Private Company Employees Who Blow the Whistle on Public Company Fraud Are Protected from Retaliation

Written by Allison Anderson

March 6, 2014

When it passed the Sarbanes-Oxley Act of 2002 ("SOX"), Congress established protections against retaliation for "employees" who report fraud at public companies. Since then, however, courts and commentators have disagreed about who are "employees" for the purpose of those protections -- only the employees of public companies or also the employees of private companies? On March 4, 2014, in *Lawson v. FMR, LLC*, the Supreme Court resolved that controversy, holding that the whistleblower protections of SOX extend to people who work at private companies that contract with or provide services to public companies. In so ruling, the Court broadly defined the class of potential plaintiffs who may file retaliation claims against their employers.

In *Lawson*, the plaintiffs, Jackie Lawson and Jonathan Zang, worked for investment advisor companies, which were not themselves public companies but which provided investment advisory and management services to public mutual funds. Lawson alleged that she had been constructively discharged after she reported concerns about accounting methods used in operating a mutual fund, and Zang claimed he was fired after reporting inaccuracies in a draft SEC registration statement. They both filed suit in the U.S. District Court for the District of Massachusetts. The District Court initially held that private company employees can seek relief under SOX, but on interlocutory appeal, the Court of Appeals for the First Circuit reversed and dismissed the plaintiffs' complaint, holding that the whistleblower protections apply only to employees of public companies.

In a 6-3 decision, the Supreme Court held that Lawson and Zang can go forward with their retaliation claims. For a four-member plurality, Justice Ginsburg wrote that, based on the statutory text, "the mischief to which Congress was responding," and other similar retaliation statutes, the whistleblower provision of SOX "shelters employees of private contractors and subcontractors, just as it shelters employees of the public company served by contractors and subcontractors." Justice Ginsburg emphasized "Congress' concern about contractor conduct of the kind that contributed to Enron's collapse," asking whether Congress, which enacted SOX in the wake of "the Enron debacle," would have excluded from whistleblower protection "countless professionals equipped to bring fraud on investors to a halt."

In her dissent, Justice Sotomayor recognized the long shadow that the Enron collapse cast over the case, but she expressed concern that an expansive reading of SOX was inconsistent with the law's wording and would lead to "absurd results" in the future. Justice Sotomayor described a parade of private company employees -- from day laborers and checkout clerks to nannies and gardeners -- who provide services to public companies or the officers and directors of public companies and who might now file suits claiming retaliation for their reports of fraud. Justice Sotomayor suggested that Congress did not want to encourage extensive private litigation against private companies but rather "vest[ed] regulatory authority in the hands of experts with the power to sanction wrongdoers" -- the SEC for lawyers and the PCAOB of accountants, for example.

After *Lawson*, private companies, such as law firms, accounting firms and investment advisory companies, that contract with or provide services to public companies can be sued under SOX's whistleblower provision if they retaliate against their own employees for reporting fraud at public companies. The full extent of this potential liability remains unclear from the decision. The dissent feared that the Court had opened the floodgates to claims by countless employees with no exposure whatsoever to investor-related activity, but the majority dismissed those "fanciful visions," concluding that the Court need not "determine the bounds" of the whistleblower protection in *Lawson*, because this case presented a "mainstream application" of the law and the retaliation claims by Lawson and Zang "fall squarely within Congress' aim" in enacting the relevant provisions of SOX.

RELATED INDUSTRIES

- Investment Advisers & Private Funds
- Professional Services

RELATED PRACTICES

- Business Counseling
- Labor & Employment
- Retaliation & Whistleblowing Issues
- Securities Litigation
