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# First Sarbanes-Oxley Whistleblower Decision

***Lessons for the Conduct of Internal Investigations, and Consideration of When Individual Counsel May Be Excluded from Witness Interviews***

**By Mark Rochon and Simon Kann**

In the first ruling applying the whistleblower protections of the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1514A, an Administrative Law Judge (ALJ) ordered a bank holding company to rehire its former Chief Financial Officer (CFO), after finding that the company fired the CFO in retaliation for reporting alleged accounting misconduct to the company's Chief Executive Officer (CEO), outside auditors, and others. *Welch v. Cardinal Bankshares Corp.*, No. 2003-SOX-15 (Dep't Labor, Jan. 28, 2004) (hereinafter "Op.") The sole reason given by the company for the firing was the CFO's refusal to attend an internal investigation interview regarding the allegations without his personal attorney, which the company alleged constituted a failure to cooperate with the company's internal investigation instigated in response to the CFO's allegations of wrongdoing. The ALJ found the company's stated reason for the firing was mere pretext and that the CFO, David Welch, was, in fact, fired in retaliation for reporting the potential accounting misconduct he had discovered.

**Mark Rochon** (202-626-5819; mrochon@milchev.com) is a member of the Washington, DC, law firm of Miller & Chevalier Chartered. **Simon Kann** (202-626-5863; skann@milchev.com) is a senior associate at the firm. Their practice focuses on corporate internal investigations, government investigations, and white-collar criminal defense.

## Significance of This First Decision

The opinion has received significant legal coverage because it is the first decision under the Sarbanes-Oxley whistleblower protections. The interest in the opinion is understandable, given that the provisions are untested and, on their surface, are more expansive than other such protections. They are somewhat easier to trigger than whistleblower protections under other federal and state laws — requiring only that an employee of a publicly traded company provide information to his or her employer or to the Federal Government which the employee reasonably believes constitutes fraud or violations of the securities laws, regardless of whether a lawsuit or enforcement action by the government or private litigants is filed or threatened. 18 U.S.C. § 1514A. In contrast, the whistleblower protections of the False Claims Act protect only those employees who act in furtherance of an action filed or to be filed. 31 U.S.C. § 3730(h). While there are variations among other whistleblower statutes, for the most part their protections are not as easily triggered as are the protections under Sarbanes-Oxley. *See generally*, Leonard M. Baynes, Symposium: Enron and Its Aftermath: Just Pucker and Blow?: An Analysis of Corporate Whistleblowers, The Duty of Care, The Duty of Loyalty, and The Sarbanes-Oxley Act, 76 St. John's L. Rev. 875, 888-890 (2002).

Additionally, individuals and companies that retaliate against a Sarbanes-Oxley whistleblower may face criminal charges and sentences as long as 10 years. Sarbanes-Oxley amended existing criminal obstruction of justice statutes to include "interference with the lawful employment or livelihood of any person" as a prohibited criminal means of retaliation for providing information to law enforcement. 18 U.S.C. § 1513(e). On its face, this provision only criminalizes retaliation against employees who report misconduct to the government. However, it can be argued that employers that retaliate based only on internal whistleblowing may nonetheless be found guilty of obstruction of justice under this, and other statutes.

Therefore, the curiosity and some apprehension about the extent of Sarbanes-Oxley whistleblower protections is justified. For example, the ruling in *Welch* raises the question of whether employees will now be entitled to bring their own counsel to internal investigation interviews. However, it is important to note that the *Welch* decision does not so hold. Indeed, to the contrary, some courts have stated that employees generally have no right to personal counsel at internal investigatory interviews. *See, e.g., TRW, Inc. v. Superior Court*, 25 Cal. App. 4th 1934 (1994). In *Welch,* the ALJ found that the CFO was *not* fired because he refused to be interviewed without his attorney, but in retaliation for his whistleblower activities. Therefore, any general right to a personal attorney at the interview was not the decisive issue.

### ABOUT *WELCH*

The case highlights that companies planning an internal investigation should carefully consider the pros and cons of allowing personal attorneys to attend employee interviews, in order to avoid the potentially disastrous consequences of proceeding as did the company in *Welch*. For companies deciding to exclude personal attorneys from internal investigation interviews, the facts of *Welch* show how *not* to go about carrying out this decision and provide guidance on ways to prevent the decision to exclude personal attorneys from hindering a company's ability to deal with uncooperative employees — including the ability to discharge those who refuse to be interviewed without personal counsel. These lessons apply generally to any internal investigation, but in situations where whistleblower protections like those of Sarbanes-Oxley and other laws may be involved, careful consideration of the five lessons below is even more important.

### *LESSON ONE*

Establish A Clear And Consistent Policy Regarding Personal Attorneys. In *Welch*, the ALJ found that the company's President/CEO/Chairman of the Board "imposed an arbitrary requirement that Welch could not have his personal attorney present while being questioned," and that this decision had been made "unilaterally" by the President and outside counsel (Op. at 42, 43). Neither the Board of Directors nor the Audit Committee was involved in the formulation or implementation of this "requirement."

To avoid accusations of arbitrariness, companies should adopt a clear and consistent policy that applies to all employees interviewed during the internal investigation. In addition to being consistent on its face, the policy should also be consistently applied in practice. However, some measure of flexibility can be built into the policy that allows for exceptions in limited circumstances. The rationale for application of the exceptions should be carefully documented.

The policy should also be properly authorized. Companies planning an internal investigation should seek authorization of such a policy from the Board of Directors or the Audit Committee. A corollary to this is that the authorization should be properly documented. In *Welch*, the ALJ noted the absence of formal resolutions or notation regarding the issue in the minutes of meetings of the Board or the Audit Committee.

A company need not wait until an investigation is being considered to establish a policy concerning the presence of personal attorneys during interviews. Companies should consider creating a general policy applicable to all future internal investigations. A previously adopted policy, rather than one established at the beginning of an investigation, makes it harder for an employee involved in the investigation to claim the policy was arbitrarily created to apply to him or her.

As an alternative, a company can also rely on consistent procedures established by outside counsel retained to pursue an internal investigation. Such procedures should be established and applied by outside counsel without any interference by management that imposes greater burdens on some employees than on others. However, even when outside counsel is involved in creating the policy (as was the case, at least to some extent, in *Welch*) the a company will not be protected when that policy is misused, as discussed in Lesson Five.

### *LESSON TWO*

Ensure That Policymakers Have Complete Information. When considering the policy, the company should ensure that the decision makers (*eg*, the Board or the Audit Committee) have been provided all material information. For example, in *Welch*, despite the fact that the Audit Committee unanimously agreed it wanted the whistleblowing CFO to be interviewed, the Committee was not informed by management that Welch was willing to speak to the Committee directly without counsel, but only refused to meet with the company's internal investigators without counsel (Op. at 19, 44). If the Audit Committee had been inclined to adopt a policy regarding personal attorneys (as Lesson One suggests should be done), the failure to inform the Committee that the CFO was willing to talk to the Committee without counsel would have hindered the Committee's ability to make an informed decision regarding such a policy.

### *LESSON THREE*

Truthfully Inform Employees Of the Policy Regarding Personal Attorneys. In *Welch*, there was evidence that the company's internal investigators misrepresented that the Audit Committee had adopted a formal resolution precluding Welch from bringing his personal attorney to the interview when, in fact, the Audit Committee had adopted no such resolution (Op. at 43). Obviously, lack of honesty as to the existence of a policy is intolerable. Moreover, once a policy has been adopted, it should be clearly communicated to all employees that may be affected. To avoid misunderstandings or allegations of arbitrary application, there should be no secrecy regarding the policy.

The obligation to be truthful regarding the policy is obvious. Less obvious is the benefit from transparency in the procedures to be used during the interview process. Most attorneys experienced in the conduct of internal investigations will have a litany that they recite at the beginning of an interview, regarding the interview protocol. All interviewees should be advised that the company has developed a policy regarding private counsel. Thus, should an issue arise, there will be available documentation of the uniform application of the policy and of its disclosure to each witness.

### *Lesson Four*

Before Excluding Personal Attorneys Based on Concerns of Confidentiality and Privilege, Consider Whether Disclosure to Third Parties Has Already Occurred. Whether to adopt a policy excluding personal attorneys is an issue beyond the scope of this article. One rationale for excluding personal attorneys that is often considered is the potential waiver of attorney-client privilege and confidentiality concerning the subject matter of the internal investigation if personal attorneys are permitted to attend interviews. However, if a policy excluding personal attorneys is to be justified by this concern, a company should consider whether the confidentiality and privilege associated with the investigation has already been waived or compromised.

In *Welch*, the allegations of misconduct that were to be the subject matter of Welch's interview had already been shared with parties outside the company including the SEC and a third-party that was considering a merger with the company (Op. at 45-46). Given previous disclosure of the subject matter to non-privileged parties, the ALJ found that the company's expressed concern over confidentiality and privilege was a pretext for the decision to exclude Welch's attorney that led to his firing. However, had the company not engaged in an *ad hoc* decision to exclude counsel, it would not have had to defend its decision on the basis of the particular facts of the case. A pre-existing and consistently applied policy can be defended without regard to the exigencies of particular cases.

### *Lesson Five*

Do Not Misuse Internal Investigations for Ulterior Motives. The ALJ in *Welch* held that the "purpose of the meeting [from which Welch's personal attorney was excluded] was not to conduct a legitimate inquiry into the various concerns raised by Welch … Rather, it was [the company's] intent to create a situation whereby Welch would not attend the meeting so they could use that act as justification for terminating his employment." (Op. at 44). The ALJ went on to conclude that this was pretext and that Welch was fired in retaliation for raising the concerns over accounting misconduct. As evidence of this, the ALJ noted that immediately *after* Welch had made his allegations of misconduct known to the company, but *before* the meeting where he refused to attend without personal counsel, the President/CEO/Chairman of the Board and outside counsel vehemently disparaged Welch's performance, denied his allegations of wrongdoing (or blamed Welch), and called for his termination before the Board of Directors and the Audit Committee. (Op. at 42-43).

### Conclusion

This case illustrates the obvious point that internal investigations should not be used for ulterior motives, but to honestly investigate allegations of misconduct or impropriety. The misuse of the investigation in *Welch* led to the ALJ's order to reinstate the fired CFO. Another internal effect of such misuse is the hindering of the internal investigation's proper purpose — investigating the allegations. Misuse of an internal investigation also has external effects. For example, if a company ever draws the attention of the government (either because of alleged misconduct upon which an internal investigation was based, or because of other reasons), the existence or absence of an effective corporate compliance program will factor into decisions regarding indictment of the corporation as well as sentencing. A company that has been found to have misused an internal investigation is unlikely to be deemed to have an effective compliance program.

It is important to note that even a non-arbitrary, duly adopted, consistently applied, and well-communicated policy regarding personal attorneys may not shield a company from liability in all situations. For example, if, despite such a policy, there is evidence that the internal investigation was not intended to discover information, but only to provide an excuse for terminating a whistleblowing employee, it is a virtual certainty that a retaliation claim will be successful.

It is too early to say whether the notoriety of *Welch* will extend beyond its being the first Sarbanes-Oxley whistleblower protections decision, or even whether the CFO's reinstatement will survive further review and appeal. Whatever the "shelf life" of *Welch,* it should educate companies on the need to have investigative protocols in place in order to ensure that employee-initiated investigations do not become the basis for collateral employment litigation under the whistleblower statute. Moreover, companies should learn from the lessons provided by the allegedly egregious conduct of the internal investigation in this case, so as not to suffer consequences like those imposed by the ALJ, let alone other, potentially more harmful, consequences.