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Contractors and Agents Beware: Non-public Bankruptcy Specialist Firm Held Liable for Whistleblower Retaliation As an "Agent" of Issuer under Sarbanes-Oxley Act

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In another expansive ruling on a whistleblower complaint under the Sarbanes-Oxley Act (SOX), an administrative law judge recently demonstrated a willingness to extend liability for whistleblower retaliation under SOX to *non-public companies* that are contractors or agents of public companies. The Sarbanes-Oxley Act prohibits retaliation by any corporate "officer, employee, contractor, subcontractor or agent" of a publicly traded company. Previously, administrative law judges have held that non-publicly traded subsidiaries of publicly traded companies are covered under the Act, as long as the publicly traded parent company is named in the employee's complaint, and the parent company and subsidiary are reasonably intertwined and/or the parent company's value and performance is based, in part, on the value and performance of its subsidiaries.

On July 18, an administrative law judge extended this line of reasoning by applying the Act's whistleblower protections to an "agent" company that was not a subsidiary or predecessor [*See Kalkunte v. DVI Financial Services, Inc., and AP Services, LLC*, 2004-SOX-56 (ALJ July 18, 2005)]. Here, AP Services (a private company) contracted with DVI Financial Services, Inc. (a publicly traded company subject to SOX), to provide leased employees to manage DVI through bankruptcy and dissolution. The contract contained mutual indemnification in case of liability and provided AP with significant control over DVI in its role of "manag[ing] the corporation and its assets in light of the pending bankruptcy."

The judge denied summary judgment to AP on the basis that AP was "both a subcontractor and agent of DVI and/or DVI's trustee in bankruptcy" and could be liable for retaliation against a DVI employee. Among the facts cited by the judge were the following: The key "protagonist" in the alleged retaliation against the whistleblower at DVI was a principal employee of AP, was paid by AP and used AP's health insurance plan and email network server. The administrative law judge found these facts "a manifestation of consent to act...on AP's behalf and subject to its control." This protagonist also had unusual power within the parent company, having been appointed by DVI's board of directors to serve full-time as DVI's president and CEO, with authority to hire and fire employees at the company. During the relevant time period, the protagonist did not perform any other work for AP. The administrative law judge observed that "[b]y nature of its responsibilities to

DVI, the agent significantly affected [the whistleblower's] access to employment opportunities. [AP's consultants] controlled the flow of work to DVI employees and made the decisions as to which DVI employees would be included in the reduction in force, and made decisions about how to pay the remaining DVI employees." In the alternative, the administrative law judge found that AP had "assumed *respondeat superior* liability to the" employee.

In contrast, prior to this decision, several administrative law judges had declined to find contractor or agent liability for whistleblower complaints in various situations, including:

- A financial insurance company providing insurance to segments of the municipal bond market and debt securities for publicly traded companies was not considered a "contractor, subcontractor or agent" of a publicly traded company. The administrative law judge reasoned that "the fact that publicly traded companies rely upon [the defendant company's] services and purchase its products does not make [it] their contractor, subcontractor, or agent.... I acknowledge that [the defendant company's] activities have the potential to [affect] the financial welfare of publicly traded companies with which it does business. However, any product or service that the company purchases creates the potential for profit or loss for the company that purchases it."
- A separately incorporated limited liability company that was operated as a joint venture by two major aircraft companies (the LLC members) was found sufficiently separate from the LLC members such that they were not held liable for the joint venture's alleged retaliation against an employee-whistleblower of the LLC. The administrative law judge noted that "if" the LLC members "could affect" the whistleblower's employment at the joint venture, "or...if" the joint venture were acting as an agent of the LLC members, then the two LLC members "would be covered by the Act" and held liable for the whistleblower's retaliation. However, the judge found "no evidence" that the LLC members could have, or did, affect the whistleblower's employment at the joint venture (as they had no control over the hiring or firing of employees other than the president and CEO), and the judge found "no evidence" that the joint venture was acting as the LLC members' agent with respect to the whistleblower's employment.

To a large extent, the Kalkunte decision appears to turn on the nature of the relationship between the bankruptcy specialist firm and the debtor it had been engaged to support in bankruptcy (*i.e.,* a relationship in which the bankruptcy specialist was, in essence, managing the public company). It may also have been affected by the fact that any claim made directly against the public company would have been subject to the limitations on prosecution and recovery of claims under the Bankruptcy Code. Nevertheless, the potential breadth of application of the Sarbanes-Oxley Act's whistleblower provision to any "contractor, subcontractor, or agent" of a publicly traded company—and the implications of this recent decision—means that even private companies can be liable for whistleblower retaliation, depending on the nature of the services they provide to a public company and the contractual and other relationships between the companies. This reinforces the importance for all companies to implement effective non-retaliation policies and obtain expert advice in handling employee complaints of corporate wrongdoing so as to avoid even the appearance of retaliation. *Kalkunte* also demonstrates the importance of providing employees with prompt and documented

performance feedback before claims arise, so that employers can take appropriate disciplinary action without the fear that it may be misconstrued as retaliation.

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