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## [Recent Court Ruling Exposes Mutual Funds to Whistleblower Suits](#)

Mutual fund companies have traditionally argued that they are exempt from the whistleblower protections of the Sarbanes-Oxley Act (“SOX”) because the funds themselves do not have any employees. Massachusetts District Court Judge Douglas P. Woodlock soundly rejected that argument in a ruling issued March 31 and, in so doing, may have opened the door to a tidal wave of whistleblower suits against mutual fund companies.

The ruling came in response to motions to dismiss filed in two separate lawsuits brought by former employees of Fidelity affiliates. In each case, the former employees alleged that they were retaliated against in violation of SOX when they internally reported what they believed was unlawful conduct.

The Fidelity affiliates argued that, in order to be covered by SOX’s whistleblower protections, an individual must be an employee of a publicly traded company. Accordingly, their employees could not be covered by SOX because they are technically employees of the affiliates, which are privately held, rather than the funds themselves, which are publicly traded.

After an extensive examination of the statutory text, the existing case law, legislative history, and Department of Labor regulations, Judge Woodlock determined that the proper interpretation of SOX’s whistleblower provision is to extend protection to employees of the privately held agents of publicly traded companies. He reasoned that this interpretation was most in line with the underlying purpose of SOX: to prevent and punish corporate fraud. Judge Woodlock specifically found that SOX’s whistleblower protections should cover employees of the privately held companies providing investment advice to mutual funds because to find otherwise would leave unprotected all reporting of fraud involving a mutual fund’s shareholders “for the very simple reason that no “employee” exists for this particular type of public company.”

Judge Woodlock further found that protecting employees of a public company’s related entities will not result in an overly broad application of SOX because the type of reporting that is protected is sufficiently narrow. Specifically, Judge Woodlock construed SOX as only protecting employees who report activity that is related to “fraud against shareholders.”

While we cannot yet know the true impact of this ruling, mutual fund companies should take steps now to

protect themselves from potential whistleblower lawsuits. Fund companies should ensure that they have systems in place to facilitate internal reporting and that they thoroughly investigate all internal complaints.

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