

WHISTLEBLOWER WINS REINSTATEMENT AND MONEY DAMAGES

Remedies Ruling in *Welch v. Cardinal Bankshares Corp.*

On February 15, 2005, a U.S. Department of Labor administrative law judge (ALJ) ordered Cardinal Bankshares Corporation to reinstate its former CFO, David Welch, even though the company's CEO and board of directors strongly mistrusted and disliked Welch and had already hired another CFO to replace Welch. The ALJ also ordered Cardinal to pay Welch \$65,000 in back pay and special damages and \$108,000 for attorney's fees.

This ruling came in Welch's claim against Cardinal under Section 806 of the Sarbanes-Oxley Act.

Sarbanes-Oxley was signed into law in July 2002 in the wake of revelations of corporate fraud at Enron and Worldcom. Section 806 gives a civil cause of action to any employee of a publicly traded company (or of a non-publicly traded subsidiary of a public company) who claims he or she was retaliated against for providing information or making a complaint regarding activity the employee "reasonably believes" violates federal antifraud or securities laws or regulations.

Cardinal terminated Welch on October 1, 2002, shortly after he complained to Cardinal's board that its CEO was improperly overriding internal financial controls and engaging in insider trading. Welch claimed his complaints amounted to "protected activity" under Section 806.

Cardinal's Audit Committee directed an investigation of Welch's allegations and concluded he had been deficient in his performance as CFO. As tensions mounted between Welch and the company, Cardinal's CEO asked Welch to attend a meeting with two attorneys and an outside auditor for the bank. When Welch declined to attend without his lawyer present, he was terminated.

In a January 28, 2004 order, the ALJ concluded that Welch's termination violated Section 806. The judge emphasized the proximity in time between Welch's complaints and his termination, and he noted that Cardinal's CEO had never given Welch a formal performance evaluation. After a year of unsuccessful appeals by Cardinal, the ALJ entered his remedies order in February 2005.

Successful Section 806 claimants are entitled to "make whole" relief, including in a termination case like Welch's, reinstatement (or, if reinstatement is inappropriate in a given case, "front pay," the economic equivalent of reinstatement); back pay with interest; "special damages" (such as litigation costs and the cost of conducting a job search); expert witness fees; and reasonable attorney's fees.

In his remedies order, the ALJ rejected Cardinal's argument that reinstatement was inappropriate, stating:

Any hostility which has developed since this litigation is no different in kind or degree from that which, regrettably, occurs all too frequently following litigation of this sort. Further, although Welch will be required to report to a CEO and board of directors who have been openly critical of Welch since this litigation was initiated, that circumstance is not sufficiently "unusual" in the context of a Sarbanes-Oxley case to warrant denying him reinstatement.

The judge also dismissed Cardinal's argument that reinstating Welch would require the reassignment of the current CFO, explaining:

If the present CFO was unaware of the likelihood of Welch's reinstatement, responsibility for that ignorance rests squarely with Cardinal, and it should not be permitted to profit from its actions of blocking Welch's reinstatement to the position from which he was unlawfully removed.

Cardinal has appealed the ALJ's order.

Implications for Privately and Publicly Owned Employers

In addition to Section 806, Sarbanes-Oxley contains a second major whistleblower protection statute.

Section 1107 of the Act generally makes it a crime for any employer—including **privately owned employers**—to retaliate against employees who provide a law enforcement officer truthful information relating to the possible commission of any federal offense. Violations of Section 1107 are punishable by fines of up to \$500,000 and imprisonment for up to 10 years.

Approximately 30 other federal laws—and in the Carolinas, a handful of state laws—protect employees who complain about or oppose unlawful activity. Most of these laws—including the Federal Deposit Insurance Act, the Federal Credit Union Act, the False Claims Act, and the Emergency Medical Treatment and Access to Labor Act—protect employees of **both privately and publicly owned employers**. Most also provide for the same types of remedies as Section 806 of Sarbanes-Oxley.

The *Welch v. Cardinal Bankshares Corp.* case illustrates the dilemma employers face when addressing job performance issues with high-ranking employees who allege wrongdoing. With the possibility of having to reinstate a terminated employee and pay damages in cases under Section 806 or under other whistleblower protection laws—and go to jail for 10 years in a Section 1107 case—the stakes are high.

There are steps employers can take to reduce the risk of being found liable for retaliation against a whistleblower. Many of these steps are similar to the steps taken to avoid retaliation against employees who complain of harassment. They include:

- Adopting a corporate ethics policy that requires employees to report fraud and other illegal conduct;
- Stating in the policy that employees who report violations will be protected from retaliation based on their reports;
- Identifying more than one individual to whom employees can report complaints;
- Training experienced personnel to investigate reports of ethical or legal violations;
- Documenting all communications with the complaining employee about his or her complaint and its investigation;
- Getting legal advice before taking disciplinary action against employees who report complaints;
- Documenting the valid, non-retaliatory reasons for any disciplinary action; and
- Giving employees written performance feedback on a regular basis so that appropriate disciplinary action can be taken promptly if and when necessary, even if an employee complains of a violation of the ethics policy.

Taking steps like these may not prevent whistleblower claims, but they should reduce the risk of litigation and liability.

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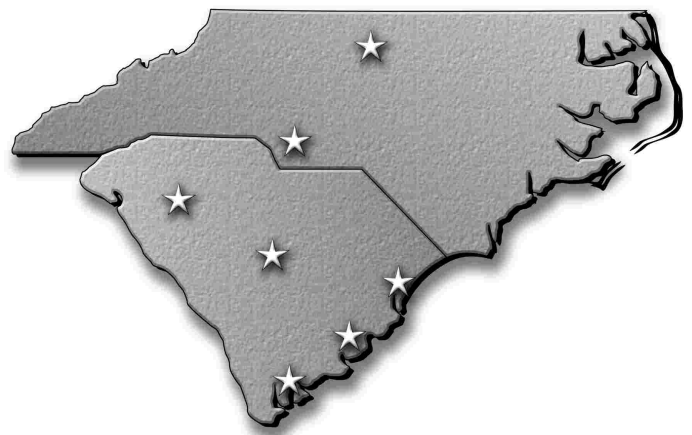
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