Labor and Employment Law

Sarbanes-Oxley Whistleblower Provisions: A Study in Statutory Construction

*By Jay P. Lechner**

"When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean—neither more nor less." "The question is," said Alice, "whether you can make words mean so many different things." "The question is," said Humpty Dumpty, "which is to be master—that's all."[1]

In the February 2007 issue of *Engage*, J. Gregory Grisham and James H. Stock, Jr. expertly explored the civil whistleblower provision of the Sarbanes-Oxley Act ("SOX") and addressed criticisms that the scope of SOX's civil whistleblower provision does not provide sufficient protection to employees. The authors concluded that plaintiffs have not fared well under this provision and that judges have "been reluctant to stray from the specific statutory language set out in Section 1514A…."[2] The purpose of the instant article is not to recover the same ground already thoroughly addressed by Grisham and Stock, but rather to argue that judges have been inconsistent in their interpretation of Section 1514A, and in fact have often strayed from its specific statutory language to the detriment of employers. Furthermore, the ambiguous and incomplete language of both SOX's civil and criminal whistleblower provisions invites further unintended anti-employer construction, unless judges are consistent in strictly construing the statutory text.

In the rush to push SOX through Congress, nearly no discussion took place regarding its whistleblower provisions. Thus, statutory gaps, omissions, and ambiguities inevitably slipped through the cracks.[3] As a result, it has been left to judges to fill those holes on a case-by-case basis through statutory construction. As is often the case with matters of statutory construction, judges have interpreted the pertinent statutory provisions inconsistently. Exacerbating these problems, SOX governs fields such as corporate governance mandates, accounting standards, and corporate whistleblower protections that traditionally were reserved for the states, and for which federal agencies such as the Department of Labor lack any meaningful experience.[4]

Not surprisingly, SOX's ambiguities have given rise to unanticipated legal issues. For example, courts and administrative law judges (ALJs) have come to conflicting conclusions as to whether SOX's whistleblower provisions extend to subsidiaries of publicly traded companies, whether their jurisdiction extends to parent companies of non-publicly traded employers, and what type of complaints may constitute "protected activity." Moreover, judges, and even foreign governments, have struggled with issues arising from application of SOX's whistleblower protections to overseas companies and employees. Finally, ambiguities in SOX's Section 1107 criminal whistleblower provisions have presented complex issues which have yet to be resolved by the courts.

** Jay P. Lechner is an attorney with Greenberg Traurig, P.A., in Tampa, Florida, where he represents employers in the areas of labor and employment litigation, including whistleblower, discrimination, and wage and hour.*

I. Whether Employees of Subsidiaries Are Covered

Section 806, SOX's civil whistleblower provision, clearly covers publicly traded companies. It does not expressly cover subsidiaries of publicly traded companies. Yet, many publicly traded companies own and operate through subsidiaries; indeed, Enron had over 2,500. In light of SOX's statutory purpose, should employees of these subsidiaries be covered under SOX's whistleblower provisions? In interpreting the relevant statutory language (with varying degrees of liberality), judges have addressed three distinct inquiries: (1) whether the employee of the subsidiary is a covered "employee" under SOX; (2) if so, if the employee names the subsidiary as a respondent, whether the subsidiary is a covered entity subject to suit; and (3) if the employee names the parent as a respondent, whether the existence of separate corporate identities insulates the parent from liability.

A. Is an Employee of a Subsidiary a Covered "[E]mployee"?

Section 806 prohibits publicly traded companies from retaliating against whistleblowing "employees."[5] The term "employee" is not defined, but employees of subsidiaries of publicly traded companies are not expressly covered. Despite this lack of statutory authority, judges and ALJs consistently have found that, based primarily on perceived legislative intent and common law principles, employees of subsidiaries are covered under SOX.

In some cases, judges have looked to the interrelatedness of the corporate structures in ultimately concluding the subsidiary's employee was covered. For example, in *Collins v. Beazer Homes USA, Inc.*, a district court in Georgia held that a subsidiary's employee was covered because officers of the publicly traded parent had authority to affect the employment of the subsidiary's employees.[6] Similarly, in *Platone v. Atlantic Coast Airlines Holdings Inc.*, an ALJ held that a subsidiary's employee was covered where the company's publicly traded holding company was the alter ego of the subsidiary and had the ability to affect the employee's employment.[7]

Other judges, looking to SOX's legislative intent and purpose of SOX, have found that employees of subsidiaries are almost automatically covered, regardless of the subsidiary's relationship with its parent. The First Circuit, in *Carnero v. Boston Scientific Corp.*, suggested in dicta that an employee of a subsidiary of a publicly traded company could be a covered employee because the subsidiary could be considered an "agent" of the parent.[8] The court opined that "the fact that [complainant] was employed by [the parent's] subsidiaries may be enough to make him a[n] 'employee' [of the parent] for purposes of seeking relief under the whistleblower statute." Likewise, in *Morefield v. Exelon Servs. Inc.*, an ALJ concluded that employees of subsidiaries of publicly traded companies are covered regardless of the parent company's role in affecting the employment of the subsidiary's employees.[9] An ALJ, in *Gonzalez v. Colonial Bank,* agreed with *Morefield* that based on legislative intent a subsidiary's employee was covered.[10]

As these divergent results reflect, in the absence of unambiguous statutory language, a judge's approach to statutory construction plays a significant role in the development of the law.

B. Is a Non-Publicly Traded Subsidiary a Covered Entity?

An inquiry that has resulted in even more mixed results is whether a subsidiary of a publicly traded parent company, standing alone, is a covered entity subject to suit. Section 806 prohibits any publicly traded company or "any officer, employee, contractor, subcontractor or agent of such company" from retaliating against whistle-blowing employees. These terms are not defined in the statute. Whether these terms incorporate subsidiaries appears primarily to depend upon whether the judge applies a strict or liberal construction of the statute.

There appears to be a developing trend of federal courts construing the pertinent statutory provision more strictly than ALJs. For instance, in *Rao v. Daimler Chrysler Corp.*, a district court in Michigan narrowly interpreted Section 806 as not providing a cause of action directly against the subsidiary alone.[11] The court reasoned that "Congress could have specifically included subsidiaries within the purview of § 1514A if they wanted to," and, because they did not, "the general corporate law principle would govern and employees of non-public subsidiaries are not covered under § 1514A." The judge appropriately concluded that "it is not the job of the Court to rewrite clear statutory text."

The strict interpretation of *Rao* is consistent with a series of earlier ALJ decisions holding that Section 806 does not provide a cause of action directly against the subsidiary. For example, in *Ambrose v. U.S. Foodservice, Inc.*, the ALJ dismissed a SOX complaint on the basis that the complainant, an employee of a wholly owned subsidiary of a publicly traded company, was not protected under Section 806.[12] The ALJ reasoned that Section 806's caption, "Whistleblower Protection For Employees Of Publicly Traded Companies," clearly reflected Congress' intent to not extend coverage to employees of non-publicly traded subsidiaries. Similarly, in *Grant v. Dominion East Ohio Gas,* the ALJ concluded that the plain language of Section 806 provides no cause of action against a non-public subsidiary standing alone, regardless of whether complainant could produce evidence to justify piercing the corporate veil.[13] The ALJ reasoned that, even if the complainant could establish that the parent company was liable for the acts of its subsidiary, this "does not cure the deficiency of not naming a company covered by the Act as Respondent. In other words, neither the doctrine of piercing the corporate veil, nor agency law principles generally operate to pull a parent company into litigation if the parent company is not named as a party in the first place."

This strict construction line of ALJ decisions may have reached its conclusion with the Administrative Review Board's ("ARB") 2006 adoption of a more liberal construction in *Klopfenstein v. PCC Flow Technologies Holdings, Inc.*[14] In *Klopfenstein*, the ARB found that a whistleblower claim may proceed directly against a non-publicly traded subsidiary under the theory that the subsidiary is an "agent" of the parent company. The ARB explained that whether a subsidiary is an agent of a publicly traded parent "should be determined according to principles of the general common law of agency." The ARB explained that an agency relationship may be found where there is a manifestation by the principal that the agent shall act for it, the agent's acceptance of the undertaking, and the understanding of the parties that the principal is to be in control. The ARB concluded that commonality of management and involvement by the principal in decisions relating to the complainant's employment were factors weighing in favor of finding existence of an agency relationship.

Unlike the courts, ALJs are bound by *Klopfenstein*. For instance, in *Savastano v. WPP Group, PLC*, an ALJ followed *Klopfenstein*, but narrowed it somewhat by holding that the agency relationship must pertain to employment matters.[15] The ALJ explained that "for an employee of a non-public subsidiary to be covered under Section 806, the non-public subsidiary must act as an agent of its publicly held parent, and the agency must relate to employment matters." In other words, the fact that the companies share an agency relationship for other purposes, such as collecting and reporting financial data, is insufficient to establish subsidiary coverage under SOX.

To further complicate the picture, the Solicitor of Labor has argued for an alternate approach to subsidiary coverage—the four-part "integrated enterprise" test.[16] The "integrated employer" test focuses on (a) interrelation of operations; (b) common management; (c) centralized control of employment decisions; and (d) common ownership or financial control. The integrated enterprise theory finds some support in the case law interpreting Section 806. Likewise, in *Hughart v. Raymond James & Associates, Inc.*,[17] the ALJ (in a pre-*Klopfenstein* decision) suggested that a case under Section 806 may proceed solely against a subsidiary if the parent company and its wholly owned subsidiary are "so intertwined as to represent one entity."[18]

In sum, courts, ALJs and the DOL have all adopted widely differing views regarding whether and under what conditions a subsidiary is covered under SOX. With the courts and the ALJs headed down divergent paths, the unintended practical effect will be that an employee's choice of forum may have a material impact upon whether he/she ultimately can recover under the statute.

C. Does the Existence of Separate Corporate Identities Insulate the Parent from Liability?

The final inquiry—whether the existence of separate corporate identities insulates the parent from liability for acts of the subsidiary—focuses on whether piercing the corporate veil or some other basis for ignoring corporate separateness is warranted so that the parent may be subject to suit. In cases following the ARB's *Klopfenstein* reasoning, this inquiry may now be moot because the complainant usually will be permitted to proceed directly against the subsidiary alone. However, in cases applying the narrower view that non-publicly traded subsidiaries are not directly subject to suit, addressing corporate separateness may often become important.

Federal courts have not yet addressed this issue, but the pre-*Klopfenstein* ALJs who have done so have not agreed upon the proper standard for holding a parent company liable. In *Powers v. Pinnacle Airlines Corp.*, an ALJ dismissed a subsidiary employee's complaint because his attempt to hold the parent liable "ignore[d] the general principle of corporate law that a parent corporation is not liable for the acts of its subsidiaries."[19]

The ALJ, noting that the subsidiary's impact on the parent was "questionable at best," found no basis for piercing the corporate veil. In *Hasan v. J.A. Jones-Lockwood*, an ALJ held that a parent company was not an "employer" under the ERA merely because it was the parent of the employer where no evidence showed that it had the power to hire, promote, discipline or give raises or had input in those decisions.[20]

By contrast, the ALJ in *Platone v. Atlantic Coast Airlines Holdings Inc.* held that the parent/holding company *was* a proper respondent in an action by an employee of a non-publicly traded subsidiary where the subsidiary was a "mere instrumentality" of the holding company.[21] The ALJ reasoned that the holding company had no employees; the companies disregarded the separate identity of the subsidiary in its dealings with the public, the SEC, and its employees; there was a great degree of commonality between the senior management of the two corporate entities, including those responsible for labor relations within the subsidiary; and the holding company had the ability to affect the complainant's employment, including making the ultimate termination decision.

In addition, constitutional and jurisdictional principles may limit courts' efforts to hold parent companies liable for the acts of its subsidiaries. For example, if courts continue to hold that there is no direct cause of action against non-publicly traded subsidiaries, they inevitably will be required to address whether, and to what extent, they have personal jurisdiction over distant publicly traded parent corporations. In *Personalized Brokerage Servs., LLC v. Lucius*, the parent company was a German company with no contacts with the forum state other than the fact that its subsidiary operated there.[22] The court, finding that "there is no case authority that the Act permits a court to dispense with jurisdictional prerequisites in this context," dismissed the plaintiff's Section 806 claim on the ground of lack of personal jurisdiction. The court noted that there was no evidence the subsidiary was an "alter ego" of the parent.[23]

Whether ALJs interpret similar restrictions into the administrative process could impact whether some complainants opt to proceed through the ALJ process rather than run the risk of dismissal by a federal court.

II. Extraterritoriality

Foreign corporations doing business in the United States are subject to Section 806's whistleblower provisions; however, SOX does not express whether its whistleblower protections are intended to extend to employees working outside the United States.[24] Courts and ALJs generally have refused to afford such protections; at least where the complainant is not a U.S. citizen and the employment relationship lacks a substantial nexus with the U.S. To date, it is unclear what degree of nexus will be required to establish coverage for overseas workers.

In *Carnero*, the First Circuit refused to apply Section 806 to a foreign national who was directly employed by Argentinian and Brazilian subsidiaries of a corporation covered by SOX.[25] The court reasoned that Congress was silent as to its intent to apply Section 806 abroad, and it is presumed that federal statutes do not apply extraterritorially absent clear language to extend the statute's protections abroad. However, the court left open the possibility that Section 806 may apply to conduct occurring overseas where a complainant's employment relationship had a more substantial nexus to the U.S.

Similarly, in *Beck v. Citigroup, Inc.*, the ALJ refused to apply Section 806 to a foreign national working exclusively in Germany for respondent's German division.[26] The ALJ reasoned that, although the complainant reported the alleged misconduct to U.S.-based company officials, and although U.S.-based company officials may have participated in the decision to terminate his employment, "the essential nature of the employment relationship" was foreign.[27]

Despite this reluctance to apply SOX's whistleblower provisions overseas, several decisions have acknowledged the potential application of Section 806 to foreign conduct where the complainant's employment relationship has a significant connection to the United States. In *Penesso v. LLC International, Inc.*, although the complainant worked in Italy, the ALJ denied summary decision for the employer, finding "this case has a substantial nexus to the United States, and it is appropriate for the complainant to bring this claim under §1514A of the Sarbanes-Oxley Act."[28] The ALJ reasoned that the complainant was a U.S. citizen, much of the protected activity took place in the U.S. when the complainant came to the company's U.S. headquarters to inform corporate officers of alleged financial improprieties, and at least one of the alleged retaliatory actions took place in the U.S.

In *Neuer v. Bessellieu*, the complainant was not a U.S. citizen, the alleged SOX protected activity occurred in Israel, and the parent company was located in Israel.[29] Nonetheless, the ALJ refused to dismiss the complaint based on lack of extraterritorial effect because the complainant alleged he was employed by a U.S. subsidiary, spent most of his time working in the U.S., that his termination occurred in the U.S., and that there was significant intermingling of the business activities of the Israel-based parent company and its U.S. subsidiary.

The overriding theme of these cases is that, although Section 806 presumably will not apply extraterritorially, it may apply overseas if there is a substantial nexus with the United States. If so, there is a serious concern that SOX's whistleblower protections may conflict with foreign law and cultural norms.[30] For example, the French Data Protection Authority (CNIL) has found that whistleblower hotlines proposed by French subsidiaries of McDonald's and CEAC to comply with SOX Section 301 were in violation of French privacy laws.[31] The CNIL later issued a Guidance explaining that SOX whistleblowing systems are not necessarily prohibited by French law, provided that eleven conditions are satisfied that ensure that "the rights of individuals directly or indirectly incriminated through them are guaranteed with regard to personal data protection rules."[32]

Likewise, a European Union organization recently issued an opinion setting forth a number of conditions which must be met to ensure that internal whistleblowing systems comply with EU data protection rules.[33] In Germany, a Düsseldorf court invalidated Wal-Mart's whistleblowing policy on the ground that it was not first presented to the works council for approval. The court did not address whether the policy violated German privacy laws.[34]

Although these European decisions do not directly address Section 806, they do highlight some of the concerns that might arise if SOX whistleblower provisions are broadly applied to overseas employees.

III. Protected Activity

The issue of what constitutes SOX protected activity has involved difficult questions, such as when does an employee have a "reasonable belief" that conduct violates the predicate fraud or securities provisions, how particularly must the employee articulate a violation of those provisions, and must the alleged wrongdoing have an impact on shareholders? Understandably, OSHA investigators (and employment lawyers) with little background in the vagaries of securities law have been wary of tackling these issues head-on.

A. Is an Allegation of Fraud Against Shareholders Required?

To constitute protected activity, the subject matter of a SOX complaint must involve a purported violation of federal mail, wire, bank or securities fraud laws, any SEC rule or regulation, or "any provision of Federal law relating to fraud against shareholders." A conflict exists among the various courts and ALJs that have addressed the issue as to whether this statutory provision limits protected activity under SOX to complaints alleging fraud "against shareholders." Some judges have adopted a narrow view that "[t]o be protected under Sarbanes-Oxley, an employee's disclosures must be related to illegal activity that, at its core, involves shareholder fraud."[35]

Other judges have applied a broader interpretation which appears more consistent with the statute's plain meaning, that complaints of mail, wire, bank or securities fraud, or violation of any SEC rule or regulation need not relate to fraud against shareholders.[36] This broader approach appears to be developing into the prevailing view. For instance, in *Reyna v. ConAgra Foods, Inc.*, a district court in Georgia found that "[t]he statute clearly protects an employee against retaliation based upon that employee's reporting of mail fraud or wire fraud regardless of whether that fraud involves a shareholder of the company."[37] The court concluded that when a complaint involves noncompliance with internal accounting controls promulgated in compliance with Sarbanes-Oxley mandates or SEC rules and regulations, the non-compliance itself would constitute a violation of one of the laws enumerated in section 806.[38]

Another area of disagreement has been whether a complaint must allege intentional deceit as an element of protected activity. In *Hopkins v. ATK Tactical Systems*, an ALJ found that a complaint was not protected where it did not allege that the company's activities involved intentional deceit.[39] The ALJ reasoned that "an element of intentional deceit that would impact shareholders or investors is implicit" under the SOX whistleblower provision. Similarly, in *Getman v. Southwest Securities, Inc.*, an ALJ noted that the scienter requirement under the "any rule or regulation of the SEC" provision, specifically Rule 10b-5, requires "a mental state embracing intent to deceive, manipulate, or defraud," and is established by showing that the respondent acted intentionally or with severe recklessness.[40]

In contrast, other judges have determined that a complaint need not implicate intentional deceit as long as a violation of SEC rule or regulation is raised. For example, in *Smith v. Corning, Inc.*, a federal district court found that the submission of quarterly reports that simply were not prepared in accordance with General Accepted Accounting Principles (GAAP) would violate a "rule or regulation of the Securities and Exchange Commission," and therefore an employee who alleged that the defendants refused to address a problem that was resulting in incorrect financial information being reported to the company's general ledger sufficiently alleged protected activity under SOX.[41] Likewise, in *Morefield v. Exelon Servs. Inc.*, an ALJ concluded that the catchall, "any provision of Federal law relating to fraud against shareholders" provision "may provide ample latitude to include rules governing the application of accounting principles and the adequacy of internal accounting controls implemented by the publicly traded company in compliance with such rules and regulations."[42]

In short, in light of the purposes of SOX, one might reasonably conclude that some level of fraud and intentional deceit relating to shareholders is required for a complaint to be protected. However, the plain statutory language does not appear to support such an interpretation.

B. Must the alleged wrongdoing be material?

Taken to a logical extreme, almost any wrongdoing by a publicly traded company, no matter how insignificant, and regardless of the existence of fraud, may have some degree of impact on its shareholders, and therefore could implicate SOX. To date, judges have struggled with the issue of whether, and to what degree, employee complaints must implicate material wrongdoing.

Materiality is an element of the predicate fraud provisions.[43] In addition, ALJs have applied a materiality element under SOX's "any rule or regulation of the SEC" and "any provision of Federal law relating to fraud against shareholders" provisions. However, some ALJs have not applied a materiality requirement. For example, in *Morefield*, the ALJ placed little emphasis on the materiality requirement under the catchall "any provision of Federal law relating to fraud against shareholders," and denied respondent's motion to dismiss despite the fact that the amounts involved totaled less than .0001% of the annual revenues of the parent company.[44] The ALJ reasoned that whether or not "materiality" is a required element of a criminal fraud conviction "we need be mindful that Sarbanes-Oxley is largely a prophylactic, not a punitive measure."

In contrast, judges appear to apply a heightened materiality requirement when the employee does not complain directly about accounting or security-related matters. For instance, several complainants have argued that their complaints about violations of other employment laws were protected under SOX because the potential liability could have an adverse impact on shareholders. Judges have accepted this argument in theory, but to date have not found a sufficient level of materiality or nexus to fraud against shareholders to warrant protection.

One such case is *Harvey v. Home Depot, Inc.*, in which an ALJ concluded that an employee complaint about alleged race discrimination that had "a very marginal connection with" a corporation's accurate accounting and financial condition did not constitute activity protected under SOX.[45] The ALJ recognized that a company's discriminatory practices can

implicate federal law relating to fraud against shareholders in that it is acting contrary to the best interests of its shareholders, but rejected this argument because its nexus to fraud against shareholders was extremely tenuous. The only applicable federal law that could have possibly been implicated was SOX itself (which requires certification that a financial disclosure is accurate and does not contain any untrue statement of material fact). However, "the connection between the incident of discrimination and the accuracy of corporate disclosures was "tenuous upon close examination of SOX." The ALJ noted that the discrimination complaints at issue centered on the alleged *existence* of discrimination, not the company's *failure to report* such discrimination to the public. Nevertheless, the ALJ suggested that perhaps the failure to disclose a class action discrimination lawsuit might become the subject of a SOX protected activity "if an individual complained about the failure to disclose that situation."

Similarly, in *Harvey v. Safeway, Inc*., 2004-SOX-21 (ALJ Feb. 11, 2005), the complainant complained that discrepancies in his weekly paychecks violated the FLSA. In his subsequent SOX complaint, the complainant argued his reports of FLSA violations constituted protected activity. The ALJ rejected this argument based on a lack of materiality, explaining that the employee's "personal experience over the course of a couple of weeks with Safeway and an anecdotal report of one other employee's wage concerns did not provide an objectively reasonable factual foundation for a... complaint about systematic wage underpayment." Implicit in this reasoning is that had the company actually engaged in systemic wage underpayment and not reported it to its shareholders, the employee's complaint may have been protected.

Likewise, in *Smith v. Hewlett Packard*, an employee alleged that his threats to take allegations of a potential race discrimination class action to the EEOC constituted protected activity under SOX.[46] The ALJ rejected this argument, reasoning that "[m]ere knowledge that an employee-evaluation process adversely affected minorities (without knowing whether this result was intentional), coupled with an insider's access to disgruntled employees' conversations about 'external' resolutions, is not enough." The ALJ noted that a rumor of a class-action lawsuit, absent such litigation, is not something the company must disclose to its shareholders. The ALJ did state, however, that disclosure of company-wide discrimination could form the basis of SOX whistleblower claim if "such a suit actually been filed, and if HP had prevented that information from reaching its shareholders, and if the Complainant learned of this omission and if he had reported it."

C. How Have Judges Interpreted "Reasonable Belief"?

An employee must "reasonably believe" the conduct at issue constitutes a violation of the predicate fraud or securities provisions. SOX does not define "reasonable belief," and it has not been clear how the DOL and courts would interpret this phrase under SOX. However, the prevailing view now appears to be that this term should be interpreted consistent with the "reasonable belief" standard commonly applied under other employment-related statutes, which contains both a subjective and objective component.

An interesting effect of the reasonable belief analysis in the SOX context is that judges have evaluated reasonableness based in part on the level of the complaining employee's knowledge or expertise regarding the matters about which he/she complains. Therefore, employees with little or no expertise in accounting, for example, have been held to a very low standard, while employees with extensive pertinent knowledge or expertise are held to a higher standard. For example, in *Grove v. EMC Corp*., an ALJ found that, although the company did not engage in any fraudulent or wrongful activities enumerated in Section 806, because the complainant was a salesman with no specialized training or expertise in the area of corporate acquisitions, it was not unreasonable for a person in the complainant's position to believe that the company's actions impacted the company's financial condition.[47]

In contrast, in *Welch v. Cardinal Bankshares Corp*., the company's CFO, an experienced CPA, complained about figures contained in the company's SEC financial reports.[48] The ARB found that because the complainant was an experienced CPA/CFO, he could not have reasonably believed that errors in the company's quarterly SEC report presented a misleading picture of the company's financial condition.

A corollary to this trend is that employers may argue, understandably, that an employee with little or no experience in accounting or corporate fraud matters may not have a *subjective* belief of a violation of SOX's predicate fraud provisions because the employee lacks familiarity with the requisite elements under those provisions. To date, the response to this argument appears to have been that employees with less pertinent expertise or knowledge will be held to a lower standard.

D. How Particular Must the Employee's Complaint Be?

Another issue upon which the statute is silent is with what level of particularity must an employee articulate in the complaint a violation of the predicate fraud or securities provisions? Thus far, judges have reached mixed results on this issue.

Some judges have interpreted the statute as requiring very specific allegations of fraud of securities violations. For example, in *Van Asdale v. International Game Technology*, a federal district court explained that, to constitute protected activity, "an employee's act must implicate securities fraud definitively and specifically.... Thus, the whistleblowing cannot be vague...."[49] The court found that plaintiff's recommendation that the company "investigate these issues, the potential for fraud" did not rise to the level of protected activity because the court could not "infer that [plaintiff] implied that shareholder fraud had occurred and that [defendant] understood the implication."

Likewise, in *Lerbs v. Buca Di Beppo, Inc*., an ALJ found that the complainant failed to show that he engaged in protected activity because his alleged complaints did not state a particular concern about the company's practices.[50] Rather, he simply asked about certain entries in a general ledger and on another occasion allegedly told an officer that he thought an entry was misleading. The ALJ found that these remarks were more like general inquiries which are not protected under SOX.

Rejecting such an exacting standard, a federal district court in *Collins v. Beazer Homes USA, Inc*., found a genuine

issue of material fact as to whether the plaintiff engaged in protected activity where she contended that her complaints to management disclosed attempts to circumvent the company's system of internal accounting controls in violation of Section 13 of the Exchange Act.[51] The court rejected that the complaints were too vague, noting that the company took the allegations seriously enough to investigate. Moreover, the court concluded that "the mere fact that the severity or specificity of her complaints does not rise to the level of action that would spur Congress to draft legislation does not mean that the legislation it did draft was not meant to protect her."

IV. Procedural Issues

Under the SOX administrative scheme, a complainant must exhaust certain administrative requirements prior to initiating adjudicatory proceedings. However, SOX contains a "kick out" provision that, in most cases, allows the complainant to bring a *de novo* action in district court if the DOL does not issue a final decision within 180 days. In deciding between federal court or remaining before the DOL OALJ, a complainant must take into consideration a number of factors, including the possibility of fewer evidentiary restrictions, less formal pleading requirements in agency adjudications, and the likelihood that one forum may interpret ambiguous statutory language more favorably than another. The trend appears to be that federal courts are more likely than ALJs to strictly construe administrative exhaustion and pleading requirements.

A. May a Complainant Add Claims After the Initial OSHA Determination?

One procedural issue that has led to divergent construction is whether a complainant is permitted to add claims after OSHA issues its initial determination. The federal courts have held that a SOX complaint filed in federal court after the expiration of 180 days generally must be limited to the claims identified in the initial OSHA complaint. For example, in *Willis v. Vie Financial Group, Inc*., the court held that the SOX administrative exhaustion requirement precluded recovery for a discrete act of retaliation which was never presented to OSHA for investigation.[52] The court reasoned that the SOX administrative scheme, unlike that of Title VII, "is judicial in nature and is designed to resolve the controversy on its merits…."

One issue that was not presented to the *Willis* court, however, was whether a complainant should be permitted to add claims, which were not before OSHA during the investigation, in *an ALJ proceeding* after OSHA issued its initial determination. ALJs have been inconsistent on this issue. Reading the statute narrowly, the ALJ in *Ford v. Northwest Airlines, Inc*., reasoned that although the substance of the new claims was based on the same core of operative facts, OSHA was not given the opportunity to investigate the allegations "under the two-tiered scheme Congress provided for handling whistleblower claims."[53] The ALJ concluded:

> I will not arbitrarily usurp the system established by Congress and determine the legitimacy of this allegation in the first instance. A better procedure is to make the initial complaint to OSHA and then move to consolidate the complaint with litigation pending before the OALJ.[54]

In contrast, in *Hooker v. Westinghouse Savannah River Co*., the complainant failed to allege his refusal to rehire claim in his initial ERA discrimination complaint.[55] The ALJ sua sponte amended the complaint to include the refusal to rehire allegation. On review, the ARB did not contest the sua sponte amendment, but explained that the proper procedure for amending complaints is found at 29 C.F.R. § 18.5(e).

B. May a Complainant Add Parties After the Initial OSHA Determination?

Another procedural issue that has led to divergent construction is whether a complainant is permitted to add parties after OSHA issues its initial determination. Federal courts generally have rejected plaintiffs' efforts to add new defendants who were not named in the initial OSHA complaint.

For example, in *Smith v. Corning, Inc*., the employee named the company but not his supervisor as a respondent in his OSHA complaint.[56] He then filed a complaint in federal court naming both the company and his supervisor as defendants. The court dismissed the claims against the supervisor, finding that plaintiff failed to exhaust his administrative remedies as against the supervisor. Likewise, in *Bozeman v. Per-Se Techs., Inc*., the court dismissed claims against individual defendants who were not named in the OSHA proceedings.[57] The court reasoned that, "[w]hile the regulations implementing SOX may provide for individual liability, that does not obviate the need for the Plaintiff to exhaust his administrative remedies for each claim he seeks to assert against each defendant."[58]

Complainants' attempts to add new respondents during an *ALJ proceeding* subsequent to an initial determination by OSHA have met with much friendlier results. For instance, in *Gallagher v. Granada Entertainment USA*, the ALJ, citing no authority, stated that "[i]ndividuals and entities may be added as parties when they were not joined below through error."[59] The ALJ permitted the complainant to add as respondents the individual executives of the named corporate respondent, named as those who terminated the complainant's employment. Although the ALJ observed that the initial OSHA complaint is "not a pleading under Rule 8(a), Fed.R.Civ.P., but a complaint in the ordinary sense," the ALJ did not reconcile this observation with 29 CFR § 18.5(e), which only grants the ALJ discretion to permit amendments to "complaints, answers and other pleadings, as defined by the Rules."

Likewise, in *Gonzalez v. Colonial Bank*, the ALJ, citing 29 C.F.R. § 18.5(e), permitted complainant to amend his initial OSHA complaint to include the parent as a respondent.[60] Further, the ALJ permitted the amendment to relate back to the date of the initial OSHA complaint, thereby rendering the claims against the parent timely. The ALJ reasoned that, although the complainant was aware of the identity and role of the parent from the outset, "amending the complaint filed before OSHA by adding... the parent company... as a respondent comports with the purpose of Rule 15(c) and the purpose of the Act." This decision illustrates why a complainant might choose to pursue agency adjudication rather than removing to federal district court. For example, if the complainant in *Gonzalez* had removed to federal court, the court, consistent with the reasoning in *Willis* and *Smith*, likely would have held that SOX's administrative exhaustion requirement precluded addition of the parent as a defendant. Moreover, in federal court, the OSHA administrative complaint would not have been

subject to amendment under Rule 15(a), Fed.R.Civ.P. Although the OALJ Rules of Practice would appear consistent with the federal rules on this issue, the ALJ was willing to interpret the rules more liberally than a federal judge likely would have, in light of the statutory purpose.

V. Section 1107 Criminal Provision

Section 1107 makes it a crime to knowingly and intentionally retaliate against any person who provides truthful information to a law enforcement officer relating to the commission or possible commission of any federal offense.[61] Criminal sanctions include, for individuals, fines up to $250,000 and/or imprisonment up to ten years and, for organizations, fines up to $500,000.[62]

A. Potentially Expansive Criminal Liability under Section 1107

To date, Section 1107 has not been extensively litigated. However, there are several aspects of Section 1107 that could be construed liberally to result in its extremely broad application. Section 1107 applies not only to publicly traded companies, but to *any* "person," meaning employers, supervisors and other employees may be criminally liable for retaliatory conduct. Employers are covered regardless of their corporate status or number of employees. Moreover, Section 1107 coverage is not limited to the employment relationship, therefore third parties, regardless of their agency relationship with the employer, may be liable.

In addition, Section 1107 is not limited to employees reporting fraud or securities violations. In fact, Section 1107 covers disclosures to *any* federal law enforcement officer relating to commission or possible commission of any federal offense. Because the term "law enforcement officer" is broadly defined as any federal officer or employee "authorized under law to engage in or supervise the prevention, detection, investigation, or prosecution of an offense," this provision reasonably could be interpreted as encompassing complaints to the EEOC under federal employment discrimination statutes such as Title VII, ADA or ADEA or complaints under various other labor statutes such as NLRA, OSHA, FLSA, etc.[63] Whether such an interpretation is adopted hinges largely on the meaning of the term "federal offense," which is not defined in SOX, but which has been applied in both civil and criminal contexts.[64]

Finally, the conduct prohibited by Section 1107 is extremely broad, covering any action "harmful" to a person, including "interference with the lawful employment or livelihood" of any person. Moreover, an employee need not report an actual violation, as long as his/her disclosure is "truthful" and relates to the "possible commission" of a federal offense. Because there is no statutory language limiting the terms "harmful" or "interference" to injuries involving economic harm, or even to retaliation occurring within the scope of the employment relationship, the scope of prohibited conduct under Section 1107 is probably at least as broad as conduct prohibited under the hostile work environment theory under other employment statutes.

Due to Section 1107's broad scope, it would not be unreasonable to interpret Section 1107 as criminalizing retaliatory conduct that previously only would have given rise to civil liability under Title VII or other federal employment statutes. In *MacArthur v. San Juan County*, plaintiffs contended they suffered retaliation in violation of Section 1107 for having informed their employer/hospital's governance board of ethnic remarks made by hospital administration concerning another employee.[65] The court noted that Section 1107 "simply cannot be read to reach the reporting of ethnic remarks to a local hospital's governance board." The court did not address, however, whether such reports would have been covered if they instead had been made to the EEOC. The court also did not address whether a private cause of action even exists under Section 1107, although every court to date to address this issue has held that it does not.[66]

B. SOX Violations Could Give Rise to Civil RICO Claims

Retaliation against corporate whistleblowers may give rise to a cause of action under the civil RICO statute. Section 1107 amends 18 U.S.C. § 1513(e) and, under RICO, "racketeering" includes "any act which is indictable under... 18 U.S.C. § 1513."[67] Therefore, by engaging in retaliation prohibited by Section 1107 (*e.g.,* conceivably by engaging in ongoing retaliatory acts or creating a hostile work environment), a company or person commits a predicate act of racketeering under RICO.

With the availability of treble damages, plaintiffs have an incentive to pursue civil RICO claims. Prior to the enactment of Section 1107, civil RICO claims arising from retaliatory discharge rarely succeeded because retaliatory discharge did not fall within the definition of "racketeering."[68] Even if an employee could legitimately allege that the employer committed a predicate act under RICO, the employee rarely could assert a viable RICO claim because the employee's injury was almost never proximately caused by the predicate act, but rather by a separate adverse employment action.[69] Section 1107, by including retaliatory conduct as a predicate act, significantly expands the likelihood of establishing the necessary causal link between the predicate act and the injury.

Of course, courts have been reluctant to expand civil RICO coverage, and a plaintiff must still establish the other civil RICO elements, such as existence of an enterprise and a "pattern of racketeering." For example, in *Compact Disc Minimum Advertised Price Antitrust Litigation*, plaintiff alleged he was fired in retaliation for conveying truthful information during a federal investigation, and that his firing constituted a predicate act for purposes of RICO under 18 U.S.C. § 1513.[70] The court dismissed plaintiff's RICO claims because he failed to establish a "pattern of racketeering." The court reasoned that the single act of termination, combined with alleged instructions by the employer to withhold information during "a single federal investigation," did not constitute a "pattern" sufficient to support a RICO claim. It remains to be seen whether an ongoing hostile work environment or systematic retaliation (as opposed to a single adverse employment action) may give rise to a "pattern of racketeering" under RICO.

Therefore, although a plaintiff alleging a civil RICO claim arising for a Section 1107 violation faces significant hurdles, a broad interpretation of the statute could provide a basis for such claims.

C. Potential SEC Criminal Issues

Beyond Section 1107, Section 3(b) of SOX states that "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 Act or such rules or regulations." Due to this broad and ambiguous language, Section 3(b) could reasonably be interpreted as expanding *criminal* liability for any retaliatory action prohibited by Section 806, regardless of whether the retaliation was related to the disclosure of truthful information to a law enforcement officer.

Indeed, some in Congress have pushed for such a broad interpretation. In November 2004, Senators Grassley and Leahy sent a letter to SEC Chairman William Donaldson stating that they wanted "aggressive enforcement to deter retaliation against corporate whistleblowers," asking: "[w]hat is your position on whether or not a violation of the Section 806 whistleblower prohibitions can generate criminal liability under Section 3(d) [sic] of the Act?" Chairman Donaldson responded to the effect that, while Section 3(b) is a useful provision allowing the SEC to enforce SOX, the SEC would leave it to the Labor Department to investigate and prosecute potential Section 806 whistleblower violations.[71]

Although to date the SEC has not pursued Section 3(b) actions in this context, the broad statutory language could allow future administrations to adopt a broader interpretation of this provision. Moreover, even if Section 3(b) is not interpreted as criminalizing retaliation prohibited by Section 806, all Section 806 complaints are referred to the SEC and could give rise to prosecution for substantive violations of the securities laws. For example, in *Matter of Ashland Inc.*, an employee filed a complaint with DOL alleging retaliation for raising concerns about understatement of the company's environmental reserves.[72] Upon referral from the DOL, the SEC instituted proceedings against the company, ultimately finding the company violated the reporting, books and records, and internal controls provisions of the Exchange Act. The company and the SEC settled the matter.

CONCLUSION

Ambiguities in the statutory language of SOX's whistleblower provisions have forced judges to resolve important issues under the law on a case-by-case basis through statutory construction. Judges' contrasting approaches to statutory construction have led to divergent results, which has exacerbated the lack of clarity in the law and has created a situation where parties' choice of forum may materially impact their substantive rights under the law. Additionally, ambiguities in Section 1107's criminal whistleblower provision have created uncertainty regarding its scope. A broad interpretation of Section 1107 could result in serious criminal and civil liability well beyond its intended scope. Finally, the expansive reach of SOX's whistleblower protections has created extraterritoriality and jurisdictional concerns. A consistent, strict construction of SOX's whistleblower provisions would minimize conflicts and create a greater degree of uniformity in this evolving area of law.

Endnotes

1 Lewis Carroll, Through the Looking-Glass, Ch. 6 (1872).

2 J. Gregory Grisham & James H. Stock, Jr. 8 Engage 1, 29, 33 (Feb. 2007).

3 It has been said that SOX was "rushed into law in the hysterical atmosphere surrounding the Enron and WorldCom bankruptcies." *See* 151 Cong. Rec. E657 (daily ed. Apr. 15, 2005) (statement by Rep. Ron Paul). The bill, H.R. 3763, passed the House by a vote of 423-3 and passed the Senate unanimously. *See* Final Vote Results For Roll Call 348, *available at* <http://clerk.house.gov/evs/2002/roll348.xml> and U.S. Senate Roll Call Votes 107th Congress, *available at* <http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=107&session=2&vote=00192>.

4 SOX's whistleblower provisions were expressly intended to correct what some in Congress perceived as a "patchwork and vagaries" of state laws relating to corporate whistleblowers. *See* 148 Cong. Rec. S7420 (daily ed. July 26, 2002) (statement of Senator Leahy). *See also* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L.J. 1521, 1523 (May 2005).

5 18 U.S.C. § 1514A(a).

6 334 F. Supp. 2d 1365 (N.D. Ga. 2004).

7 2003-SOX-27 (ALJ Apr. 30, 2004).

8 433 F.3d 1 (1st Cir. 2006).

9 2004-SOX-2 (ALJ Jan. 28, 2004).

10 2004-SOX-39 (ALJ Aug. 20, 2004).

11 2007 U.S. Dist. LEXIS 34922 (E.D. Mich. May 14, 2007).

12 2005-SOX-105 (ALJ Apr. 17, 2006).

13 2004-SOX-63 (ALJ Mar. 10, 2005).

14 ARB 04-149, 2004-SOX-11 (ARB May 31, 2006).

15 2007-SOX-34 (ALJ July 18, 2007).

16 *See* Brief of the Assistant Secretary of Labor for Occupational Safety and Health, Ambrose v. U.S. Foodservice, Inc., ARB 06-096, 2005-SOX-105 (brief filed Sept. 1, 2006).

17 2004-SOX-9 (ALJ Dec. 17, 2004).

18 *See also* O'Keefe v. TIAA-CREF, 2005-SOX-86 (ALJ Oct. 19, 2005) (denying respondent's motion for summary decision because a question of fact existed as to whether "the high degree of intermingling between TIAA and its subsidiaries, between TIAA and CREF and the presentation of TIAA-CREF as one company to its customers, employees and the public" should result in TIAA-CREF's treatment as one publicly traded entity under the Act).

19 2003-AIR-12 (ALJ Mar. 5, 2003).

20 2002-ERA-5 (ALJ Sept. 17, 2002).

21 2003-SOX-27 (ALJ Apr. 30, 2004).

22 2006 U.S. Dist. LEXIS 75225 (D. Minn. Oct. 16, 2006).

23 *See also* Andrews v. ING North America Insurance Corp., 2005-SOX-50 (ALJ Feb. 17, 2006) (dismissing complaint because complainant could not proceed directly against the subsidiary and complainant did not attempt to add the publicly traded parent because of inability to sue the parent due to its foreign status).

24 Carnero v. Boston Sci. Corp., 433 F.3d 1 (1st Cir.) ("These registration and reporting provisions apply to U.S. and foreign companies listed on U.S. securities exchanges") *cert. denied*, 126 S. Ct. 2973 (2006); Ward v. W & H Voortman, Ltd., 685 F. Supp. 231, 232 (M.D. Ala. 1988).

25 433 F.3d 1 (1st Cir. 2006).

26 2006-SOX-3 (ALJ Aug. 1, 2006).

27 *See also* O'Mahony v. Accenture Ltd., 2005-SOX-72 (ALJ Jan. 20, 2006); Ede v. Swatch Group, 2004-SOX-68, 2004-SOX-69 (ALJ Jan. 14, 2005); Concone v. Capital One Fin. Corp., 2005-SOX-6 (ALJ Dec. 3, 2004).

28 2005-SOX-16 (ALJ Mar. 4, 2005).

29 2006-SOX-132 (ALJ Dec. 5, 2006).

30 *See* 69 Fed. Reg. 52104, 52105 (Aug. 24, 2004).

31 *See* Decisions of the Commission nationale de l'informatique et des libertés (May 26, 2005), *available at* <http://www.cnil.fr/index.php?id=1834> and <http://www.cnil.fr/index.php?id=1833>.

32 *See* Guideline document of the Commission nationale de l'informatique et des libertés (Nov. 10, 2005), *available at* http://www.cnil.fr/fileadmin/documents/uk/CNIL-recommandations-whistleblowing-VA.pdf.

33 *Available at* http://europa.eu.int/comm/justice_home/fsj/privacy/docs/wpdocs/2006/wp117_en.pdf.

34 *See* Decision of Landesarbeitsgericht, 10 TaBV 46/05 (Nov. 14, 2005).

35 Livingston v. Wyeth, Inc., 2006 U.S. Dist. LEXIS 52978 (M.D.N.C. July 28, 2006). *See also* Bishop v. PCS Admin. (USA), Inc., 2006 U.S. Dist. LEXIS 37230 (N.D. Ill. May 23, 2006) (finding that the phrase "relating to fraud against shareholder" must be read as applying to all violations enumerated under section 806); Marshall v. Northrup, 2005-SOX-0008 (ALJ June 22, 2005); Wengender v. Robert Half Int'l Inc., 2005-SOX-59 (ALJ March 30, 2006).

36 Collins v. Beazer Homes USA, Inc., 334 F. Supp. 2d 1365 (N.D. Ga. 2004) ("The threshold is intended to include all good faith and reasonable reporting of fraud"); Walton v. Nova Inf. Sys., 2005-SOX-1076; 2006-SOX-18 (ALJ March 29, 2006) (rejecting argument that report of violation or rule or regulation of the SEC must relate to fraud against shareholders).

37 2007 U.S. Dist. LEXIS 42112 (M.D. Ga. June 11, 2007).

38 *See also* Johnson v. Stein Mart, Inc., 26 I.E.R. Cas. (BNA) 470 (M.D. Fla. June 20, 2007) (allegations of accounting improprieties even in absence of fraud allegations constituted protected activity); Mahony v. KeySpan Corp., 2007 U.S. Dist. LEXIS 22042 (E.D.N.Y. Mar. 12, 2007) (finding plaintiff reasonably believed that the company was engaging in accounting practices that needed to be corrected before its financial statements misled shareholders).

39 2004-SOX-19 (ALJ May 27, 2004).

40 2003-SOX-8 (ALJ Feb. 2, 2004).

41 2007 U.S. Dist. LEXIS 52773 (W.D.N.Y. July 9, 2007).

42 2004-SOX-2 (ALJ Jan. 28, 2004).

43 *See, e.g.,* Neder v. United States, 527 U.S. 1, 4 (1999).

44 2004-SOX-2 (ALJ Jan. 28, 2004).

45 2004-SOX-20 (ALJ May 28, 2004).

46 2005-SOX-88 (ALJ Jan. 19, 2006).

47 2006-SOX-99 (ALJ July 2, 2007).

48 ARB No. 05 064, ALJ No. 2003-SOX-15 (ARB May 31, 2007).

49 2007 U.S. Dist. LEXIS 53867 (D. Nev. June 13, 2007).

50 2004-SOX-8 (ALJ June 15, 2004).

51 334 F. Supp. 2d 1365 (N.D. Ga. 2004).

52 2004 U.S. Dist. LEXIS 15753 (E.D. Pa. Aug. 6, 2004).

53 2002-AIR-21 (ALJ Oct. 18, 2002).

54 *See also* Kingoff v. Maxim Group LLC, 2004-SOX-57 (ALJ July 21, 2004) (denying complainant's attempt to add constructive discharge claims after OSHA issued its initial determination).

55 ARB No. 03-036, ALJ No. 2001-ERA-16 (ARB Aug. 26, 2004).

56 2007 U.S. Dist. LEXIS 52958 (W.D.N.Y. July 23, 2007).

57 2006 U.S. Dist. LEXIS 77885 (N.D. Ga. Sept. 12, 2006).

58 *Accord,* Hanna v. WCI Communities, Inc., 2004 U.S. Dist. LEXIS 25652 (S.D. Fla. Nov. 15, 2004) (dismissing SOX claim against individual defendant not named as respondents in plaintiff's OSHA complaint).

59 2004-SOX-74 (ALJ Oct. 19, 2004).

60 2004-SOX-39 (ALJ Aug. 9, 2004).

61 *See* 18 U.S.C. § 1513(e).

62 *See* 18 U.S.C. § 3571.

63 18 U.S.C. § 1515(a)(4).

64 *See, e.g.,* Cole v. United States Dept. of Agric., 133 F.3d 803 (11th Cir. 1998) (referring to "criminal and civil offenses").

65 2005 U.S. Dist. LEXIS 25235 (D. Utah June 13, 2005).

66 *See* Compact Disc Minimum Advertised Price Antitrust Litig., No. 05-cv-118 (D. Conn. Sept. 25, 2006); Deep v. Recording Indus. Ass'n of Am., No. 2:05-cv-00118 (D. Me. Oct. 2, 2006); Fraser v. Fiduciary Trust Co. Int'l, No. 04 Civ. 6958 (S.D.N.Y. June 23, 2005).

67 *See* 18 U.S.C. § 1961.

68 *See* Beck v. Prupis, 529 U.S. 494 (2000).

69 *See* Sedima, S.P.R.L. v. Imrex Co., Inc., 473 U.S. 479 (1985); Miranda v. Ponce Fed. Bank, 948 F.2d 41 (1st Cir. 1991).

70 No. 05-cv-118 (D. Conn. Sept. 25, 2006).

71 *See* James Hamilton, *SEC Responds to Senate Letter on Whistleblower Provisions*, 2005-32 SEC Today Online (CCH) (Feb. 17, 2005).

72 No. 3-12487 (SEC Nov. 29, 2006).