Are You Covered By Sarbanes – Oxley's Whistleblower Protections?

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Recent United States Supreme Court Decision Expands Coverage of Sarbanes-Oxley

In the wake of the Enron scandal, Congress passed the Sarbanes-Oxley Act of 2002 ("SOX"). Title VIII of SOX aims to increase accountability for those who engage in certain fraudulent activity, such as the manipulation, destruction, alteration and/or falsification of financial records. In an effort to strengthen the proscriptions contained in Title VIII, Congress included a provision designed to protect individuals who reported corporate misconduct – a.k.a., whistleblowers. The provision, Section 806 of SOX, reads in pertinent part:

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 any lawful act done by the employee [to report conduct that the employee reasonably believes constitutes 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] (emphasis added).

The law itself is not an easy read, and the scope of its reach is debatable.It is agreed that Section 806 protects employees of public companies from being retaliated against if they raise concerns of misconduct identified in SOX. ***Thus, if you are employed by a public company and have been demoted or terminated in retaliation for making a complaint of misconduct identified in SOX, you can bring a civil action to recover damages,*** including "all relief necessary to make [you] whole," including "reinstatement . . . back pay with interest, and compensation for litigation costs."

However, what about employees who are employed by private companies? Are they entitled to protection under Section 806? The law itself includes "contractor[s], subcontractor[s], or agents" of a public company, but the question remains: are privately held contractors, subcontractors or agents of a publicly held company barred only from retaliating against employees of the publicly held company, or, are they also barred from retaliating against their own employees?

On March 4, 2014, the Supreme Court of the United States held that privately held contractors, subcontractors or agents of a publicly held company can be sued under Section 806 of SOX for retaliating against their own employees. ***Thus, if you work for a privately held company that does work as a contractor, subcontractor or agent of a publicly held company, you likely are protected under Section 806 of SOX.*** For example, if your company is privately held, but provides accounting, legal, financial, advisory, management, consulting or other services to a publicly held company, you likely are protected under Section 806 of SOX.

The case recently decided, Lawson, *et al*. v. FMR LLC, *et al.*, No. 12-3, 2014 WL 813701 (U.S. Mar. 4, 2014), involved employees of privately held companies that provided management and advisory services

to certain mutual funds. Both employees suffered adverse actions (one constructively discharged, the other terminated) by their employers after raising concerns of potential fraud relating to the mutual funds. The employees sued their former employers, which were privately held companies.

The employers, referred to collectively as "FMR," moved to dismiss the lawsuit, arguing that Section 806 of SOX does not protect employees of privately held companies. The employees, in turn, argued that SOX does protect employees of a privately held company ***if*** the privately held company is a contractor, subcontractor or agent of a publicly held company. Thus the employees argued that they were protected under Section 806 because FMR provided certain management and advisory services to the public company mutual funds. The lowest court sided with the employees and held that they were protected. However, the First Circuit Court of Appeals reversed, holding that Section 806 only protects employees of a public company.

The case was appealed to the Supreme Court and, as stated above, the Court held that employees of a private company are protected by Section 806 if the private company is a contractor, subcontractor or agent of a publicly held company. The Court provided many reasons for its decision, some of which include:

- The plain language of the text, when boiled down, reads "no . . . contractor . . .may discharge . . . an employee." There is nothing in the text that limits the term "employee" to employees of a public company. In order for the FMR's interpretation to make sense, SOX would have to read "no . . . contractor . . . may discharge . . . an employee ***of a public company***."
- If SOX only covered employees of a public company, the reference to contractors would make no sense. It is extremely unlikely that a private contractor would be able to fire an employee of a public company for which it works.
- SOX was passed in response to the Enron scandal. During the investigation of the Enron scandal, there was substantial evidence that contractors working with Enron – including the accounting firm Arthur Anderson – retaliated against their own employees when they raised concerns regarding Enron. This retaliation discouraged other individuals who could have come forward to expose Enron, which was a problem that SOX intended to address.
- Many publicly held companies have no employees – mutual funds, for instance.

These companies are often controlled and operated by private contractors. If SOX did not protect employees of private contractors, it would have no application to mutual funds and similarly run companies.

The important takeaway for employees is that you may be protected under Section 806 from retaliation even if you are employed by a privately held company. For privately held employers, it is important to fully understand the scope of the coverage of Section 806 to determine your potential liability.

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