available at http://www.sec.gov/news/press/2011/2011-223.htm.

17. Order at 3, *SEC v. Gupta*, No. 11-cv-7566 (S.D. N.Y. Nov. 30, 2011).
18. Order Instituting Proceedings, *In the Matter of David W. Baldt*, SEC Admin. Proc. No. 3-13887 (May 11, 2010), available at http://www.sec.gov/litigation/admin/2010/33-9124.pdf.
19. An ETF is a security that tracks an index, a commodity or basket of assets like an index fund, but trades like a stock on an exchange. *See* http://www.investopedia.com/terms/e/etf.asp#axzz1ioTdKwDK.
20. Order Instituting Proceedings, *In the Matter of Spencer D. Mindlin*, SEC Admin. Proc. No. 3-14557 (Sept. 21, 2011), available at http://www.sec.gov/litigation/admin/2011/33-9261.pdf.
21. *60 Minutes* "Congress: Trading stock on inside information?" (CBS television broadcast Nov. 13, 2011), available at http://www.cbsnews.com/8301-18560_162-57323527/congresstrading-stock-on-inside-information.
22. Jonathan Macey, "Congress' Phony Insider-Trading Reform," Wall St. J., Dec. 13, 2011, available at http://online.wsj.com/article/SB10001424052970203413304577088881987346976.html.
23. The Wall Street Journal noted that "senators outperform the market by an astonishing 12% on an annual basis." Macey, *supra* note 105.
24. H.R. 1148, the *Stop Trading on Congressional Knowledge Act*: Hearing before the H. Comm. on Fin. Servs., 112th Cong. (2011) (testimony of Robert Khuzami, Dir., Div. of Enforcement, SEC), (Khuzami testimony) available at http://www.sec.gov/news/testimony/2011/ts120611rk.htm.
25. Khuzami testimony.
26. Khuzami testimony.
27. Khuzami testimony.
28. *Kahn v. Kolberg Kravis Roberts & Co.*, 23 A.3d 831 (Del. 2011).
29. *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981).
30. *Kahn*, 23 A.3d at 837-38.
31. Additionally, "derivative actions may not be removed to federal court under the Securities Litigation Uniform Standards Act of 1998." Posting of Eduardo Gallardo et al. to Harvard L. Sch. F. on Corp. Governance and Fin. Reg., http://blogs.law.harvard.edu/corpgov/2011/07/26/court-broadens-insidertrading-claims-under-delaware-law (July 26, 2011, 9:21).
32. George Packer, "A Dirty Business," The New Yorker, June 27, 2011, available at http://www.newyorker.com/reporting/2011/06/27/110627fa_fact_packer?currentPage=all.

# No SOX Whistleblower Protection for Employees in the Mutual Fund Industry According to First Circuit Decision in *Lawson*

**BY ROSANNE E. FELICELLO**

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The Sarbanes-Oxley Act of 2002 (SOX) includes an antiretaliatory provision that provides an explicit private right of action to protect employees who alert the authorities to a securities law violation. The U.S. Court of Appeals for the First Circuit ruled February 3 in *Lawson v. FMR LLC*[1] that this provision does not provide whistleblower protection for employees who work at the private companies that run mutual funds—as well as the employees who work at private vendors or contractors in other industries—because the only employees afforded protection are those who work at public companies. This limitation is not found in the statute and will likely have a chilling effect on potential whistleblowers in the mutual fund and other industries.

A year ago, in its landmark *Thompson v. North American Stainless, LP*[2] decision, the U.S. Supreme Court analyzed the scope of the antiretaliation provision of Title VII of the Civil Rights Act of 1964 (Title VII). Relying on a textual analysis and the Court's "understanding of the antiretaliation provision's purpose,"[3] the Court determined that Eric Thompson, who was fired three weeks

after his co-worker fiancée filed a charge of sex discrimination, was within the zone of interests and had standing to bring an antiretaliatory claim.

The Supreme Court acknowledged that allowing third-party claims for antiretaliation "will place the employer at risk any time it fires any employee who happens to have a connection to a different employee who filed a charge with the EEOC [Equal Employment Opportunity Commission]."[4] But that is a risk that the employer has because "Title VII's anti-retaliation provision is worded broadly… [T]here is no textual basis for making an exception to it for third-party reprisals, and a preference for clear rules cannot justify departing from statutory text."[5]

Faced with the task of interpreting a similar antiretaliatory provision and with seemingly no regard for the *Thompson* opinion, the First Circuit has recently decided in *Lawson* to significantly depart from the statutory text to avoid "very broad coverage" for the whistleblower protections of SOX.

In the *Lawson* case, two employees of separate FMR LLC subsidiaries brought retaliation claims pursuant to § 1514A of SOX. Plaintiff Jackie Hosang Lawson was employed by Fidelity Brokerage Services, LLC, a private subsidiary of FMR Corp, which was succeeded by FMR LLC. The three entities, together, operate under the trade name Fidelity Investments. Plaintiff Johnathan M. Zang was employed by Fidelity Management & Research Co., and later by FMR Co., which was formed as a subsidiary of Fidelity Management & Research Co. (collectively, the Fidelity Management companies).

Fidelity Investments and the Fidelity Management companies are private companies that provide advising or management services by contract to the Fidelity family of mutual funds. As noted by the First Circuit, "As is not unusual among funds organized under the Investment Company Act, the Fidelity funds have no employees of their own."[6] Rather, they rely on the employees of their contractors (*i.e.* Fidelity Investments and the Fidelity Management companies) to carry out the business of the mutual funds.

While still employed, Lawson filed SOX complaints against her employer and its parents alleging retaliation for raising concerns primarily relating to cost accounting methodologies. Within two months of his termination, Zang filed a complaint with the Occupational Health & Safety Administration (OSHA) alleging that he had been terminated in retaliation for raising concerns about inaccuracies in a draft revised registration statement for certain Fidelity funds and that he reasonably believed the inaccuracies violated several federal securities laws.

## First Circuit Reverses

A Massachusetts district court determined that the employees of private companies that are contractors or subcontractors of those public companies are afforded the whistleblower protection of § 1514A, but limited this protection to those employees reporting violations "relating to fraud against shareholders."[7] On review, the First Circuit reversed the district court's decision and concluded that the text of the statute is "clear" that the only employees afforded whistleblower protection are the employees at the public company supposedly engaged in the wrongdoing.

The *Lawson* decision is remarkable for the labor that the Circuit Court undertook to reach a result at odds with both the text of the statute and the purpose of the antiretaliatory provisions.

The statute, while not perfect, is clear. It reads:

> **§ 1514A. Civil action to protect against retaliation in fraud cases:**
>
> **(a) Whistleblower protection for employees of publicly traded companies. — No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 781), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), 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 any lawful act done by the employee:**
>
> **(1) to provide information… regarding any conduct which the employee reasonably believes constitutes a violation of… any rule or regulation of the Securities and Exchange Commission.[8]**

According to the First Circuit, the "more natural reading"[9] of the statute is to add "of such public company" as a modifier after the last "employee." And the First Circuit labors for 30-plus pages in its decision to attempt to provide support for this drastic modification.

Not once does the First Circuit consider the "antiretaliation provision's purpose," which the Supreme Court looked to in deciding the *Thompson* case.

The *Thompson* opinion is one based on statutory text and common sense. Unfortunately, the *Lawson* opinion is lacking on both. For instance, in the *Thompson* opinion, the Supreme Court says "[w]e think it obvious that a reasonable worker might be dissuaded from engaging in protected activity if she knew that her fiancé would be fired"[10] as support for why a fiancé should be within the scope of those protected by the antiretaliatory provisions of Title VII. In contrast, the First Circuit never pauses to consider whether it would be reasonable to imagine that an employee of a contractor would be the employee most likely to come forward with relevant information and the one in most need of protection.

Aside from its disregard of the plain language of the statute, the second most glaring omission from the First Circuit's opinion is any discussion of the purpose of the statute. The purpose is to protect potential whistleblowers from being fired or otherwise retaliated against for reporting wrongdoing. If you were drafting such a statute, who would you want to protect? You would want to protect as many people as possible, right? You would want the protection for whistleblowers to be broad to encourage people to come forward to report wrongdoing without fear of reprisal. You would want to protect the employees of a public company's contractors, subcontractors, officers and other agents. These are the very type of people likely to have information about wrongdoing and who may want to report the wrongdoing. The First Circuit's opinion eliminates protection for these people. It limits protection to those whistleblowers who happen to work at the public company, the very people most likely to be involved in the wrongdoing, most likely to be interested in covering it up, and most *unlikely* to come forward.

And it's even worse, because the opinion eviscerates any protection for employees in the mutual fund industry, even those employees who work directly with the fund. This is due to the unique set up of the mutual fund industry. The public mutual funds themselves generally do not have any employees (as is the case for the Fidelity funds at issue in *Lawson*). All of the employees who work on the funds are employed by private companies who contract with the mutual fund to provide their services. According to the First Circuit's opinion, none of the employees of the private fund advisers are protected by the whistleblower protection of SOX.

## A Congressional Solution

The First Circuit says that if Congress meant to offer whistleblower protection to employees in the mutual fund industry, it could have said so explicitly. Even though, as pointed out by the dissent, elsewhere in the statutory scheme, Congress only mentions the mutual fund industry when it is *excluding* the industry from specific requirements. That is, all of the provisions of SOX apply to the mutual fund industry unless the provision specifically *excludes* those companies from the regulation at issue.

The majority opinion does not answer why Congress would have excluded the mutual fund industry from this antiretaliatory provision. Indeed, there is no sensible reason for this exclusion, which Congress surely did not intend.

Circuit Judge O. Rogeriee Thompson also noticed the odd logic of the First Circuit's opinion and wrote a scathing dissent:

**"Because my colleagues impose an unwarranted restriction on the intentionally broad language of the Sarbanes-Oxley Act, employ a method of statutory construction diametrically opposed to the analysis this same panel employed just weeks ago, take pains to avoid paying any heed to considered agency views to which circuit precedent compels deference, and as a result bar a significant class of potential securities-fraud whistleblowers from any legal protection, I dissent."**[11]

The majority opinion ends by inviting Congress to amend the statute if it "intended the term 'employee'… to have a broader meaning than the one we have arrived at."[12] But it is not the statute that has inexplicably added "of such public company" to "employee." The Circuit Court has. Now it is up to either the First Circuit to agree to review this case *en banc*, or have the Supreme Court or Congress restore the protection of whistleblowers in the mutual fund industry under SOX.

In the *Thompson* decision, Supreme Court Justice Antonin Scalia, arguably the judicial leader of textualism, took notice of the purpose of the antiretaliatory provision at issue in determining its meaning. It is disappointing that the First Circuit did not follow this same approach. As a result of its failure to do so, we are left with a statute that does not provide whistleblower protection for a large portion of the industry it was meant to protect.

**NOTES**

1. *Lawson v. FMR LLC*, No. 10-2240, (1st Cir. 2012).
2. *Thompson v. North American Stainless, LP*, 131 S. Ct. 863, 178 L. Ed. 2d 694, 111 Fair Empl. Prac. Cas. (BNA) 385, 94 Empl. Prac. Dec. (CCH) P 44081 (2011).
3. *Thompson,* 131 S. Ct. at 868.
4. *Thompson*, 131 S. Ct. at 868.
5. *Thompson*, 131 S. Ct. at 868.
6. *Lawson*, Background.
7. *Lawson v. FMR LLC*, 724 F. Supp. 2d 141, 30 I.E.R. Cas. (BNA) 966, 93 Empl. Prac. Dec. (CCH) P 43854, Fed. Sec. L. Rep. (CCH) P 95663, 2010 O.S.H. Dec. (CCH) P 33053 (D. Mass. 2010).
8. Title VII of the Civil Rights Act of 1964 § 1514A.
9. *Lawson v. FMR LLC*, No. 10-2240, 2012 WL 335647 (1st Cir. 2012).
10. *Thompson,* 131 S. Ct. at 868.
11. *Lawson*, Dissent.
12. *Lawson*, Conclusion.

# Companies Increasingly Seeking Forum Selection in Charters and Bylaws, Report Shows

**BY CLAUDIA H. ALLEN**

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The number of Delaware corporations that have adopted or proposed adopting forum selection provisions in charters and bylaws more than doubled from 82 in the April 2011 edition of "Study of Delaware Forum Selection in Charters and Bylaws" (the Study) to 195 as of December 31, 2011. The sheer increase in numbers does not, however, tell the whole story. The increase has occurred in an environment where questions linger as to the enforceability of forum selection provisions, and shareholder activists are beginning to express their opposition to exclusive forum clauses.

The Study analyzes the 195 exclusive Delaware charter and bylaw forum selection provisions adopted or proposed through December 31, 2011, and the legal issues associated with such provisions. While Delaware exclusive forum clauses generally provide for the Court of Chancery to be the sole and exclusive forum for enumerated categories of actions, the exact language and contours of such provisions are continuing to evolve.

Whether a company adopts a charter provision or a bylaw provision remains closely tied to whether a company is going public or is already