

## SARBANES–OXLEY AND THE CLOSELY HELD BUSINESS: CRIMINALIZING RETALIATION AGAINST WHISTLEBLOWERS

*By John J. Scharkey III*

The Sarbanes-Oxley Act (SOX) is not limited to publicly traded companies. Although most provisions of SOX apply only to public companies, some do reach privately held companies. Companies who violate these provisions face criminal prosecution – and human resource managers and company supervisors should be aware of them.

SOX was a direct response to massive investor fraud in several recent, high-profile accounting scandals. It was written to ensure standards of corporate responsibility, governance, and reporting. The core of SOX establishes minimum internal controls so that a company's financial data – assets, liabilities, and other items bearing on its fiscal health – are accurately reported. These reporting requirements protect the investing public, who, unlike the owners of private companies, are not involved in the day-to-day management of the company and do not have access to the company's financial records.

Yet SOX reaches beyond public companies whose securities are federally regulated. Under SOX, it is a federal offense for *any* company – public or private – to destroy, alter, or falsify documents or records in an attempt to impede or influence a federal investigation or official proceeding. This provision is particularly important for private companies who work with publicly traded companies as subcontractors or affiliates because an investigation of the public company – the target – may very well lead back to the private company and its dealings with the public company.

To help ensure that companies comply with SOX, it encourages employees to report misconduct – to “blow the whistle” – by companies or employees who violate SOX or commit any other federal offense. SOX protects whistleblowers by making it a crime for *any person* – including officers, directors, and employees – to knowingly and intentionally retaliate against an employee (i.e., to “discharge, demote, suspend, threaten, harass or in any other manner discriminate . . . in the terms and conditions of employment”) who provides “truthful information relating to the commission or possible commission of *any federal offense*.”

The criminal penalties for retaliating against a whistleblower are not trivial. Fines can reach up to \$250,000 for individuals; \$500,000 for organizations. More importantly, an individual who violates the anti-retaliation provision of SOX may also face criminal prosecution, a conviction, and a prison sentence of up to ten years.

Beyond the criminal penalties, a private company and its supervisory employees may also face liability under the Racketeering Influenced and Corrupt Organizations Act (RICO) for retaliating against whistleblowers. Before SOX became law, retaliation was not actionable under RICO. However, RICO was amended by SOX and the term “racketeering” is now defined to include “any act . . . indictable under . . . [the criminal provision of the Sarbanes-Oxley Act of 2002].”

Thus, supervisors and managers who participate in a decision to “discharge, demote, suspend, threaten, harass or in any other manner discriminate against an employee in the terms and conditions of employment” may now very well face liability under RICO. This is significant because RICO violations may lead to a verdict that includes treble damages and the whistleblower's attorneys' fees.

The extent to which the government will criminally prosecute company employees remains to be seen. SOX is still in its infancy and there are no reported decisions to gauge how stridently the Justice Department will enforce this provision or how willingly the courts will impose fines or sentence those convicted. Until criminal prosecutions and RICO cases under SOX are litigated and make their way through the courts, the range of penalties levied against individuals and organizations will remain unclear.

What is clear, however, is that companies – including privately held companies – should know that retaliatory action taken against a whistleblower may have unintended consequences – and may result in a criminal prosecution. For that reason, companies should take steps to ensure that human resource managers and supervisory employees who make employment decisions seek the advice of counsel before taking any action against a whistleblower that could be construed as retaliation.

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