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Sarbanes-Oxley Act (SOX) Protections for Employees of Public Companies' Contractors and Subcontractors

Article By:

Allyson N. Ho

Daryl S. Landy

Andrew J. Schaffran

Samuel S. Shaulson

Sarah E. Bouchard

Joseph J. Costello

The U.S. Supreme Court extends Sarbanes-Oxley whistleblower protections, but the reach of the decision may be curtailed by "limiting principles" referenced by the Court.

On March 4, the U.S. Supreme Court issued its decision in ***Lawson v. FMR LLC***,[1] holding that the whistleblower protections afforded by **18 U.S.C. § 1514A of the Sarbanes-Oxley Act of 2002 (SOX)** extend to employees of contractors and subcontractors of public companies. The Court addressed concerns about the potential reach of its decision, however, by referencing "various limiting principles" that were advanced by the plaintiffs and Solicitor General, including that an entity may not be considered a "contractor" unless its "performance of [the] contract will take place over a significant period of time" and that SOX would "protect[] contractor employees only to the extent that their whistleblowing relates to the contractor fulfilling its role as a contractor for the public company, not the contractor in some other capacity."[2] Because the plaintiffs at issue sought only "mainstream application" of SOX protections, however, the Court determined that it did not need to "determine the bounds of §1514A today."[3]

Background and Summary

Plaintiffs Jackie Hosang Lawson and Jonathan M. Zang originally filed separate complaints with the Occupational Health & Safety Administration of the U.S. Department of Labor (DOL) alleging unlawful retaliation under § 1514A by their respective former employers—privately held companies (collectively, the defendants) that provide advisory and management services to a family of SOX-covered mutual funds that have no employees and thus were not parties to either case. Each plaintiff separately

sought de novo review of his or her complaint by the U.S. District Court for the District of Massachusetts after the 180-day period specified in § 1514A(b)(1) concluded without a final decision by the DOL.

The defendants moved to dismiss both complaints on the grounds that neither plaintiff was covered by § 1514A as both were employees of privately held companies and SOX whistleblower protections extend only to employees of defined publicly traded companies. The district court denied the defendants' motions to dismiss, holding that the whistleblower protections of § 1514A extend to employees of private agents, contractors, and subcontractors to public companies.[4]

A divided panel of the U.S. Court of Appeals for the First Circuit, reviewing the district court's decision via interlocutory appeal, reversed. The majority found that § 1514A unambiguously confined its reach to employees of companies that have a class of securities registered under section 12 of the Securities Exchange Act of 1934 (1934 Act) or those that file reports with the SEC pursuant to section 15(d) of the 1934 Act.[5]

The Supreme Court granted certiorari and reversed the First Circuit in a 6–3 decision, holding that § 1514A "shelters employees of private contractors and subcontractors, just as it shelters employees of the public company served by the contractors and subcontractors."[6] Justice Ruth Bader Ginsburg, writing for the majority, based this decision on several factors, including the fact that the majority of mutual funds are public companies with no employees; therefore any purported whistleblowing must be made by an employee on "another company's payroll." Justice Ginsburg reasoned that, if § 1514A did not apply to these employees, all possible persons equipped to raise concerns of fraud on investors with respect to such mutual funds would be left unprotected by SOX. The majority believed that such a reading of the statute would be contrary to Congress's intent to protect and encourage corporate whistleblowers in the wake of the Enron scandal. Justice Antonin Scalia, joined by Justice Clarence Thomas, concurred in principal part and in the majority's judgment.

Justice Sonia Sotomayor, joined by Justice Anthony Kennedy and Justice Samuel Alito, authored a strong dissent, arguing that the majority's interpretation of § 1514A gives it a "stunning reach."[7] Indeed, in reaching such a decision, the dissent argued that the majority's holding expanded the definition of "employee" well beyond reason and included the household employees of the millions of people who work for public companies as well as any employee of a private business that contracts to perform work for a public company. The dissent offered as an example a babysitter being afforded SOX whistleblower protections after experiencing retaliation by a parent, who happens to work for a public company, for reporting that the parent's teenage son may have participated in Internet fraud. This, Justice Sotomayor argued, is an absurd result and is "not the statue Congress wrote."[8]

The Court's Reference to Limiting Principles

To address concerns that extending coverage to any employee of any contractor would extend SOX too far, the majority acknowledged that both the plaintiffs and the Solicitor General identified various "limiting principles" that could be applied to resolve this issue. The plaintiffs argued that "in 'common parlance,' the term 'contractor' does not extend to every fleeting business relationship."[9] Rather, the term "refers to a party whose performance of a contract will take place over a significant period of time."[10]

In addition, the Solicitor General argued that § 1514A should only protect employees to the extent that their whistleblowing relates to "the contractor fulfilling its role as contractor for the public

company, not to the contractor in some other capacity."[11]

Ultimately, the Court declined to rule on the precise bounds of § 1514A in *Lawson* because it determined that the plaintiffs fell within a "mainstream application" of SOX in that they alleged retaliation after reporting alleged fraudulent practices that would directly implicate the mutual funds' shareholders.

Although Justice Scalia, joined by Justice Thomas, concurred with the majority in principal part and in the judgment, Justice Scalia specifically disagreed "with the Court's acceptance of the possible validity of the Government's suggestion that §1514A protects contractor employees only to the extent that their whistleblowing relates to the contractor fulfilling its role as a contractor for the public company."[12]

Practical Implications and Conclusions

The Supreme Court's decision in *Lawson* makes it clear that if a private company performs sufficient work for a public company to be considered a contractor or subcontractor and if an employee of the contractor or subcontractor engages in SOX-protected activity with respect to the contractor's or subcontractor's work for that public company, the employee will be afforded whistleblower protections under § 1514A. The scope and application of the "limiting principles" invoked by the Court likely will be the subject of subsequent litigation. Additionally, the Supreme Court did not address whether **individual** independent contractors of a public company would be afforded whistleblower protections under SOX. Rather, the Court decided only whether **employees** of a public company's contractors or subcontractors are protected.

Public companies should look to review and update their current whistleblower policies and procedures to provide for the reporting and handling of concerns raised by employees of contractors and subcontractors and prohibit retaliation against employees of contractors and subcontractors who report covered concerns.

Public companies also should review their contractor relationships to ensure that contractors have adequate whistleblower policies and procedures. In addition, public companies should consider including antiretaliation requirements in their contracts and should allocate responsibility for claims of retaliation by contractor or subcontractor employees.

Finally, private companies that conduct business with public companies should, if they have not already done so, consider adopting whistleblower policies and procedures for the reporting and handling of violations of law or policy as well as prohibitions on retaliation against employees who report such concerns.

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[1]. No. 12-3 (U.S. Mar. 4, 2014), *available* here.

[2]. *Id., slip op. at* 23 (internal quotations omitted).

[3]. *Id.* at 24.

[4]. *Lawson v. FMR LLC*, 724 F. Supp. 2d 141 (D. Mass. 2010).

[5]. *Lawson v. FMR LLC*, 670 F.3d 61 (1st Cir. 2012).

[6]. *Lawson*, No. 12-3, slip op. at 2.

[7]. *Id*. at 2 (Sotomayor, J., dissenting).

[8]. *Id*. at 20 (Sotomayor, J., dissenting).

[9]. *Id.* at 23.

[10]. *Id*. (internal quotations omitted).

[11]. *Id.* (internal quotations omitted).

[12]. *Id.* at 3 (Scalia, J., concurring).

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