

A Biweekly
Newsletter of
Federal Securities,
Corporate &
Banking Law
Developments

JUDGE ISSUES FIRST SARBANES- OXLEY WHISTLEBLOWER DECISION

On January 28, 2004, a U.S. Department of Labor administrative law judge issued the first decision under the whistleblower provisions of the Sarbanes-Oxley Act of 2002. The judge ordered Cardinal Bankshares Corporation and its subsidiary, Bank of Floyd (Floyd, VA), to rehire, with back pay and interest, its former Chief Financial Officer and to pay his attorney's fees and expert witness costs. *Welch v. Cardinal Bankshares Corporation*. (<http://www.oalj.dol.gov>)

The CFO was fired by Cardinal after raising concerns with management and the SEC about improper accounting entries, possible SEC reporting problems and alleged insider trading. Cardinal contended that the CFO was fired for refusing to meet with the company's attorney and external auditor, as part of an investigation ordered by Cardinal's audit committee, unless his personal attorney was present.

The judge did not address whether the CFO's claims were true, but rather found that the CFO had a "reasonable belief" that violations existed and thus was entitled to whistleblower protection. The judge then held that the CFO's reporting of his concerns was a "contributing factor" in his termination and that Cardinal failed to show by "clear and convincing evidence" that the termination would have occurred anyway.

This case is significant because it highlights the challenge of addressing job performance issues of persons who also handle sensitive financial information.

■ NYSE ISSUES FAQ ON NEW CORPORATE GOVERNANCE STANDARDS

On January 29, 2004, the NYSE issued answers to frequently asked questions ("FAQ") about its

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If you would like more information on these topics or have any questions, please e-mail us at CorporateNotes@KutakRock.com.

new corporate governance standards. (<http://www.nyse.com/pdfs/section303Afaqs.pdf>) The interpretations in the FAQ include the following:

- Proxy statements for the upcoming annual meeting do not have to include the new NYSE disclosures because the new rules do not apply until the date of the annual meeting itself;
- Immediately following a company's 2004 annual meeting, its website should contain the charters of its audit, nominating, and compensation committees, as well as its Code of Business Conduct and Ethics and Corporate Governance Guidelines;
- The five tests for determining director independence are not exclusive, and boards must still make an affirmative determination that a director does not have a material relationship with the company that could affect the director's judgment;
- The NYSE will soon issue a form that CEOs can use for their required annual certification of compliance with the corporate governance rules; and
- Any disqualifying transaction that would prevent a director from being independent actually starts a 12-month period, only after which the required three-year period for

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director independence starts. This effectively creates a 4-year look back period.

This FAQ can help companies avoid improper application of the corporate governance standards.

■ PROPOSED CHANGES TO COLI WOULD LIMIT USE, TERMS

Under proposed tax law changes affecting company-owned life insurance (COLI), also known as bank-owned life insurance (BOLI), death benefits in excess of premiums paid would be taxable unless new notice and consent conditions are met. These proposals follow public reports of alleged misuse of these policies. (<http://www.house.gov/jct/x-8-04.pdf>)

The proposed tax changes would permit COLI death benefits to remain tax-free if:

- The insured was a company employee any time in the 12 months preceding death;
- The benefits were payable for the insured's benefit or to buy back employer stock;
- The insured is notified in writing of the insurance;
- The insured consents in writing to being insured; and
- The insured is notified in writing if the company will be the beneficiary of any proceeds payable upon death.

These new tax rules would not apply to COLI on highly compensated employees or large stockholders if the notice/consent rules are followed.

In purchasing COLI, companies should consider whether the new policies would satisfy these proposed restrictions.

■ WHEN PRICE IS FAIR, DIRECTORS NOT LIABLE FOR UNFAIR MERGER NEGOTIATIONS

Although deficiencies in merger negotiations suggested that a company's board of directors

acted in bad faith when purchasing companies from its chairman, the Delaware Supreme Court recently refused to hold the directors liable because the price paid was ultimately found to be fair. Thus, there were no damages incurred.

In this case, the acquirer purchased 13 companies from its chairman and chief executive officer. During the negotiations, the chairman attended board meetings at which the purchase was discussed. However, the board also engaged an independent valuation firm that determined a fair purchase price for the companies. Because a lower court found that the price paid was fair, the Court did not address the effect of the independent directors' bad faith because they would not be liable for monetary damages anyway.

Companies that engage in transactions with directors should exclude those directors from board deliberations on the subject, and should obtain an independent price valuation if possible.

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