THE "GREED IS GOOD" PHILOSOPHY RUNS ITS COURSE: THE CORPORATE RESPONSIBILITY ACT OF 2002

RODOLPHO SANDOVAL*

On July 25th, the Sarbanes-Oxley Act of 2002, also known as the Corporate Responsibility Act, was passed by the Senate,[1] and on July 30th, *President* Bush signed it into law. [2] The Act is a response to the national accounting scandal of 2001 and 2002 involving Enron, Arthur Andersen, and WorldCom. Without question, the Act will have a greater impact on the financial record keeping community and the accounting profession than any legislation in the past 70 years. The Act covers a broad sector of professions and professionals including corporate accountants, managers, corporate directors, public accountants and securities analysts.

The Sarbanes-Oxley Act extends across eleven separate Titles.[3] Its primary objective is to promulgate protective legal infrastructures and enact tough new provisions to deter and punish corporate and accounting fraud and corruption. The Act purports to ensure justice for wrongdoers and protect the interests of workers and shareholders.[4] Specifically, the Act creates a public company accounting oversight board to enforce professional standards, ethics, and competence for the accounting profession. It strengthens the independence of firms that audit public companies; increases corporate responsibility and the usefulness of corporate financial disclosure; increases penalties for corporate wrongdoing; protects the objectivity and independence of securities analysts; and increases the resources of the Securities and Exchange Commission.

While some of the Titles[5] may appear short in nature, the subsequent promulgation of Rules[6] by the Security and Exchange Commission may require the devotion of one entire law review article to one Title, i.e. *Rules of Professional Responsibility for Attorneys*.[7] Therefore, the purpose of this paper is to focus on and analyze the legal implications of selected Titles of the Sarbanes-Oxley Act and to identify new requirements which Sarbanes-Oxley imposes on the corporate world with respect to (1)

---

*Professor Sandoval, M.A., J.D., LL.M. is an Associate Professor of Business Law and the Associate Vice President for Administration at the University of Texas at San Antonio. He is a graduate of the University of Notre Dame and the Harvard Law School and is a former law professor at the Notre Dame Law School.
My gratitude and appreciation to Gilbert Vazquez, a partner in the law firm of Akin Gump, Struss, Hauer & Feld, LLP for his invaluable contribution, critique and advise in writing this paper. He has an A.B. from Yale College and a J.D. from the Harvard Law School.

[1] Sarbanes-Oxley Act of 2002, H.R. 3763, 107 Cong. (2002); Corporate Governance, Pub. L. No. 107- 204, 116 Stat. 745 (2002); 15 U.S.C. §7201(2002) [hereinafter Sarbanes-Oxley].

[2] *Id.*

[3] *Id*. The Titles include: I. Public Company Accounting Oversight Board; II. Auditor Independence; III. Corporate Responsibility; IV. Enhanced Financial Disclosure; V. Analyst Conflicts of Interest; VI. Commission Resources and Authority; VII. Studies and Reports; VIII. Corporate and Criminal Fraud Accountability; IX. White Collar Crime Penalty Enhancement; X. Corporate Tax Returns; and XI. Corporate Fraud and Accountability.

[4] *See* http:///www.whitehouse.gov/infocus/corporateresponsibility/

[5] *See* Sarbanes-Oxley, supra note 1 at § 307 Rules of Professional Responsibility for Attorneys.

[6] *See* Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. §205, 240 and 249; *see also* <wysiwyg://2file:/C|/TEMP/33-8186.htm>.

[7] *See* Sarbanes-Oxley, supra note 5.

corporate responsibility, including corporate fraud and accountability, (2) corporate and criminal fraud accountability, and (3) white collar crime penalty enhancements. The reason for pursuing an analysis of these Titles is that Congress has deemed them to be the major components and heart of the statute.

I. CORPORATE RESPONSIBILITY

A. PUBLIC COMPANY AUDIT COMMITTEES

The Act requires that not later than 270 days after the date of enactment, i.e., by January 26, 2003, the Securities and Exchange Commission issued a rule directing the National Securities Exchanges and the national securities associations to prohibit the listing of any securities[8] of an issuer[9] that is not in compliance with the Act.[10] On Feb 18, 2003, the Securities and Exchange Commission *proposed* a new rule to comply with this requirement.[11] After the *final* rules are promulgated they will become operative one year after their publication.[12]

One of the objectives of the Act is to enhance the independence of public company audits. A dilemma currently exists between companies and auditing firms in that the auditing process "may be compromised when a company's outside auditors view their main responsibilities as serving the company's management rather then its full board of directors or its audit committee." This is inevitable when "the auditor views management as its employer with hiring, firing and compensatory powers."[13] The Act, therefore, charges the audit committee[14] of each issuer to be directly responsible for the "*appointment, compensation, and oversight* of the work of any registered public accounting firm employed by that issuer for the purpose of preparing or issuing an audit report or related work, and requires each such registered public accounting firm to report directly to the audit committee."[15] Hence, the Act purpose is to make the audit committee independent from management. The Commission proposes to include additional

---

[8]*See* Sarbanes-Oxley, *supra* note 1, at § 301 (1)(A).
[9]See *id*, at § 2 (7) *stating* that an "issuer" means one that is defined in 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 a report under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that is it has not withdrawn.
[10] *See* Sarbanes-Oxley, supra note 1, at § 301 (1)(A).
[11] *See* Proposed Rule*: Standards Relating to Listed Company Audit Committees*, 17 CFR Parts 228,229, 240, 249 and 274, release nos. 33-8173; 34-47137; and IC-25885. The proposal is to implement § 10A (m)(1) of the Exchange Act and added to the § 301 of the Sarbanes-Oxley Act. The Rule is to become effective on April 26, 2003.
[12]See U.S. Securities and Exchange Act of 1934, 15 U.S.C. 78c(A)(47) [*hereinafter* Securities and Exchange].
[13]*See* Proposed Rule: *Standards Relating to Listed Company Audit Committee*, Release No. 34-4713, 17 CFR Parts 228, p.11 (Feb. 18, 2003). *See also* <http://www.sec.gov/rules/proposed/34-47137.htm> p.11 (visited on Jan. 31, 2003) [hereinafter Proposed Rule: Standard].
[14] *See* Sarbanes-Oxley, supra note 1, at § 2 (3) *stating* that an "audit committee" means a committee established by and amongst the board of directors of the issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and if no such committee exists with respect to an issuer, the entire board of directors of the issuer.
[15]*See* Sarbanes-Oxley, *supra* note 1 at §301(2) (2002).

authority for the audit committee to retain the outside auditor, and "would include the power [for the audit committee] not to retain or to terminate the outside auditor." In addition, it is proposed that the audit committee have the "ultimate authority to approve all audit engagement fees and terms, as well as all significant non-audit engagements of the independent auditor."[16]

The Act reflects current practice and requires that each member of the audit committee of the issuer be a member of the board of directors of the issuer.[17] Therefore, the same personnel that are elected and accountable to the shareholders become the "focal point of the corporate governance system" by requiring the audit committee members to also be members of the board to serve as a "check and balance on a company's financial reporting system." This is an interesting symbiotic relationship because the audit committee/board of directors are responsible for providing an independent review and oversight of a company's "financial reporting processes, internal controls and independent auditors."[18] The Securities and Exchange Commission seems to believe that this audit committee/board of director's infrastructure will "ensure that management properly develops and adheres to a sound system of internal controls, objectively assesses management's practices …, and objectively assesses the company's financial reporting practices."[19]

The Act attempts to create a wall between the audit committee/board of directors and the issuer by imposing new relationship restrictions requiring the independence of the audit committee members/board of directors by prohibiting any *consulting, advisory, or other compensatory fee* to audit committee members from the issuer.[20] The Securities and Exchange Commission's proposed Rules prohibit both direct and indirect payment to members of the audit committee. Indirect payments include payments to "spouses, minor children or stepchildren sharing a home with the member, as well as payments accepted by an entity in which an audit committee member is a partner, member or principal or occupies a similar position and which provides accounting, consulting, legal investments, banking, financial or other advisory services or similar services to the issuer."[21] A question arises as to whether members of the board of directors acting in their director capacity are also prohibited from these activities or whether the prohibition only applies when they are acting in the capacity of audit committee members. The SEC's proposed Rules indicate that the audit committee members are barred from accepting compensation, but that the board members acting in that capacity are not.[22] This arrangement may appear theoretically sound, but the practical application may become ensnared in a scenario that creates the potential for a conflict of interest. What are the rules and who decides when a person is acting as a board member or an audit committee member?

---

[16] *See* Proposed Rule*: Standard, supra* note 13 at 11.
[17] *See* Sarbanes-Oxley, *supra* note 1, at §301 (3) (2002).
[18] *See* Proposed Rule: *Standards*, supra note 13.
[19] *Id.*
[20] *See* Sarbanes-Oxley, *supra* note 1, at §301(3)(B)(i).
[21] *See* Proposed Rule: Standards, *supra* note 13.
[22] *Id.*

The Act allows the Commission to exempt particular relationships[23] that may exist between audit committee member and the issuer, as the Commission determines appropriate, in light of the circumstances.[24] The Securities and Exchange Commission's proposed rules identify two types of exempt relationships. First, where companies "coming to market for the first time may face particular difficulty in recruiting members that meet the proposed independence requirements."[25] The Commission avers that it may be difficult to recruit "independent directors before an initial public offering and may discourage companies from accessing the public markets to grow their business and provide liquidity if all of their audit committee members must be independent at the time of the initial public offering."[26] Therefore, the Commission proposes to exempt "one member of a non-investment company issuer's audit committee from the independence requirements for 90 days from the effective date of the issuer's initial registration statement…"[27] Second, many companies such as "financial institutions and other entities with a holding company structure, operate through subsidiaries." For these companies, "the composition of the boards of the parent company and the subsidiary are sometimes similar given the control structure between the parent and the subsidiary." Hence, if an "audit committee member of the parent is otherwise independent, merely serving also on the board of a controlled subsidiary should not adversely affect the board member's independence." Hence, the Commission proposes to exempt from the "affiliated person"[28] "requirement a committee member that sits on the board of directors of both a parent and a direct or indirect consolidated majority-owned subsidiary, if the committee member otherwise meets the independence requirement for both the parent and the subsidiary…"[29]

Under the Act, each audit committee is required to establish an infrastructure of procedures for the *receipt*, *retention*, and *treatment of complaints* received by the issuer regarding (1) accounting, (2) internal accounting controls, or (3) auditing matters.[30] The Commission states that the "audit committee must place some reliance on management for information about the company's financial reporting process."[31] But this philosophy seems to defeat the entire purpose of the Act, i.e. to create an independent audit committee so that it does not have to rely on the company financial reports. Management's natural instinct for self-preservation may not have the "incentive to self-report all questionable practices."[32] Therefore, it seems imperative that the audit committee establishes an independent infrastructure of procedures utilizing a variety of

---

[23] *See* Sarbanes-Oxley, Supra note 1, at 301(3)(B) *stating* that in order to be independent, a member of an audit committee of an issuer may not …be an affiliated person of the issuer or any subsidiary."
[24] *See* Sarbanes-Oxley, *supra* note 1, at §301(3)(C).
[25] *See* Proposed Rule: *Standards*, *supra* note 13.
[26] *Id*.
[27] *Id.*
[28] *See* Proposed Rule: Standards Relating to Listed Company Audit Committee, Release No. 34-4713, 17 CFR Parts 228 (Feb. 18, 2003). *See also* < http://www.sec.gov/rules/proposed/34-47137.htm> p. 7 (visited on Jan. 31, 2003) *stating* that an affiliated person means a person that directly or indirectly through on or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.
[29] *See id*.
[30] *See* Sarbanes-Oxley, *supra* note 1, at §301(4)(A).
[31] *See* Proposed Rule: Standards, supra note 13. *See also* < http://www.sec.gov/rules/proposed/34-47137.htm> at 13 (visited on Jan. 31, 2003).
[32] *Id.*

sources to obtain information concerning management financial practices. Unfortunately, the Commission does not propose to "mandate specific procedures that the audit committee must establish." It believes that companies should be provided "with flexibility to develop and utilize procedures appropriate for their circumstance."[33]

In addition, under the Act the committee is required to *install procedures for receiving confidential, anonymous information* from employees of the issuer concerning questionable accounting and auditing matters.[34] The Commission defers from creating rules for the audit committee for installing procedures to acquire information from employees, and states that it expects each "audit committee to develop procedures that work best consistent with its company's individual circumstances."[35] Unfortunately, the Commission does not even provide minimum standards and guidelines to create an infrastructure for the issuer to receive confidential and anonymous information from employees.

The Act confirms current practice and establishes the audit committee's authority to hire independent counsel and other advisors, as it deems necessary, to carry out it functions and duties.[36] It is therefore recognized that "outside advisors may be necessary to identify potential conflicts of interest and assess the company's disclosure and other compliance obligations with an independent and critical eye.[37] The Act further requires each issuer to provide appropriate funding as determined by the audit committee for payment of compensation to any advisors employed by the audit committee.[38] The Act also requires issuers to pay compensation for the registered public accounting firm employed for the purpose of rendering or issuing an audit report.[39] Obviously, the independent nature of the advisors would be compromised if their compensation were wholly dependent on their goodwill relationship with management. If advisors are to make an independent determination concerning the operation of the company, its finances and its management, then, perforce, it must remain independent by being compensated by the audit committee and not the company it is auditing.

The Securities and Exchange Commission suggests that the new proposed standards will (1) provide a framework in which audit committees can be more effective in protecting shareholders' interests; (2) the Audit Committee is more likely to be more effective in its oversight role when it has adequate resources; (3) it will be empowered to accomplish its responsibilities independently of management especially with respect to conflict of interest issues, and (4) the committee is more likely to be objective when evaluating financial disclosure and internal controls.[40]

---

[33] *See id*.
[34] *See* Sarbanes-Oxley; *supra* note 1, at §301(4)(B).
[35] *See* Proposed Rule: Standards, *supra* note 13.
[36] *See* Sarbanes-Oxley; *supra* note 1, at §301(5).
[37] *See* Proposed Rule: Standards, *supra* note 13. *See also* < http://www.sec.gov/rules/proposed/34-47137.htm> p. 14 (visited on Jan. 31, 2003).
[38] *See* Sarbanes-Oxley; *supra* note 2, at §301(6)(B).
[39] *See id*, at §301(6)(A).
[40] *See* Proposed Rule: Standards, supra note 13. *See also* < http://www.sec.gov/rules/proposed/34-47137.htm>.

B. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS

Under the Act, the principal executive officer or officers and the principal financial officer or officers, or other persons performing similar functions are required to certify[41] in each annual or quarterly report filed in accordance to the Securities Exchange Act of 1934 [42] that (1) the signing officer has reviewed the report,[43] (2) based on the officers' knowledge, the report does not contain any untrue statement nor does it omit any material fact causing the report to be misleading,[44] and (3) based on the officer's knowledge, the financial statements, and other financial information included in the report, fairly represent the financial condition and results of operations of the issuer for the period presented in the report.[45]

The signing of the reports also imports certain responsibilities to the officers such as certifying that (1) they are responsible for establishing and maintaining internal controls;[46] (2) they have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities;[47] (3) they have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report;[48] and (4) they have indicated in the signed report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date.[49] The Act also requires the officers to certify that they have disclosed to the issuer's auditors and the audit committee of the board of directors all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to *record*, *process*, *summarize*, and *report* financial data.[50] They must also certify that they have identified for the issuer's auditors any material weaknesses in internal controls. In addition, the officers are required to disclose any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls[51] Finally, the signing officer must certify in the report whether or not there were significant changes in internal controls that could significantly affect internal controls subsequent to the date of their evaluations, including any corrective actions with regard to significant deficiencies and material weaknesses.[52] The requirements are the same even if an issuer has reincorporated and moved its domicile from the United States to a foreign country outside the United States.[53]

---

[41] *See* Sarbanes-Oxley *supra* note 1, at §302(a).
[42] *See* the Securities Exchange Act of 1934, 15 U.S.C. 78m and 78o(d) *stating* the requirements for periodic reports.
[43] *See* Sarbanes-Oxley; *supra* note 1, at §302(a)(1).
[44] *See id*. At §302(a)(2).
[45] *Id*. at §302(a)(3).
[46] *See id*. at §302(a)(4)(A).
[47] *See id*. at §302(a)(4)(B).
[48] *See* Sarbanes-Oxley, *supra* note 1, at §302(a)(4)(C).
[49] Id. at §302(a)(4)(D).
[50] *Id*. at §302(a)(5)(A).
[51] *Id.* at §302(a)(5)(B).
[52] *Id.* at §302(a)(6).
[53] *Id*. at §302(b).

Criminal penalties *for certifying* any statement knowing that the periodic report requirements set out in the Act do not comport with the statutory requirement will cause a fine to be levied in the amount of $1,000,000 or imprisoned not more than 10 years, or both.[54] For *willfully certifying* the same will cause a fine of $5,000,000, or imprisonment of not more the 20 years or both.[55]

C. IMPROPER INFLUENCE ON CONDUCT OF AUDITS

The Act declares unlawful for an officer or director of an issuer or any other person acting under their direction to take any action to *fraudulently influence*, *coerce*, *manipulate*, or *mislead* any independent public or certified account engaged in the performance of an audit of the financial statement of that issuer for the purpose of rendering such financial statements materially misleading.[56] Notwithstanding the fact that this statute becomes effective on July 30, 2002, it is still a work in progress. The Securities and Exchange Commission has exclusive authority to enforce this provision, and must propose rules by October 28, 2002 and issue final rules by April 2003.

D. FORFEITURE OF CERTAIN BONUSES AND PROFITS

Where the issuer is required to prepare an accounting restatement of any financial reporting requirement under the securities laws due to *material noncompliance as a result of misconduct*, the Act requires the chief executive officer and chief financial officer of the issuer to reimburse the issuer[57] for (1) any *bonus* or *other incentive-based* or *equity-based compensation* received by the officers from the issuer during the 12 month period following the first public issuance or filing with the Commission of the required financial documents[58] and any profits realized from the sale of securities of the issuer during the same 12 month period.[59] However, the Commission may exempt any person from being penalized the *bonuses* or *other incentive-based* or *equity-based compensation* received by the officers.[60] This section of the statute becomes effective on July 30, 2002, but unfortunately, it does not set a date for the Securities and Exchange Commission to propose a rule. Therefore, there is lack of guidance as to when the Commission may exempt a person from being penalized except when the Commission deems it "necessary and appropriate."[61]

[54] Id. at §906(a) *amending* 18 U.S.C. *and adding* §1350(c)(1).
[55] Id. at §906(a) *amending* 18 U.S.C. *and adding* §1350(c)(2).
[56] *Id.*at §303(a).
[57] *Id.*at §303(a).
[58] *Id* . at §304(a)(1).
[59] *Id.* at §304(a)(2).
[60] *See* Sarbanes-Oxley, *supra* note 1, at §304(b).
[61] *Id*. at § 304(b).

E. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS

The Act prohibits directors and executive officers of an issuer of any equity security to *purchase, sell, or otherwise acquire or transfer any equity security* of the issuer during any blackout period[62] if they acquired such security in connection with his or her service or employment as a director or executive officer.[63] How does a director or an executive officer know when a blackout will occur or is in existence? The Act, amends Section 101 of the Employee Retirement Income Security Act of 1974 to require any Plan Administrator for an individual account [retirement] plan to timely notify such director or officer, the Securities and Exchange Commission and the issuer[64] of such blackout period[65]. It is also the Plan Administrator's responsibility to provide written[66] notification[67] to the plan participants and beneficiaries who will be affected by the action[68] at least 30 days in advance of the blackout[69] period.[70] If, after providing due and appropriate notice, there is a change in the beginning date or length of the blackout,[71] the administrator shall provide the affected participants and beneficiaries notice of the change as soon as reasonable and practical.[72] But the term *blackout period* seems to be a moving target. On the one hand, *blackout period* is defined as any three consecutive days during which 50 percent or more of the participants are restrained from alienating their securities.[73] On the other hand, the term contains certain exceptions when it involves the

---

[62] Blackout means "any period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any plan is temporarily suspended by the issuer or by the fiduciary of the plan" *See* Sarbanes-Oxley, *supra* note 1at §06(a)(4)(A).

[63] *See* Sarbanes-Oxley, *supra* note 1, at §306(a)(1).

[64] *See id*. at §306(b)(1)(i)(2)(E).

[65] *Id.* at §306(a)(4).

[66] Notice may be in electronic or other form to the extent that such form is reasonable accessible to the recipient, s*ee id*. at §306(b)(1)(i)(2)(D).

[67] The statute requires that the notice be written in such a manner as to be understood by the average plan participant, *See id*. at §306(b)(1)(i)(2)(A). The notice shall contain the following (i) the reason for the blackout period, (ii) the identification of the investments and other rights affected, (iii) the expected beginning date and length of the blackout period, (iv) a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period.

[68] *See* Sarbanes-Oxley, *supra* note 1, at §306(b)(1)(i)(1).

[69] *But* cf. *id*. at §306(b)(i)(7)(B) *stating* that the term "blackout" does not include a suspension, limitation, or restriction (i) which occurs by reason of the application of the securities laws, (ii) which is a change to the plan which provides for a regularly schedule suspension, limitation, or restriction which is disclosed to participants or beneficiaries through any summary of material modification, any materials describing specific investment alternatives under the plan, or any changes thereto, or (iii) which applies only to one or more individuals, each of whom is the participant, an alternate payee.

[70] *See* Sarbanes-Oxley, *supra* note 1, at §306(b)(1)(i)(2)(B).

[71] For purposes of this subsection, "blackout" means in connection with an *individual account plan*, any period the plan, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited or restricted, or such suspension, limitation, or restriction is for any period of more then 3 consecutive business days, *see id.* at §306(b)(i)(7)(A).

[72] *See* Sarbanes-Oxley, *supra* note 1, at §306(b)(i)(4) also *stating* that the extended blackout period notice shall meet the requirements of ¶(2)(D) and shall specify any material change in the matters referred to in clauses (i) through (v) of ¶(2)(A).

[73] *See supra* note 62 re definition of 'blackout period."

(1) suspension, (2) limitation, or (3) restriction of securities in *individual account plans*[74] when (a) dictated by the Securities and Exchange Commission (b) where the participants are advised of the restriction through summary notices, and (c) when it applies to one or more individuals, each of whom is the participant pursuant to a qualified domestic relations order.[75] However, the 30 days notice may be deferred due to events that are *unforeseeable* or *circumstances that are beyond the reasonable control* of the Plan Administrator, and a Fiduciary of the plan reasonably so determines in writing.[76] What events are unforeseeable, or are beyond the reasonable control of the Plan Administrator is not clear. Failure by the Plan Administrator to provide proper notice will cause the Secretary to assess a civil penalty of up to $100 a day from the date of the Plan Administrator's failure or refusal to provide notice to the participants and beneficiaries. Each violation with respect to any single participant or beneficiary shall be treated as a separate violation.[77]

The penalty for violation of this section of the Act is that the violator will forfeit any profit realized from any *purchase*, *sale*, or *other acquisition* or *transfer irrespective of any intention* on the part of the violator.[78] Furthermore, the violator may be sued in law or equity in any court of competent jurisdiction by the issuer or the owner of the security on behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of the request or the issuer fails diligently to prosecute the action. The statute of limitation for bringing a cause of action against the violators is two years after the date on which such profit was realized.[79] Final Rules for section 306 are to be promulgated by the Secretary of Labor by October 13, 2002.

F. RULES OF PROFESSIONAL RESPONSIBILITIES FOR ATTORNEYS

Section 307 of the Sarbanes-Oxley Act address issues with respect to professional responsibilities of attorneys appearing and practicing before the Commission in any way in the representation of issuers.[80] The Act directs the Securities and Exchange Commission to promulgate rules affecting this section. On November 6, 2002 the SEC proposed rules proscribing "minimum standard of professional conduct for attorneys."[81] The eighty-eight-page document delineates the rules "requiring an attorney to report evidence of a material violation of securities law or fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company."[82] The Commission also issued proposed rules to address the consequences for violating this section such that if the counsel or officer does not appropriately respond to the evidence, requiring the attorney to report the evidence to the

[74] *See* Sarbanes *supra* note 1, at §306(b)(i)(8) *stating* that the term does not include a one-participant retirement plan.
[75] *See id.* at §306(b)(i)(7)(A) and (B).
[76] *Id.* at §306(b)(1)(i)(2)(C)(ii).
[77] *Id.* at §306(b)(i)(8)(3).
[78] *Id.* at §306(a)(2)(A).
[79] *Id.* at §306(a)(2)(B).
[80] *Id.* at §307.
[81] *Id*.
[82] *Id.* at §307(1).

audit committee of the board of directors of the issuer, or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or the board of directors.[83] Because of the extensive material that is being generated by the Securities and Exchange Commission's proposed Rules, and the important issues raised by section 307 concerning attorney-client privilege communication, this section will be deferred to a subsequent law review article.

II. CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

A. CRIMINAL VIOLATIONS AND PENALTIES FOR ALTERING DOCUMENTS

Title VIII of the Sarbanes-Oxley Act is also known as the Corporate and Criminal Fraud Accountability Act of 2002.[84] It delineates the prohibitions of *destruction, alteration* or *falsification* of records as follows.

> Whosoever *knowingly* alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the *intent* to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States…in relation to or contemplation of any such matter… shall be fined under this title, imprisoned not more then 20 years, or both.[85] (Emphasis added.)

The element of *intent* is a prerequisite with respect to (1) *impeding, (2) obstructing* (3) *influencing an investigation, or (4) proper administration.* "While destruction of documents with intent to obstruct a federal investigation already was a criminal offense under existing law, that statute only applied to ongoing investigations, where as the new offenses also cover contemplated investigations."[86] Punishment for violation of this title includes a fine and/or imprisonment for not more then 20 years.[87]

Moreover, the President of the United States, through an executive order, has established within the Department of Justice a Corporate Fraud Task Force[88] to

---

[83] *See* Sarbanes-Oxley, *supra* note 1, at §307(2).

[84] *See id.* Corporate and Criminal Fraud Accountability Act of 2002, §1519.

[85] *See* Sarbanes-Oxley, *supra* note 1, at §802(a); *see also* 18 U.S.C. Part I, Chap. 73 §1519.

[86] See Robert J. Saville, Laurence S. Hirsh and Richard P. Swanson at Thelen Reid & Priest LLP, Attorney's at Law (Newsletter) August 22, 2002, at 1, (visited Feb. 21, 2002) <http://www.thelenreid.com/articles/article/art_138_idx.htm> [hereinafter Saville].

[87] *See* Sarbanes-Oxley, *supra* note 1, at §802(a); s*ee* also 18 U.S.C. Part I, Chap. 73 §1519.

[88] See Executive Order "Establishment of the Corporate Fraud Task Force," <http://www:whitehouse.gov. news/releasees/2002/07/print/20020709-2.html> *stating* that membership includes: (1) the Deputy Attorney General, who shall serve as Chair, (2) the Assistant Attorney General (Criminal Division), (3) the Assistant Attorney General (Tax Division), (4) the Director of the Federal Bureau of Investigation, (5) The United States Attorney for the Southern District of New York, (6) …for the Eastern District of New York, (7)…for the Northern District of Illinois, (8)…for the Eastern District of Pennsylvania, (9)….for the Central District of California, (10)…for the Northern District of California, (10)…for the Southern District of Texa s, and (11) others as the Attorney General deems appropriate.

"investigate and prosecute significant financial crimes, recover the proceeds of such crimes, and ensure just and effective punishment of those who perpetrate financial crimes."[89]

1. RECORD MAINTENANCE RESPONSIBILITIES

Title VIII also extends the period of time for which accountants must maintain audit records. They are required to maintain all audit or review work papers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.[90] Most accounting firms "already retain audit and review records for at least 5 years, so this provision may have minimal practical impact."[91] However, the implementation of the new SEC rules and regulations concerning document retention could lead to "accounting firms retaining more records than in the past out of precaution with respect to criminal prosecution, leading to substantial more records being available and subject to discovery by plaintiffs class action lawyers or criminal prosecutors."[92]

It is the Securities and Exchange Commission that has the responsibility of promulgating rules and regulations relating to the *retention* of relevant records. These records include work papers, documents that form the basis of an audit or review, memoranda, correspondence, communications, and records which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analysis, or financial data relating to such an audit or review.[93] The penalty for violating this section is a fine, imprisoned for not more than 10 years, or both.[94] Section 1101 of the Act goes further and states that whosoever *corruptly* alters, destroys, mutilates, or conceals a record, document, or other object, or *attempts* to do so, with the *intent* to impair the object's integrity or availability for use in an official proceeding[95] shall be fined or imprisoned not more than 20 years or both.[96] There are two methods by which a person could be brought within the boundaries of the statute. First, if the person acts in a *corruptive* manner; and second, if the person *attempts* to do so. In both cases, the prerequisite of *intent* is imperative.

2. STATUTES OF LIMITATION

The statutes of limitation for a private right of action[97] that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws[98] may be brought not later than the earlier[99] of 2 years after the discovery of the facts constituting the violation[100] or 5 years after such violation.[101]

---

[89] *See id.*
[90] *See* Sarbanes-Oxley, *supra* note 1, at §802(a); 18 U.S.C. Part 1, Chap. 73 §1520(a)(1).
[91] *See* Saville, supra note 77 at 1.
[92] *See id.*
[93] *See* Sarbanes-Oxley, *supra* note 1 at §802(a); *see also* 18 U.S.C. §1520(a)(2).
[94] *Id*. at §802(a); *see also* 18 U.S.C.1520 (b).
[95] *Id.* at §1102; *see also* 18 USC §1512(c)(1)
[96] *Id*. at §1102; *see also* 18 USC §1512 (c)(2).
[97] *Id*. at §804(c)
[98] *See* Securities Exchange Act of 1934, §3(a)(47) 15 U.S.C.§78c(a)(47).

B. WHISTLEBLOWER PROTECTION

Section 806 of the Sarbanes-Oxley Act[102] "significantly impacts the workplace and the manner in which employers deal with their employees who help expose any wrongdoing by public companies."[103] It provides whistle-blower protection for employees of publicly traded companies against retaliation. It states that:

> No company with a class of securities regulations[104] or one that is required to file reports under section 15(d) of the Securities Exchange Act of 1934[105] or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the term and conditions of employment because of *any lawful act* done by the employee.[106]

The *lawful act* may include providing information, causing information to be provided, or otherwise assisting in an investigation regarding any conduct that the employee reasonably believes constitutes a violation of the Securities and Exchange Act, or any provision of Federal law relating to fraud against shareholders.[107] The whistle-blower is protected under the statute when the information or assistance is provided to or an investigation is conducted by (1) a Federal regulatory or (2) law enforcement agency;[108] (3) by any member or committee of Congress;[109] or (4) a person with supervisor autho rity over the employee.[110] Section 1107 of the Act provides for criminal penalties of up to ten years in prison and a fine for retaliation against informants.[111] The *lawful act* may also include filing, causing to be filed, testifying, participating in, or otherwise assisting in a proceeding filed or about to be filed with respect to Securities violations or any provision of Federal law relating to fraud against shareholders.[112]

---

[99] *See* Sarbanes, s*upra* note 1 at §804(b)
[100] *Id*. at §804(b)(1).
[101] *Id.* at §804(b)(2).
[102] See Sarbanes, *supra* note 1 at §806 Protection for Employees of Publicly Traded Companies who provide evidence of Fraud; see also 18 U.S.C.§ 1514A.
[103] See Charles H. Kaplan, at Thelen Reid & Priest LLP, *The Sarbanes-Oxley Act of 2002--Employment Law Aspects---Whistleblower and Securities Analyst Protection* (Newsletter), p.1, http://www. thelenreid.com/articles/article/art_165.htm [hereinafter Kaplan].
[104] *See* Securities Exchange Act of 1934, 15 U.S.C 78L §12. *See also* Sarbanes-Oxley, note 1 at §806(a), *citing* 18 U.S.C. §1514A.
[105] 15 U.S.C. Chap. 2B, §78o (d).
[106] *See* Sarbanes-Oxley, supra note 1, at §806(a), *citing* 18 U.S.C. §1514A(a).
[107] *See id. at* §806(a), *citing* 18 U.S.C. §1514A(a)(1).
[108] *See id. at* §806(a), *citing* 18 U.S.C. §1514A(a)(1)(A).
[109] *Id. at* §806(a), *citing* 18 U.S.C. §1514A(a)(1)(B).
[110] *Id.* at §806(a), *citing* 18 U.S.C. §1514A(a)(1)(C) including other persons working for the employer who has the authority to investigate, discover, or terminate misconduct.
[111] 18 U.S.C. § 1513(e).
[112] *See* Sarbanes-Oxley, supra not 1 at §806(a), *citing* 18 U.S.C. §1514A(a)(2).

A whistle-blower that alleges discharge or other discrimination by any person in violation of this statute[113] is entitled to all relief necessary to make the employee whole.[114] For example, section 806 creates a right of civil action in federal court that protects whistle-blowers against retaliation in securities fraud cases.[115] The Whistle-blower may also seek relief by filing a complaint not later than 90 days after the date on which the violations occurs,[116] with the Secretary of Labor.[117] "The filing empowers the Secretary to investigate and conduct a hearing regarding complaints of retaliation, as well as to issue a final decision providing the Whistle-blower-employee with an appropriate remedy or denying the complaint."[118] If the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, the Whistle-blower may bring an action at law or equity for de novo review in the district court of the United States, and that court, under this statute, will have jurisdiction without regard to the amount in controversy.[119]

Charles H. Kaplan[120] has an interesting analysis of the 90 and 180 days rules.

> The interplay between Section 806's 90-day statue of limitation period and the 180-day period in which the Secretary has to file a final decision causes ambiguity concerning precisely when a claimant must file an action in federal court. Read literally, the statute of limitations in Section 806 prevents a claimant from filing such an action anytime after 90 days following an employer's alleged violation of the Act. However, the claimant is precluded from filing an action in federal court until either the Secretary issues a final order or the 180-day period after the date the claimant files a complaint with the Secretary expires, whichever occurs first. In most cases, it will be highly unlikely that a claimant will file a complaint with the Secretary and will receive the Secretary's final decision with 90 days after the occurrence giving rise to the claim under Section 806. Thus, most claimants will not be able to satisfy the 90-day limitations period, as strictly applied.[121]

Compensatory damages for Whistle-blowers will include reinstatement with the same seniority status that the employee would have had, but for the discrimination;[122] the amount of back pay, with interest;[123] and compensation for any special damages

[113] *See id. at* §806(a), *citing* 18 U.S.C. §1514A(b)(1).
[114] *Id*. at §806(a), *citing* 18 U.S.C. §1514A(c)(1).
[115] 18 U.S.C. §1514A.
[116] *See Sarbanes, supra* note 1, at §806(a), *citing* 18 U.S.C. §1514A(b)(1)(D)
[117] *Id*. at §806(a), *citing* 18 U.S.C.§1514A(b)(1)(A); the filing and handling of the complaint is governed by 49 U.S.C. § 42121(b).
[118] *See* Kaplan, *supra* note 103, at 2 *stating* that if the Secretary does not issue a final decision within 180 days of the filing of the complaint, the employee has the right to file a private civil action in federal court.
[119] 18 U.S.C. §1514A(b)(1)(B).
[120] *See* Kaplan, *supra* note 103, at 2.
[121] *Id.*
[122] *See* Sarbanes, *supra* note 1, at §806(a), *citing* 18 U.S.C. §1514A(c)(2)(A).
[123] *Id.* at §806(a), *citing* 18 U.S.C. §1514A(c)(2)(B).

sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.[124] The whistle-blower will retain all of his/her rights, privileges or remedies under any Federal or State law or under any collective bargaining agreement.[125]

B. SECURITIES FRAUD

Section 807 of the Sarbanes-Oxley Act amends the securities fraud[126] section of the Securities Exchange Act of 1934.[127] The new Statute states that whoever *knowingly* executes, or *attempts* to execute, a (1) scheme or artifice[128] to defraud any person in connection with any security of an issuer with a class or securities registered under the securities Exchange Act of 1934[129] or (2) is required to file a report[130] shall be fined or imprisoned not more then 25 years, or both. However, the original statute, section 1341, allows a fine of not more than $1,000,000 or imprisoned not more than 30 years, or both for securities fraud.[131] The new statute seems to have scaled back the number of years of imprisonment from 30 to 25. The same penalties are applicable if one *knowingly* executes, or attempts to execute, (1) a scheme or artifice[132] to obtain, by means of false or fraudulent pretenses representation, or promises, any money or property in connection with the purchase or (2) sale of any security of an issuer.[133]

III. WHITE COLLAR CRIME PENALTY ENHANCEMENTS

Section 902 of the Sarbanes-Oxley Act[134] makes the offense of *attempt* and *conspiracy* by persons under this Act subject to the same penalties as those prescribed for attempts and conspiracy[135] crimes. In addition, Section 903 of the Sarbanes-Oxley Act modifies a former Mail[136] and Wire[137] fraud statute by increasing the imprisonment period from five years to twenty. However, the Mail Fraud statute was modified in 1990 to increase the number of years for *mail* fraud from twenty to thirty years imprisonment.[138] Similarly, the Wire Fraud statute was also modified in 1990 to increase the number of years for *wire* fraud from twenty to thirty years.[139] Does this mean that the

---

[124] *See id* at §806(a), *citing* 18 U.S.C. §1514A(c)(2)(C).
[125] *See id.* at §806(a), *citing* 18 U.S.C. §1514A(d) Rights Retained by Employee.
[126] *See* Sarbanes-Oxley, supra note 1, at §807, *citing* 18 U.S.C. §1348.
[127] 18 U.S.C. §1348 Securities Fraud.
[128] *Id.* at §807, *citing* 18 U.S.C. §1348.
[129] 15 U.S.C. §12.
[130] 15 U.S.C. §15(d).
[131] 18 U.S.C. §1341, Frauds and Swindles.
[132] *See S*arbanes, *supra* note 1 at §807, *citing* 18 U.S.C. §1348.
[133] *Id.* at §807, *citing* 18 U.S.C. §1348(2).
[134] See *id*. at §902 *amending* 18 U.S.C. §1349.
[135] See 18 U.S.C. § 371 (2001).
[136] See 18 U.S.C. §1341 (2002).
[137] See 18 U.S.C. §1343 (2002). Fraud by wire, radio, or television.
[138] See Fraud by Wire, Radio or Television, 18 U.S.C. 1343. See also. Pub. L. 101-647 (1990).
[139] See Mail Fraud, Pub.L.101-647 (1990).

Sarbanes-Oxley Act rolls back the penalty for mail and wire fraud from 30 to 20 years imprisonment?[140] Apparently this section does nothing to increase the penalty.

Section 904 addresses the issue of penalties with respect to violations of the Employee Retirement Income Security Act of 1974.[141] The Sarbanes-Oxley Act amends the Employee Retirement Act by increasing the penalty for persons violating the statute by 20 times to an amount from $5,000 to $100,000.[142] It also increases the time of imprisonment 10 times from one year to 10 years.[143] If the violation is by a person not an individual, i.e. a corporation, the fine is increased from $100,000 to $500,000.[144]

CONCLUSION

The Sarbanes-Oxley Act of 2002 is one of the most comprehensive pieces of legislation concerning the record keeping, legal and accounting profession in three-quarters of a century. It emerges out of the ashes of corporate misconduct and attempts to create a transparent corporate and legal infrastructure to assist those companies achieve their objectives in an ethical and responsible manner. The Act is extensive and covers eleven separate Titles of which only four are addressed in this article. As mentioned above, notwithstanding the broad scale of issues addressed in the Act, there still exist loopholes that need to be addressed by the Securities and Exchange Commission by promulgating appropriate Rules. The relationship between the mandated audit committee and the board of directors is still troublesome where the same party is a member of both. The problem is exacerbated with respect to the potential conflict of interest that arises where an audit committee member is prohibited from accepting consulting and advisory compensation, and the same person, who is also a board of directors, is not. Notwithstanding potential shortcomings, the Act is a step in the right direction in beginning to address some of the critical issues exposed by Enron.

---

[140] See Sarbanes-Oxley, supra note 1 at §903 *amending* 18 U.S.C. 1341 and §1343 (2002).
[141] 29 U.S.C. §1131.
[142] See Sarbanes-Oxley, supra note 1 at §904(1).
[143] Id. at §904(2).
[144] Id. at §904(3).