and in doing so fired a "squeaky wheel" in the bankrupt company's legal department. Defendants also highlighted the fact that the statue does not just prohibit firing, but also prohibits harassing and threatening. Defendants noted that there are protections for employees of private companies contained in other laws, including state law as well as in Dodd-Frank. Likewise, Defendants noted that accountants and law firms are covered by portions of SOX other than the section in question: "So we have … a coherent reading of the statute … that gives meaning to every word in the statute [and] that fits exactly the title that Congress used. … It makes perfect sense and it doesn't have any untoward results."

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- Justice Scalia

Defendants concluded: "The Sarbanes-Oxley Act was the first major widespread corporate governance reform at the federal level, and Congress didn't purport to do everything at once. It went a long way. But for my friends to suggest that they covered not just the 5,000 public companies, but all six million private companies without ever mentioning the fact, without ever discussing it, without debating it, without acknowledging that that would be the consequence is … a dramatic expansion of this statute that was already pretty dramatic to be begin with, that barely passed, as the Court may remember."

IMPLICATIONS

In *Lawson*, the Court has the opportunity to clarify the breadth of the SOX anti-retaliation provisions. If the Court agrees with the plaintiffs' position, the scope of the whistleblower protection provision would encompass not only public company employees but also employees of private companies acting as contractors to public companies and involve any type of fraud claim. Based on the Justices' questioning at oral argument yesterday, however, this result seems unlikely. If the Court adopts the government's "middle-of-the-road" approach, the statute would apply only to securities fraud and to contractors acting in their role as a contractor for the public company. Under this approach, "far-fetched" scenarios would be handled by the agency expertise of OSHA. As the Assistant Solicitor General noted, this is the current state of play and

the floodgates have not opened. On the other hand, if the Court adopts the narrower, strict construction of the statute adopted by the First Circuit, there would still be serious implications for the financial services industry and its employees, as a significant class of potential securities-fraud whistleblowers would be omitted from the SOX protections.

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