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Seventh Circuit Revives Whistleblower Claim Brought Under RICO

By Scott Preston

A new federal court ruling creates an avenue for employees to rely on the Sarbanes-Oxley Act (SOX) to pursue retaliation claims under the Racketeer Influenced and Corrupt Organizations Act (RICO).

RICO was originally enacted in 1970 as a way to combat organized crime. 18 U.S.C. §§ 1961–1968. Today, RICO sets forth dozens of federal statutes that serve as “predicate acts” to support a RICO violation. Before SOX, retaliation against an employee was not considered a predicate act under RICO, and courts routinely denied RICO standing to employees terminated for refusing to cooperate in alleged racketeering activity. In 2002, Congress enacted SOX and made it a felony to retaliate against whistleblowers who provide information about corporate fraud to law enforcement officers. Although Congress also amended RICO to include retaliation under SOX as a predicate act, courts until recently have refused to recognize retaliatory discharge under SOX as a racketeering activity. In *DeGuelle v. Camilli*, No. 10-2172, 2011 U.S. App. LEXIS 24868 (7th Cir. Dec. 15, 2011), a federal court of appeals for the first time concluded that alleged retaliation under SOX could provide a predicate act for racketeering activity under RICO.

The Underlying Facts

In the case, a former tax employee of S.C. Johnson & Son alleged that he discovered the company had improperly received more than \$5 million in foreign tax credits, beginning in 2000. He allegedly reported his concerns to his supervisor, who the employee claimed directed him to “alter or destroy records so that the errors would not be detected.” The employee alleged that the pattern of fraudulent activity continued and that, on each occasion, he voiced his concerns to his supervisor and other management personnel.

In 2007, the employee met with Human Resources and claimed his supervisor was creating a “hostile work environment” and that the employee was being directed to engage in fraudulent tax practices. Human Resources investigated the allegations and hired outside counsel to conduct an internal investigation. The investigation revealed no evidence of fraud.

In 2008, the employee received a negative performance evaluation and claimed that it was “retaliation for his whistleblowing activities.” While the company later rescinded the review, the employee stated that he intended to file a SOX whistleblower suit against the company with the

Department of Labor. The employee alleged he was offered a severance in exchange for dropping his claims of tax fraud and signing a release of claims and confidentiality agreement. The employee declined the company's offers and instead filed a SOX whistleblower complaint, attaching financial statements, tax documents and internal communications. In February 2009, the Department of Labor concluded that the company was not a covered entity under SOX and dismissed the whistleblower complaint.

Subsequently, the company learned that the employee had attached confidential documents to his Department of Labor complaint. After a brief internal investigation, the company terminated his employment and sued him in state court, seeking recovery of its confidential information. The former employee filed suit in the U.S. District Court for the Eastern District of Wisconsin, alleging two civil claims under RICO. (The company's lawsuit against the employee recently resulted in an order to return the documents and a \$50,000 liability finding against the employee, who is currently appealing.)

The Basis for the RICO Theory

Under RICO, "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefore in any appropriate United States district court . . ." 18 U.S.C. § 1964(c). The employee alleged the company violated 18 U.S.C. section 1962(c), which makes it unlawful for an employee of an enterprise engaged in interstate commerce "to conduct or participate, directly or indirectly in the conduct of such enterprise's affairs through a *pattern of racketeering activity* . . ." (emphasis added). A "pattern" requires the commission of at least two predicate acts of racketeering activity occurring within ten years of each other. "Racketeering activity" is limited to those acts specifically enumerated in the statute.

The employee's complaint alleged several acts of "racketeering activity" including: mail fraud; destruction or concealing documents with the intent to obstruct justice; tampering with a witness; and retaliation against a witness or informant in violation of SOX. The parties did not dispute the alleged acts took place within the last ten years.

In 1989, the Supreme Court held that to show a pattern of racketeering activity, a plaintiff must demonstrate a relationship between the predicate acts as well as a threat of continuing activity. *H.J. Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229, 239 (1989). A relationship is established if the criminal acts "have the same or similar purposes, results, participants, victims or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events." As a general matter, "continuous activity" requires a threat of long term continued future criminal activity.

Even if a plaintiff establishes a RICO violation through a pattern of racketeering activity, a plaintiff may only recover damages for injuries to his "business or personal property" occurring as a result of that violation. A plaintiff must establish both that the RICO violations were the "but for" cause and the proximate cause of his or her injuries. Thus, the only way the employee could recover civil damages under RICO was to claim those damages were related to his termination for whistleblowing activities under SOX.

Both the district court and Seventh Circuit agreed that the employee's termination in violation of SOX on its own did not demonstrate a pattern of racketeering activity. Thus, in order for the employee's RICO claims to have any merit, the retaliation predicate acts (*i.e.*, retaliation, being sued in state court and defamation) must be grouped together with other predicate acts (*i.e.*, mail fraud, destruction of documents and witness tampering) to form a pattern of racketeering activity.

The Seventh Circuit's Decision

The district court determined that the predicate acts consisting of retaliatory actions were unrelated to those alleged as part of the tax fraud scheme and failed to establish a "pattern of racketeering activity" sufficient to support the RICO claims. On appeal, the Seventh Circuit reversed, agreeing with the employee that the addition of SOX as a predicate act allows his RICO claims to proceed. The court of appeal noted that "[t]he addition of § 1513(e) as a predicate act raises the relationship between retaliatory actions and the underlying wrongdoing." Because "[r]etaliatory acts are inherently connected to the underlying wrongdoing exposed by the whistleblower," the court found that "a relationship can exist between § 1513(e) predicate acts and predicate acts involving the underlying cause for such retaliation."

The Seventh Circuit rejected the district court's finding that the two schemes were unrelated. The court cited overlapping actors in both the tax fraud and the retaliation schemes to establish a factual link between the two. The court also found a temporal relationship between the

predicate acts involving the tax fraud and those involving retaliation, explaining that “over a five month period the company engaged in two acts of tampering, one act of mail fraud and three acts of retaliation.” Thus, the court concluded that the two schemes were related and that the continuity requirement under RICO was satisfied.

Finally, while the Seventh Circuit recognizes *in dicta* that termination (*i.e.*, alleged retaliation) will not always be related to the underlying predicate acts of wrongdoing, the court presupposes that it will. According to the court, “logic implies” that “[r]etaliatory acts are inherently connected to the underlying wrongdoing exposed by the whistleblower.” Thus, because the court suggests that there will always be a relationship between the predicate acts, employers could be left to argue only that there is no threat of continuing activity. The court acknowledges as much when it stated, “we are confident the continuity requirement will often weed out those claims which do not truly demonstrate a threat of continuing wrongdoing.”

The Seventh Circuit did not address how an employee can rely on SOX as a RICO predicate act if, as the Department of Labor concluded in this case, the employer is not a SOX-covered entity.

What This Potentially Means for Employers

This case is deeply troubling for employers. It allows an aggrieved employee to pursue wrongful termination claims under the federal racketeering statute simply by claiming that the employer retaliated against him or her for whistleblowing activities and identifying additional, simple predicate acts. For example, nowhere did the employee allege that the company was liable for tax fraud, because tax fraud is not an enumerated “racketeering act” in RICO. Instead, it was the individual acts *in furtherance* of the fraudulent tax scheme that the employee claimed constituted racketeering activity under RICO. Going forward, any employer that conducts business using the U.S. mail, fails to preserve documents or offers a severance package or promotion in exchange for a release of claims to a putative whistleblower, may be vulnerable in a RICO lawsuit and subject to mandatory treble damages set forth under the statute.

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