IN THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 10-2240

JACKIE HOSANG LAWSON; JONATHAN M. ZANG,

Plaintiffs – Appellees/Cross Appellants

vs.

FMR LLC f/k/a FMR Corp.; FMR CO., INC.; FMR Corp., d/b/a Fidelity Investments; FMR LLC, d/b/a Fidelity Investments; FIDELITY BROKERAGE SERVICES, INC., d/b/a Fidelity Investments; FIDELITY MANAGEMENT & RESEARCH COMPANY

Defendants – Appellants/Cross-Appellees

BRIEF OF CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* SUPPORTING DEFENDANTS-APPELLANTS

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Case No. 10-2240
Lawson v. FMR LLC & Zang v. FMR LLC, Et Al.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rules 26.1 and 29(c) of the Federal Rules of Appellate Procedure, *amicus curiae* the Chamber of Commerce of the United States of America states as follows:

The Chamber of Commerce of the United States of America has no parent corporation and no subsidiary corporation. No publicly held company owns 10% or more of its stock.

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STATEMENT OF INTEREST OF THE AMICUS

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents an underlying membership of three million professional organizations of every size, in every industry sector, and from every region of the country. More than 96% of U.S. Chamber members are small businesses with 100 employees or fewer. A central function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus* briefs in cases that raise issues of vital concern to the nation's business community.

ARGUMENT

I. THIS COURT SHOULD REVERSE THE DISTRICT COURT'S DECISION

The district court's decision to dramatically expand the coverage of Section 806 of the Sarbanes-Oxley Act of 2002 ("SOX") to privately held companies that contract with public companies is contrary to the text, title and legislative history of the statute. As Defendants-Appellants have aptly demonstrated, the district court reached this result by eschewing the traditional tools of statutory interpretation and improperly relying on its own policy-based analysis of the broad purposes behind SOX. In doing so, the district court reached a result that directly undermines Congressional intent and unsettles the reasonable expectations of privately-held companies by exposing them to costly litigation and compliance efforts in a complex and unfamiliar area of the law. While the district court attempted to justify this result by reasoning that its decision would advance SOX's purpose of targeting fraud involving public companies, the exact opposite is true.

Prior to the district court's decision, most privately held companies had no reason to concern themselves with SOX or its whistleblower provision. The vast majority of privately held companies are not covered by securities laws and had little reason to expect that a whistleblower law concerning shareholder fraud might apply to them. Moreover, the language and legislative history, as well as judicial precedent, firmly establish that privately held companies are not covered by SOX's

whistleblower provision ("Section 806"). The district court's decision, if allowed to stand, will unsettle these reasonable expectations. It may force privately held companies to not only defend these complex claims, but also to understand unfamiliar and complex securities laws and implement appropriate measures to minimize the risk of such litigation. In short, at a time when privately held businesses are struggling to remain viable, the district court's decision exposes them to significant time and expense in ensuring compliance and defending against a new set of claims – many of which will be frivolous and most of which will be costly – despite the utter lack of congressional intent that SOX extend to their operations.

While the district court's decision will certainly impose costly and unanticipated burdens on small businesses, it will do virtually nothing to advance SOX's overall purpose. The district court's assumption that employees of privately held companies will serve an important role in uncovering fraud at public companies is misguided. Cases brought against public companies demonstrate that Section 806 litigation often has only the most tenuous, if any, connection to actual shareholder fraud; claims are regularly brought by employees who lack any accounting or securities experience and are based on allegations of shareholder fraud that just scarcely meet Section 806's "reasonable belief" standard. Employees of privately held companies, who will have far less exposure to the full

range of facts necessary to accurately identify shareholder fraud, are even less likely to bring legitimate SOX whistleblower claims. Indeed, a brief review of SOX whistleblower litigation against publicly held companies demonstrates that the main impact of the district court's decision will be to generate additional costly and time consuming claims while doing little to serve what the district court characterized as SOX's purpose – *i.e.*, eradicating shareholder fraud.

For these reasons, the Chamber supports Defendants-Appellants' request for reversal of the district court's decision.

A. The District Court Decision Exposes Small, Privately Held Businesses To Costly Litigation Regarding Complex and Unfamiliar Securities Law Issues.

The district court's decision expands coverage under Section 806 to all private contractors and subcontractors of publicly held companies, thus creating litigation exposure for a range of privately-held companies, without regard to industry, number of employees or revenue. Although the district court's decision focuses on a narrow set of facts, the list of privately held companies potentially affected by the decision is truly expansive. Publicly held companies increasingly look to third party service providers, whether by way of outsourcing relationships or one-time engagements, to handle both core and non-core functions. As a result, private contractors perform an endless range of services for public companies – from information technology services to marketing, to human resources and back

office functions. Many of these private contractors have limited revenue, too much of which is already allocated to defending employment-related litigation. In fact, surveys repeatedly show that employment-related litigation is one of the largest areas of litigation for many companies of all sizes. Fulbright & Jaworski L.L.P., Fulbright's 7th Annual Litigation Trends Survey Findings, (2010), http://www.fulbright.com/images/publications/Fulbrights7thAnnualLitigationTrendsReport.pdf; Fulbright & Jaworski L.L.P., Fulbright's 6th Annual Litigation Trends Survey Report, (2009), http://www.fulbright.com/litigationtrends07. Small, privately held businesses can ill afford to add to the list of employment related matters they are required to defend.

Requiring privately held businesses to defend against Section 806 claims is particularly troublesome, given the complexity of these claims. In particular, Section 806 claims require nuanced inquiries into, among other things, whether employee "whistleblower" complaints relate to securities laws or shareholder fraud. The vast majority of privately held companies are not covered by such securities laws and thus are ill-positioned to implement compliance measures and defend against these claims. Requiring privately held companies to deal with securities laws that heretofore have not applied to them is certainly not something Congress intended in passing an act to target fraud within *publicly held* companies.

B. The District Court's Decision Unsettles Reasonable Expectations of Private Employers.

The district court's decision is at odds with reasonable employer expectations that have developed around the language, legislative history and judicial interpretations of the statute. Given SOX's emphasis on publicly held companies, private employers have no expectation of being covered by SOX's whistleblower provision. The reasonableness of this expectation has been confirmed by a number of decisions in which courts and administrative law judges have rejected the proposition that Section 806 covers private employers. *See, e.g.*, *Fleszar v. U.S. Dep't of Labor*, 698 F.3d 912, 915 (7th Cir. 2010); *Brady v. Calyon Securities, Inc.*, 406 F. Supp. 2d 307, 317-318 (S.D.N.Y. 2005); *Zang v. Fidelity Management & Research Co.*, 2007-SOX-27, 2008 WL 7835900, at *7-8 (ALJ Mar. 27, 2007); *Goodman v. Decisive Analytics Corp.*, 2006-SOX-00011, 2006 WL 3246820, at *8 (ALJ Jan. 10, 2006).

In these decisions, judicial authorities, based on a thoughtful review of the statutory language, title and legislative history, have reached the sound conclusion that private employers are not covered. For instance, in *Brady*, Judge Lynch, before his recent elevation to the Second Circuit, examined the precise phrase at issue – i.e., Section 806's reference to any "officer, employee, contractor, subcontractor or agent" – and determined that it "simply lists the various potential actors who are prohibited from engaging in discrimination on behalf of" public

companies. 406 F. Supp. 2d 307, 318 (S.D.N.Y. 2005). In other words, the "Act makes plain that neither publicly traded companies nor anyone acting on their behalf, may retaliate against qualifying whistleblower employees." *Id*. Judge Lynch further concluded that "[n]othing in the Act suggests that it is intended to provide general whistleblower protection" to any employee of "any privately-held employer, such as a local realtor or law firm, that has ever had occasion, in the normal course of its business, to act as an agent of a publicly traded company …." *Id*.

The Seventh Circuit recently agreed, explicitly taking issue with the "belief that the phrase 'contractor, subcontractor, or agent' means anyone who has *any* contract with an issuer of securities," noting that "[n]othing in § 1514A implies" or supports such an understanding of the statutory language. *Fleszar v. U.S. Dep't of Labor*, 698 F.3d 912, 915 (7th Cir. 2010) (emphasis in original). Rather, the court clarified that, "[i]n context, 'contractor, subcontractor or agent' sounds like a reference to entities that participate in the issuer's activities" and that thus, "can't retaliate against whistleblowers" on behalf of covered publicly held entities. *Id*.

Similarly, the ALJ in *Goodman* concluded that "the terms 'contractor' and 'subcontractor' in the provision reference two of various entities of a publicly traded company that may not adversely affect the terms and conditions of an employee of a publicly traded company." *Goodman v. Decisive Analytics Corp.*,

2006-SOX-00011, 2006 WL 3246820, at *8 (ALJ Jan. 10, 2006) (emphasis in original). "Any broader interpretation," the court explained, "means that every non-publicly traded company becomes subject to SOX if it engages in any contractual relationship with a publicly traded company." *Id*.

During administrative proceedings in one of the cases on appeal, *Zang v. Fidelity Management & Research Company, et al.*, the ALJ found that if Congress had "intended [] an expansive application" of SOX such that it would apply to "any privately owned company having a contract or having any type of agency relationship with a publicly traded company," "it would have plainly said as much." 2007-SOX-27, 2008 WL 7835900, at *7 (ALJ Mar. 27, 2007). *Id*. The ALJ reached this conclusion based on a thorough examination of statutory language and legislative history. *Id*.

In sum, prior to the district court's decision, private employers had no basis to conclude that SOX imposed burdensome new requirements on them. If, contrary to this reasonable expectation, the district court's decision stands, private employers may be forced to implement costly litigation avoidance measures, and despite such measures, will inevitably incur additional costs defending Section 806 whistleblower litigation, much of which is likely to be frivolous.

C. The District Court's Analysis of Section 806's Title Is Particularly Deficient In That It Disregards Clear Statements Of Congressional Intent That Private Companies Be Excluded From Sarbanes-Oxley Act Coverage.

The district court's analysis of Section 806's title is particularly troubling to privately held companies, as it fundamentally misconstrues the setting in which SOX was passed. The district court disregarded the title chosen by Congress for Section 806, namely, "Whistleblower Protection For *Employees of Publicly Traded Companies*," 18 U.S.C. § 1514A (emphasis added). Although this title evinces a clear intent to limit Section 806's coverage to employees of publicly held companies, the district court set it aside as a "shorthand reference" which includes employees of privately held companies.

Privately held companies were not an "afterthought" that Congress would have referenced through "shorthand." To the contrary, the legislative history evinces a clear focus on ensuring that privately held companies would not be covered by SOX. Senator Sarbanes, SOX's primary sponsor, took special care to "make very clear that SOX applies exclusively to public companies – that is, to companies registered with the Securities and Exchange Commission. It is not applicable to the private companies, who make up the vast majority of companies across the country." 148 CONG. REC. S7350, 7351 (July 25, 2002). Likewise, Senator Leahy, with specific regard to Section 806, clarified that the whistleblower provision was required because, as opposed to employees of governmental entities,

there was "no similar protection for employees of publicly traded companies." 148 CONG. REC. S1783, 1787-88 (Mar. 12, 2002). Other clear statements in the Congressional Record indicate that the purpose of Section 806 is to "provide whistleblower protection to employees of publicly traded companies." 148 CONG. REC. S7418, 7418 (Mar. 12, 2002).

In light of this history, it is simply absurd to suggest that, had Congress intended to depart from its general intent of excluding privately held companies from SOX's coverage, it would have done so without explicitly referencing privately held companies in the title of Section 806.

D. The District Court's Decision Will Not Advance The Purposes of SOX.

After erroneously concluding that the scope of coverage was not resolved by the statute's language, title or legislative history, the district court grounded its holding on its view that the overall purpose of SOX – namely, to "target[] … fraud involving *public* companies" – would be advanced by extending coverage to *private* contractors and subcontractors of public companies. *See* Memorandum and Order, dated March 31, 2010 (the "March Order") at 36) (emphasis added). In this regard, the district court's analysis is deeply flawed, as it incorrectly assumes that employees of privately held contractors will play a useful role in detecting fraud at public companies, and that extending coverage to such employees outweighs

countervailing concerns, such as the imposition of unwarranted litigation and compliance costs on their privately held employers.

Importantly, the district court conceded that extending coverage to private contractors in general would undermine the purposes of SOX, since SOX targets fraud in public, not private companies. *Id*. However, the district court opined that the expansive reach of its holding would be limited by the requirement that covered complaints relate to "shareholder fraud." *Id*. at 40.

While the requirement that whistleblower complaints relate to "shareholder fraud" may provide private employers with an additional defense, it will not insulate such employers from frivolous and costly litigation. Employees of publicly held companies have brought Section 806 litigation based on complaints regarding matters that have little, if any, discernable connection to shareholder fraud. *See, e.g.*, *Reed* v. *MCI, Inc*., 2006-SOX-71, 2008 WL 7835840, at *2-3 (ALJ Apr. 30, 2008) (software systems engineer complains about misuse of unlicensed computer software); *Harvey v. Safeway, Inc*., 2004-SOX-21, 2005 WL 4889073, at *28 (ALJ Feb. 11, 2005) (grocery store clerk complains of discrepancies in his paychecks); *Lerbs v. Buca Di Beppo, Inc*., 2004-SOX-8, 2004 WL 5030304, at *12-13 (ALJ June 15, 2004) (cash manager for restaurant chain complains about inflated sales, conflict of interest in hirings and improper general ledger entries).

Although such alleged whistleblower complaints should be and often are dismissed based on pre-trial motions, it can be costly for employers to obtain such dismissals, particularly in Section 806 cases, which often require expensive discovery regarding potentially fact-intensive issues, such as whether the alleged whistleblower had a "reasonable belief" that shareholder fraud had occurred. *See Richards v. Lexmark Int'l, Inc*., 2004-SOX-49, 2006 WL 3246874, at *26 (ALJ June 20, 2006) ("Under the Act, it is only necessary for the complainant to establish that he 'reasonably believed' there was a securities violation….The test does not measure the accuracy or falsity of a Complainant's allegations").

Indeed, relying on the reasonable belief requirement, some courts, again addressing public company employees, have held that a whistleblower need not have an accounting background or any training on securities fraud. *See* e.g., *Sequiera v. KB Home*, No. H-07-cv-03036, 2009 WL 6567043, at *9-13 (S.D. Tex. Jan. 12, 2009) (marketing manager without "any formalized training in accounting or Sarbanes-Oxley compliance," could have reasonable belief of shareholder fraud based on company's acceptance of false vendor invoices, improper transfer of inventory, and direction for him to destroy budget data; summary judgment denied); *Collins v. Beazer Homes USA, Inc*., 334 F. Supp. 2d 1365, 1376-78 (N.D. Ga. 2004) ("if Congress had intended to limit the protection of Sarbanes-Oxley to accountants … it could have done so. It did not"; denying summary judgment of

director of marketing's complaints about overpayment of advertising agency, improper break-down of marketing costs, and suspected kickbacks on lumber purchases).

As such, just about any employee working in any area of corporate activity can raise a claim to whistleblower status. And, although claims that are unrelated to shareholder fraud should be dismissed early in the proceedings, courts often construe the "reasonable belief" standard as requiring expensive discovery, even in the most frivolous of claims. *e.g.*, *Ciavarra v. BMC Software, Inc*., No. H-07-0413, 2008 WL 352273, at *3-4 (S.D. Tex. Feb. 7, 2008) (account representative "reasonably believed that the improper recognition of the amount reflected in the invoice was a violation of Sarbanes-Oxley and other federal laws relating to fraud against shareholders"; summary judgment denied); *Mahoney v. Keyspan Corp*., No. 04 CV 554 SJ, 2007 WL 805813, at *1-6 (E.D.N.Y. Mar. 12, 2007) (strategic planning director with "neither personal knowledge of the fraud nor the educational background to discover the fraud on his own," could reasonably believe that improperly reported "post-employment benefits" and severance payments constituted shareholder fraud; summary judgment denied).

In sum, there is no basis to believe that any general, overarching purpose of SOX will be served by subjecting privately held companies to frivolous and costly litigation. Nor was it necessary for the district court to resolve the coverage issue

by resorting to nebulous statements of SOX's general purposes, when the language and legislative history so clearly indicate that employees of privately held companies are not covered.

CONCLUSION

For the foregoing reasons, the *amicus curiae* Chamber of Commerce of the United States of America respectfully requests that this Court reverse the district court's decision.

Respectfully submitted,

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Dated: December 27, 2010

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitation set forth in FRAP 29(d) and FRAP 32(a)(7)(B). This brief contains 2,883 words.

Dated: December 27, 2010

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CERTIFICATE OF SERVICE

I hereby certify that, on December 27, 2010, I electronically filed the foregoing BRIEF *AMICUS CURIAE* OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF APPELLANTS with the United States Court of Appeals for the First Circuit by using the CM/ECF system. I certify that the following parties or their counsel of record are registered as ECF Filers and that they will be served by the CM/ECF system:

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