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Business Crimes **Perspectives**

In This Issue:

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- The Sarbanes-Oxley Act provides whistleblower protection to certain employees who report wrongdoing by a publicly-traded company.
- A federal district court in Massachusetts has held that Sarbanes-Oxley whistleblower protection covers not only employees of the publicly-traded company, but also employees of that company's contractors, subcontractors, and agents.
- The district court is the only one in the United States that has interpreted Sarbanes-Oxley whistleblower protection to be so broad.
- The First Circuit has accepted the case for interlocutory appeal, and will likely be the first appellate court to determine the proper coverage of Sarbanes-Oxley whistleblower protection.

First Circuit to Determine Whether Sarbanes-Oxley Act Extends Whistleblower Protection to Employees of Contractors, Subcontractors, and Agents of Publicly-Traded Companies

The First Circuit has agreed to hear an appeal from a recent District of Massachusetts decision taking a very broad view of the whistleblower protection provision of the Sarbanes-Oxley Act. The district court interpreted Sarbanes-Oxley to extend whistleblower protection not merely to employees of a publicly-traded company who allege certain types of malfeasance at that company, but also to employees of that company's contractors, subcontractors, and agents, even though those entities may be small, privately-held businesses. If the Appeals Court agrees with this interpretation, Sarbanes-Oxley whistleblower protection may provide whistleblower protection or anti-retaliation claims to employees of:

- A publicly-traded company's outside consultant;
- A publicly-traded company's outside public relations firm;
- A publicly-traded company's outside accountant;
- A publicly-traded company's outside counsel;
- A publicly-traded company's contractual loan administrator/servicer;
- All firms that contract to buy from a publicly-traded company;
- All firms that contract to sell to a publicly-traded company;
- And many others.

Any firm—public or private, no matter how small—that does business with a publicly-traded company may be subject to a Sarbanes-Oxley claim based on the manner in which it treats an employee who brings an allegation of corporate malfeasance at the publicly-traded company to light.

Background

In addition to imposing a wide range of substantive obligations intended to prevent fraud against shareholders of publicly-traded companies, the Sarbanes-Oxley Act provided employment-related protection to persons who disclose such fraud. Specifically, Sarbanes-Oxley's whistleblower provision, 18 U.S.C. § 1514A, at the time of its enactment provided:

> No [publicly-traded] company . . . or any officer, employee, contractor, subcontractor, or agent of such company, may [retaliate] against an employee in the terms and conditions of employment

because of the employee's protected whistleblowing activities (defined by statute). Read literally, Section 1514A, is ambiguous as to who is protected: Is protection limited to employees of publicly-traded companies, or does it also extend to employees of "officers, employees, contractors, subcontractors, and agents" of publicly-traded companies?

A number of courts had previously encountered this question in connection with a retaliation claim brought by an employee of a privately-held subsidiary of a publicly-traded company. Their reactions ranged from:

- Assuming without deciding that the subsidiary's employee was protected against retaliation; *Carnero v. Boston Scientific Corp.*, 433 F.3d 1 (1st Cir. 2006); and

- Concluding that the subsidiary's employee was protected because her "employment could be affected" by officers of the publicly-traded parent; *Collins v. Beazer Homes USA, Inc.*, 334 F. Supp. 2d 1365 (N.D. Ga. 2004); to

- Concluding that the subsidiary's employee was not protected because the subsidiary was not publicly-traded and the employee did not name the publicly-traded parent in his complaint; *Rao v. Daimler Chrysler Corp.*, 2007 WL 1424220 (E.D. Mich. May 14, 2007); and

- Concluding that the subsidiary's employee was not protected because the subsidiary was neither an agent of the parent with respect to employment matters nor directly involved with the alleged underlying misconduct. *Malin v. Siemens Medical Solutions Health Services*, 638 F. Supp. 2d 492 (D. Md. 2008).

The only court to encounter and resolve the question in connection with the retaliation claim of an employee of a separately-owned "contractor, subcontractor, or agent" was *Brady v. Calyon Securities (USA)*, 406 F. Supp. 2d 307 (S.D.N.Y. 2005) (Lynch, J.). In that case, an equities analyst alleged that he had been terminated because of his complaints that his employer's practices violated Sarbanes-Oxley and N.Y. Stock Exchange and National Association of Securities Dealers rules. The employee conceded that his employer was not itself publicly traded, but argued that it had acted as an "agent[] and/or underwriter[] of numerous public companies."

The court, however, held that the analyst was not protected and that § 1514A's reference to "any officer, employee, contractor, subcontractor, or agency" of a publicly-traded company "simply lists the various potential actors who are prohibited from engaging in discrimination on behalf of a covered employer. . . . Nothing in the Act suggests that it intended to provide general whistleblower protection to the employees of any employer whose business involves acting in the interests of public companies." The court went on to assert that even the term "agent" as used in § 1514A is limited to those who "have acted as agents of publicly-traded companies with respect to their employment relationships."

The Seventh Circuit recently suggested in dicta that it does not agree that "the phrase 'contractor, subcontractor, or agent' means anyone who has any contract with an issuer of securities. Nothing in § 1514A implies that, if [a private firm] buys a box of rubber bands from Wal-Mart, a company with traded securities, [that private firm] becomes covered by § 1514A." *Fleszar v. U.S. Dep't of Labor*, 598 F.3d 912, 915 (7th Cir. 2010) (Easterbrook, J.). The court went on, however, to reject the plaintiff's retaliation claim on different grounds.

The First Circuit has interpreted and applied § 1514A only once, in *Day v. Staples, Inc.*, 555 F.3d 42 (2009). Although the plaintiff in that case was an employee of a publicly-traded company—and the court therefore did not need to consider whether he was covered by Sarbanes-Oxley's whistleblower provision—the court did reaffirm Sarbanes-Oxley's broad remedial purposes in determining that the plaintiff's disclosures were not protected by § 1514A.

The District Court Decision in *Lawson v. FMR LLC*

In *Lawson v. FMR LLC*, two former employees—a finance director and a portfolio manager—alleged that they had been retaliated against because of various protected whistleblowing activities. 2010 WL 1345153 (D. Mass. Mar. 31, 2010) (Woodlock, J.). Each plaintiff had worked for one or more

members of the Fidelity family of companies, privately-held firms that functioned as contractual investment advisers to publicly-held mutual funds. Each employee filed a complaint against his respective employer, claiming that he had made a disclosure of wrongdoing protected by Sarbanes-Oxley, and that his employer had retaliated against him in violation of § 1514A. In each case, the employer moved to dismiss the complaint on the ground that the employer was privately held, and the plaintiff therefore was not covered by § 1514A.

In an opinion that required him—in his own words— to "deploy all of the contents of the judicial toolkit," Judge Woodlock held that § 1514A prohibits a contractor, subcontractor, or agent of a publicly-traded company from retaliating against its own employee for protected whistleblowing activity.

Judge Woodlock observed that the statutory text was facially ambiguous, but found that neither party's suggested interpretation was perfect: The employees' interpretation would implausibly prohibit retaliation against "employees of employees" of a public company, while the employers' interpretation would implausibly contemplate that a public company's contractor or subcontractor would be in a position to "discharge" a public company's employee. The court then reviewed the diverging district court decisions discussed above, and noted that they had "engaged in little thorough discussion of the text of the statute and the different meanings that the word 'employee' could bear."

Judge Woodlock found no guidance in Sarbanes-Oxley's other provisions as to the meaning of § 1514A. Turning to the legislative history, Judge Woodlock found that Sarbanes-Oxley's general purpose "to prevent and punish corporate fraud" supported the employees' broad interpretation of § 1514A (in the process interpreting another clause of § 1514A to corroborate his conclusion). Judge Woodlock, however, declined to rely on an OSHA regulation (29 C.F.R. § 1980.101) supporting the employees' broad interpretation of § 1514A, finding that the regulation was not entitled to deference because it was procedural in nature and because Congress had not delegated to OHSA authority to interpret § 1514A.

Finally, Judge Woodlock invoked the unique structure of mutual funds to support the broad interpretation of § 1514A. Specifically, Judge Woodlock observed that a mutual fund does not have any of its own employees and must be managed through a contractual investment adviser, and that therefore the narrow interpretation of § 1514A would afford no whistleblower protection in connection with mutual funds.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

Enacted after Judge Woodlock's decision, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") expressly extended the coverage of § 1514A to include: (1) private subsidiaries of a public company (Dodd-Frank § 929A); and (2) nationally recognized statistical rating organizations (e.g., Moody's Investor Service, Standard & Poor's, etc.) (Dodd-Frank § 922). As of Dodd-Frank's enactment on July 21, 2010, § 1514A now provides:

> No [publicly-traded] company . . . *including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company, or nationally recognized statistical rating organization* or any officer, employee, contractor, subcontractor, or agent of such company or nationally recognized statistical rating organization, may [retaliate] against an employee in the terms and conditions of employment

because of the employee's protected whistleblowing activities (defined by statute).

The Dodd-Frank amendments to the text of § 1514A supersede the holdings of *Carnero, Collins, Rao*, and *Malin*, because each of those decisions concerned an employee of a private subsidiary of a publicly-traded company. Such employees now are clearly covered by § 1514A.

The Dodd-Frank amendments, however, do not address the issue in *Lawson* and *Brady*: Whether "an employee" relates to "officers, employees, contractors, subcontractors, or agents" (or, for that matter, to a "nationally recognized statistical rating organization," now that such language appears in the statute), or only to the publicly-traded company itself.

The First Circuit Appeal in *Lawson v. FMR LLC*

On the employers' motion, Judge Woodlock certified his decision for interlocutory appeal. All parties then petitioned the First Circuit to accept the appeal and, last week, the First Circuit agreed to hear the appeal.

Since Judge Woodlock's decision, the U.S. Securities and Exchange Commission has explicitly argued to another Court of Appeals that Sarbanes-Oxley's whistleblower protection extends to all employees of private contractors, subcontractors and agents of a publicly-traded company, including outside investment advisers, accountants, auditors, and attorneys. *See* Brief of Securities and Exchange Commission as *Amicus Curiae, Klopfenstein v. Admin. Review Bd., U.S. Dep't of Labor*, No. 10-60144 (5th Cir. Jul. 30, 2010), at 6-14. The SEC's argument—especially when read alongside the equally-broad OSHA regulation that Judge Woodlock declined to rely upon (29 C.F.R. § 1980.101)—highlights the practical impact if the First Circuit adopts the district court's broad interpretation of § 1514A. Any one of these firms, large or small, would face the risk that one of its employees could bring a Sarbanes-Oxley retaliation claim against it based on that employee's blowing the whistle on misconduct occurring at a publicly-traded company with which the firm did business.

No briefing schedule or hearing date for the First Circuit appeal has yet been set. Foley Hoag's *Business Crimes Perspectives* will keep you posted as the appeal proceeds.

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