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SOX Whistleblower Provision Does Not Apply to Employee Working Overseas, Says the Department of Labor

Money moves easily in international channels, but laws tend to get stuck at the borders. The Supreme Court has made clear that U.S. laws are presumed to be limited in their application to U.S. territory, unless Congress has specifically declared that a law is to be applied abroad.

For multinational corporations, with subsidiaries and employees spread around the globe, the prospect that any employee, however far removed from the U.S., could take advantage of the extensive whistleblower protections of Sarbanes-Oxley and Dodd-Frank raises very substantial concerns. Recently, an administrative tribunal at the Department of Labor waded into this thicket. In a split decision, the DOL Administrative Review Board held that a foreign citizen working abroad for a foreign company indirectly related to a U.S. corporation could not maintain a claim under Sarbanes-Oxley that he was fired by U.S. management for exposing tax fraud in his company. However, the Board left open the possibility that a different combination of foreign and domestic interests could yield a different result. *Villanueva v. Core Labs. NV,* Arb. Case No. 09-108 (Dep't of Labor Dec. 22, 2011).

The complaint was brought by William Villanueva, a non-U.S. citizen who never worked or lived in the U.S. For 24 years he was employed in Colombia, the last 16 years as the CEO of a subsidiary (through a series of foreign entities) of Core Labs, a Dutch company engaged in the business of providing services to companies in the petroleum industry. Claiming that the Colombian company, with the assistance of a related foreign company based in the Dutch Antilles, had systematically understated its Colombian revenue (thus underpaying its Colombian taxes), Villanueva refused to sign the company's tax returns. He claimed that in retaliation for his taking a stand against Colombian tax fraud, officials in Core Labs's Houston office had him fired. Because the parent corporation has issued securities that are registered and traded in the U.S., Villanueva claimed that his termination violated the whistleblower protection provisions of Sarbanes-Oxley Section 806.

In June 2009, an administrative law judge at the Department of Labor dismissed the claim for lack of jurisdiction. He declared that Sarbanes-Oxley had no application outside the U.S., and this dispute between a foreign executive and a foreign company regarding an alleged scheme to defraud a foreign country, resulting in the loss of foreign employment, thus did not fall within the purview of Sarbanes-Oxley.

The Board's Opinion

On December 22, 2011, the DOL Administrative Review Board affirmed the dismissal. Although the Board and ALJ reached the same outcome, the analysis was somewhat different.

In its analysis, the Board began with the recent Supreme Court decision in *Morrison v. National Australian Bank, Ltd.*, 130 S. Ct. 2869, 2878 (2010), which established a "two-step process" for determining the extraterritorial application of U.S. law.

Under *Morrison*, a court or agency must analyze the text of the statute, along with the relevant context and legislative history, to determine if Congress intended the law to apply overseas. "When a statute gives no clear indication of an extraterritorial application," the Supreme Court held, "it has none." The Supreme Court expressly rejected the concept put forward by some courts of appeals that the determination of the extraterritorial reach of a statute could be affected by an analysis of the conduct at issue or its effects in the U.S.

The second element of the analysis under *Morrison* is the determination of where the "essential events" of the particular case occurred, to determine whether the application of a particular law to them would constitute an extraterritorial application of that statute. Thus, in *Morrison,* the Supreme Court held that the primary focus of the Securities Exchange Act of 1934 was to protect the purchasers of securities in the U.S., and the claimed fraud affecting the sale of shares on the Australian stock exchange was therefore not subject to the U.S. law.

In *Villanueva,* the Board decided to start with the second step – whether the "essential events" of Villanueva's claims concerned the "primary focus" of Sarbanes-Oxley. The Board determined that SOX's primary focus was "to prevent and uncover corporate financial fraud, criminal conduct in corporate activity, and violations of securities and financial reporting laws." According to the Board, however, the violations of law that were the subject of Villanueva's complaint "involved Colombian laws with no stated violation or impact on U.S. securities or financial disclosure laws."

Indeed, the alleged fraud in *Villanueva* involved allegedly improper transactions between two foreign companies, "center[ing] on the accounting practices of Saybolt Colombia and its compliance with Colombian tax law." According to the Board, whether Core Labs "directly controlled" the Colombian subsidiary's business operations "do[es] not change the fact that the disclosures involved violations of extraterritorial laws and not U.S. laws or financial documents filed with the SEC." And the fact that the complainant reported the alleged misconduct to Core Labs officials in Houston, Texas, or that they directed his termination, did "not change the foreign nature of the fraud."

In a long footnote, the Board assessed four factors to evaluate in determining whether a case involves the attempted extraterritorial application of SOX: (1) "the location of the protected activity," (2) "the location of the job and the company the complainant is fired from," (3) "the location of the retaliatory act," and (4) "the nationality of the laws allegedly violated that the complainant has been fired for reporting." In weighing these factors, the Board determined that "the driving force of the case, the fraudulent activity being reported, was *solely* extraterritorial and takes the events outside Section 806's scope." The Board noted, however, that "a case where the complainant, for example, is working for a covered company in the United States, but may have worked in a foreign office of the company for part of the time, may require a different outcome."

Having concluded that Villanueva's claims would require extraterritorial application of SOX, the Board turned to the first step of the *Morrison* analysis. It concluded that the whistleblower protection in SOX Section 806, by its "silence as to its extraterritorial application requires that we not extend it in that way . . . [and] does not allow for its extraterritorial application." The Board stressed that it was evident Congress did not intend extraterritorial application of the SOX whistleblower protections, because it had expressly included such extraterritorial application elsewhere in the statute (involving criminal proceedings for individuals charged with retaliating against a witness, victim or informant), but made no reference to it in Section 806.

The Board makes the same illustration with Dodd-Frank. Section 929A – which clarifies that Section 806(a) applied to "any subsidiary or affiliate whose financial information is included in the consolidated financial statements" of an otherwise covered company – makes no mention of extraterritorial application. However, Section 929P grants extraterritorial jurisdiction to federal courts for actions brought by the Securities Exchange Commission or the Department of Justice, so long as the (1) conduct within the United States constitutes significant steps in furtherance of the violation (even if the securities transaction occurs outside the United States and involves only foreign investors), or (2) the conduct occurring outside of the United States has a foreseeable substantial effect within the United States.

Dissenting Opinions

There were two dissents in the *Villanueva* decision. Administrative Appeals Judge Joanne Royce contended that limiting Section 806's application to the United States would "severely undercut Congress' remedial purpose," considering that "Congress adopted SOX against a backdrop of corporate misconduct conducted on a global arena," and "SOX's legislative history contains repeated references to the interconnectedness and internationalization of national markets."

She also determined that "numerous other provisions [of SOX] are routinely accorded extraterritorial application despite the absence of express extraterritorial language." This contention is based on the premise that these provisions apply to publicly traded companies, "domestic and foreign alike." For that reason, Royce declares that Section 301 – which mandates that certain companies provide whistleblower hotlines for anonymous and/or confidential reporting of accounting misconduct – necessarily applies abroad. Whether Section 301 applies abroad is, however, still an unsettled question.

The other dissent, written by Chief Administrative Appeals Judge Cooper Brown, concentrated on the "second-step" of the Board's *Morrison* analysis, which concluded that fraudulent evasion of Colombian taxes did not touch on the primary focus of SOX. Brown argued to the contrary: (1) the alleged fraud on the part of Core Labs was, as a matter of law, domestic in origin, and (2) the Board's focus on the fraudulent conduct was misplaced, *i.e.,* "the when and where of [the complainant's] notification are not the time and place of the wrong that injured him." In his view, the fact that the decision-makers were located in the U.S. should have been given far greater weight.

Take-Away

Villanueva's lawyer has declared his intention to seek court review of the Board's dismissal of his claim. At this point, however, the Board is clear that Section 806 does not allow for extraterritorial application. Still to be determined is the degree to which claims mixing foreign and domestic elements will fall within the purview of Section 806.

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