

# Report for Congress

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## **Securities Law: Sarbanes-Oxley Act of 2002 and Selected 108<sup>th</sup> Congress Bills Concerning Corporate Accountability**

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# Sarbanes-Oxley Act of 2002 and Selected 108<sup>th</sup> Congress Bills concerning Corporate Accountability

## Summary

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, P.L. 107-204. This law has been described by some as the most important and far-reaching securities legislation since passage of the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.*, and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*, both of which were passed in the wake of the Stock Market Crash of 1929.

The Act establishes a new Public Company Accounting Oversight Board which is to be supervised by the Securities and Exchange Commission. The Act restricts accounting firms from performing a number of other services for the companies which they audit. The Act also requires new disclosures for public companies and the officers and directors of those companies. Among the other issues affected by the new legislation are securities fraud, criminal and civil penalties for violating the securities laws and other laws, blackouts for insider trades of pension fund shares, and protections for corporate whistleblowers.

The 108<sup>th</sup> Congress is also concerned with corporate responsibility, and several bills affecting such issues as SEC staffing, financial report certification, and corporate expatriation have been introduced. These include H.R. 275, H.R. 657, H.R. 658, H.R. 746, H.R. 1000, S. 183, S. 476, and S. 513.

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# Securities Law: Sarbanes-Oxley Act of 2002 and Selected 108<sup>th</sup> Congress Bills concerning Corporate Accountability

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, P.L. 107-204. This law has been described by some as the most important and far-reaching securities legislation since passage of the Securities Act of 1933<sup>1</sup> and the Securities Exchange Act of 1934,<sup>2</sup> both of which were passed in the wake of the Stock Market Crash of 1929.

Sarbanes-Oxley had its genesis early in 2002 after the declared bankruptcy of the Enron Corporation, but for some time it appeared as though its impetus had slowed. However, when the WorldCom scandal became known in late June, the Congress showed renewed interest in enacting stiffer corporate responsibility legislation, and Sarbanes-Oxley quickly became law.

The Act establishes a new Public Company Accounting Oversight Board, which is to be supervised by the Securities and Exchange Commission (SEC or Commission). The Act restricts accounting firms from performing a number of other services for the companies which they audit. The Act also requires new disclosures for public companies and the officers and directors of those companies. Among the other issues affected by the new legislation are securities fraud, criminal and civil penalties for violating the securities laws and other laws, blackouts for insider trades of pension fund shares, and protections for corporate whistleblowers. This report summarizes major provisions of this Act. Because the 108<sup>th</sup> Congress is also concerned with corporate responsibility, the report also mentions selected 108<sup>th</sup> Congress bills which would add to the requirements mandated by Sarbanes-Oxley.

## **Title I: Public Company Accounting Oversight Board**

*Section 101* establishes the Public Company Accounting Oversight Board (Board), a new, independent regulatory body, to oversee the auditing of issuers (public companies which are subject to the federal securities laws). The Board's oversight of auditors is for the purpose of protecting the interests of investors.

The Board shall not be an agency or establishment of the United States Government and shall be a nonprofit corporation subject to the District of Columbia

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<sup>1</sup> 15 U.S.C. §§ 77a *et seq.*

<sup>2</sup> 15 U.S.C. §§ 78a *et seq.*

Nonprofit Corporation Act. No employee shall be deemed an officer, employee, or agent of the federal government.

The Board is subject to the oversight of the Securities and Exchange Commission, and subject to this oversight the Board shall register public accounting firms which prepare audit reports for issuers subject to SEC registration, establish standards concerning the preparation of audit reports, conduct inspections of registered public accounting firms, conduct investigations and disciplinary proceedings where justified upon registered public accounting firms, perform other duties as determined by the SEC, enforce compliance with the Act, and set the budget and manage the operations of the Board and its staff.

The Board shall have five members, who shall be prominent individuals of integrity with a demonstrated commitment to the interests of investors and the public. They must understand the financial disclosures required of issuers under the securities laws and the obligations of accountants concerning the preparation and issuing of audit reports concerning these disclosures.

Only two members of the Board shall be or have been certified public accountants. If one of those persons is the chairperson, that person may not have been a practicing certified public accountant for at least five years before appointment to the Board. Each Board member must serve on a full-time basis and may not have other employment while serving on the Board. No Board member can share in the profits of or receive payments from a public accounting firm, except for fixed continuing payments under standard retirement arrangements, subject to conditions imposed by the SEC.

Not later than ninety days after the Act's enactment, the SEC, after consulting with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson of the Board and other initial members and shall designate each person's term of service.

The term of service of each Board member is five years, except that the terms of office of the initial Board members shall expire in annual increments. Any Board member appointed to fill a vacancy occurring before the expiration of the term of the predecessor shall be appointed only for the remainder of that term.

No person may be a member or chairperson of the Board for more than two terms, whether or not consecutive. A member of the Board may be removed by the SEC for good cause.

The Board may issue rules concerning its operation and administration and other matters, subject to the approval of the SEC.

The Board must submit an annual report to the SEC; the SEC shall transmit a copy of that report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services.

*Section 102* requires that, beginning 180 days after the Commission determines that the Board can fulfill its duties, it shall be unlawful for any person not a registered

public accounting firm to prepare or issue or participate in the preparation or issuing of any audit report concerning any issuer.

Each accounting firm must submit as part of its application for registration the names of all issuers for which it prepared or issued audit reports during the preceding calendar year; the annual fees received from each issuer for audit services, other accounting services, and non-audit services; other current financial information as requested by the Board; a statement of the firm's quality control practices; a list of all accountants associated with the firm who help to prepare audit reports; information concerning civil, criminal, or administrative actions or disciplinary proceedings pending against the firm or any person associated with the firm in connection with any audit report; copies of any disclosures filed by an issuer with the Commission concerning accounting disagreements; and any other specified information.

The Board shall approve a completed application for registration not later than 45 days after the date of receipt unless the Board issues a notice of disapproval or requests more information. Each registered public accounting firm shall submit an annual report to the Board and may be required to update reports more frequently. Registration applications and annual reports shall be made available for public inspection.

The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm to cover the costs of processing and reviewing.

*Section 103* requires the Board to establish by rule such quality control standards to be used by registered public accounting firms in the preparation and issuing of audit reports, as required by the Act or the rules of the Commission or as necessary or appropriate in the public interest or for the protection of investors. The Board may consult with professional groups of accountants or advisory groups.

The Board's rules shall require that each registered public accounting firm must keep work papers for at least seven years, provide a concurring or second partner review of the audit report, and describe in each audit report the internal control structure and procedures of the issuer.

The Board shall cooperate with professional groups of accountants and advisory groups in the examination of the need for changes in accounting standards.

*Section 104* requires the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm. Inspections shall be conducted annually for each registered public accounting firm providing audit reports for more than 100 issuers and at least once every three years for each firm providing audit reports for 100 or fewer issuers.

*Section 105* requires the Board to issue rules concerning fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of the firms. The Board may conduct an investigation of any act or practice by a registered public accounting firm which may be a violation of the Act, the

Board's rules, or the securities laws concerning preparation and issuing of audit reports and liabilities of accountants.

If a registered public accounting firm or person associated with the firm refuses to cooperate with the investigation, the Board may impose such sanctions as suspending or revoking the registration of the public accounting firm.

The Board may refer an investigation to the Commission, any other federal functional regulator, the Attorney General of the United States, the attorney general of one or more states, and the appropriate state regulatory authority.

For the most part information received by the Board concerning an investigation shall be privileged and confidential in any proceeding in federal court, state court, or administrative agency until presented in connection with a public proceeding.

If the Board finds that a registered public accounting firm has violated the Act, the rules of the Board, or the securities laws concerning audit reports and accountants, it may impose appropriate sanctions, including temporary suspension or permanent revocation of registration; a civil penalty for each violation in an amount not more than \$100,000 for a natural person or \$2,000,000 for any other person; if in a case involving intentional or other knowing conduct, a fine not more than \$750,000 for a natural person or \$15,000,000 for any other person; censure; or any other appropriate sanction. Such sanctions as registration suspension and revocation and the larger monetary penalties shall apply only to intentional or knowing conduct, including reckless conduct, or in repeated instances of negligent conduct.

*Section 106* states that any foreign accounting firm which prepares or furnishes an audit report concerning any issuer is subject to the Act and the rules of the Board and the SEC issued under the Act to the same extent as a United States public accounting firm. Audit workpapers of the foreign accounting firm shall be produced if a United States public accounting firm relies upon the opinion of a foreign accounting firm in auditing an issuer.

The Commission and the Board may exempt any foreign public accounting firm from any provision of the Act or from rules of the Board or the Commission in the public interest or for the protection of investors.

*Section 107* provides that the Commission shall have oversight and enforcement authority over the Board. No rule of the Board shall become effective without prior approval by the Commission. The Board is to be treated as a registered securities association for purposes of approval of its rules by the Commission. The Commission may modify a sanction imposed by the Board upon a registered public accounting firm if it finds that the sanction is not necessary or appropriate or is excessive, oppressive, or inadequate.

*Section 108* allows the Commission to recognize as "generally accepted" for purposes of the securities laws any accounting principles established by a standard setting body that is a private entity, has a board of trustees the majority of whom are not and have not been for two years associated with a registered public accounting

firm, is funded as required, has adopted procedures to ensure prompt changes to accounting principles necessary to reflect changing business practices, and considers the need to keep standards current. This standard setting body must have the capacity to assist the Commission. The standard setting body must submit an annual report to the Commission and the public.

The SEC shall conduct a study on adoption by the United States financial reporting system of a principles-based accounting system to replace the rules-based accounting system.

*Section 109* concerns funding of the Board and the standard setting body, known as the Financial Accounting Standards Board. The Board and the standard setting body shall establish an annual budget, which is subject to approval by the SEC.

The budget of the Board shall be payable from annual accounting support fees assessed upon publicly traded companies.

## **Title II: Auditor Independence**

*Section 201* prohibits a registered public accounting firm which performs an audit for any issuer to provide to that issuer any non-audit service, such as bookkeeping, financial information systems design, actuarial services, management functions, investment banking service, and legal services. Accounting firms may provide certain other non-audit services, including tax services, for an audit client if the activity is approved by the audit committee of the issuer.

*Section 202* requires that all auditing services and non-audit services provided to an issuer by the auditor of the issuer be preapproved by the audit committee of the issuer (or, if no such committee exists, the entire board of directors of the issuer). Approval by an audit committee of a non-audit service to be approved by the auditor shall be disclosed to investors in periodic reports.

*Section 203* prohibits a registered public accounting firm from providing audit services to an issuer if the lead audit partner has performed audit services for the issuer in each of the five previous fiscal years.

*Section 204* requires each registered public accounting firm performing an audit for an issuer to report to the audit committee all critical accounting policies and practices, all alternative treatments of financial information, and other material written communications.

*Section 206* makes it unlawful for a registered public accounting firm to perform any audit service if a chief executive officer, controller, chief financial officer, or chief accounting officer was employed by that independent registered public accounting firm and participated in any capacity in the audit of that issuer during the one year period preceding the date of the initiation of the audit.



### **Title III: Corporate Responsibility**

*Section 301* requires each member of the audit committee of the issuer to be a member of the board of directors of the issuer and to be independent otherwise. In order to be considered independent, a member of an audit committee may not accept any consulting, advisory or other compensatory fee from the issuer or be an affiliated person of the issuer or any subsidiary.

Each audit committee must establish procedures for the treatment of complaints concerning accounting or auditing matters and anonymous submissions by employees of the issuer concerning questionable accounting or auditing matters.

*Section 302* directs the Commission to issue a rule requiring for each company filing periodic reports under the Securities Exchange Act of 1934 that the principal executive officer and the principal financial officer certify in each annual or quarterly report that the signing officer has reviewed the report and that, based on the officer's knowledge, the report does not contain untrue statements and does not omit statements resulting in a misleading report and that the financial statements fairly represent the financial condition of the company. The signing officers are responsible for establishing and maintaining internal controls. The signing officers must disclose to the issuer's auditors and to the audit committee significant deficiencies in the internal controls and any fraud which involves management or employees who have a significant role in the issuer's internal controls.

The requirements of this provision shall not be diminished if an issuer reincorporates or transfers domicile or offices from inside the United States to a foreign country.

*Section 303* declares unlawful any officer's or director's taking any action fraudulently to influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in auditing financial statements for the purpose of making those financial statements materially misleading.

*Section 304* provides that, if an issuer is required to prepare an accounting restatement because of material noncompliance of the issuer as a result of misconduct, the chief executive officer and the chief financial officer shall reimburse the issuer for any bonus received during the previous twelve month period and any profits from the sale of securities of the issuer during that twelve month period.

*Section 305* gives the SEC the authority to bar a person from serving as an officer or director if that person committed a securities law violation and his conduct demonstrated unfitness to serve as an officer or director.

The Commission may also seek in federal court any equitable relief appropriate or necessary for the benefit of investors.

*Section 306* prohibits directors or executive officers from engaging in transactions involving any equity security of the issuer during any blackout period if

the director or officer acquires the equity security in connection with service or employment as a director or officer. A “blackout period” is defined as any period of more than three consecutive business days during which the ability of not fewer than 50% of the participants or beneficiaries under all individual retirement account plans maintained by the issuer to purchase or sell any equity of the issuer held in an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan.

This section also requires that participants in retirement plans be provided with written notice at least 30 days before a blackout period. There are two exceptions to the 30 day notice: 1. the deferral of the blackout period would violate ERISA provisions requiring fiduciaries to act exclusively on behalf of participants and ERISA provisions requiring trustees to act prudently in their decisions concerning plan assets could not be complied with or 2. the inability to provide notice is because of unforeseeable events or circumstances beyond the reasonable control of the plan administrator.

The Secretary of Labor may assess a civil penalty against a plan administrator of up to \$100 a day from the date of the plan administrator’s failure or refusal to provide notice to participants and beneficiaries.

*Section 307* requires the Commission to issue rules in the public interest and for the protection of investors to set forth minimum standards of professional conduct for attorneys who practice before the Commission in representing issuers. The rules must require an attorney to report evidence of a material violation of securities law or breach of fiduciary duty by the company or its agent to the chief legal counsel or to the chief executive officer of the company. If the counsel or officer does not respond to the evidence, the attorney must report the evidence to the audit committee or to the board of directors.

*Section 308* allows civil penalties levied by the Commission as a result of any judicial or administrative action to be placed into a disgorgement fund for the benefit of harmed investors. The SEC may also accept gifts and bequests for this fund.

## **Title IV: Enhanced Financial Disclosures**

*Section 401* requires each financial report filed as part of periodic disclosures by an issuer to reflect all material correcting adjustments identified by a registered public accounting firm.

The Commission is required to issue rules providing that annual and quarterly financial reports filed with the Commission shall disclose all material off-balance sheet transactions that may have a material current or future effect on financial condition, changes in financial condition, or significant components of revenues or expenses.

The Commission must also issue rules providing that pro forma financial information included in any report filed with the SEC shall not contain an untrue

statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information not misleading.

The SEC is required to conduct a thorough study of special purpose entities, including the potential exposure faced by investors.

*Section 402* prohibits personal loans of any kind by an issuer to a director or executive officer of the issuer.

*Section 403* requires insiders, defined as officers, directors, and 10% shareholders, to file with the SEC reports of their trades of the issuer's stock before the end of the second business day on which the trade occurred or at such other time if the SEC determines that the two-day period is not feasible. Beginning within one year after passage of this Act, the filing shall be done electronically and the information shall be provided on an Internet site within one day after filing.

*Section 404* requires the Commission to prescribe rules requiring each annual report to contain an internal control report which shall state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting and an assessment of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

*Section 405* exempts registered investment companies from certain disclosure requirements, such as filing a statement assessing the effectiveness of internal controls.

*Section 406* requires the SEC to issue rules to require each issuer to disclose whether or not, and, if not, the reason why, it has adopted a code of ethics for senior financial officers, such as the principal financial officer, comptroller, or principal accounting officer.

*Section 407* requires the Commission to issue rules to require each issuer to disclose whether or not, and, if not, the reason why, the audit committee of that issuer has at least one member who is a financial expert. A "financial expert" is a person who: 1. has an understanding of generally accepted accounting principles and financial statements; 2. experience in the preparation or auditing of financial statements of generally comparable issuers; 3. experience in the application of these principles in connection with the accounting for estimates, accruals, and reserves; 4. experience with internal accounting controls; and 5. an understanding of audit committee functions.

*Section 408* requires the Commission to review disclosures by issuers at least once every three years.

*Section 409* requires each issuer to disclose in plain English to the public on a rapid and current basis additional information concerning material changes in the financial condition and operations of the issuer.

## **Title V: Analyst Conflicts of Interest**

*Section 501* requires the Commission or a registered securities association or national securities exchange within one year to adopt rules designed to address conflicts of interest facing securities analysts. These rules must restrict the pre-publication clearance of research or recommendations by investment bankers not directly responsible for investment research, limit the supervision and compensatory evaluation of research personnel to officials not engaged in investment activities, and protect securities analysts from retaliation or threats of retaliation by investment banking staff because of unfavorable research reports.

The rules must also require a stock analyst to disclose the extent to which he owns stock being discussed, whether he or his employer has received any income from the company whose stock is being discussed, whether his employer has had any business dealings within the past year with the company, and whether the analyst's compensation was tied to investment banking revenue.

## **Title VI: Commission Resources and Authority**

*Section 601* authorizes the appropriations of the SEC for fiscal year 2003. It shall receive \$776,000,000, of which \$102,700,000 shall be available to fund additional compensation, including salaries and benefits; \$108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the attacks on September 11, 2001; and \$98,000,000 shall be available to add at least 200 qualified professionals to provide enhanced oversight of auditors and audit services and support staff to strengthen full disclosure.

*Section 602* authorizes the Commission to censure any person or deny to any person the privilege of appearing or practicing before the Commission if the Commission finds that person not to possess the 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 or abetted the violation of the securities laws or regulations.

*Section 603* allows a court to prohibit a person from participating in an offering of penny stock.

*Section 604* authorizes the SEC to bar from the securities industry persons who have been suspended or barred by a state securities, banking, or insurance regulator because of fraudulent, manipulative, or deceptive conduct.

## **Title VII: Studies and Reports**

This title requires that a number of studies and reports be conducted. For example, the Comptroller General is required to conduct a study concerning factors leading to the consolidation of public accounting firms. The Commission is required to conduct a study concerning the role and function of credit rating agencies in the operation of the securities market. The Commission is also required to conduct a study of securities professionals who have aided and abetted violations of the federal

securities laws. The Commission must review and analyze its enforcement actions concerning violations of securities law reporting requirements and restatements of financial statements over the past five years. The General Accounting Office is required to conduct a study on the role of investment banks and financial advisers in assisting public companies in manipulating their earnings and obscuring their true financial condition. GAO is specifically directed to address the role of investment banks in the bankruptcy of Enron and the failure of Global Crossing.

## **Title VIII: Corporate and Criminal Fraud Accountability**

*Section 801* indicates that Title VIII of the bill may be cited as the “Corporate and Criminal Fraud Accountability Act of 2002.”

*Section 802* creates two new federal crimes. 18 U.S.C. § 1519 imposes criminal sanctions for destruction, alteration, or falsification of records in federal investigations and bankruptcy. Under this section, anyone who “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 department or agency of the United States or any case filed under title 11 [of the United States Code, dealing with bankruptcy], or in relation to or in contemplation of any such matter or case” would be subject, upon conviction, to imprisonment of up to 20 years, a fine under title 18 of the United States Code, or both. Under 18 U.S.C. § 3571, individuals convicted of a felony may be fined the greater of either the amount set forth in the offense statute or an amount not more than \$250,000, while the maximum fine for an organization convicted of a felony would be the greater of the amount set forth in the offense statute or an amount of not more than \$500,000. This section also provides for an alternative fine based on pecuniary gain or loss. If anyone has derived pecuniary gain from the offense or if the offense results in pecuniary loss to any person, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss, unless the imposition of a fine under this subsection would unduly complicate or prolong the sentencing process.

New 18 U.S.C. § 1520, in part, provides criminal sanctions for destruction of corporate audit records. Under subsection 1520(a)(1), an accountant who conducts an audit of an issuer of securities to which 15 U.S.C. § 78j-1(a) applies is required to maintain all audit or review workpapers for 5 years after the end of the fiscal period within which the audit or review was concluded. Subsection 1520(a)(2) directs the SEC to promulgate rules and regulations within 180 days, after a notice and comment period, regarding record retention relating to such an audit or review, and authorizes the SEC to amend or supplement them. Anyone who knowingly and willfully violates 18 U.S.C. § 1520(a)(1) or any rules or regulations promulgated under 18 U.S.C. § 1520(b) is subject to a fine under title 18 of the U.S. Code,<sup>3</sup>

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<sup>3</sup> See discussion of possible fines for felony convictions under 18 U.S.C. § 3571, in text regarding Section 802 of P.L. 107-204, above.

imprisonment of not more than 10 years, or both.<sup>4</sup> The provisions of new 18 U.S.C. § 1520 do not alter any other obligations or duties imposed by federal or state laws or regulations regarding record retention.<sup>5</sup>

*Section 803* renders debts incurred in violation of securities fraud laws nondischargeable in bankruptcy proceedings. More specifically, it amends 11 U.S.C. § 523(a) by adding a new subsection (19) providing that a discharge under 11 U.S.C. §§ 727, 1141, 1228(a), 1228(b), or 1328(b) does not discharge an individual debtor from a debt that meets two criteria: (1) the debt is for a violation of federal securities laws; state securities laws; regulations under federal or state securities laws; common law fraud, deceit or manipulation in connection with the purchase or sale of any security; *and* (2) the debt results from a judgment, order, consent order, or decree entered in a federal or state judicial or administrative proceeding; a settlement agreement entered into by the debtor; or a court or administrative order for damages, fine, penalty, citation, restitution, disgorgement, attorney fee, cost, or other payment owed by the debtor.

While creating no new private rights of action, *section 804* modifies 28 U.S.C. § 1658 to establish a statute of limitations for private rights of action involving a claim of fraud, deceit, manipulation, or contrivance in violation of a securities regulatory requirement committed on or after the effective date of the Act. The new limitation period is the earlier of either 2 years after discovery of the facts constituting the violation or 5 years after the commission of the violation.

*Section 805* directs the U.S. Sentencing Commission to review and amend the sentencing guidelines for obstruction of justice and violations of 18 U.S.C. §§ 1519 and 1520 to ensure that they are sufficient to deter and punish such offenses. In addition, it directs the Commission to provide a specific offense characteristic sentencing enhancement under Guideline 2B1.1 for a fraud offense endangering the solvency or financial security of a substantial number of victims. Further, the Commission is directed to make certain that the organizational sentencing guidelines under Chapter 8 of the U.S. Sentencing Guidelines are sufficient to deter and punish organizational criminal misconduct. The Commission must promulgate these guidelines or amendments within 180 days of enactment of the Act.

*Section 806* adds new 18 U.S.C. § 1514A, which creates a civil action to protect employees of publicly traded companies against discrimination in the terms and conditions of employment in retaliation for whistleblowing in securities fraud cases. This section covers situations where such employees have engaged in any lawful act to provide information, to cause information to be provided, or otherwise to assist any investigation by a federal regulatory or law enforcement agency, a Member of Congress or congressional committee, or a person having supervisory authority over the employee or investigative authority for the employer, regarding any violation of 18 U.S.C. §§ 1341 (mail fraud), 1343 (wire fraud), 1344 (bank fraud), 1348 (securities fraud against shareholders), or any SEC rule or regulation; or of any federal law regarding fraud against shareholders. In addition, 18 U.S.C. § 1514A

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<sup>4</sup> 18 U.S.C. § 1520(b).

<sup>5</sup> 18 U.S.C. § 1520(c).

authorizes an employee alleging such wrongful discharge or other discrimination to seek relief by filing a complaint with the Secretary of Labor, using procedures set forth in 49 U.S.C. § 42121(b)(1). In the absence of delay due to bad faith of the employee, if the Secretary of Labor does not issue a final decision within 180 days, the employee may bring an action in the appropriate U.S. District Court, seeking de novo review.<sup>6</sup> The section requires that an action brought pursuant to 18 U.S.C. § 1514A(b)(1) must be commenced within 90 days after the date on which the violation occurs.<sup>7</sup> Remedies provided an employee prevailing in an action under section 1514A(b)(1) includes all relief necessary to make him or her whole, including reinstatement with pre-discrimination seniority status, back pay with interest, and compensation for any special damages incurred due to the discrimination, including litigation costs, expert witness fees, and reasonable attorneys fees.<sup>8</sup> Section 1514A(d) leaves the employee with all rights, privileges or remedies under federal or state law or any collective bargaining agreement.

*Section 807* creates a new securities fraud crime with penalties including a fine under Title 18, U.S. Code.<sup>9</sup> The offense covers anyone who knowingly executes or attempts to execute a scheme or artifice to defraud any person in connection with a security of an issue with a class of securities registered under 15 U.S.C. § 78l or required to file reports under 15 U.S.C. § 78o(d); or to obtain by false or fraudulent pretenses, representations or promises, any money or property in connection with purchase or sale of a class of securities registered under 15 U.S.C. § 78l or required to file reports under 15 U.S.C. § 78o(d). Upon conviction an offender would face up to 25 years in prison, a fine under Title 18, U.S.C., or both.

## **Title IX: White Collar Crime Penalty Enhancements**

*Section 901* designates this title of the Act as the “White-Collar Crime Penalty Enhancement Act of 2002.”

*Section 902* adds a new 18 U.S.C. § 1349 to the U.S. Code, which indicates that any person who attempts or conspires to commit an offense under 18 U.S.C. § 1341-1348 (dealing generally with fraudulent acts of various types) shall face the same penalties as those provided for the offense that was the object of the attempt or the conspiracy.

*Section 903* increases the potential maximum term of imprisonment available upon conviction for mail fraud (18 U.S.C. § 1341) or wire fraud (18 U.S.C. § 1343), other than mail fraud or wire fraud affecting a financial institution, from five years to twenty years.

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<sup>6</sup> 18 U.S.C. § 1514A(b)(1).

<sup>7</sup> 18 U.S.C. § 1514A(b)(2)(D).

<sup>8</sup> 18 U.S.C. § 1514(c).

<sup>9</sup> For a discussion of the fines that may be imposed under 18 U.S.C. § 3571 upon conviction of a felony, see discussion of section 802 of P.L. 107-204, above.

*Section 904* raises the maximum criminal penalties available upon conviction of anyone willfully violating Title I, subtitle B, part 1 of ERISA, or any regulation or order issued thereunder. Heretofore, 29 U.S.C. § 1131 provided that individual offenders faced a maximum fine of \$5,000 (unless a larger fine was imposed under 18 U.S.C. § 3571),<sup>10</sup> a maximum term of imprisonment of 1 year, or both. Section 904 of the Act increases the maximum fine for an individual defendant convicted under 29 U.S.C. § 1131 to \$100,000, and the maximum term of imprisonment to 10 years. Under the new language in this offense provision, organizational defendants will face an increased fine level, raised from \$100,000 to \$500,000. It is noteworthy that the increased maximum term of imprisonment changes this offense from a misdemeanor to a felony.<sup>11</sup>

*Section 905* directs the U.S. Sentencing Commission, within 180 days of the date of enactment of the Act, to review, and, as appropriate, to amend the applicable sentencing guidelines and related policy statements to implement the Act, thereby ensuring, among other things, that the pertinent guidelines and policy statements reflect the seriousness of the offenses, the growing incidence of such fraud offenses, and the need to modify these guidelines and policy statements to deter, prevent, and punish such offenses.

*Section 906* creates a new 18 U.S.C. § 1350, dealing with corporate responsibility for financial reports. Subsections 1350(a) and (b) require the chief executive officer and chief financial officer (or their equivalent) of an issuer to certify the accuracy of periodic financial statements filed by the issuer with the SEC under 15 U.S.C. §§ 78m(a) or 78o(d) and the compliance of those reports with statutory requirements in 18 U.S.C. § 1350. Anyone who makes such a certification knowing that the report accompanying the certifying statement does not meet the statutory requirements would, upon conviction, face up to \$1 million in fine, up to 10 years in

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<sup>10</sup> Note that 18 U.S.C. § 3571 provides, for a Class A misdemeanor not resulting in death, that a fine of the greater either of the amount set forth in the offense section or of not more than \$100,000 may be imposed upon an individual defendant, while a fine of the greater of the amount set forth in the offense section or of not more than \$200,000 may be imposed upon an organization. This section also provides for an alternative fine based on pecuniary gain or loss. If anyone has derived pecuniary gain from the offense or if the offense results in pecuniary loss to any person, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss, unless the imposition of a fine under this subsection would unduly complicate or prolong the sentencing process. A Class A misdemeanor is defined in 18 U.S.C. § 3559(a)(6) as an offense not specifically classified by a letter grade in the section defining it, for which the maximum authorized term of imprisonment is “one year or less but more than six months.”

<sup>11</sup> Under 18 U.S.C. § 3571, individuals convicted of a felony may be fined the greater of either the amount set forth in the offense statute or an amount not more than \$250,000, while the maximum fine for an organization convicted of a felony would be the greater of the amount set forth in the offense statute or an amount not more than \$500,000. This section also provides for an alternative fine based on pecuniary gain or loss. If anyone has derived pecuniary gain from the offense or if the offense results in pecuniary loss to any person, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss, unless the imposition of a fine under this subsection would unduly complicate or prolong the sentencing process.



prison, or both. Anyone willfully certifying compliance knowing that the periodic report accompanying the statement does not comport with the requirements of 18 U.S.C. § 1350 would face a fine of up to \$5 million, imprisonment of not more than 20 years, or both.<sup>12</sup>

## **Title X: Corporate Tax Returns**

*Section 1001* states that it is the sense of the Senate that the federal income tax return of a corporation should be signed by the chief executive officer of the corporation.

## **Title XI: Corporate Fraud Accountability**

*Section 1101* designates this title of the Act as the “Corporate Fraud Accountability Act of 2002.”

*Section 1102* amends 18 U.S.C. § 1512 to add a new subsection (c) which defines a new crime. Under this new subsection, anyone who corruptly alters, destroys, mutilates, or conceals a record, document, or other object with the intent to impair the object’s integrity or availability for use in an official proceeding or who otherwise obstructs, influences, or impedes such a proceeding, or attempts to do any of these things, faces a maximum of 20 years in prison, a fine under Title 18, U.S. Code,<sup>13</sup> or both.

Under *Section 1103*, 15 U.S.C. § 78u-3 is amended to afford the SEC the right, during the course of a lawful investigation of possible securities law violations by an issuer of publicly traded securities or its directors, officers, partners, controlling partners, agents, or employees, the power, under specified circumstances, to petition a U.S. district court for temporary freeze authority. This mechanism would become available when the SEC deems it likely that the issuer will be making extraordinary payments to any of those persons. In response to such a petition, the court may require the issuer to escrow those payments in an interest-bearing account for 45 days under court supervision. Unless impracticable or contrary to the public interest, the court will give those affected notice and an opportunity to be heard. An order entered under this provision may be extended for up to 45 additional days upon good cause shown. If the issuer or any of those persons referenced is charged with a securities law violation before the expiration of such an order, the order shall continue in effect, subject to court approval, until the conclusion of pertinent legal proceedings. Otherwise, the order will terminate and the payments will be returned to the affected recipients.

*Section 1104* directs the U.S. Sentencing Commission to review sentencing guidelines applicable to securities fraud, accounting fraud, and related offenses, to consider sentencing enhancements for officers or directors of publicly traded

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<sup>12</sup> See the provisions of 18 U.S.C. § 3571(d) with respect to an alternative fine level calculated based upon twice the gross pecuniary gain or loss resulting from the offense.

<sup>13</sup> See the discussion of 18 U.S.C. § 3571 at fn. 11, *supra*.

corporations who commit such offenses, and to report thereon to Congress. The section specifies considerations that should be taken into account by the Commission in making its review. The U.S. Sentencing Commission is directed to promulgate resulting new guidelines or amendments to existing guidelines within 180 days of the date of enactment of the Act.

*Section 1105* amends 15 U.S.C. § 78u-3 to provide the Commission authority, in any cease-and-desist proceeding under Section 78u-3(a), to issue an order prohibiting anyone who has violated Section 10(b) (15 U.S.C. § 78j(b)) or related rules or regulations from acting as an officer or director of any issuer of a class registered under Section 12 (15 U.S.C. § 78l) or required to file reports pursuant to section 15(d) (15 U.S.C. § 78o(d)), if the person's conduct demonstrates unfitness to serve in such capacity. In addition, it amends 15 U.S.C. § 77h-1 to authorize the SEC, in such a cease-and-desist proceeding, to issue an order prohibiting any person who has violated section 17(a)(1) (15 U.S.C. § 78q(a)) or related rules or regulations from acting as an officer or director of such an issuer if the person's conduct demonstrates unfitness to serve in such a capacity. In either of these types of orders prohibiting service as an officer or director of such an issuer, the prohibition may be conditional or unconditional and may be permanent or for such time as the SEC may determine.

Under *Section 1106* of the Act, the criminal penalties available under 15 U.S.C. § 78ff(a) for individual defendants are increased from a maximum fine of \$1 million to \$5 million and a maximum term of imprisonment from 10 years to 20 years, or both, while the maximum fine for organizational defendants is increased from \$2.5 million to \$25 million.<sup>14</sup>

Finally, *Section 1107* amends 18 U.S.C. § 1513 to add a new subsection which provides, upon conviction, for imposition of a sentence including a fine under Title 18, U.S. Code; imprisonment for up to 10 years; or both; upon anyone who knowingly takes harmful action, including interference with the lawful employment or livelihood of any person, with intent to retaliate for providing truthful information to a law enforcement officer regarding the commission or possible commission of any federal offense.

## **Selected Bills Introduced in the 108<sup>th</sup> Congress**

H.R. 275, referred to the Committee on Financial Services, would require covered corporations to disclose charitable contributions whose value exceeded the designated amount (determined by the Commission) made by the issuer the previous year to an organization of which a director, officer, or controlling person (or spouse of one of these persons) of the issuer was a director or trustee. Annual statements of the total value of charitable contributions made by the issuer must be filed with the Commission.

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<sup>14</sup> For a discussion of an alternative method of calculating fines based upon twice the gross pecuniary gain or twice the gross pecuniary loss to any person resulting from the commission of the offense, see 18 U.S.C. § 3571(d).

H.R. 657 was reported by the Committee on Financial Services (H.Rept. 108-19) on February 25, 2003, agreed to by voice vote in the House on February 26, 2003, and referred to the Senate Committee on Banking, Housing, and Urban Affairs on February 27, 2003. This bill would grant the SEC the authority in an emergency to reduce, eliminate, or prevent the substantial disruption of the securities markets or the transmission or processing of securities transactions.

H.R. 658, reported by the Committee on Financial Services (H.Rept. 108-63, Part I), would streamline the hiring process at the SEC for certain positions by excepting from the competitive service all accountant, economist, and securities compliance examiner positions.

H.R. 746, referred to the Committee on Government Reform and to the Committee on Financial Services, would prohibit the federal government from entering into contracts with companies that have not certified under section 302(a) of Sarbanes-Oxley the truthfulness of certain financial statements.

H.R. 1000, reported by the Committee on Education and the Workforce on March 18, 2003 (H.Rept. 108-43, Part I), is a complex bill which would amend Title I of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986 to provide additional protections, such as portfolio diversification, to participants and beneficiaries in individual retirement account plans. The bill would also promote providing retirement investment advice to workers about managing their retirement income assets.

S. 183, referred to the Committee on Banking, Housing, and Urban Affairs, would amend the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers' Act of 1940 to allow the SEC to impose a civil monetary penalty (increased penalty amounts specified in the bill) if it finds that a person is violating, has violated, or is or was a cause of the violation of the statute or any rule or regulation and that the penalty is in the public interest. The bill would also allow the SEC to subpoena financial records from a financial institution and transfer them to another government authority without notice that a records request has been made.

S. 476, passed by the Senate on April 9, 2003, incorporates in section 723 the provisions of S. 183. It has been reported that this provision would make it easier for the SEC to punish attorneys, accountants, and corporate officers and directors by allowing the agency to impose large fines on wrongdoers without first obtaining approval by a federal judge. Investigators would also be able to subpoena more easily financial records without first notifying the subject of the inquiry.<sup>15</sup>

S. 513, referred to the Committee on Finance, would prevent the avoidance of United States income tax to United States corporations which are acquired by a nominally foreign corporation. The bill would also require disclosure to shareholders of the effects of a corporate expatriation transaction.

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<sup>15</sup> *Senate Votes to Strengthen S.E.C.'s Hand*, N.Y. TIMES, April 10, 2003, at C1.

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