

First Ruling in Whistleblower Case Under Sarbanes-Oxley Finds in Favor of Former Chief Financial Officer

Since the Sarbanes-Oxley Act was passed in July 2002, over 200 employees have filed whistleblower claims with the U. S. Department of Labor (DOL) alleging that they have suffered discrimination because of reporting concerns about financial improprieties. Observers have been waiting for the first DOL decision on the merits, among other reasons, to determine whether the DOL will be a receptive forum for such claims. In the first decision on the merits in a Sarbanes-Oxley (SOX) whistleblower case, Administrative Law Judge Stephen Purcell held that Cardinal Bankshares Corporation violated Section 806 of SOX¹ by terminating its former Chief Financial Officer David Welch in retaliation for raising concerns about Cardinal's internal accounting controls and financial statements.² Judge Purcell ordered Cardinal to reinstate Welch and awarded him back pay and attorney's fees and expenses.

Protected Conduct

Section 806 of SOX prohibits publicly traded companies from discriminating against an employee in retaliation for certain protected conduct by the employee. Under Section 806, protected conduct includes: (1) providing information or otherwise assisting in any investigation (conducted by the employer or by the government) involving corporate fraud or accounting abuses; and (2) filing, testifying, participating in, or otherwise assisting in any proceeding related to an alleged violation of corporate fraud laws or regulations. SOX protects employees who raise concerns internally or externally. Complainants need not demonstrate that the concerns they raised are valid; they need only show that they had a reasonable belief that their employer was violating a corporate fraud or securities law.

Judge Purcell held that Welch engaged in at least two protected activities. First, in August 2002, Welch wrote a letter to Cardinal's external auditor warning that he would not certify Cardinal's financial statements because journal entries were

made by persons outside Cardinal's Finance Department without Welch's prior knowledge or review and because the auditors had excluded him from their communications with Leon Moore, Cardinal's CEO. Second, he submitted two memoranda to Moore, informing him that he would not certify Cardinal's financial statements because accounting errors resulted in Cardinal overstating its profits by 14%.

Welch's Protected Activity Was a "Contributing Factor" in his Termination

A SOX complainant need not establish that protected activity was a motivating or substantial factor in the employer's decision to take an adverse personnel action, but instead merely must demonstrate that it was a "contributing factor." A "contributing factor" is "any factor which, alone or in connection with other factors, tends to affect in any way the outcome of the decision."³

Judge Purcell initially noted that the proximity in time between Welch's protected activities and the adverse action, a period spanning approximately seven weeks, was itself sufficient to create an inference of unlawful discrimination.⁴ Judge Purcell concluded that, even without this inference of unlawful discrimination, Welch's termination was motivated by discriminatory intent. A few days after Welch sent a memorandum to Moore reiterating his concerns about Cardinal's financial statements, Moore convened a special meeting of Cardinal's Board of Directors for the purpose of addressing Welch's concerns. During the meeting, Moore offered a lengthy and detailed criticism of Welch's performance prior to describing Welch's concerns. In addition, Moore characterized Welch's allegations as unfounded and attributed Welch's concerns to Welch's failure to perform his job. Cardinal's Audit Committee directed Cardinal's external auditors and in-house counsel to investigate Welch's concerns. As part of the investigation, Moore directed Welch to meet with Cardinal's in-house counsel and external auditors

about his concerns, and informed Welch that he would not be permitted to bring his own attorney to the meeting because the meeting would address internal Company matters. Welch refused to attend the meeting without his attorney, and was terminated for insubordination. Cardinal asserted that it barred Welch's attorney from attending the meeting to avoid waiving the attorney-client privilege. Judge Purcell found this reason unpersuasive, concluding instead that Cardinal barred Welch's attorney from the meeting "for purpose of using Welch's anticipated refusal to comply as a pretext for firing him."⁵

Avoiding Whistleblower Claims

The *Welch* decision underscores the importance of avoiding whistleblower claims. The low burden for establishing a violation and the broad relief afforded by the statute, including reinstatement and attorney's fees, provide a strong incentive for employees to challenge unfavorable personnel actions. Indeed, as noted above, more than 200 SOX whistleblower claims already have been filed with the DOL. Moreover, in addition to the civil cause of action available to employees of publicly traded companies, SOX imposes criminal penalties for retaliation, which are not limited to publicly traded companies and are not restricted in scope to whistleblowing concerning corporate fraud or accounting abuses. Accordingly, all employers should consider taking measures to avoid whistleblower claims, including the following:

Establish an Employee Concerns Program. Establishing a credible in-house forum in which employees can raise concerns and have confidence that their concerns will be investigated will significantly reduce the risk that an employee will feel compelled to pursue his or her concern externally. In addition, an Employee Concerns Program can help alert management to wrongdoing early on, thereby providing an opportunity for the company to intervene and prevent further damage.

Train Managers and Supervisors to Instill a Corporate Culture Conducive to Employees Raising Their Concerns. One of the lessons learned from the recent accounting scandals is the value of fostering a culture conducive to

raising concerns. Managers and supervisors should be trained how to handle employee concerns and how to foster an environment in which employees feel comfortable raising concerns without fear of reprisal.

Take Disciplinary Action Against Those Who Engage in Retaliation. All employees should be put on notice (e.g., through training and the employee handbook) that if they harass or discriminate against another employee for raising a concern, they will be subject to disciplinary action. Employees found to have engaged in retaliation should be dealt with severely.

Document Performance Issues. Section 806 of SOX provides that relief may not be awarded if the employer demonstrates by "clear and convincing" evidence that the employer would have taken the same unfavorable personnel action in the absence of the complainant's protected conduct. To meet this "clear and convincing" standard, it is critical to have thorough, unambiguous evidence demonstrating that the same unfavorable personnel action would have been taken in the absence of the complainant's protected conduct. Accordingly, managers should thoroughly document performance issues on an ongoing basis.

* * *

Shaw Pittman has extensive experience representing companies faced with whistleblower claims brought under federal and state statutes, and in establishing programs and procedures designed to prevent such claims, including employee concerns programs. In particular, Shaw Pittman has assisted companies in the nuclear power and health care industries, which have been subject to whistleblower claims for many years, in avoiding these claims and, where necessary, has litigated whistleblower claims to successful outcomes. With regard to SOX, Shaw Pittman has been advising both publicly traded and privately held companies about formulating policies prohibiting retaliation and procedures for the receipt and handling of concerns regarding accounting issues. We would be pleased to discuss with you steps you can take to minimize your organization's exposure to a claim under SOX.

If you have any questions regarding this *Alert* or any other related matter, please contact:

Whistleblower Defense

Patrick Hickey
patrick.hickey@shawpittman.com 202.663.8103

Dan Westman
dan.westman@shawpittman.com 703.770.7616

Daryl Shapiro
daryl.shapiro@shawpittman.com 202.663.8507

Jason Zuckerman
jason.zuckerman@shawpittman.com 202.663.8949

Employment Litigation

David Cynamon
david.cynamon@shawpittman.com 202.663.8492

Paul Mickey
paul.mickey@shawpittman.com 202.663.8233

Tina Kearns
christine.kearns@shawpittman.com 202.663.8488

Joyce Oliner
joyce.oliner@shawpittman.com 202.663.8178

¹ 18 U.S.C. §1514A.

² Judge Purcell's decision in *Welch v. Cardinal Bankshares Corp.*, 2003-SOX-15 (ALJ Jan. 28, 2004) is posted on the DOL's website at <http://www.oalj.dol.gov/public/wblower/decsn/03sox15c.htm>.

³ *Welch*, 2003-SOX-15 at 36 (citing *Marano v. Dept't of Justice*, 2 F.3d 1137, 1140 (Fed. Cir. 1993) (interpreting the Whistleblower Protection Act).

⁴ *Id.* at 42.

⁵ *Id.* at 42.