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BNA Insights

Supreme Court Extends Whistle-Blower Protections to Employees at Private Firms: A New Frontier For Outside Counsel

BY LAUREN J. REGIS AND
CHRISTOPHER F. ROBERTSON

On Mar. 4, 2014, a divided Supreme Court ruled 6-3 that the Sarbanes-Oxley Act's whistle-blower protection includes employees of a public company's private contractors and subcontractors.¹

The whistle-blower protection of the Sarbanes-Oxley Act of 2002 is codified in § 1514A, which states 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].”²

In *Lawson*, the Supreme Court reversed the U.S. Court of Appeals for the First Circuit to hold that this provision shields employees of privately held contractors and subcontractors to public companies.

Underlying Controversy

The petitioners, a senior director of finance and a portfolio manager respectively, brought separate proceedings against their former employer, Fidelity Brokerage Services, LLC (“FMR”), a privately held company that provides advisory and management services to the Fidelity family of mutual funds. Although Fidelity's mutual funds are public companies (within the ambit of

§ 1514A(a)) and are required to file reports with the Securities and Exchange Commission, management services are provided under contract by private companies, including FMR.

Petitioners claimed that they were terminated in retaliation for raising concerns about FMR's management of certain Fidelity mutual funds. The U.S. District Court for the District of Massachusetts denied FMR's motion to dismiss on the grounds that § 1514A protects contractors of public companies, and the petitioners, as employees of a private subcontractor, were protected.³

On appeal, a divided panel of the First Circuit reversed. The appeals court acknowledged that FMR is a “contractor” within the meaning of § 1514A and therefore prohibited from retaliating against “an employee” who engages in protected activity. The majority agreed with FMR, however, that the term “employee” within the provision refers only to employees of public companies and does not cover a contractor's own employees.⁴

¹ *Lawson v. FMR LLC et al.*, 2014 BL 57958, U.S., No. 12-3, 3/4/14 (29 CCW 83, 3/12/14).

² Emphasis added.

³ *Lawson v. FMR LLC*, 724 F. Supp. 2d 141D. Mass., C.A. No. 08-10466-DPW, 3/31/10 (25 CCW 107, 4/7/10).

⁴ *Lawson v. FMR LLC*, 670 F.3d 61, 1st Cir., No. 10-2240, 2/3/12 (27 CCW 45, 2/8/12).

Lauren J. Regis is a litigation associate in Seyfarth Shaw LLP's Boston office, and is a member of the firm's Commercial Litigation, Securities and Financial Litigation, and Consumer Financial Services Practice Groups. She is also an active member of the firm's Sarbanes-Oxley Whistleblower Team. Christopher F. Robertson is a partner at Seyfarth Shaw, specializing in complex commercial and financial litigation, securities litigation, consumer fraud litigation, regulatory compliance, corporate governance and internal investigations. He is co-chairman of the firm's National Whistleblower Team, and a member of the Boston office's Complex Litigation, Capital Markets and Investment Management practice areas.

Supreme Court Reversal

The Supreme Court disagreed. In the majority opinion, Justice Ruth Bader Ginsburg wrote that the “mischievous” Congress was responding when it enacted Sarbanes-Oxley made it clear that the protections should extend to subcontractors, including investment advisers.⁵ The Court reasoned that to hold otherwise would insulate “the entire mutual fund industry from § 1514A,” a result that the Court concluded Congress did not intend. Joined by three other Justices, Justice Ginsburg also suggested that employees of law firms and accounting firms are within the statute’s reach.⁶

Justice Ginsburg noted that in the Enron scandal, which prompted the passage of Sarbanes-Oxley, “contractors and subcontractors, including the accounting firm Arthur Andersen, participated in Enron’s fraud and its coverup.” Justice Ginsburg further noted that Sarbanes-Oxley contains “numerous provisions” aimed at controlling the conduct of “accountants, auditors and lawyers who work with public companies,” and thus concluded that § 1514A should be read to protect whistle-blowers who work for the public company’s attorneys, accountants or other professional advisers.⁷

According to Justice Ginsburg, an opposite conclusion would mean that “[l]egions of accountants and lawyers would be denied § 1514A’s protections,” and she queried why Congress, “prompted by the Enron debacle, would exclude from whistle-blower protection countless professionals equipped to bring fraud on investors to a halt.”⁸

Justice Scalia, joined by Justice Thomas, authored a concurring opinion, joining Justice Ginsburg in her analysis of the statutory text, but refusing to endorse “the Court’s occasional excursions beyond the interpretative terra firma of text and context, into the swamps of legislative history.”

By way of illustration, Justice Scalia cited a remark made by Sarbanes-Oxley’s lead sponsor, former Sen. Paul Sarbanes (D-Md.), who made it “very clear that [the Act] applies exclusively to public companies—that is, to companies registered with the Securities and Exchange Commis-

sion. It is not applicable to private companies, who make up the vast majority of companies across the country.” Ultimately, however, the two Justices agreed with the majority.⁹

Justice Sotomayor, joined by Justices Kennedy and Alito, dissented, fearing that the majority’s interpretation gives the law “a stunning reach.” Now, wrote Justice Sotomayor, “individuals and private businesses” are subject to litigation over fraud reporting that in no way furthers Congress’s goal of protecting “the interests of public company shareholders.” By way of example, Justice Sotomayor wrote, “a babysitter [is now authorized] to bring a federal case against his employer—a parent who happens to work at the local Walmart (a public company)—if the parent stops employing the babysitter after he expresses concern that the parent’s teenage son may have participated in an Internet purchase fraud.”¹⁰

Although the babysitter example can be viewed as extreme in order to make a point, what cannot be denied is that four Justices would unquestionably conclude that Sarbanes-Oxley’s anti-retaliation provisions include all employees of law firms and accounting firms. The implications of *Lawson* are far-reaching, particularly in the context of attorney-client privilege issues that are necessarily implicated by a situation where lawyers blow the whistle on the public company for whom they work.

Implications for Counsel

In the wake of *Lawson*, even outside counsel working for a law firm that is retained by a public company could bring a whistle-blower claim against the firm if the firm arguably retaliated against him or her. Such a claim would then place the attorney squarely in the ethical dilemma of protecting his or her own rights while also protecting the rights that same attorney owes to the law firm’s client.

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This ethical dilemma already exists and courts have faced it in situations where an in-house counsel is a whistle-blower. For example, in *GTE Products Corp. v. Stewart*, the Massachusetts Supreme Judicial Court held that an attorney’s status as legal in-house counsel did not bar him from maintaining a wrongful discharge action against his employer.¹¹ There, the in-house counsel had raised concerns to corporate officers and officials about three products manufactured by the corporation’s lighting business. His advice was “disregarded on some occasions and generally not well received.”¹² Eventually, he resigned after experiencing several of what he alleged were “precursors to discharge.” The court noted the potentially “destructive impact recognition of the claim would have on the attorney-client relationship that exists between an employer and in-house counsel”¹³

However, the court ultimately found that the public policy benefits outweighed the risk, citing in support *General Dynamics Corp. v. Superior Court of San Bernardino County*, in which the Supreme Court of California ruled that there were sound reasons for recognizing the right of in-house counsel to sue for wrongful discharge, including protecting the policy expressed in the statute or rule the employer allegedly violated.¹⁴

The Massachusetts court concluded that “public interest is better served if in-house counsel’s resolve to comply with ethical and statutorily mandated duties is strengthened by providing judicial recourse when an employer’s demands are in direct and unequivocal conflict with those duties,”—limited, however, to instances where “the claim can be proven without any violation of the attorney’s obligation to respect client

¹¹ 653 N.E.2d 161, 167–68 (Mass. 1995).

¹² *Id.* at 164.

¹³ *Id.* at 165.

¹⁴ 7 Cal. 4th 1164, 1181 (1994).

⁵ *Lawson*, 2014 BL 57958, at *3–4.

⁶ *Id.* at *10–12.

⁷ *Id.* at *3–4.

⁸ *Id.* at *9.

⁹ *Id.* at *17–18 (Scalia, J., concurring).

¹⁰ *Id.* at *18–19 (Sotomayor, J., dissenting).

confidences and secrets.”¹⁵ Likewise, the California Supreme Court concluded that “where the elements of a wrongful discharge in violation of fundamental public policy claim cannot, for reasons peculiar to the particular case, be fully established without breaching the lawyer-client privilege, the suit must be dismissed in the interest of preserving the privilege.”¹⁶

Policies in Conflict?

This last point raised by the Massachusetts and California courts is the critical piece of analysis that will now be required not only by in-house counsel seeking to bring a whistleblower claim, but also by outside counsel attorneys to public companies. Specifically, how can an attorney advance or prove the claim without breaching the attorney’s ethical obligations to the client to maintain confidences?

Numerous courts have struggled with this issue, seeking to strike a balance between the competing public policies of the whistle-blower statutes and the attorney-client privilege. In *Van Asdale v. International Game Technology*, for example, in-house attorneys based in Nevada, but who were licensed in Illinois, brought claims under 18 U.S.C. § 1514A, al-

leging that they had been retaliated against after raising issues with the viability of certain patents in connection with a merger transaction.¹⁷ The company argued that the claims must be dismissed because maintaining the claims would necessarily require the disclosure of confidential information and thus violate the Illinois Rules of Professional Conduct.

The U.S. Court of Appeals for the Ninth Circuit rejected this argument, relying on earlier cases from the U.S. Courts of Appeals for the Third and Fifth circuits, and finding that the Illinois Rules did not overcome the Sarbanes-Oxley whistle-blower regime. Instead, the court concluded that the proper approach was not to prohibit the claim altogether, but to “use the many equitable measures” at the trial court’s disposal to minimize the possibility of harmful disclosures.¹⁸

Taking a more conservative approach, the U.S. Court of Appeals for the Second Circuit in *United States ex rel. Fair Laboratory Practices Assocs. v. Quest Diagnostics Inc.* found that a former in-house counsel had violated his ethical obligations in advancing a claim under the False

Claims Act, affirming the dismissal of his lawsuit and his disqualification.¹⁹

In reaching this conclusion, the Second Circuit held that the FCA “does not preempt state ethical rules governing the disclosure of client confidences.”²⁰ Likewise, in *General Dynamics*, the California Supreme Court laid the issue squarely at the foot of the lawyer, concluding that an attorney who unsuccessfully pursues a retaliation claim risks being subject to state bar disciplinary proceedings.²¹

Conclusion

Assuming that § 1514A now covers employees of private law firms to public companies, law firms should revisit their own anti-retaliation policies to assure themselves that they have clear prohibitions on retaliation, as well as clear policies regarding the confidentiality of client information to be in the best position to protect that information in the event an attorney does file a retaliation claim for reporting suspected fraud at a public company client.

Attorneys considering filing a retaliation claim also must appreciate that the claim may or may not survive, and there is also a risk to the attorney’s license if an ethical line is crossed while advancing the claim.

¹⁷ 577 F.3d 989 (9th Cir. 2009).

¹⁸ *Id.* at 996 (citing *Willy v. Administrative Review Board*, 423 F.3d 483 (5th Cir. 2005) and *Kachmar v. SunGuard Data Sys., Inc.*, 109 F.3d 173 (3rd Cir. 1997)).

¹⁹ 734 F.3d 154 (2d Cir. 2013).

²⁰ *Id.* at 168.

²¹ 7 Cal. 4th at 1191.

¹⁵ *GTE Products*, 653 N.E.2d at 166.

¹⁶ *General Dynamics Corp.*, 7 Cal. 4th at 1190.