Journal of Business & Technology Law

Volume 2 | Issue 1 Article 11

The Impact on Shareholders and Other Constituents

Brett McDonnell

BRETT MCDONNELL*

CRIMINALIZATION OF CORPORATE LAW
The Impact on Shareholders and Other Constituents

I CAME AT THIS FROM A SLIGHTLY DIFFERENT ANGLE which will hopefully be useful. I chose the shareholders and other constituents panel because I am interested in another constituent group in a lot of my writing, namely, the role of employees in governance of corporations. I think employees are a place to look for improved corporate governance. If you are looking for ways to fight fraud and other sorts of wrongdoing by corporations you need people who are both informed about what is going on in the corporation and motivated to do something about it potentially, so employees are a good group to look at for trying to control misbehavior.

That led me to thinking about the whistle-blowing provisions of Sarbanes-Oxley,[1] which are quite interesting. Employee whistle-blowing is a way both to try to stop corporate fraud and also a way to inform on other forms of corporate crime as well. The problem with whistle-blowing is for a variety of reasons, including corporate culture reasons I talked about a little bit earlier, there are strong pressures to stop employee whistle-blowers, and insofar as you might try to look for strategies to counteract those pressures that might be useful.

There might be problems with whistle-blowing so that we should not want to encourage it, but let us for the rest of these few minutes assume it as given that encouraging whistle-blowing is potentially a useful strategy to follow. Sarbanes-Oxley has a whistle-blower criminal provision. Section 1107 of Sarbanes-Oxley makes it a crime to retaliate against whistle-blowers by taking harmful action, including negative job actions, against the whistle-blower if they have given truthful information to a law enforcement officer for the commission of any federal offense.[2] This is not limited to securities fraud. This is a criminal provision.

But what is interesting, I think, in terms of the topic of this whole roundtable is that's just one of three whistle-blower provisions in Sarbanes-Oxley. There are two

* Professor of Law, University of Minnesota Law School.

1. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 775 (codified as amended at 15 U.S.C. § 78j-1 (2002)); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 806, 116 Stat. 745, 802–04 (codified as amended at 18 U.S.C. § 1514A (2002)); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 1107, 116 Stat. 810 (codified as amended at 18 U.S.C. § 1513 (2002)).

2. *Id.* at § 1107.

others that take totally different approaches as to how you go about protecting whistle-blowers.[3] There is Section 301 of Sarbanes-Oxley, which is the audit committee provision, part of which says that it is a responsibility of the audit committee to have a procedure in place for taking complaints from employees, including confidential complaints, for information concerning only accounting and auditing matters, much more limited subject matter than Section 1107.[4] So that's a traditional corporate governance approach.

And then there is Section 806 of Sarbanes-Oxley, which gives a private cause of action to people who have had their employer discriminate against them if they provided information on securities fraud-related types of issues to a federal agency, Congress, or a supervisor within the company.[5] It would be interesting to take a closer look at the three different provisions, which is something I am considering doing in the long run. One issue would be to ask if Congress has made any sort of sensible division. Why do they have three different provisions? They differ in terms of the scope. What kinds of information are covered? Who are you reporting to? Is there any sort of sensible division here? On its face there might be. Giving information to a law enforcement agent about a federal offense might be the kind of behavior we most want to protect with criminal sanctions for retaliation, so it might make some sort of sense, but I am not sure if they in the end do make sense.

But the other issue I suspect that might be quite interesting to look at here comes from the different scope of these provisions, because they apply to different types of corporations. There is a list of corporations covered by Section 301,[6] all companies are covered by Section 1107.[7] It would be interesting to look and see if we can tease out which provision is having more effect on actual behavior. Is it the private cause of action? Is it the audit committee reporting? Or is it the threat of criminal sanction? The different scope of who is covered might allow us to disentangle the effects of the three provisions, since some corporations are covered by one provision but not the others. It is hard to tell, from the literature that I've been able to see out there so far, which is actually having more effect on behavior, but it is an interesting little case study of Sarbanes-Oxley as to whether a criminal approach makes more sense, or one of these other approaches makes more sense, or maybe they complement each other in a useful sort of way.

3. *Compare id.* at § 301, *with id.* at § 806.
4. *Compare id.* at § 301, *with id.* at § 1107.
5. *Id.* at § 806.
6. *Id.* at § 301.
7. *Id.* at § 1107.