Client Alert **Employment & Labor**

Employers Beware - Three Significant Decisions with Broad Implications

Two highly anticipated United States Supreme Court decisions were decided recently, both of which have a significant impact on employers. In *Lawson v. FMR LLC et al.,* the Supreme Court held that the whistleblower protection of the Sarbanes-Oxley Act of 2002 ("SOX") extends to the employees of a public company's private contractors and subcontractors, which is a departure from prior SOX interpretation. In contrast, in *U.S. v. Quality Stores, Inc., et al.*, No. 12-1408 (March 25, 2014), the Supreme Court sustained the long-standing position of the Internal Revenue Service, holding that severance compensation paid to involuntarily terminated employees is taxable "wages" for the purposes of the Federal Insurance Contributions Act ("FICA"). Finally, the Court of Appeals for the Third Circuit, which has jurisdiction over New Jersey, Pennsylvania, Delaware and the Virgin Islands, followed the lead of other circuits and set forth the standard for determining successor liability under federal wage and hour laws.

Lawson v. FMR LLC et al.

In *Lawson v. FMR LLC*, the Supreme Court considered the issue of who is a covered "employee" under Section 1514A of SOX, which protects whistleblowers. In a 6-3 decision, the Supreme Court held that the whistleblower protections under SOX extend not only to employees of publicly-held companies, but also to the employees of privately-held contractors and subcontractors who perform work for public companies.

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Prior to this decision, privately owned companies were not thought to be subject to SOX whistleblower claims.

The impact of the decision on SOX whistleblower litigation, however, remains unclear given the lack of clarity on what types of companies will qualify as "contractors." Although the dissenting justices warned that the majority's decision "threatens to subject private companies to a costly new front of employment litigation"; the majority found there to be "scant evidence" that the decision will open any floodgates for whistleblower suits outside of §1514A's purpose.

SOX was enacted in 2002 against a backdrop of corporate scandals such as WorldCom and Enron. SOX imposed comprehensive standards for publicly traded companies, including anti-retaliation protections for employee whistleblowers.

The plaintiffs were two former employees of FMR subsidiaries, private companies that provided management and advisory services to the publicly traded Fidelity family of mutual funds, which did not have its own employees. The plaintiffs were not employees of the publicly traded company. The plaintiffs brought suit under SOX alleging that their employers retaliated against them for questioning whether certain cost accounting methods overstated expenses and the accuracy of a draft SEC filing.

The defendant moved to dismiss, arguing that SOX protects only employees of publicly traded companies and not employees of private companies that contract with public companies. The district court denied FMR's motion, holding that SOX's whistleblower protections extend to the employees of a public company's private contractors. On appeal, the Court of Appeals for the First Circuit reversed, holding that the protections of the retaliation provision extended only to employees of public companies, but not to the employees of a contractor of a public company.

The Supreme Court reversed the First Circuit's decision, relying both on the language of SOX, and the Act's purpose to safeguard investors in public companies and restore trust in the financial markets. Although the Supreme Court focused on the unique circumstances present in this case, including that the publicly traded mutual fund company did not have its own employees and relied on a non-employee/all contractor workforce, the Court did not so limit its ruling. As a result, employees of privately owned companies, in some instances, may avail themselves of SOX whistleblower provisions.

U.S. v. Quality Stores, Inc., et al.

In a unanimous decision (with one Justice not participating), the Supreme Court ruled that certain severance payments paid to employees who were involuntarily terminated were taxable wages for purposes of FICA. In doing so, the Court sustained the long-standing position of the IRS, the U.S. Tax Court and several federal Courts of Appeals. Had the Supreme Court ruled that such payments were not subject to FICA, this would have triggered a wave of payroll tax refund requests.

Quality Stores made severance payments to employees who were involuntarily terminated as part of its Chapter 11 bankruptcy. The payments were made pursuant to two different plans which varied based on job seniority and time served and did not tie payments to the receipt of state unemployment insurance. Quality Stores paid and withheld taxes required under FICA, but later sought a refund on behalf of itself and about 1,850 former employees arguing the payments should not have been taxed as wages under FICA. Both the district court and the Sixth Circuit held in favor of Quality Stores, holding that the severance payments were not wages under FICA.

The Supreme Court disagreed and determined that such payments are subject to FICA. The Court held that FICA defines "wages" broadly as "all remuneration for employment" and that severance payments fit this definition given that they are a form of remuneration made only to employees in consideration for employment.

Thompson v. Real Estate Mortgage Network

On April 3, 2014, the Third Circuit Court of Appeals issued a decision which set forth the applicable standard for imposing liability on successor entities under the Fair Labor Standards Act ("FLSA").

The plaintiff Patricia Thompson worked as a mortgage underwriter for the defendant Security Atlantic Mortgage Company ("Security Atlantic"). Shortly thereafter, she was assigned to a training class led by a representative for a different mortgage company, defendant Real Estate Mortgage Network ("REMN"), a sister company of Security Atlantic. The plaintiff filed a class and collective action complaint under the FLSA and New Jersey wage and hour law alleging that the defendants (which included two individuals, the co-owners of Security Atlantic) did not pay overtime for time worked and misclassified her as exempt. She also sought to hold REMN liable for Security Atlantic's own statutory violations under the theories of joint liability and successor liability. The District Court dismissed her claims, emphasizing that the plaintiff's

employment by Security Atlantic was separate and distinct from her employment at REMN.

On appeal, the Third Circuit noted that Thompson alleged that there was a certain degree of corporate comingling and that REMN had at least some authority to promulgate work rules and assignments even before plaintiff was formally hired by REMN. The Third Circuit agreed with the plaintiff and held that the federal common law standard of successor liability should apply under the FLSA, rather than the narrower successor liability rules under New Jersey law. The federal standard for successor liability dictates consideration of only the following factors: (1) continuity of operations and work force of the successor and predecessor employers; (2) notice to the successor-employer of its predecessor's legal obligation; and (3) ability of the predecessor to provide adequate relief directly.

The Third Circuit also had jurisdiction over the state law claims and concluded that that even under the New Jersey standard for successor liability, the claims should not be dismissed. The New Jersey standard is that successor corporations are legally distinct and do not assume the debts and liabilities of the predecessor, except where: (1) the purchasing corporation expressly or impliedly agreed to assume such debts and liabilities; (2) the transaction amounts to a consolidation or merger of the seller and purchaser; (3) the purchasing corporation is merely a continuation of the selling corporation; or (4) the transaction is entered fraudulently in order to escape responsibility for such debts and liabilities.

Finally, the Third Circuit vacated the District Court's dismissal of the claims against the individual defendants and remanded for further proceedings given that the FLSA imposes liability on "any person acting directly or indirectly in the interest of an employer in relation to the employer." In addition to the a corporate entity itself, a company's owners, officers or supervisory personnel may also constitute joint employers for purposes of FLSA liability.

Tips for Employers

» To ensure SOX compliance, employers who provide services to public companies are advised to update and revise their compliance and anti-retaliation policies, procedures, training and related corporate governance.

» Employers who provide severance payments to employees should ensure that such payments are subject to appropriate FICA withholdings.

» Employers must keep in mind that successor employers, as well as officers, can be held liable under certain circumstances for the wage and hour violations of their predecessors. In the event of a merger or acquisition, it is critical for the buyer to conduct thorough wage and hour due diligence and consider any potential liabilities during the negotiation process.

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