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KD Alert: The Supreme Court of the United States Opens the Door to Additional Whistleblower Claims and Shareholder Litigation

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On March 4, 2014, in a 6-3 decision, the United States Supreme Court extended whistleblower protections afforded by the Sarbanes-Oxley Act of 2002 ("SOX") to employees of private companies that contract with public companies in a case called Lawson et al. v. FMR LLC et al.[1] The court held that employees of privately held investment advisors that manage or advise publicly-traded mutual funds are entitled to SOX whistleblower protection for reporting fraud that they observed in connection with the management of those funds. This ruling may result in more employment-related whistleblower lawsuits being filed by employees who report such alleged fraud and are then subjected to an adverse employment action as a result. The ruling also has the potential to increase the number of securities litigation cases filed, as employees of investment advisors who may wish to report misconduct in connection with the advisors' management of a mutual fund now know that they are entitled to whistleblower protection and may speak more freely, both within the company and to regulators, regarding any improprieties that they may have observed. In turn, this may lead to more shareholder litigation concerning alleged misconduct that has taken place in connection with management of mutual funds, as such misconduct will be more readily disclosed.

In the Lawson case, two Plaintiffs separately initiated legal proceedings against their former employers, which were privately held companies that provided advisory and management services to the Fidelity family of mutual funds. Plaintiff Jackie Hosang Lawson alleged that she was constructively discharged by Fidelity Brokerage Services, LLC after she raised concerns regarding her employer's use of cost accounting methods that she believed overstated expenses associated with operating Fidelity mutual funds. Plaintiff Jonathan M. Zang alleged that he was terminated by FMR Co., Inc. for raising concerns regarding a draft SEC registration statement relating to certain Fidelity mutual funds. Both Plaintiffs alleged that they had been subjected to retaliation that is prohibited under 18 U.S.C. § 1514A, which provides:

> *"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 [whistleblowing or other protected activity.]" 18 U.S.C. § 1514A (2006 ed.)*

FMR moved to dismiss these lawsuits on the grounds that FMR and its related entities are privately held and that the protections of §1514A apply only to employees of public companies. The Supreme Court held that the prohibition against a "contractor" discharging an "employee" for engaging in whistleblowing activity applies to the contractor's own employee. The court reasoned that where Congress meant "an employee of a public company," it so stated, as is evident from the first part of the statute that prohibits all officers, employees, contractors, subcontractors, or agents "of such [public] company" from engaging in retaliatory activity. In addition, the Court noted that contractors are not generally in a position to undertake adverse employment actions with respect to employees of public companies with which they contract. In the case of the mutual fund industry, limiting whistleblower protection to only those employees of public companies would effectively eliminate all such protections, as mutual funds are generally publicly held companies with no employees that are managed or advised by privately held companies.

As a result of the Supreme Court's decision in Lawson, privately held companies that provide services to public companies should be aware that their employees are afforded SOX whistleblower protections. The fact that such whistleblower protections now extend to investment advisors that advise or manage public companies such as mutual funds may give employees of such investment advisors more confidence that they can disclose alleged mismanagement or improprieties that they believe are taking place with regard to management of the funds, without fear of retaliatory or discriminatory repercussions. This, in turn, may result in increased shareholder litigation with respect to these funds.

For more information on this decision, please contact the attorneys in KD's Financial Services and Employment Law and practice groups.

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[1] *The decision is available at http://www.supremecourt.gov/opinions/13pdf/12-3_4f57.pdf.*