SARBANES-OXLEY ACT OF 2002

by

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INTRODUCTION

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. The Act effects the broadest changes in the federal securities laws since the adoption of the Securities Act of 1933 and the Securities Exchange Act of 1934. When signing the Act, President Bush stated, "Today I signed the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt."

The Act is directed to respond to a growing crisis in investor confidence in the wake of the events surrounding Enron, Global Crossing, Worldcom and other high profile corporate cases. In remarks on August 12, 2002 before the Annual Meeting of the American Bar Association's Business Law Section, SEC Chairman Harvey Pitt stated, "Recent events underscore what we already knew – confidence in our capital markets cannot be maintained if the public believes that corporate leaders, their advisors or their cohorts, are 'gaming' the system and focusing principally, if not exclusively, on their own personal gain." Mr. Pitt specifically acknowledged that the Sarbanes-Oxley Act was

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the type of action needed to reassure investors that the string of recent scandals is not, and will not be allowed to become, the norm in American business.

The Act adopts civil and criminal standards for corporate governance, including personal certification by chief executive officers and chief financial officers that periodic reports filed with the U.S. Securities and Exchange Commission (SEC) fully comply with the reporting requirements of the federal securities laws and that the information in the reports fairly presents, in all material respects, the public company's financial conditions and operating results. Severe criminal liability attaches to everyone who certifies any statement while knowing that the report does not comport with all of the relevant requirements.

The Act also establishes restrictions for SEC reporting companies on perceived abuses in corporate governance, including company loans to corporate officers and directors as well as trading by company insider during certain periods. It requires enhanced and more timely disclosures by public companies and incorporates "whistle-blower" protection provisions for employees who identify and report securities laws and other violations. In addition, attorneys will be required to report evidence of a material violation of securities laws, breaches of fiduciary duty, or similar violations by a company or its agents, to the company's CEO or Chief Legal Officer. Should such officers fail to respond appropriately, the attorney must make the evidence known to the Board of Directors or the Audit Committee.

The law also addresses at length a variety of measures to attempt to ensure the integrity of the auditing process for public companies. The Act establishes a Public

Company Accounting Oversight Board to provide for pervasive regulation of the accounting profession. It empowers audit committees of public companies and enacts a number of provisions generally designed to avoid conflicts of interest.

Also included are a number of provisions to increase the enforcement authority of the SEC, expand the statute of limitations of federal securities fraud actions, and add new criminal statutes and increased criminal penalties for white-collar crimes. A summary of key provisions of the Act is discussed below.

I. Enhanced CEO and CFO Responsibilities for Financial Reports

The Act contains two provisions governing certification of financial reports by SEC reporting companies. Section 302 (Corporate Responsibility for Financial Reports) mandates that the SEC adopt rules requiring the principal executive officer or officers and the principal financial officer or officers certify in each annual or other periodic report filed with the SEC that: (1) the officer has reviewed the report, (2) to the officer's knowledge, the report does not contain an untrue statement of a material fact or omit to state a material fact, (3) based on the officer's knowledge, the financial statements present in all material respects the financial condition and operations of the company, (4) the officers have established and maintain internal controls designed to ensure that material information is timely made known to the officers and that they have evaluated the effectiveness of the internal controls within the last ninety days, and presented their conclusions in the report, (5) the officers have disclosed to the company's auditors and to the audit committee of the board deficiencies and material weaknesses in the controls, any fraud that involves management or other employees involved in the company's

internal controls, and (6) whether or not there were significant changes in the internal controls or other factors that could significantly affect the controls at the time of the evaluation.

In addition to the SEC rules that the Act mandates for adoption concerning CEO and CFO certification and financial reports, section 906 of the Act amends the criminal statutes. The law now requires each periodic report containing financial statements filed with the SEC be accompanied by a written statement by the CEO and the CFO certifying that the periodic report "fully complies" with the reporting requirements of the Securities Exchange Act and that the information in the report fairly presents in all material respects the financial condition and operating results of the company. This section became effective immediately upon enactment on July 30, 2002.

Section 906 provides for criminal liability to anyone who certifies a statement knowing that the report does not comport with all of the relevant requirements. A person who makes a section 906 certification knowing that the certification is false is subject to a fine of $1 million or imprisonment for not more than 10 years or both. A "willful" violation subjects a person to a fine of not more than $5 million or imprisonment for not more than 20 years, or both. Sections 302 and 906 create overlapping certification requirements.

II. Corporate Governance

The Act also is directed against other perceived inadequacies of prior law concerning corporate governance.

Loans to Insiders. The Act imposes broad prohibitions, subject to certain limited exceptions, on new loans by issuers[2] to directors or executive officers. The Act exempts loans in place as of the date of enactment, provided that there are no material modifications to any terms of the loan or any renewal of the loan. It also exempts any home improvement and manufactured home loans, consumer credit, or any extension of credit under an open-end credit plan or a charge card, or any extension of credit by a registered securities broker or dealer.

Blackout periods for trading company stock. The Act makes it unlawful for an issuer's directors or officers to buy company securities, or sell or transfer the securities acquired by them in connection with their employment, during a "blackout" period imposed on employee plans generally.[3] The issue of insider trading during blackout periods was acutely raised in connection with the Enron bankruptcy. Under the Act, any profits from any such prohibited sales would be recoverable by the issuer. The trading restrictions and notice requirements become effective January 26, 2003.

Attorney Responsibilities. The Act also contains rules of professional responsibility for attorneys. Section 307 of the Act provides that no later than 180 days

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[2] *The Act defines an issuer to mean, "an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15d (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that has not been withdrawn.*

[3] *A blackout period is defined as any period greater than three business days during which at least half of the participants in a company's individual account plans are unable to buy, sell or transfer their stock. The term does not include regularly scheduled suspensions incorporated into individual account plans and timely disclosed to employees, or any suspension imposed solely in connection with a merger, acquisition or divestiture involving the plan or the plan sponsor.*

after enactment, the SEC shall issue rules requiring an attorney appearing and practicing before the SEC to report evidence of "a material violation of securities law or breach of fiduciary duty or similar violation" by an issuer or its agents to the Chief Legal Officer or the CEO of the company. If the counsel or the officer does not appropriately respond, the attorney is required to report the evidence to the audit committee of the board, to another committee of the board comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

Section 307 applies to attorneys, "appearing and practicing before the Commission in any way in the representation of issuers." SEC regulations have defined the phrase, "practice before the Commission" to include, "transacting any business with the Commission" and the "preparation of any statement, opinion, or other paper by any attorney filed with the Commission in any registration statement, notification, application, report, or other report with the consent of such attorney."[4] The language appears broad enough to include both in-house and outside counsel involved in a securities offering for an issuer. Notably, it is *not* limited to those who sign documents filed with the SEC. While existing SEC rules have been used against attorneys, the principal focus in the past has been accountants. The current Act may very well involve the SEC in setting standards of professional conduct which have previously been largely

[4] *SEC Rules of Practice 1.02(f) provides: Practice Defined. For the purposes of these Rules of Practice, practicing before the Commission shall include, but shall not be limited to:*
(1) transacting any business with the Commission; and
(2) the preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other professional or expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney, accountant, engineer or other professional or expert.

LA #250632 v1-800002-040219

left to the states and the enforcement mechanisms of the bar associations. The potential for conflict in these standards remains to be assessed following the SEC's enactment of rules implementing Section 307. The SEC has until January 26, 2003 to adopt applicable rules.

Protection for whistle-blowers. The Act has also incorporated special protections for whistle-blowers. Public companies (i.e., companies with a class of securities registered under section 12 of the Securities Exchange Act of 1934 or required to file reports under section 15 of the Exchange Act) may not discharge, demote, suspend, threaten, harass or in any other manner discriminate against an employee for providing information in an investigation which the employee reasonably believes constitutes an SEC violation or relates to fraud against shareholders if that investigation is being conducted by a federal regulatory or law enforcement agency, a member of Congress or a Congressional Committee, or a supervisory employee with appropriate authority.[5] The same protection is afforded to employees filing, testifying, participating or otherwise assisting in a proceeding filed or about to be filed relating to an SEC violation or any provision of Federal law relating to fraud against shareholders. The Act provides for enforcement of the foregoing through a complaint filed with the Secretary of Labor or, if the Secretary of Labor does not timely file a complaint, through a private civil action.

In addition to civil protections, the Act imposes criminal liability for actions taken against whistleblowers. Section 1107 of the Act adds a new section to the Federal Criminal Code which provides that whoever knowingly, with intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or

livelihood of any person, for providing a law enforcement officer any truthful information relating to the commission or possible commission of any federal offense, shall be fined not more than $250,000 or imprisoned for not more than 10 years or both.

III. Audits and Audit Committees

A primary focus of the Act is the regulation of the accounting profession, including auditing and oversight of the auditing process.

Public Company Accounting and Oversight Board. The Act establishes a Public Company Accounting Oversight Board that will function as a self-regulatory body subject to supervision by the SEC and the NASD.[6] The functions of the Oversight Board include: (1) registration of public accounting firms that prepare audit reports for issuers, (2) establishing auditing quality control, ethics, independence and other standards relating to the preparation of audit reports for issuers, (3) conducting inspections of registered public accounting firms, (4) conducting investigations and disciplinary proceedings concerning public accounting firms and associated persons and, where justified, imposing appropriate sanctions; (5) performing such other duties or functions as the Board or the SEC determines are necessary or appropriate to promote high professional standards for the quality of audit services by registered public accounting firms, (6) enforcing compliance with the Act, the rules of the Oversight Board, professional standards and the securities laws relating to the preparation and issuance of audit reports and the

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[5] *Section 806(a).*
[6] *Section 101.*

LA #250632 v1-800002-040219

obligations and liabilities of accountants with respect thereto, and (7) setting the budget and managing the operations of the Oversight Board and the staff of the Oversight Board.

The authority of the Oversight Board is limited to acts relating to the audits of public companies. The Oversight Board is required to be operational on or before April 26, 2003.[7]

The Oversight Board will consist of five-members "appointed from among prominent individuals of integrity and reputation who have demonstrated a commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures."[8] Two of the five members must be CPAs. If one of those two is the chairperson, that person must not have practiced as a CPA for at least five years before appointment to the Board. The members of the board cannot be employed elsewhere, nor can they engage in any other business or professional activity. The Oversight Board's audit standards must ensure that each registered public accounting firm, in connection with performing an audit, (1) maintains audit work papers and other information related to any audit report for at least 7 years in sufficient detail to support the report's conclusions, (2) provides a concurring or second partner review and approval of any audit report, and concurring approval in its issuance, by a "qualified person" or an "independent reviewer" and (3) describes in each audit report the scope of the auditor's

[7] *The Oversight Board is similar to the public accountability board proposed to be established by rule by the SEC. In light of the Act, it is likely that the SEC's proposed board will not be established.*

[8] *Section 101(e).*

testing of the internal controls, structure and procedures of the client for financial reporting required by the Act.

The Oversight Board will have authority to conduct inspections, investigations and disciplinary proceedings with respect to evaluating compliance with the Act by registered public accounting firms and their associated persons. The Oversight Board will conduct annual inspections of firms that audit more than 100 issuers. It will inspect other firms at least once every three years. The Oversight Board's investigatory authority will include authority to compel testimony of any registered public accounting firm and its associated persons, require production of documents and information in the possession of any registered public accounting firm and its associated persons, request testimony or document production of any person, and seek issuance by the SEC of a subpoena to require testimony or document production of any person.

The Oversight Board has authority to impose sanctions as it determines appropriate, including suspension or permanent termination of registration, and civil penalties up to $100,000 for an individual or $2 million for a firm.

A safe harbor is established so that the Oversight Board cannot sanction a firm for failure to reasonably supervise if the firm has established procedures, and a system for applying those procedures, that comply with applicable rules of the Oversight Board. The procedures and implementing system must reasonably be expected to prevent and detect violations by associated persons. If the firm has reasonably discharged the duties and obligations incumbent upon it by reason of the procedures and system, and has no

reasonable cause to believe that the procedures and system were not being complied with, it has met its obligations under the Act and cannot be sanctioned.

Audit Committees and Audit Services.

The Act contains a variety of provisions designed to foster the establishment of strong audit committees for the Boards of public companies and to attempt to ensure independent audit services free of real or perceived conflicts.

Section 301 requires that the SEC, within 270 days of enactment, establish rules that direct the national stock exchanges and the national securities associations to de-list the security of any company that is not in compliance with the following requirements:

- The audit committee of each issuer shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by the issuer for the purpose of preparing or issuing an audit report or related work and each such accounting firm shall report directly to the audit committee (which shall have authority to resolve disagreements between management and the auditor regarding financial reporting).

- Each member of the audit committee shall be independent, unless exempted by the SEC.[9]

[9] *A member of an audit committee is deemed "independent" if the member does not accept any consulting, advisory or other compensatory fee from the issuer, is not an affiliated person of the issuer or any subsidiary thereof.*

- The audit committee shall establish procedures for the receipt, retention and treatment of complaints received by the issuer regarding accounting, accounting controls and auditing matters.

- Each audit committee shall have authority to engage independent counsel and other advisers.[10]

- Each issuer shall provide for appropriate funding as determined by the audit committee for payment to a registered public accounting firm for the purpose of providing an audit report and to employ advisers for the audit committee.

The Act is designed to strongly encourage public companies to appoint at least one person to the audit committee who is a "financial expert," as defined by the SEC. This is accomplished through a new disclosure requirement embodied in Section 407 of the Act. Specifically, the SEC is required within 180 days of enactment to issue final rules requiring all companies reporting under the Securities and Exchange Act to disclose, together with their periodic reports, whether or not (and if not, why not) the audit committee includes at least one member who is a financial expert. The specific requirements of status as a financial expert are to be determined by the SEC, but the SEC is directed by the Act to consider factors including understanding of and experience with GAAP and the preparation or auditing of financial statements, experience with internal accounting controls, and an understanding of audit committee functions.

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[10] *These provisions are substantially similar to the June 6 proposal of the New York Stock Exchange Corporate Accountability and Listing Standards Committee.*

Section 204 of the Act requires registered public accounting firms to make timely reports to the audit committee of all critical accounting policies and practices to be used, all alternative treatments of financial information within generally accepted accounting principles (GAAP) that have been discussed with management, ramifications of the use of such alternatives, and the treatment preferred by the accounting firm, and any other material written communications between the accounting firm and management such as any management letters or schedule of unadjusted differences. That section further provides that an independent auditor is required to timely report to the audit committee all critical accounting policies and practices used, all alternative treatments of financial information within GAAP discussed with management and the ramifications of the use of alternative disclosures and treatments as well as the treatment preferred by the independent auditor and other written communications, including the management letter and schedule of unadjusted differences, between the independent auditor and management.

Subject to certain *de minimus* exceptions, the audit committee shall preapprove all services provided by the auditor of an issuer.[11] The Act prohibits registered public accounting firms from providing to any issuer, "contemporaneously with the audit," any professional services other than those provided in connection with an audit or a review of the financial statements of the company.[12] The Act further requires the audit committee to pre-approve all auditing services (including the provision of conflict letters) and (subject to *de minimis* exceptions) all permitted non-audit services to be approved by the independent accounting firm, with the audit committee having the right to delegate to one

[11] *Section 202.*

LA #250632 v1-800002-040219

or more of its members the authority to grant pre-approvals. Approvals of non-audit services are required to be disclosed in periodic reports filed with the SEC. It is likely that, as a matter of practice, audit committees will limit non-audit services primarily to preparation of tax returns and other very limited matters.

The Act also provides for other efforts to avoid the appearance of conflicts by auditors, including rotating audit partners every five years[13] and a prohibition against registered public accounting firms auditing a company if a company's CEO, CFO, Chief Accounting Officer or an equivalent employee was employed by the auditing firm and participated in the audit of that issuer during the one-year period preceding initiation of the current audit.[14]

The SEC is to issue final rules within 270 days after enactment of the Act implementing the statutory provision making it unlawful for any officer or director of an issuer, or any person acting under the issuer's direction, to fraudulently influence, coerce, manipulate or mislead any independent public or certified accountant engaged in the performance of an audit of the issuer's financial statements for the purpose of rendering those financial statement materially misleading.

IV. Research Analyst Independence and Conflicts of Interest

The Act also addresses analyst conflicts of interest. Section 501 requires the SEC, or upon the authorization and direction of the SEC, a registered securities association or national securities exchange, to adopt rules within one year of enactment

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[12] *Section 201.*
[13] *Section203.*

reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and during public appearances. The goal is to improve the objectivity of research and provide investors with more meaningful, reliable information. The rules should (1) restrict the prepublication clearance or approval of research reports by persons employed by securities brokers or dealers engaged in investment banking activities, or persons not directly responsible for investment research other than legal or compliance staff; (2) limit the supervision and compensation evaluation of securities analysts to those officials employed by the securities broker or dealer who are not engaged in investment banking activities; (3) prohibit certain retaliation against any securities analyst employed by a securities broker or dealer or its affiliates as a result of an unfavorable research report that could adversely affect the investment banking relationship; (4) define blackout periods during which brokers or dealers who have participated in, or will participate in, a public offering as underwriters or dealers cannot publish or distribute research reports relating to such securities or the issuers of such securities; (5) establish safeguards within registered securities brokers or dealers to ensure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision; and (6) address such other issues as the SEC or such association or exchange determines appropriate.[15]

Rules are also to be adopted within one year concerning disclosure of conflicts of interest by securities analysts in connection with public appearances and research reports.

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[14] *Section 206.*

The disclosure would include the extent to which the analyst has investments in an issuer that is the subject of the appearance or report; the receipt, if any, of compensation from the issuer (subject to appropriate exemptions to be adopted by the SEC); whether the issuer is or has within one year been a client of the broker or dealer; whether the analyst received compensation with respect to the research report based in whole or in part on investment banking revenues of the broker dealer; and such other disclosure of conflicts of interest that are material to investors, research analysts or the broker or dealer as the Commission determines.[16]

VI. Enhanced Disclosure Requirements

Specifically addressed are enhanced financial disclosures. Requirements that are specifically included by the Act cover a wide variety of topics primarily directed to accounting procedures. Some of the more important provisions are discussed below.

Disclosures in periodic reports. Reflecting concern with material adjustments, Section 401 requires that each report filed with the SEC containing financial statements must be prepared in accordance with, or reconciled to, GAAP, and must reflect all material correcting adjustments that have been identified by the independent auditors. The provision became effective upon the enactment, but only applies to material correcting adjustments identified by a registered public accounting firm. Firms will be

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[15] *Section 501(a).*

[16] *Section 501(b). New York Stock Exchange Rules 472 and NASD Rule 2210 have already adopted much of what is required with respect to the foregoing, as changes were approved by SEC on May 10, 2002. The SEC's prior approval was based upon one specific authority. The new Act's rules are somewhat more specific and stringent.*

registered as public accounting firms in accordance with provisions that will ultimately be implemented by the Oversight Board.[17]

Section 401 of the Act directs the SEC to issue final rules by January 26, 2003 requiring that annual and quarterly financial reports filed with the SEC disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and other relationships of the issuer with unconsolidated entities or others that may have a material current or future effect on its financial condition, changes in financial condition, operating results, liquidity, capital expenditures, capital resources or significant components of its revenues or expenses.

Section 401 further amends the Exchange Act to require the SEC, by January 26, 2003, to adopt final rules requiring that *pro forma* financial information included by public companies in any periodic or other report filed with the SEC, or in any public disclosure or press or other release, be presented in a manner that does not contain an untrue statement of a material fact or omit to state a material fact that reconciles the pro forma disclosures to the company's GAAP financials. This provision is substantially consistent with a more detailed December 4, 2001 Cautionary Advice issued by the SEC regarding the use of *pro formas*.[18]

Disclosure of transactions involving management and principal stockholders. Effective 30 days after enactment, there will be expedited disclosure of transactions involving management and principal stockholders. Every director, officer or beneficial owner of more than 10% of a company's securities registered pursuant to Section 12 of

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[17] *Section 401..*

LA #250632 v1-800002-040219

the Securities Exchange Act must file with the SEC by the end of the second business day following the date in the change of ownership of those securities (or following such person's purchase or sale of a security-based swap agreement involving those securities), reporting statements accurately reflecting the ownership changes. This requirement accelerates the previously effective reporting requirements that allowed filings to be made 10 days after the end of the month in which the ownership change transaction occurred. In addition, beginning one year after the date of enactment, the statements of beneficial ownership changes will have to be filed electronically. The SEC will then provide access to these filings on its website by the end of the business day following the filings. The issuer will be required within the same time frame to post the information on its corporate website.

Under Section 404, the SEC must prescribe new rules mandating that each annual report filed by a public reporting company contain an "internal control report." The report will need to address the responsibility of management for establishing and maintaining adequate internal controls and reporting procedures and will have to include an assessment, as of the end of the most recent fiscal year, as to the effectiveness of the controls and procedures. Each registered public accounting firm that conducts the audit of the reporting public company's financial statements for that year will be required to report on and attest to management's assessment in accordance with standards issued or adopted by the Oversight Board. The Act does not specify a deadline for the adoption of the SEC rules pursuant to this section.

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[18] *SEC Release No. 33-8039, 34-45124.*

Code of ethics for senior financial officers. Section 406 of the Act requires the SEC to issue rules to require each issuer to disclose with its periodic reports whether or not (and, if not, why not) it has adopted a code of ethics for its senior financial officers, applicable to the principal financial officer, comptroller and similar persons. The code of ethics means standards that are reasonably necessary to promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships, full, fair, accurate, timely and understandable disclosure in the issuer's periodic reports, and compliance with governmental regulations.

In addition, the SEC is directed to revise its rules governing prompt Form 8-K[19] filing requirements to mandate the immediate disclosure by the filing of a Form 8-K, or by dissemination of information over the internet or other electronic means, of any change in or waiver of the code of ethics.

The foregoing disclosure policy is substantially consistent with the corporate governance changes in this area recommended by the New York Stock Exchange Corporate Accountability and Listing Standards Committee proposed for consideration in its report made available on June 6, 2002. In that proposal, the New York Stock Exchange concluded that listed companies should be required to adopt and disclose codes

[19] *A Form 8-K is used for current reports under Section 13 or 15(d) of the Securities Exchange Act of 1934 for filing information concerning changes in control of the registrant, acquisition of disposition of a significant amount of assets, otherwise than in the ordinary course of business, bankruptcy or receivership, changes in the registrant's certifying accountant, resignation of the registrant's directors and at the registrants option, other events deemed to be of importance to security holders.*

of business conduct and ethics for directors, officers and employees and to properly disclose any waivers of the code for directors and executive officers.[20]

Real time disclosure. In section 409 of the Act, issuers reporting under sections13 (a) or 15(d) of the Securities and Exchange Act are required to disclose to the public on a "rapid and current basis" such additional information concerning material changes in the financial condition or operations of the issuer "in plain English," which may include trend and qualitative information and graphic presentations as the SEC determines by rule is necessary or useful for the protection of investors and the public interest.

VII. Securities Litigation, SEC Enforcement and Criminal Liabilities

The Act contains provisions that will generally make it easier to pursue private securities litigation, expand the SEC's enforcement activities, established new crimes and increase maximum penalties for white-collar offenses.

Private civil litigation. The statute of limitations for private securities fraud actions is lengthened. The statute of limitations will be two years after discovery of the facts constituting a violation and no more than five years after the violation.[21] Previously, the statute of limitations for similar activity was one year and three years,

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[20] *On June 6, 2002, the Committee published a comprehensive set of recommendations embodying pervasive changes to the corporate governance listing standards for New York Stock Exchange listed companies. The New York Stock Exchange Board formally adopted these recommendations on August 1, 2002, and the New York Stock Exchange has announced that it intends promptly to submit a rule filing to the SEC for its review. The adjustments incorporated in the final New York Stock Exchange proposal were made to effect clarifications and to accommodate the Sarbanes-Oxley Act.*

[21] *Section 804.*

LA #250632 v1-800002-040219

respectively. The change applies to "proceedings . . . that are commenced on or after the date of enactment [of the Act]."[22] The limitations period in section 804 applies to violations of the "securities laws" which are defined to include the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act, the Investment Advisors Act of 1940 and the Securities Investor Protection Act of 1970.[23]

Section 306(a)(2)(B) of the Act provides that actions may be brought by a shareholder in the name of the issuer to recover profits from officers who traded in violation of the blackout provisions of the Act.

Section 803 of the Act amends the U.S. Bankruptcy Code to provide that certain debts resulting from penalties under the securities laws are not dischargeable in a bankruptcy proceeding. A debt does not qualify for discharge if it is for the violation of any federal or state securities laws, or any regulation or order issued thereunder or common fraud, deceit or manipulation in connection with the purchase or sale of any security and results from judgments, orders, penalties or settlements.

SEC enforcement. The Act addresses enhancing SEC enforcement activities in a number of ways. It provides the SEC with increased responsibilities and authority. In addition, it authorizes additional funds for the SEC. The Act specifically authorizes

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[22] *Section 804(b).*
[23] *See section 3(a)(47) of the Securities Exchange Act.*

LA #250632 v1-800002-040219

appropriations of $776 million for fiscal year 2003 to the Commission in addition to any other funds authorized to be appropriated to the Commission.[24]

Section 1103 provides that the SEC may petition a federal court for a 45-day halt against issuers making extraordinary payments to directors, officers, employees, agents, and others.

The Act changes the standard for obtaining an officer and director bar from "substantial unfitness" to "unfitness" which the SEC may now seek by administrative proceeding rather than having to seek a court order.[25]

The SEC is also given additional authority including the authority to censure any person or deny, temporarily or permanently, any person the privilege of appearing or practicing before the Commission in any way if that person is found by the Commission, after notice and an opportunity for a hearing, not to possess the requisite qualifications to represent others, to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct, or to have willfully violated or willfully aided and abetted the violation of any provision of the securities laws or the rules and regulations thereunder.[26]

Section 305 of the Act provides broadly that in any SEC action or proceeding under the securities laws, the SEC, "may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors."

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[24] *Section 601.*
[25] *See sections 305 and 1105(a), (b) of the Act.*
[26] *Section 602.*

Section 604(a) of the Act authorizes the SEC to bar from the securities industry persons who have been suspended or barred by a state securities, banking or insurance regulator, or are otherwise subject to any SEC order suspending or barring the right of the persons to be associated with a broker or dealer because of fraudulent, manipulative or deceptive conduct. Section 604(b) provides similar authority with respect to investment advisors under the Investment Advisors Act.

Although the Act empowers the SEC, it also imposes duties. It requires the SEC to review the filings of public companies on a regular and systematic basis, not less than once every three years.[27] The Commission is further required to prepare certain specified studies.[28]

New crimes and increased criminal penalties. The Act establishes new crimes and increases the maximum penalty for others. As discussed above, the sections relating to CEO and CFO certification of periodic reports provide for criminal penalties of up to 20 years in prison.[29]

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[27] *Section 408. In the past, the SEC has not generally conducted extensive reviews of all publicly traded companies. For purposes of scheduling the reviews now required, the SEC is mandated to consider, among other factors, issuers that have material restatements of financial results, issuers that experience significant volatility in their stock price as compared to other issuers, issuers with the largest market capitalization, emerging companies with disparities in price to earning ratios, issuers whose operations significantly affect any material sector of the economy, and any other factors the SEC may consider relevant.*

[28] *See section 401(c) (SEC to report and submit recommendations concerning off-balance sheet issues), section 702 (SEC to prepare a study and report regarding credit rating agencies), section 703 (SEC to prepare a study and report on securities violators and violations). and section 704 (SEC to prepare a study and report on SEC enforcement actions).*

[29] *Sections 906 and 1106 of the Act..*

A new statute provides for imprisonment of up to 25 years for any person who knowingly executes or attempts to execute a scheme or artifice to (1) defraud any person in connection with any security of an issuer or with class of securities registered under sections12 or 15(d) of the Securities Exchange Act; or (2) to obtain, by means of false or fraudulent pretenses, representations or promises, any money or property in connection with the purchase or sale of any security of an issuer meeting the same qualifications.[30]

In addition, the Act makes it a crime punishable by up to 10 years in prison to knowingly and willfully violate new provisions regarding retention of corporate audit records.[31] The Act requires accountants who audit issuers subject to section 10(A)(a) of the Securities and Exchange Act to maintain all audit and review work papers for five years from the end of the applicable fiscal period. The Act makes it a crime punishable by imprisonment of up to 20 years to knowingly alter, destroy, conceal, etc. records or documents with the intent to impede, obstruct or influence a federal investigation or case filed in bankruptcy or in relation to or contemplation of any such matter or case.[32]

The Act further makes it a crime punishable by imprisonment of up to 20 years to "corruptly" alter, destroy, mutilate or conceal records or documents with the intent to impair the integrity or availability in an official proceeding or to otherwise instruct, influence or impede a proceeding or attempt to do so.[33]

Section 1349 provides that any person who attempts or conspires to commit mail fraud, wire fraud, bankruptcy or securities fraud or who conspires to submit a false

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[30] *Section 807.*
[31] *Section 802(a).*
[32] *Section 802(a).*

certification of financial reports shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

The maximum period of incarceration for violation of mail fraud and wire fraud is increased from 5 years to 20 years.

Section 904 of the Act increases criminal penalties for willful violations of the reporting and disclosure provisions under ERISA (and regulations thereunder) to a maximum penalty of $100,000 fine and 10-year imprisonment. The prior penalties were capped at a $5,000 fine and 1-year imprisonment. For corporate and legal entities, the maximum fine under the Act is increased from $100,000 to $500,000.

Finally, the Act directs the U.S. Sentencing Commission to review and amend, as necessary, The Federal Sentencing Guidelines and related policy statements to ensure that the Guidelines adequately assign guideline levels and enhancements for white collar crime so as to be reasonably consistent with the other sentencing guidelines and to sufficiently deter and punish white collar crime.

CONCLUSION

The Act provides a broad and vigorous response to the growing public concern over fraud and mismanagement in the corporate world. At this time it is difficult to reconcile all of the overlapping provisions or fully understand the implementation of the Act since much of it will depend upon rule making by the SEC and the development of case law. It is clear, however, that the Act has provided a broad spectrum of relief,

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[33] *Section 1102.*

LA #250632 v1-800002-040219

enhanced government regulation in the securities industry, and the increase of potential criminal liability.