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Whistleblower Protection Under the Sarbanes-Oxley Act

by David B.H. Martin, Barbara Hoffman, and Erin F. Casey*

Section 806 of the Sarbanes-Oxley Act of 2002 confers legal protection upon employees of public companies who report suspected violations of a range of federal offenses—including those relating to fraud against shareholders. If a whistleblower believes that he or she has suffered discrimination as a result of whistleblowing, the whistleblower may bring a private action against both the company and its employees and agents to demand reinstatement and back pay.¹

The Occupational Safety and Health Administration (OSHA), an agency within the Department of Labor that administers and enforces a variety of whistleblower statutes, has been given oversight responsibilities for whistleblower cases under the Sarbanes-Oxley Act.² Although a Sarbanes-Oxley whistleblower complaint must be filed with OSHA in the first instance, Sarbanes-Oxley uniquely gives the whistleblower the option of

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Letter From the Editors

Section 1103 of Sarbanes-Oxley provides, "Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days." If the individual who was to receive the supposed "extraordinary payments" actually is charged with a securities violation in a civil proceeding, a court can permit the escrow to continue until the conclusion of that proceeding.

Neither the statute nor any SEC implementing regulations issued to date defines "extraordinary payment," but we're following a case of first impression that will take a crack at the phrase.

In May, a three-judge panel of the Ninth Circuit held in *SEC v. Yuen* (367 F. 3d 1087) that multi-million dollar termination fees to be paid to two executives of Gemstar after the company discovered millions in overstated revenue (among other problems) were not "extraordinary." The court complained that "there was no evidence as to what would be an ordinary payment under comparable circumstances," and took the district court to task for relying on "conclusory statements" rather than proof when it granted the Commission's request for an order placing the proposed payments in escrow.

The district court had several bases for its opinion. First, the terminations and the related payments were negotiated over a long period of time, by several different groups of people. The district court deemed this process "extraordinary"; the court of appeals said that, without evidence as to what is common in these situations, the district court had no basis for arriving at that conclusion. Second,

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Whistleblower . . .

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filing a complaint in federal district court if OSHA does not reach a final decision within a specified period of time. This article summarizes what occurs when a whistleblower files a formal complaint with OSHA under Section 806, discusses OSHA's regulations implementing the whistleblower provisions,³ and summarizes the reported Sarbanes-Oxley whistleblower decisions.

Who is Eligible for Whistleblower Protection?

For purposes of the Sarbanes-Oxley Act, a whistleblower is an employee of a public company⁴ who provides information regarding any conduct that the employee reasonably believes constitutes a violation of:

- any rule or regulation of the Securities and Exchange Commission;
- federal criminal provisions relating to securities, bank, mail, or wire fraud; or
- any federal law relating to fraud against shareholders.

An employee who provides such information to a federal regulatory or law enforcement agency, to a member or committee of Congress, or to a person with supervisory authority over the employee is protected by Section 806. An employee who assists in any proceeding (whether filed or about to be filed) relating to an alleged violation of the same laws and regulations also is entitled to protection as a whistleblower. Officers, employees, contractors, subcontractors, and agents of the company are forbidden to engage in any retaliation against the whistleblower.⁵

The statute itself does not define the "employee" to whom whistleblower protection applies. However, in issuing its final implementing regulations, OSHA stated that it believes the protection of the statute extends not only to employees of public companies, but also to the employees of contractors, subcontractors, and agents of public companies. This belief is reflected in OSHA's definition of "employee."⁶ Some of the comments OSHA received on its interim final regulations asserted that OSHA's

definition improperly expanded the statutory coverage; this assertion has not yet been addressed in any of the reported cases.

Initial OSHA Proceedings

Filing the complaint

An employee who believes he or she has been discharged, demoted, suspended, threatened, harassed, coerced, or blacklisted as a consequence of whistleblowing may file a complaint with OSHA. Any complaint must be filed within ninety days of the alleged discriminatory treatment. Upon receipt of the complaint, OSHA will notify the employer of the allegations and of the substance of the supporting evidence.⁷

If the Secretary of Labor fails to issue a final decision within 180 days of the filing of the complaint, and the delay was not due to bad faith on the part of the complainant, the whistleblower claimant may bring an action for *de novo* review in a federal district court.

Review of the complaint by OSHA

OSHA conducts an initial review of all Sarbanes-Oxley whistleblower complaints to determine whether the employee has made out a *prima facie* case against the employer. The elements of such a case are as follows:

- The employee engaged in a protected activity or conduct;
- The employer knew or suspected, actually or constructively, that the employee engaged in the protected activity;
- The employee suffered an unfavorable personnel action;⁸ and
- The circumstances were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action.

If the alleged protected activity is that the employee provided information, it does not matter whether the employer actually violated the specified laws and regulations; all that is required is that the employee have an objectively *reasonable belief* that the employer's conduct constitutes such a violation.⁹ If the alleged protected activity is that the employee assisted in a proceeding concerning an alleged violation, neither an actual violation nor belief in such a violation by the employee is necessary.

A *prima facie* showing is made if the complaint on its face—supplemented as appropriate by interviews with the complainant—alleges the existence of facts and either direct or circumstantial evidence to satisfy the required elements.

If no *prima facie* showing has been made, OSHA will so advise the complainant and will dismiss the complaint without investigation.

[A]ll that is required is that the employee have an objectively reasonable belief that the employer's conduct [violates a particular law or regulation].

If OSHA finds that the complainant has made a *prima facie* showing, the employer is given twenty days from its receipt of the notice of the filing of the complaint to respond. The employer may present written statements or affidavits, and request a meeting with OSHA, to demonstrate by clear and convincing evidence that it would have taken the same personnel action even in the absence of the employee's whistleblowing. If OSHA finds that the employer has made the required clear and convincing showing, it will dismiss the complaint. Otherwise, OSHA will conduct a formal investigation into the merits of the complaint.

Investigation by OSHA

OSHA whistleblower investigators are instructed to interview individually all company officials who have direct involvement in the case. If the company has notified OSHA that it is represented by counsel, the investigator will contact counsel to arrange interviews with managerial and supervisory personnel. Significantly, however, it is OSHA's position that company counsel does not have the right to be present during interviews of non-management and non-supervisory personnel. As a matter of practice, OSHA will not necessarily notify the company or company counsel of its contacts with such personnel.¹⁰ OSHA also will redact witness statements or reduce them to summaries as necessary to protect the identity of confidential informants.

OSHA's investigative findings and preliminary order

At the conclusion of its investigation, OSHA will determine whether there is reasonable cause to believe the employer discriminated against the complainant in violation of Sarbanes-Oxley's whistleblower provisions. If OSHA concludes that reasonable cause exists, it will prepare a preliminary order providing all relief necessary to make the complainant whole.

OSHA's preliminary order may include reinstatement unless the employer establishes that the complainant is a security risk or OSHA determines that reinstatement is otherwise inappropriate. If OSHA believes that preliminary reinstatement is warranted, OSHA will again contact the employer to give notice of the relevant evidence supporting the complainant's allegations as developed during the investigation. The employer will have an opportunity to submit a written response, to meet with the investigators to present statements from its own witnesses, and to present legal and factual arguments in support of its position that preliminary relief is not warranted. This evidence must be presented within ten business days of OSHA's notification to the employer, unless OSHA and the employer agree otherwise.

A party (either complainant or employer) that disagrees with OSHA's findings may file an appeal with the Chief Administrative Law Judge in the Department of Labor within thirty days of receipt of the findings. If neither party appeals within thirty days, the preliminary order becomes the final decision of the Secretary of Labor and is not subject to judicial review.

Appeal of OSHA Findings

Appeal to an administrative law judge

If a timely objection is filed, OSHA's preliminary order is stayed *except those portions providing for preliminary reinstatement of the employee*. The preliminary reinstatement is effective immediately upon the employer's receipt of the order, but under OSHA's final regulations the employer may petition the Office of Administrative Law Judges for a stay of the reinstatement. OSHA does not expect such a stay to be granted except in exceptional circumstances where the employer can establish the

criteria necessary for injunctive relief: irreparable injury, a likelihood of success on the merits, and a balancing of the possible harms to the parties and the public.

[On appeal, t]he complainant has the burden of proving the elements of his claim by a preponderance of the evidence.

After a timely objection to a preliminary order has been filed, an administrative law judge conducts a hearing *de novo*, on the record, with broad power to limit discovery to expedite the process. The Assistant Secretary of Labor may choose to participate as a party, or may participate as *amicus curiae* at any time in the proceedings. The right to participate includes the right to petition for review of the decision of the administrative law judge.¹¹

The complainant has the burden of proving the elements of his claim by a preponderance of the evidence. Even if the complainant meets this burden, however, the employer can prevail by presenting clear and convincing evidence that it would have taken the same personnel action in the absence of the employee's whistleblowing.

The final decision reached by an administrative law judge after the hearing must contain findings, conclusions, and an order stipulating the remedies (if any) to be provided to the employee. The range of remedies available under Section 806 is broad. The administrative law judge can, for example, order reinstatement of the employee to his or her former position with the seniority status the employee would have had but for the discrimination, back pay with interest, and compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorneys' fees.

Appeal to the Administrative Review Board

An administrative law judge's order may be appealed to the Department of Labor's Administrative Review Board. A petition for review must be filed within ten business days of the administrative law judge's decision.

Review by the Board is discretionary. Unless the Board accepts the case within thirty days of the filing of the petition for review, the decision

of the administrative law judge becomes the final order of the Secretary. If the Board does accept the case, the Board will review the factual determinations of the administrative law judge under the substantial evidence standard. The Board's decision is the final order of the Secretary. Like many final agency decisions, it may be appealed to the United States Court of Appeals.

Federal Court Option Available to Employee After 180 Days

As noted above, if the Secretary of Labor fails to issue a final decision in any case brought by an employee under Section 806 within 180 days of its filing, the complainant may bring an action at law or equity for *de novo* review in the appropriate federal district court without regard to the amount in controversy, unless the delay was caused by the bad faith of the complainant.

Thus far, at least 25% of reported Sarbanes-Oxley whistleblower cases have been dismissed or withdrawn because employees have taken advantage of the 180-day limit and opted out of the administrative law system and into federal district court. Almost an equal number of cases, however, have been dismissed or withdrawn for unstated reasons. A number of these dismissals could also be due to an employee's opting to file in federal district court, which would make the actual percentage of cases transferred by the employee to federal district court much higher.

Duration of the Average Whistleblower Case

Because the complainant may bring an action *de novo* in federal district court if there is no final Department of Labor decision within 180 days, the Department of Labor's timing in Sarbanes-Oxley whistleblower cases is important.¹²

OSHA preliminary orders

The Department of Labor does not appear to be resolving whistleblower cases within the time limits stipulated by its own rules. Those rules state that OSHA "will issue, within 60 days of filing of the complaint, written findings." A review of the sixty-four reported cases,¹³ however, shows that it takes OSHA an average of ninety days to issue a preliminary order with written findings after a complaint is first filed.

Orders on appeal

OSHA's rules do not establish a formal timeline for administrative law judge and Administrative Review Board decisions in cases in which OSHA's initial findings are challenged on appeal. But the rules do provide that if final orders have not been issued within 180 days of a complaint being filed, the employee may bring suit in federal district court. Thus, the statute would seem to envision a 120-day window after OSHA's preliminary findings are released as the time any appeals process within the Department of Labor ought to be completed. A review of the reported cases demonstrates, however, that it takes an average of 150 days for a final order to be issued by an administrative law judge after OSHA's preliminary findings have been made.¹⁴

Administrative Review Board final orders

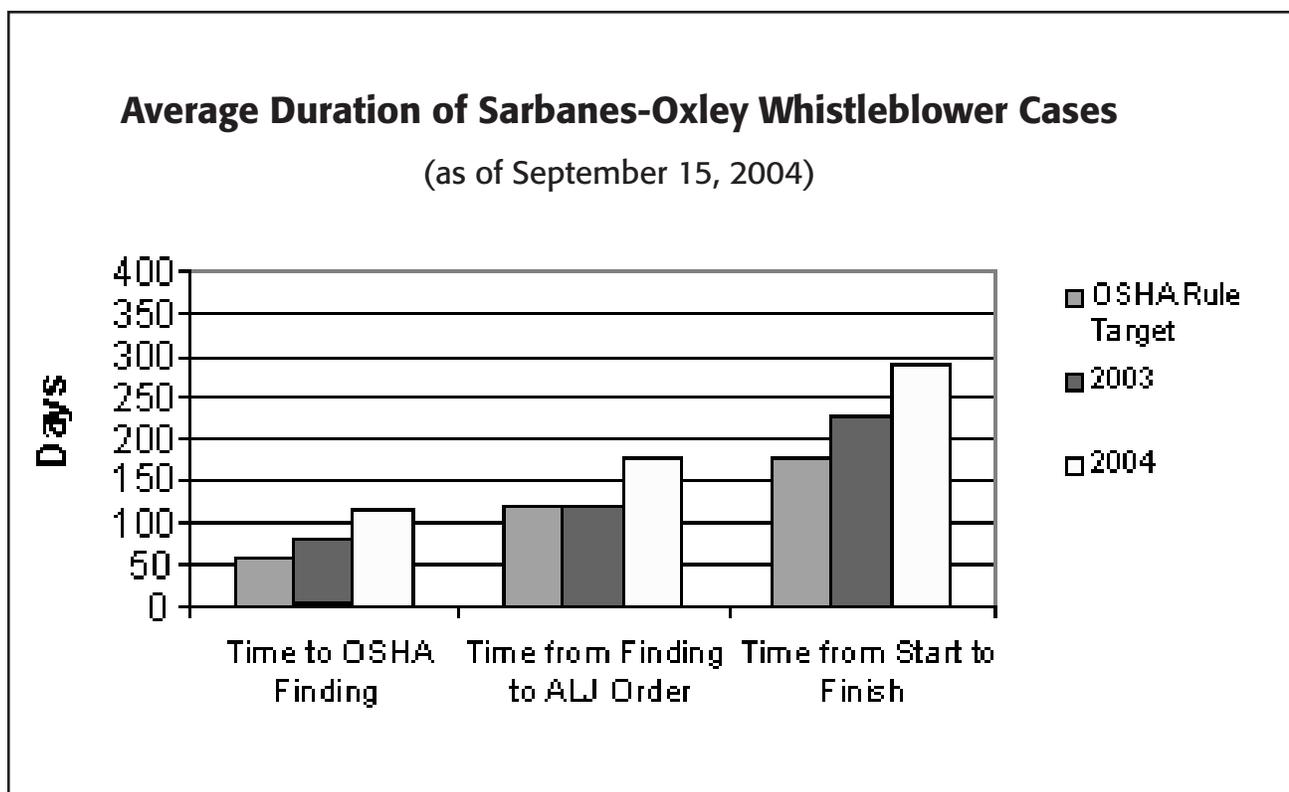
For those few cases appealed to the Administrative Review Board, an additional 197 days were, on average, required before a final decision was issued.

Summary

A conservative estimate of how long a case lasts from the moment it is filed until a final order is issued by an administrative law judge is 264 days. However, this number does not reflect what appears to be an increasing backlog of cases in the Department of Labor. The average duration of cases handed down in 2003 was 228 days. In contrast, the average duration of cases reported in the first eight and a half months of 2004 was 289 days. Charts depicting case duration and disposition accompany this article.

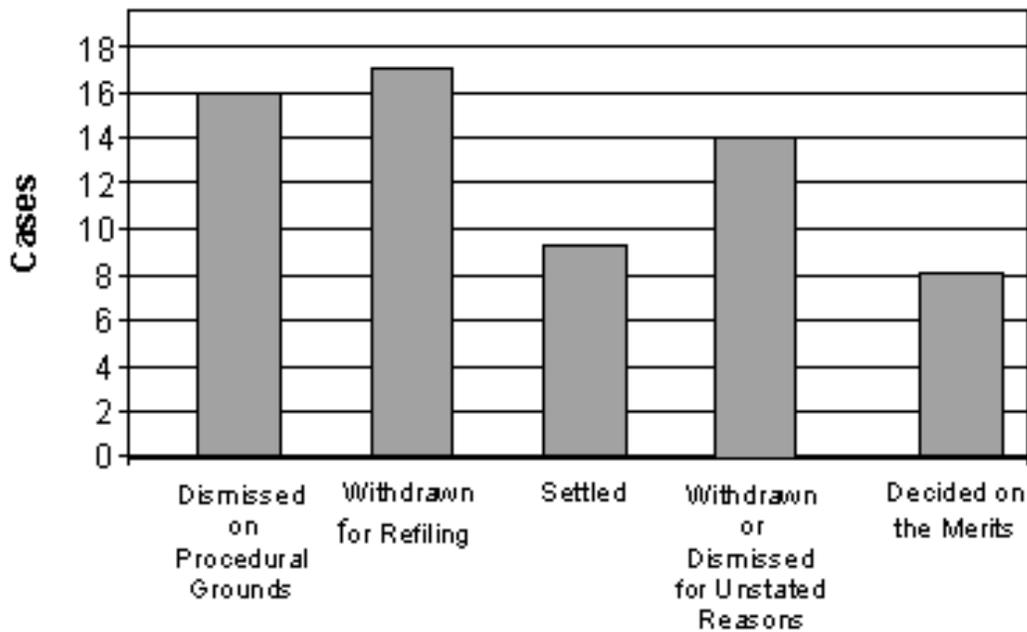
The Outcome of the "Typical" Whistleblower Case

Of the sixty-four Sarbanes-Oxley whistleblower retaliation cases (through September 15) reported on the Department of Labor's Web site that have been considered by administrative law judges, the majority have been dismissed or withdrawn without reaching the merits: sixteen cases were dismissed for untimeliness or failure to follow proper procedures; seventeen were withdrawn to be refiled in federal



ALJ Disposition of Sarbanes-Oxley Whistleblower Cases

(as of Sept. 15, 2004)



or state court or before an arbitral body; fourteen were withdrawn or dismissed for unstated reasons; nine were settled; and eight were decided on the merits. Of the cases decided on the merits, three were decided in favor of the employee and five were decided in favor of the employer.

In those cases that reach the merits, as might be expected, the inquiry is extremely fact-intensive. But, the cases do provide several general guidelines.¹⁵

Credibility matters. In each of the cases decided in favor of the employee, the administrative law judge found that the employee told a more credible story than the supervisors. Because credibility is so important in these types of cases, an employer needs to think carefully about how its case will be perceived through both the voice and the demeanor of its witnesses.

Documentation can carry the day. In one case, officers at a major information technology company documented proceedings at each performance review with a whistleblower *before* he made any allegations of accounting irregularities. This documentary trail—showing a long history of run-ins with colleagues, threats to

subordinates, and clear violations of company policies—supported the administrative law judge’s finding that the company would have taken the same action regardless of the employee’s allegations of retaliation.¹⁶ This highlights one of the benefits of programs that emphasize a written record of substantive meetings with employees.

Take it slow; get it right. In another case decided on the merits, a chief financial officer of a publicly traded bank was suspended just twelve days after he circulated a memo reiterating his reasons for having refused to certify the bank’s financial statements for the preceding quarter.¹⁷ The administrative law judge noted that “proximity in time between [the] protected activity and the adverse action is itself sufficient to create an inference of unlawful discrimination” and that the inference, in this case, was amply supported by other evidence. This suggests the benefits of taking complaints or claims seriously, investigating them thoroughly, and then deliberating on the findings before taking any personnel action. In other words, employers must be sensitive to considerations of due process.

Be mindful of the “reasonable belief” standard. In a number of the reported cases decided on the merits, the administrative law judges emphasized that it was irrelevant whether a company *actually* violated, or *intended* to violate, any federal fraud statute. All the Sarbanes-Oxley Act requires is that an employee *reasonably believe* that a company has engaged in such conduct. If the employee meets that test and discloses the conduct to the federal government or to his employer, then that person is protected against retaliation.

Federal District Court Decisions

Only five reported federal district court decisions have addressed Sarbanes-Oxley whistleblower claims. Four of the decisions concerned procedural and claimant eligibility aspects of the whistleblower provisions.¹⁸ Only one decision has addressed the substance of a whistleblower claim, and then only in the course of denying a motion for summary judgment.

In *Collins v. Beazer Homes USA, Inc.*,¹⁹ the court considered the issues raised by the employer’s summary judgment motion, including whether the employee had engaged in protected activity, whether the employer knew of that activity, and whether the protected activity was a contributing factor to the employee’s termination, and denied summary judgment on the grounds that there were genuine issues of material fact as to each issue. Two observations are especially noteworthy.

First, the court stated that although ALJ decisions in this area could “provide some guidance,” they were not directly applicable where, as here, the court was not considering whether relief was warranted, but whether the plaintiff’s claims could survive a motion for summary judgment—circumstances in which the court was required to view the facts in the light most favorable to the plaintiff.²⁰

Second, in an attempt to convince the court that the employee had not engaged in a protected activity, the employer cited OSHA’s finding that “the preponderance of *credible evidence* did not support [Plaintiff’s] contention that she provided information alleging a violation of any federal law regarding [Defendants’] conduct.”²¹ The court responded that it was conducting a *de novo* review, and therefore was not required to give

deference to the agency’s findings. The court also stated that it was not appropriate for the court to make credibility determinations on a summary judgment motion.²² It is not clear how much weight, if any, the court would have given the agency’s findings outside the context of summary judgment.

Although it is important not to read too much into this first federal case to address OSHA findings in any detail, the case does suggest that observations based on ALJ decisions may not be entirely accurate predictors of how federal courts will respond to similar issues, at least at the summary judgment stage. The case also suggests, as does the statutory “*de novo* review” language, that factual findings by OSHA at the agency level may not spare litigants from fact litigation at the federal district court level.

Conclusion

The Sarbanes-Oxley Act significantly expands the protection available to “whistleblowers” with respect to possible violations of federal laws and regulations related to fraud and securities compliance. As a result, an employer should take proactive steps to minimize potential liability by carefully and regularly documenting activities it takes toward employees—whether a regularly scheduled evaluation or an unscheduled personnel action—in a way that can help establish credibility and demonstrate a systemic approach for handling employee complaints.

Given the uncertainty inherent in any new adjudicatory system, it should be no surprise that the time required to resolve whistleblower cases and matters of forum selection will present interesting questions. Above all else, however, companies facing allegations of whistleblower retaliation will need to be patient as dispute resolution procedures in this new area evolve. 

- 1 Section 806 is often married conceptually with Section 301 of the Sarbanes-Oxley Act, which calls for audit committees of listed companies to establish procedures for “the receipt, retention, and treatment of complaints received by [the employer] regarding accounting, internal auditing controls, or auditing matters” and for “the confidential, anonymous submission by employees of the [employer] of concerns regarding questionable accounting or auditing matters.” These so-called “whistleblower provisions” have been implemented by the Securities and Exchange Commission and the primary exchanges. *See, e.g.*, SEC Release No. 34-47654 (Apr. 9, 2003), *available at* <www.sec.gov/rules/final/33-8220.htm>; New York Stock Exchange, Listed Companies Manual § 303A.06, Audit Committees; The Nasdaq Stock Market, NASD Manual Online § 4350(d)(3); The American Stock Exchange, Amex Company Guide § 803.
- 2 OSHA also has jurisdiction over whistleblower provisions such as the Aviation Investment and Reform Act for the 21st Century (49 U.S.C. § 42121, 29 C.F.R. § 1979), the Energy Reorganization Act (42 U.S.C. § 5851, 29 C.F.R. § 24), and the Surface Transportation Assistance Act (49 U.S.C. § 31105, 29 C.F.R. § 1978).
- 3 On August 24, 2004, the Occupational Safety and Health Administration (OSHA) published the final text of regulations implementing these whistleblower provisions and issued commentary on the public comments it had received on the interim final regulations, published on May 28, 2003. *See* 69 Fed. Reg. 52103 (Aug. 24, 2004). The regulations are codified at 29 C.F.R. § 1980 and following.
- 4 These protections and restrictions apply *only* to employees working for companies with securities registered under § 12 of the Securities Exchange Act of 1934 or companies required to file reports under § 15(d) of the Exchange Act. However, at least one judge has held that Sarbanes-Oxley whistleblower protection also extends to employees of subsidiaries of publicly traded companies, even if the subsidiary itself is not publicly traded. *See* Morefield v. Exelon Services, Inc., 2004-SOX-2 (ALJ Jan. 28, 2004), *available at* <www.oalj.dol.gov/public/wblower/decsn/04sox02a.htm>.
- 5 Section 1107 of the Sarbanes-Oxley Act contains a criminal sanction for anyone who intentionally retaliates against any person “for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense.”
- 6 *See* 69 Fed. Reg. 52103, 52105-06.
- 7 A copy of the notice to the employer is also provided to the SEC.
- 8 A personnel action is “unfavorable” if it is “reasonably likely to deter employees from making protected disclosures.” *Halloum v. Intel Corp.*, 2003-SOX-7 at 10 (ALJ Mar. 4, 2004), *available at* <www.oalj.dol.gov/public/wblower/decsn/03sox07a.htm>.
- 9 *See* *Welch v. Cardinal Bankshares Corp.*, 2003-SOX-15 (ALJ Jan. 28, 2004), *available at* <www.oalj.dol.gov/public/wblower/decsn/03sox15c.htm>.
- 10 OSHA, “Whistleblower Investigations Manual,” *available at* www.osha.gov/OshDoc/Directive_pdf/DIS_0-0_9.pdf.
- 11 The SEC, at its discretion, also may participate as *amicus curiae* at any time in the proceedings. Whether or not the SEC chooses to participate, copies of all pleadings in the case must be sent to the SEC if it so requests.
- 12 Not all of the publicly available Sarbanes-Oxley whistleblower cases offer sufficient information to determine the amount of time consumed by each stage of the complaint and review process. The statistics in this article are compiled from the available information in all of the Sarbanes-Oxley whistleblower decisions (through September 15, 2004) posted on OSHA’s Web site.
- 13 These cases are listed at <www.oalj.dol.gov/public/wblower/refrnc/sox1list.htm>.
- 14 This almost certainly understates the actual delay because OSHA’s Web site does not include the initial filing dates for fifteen cases that were withdrawn from the administrative courts and re-filed in federal district court (each of which lasted for at least 180 days).
- 15 The eight cases decided on the merits were *Klopfenstein v. PCC Flow Technologies Holdings, Inc.*, 2004-SOX-11 (ALJ July 6, 2004); *Lerbs v. Buca di Beppo, Inc.*, 2004-SOX-8 (ALJ June 15, 2004); *Harvey v. The Home Depot, Inc.*, 2004-SOX-36 (ALJ May 28, 2004); *Platone v. Atlantic Coast Airlines Holdings, Inc.*, 2003-SOX-27 (ALJ Apr. 30, 2004); *Halloum v. Intel Corp.*, 2003-SOX-7 (ALJ Mar. 4, 2004); *Getman v. Southwest Securities, Inc.*, 2003-SOX-8 (ALJ Feb. 2, 2004); *Welch v. Cardinal Bankshares Corp.*, 2003-SOX-15 (ALJ Jan. 28, 2004); and *McIntyre v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 2003-SOX-23 (ALJ Jan. 16, 2004). A link to each of these cases is available at <www.oalj.dol.gov/public/wblower/refrnc/sox1list.htm>.
- 16 *Halloum*, *supra* note 8. Of course, the creation of a paper trail is not in itself a guarantee that the company will prevail. In another case, a supervisor refused to concede the occurrence of *any* non-documented exchange. *See* *Platone*, *supra* note 15. The administrative law judge ruled in favor of the employee, holding specifically that the supervisor’s unwillingness to acknowledge undocumented exchanges did considerable damage to his credibility. So, while a paper trail may be desirable, slavish reliance upon documentation to the point of denial is not.
- 17 *Welch*, *supra* note 9.
- 18 *See* *Carnero v. Boston Scientific Corp.*, 2004 WL 1922132 (D. Mass. Aug. 27, 2004) (holding that Sarbanes-Oxley whistleblower protection does not apply to a foreign national who worked exclusively overseas); *Willis v. Vie Financial Group*, 2004 WL 1774575 (E.D. Pa. Aug. 6, 2004) (holding that the requirement that a whistleblower complaint first be filed with OSHA precludes recovery for a discrete act of retaliation that arose after the initial complaint to OSHA, but was never presented to OSHA); *Stone v. Duke Energy Corp.*, 2004 WL 1834597 (W.D.N.C. June 10, 2004) (staying ALJ proceedings because Claimant filed a complaint in federal district court); *Murray v. TXU Corp.*, 279 F. Supp. 2d 799 (N.D. Tex. 2003) (addressing the 180-day requirement).
- 19 2004 WL 2023716 (N.D. Ga. Sept. 2, 2004).
- 20 *Id.* at n.10.
- 21 *Id.* at n. 16 (original emphasis and brackets) (citing OSHA findings).
- 22 *Id.*