by Jay P. Lechner and Paul M. Sisco

Sarbanes-Oxley Criminal Whistleblower Provisions and the Workplace: More Than Just Securities Fraud

The Sarbanes-Oxley Act (SOX) was enacted in 2002 to restore investor confidence in the nation's financial markets in the wake of the Enron scandal.[1] Its whistleblower provisions, both civil and criminal, were specifically designed "to prevent recurrences of the Enron debacle and similar threats to the nation's financial markets" by protecting whistleblowers who report fraudulent activity which could damage innocent investors.[2] In light of these goals, one might reasonably assume that a whistleblowing employee must assert at least some degree of fraud affecting shareholders before SOX's protections are implicated.[3] However, as the following two scenarios demonstrate, both SOX's criminal and civil whistleblower provisions can be interpreted as extending far beyond their intended scope.

EEO Participation Clause Retaliation Claims — Potential Criminal Sanctions and Civil RICO Liability

Assume an employee at a small, privately-owned company files an EEOC complaint alleging her supervisor discriminated against her because of race. In response, the supervisor and her coworkers engage in a pattern of harassment until the employee finally complains to the owner. The owner promptly fires the harassers and resolves the problem to the employee's satisfaction. Because the company has less than 15 employees and promptly corrects any harassing behavior, liability arising from the harassment is unlikely under Title VII. In addition, because the company is not publicly traded and no fraud against shareholders is alleged, one might assume that SOX's whistleblower provisions would not be implicated. However, that is not necessarily the case.

• *SOX Criminal Whistleblower Provision* — SOX contains both civil and criminal whistleblower provisions. The criminal provision, §1107, provides:

> Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any [f]ederal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

Criminal sanctions include, for individuals, fines up to $250,000 and/or imprisonment of up to 10 years and, for organizations, fines up to $500,000.[4] The Attorney General has expressed that the DOJ will "play a critical role" in implementing the criminal provisions of SOX, including §1107.[5]

Section 1107's real value as a *substantive* prosecutorial tool may be questionable, however. It is arguably merely an extension of the already existing obstruction of justice charges currently available under 18 U.S.C §1510 (obstruction of criminal investigations) and 18 U.S.C. §1512 (tampering with witnesses, victims, or informants). What it does do, however, from a *sentencing* perspective is increase the penalty for such offenses from a maximum of five years in many cases to a maximum of 10 years.

The specific inclusion of §1107 within SOX certainly reflects Congressional intent to aggressively ferret out criminal malfeasance in the post-Enron corporate environment. As recent prosecutions such as *United States v. Scrushy*, 366 F. Supp. 2d 1134 (N.D. Ala. 2005), may suggest, however, Congress' zeal to get tough in the corporate sentencing arena often has the unintended result of creating more trials and less guilty pleas.

Additionally, §1107 does have a number of potentially significant ramifications, none of which have yet been addressed by the courts. First, §1107 applies not only to publicly-traded companies, but to *any* "person." Because the term "persons" generally includes individuals, corporations, and other organizations, §1107 covers both employers and employees. Therefore, employees who in the past were not subject to individual liability under other federal retaliation statutes now could face enormous fines and jail time for their workplace misconduct. Moreover, employers are covered regardless of corporate status or number of employees. Thus, companies too small to be covered under Title VII or other antiretaliation statutes are covered under §1107. Finally, because there is nothing limiting the criminal provision to the employment relationship, third parties, regardless of their agency relationship with the employer, may be liable for participating in prohibited retaliatory conduct.

Second, §1107 may criminalize

retaliatory conduct in seemingly unrelated contexts which, in the past, may have given rise only to civil liability. Protected activity under §1107 is not limited to complaints of fraud or securities violations, but covers truthful disclosures to *any* "law enforcement officer" relating to commission or potential commission of *any* federal offense. This provision could reasonably be interpreted as protecting complaints to the EEOC under federal employment discrimination statutes such as Title VII, ADA or ADEA, or to the DOL under the various statutes within its jurisdiction. Whether such an interpretation is adopted by the courts hinges largely on the meaning of the term "federal offense," which is not defined anywhere in SOX or the federal criminal code. Although the term is usually used in reference to criminal violations, the courts have used the term in both civil and criminal contexts.[6] Moreover, it appears that an act committed in violation of a federal statute will still be considered an "offense" even if the statute of limitations on the offense has run.[7]

Third, if the term "federal offense" is interpreted as including violations of federal civil statutes, a complaint to the EEOC, DOL, or other employment-related agency would likely be covered under §1107, because "law enforcement officer" is defined broadly as including any federal officer or employee "authorized under law to engage in or supervise the prevention, detection, investigation, or prosecution of an offense."[8] Surely, federal agencies such as the EEOC or DOL have the authority to investigate and supervise the prevention of violations of the statutes within their purview. In what appears to be the first case to date addressing this provision, hospital employees contended they suffered retaliation in violation of §1107 for having informed their employer/hospital's governance board of ethnic remarks made by hospital administration and staff concerning another employee. The court noted that §1107 "simply cannot be read to reach the reporting of ethnic remarks to a local hospital's governance board."[9] The court did not comment, however, on whether such reports would be covered if they were made to the EEOC or even if such a private cause of action would be viable under §1107.

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Finally, the conduct prohibited by §1107 is extremely broad, covering any action "harmful" to any person, including "interference with the lawful employment or livelihood" of any person. An actual violation is not required, as a disclosure is protected as long as it is "truthful" and relates to the "possible commission" of any federal offense. Unfortunately, Congress did not define the terms "harmful" or "interference," leaving it to the courts to decide their meaning. However, these concepts are certainly at least as expansive as the hostile work environment concept applied under other discrimination/retaliation statutes. Indeed, nothing limits §1107 to retaliation that causes economic harm or even to retaliation that occurs during or within the scope of the employment relationship. Thus, harassment occurring outside of the workplace could give rise to criminal sanctions even if it is not covered by Title VII. Furthermore, one can readily think of any number of workplace-related actions that may not rise to the level of "severe or pervasive" harassment or otherwise constitute an adverse employment action, but would be "harmful" to a person or would "interfere" with one's employment or livelihood within the meaning of §1107.

As a result, companies, supervisors, and coworkers who engage in participation clause-type retaliatory harassment, even if not subject to civil liability under Title VII, could be subject to felony criminal sanctions, including jail time.

• *Civil RICO* — In addition to criminal sanctions, the above harassment scenario could give rise to a cause of action under the civil RICO statute, with the availability of treble damages. This is so because §1107 amends 18 U.S.C. §1513(e), and under RICO, "racketeering" includes "any act which is indictable under . . . 18 U.S.C. §1513."[10] Therefore, by engaging in a pattern of retaliation prohibited by §1107 (*e.g.*, by creating a hostile work environment) and/or commission of other predicate offenses under RICO (*e.g.*, mail, wire, or securities fraud), an employee or company commits a predicate act of racketeering under RICO.

Of course, to state a civil RICO cause of action, one must allege more than just the occurrence of racketeering, but also "1) conduct 2) of an enterprise 3) through a pattern 4) of racketeering activity."[11] One must also allege an injury in fact arising from the conduct constituting the violation. In other words, the injury must be proximately caused by the predicate acts sufficiently related to constitute a pattern.[12] A civil RICO action may proceed even if the defendant has not been convicted of a predicate act or of a RICO violation.[13]

Prior to the enactment of §1107, retaliatory discharge did not fall within the definition of "racketeering" and, therefore, generally could not give rise to a RICO action.[14] Even if a plaintiff did allege that her employer committed a predicate act under RICO, the injury suffered from the retaliatory action would have been caused by the adverse employment decision and not the result of a predicate act under RICO.[15] Some courts recognized a limited pre-SOX exception to this rule in the rare case where the adverse employment action was proximately caused by racketeering activity, such as retaliation by commission of the predicate

offenses of witness tampering or obstruction of justice.[16] Section 1107, by identifying retaliatory discharge as a predicate act, gives whistleblower victims legitimate grounds to allege civil RICO claims against their employers or coworkers beyond the very limited circumstances involving witness tampering or obstruction of justice.

Of course, a plaintiff must also prove the other civil RICO elements, such as existence of an enterprise and a pattern of racketeering. The Supreme Court has described an "enterprise" as "an entity, for present purposes a group of persons associated together for a common purpose of engaging in a course of conduct."[17] Returning to the above scenario, one could reasonably argue that a group of coworkers who engage in long-term or ongoing harassment against a complaining employee act with a "common purpose" and could have sufficient organization and continuity to constitute an enterprise under RICO. Additionally, a "pattern of racketeering" requires at least two acts of racketeering activity and must manifest "continuity" and "relatedness."[18] Ongoing harassment egregious enough to give rise to a hostile work environment would arguably manifest "continuity" and "relatedness" and would almost always involve at least two acts in violation of §1107 sufficient to constitute a "pattern of racketeering."

FLSA Collective Actions or Discrimination Class Actions — Potential SOX Civil Liability and Criminal Sanctions

Assume an HR employee of a publicly traded company reports to her supervisor that, due to a company-wide policy of not paying employees for their 10-minute breaks, employees are regularly underpaid in violation of the FLSA. In retaliation, the supervisor fires the employee. Despite a seeming lack of connection to fraud against shareholders, this action could give rise to civil and criminal SOX liability.

• *SOX Civil Whistleblower Provision* — Under §806 of SOX, publicly traded companies may not "discharge, demote, suspend, threaten, harass or in any other manner discriminate against an employee in the terms and conditions of employment" because of any protected whistleblowing activity.[19] To constitute protected activity:

> (1) The action must involve a purported violation of a federal law relating to securities fraud, bank fraud, wire fraud, or violation of "any rule or regulation of the Securities and Exchange Commission, or any provision of [f]ederal law relating to fraud against shareholders";
>
> (2) The employee's belief about the purported violation must be objectively reasonable; and
>
> (3) The employee must communicate his concern to either a person with supervisory authority over the employee (or other person working for the employer who has the authority to investigate, discover, or terminate misconduct), the federal government or a congressional member.

Prior to the enactment of §1107, retaliatory discharge did not fall within the definition of "racketeering" and, therefore, generally could not give rise to a RICO action.

In the above scenario, the employee's complaint regarding pay shortages, although protected under the FLSA, would not appear at first glance to constitute protected activity under SOX because it does not implicate a violation of a federal law relating to fraud or violation of an SEC rule or regulation, or any "provision of [f]ederal law relating to fraud against shareholders."

Yet, one administrative law judge has written that "complaints of systemic violations of FLSA might reach the necessary magnitude to effectively perpetrate a fraud on shareholders," and, therefore, may fall within the purview of §806.[20] The judge noted that §302 of SOX, which requires corporate officer certification that a financial disclosure is accurate and does not contain any untrue statement of material fact, is "a provision of [f]ederal law relating to fraud against shareholders." Conceivably, company-wide systemic under compensation of a company's employees could rise to the level of materiality such that it could "impermissibly alter the accuracy of its financial disclosures mandated by SOX."[21] Accordingly, an employee's complaints that such systemic violations are occurring and are not being accurately reported in the company's financial disclosures could constitute protected activity under SOX.

Two administrative law judges have recently addressed similar concerns arising out of complaints of racial discrimination. One judge has suggested that "[p]erhaps, the failure to disclose a class action lawsuit based on systemic racial discrimination with the potential to sufficiently affect the financial condition of a corporation might become the subject of a SOX protected activity if an individual complained about the failure to disclose that situation."[22] Another judge has noted that a disclosure of company-wide discrimination could form the basis of a SOX whistleblower claim if the potential liability rises to a sufficient level of materiality, explaining, "[h]ad [a discrimination law]suit actually been filed, and if [the company] had prevented that information from reaching its shareholders, and if the [c]omplainant learned of this omission and if he had reported it, then he would have engaged in protected activity under the [a]ct."[23] Thus, publicly traded employers must be aware that complaints regarding systemic discrimination or FLSA violations sufficient to give rise to class or collective actions may now, in certain circumstances, give rise to SOX liability.

• *SOX §3(b) Criminal Provision* — Because there was no complaint to a "law enforcement officer," it does not appear that the above scenario regarding a complaint of pay shortages would give rise to criminal sanctions under §1107. However, beyond

§§806 and 1107, another section of SOX can be interpreted as expanding criminal liability for *any* retaliatory action prohibited by §806, including the above collective action scenario, regardless of whether the retaliation was related to the disclosure of truthful information to a law enforcement officer.

Section 3(b) provides:

> a violation by any person of th[e Sarbanes-Oxley] Act . . . shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) . . . and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that [a]ct or such rules or regulations.

In turn, the penalty provisions of the Exchange Act, 15 U.S.C. §78ff, provide for fines up to $1,000,000 and 10 years in jail for "any person who willfully violates any provision of this chapter . . . ." The SEC has jurisdiction to enforce this provision.

Interpreted broadly, §3(b) would create potential criminal liability for any act that gives rise to civil liability under §806's civil whistleblower provisions. On November 9, 2004, Senators Grassley and Leahy sent a letter to SEC Chair William Donaldson advising him that they want "aggressive enforcement to deter retaliation against corporate whistleblowers," and asking, "[w]hat is your position on whether or not a violation of the §806 whistleblower prohibitions can generate criminal liability under Section 3(d) [sic] of the [a]ct?" In February 2005, Donaldson responded to the effect that, while §3(b) is a useful provision allowing the SEC to enforce new laws enacted under SOX, the SEC has been guided by the principle that its resources can be applied most effectively to combat substantive violations of the securities laws, thereby leaving it to the DOL to investigate and prosecute potential §806 whistleblower violations.[24]

Regardless of whether the SEC interprets §3(b) as criminalizing whistleblower retaliation prohibited by §806, it is important to note that all §806 complaints are brought to the attention of the SEC and, therefore, may give rise to prosecution for substantive violations of the securities laws. In his response to Senators Grassley and Leahy, Donaldson noted that OSHA regulations require the DOL to notify the SEC of §806 complaints. The SEC and DOL have established a system under which such referrals are sent directly to the Division of Enforcement, and the DOL and SEC are considering the need for preparing a memorandum of understanding to further facilitate coordination.

Conclusion

One well-publicized example of how a whistleblower claim can give rise to both civil RICO claims as well as federal investigations by the DOJ and SEC is the case of *Whitley v. Coca-Cola Co.*, No. 03-CV-1504 (N.D. Ga., dismissed Oct. 9, 2003). In *Whitley*, a former manager asserted civil RICO and retaliation (but not SOX) claims arising from his termination, which he alleged occurred in retaliation for his reporting that Coke manipulated market tests relating to Frozen Coke. Defendant argued in a motion to dismiss that, under *Beck v. Prupis*, 529 U.S. 494 (2000), retaliatory discharge was not an act of "racketeering." The civil case quickly settled but the allegations led to investigations by both the SEC and the DOJ. According to a company press release, on April 18, 2005, the company settled with the SEC, and the DOJ decided to close its investigation.[25] Now, in light of the potentially sweeping scope of SOX's criminal and civil whistleblower protections, employers should be aware that civil liability, treble damages under RICO, federal investigation, and criminal sanctions for workplace retaliation could become more common place, even in situations where the whistleblowing activity does not appear to fall within SOX's intended scope. ❑

[1] *See* 148 Cong. Rec. S1786 (daily ed. March 12, 2002) (statement of Senator Leahy).

[2] *See* S. Rep. No. 107-146, 107th Cong., 2d Sess. 19 (2002); 148 Cong. Rec. S7420 (daily ed. July 26, 2002) (statement of Senator Leahy).

[3] *See, e.g., Minkina v. Affiliated Physician's Group*, 2005-SOX-19 (A.L.J. Feb. 22, 2005) (SOX "was enacted to address the specific problem of fraud in the realm of publicly traded companies and not the resolution of air quality issues, even if there is a possibility that poor air quality might ultimately result in financial loss").

[4] *See* 18 U.S.C. §3571.

[5] *See* Attorney General Memorandum on Implementation of the Sarbanes-Oxley Act of 2002 (Aug. 1, 2002) ("it is vital that all components of the Department of Justice …work together to ensure that we take full advantage of the provisions of this new law to enhance our prosecution of significant financial crimes").

[6] *See, e.g., Cole v. United States Dept. of Agric.*, 133 F.3d 803 (11th Cir. 1998) (referring to "criminal and civil offenses"); *Thornton v. United States Dept. of Agriculture*, 715 F.2d 1508, 1512 (11th Cir. 1983) (referring to "[b]oth criminal and civil offenses").

[7] *See United States v. Keller*, 808 F.2d 34 (8th Cir. 1986).

[8] 18 U.S.C. §1515(a)(4).

[9] *MacArthur v. San Juan County*, 2005 U.S. Dist. LEXIS 25235 (D. Utah June 13, 2005).

[10] 18 U.S.C. §1961.

[11] *See Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479 (1985).

[12] *Id.*

[13] *Id.*

[14] *See Beck v. Prupis*, 529 U.S. 494 (2000).

[15] *See Miranda v. Ponce Fed. Bank*, 948 F.2d 41, 47 (1st Cir. 1991).

[16] *See, e.g., Dooley v. United Techs. Corp.,* 1992 U.S. Dist. LEXIS 8653 (D.D.C. June 17, 1992).

[17] *United States v. Turkette*, 452 U.S. 576, 583 (1981).

[18] *Sedima*, 473 U.S. at 496 n.14.

[19] 18 U.S.C. §1514A(a).

[20] *Harvey v. Safeway, Inc.*, 2004-SOX-21 (A.L.J. Feb. 11, 2005).

[21] *Id.*

[22] *Harvey v. Home Depot, Inc.*, 2004-SOX-20 (A.L.J. May 28, 2004).

[23] *Smith v. Hewlett Packard*, 2005-SOX-88 (A.L.J. Jan. 19, 2006).

[24] *See* James Hamilton, *SEC Responds to Senate Letter on Whistleblower Provisions*, 2005-32 SEC TODAY ONLINE (CCH) (Feb. 17, 2005).

[25] *See* News Release: *The Coca-Cola Company Comments on SEC Settlement* (Apr. 18, 2005), *available at* www2.coca-cola.com/presscenter/nr_20050418_corporate_sec_settlement.html; *see also* SEC Press Release: *The Coca-Cola Company Settles Antifraud and Periodic Reporting Charges Relating to Its Failure to Disclose Japanese Gallon Pushing* (Apr. 18, 2005).

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