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Extraterritorial Protection for Corporate Whistle-blowers Under the Sarbanes-Oxley Act of 2002

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I. Introduction

Corporate whistle-blowers, those who report financial irregularities and other wrongful acts in private sector employment, are a relatively new class of protected persons in employment law.

In common law countries, retaliation against corporate whistle-blowers has only been directly addressed in the past eight years. For example, in the UK, the Public Interest Disclosure Act[1] dates back to 1998. Other common law countries, such as New Zealand[2] and South Africa,[3] enacted similar laws in 2000.

The United States was not too far behind. Although prior to the Enron scandal, U. S. corporate whistle-blower laws were mostly limited to employees reporting "health and safety" matters of "public" concern, that changed with the Sarbanes-Oxley Act of 2002 (SOX).[4]

In essence, the theory behind SOX's whistle-blower provisions is that if Sherron Watkins (the Enron whistle-blower) had been heard and protected, Enron would still be a going concern and its namesake scandal would have never happened. Although some would disagree with that theory, SOX does, for the first time, provide a statutory framework from which the next Sherron Watkins could derive some protection; that is, if she were in the United States.

However, if the next Ms. Watkins is stationed abroad, working for a publicly traded U. S. company, she would not necessarily be able to count on SOX whistle-blower protection. According to recent cases, her fate as a whistle-blower would not depend on the information she discovers or its impact on the U. S. financial market and shareholders, but on her citizenship and general nexus with the United States.

II. Whistle-Blower Protection under the Sarbanes-Oxley Act of 2002

SOX applies to all companies required to file reports with the Securities and Exchange Commission (SEC) under the Securities and Exchange Act of 1934 or which have a registration statement on file with the SEC under the Securities and Exchange Act of 1933. Many of SOX's provisions also apply to investment companies registered under the Investment Company Act of 1940. Significantly, SOX also applies to public companies domiciled outside the United States.

In addition to mandating sweeping changes in accountancy procedures, internal audits, and professional accountability (including the role of lawyers and accountants), SOX seeks to protect corporate whistle-blowers by providing for both criminal and civil liability against retaliatory employers. Criminal liability is set forth in SOX Section 1107, pursuant to which anyone who "with the intent to retaliate, takes any action harmful to any persons, including interference with the lawful employment or livelihood or any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense" would be subjected to penalties ranging from fines to 10 years' imprisonment.

Civil liability is set forth in SOX Section 806, which provides whistle-blower protection to persons who report conduct that they reasonably believe to be a violation of federal mail, wire, bank, or securities laws: SEC rules, or any federal law regarding fraud against shareholders. These prohibitions apply even if the employee was incorrect in his or her report of wrongful conduct. Thus, for example, a public company suspending an employee for reporting what he or she mistakenly believed to be accounting irregularities would be violating SOX. The reporting could be to federal agencies, to Congress or to a supervisor. Section 806 also prohibits retaliation against employees who "file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed" regarding a violation of the above-referenced laws by a public company.

The provisions of Section 1107 are more limited than Section 806 in that, unlike civil liability, criminal liability under SOX is limited to retaliation against a whistle-blower providing "truthful information" to a law enforcement agency. Accordingly, criminal penalties would not attach when retaliatory measures are taken against a whistle-blower who reports wrongful acts only to a supervisor. On the other hand, the provisions of

Section 1107 are also broader that Section 806, in that they prohibit detrimental actions taken for reporting "any Federal offense," not a specific list of offenses. Moreover, although Section 806 provides a list of prohibited detrimental acts, Section 1107 prohibits all acts of intentional retaliation "including interference with the lawful employment or livelihood of any person."

Another significant difference between the criminal and the civil provisions is that the former includes express language applying Section 1107 extraterritorially, while the latter does not.

III. Extraterritorial Whistle-Blower Protection Under SOX

In a world of interdependent global markets, a publicly traded U. S. company's acts abroad may well affect, among other things, its U. S. share price and the interests of its U. S. shareholders. Therefore, some of the same objectives that led to the enactment of SOX, such as the protection of U. S. shareholders and the prevention of fraud, would arguably be furthered by also protecting whistle-blower employees working abroad.

Under SOX Section 1107, whistle-blower employees are expressly protected extraterritorially to the extend they participate in criminal investigations abroad. However, Section 806 does not include express language regarding extraterritorial application, leaving the question of civil liability for acts occurring outside the United States open to interpretation by federal agencies and courts. So far, the issue has been interpreted narrowly, limiting extraterritorial application to specific factual situations. The first and, to date, only federal appellate decision addressing the topic is *Carnero v. Boston Scientific Corp*., 433 F. 3d 1 (1st Cir. 2006), *cert. denied* No. 05-1397, ___ U. S. ___ (June 26, 2006). In *Carnero*, the court dismissed a complaint brought by an Argentinean citizen employed by Argentinean and Brazilian subsidiaries of Boston Scientific Corporation, finding that the lack of express language applying Section 806 extraterritorially, together with the express provision for extraterritoriality elsewhere in the Act (Section 1107), as well as the absence of legislative history and the assignment of enforcement duties to a domestic agency (U. S. Department of Labor), dictated against the extraterritorial application of SOX Section 806.

Most decisions by Administrative Law Judges of the United States Department of Labor also seem to follow the "limiting" trend. *Concone v. Capital One Financial Corp*. 2005-SOX-006 (ALJ, Dec. 3, 2004), *Ede v. Swatch Group*, 2004-SOX-068, 2004-SOX-069 (ALJ, Jan. 14, 2005) (appeal dismissed), *O'Mahony v. Accenture LTD*, 2005-SOX-00072 (ALJ, Jan. 20 2006) and *Beck v. Citigroup, Inc.,* 2006-SOX00003 (ALJ, August 1, 2006) all involved non-U. S. citizens employed abroad by publicly-traded U. S. companies or their subsidiaries. The above cases were dismissed at the federal agency level mainly due to the fact that the non-U. S. citizen employees worked exclusively abroad, or that they could not establish an adequate "nexus" with the United States. However, for a variety of reasons, including amicable resolution prior to further litigation, none of these cases were litigated in court. Therefore, the question remains whether de novo factual analysis would have resulted in a finding of extraterritorial jurisdiction under SOX Section 806.

One case indicates that SOX may still be applied extraterritorially, under certain circumstances: In *Penesso v. LCC International Inc*., 2005-SOX-016 (ALJ, Mar. 4, 2005), the Department of Labor found that SOX Section 806 did apply extraterritorially to a whistle-blower employee of a publicly traded U. S. company. Like *Concone*, the complainant in *Penesso* was employed in Italy for the subsidiary of a publicly traded U. S. company. However, unlike Mr. Concone, Mr. Penesso was a U. S. citizen. Other factors also distinguished *Penesso* from the above cases: The complainant in *Penesso* engaged in protected activities at the respondent's U. S. headquarters and the alleged retaliatory acts of which he complained took place in the United States. Therefore, under certain circumstances, such as those in *Penesso*, a whistle-blower employee could be protected extraterritorially under SOX Section 806. The importance of a factual analysis is reinforced by the latest relevant case, *Beck*. Although the U. S. Department of Labor dismissed Mr. Beck's complaint for lack of jurisdiction, it did not espouse Citigroup's original argument: that SOX had no extraterritorial applicability to an overseas employee under any circumstances. In fact, the administrative lawj in *Beck* took care to emphasize that although "the instant case [was] not one of them," she recognized that "[t]here may be certain extraterritorial situations which give rise to jurisdiction under [SOX]." *Beck*, 2006-SOX-00003 at 4. Considering the line of cases after *Carnero*, it would seem that such "situations" would, at a minimum, include complaints brought by U. S. citizen employees abroad, with a reporting line linked to decision-makers in the United States.

Conclusion

Many large U. S. employers have, for years, been covered by the extraterritorial provisions of federal antidiscrimination laws, such as Title VII of the Civil Rights Act of 1964,[5] the Americans with Disabilities Act of 1990,[6] and the Age Discrimination in Employment Act of 1967,[7] as amended. SOX's corporate whistle-blower provisions, both criminal and civil, are yet another set of regulations with which such employers must comply in the vast and expanding global employment market. Until the boundaries of the extraterritorial application of SOX whistle-blower provisions are clearly defined by the Supreme Court[8] or by Congress, publicly traded employers in the United States must exercise caution in seeking to automatically dismiss a SOX whistle-blower complaint brought by a foreign-based employee, particularly if that employee is an expatriate U. S. citizen.

[1] Public Interest Disclosure Act, 1998, c. 23 (UK), amending the Employment Rights Act, 1996, c. 18 (UK)
[2] Protected Disclosures Act 2000 (New Zealand)
[3] Protected Disclosures Act 2000. (Republic of South Africa).
[4] 15 U.S.C. §§ 7201-7266 (2002).
[5] 42 U.S.C. §§ 2000 *et seq.*
[6] 42 U.S.C. §§ 12101 *et seq.*
[7] 29 U.S.C. §§ 621 *et seq.*
[8] The Supreme Court has, so far, turned down the opportunity to rule on the matter when denying certiorari in *Carnero*.

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