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Sarbanes-Oxley and Beyond

Association of Commercial Finance Attorneys

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Topics to be Covered

- Enhanced Civil Enforcement
- Code of Ethics
- New Crimes
- Additional Penalties
- Changed Approach
- Whistleblower Protections
- Obligations of Attorneys
- Other Trends
- Corporate Compliance

Enhanced Civil Enforcement

- SEC enforcement, injunctive powers and equitable relief
- civil penalties
- forfeiture of profits/bonuses
- temporary freeze authority
- other provisions

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SEC Enforcement, Injunctive Powers and Equitable Relief

- enhanced review of financial reports by SEC: at least every 3 years and criteria for schedule (e.g. when re-stated, volatile stock price)
- more staff and resources
- SEC can seek equitable relief
- SEC seek officer/director bar: Act eliminates "substantially," from "unfitness"
- real time enforcement
- parallel civil/criminal proceedings

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Civil Penalties

- SEC civil penalties added to Disgorgement Fund for victims
- 5 year study on civil penalties/restitution
- improper influence on conduct of audit

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Forfeiture of Profits/Bonuses

- If required to prepare financial restatement as a result of misconduct: CEO/CFO forfeit incentive pay and trading profits
- Huron Report: restatements up 80%
 - revenue recognition
 - large companies

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Temporary Freeze Authority

- SEC can petition federal court for 45 day freeze re: extraordinary payments to directors, officers, agents, or employees
- can be extended

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Other

- Expand S/L for civil securities fraud: from 1 to now 2 years, after discovery; from 3 to now 5 years, after violation
- settlement or order not dischargeable in Bankruptcy

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Code of Ethics

- adoption by public companies
- change/waiver disclosed immediately
- conflict of interest rules/disclosures

Adoption by Public Companies

- disclose to SEC whether code of ethics for senior financial officers adopted; if not, why not
- handling of actual or apparent conflicts
- disclosure in periodic reports
- compliance with government rules and regulations

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Change/Waiver Disclosed Immediately

- prompt disclosure in Form 8-K if any change in or waiver of code of ethics

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Conflict of Interest Rules/Disclosures: Substantive Changes

- prohibited loans
- auditor conflict rules
- disclosures:
 - off balance sheet transactions
 - audit committee financial expertise
- acceleration for reporting deadlines from directors and officers to as short as two days
- real time disclosures for material changes

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New Crimes

- willful failure to retain audit records
- destruction or altering of documents in federal investigation
- securities fraud
- attempts/conspiracy
- certification of financial reports

Willful and Knowing Failure to Retain Audit Records (for 5 Years)

- § 802, codified at 18 U.S.C. § 1520
- directed to accountants
- SEC rules
- up to 10 years in prison

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Destroys, Alters, Mutilates, or Conceals Documents With Intent to Impede, Obstruct or Influence Federal Investigation or Any Matter Within Jurisdiction of Federal Agency or Chapter 11 or in Relation to or Contemplation...

- § 802, codified at 18 U.S.C. § 1519
- includes falsification
- up to 20 years in prison
- applies to shredder or one who alters
- need to show intent to impede
- also, change in Obstruction of Justice law, § 1102, codified at 18 U.S.C. § 1512(c)

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Securities Fraud

- §807, codified at 18 U.S.C. § 1348
- felony to defraud shareholders of publicly traded companies
- augments mail/wire fraud
- don't need to show use of mail/wire
- now up to 25 years in prison

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Attempts/Conspiracy

- same penalties if attempt/conspiracy had been successful

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Certification of Financial Reports

- § 906, codified at 18 U.S.C. §1350
- CEOs and CFOs to certify that financial statements comply with 1934 Act and “fairly represents, in all material respects, the financial condition and results of operations....”
- \$1M/10 years: knowingly violate
- \$5M/20 years: willfully violate

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Additional Penalties

- violations of ERISA
- mail and wire fraud
- securities law violations
- Federal Sentencing Guidelines

Additional Penalties

- violations of ERISA
 - from 1 year to 10 years
- mail and wire fraud
 - from 5 years to 20 years
- securities law violations (1934 Act)
 - from 10 years to 20 years

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Federal Sentencing Guidelines

- Sentencing Commission directed to revise guidelines within 180 days of Act -- to ensure penalties are sufficient to deter and punish
- Commission acted on January 8, effective January 25 until replaced by permanent measure November 1, 2003

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Federal Sentencing Guidelines, cont.

- **enhancements when**
 - fraud with more than 250 victims
 - offense substantially endangered solvency or financial security of 100 or more victims or of organization with more than 1000 employees or publicly traded
 - for officers or directors of publicly traded corporations who violate securities law
 - loss greater than \$200 million and \$400 million and "loss" may take into account reduction in value of equity securities or other corporate assets

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Changed Approach

- more SEC enforcement
- greater reliance on criminal process
- use of investigative techniques
- impact of new federal crimes
- impact of increased penalties
- revised memo on Principles of Federal Prosecution of Business Organizations

More SEC Enforcement

- individuals/companies subject to criminal indictments, up 259%
- officer and director bars sought, up 147%

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Greater Reliance on Criminal Process

- impact of new federal crimes
- increased penalties

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Use of Investigative Techniques

- like organized crime/drug cases
 - informants
 - wired conversations
 - searches
 - arrests

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Principles of Federal Prosecution of Business Organizations

- revised 1/20/03
- guide federal prosecutors
- increased emphasis on and scrutiny of "authenticity" of corporation's cooperation
- corporate governance mechanisms
- waiver of attorney-client privilege

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Whistleblower Protection

- new civil action for employees of public companies
 - retaliation (discharge or other adverse action) if provide information or assist in government investigation involving federal securities law
 - back pay
 - reinstatement
 - other special damages
- criminal penalties
 - informants: 10 years - Penalty
 - providing information relating to federal offense

Obligation of Attorneys

- Section 307
- SEC rule
- ends deference (for most part) by SEC to States in regulating attorneys
- report evidence of material violation of securities law, breach of fiduciary duty or similar violation
 - to chief counsel or CEO
 - if not appropriate response, to audit committee or other outside board committee
 - or “qualified legal compliance committee”
- applies to: (1) “attorneys” who (2) “appear and practice before the Commission” (3) “in the representation of” (4) an “issuer”
- “noisy withdrawal”

Other Trends

- corporate governance standards:
 - Board performance and competence
 - greater and more rapid transparency
 - role of outside directors
 - audit committee
 - compensation committee
 - compliance plan
- D & O insurance
- shareholder/investor focus on corporate governance
- private shareholder litigation
 - Delaware Supreme Court
 - recent cases for shareholders
 - “new set of expectations for directors...that is changing how the courts look at these issues...” (Veasey, C.J.)

Corporate Compliance

- costs for non-compliance high, and not just money
- compliance program, and not just employees
- internal investigations
- overall plan

Costs for Non-Compliance High, and Not Just Money

- stock prices
- reputation
- even recruiting

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Compliance Program, and Not Just Employees

- now for financial officers
- board

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Internal Investigations

- need to investigate
- whistleblowers
- outside counsel

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Overall Plan

- co-ordinate parts
- compliance
 - what are incentives
 - training
- prepare for investigation
- public relations