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WHISTLEBLOWERS

In this BNA Insights article, attorney Gabrielle Levin looks at how federal courts have interpreted *Lawson v. FMR LLC*, the U.S. Supreme Court's first decision interpreting the whistleblower protection provision of the Sarbanes-Oxley Act. In *Lawson*, the court decided that employees of nonpublic companies may be covered by SOX.

The author discusses a number of issues, including the permissible scope of whistleblower claims by employees of nonpublic companies and whether SOX protection extends to reports that are not related to shareholder fraud. She evaluates what trends, if any, have emerged as a result of the Supreme Court's *Lawson* decision.

Lawson v. FMR LLC: One Year Later

BY GABRIELLE LEVIN

On March 4, 2014, the Supreme Court issued its decision in *Lawson v. FMR LLC*, 134 S. Ct. 1158, 37 IER Cases 1193 (2014) (42 DLR AA-1, 3/4/14), 18 U.S.C. § 1514A. The court in *Lawson* decided one important issue—that employees of nonpublic companies may be covered by SOX. But it left open a number of other issues raised by the parties, such as the permissible scope of whistleblower claims by employees of nonpublic companies and whether SOX protection extends to reports that are not related to shareholder fraud.

The first anniversary of the *Lawson* decision is an appropriate time to take stock of how federal courts have interpreted and applied *Lawson*. This article evaluates what trends, if any, have emerged as a result of the Supreme Court's *Lawson* decision.

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Lawson v. FMR LLC: The Supreme Court's Decision

In *Lawson*, the Supreme Court held 6-3 that SOX creates a cause of action not merely for the employees of public companies, but also for employees of nonpublic companies that perform work for public companies.

The plaintiffs in *Lawson* were former employees of mutual fund investment advisers, nonpublic companies that had contractual relationships with the public ''investment companies,'' or mutual funds, that they advised. The plaintiffs sued their employers under Section 806 of SOX, alleging that they had been retaliated against by the nonpublic advisers after plaintiffs reported supposed shareholder fraud at the mutual funds.

Section 806—which is titled ''Protection for Employees of Publicly Traded Companies Who Provide Evidence of Fraud''—provides in pertinent part that ''[n]o [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

[whistleblowing or other protected activity].'' 18 U.S.C. § 1514A(a).

The defendants moved to dismiss plaintiffs' complaints on the ground that Section 806, as its title suggests, creates a cause of action only for employees of public companies, protecting them from discrimination and harassment by the company and its employees, agents, and contractors. The district court disagreed and ruled for the plaintiffs, but certified the question for interlocutory review to the U.S. Court of Appeals for the First Circuit. The First Circuit reversed 2-1 (24 DLR AA-1, 2/6/12).

The Supreme Court reversed the First Circuit, holding that SOX whistleblower protection ''extends to employees of contractors and subcontractors.'' In an opinion by Justice Ginsburg, the court based its decision on its reading of the statutory text and legislative history, the ''mischief'' to which Congress was responding when it enacted SOX in the wake of the Enron scandal, and an earlier whistleblower protection law on which SOX was partly modeled.

After discussing the text of the statute, the court explained that the legislative history demonstrated ''Congress' understanding that outside professionals bear significant responsibility for reporting fraud by the public companies with whom they contract, and that fear of retaliation was the primary deterrent to such reporting by the employees of Enron's contractors.''

The Supreme Court declined to resolve a number of issues that had been considered important by the parties, their *amici*, and the courts below, including whether—if the SOX whistleblower provision extends to nonpublic company employees—there is a ''limiting principle'' that prevents the provision from being wielded against nonpublic companies in disputes that have little if anything to do with harm to shareholders, public accounting, and the concerns that led to SOX's enactment.

The court concluded it was unnecessary to reach these issues because the plaintiffs in *Lawson* had, in the court's view, reported fraudulent practices that related to the contract with the nonpublic employer. The court rejected as theoretical FMR's argument that a narrow interpretation of covered employers was necessary to avoid the ''absurd result'' that SOX protection would extend even to the personal employees of company officers and employees.

Scope of Whistleblower Claims After *Lawson*

The Supreme Court reached its decision in *Lawson* in part by declining to address some of the potentially sweeping consequences of holding that nonpublic company employees are covered by SOX. Many predicted that lower courts and litigants would continue to wrestle with a number of important questions about SOX's scope and meaning, such as delineating the permissible scope of whistleblower claims by employees of nonpublic companies, and resolving whether protection extends to reports that are not related to shareholder fraud.

SOX prohibits retaliating against employees for reporting what they ''reasonably believe'' to be a violation of the federal laws regarding mail, wire, and bank fraud, securities fraud, and ''any rule or regulation of the Securities and Exchange Commission.'' 18 U.S.C. § 1514A(a)(1).

But suppose an employee of a nonpublic company accuses his or her employer of wire fraud: Is that protected activity under SOX? And what if the accusation is unrelated to the work performed for the public company and, additionally, the contract with the public company is wholly unrelated to public accounting or securities compliance? Does SOX apply then?

The Supreme Court sidestepped these questions, brushing aside a case illustrating the potential implications of broad SOX whistleblower coverage. In *Lockheed Martin Corp. v. Administrative Review Board*, 717 F.3d 1121, 35 IER Cases 1516 (10th Cir. 2013) (107 DLR AA-1, 6/4/13), a corporate communications director had alleged SOX retaliation after she reported that her then-supervisor was using company funds to finance intimate trysts with military servicemen whom the supervisor met through a company ''pen pals'' program.

The employer argued, among other things, that ''employee reports of mail and wire fraud that do not allege shareholder fraud are not protected under Section 806.'' But the Tenth Circuit rejected that argument, ruling that an employee who reports violations of any of the SOX-enumerated laws ''need not also establish such violations relate to fraud against shareholders to be protected from retaliation under the Act.''

The Supreme Court, when confronted in *Lawson* with the broad implications of such an interpretation if private companies are covered by the law, simply noted that Lockheed itself was a public company, and that Congress could amend the law if there were an unmanageable increase in claims by private company employees premised on mail or wire fraud that had no implication for shareholders.

Post-*Lawson* Decisions

Since *Lawson* was decided one year ago, a few district courts have tackled the ''limiting principle'' questions left open by the Supreme Court.

In *Wiest v. Lynch*, 15 F. Supp. 3d 543 (E.D. Pa. 2014) (76 DLR A-5, 4/21/14), the U.S. District Court for the Eastern District of Pennsylvania held that the plaintiff, an accounts payable manager, had sufficiently pled that he was covered by SOX's whistleblower provision because his employer served as an agent of a publicly traded company.

The plaintiff sued Tyco, a nonpublic subsidiary of publicly traded Tyco Electronics Ltd. (Tyco Limited), claiming he was terminated after he began rejecting payment requests for company retreats that he believed were excessive. The plaintiff allegedly told his supervisors that the expenses were being improperly charged in the company's books and records, in violation of accounting standards and securities and tax laws.

Amendments to SOX in 2010—after the plaintiff had been terminated—made clear that SOX covers employees of subsidiaries of public companies. The court sidestepped the question whether that coverage had existed before the amendment, ruling that, regardless, the subsidiary was covered as the ''agent of'' its publicly traded parent. Of potential significance, however, is the attention the court gave the *nature* of the agency that existed between the two corporations.

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Not *any* agency relationship with a public company would produce SOX coverage, the court indicated. Instead, the court largely followed an opinion by a judge of the U.S. Department of Labor's Administrative Review Board (ARB) in ruling that an "agency based on engagement 'in securities related activities' " would result in SOX coverage, and coverage "might also be based on types of services with regard to which fraud contemplated under section 806 might be perpetrated . . . . In other words, agency could also be based on the performance, *inter alia*, of accounting and tax services and the like." (quoting concurring opinion of ARB Judge E. Cooper Brown in *Johnson v. Siemens Building Technologies, Inc.*, ARB No. 08-032, at 21-24 (DOL Mar. 31, 2011) (en banc)) (67 DLR AA-1, 4/7/11).

Following this approach, the court held that the plaintiff's allegations that officials of the parent had to approve payments he processed were sufficient to state a claim that the subsidiary was acting as an agent of the parent for SOX-related matters when it allegedly retaliated against plaintiff.

Two other district court decisions have identified limits to the potentially broad SOX coverage resulting from *Lawson*. In *Safarian v. American DG Energy Inc.*, 2014 BL 124240 (D.N.J. Apr. 29, 2014), the plaintiff was an engineer who serviced machines as an independent contractor for a publicly traded company that provided on-site electricity, heat, hot water and cooling for commercial and industrial customers. He claimed he had reported "overbilling, improper construction, and the failure to obtain permits" before his relationship with defendant was terminated.

The U.S. District Court for the District of New Jersey acknowledged that plaintiff's status as an independent contractor did not foreclose SOX coverage after *Lawson*, but ruled that the connection between the overbilling of defendant's customers and any future errors in defendant's accounting and tax submissions was too tenuous for plaintiff's disclosures to be covered by SOX. SOX is not concerned with incorrect tax submissions, the court explained, but with the accuracy of corporate securities disclosures and "controlling the conduct of accountants, auditors, and lawyers who work with public companies."

The court therefore declined to extend the statute to reports by "an engineer who has no involvement with the company's accounting or taxation practices," and where "the reported activity did not deal with corporate disclosures."

The court distinguished *Wiest* by noting that the plaintiff did not have responsibility for accounting reports or tax submissions, and had failed to show that the reported violations were "similar to, or are normally associated with, tax fraud or accounting fraud." "If the actions alleged here sufficiently relate to fraud against shareholders," the court concluded, "it is difficult to foresee an illegal act which would not fall under the purview of the Sarbanes-Oxley Act."

A judge in the U.S. District Court for the Eastern District of Pennsylvania reached a similar conclusion in *Gibney v. Evolution Marketing Research, LLC*, 25 F. Supp. 3d 741 (E.D. Pa. 2014). Evolution, a marketing research and consulting company, was sued by a former employee who claimed he was terminated after reporting fraudulent billing practices to Evolution's CEO and general counsel. According to the plaintiff, Evolution was double-billing Merck & Co., a publicly traded company, for data collection and processing services for research Merck had hired Evolution to perform.

On Evolution's motion to dismiss, the court observed that it faced an issue of first impression in the U.S. Court of Appeals for the Third Circuit regarding a question left open by *Lawson*: Whether SOX extends to "employees of private companies who, as here, report overbilling 'fraud' neither committed by the public company nor having any connection to fraud on shareholders." Calling the issue "a close question," the court concluded that SOX was not meant to reach situations "where there are allegations of fraudulent conduct between two companies who are party to a contract, and one of those companies just happens to be publicly-held."

The court acknowledged that extending protection to plaintiff's claims would be consistent with the purpose of SOX, since the cost of Evolution's inflated bills would eventually be passed on to Merck's shareholders. But the court found plaintiff's reading of SOX "impermissibly broad" for two reasons. First, the case was "fundamentally different" from *Lawson* because it did not "implicate the peculiar structure of the mutual fund industry." Unlike *Lawson*, a finding of no SOX coverage would not "insulate" an entire industry from SOX protection. And second, "in enacting SOX Congress was specifically concerned with preventing shareholder fraud either by the public company itself or through its contractors." Since plaintiff had not alleged that he blew the whistle on "fraud committed *by* Merck (either acting on its own or acting through contractors like Evolution)," but rather to "fraud *against* Merck," his claim did not fit within SOX (emphasis added). SOX is not a "general anti-retaliation statute applicable to any private company that does business with a public company," the court stated. Rather, it is intended to prevent a public company, acting alone or through its contractors, from "mak[ing] material misrepresentations about its financial picture in order to deceive its shareholders."

The Supreme Court Revisits SOX

In *Yates v. United States*, 135 S. Ct. 1074 (2015), the Supreme Court revisited SOX almost exactly a year after *Lawson*. Yates was a commercial fisherman; after an on-board inspection determined that Yates had harvested undersized fish in violation of federal conservation regulations, Yates ordered a crew member to toss the undersized fish into the sea and replace them with larger fish before the ship returned to port for a second inspection.

Yates was convicted of violating 18 U.S.C. § 1519—informally known as the "anti-shredding provision"—which was enacted as part of SOX.

Section 1519 is titled ''Destruction, alteration, or falsification of records in Federal investigations and bankruptcy,'' and it provides as follows:

> Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or ***tangible object*** with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

18 U.S.C. § 1519 (emphasis added).

The question presented to the Supreme Court was whether fish qualify as a ''tangible object'' as that term is used in the statutory text.

Pointing to Section 1519's origin as part of SOX—legislation targeting corporate fraud—Yates argued that the section sets forth a ''documents offense'' that targets records, documents, and only those ''tangible objects'' used to preserve them.

Acknowledging that Section 1519 was intended to prohibit ''corporate document-shredding to hide evidence of financial wrongdoing,'' the government argued that the provision constituted a broader ''general ban on the spoliation of evidence, covering all physical items that might be relevant to any matter under federal investigation.'' The Supreme Court disagreed with the government, holding that ''tangible object'' as used in Section 1519 ''cover[s] only objects one can use to record or preserve information, not all objects in the physical world.''

The perceived purpose of SOX's anti-shredding provision ended up tipping the balance in favor of Yates's interpretation of the statute. The court specifically noted that it was declining to adopt an interpretation of the statute that ''would cut § 1519 loose from its financial-fraud mooring.''

''Mindful that in Sarbanes-Oxley, Congress trained its attention on corporate and accounting deception and cover-ups,'' the court stated that it was adopting a ''matching construction of § 1519.'' And the court relied upon the fact that Section 1519 was ''a provision targeting fraud in financial record-keeping.''

Conclusion

In *Lawson*, the Supreme Court used SOX's perceived purpose to support a finding of SOX coverage, yet in *Yates* the same purpose-based approach had the opposite effect. While it is too early to fully assess the impact of the Supreme Court's *Lawson* decision, it appears that post-*Lawson*, courts remain receptive to arguments that the scope of the SOX whistleblower provision should not be expanded beyond the public shareholder fraud concerns underlying the passage of the Act.

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