Whistler Beware: Court of Appeals Puts Advisers' Compliance Officer at Risk

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In a controversial but important decision, the highest state court in New York has held that an employer can terminate the employment of its chief compliance officer for voicing objections to allegedly improper trading practices. Issued last week, the decision of the New York State Court of Appeals in Sullivan v. Harnisch, 2012 N.Y. Lexis 984 (2012), could have far-reaching consequences to hedge funds and other financial services firms and to compliance officers who are investigating or reporting suspicions of wrongdoing by an employer or its employees.

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In Sullivan, plaintiff Joseph Sullivan was the chief compliance officer of two affiliated registered investment advisers. According to his complaint, Sullivan objected to certain stock sales by his employer's chief executive officer on the ground that the sales purportedly constituted unlawful front-running, and Sullivan consequently was fired days later. The Court of Appeals reaffirmed the fundamental precept that absent violation of a constitutional requirement, a statute or a contract, an employer maintains the right at any time to terminate the employment of an at-will employee and refused to carve out another exception to this rule with respect to compliance officers who are objecting to misconduct.

In the seminal case Murphy v. American Home Prods. Corp., 58 N.Y.2d 293 (1983), the Court of Appeals dismissed a plaintiff's claim alleging that his employment was terminated "because of his disclosure to top management of alleged accounting improprieties on the part of corporate personnel." Similarly, in Sabetay v. Sterling Drug, Inc., 69 N.Y.2d 329 (1987), based on the Murphy holding, the Court of Appeals dismissed a plaintiff's action notwithstanding that he claimed "he was discharged because he refused to participate [in] tax avoidance schemes and maintenance of slush funds." Years later, in Horn v. New York Times, 100 N.Y.2d 85 (2003), the plaintiff, a doctor, asserted that she was fired for refusing to violate patient confidentiality, to no avail. In all of these cases, the plaintiffs' claims were dismissed because the plaintiffs were at-will employees and no exception to the at-will doctrine applied to them.

It goes without saying that compliance officers are extremely important in the overall scheme of federal securities regulation, and it is essential for investment funds and their advisers to have strong systems of control in place. By law, registered investment advisers are required to designate a chief compliance officer who is charged with administering policies and procedures designed to prevent violations of federal law and regulations. Notwithstanding these important considerations, the Sullivan court concluded that Sullivan's regulatory and ethical obligations and his duties as an employee were not "so closely linked as to be incapable of separation" and did not warrant expansion of the exceptions to the at-will doctrine. While a different set of facts could potentially precipitate a different result, the court made clear that "the existence of federal regulation furnishes no reason to make state common law governing the employer-employee relationship more intrusive" and that "[n]othing in federal law persuades us that we should change our own law to create a remedy where Congress did not."

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In a blistering dissent, Chief Judge Jonathan Lippman, joined by another judge, pointedly responded that "[i]n the wake of the devastation caused by fraudulent financial schemes – such as the Madoff Ponzi operation … – the courts can ill afford to turn a blind eye to the potential for abuses that may be committed by unscrupulous financial services companies in violation of the public trust and the law." He asserted that the majority's conclusion that the company has "every right to fire its compliance officer, simply for doing his job, flies in the face of what we have learned from the Madoff debacle, runs counter to the letter and spirit of the Court's precedent, and facilitates the perpetration of frauds on the public." Nevertheless, the Sullivan majority's opinion is the law of New York State.

Compliance officers and other employees are not without options. The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted subsequent to the events at issue in the Sullivan matter, provides whistle blower protection and a private right of action for double back pay for employees who are discharged for furnishing information to the S.E.C. pertaining to violations of the federal securities laws.

To discuss further, please contact your primary Kleinberg Kaplan attorney or:

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