

New Criminal Statutes and Penalties Under the Sarbanes-Oxley Act of 2002

Solomon L. Wisenberg
Ross, Dixon & Bell
(202) 662-2056
swisenberg@rdbl.com

Sarbanes-Oxley Act of 2002

A New Toy for Federal Prosecutors

- ◆ **Response to a Public Outcry Not Seen Since the S&L Debacle**
- ◆ **Signed into law by President Bush on July 30, 2002**
- ◆ **Titles VIII, IX and XI of the Act create new federal fraud offenses, modify fraud statutes already on the books, and enhance various fraud related penalties**

New Obstruction of Justice Offense

Title VIII, Section 802

"Destruction, alteration, or falsification of records in Federal investigations and bankruptcy"

Whoever 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 or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

18 U.S.C. § 1519

New Obstruction of Justice Offense

- ◆ Significantly enhances ability to prosecute obstruction of justice offenses related to document destruction and false entries
- ◆ Expansive wording does not even require a pending or contemplated investigation for an offense to occur
- ◆ Government only need prove intent to influence "investigation" or "proper administration of any matter" within an agency's or department's jurisdiction plus knowing document tampering
 - ◆ No need to prove willful state of mind
 - ◆ Thus, government need not establish that accused intended to violate known legal duty
 - ◆ Government probably not required to prove defendant's knowledge that "investigation" or "administration" being influenced was within particular department's or agency's jurisdiction.

Modification of Pre-Existing Obstruction of Justice Statute

Title XI, Section 1102

"TAMPERING WITH A RECORD OR OTHERWISE IMPEDING AN
OFFICIAL PROCEEDING"

(c) Whoever corruptly-

(1) 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; or

(2) otherwise obstructs, influences, or impedes any official
proceeding, or attempts to do so,

shall be fined under this title or imprisoned not more than 20 years,
or both.

18 U.S.C. § 1512(c)

R
O
S
S

D
I
X
O
N
&

B
E
L
L

Modification of Pre-Existing Obstruction of Justice Statute

- ◆ Stand alone liability - no longer need to prove that accused persuaded or attempted to persuade another
- ◆ Covers obstruction, impeding, influencing of any official proceeding -- not just document destruction
- ◆ As before:
 - ◆ no need to prove that "official proceeding" is pending or about to be instituted
 - ◆ no need to prove defendant's knowledge of federal character of proceeding
- ◆ "Corruptly" is unlikely to be interpreted as requiring proof of willfulness

New Destruction of Audit Records Offense

Title VII, Section 802 - "Destruction of corporate audit records"

(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(a)) applies, shall maintain all audit or review workpapers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.

(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(a)) applies. The Commission may, from time to time, amend or supplement the rules and regulations that it is required to promulgate under this section, after adequate notice and an opportunity for comment, in order to ensure that such rules and regulations adequately comport with the purposes of this section.

(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 10 years, or both.

(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation imposed by Federal or State law or regulation to maintain, or refrain from destroying, any document.

R
O
S
S
D
I
X
O
N
&
B
E
L
L

New Destruction of Audit Records Offense

- ◆ Audit and review workpapers must be maintained for 5 years
- ◆ Willfulness element requires proof of intentional violation of a known legal duty
- ◆ SEC has promulgated rules necessary to the retention of "relevant records" such as "workpapers," documents "that form the basis of an audit or review" and records "created, sent, or received in connection with an audit or review."
 - ◆ Rules appear to protect broader category than mere audit and review workpapers
 - ◆ Other document-retention duties imposed by law not diminished
 - ◆ Interplay between § 1520 and other statutes bearing upon document retention
 - ◆ For example, destroying documents with intent to influence "proper administration of any matter" under § 1519 could be a crime even if documents are over 5 years old.

Increased Penalties and Enhanced Sentencing

- ◆ Title VIII, Section 805 - Commands the United States Sentencing Commission to "review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements" concerning obstruction statutes and to:
 - ◆ Ensure existing Guideline provisions are adequate to deter and punish obstruction of justice and destruction of documents
 - ◆ Particular attention to destruction of large amounts of evidence, highly probative or essential evidence, destruction of evidence which involves more than minimal planning and obstruction of justice involving abuse of a special skill or position of trust
 - ◆ Ensure that Guideline offense levels and enhancements are adequate for new §§ 1519 and 1520 of Title 18
 - ◆ Enhancement for frauds that endanger "the solvency or financial security of a substantial number of victims."
 - ◆ Ensure that corporate criminal guidelines are adequate to deter and punish organizational criminal conduct.
 - ◆ The Sentencing Commission promulgated emergency Guidelines on January 25, 2003. The new Guidelines have been criticized as not tough enough.

Increased Penalties and Enhanced Sentencing

Title XI, Section 1104 - Commands Sentencing Commission to also consider Guidelines concerning securities, accounting and pension fraud, and related offenses and possible expedited amendments to Guidelines

Title XI, Section 1106 - Increases penalties for violations of the Exchange Act

- ◆ **Increases maximum term of imprisonment from 5 to 10 years**
- ◆ **Increases made fine for individuals from \$1,000,000 to \$5,000,000 and for entities from \$2.5 million to \$25 million**

R
O
S
S

D
I
X
O
N

&

B
E
L
L

Increased Penalties and Enhanced Sentencing

Title IX, Section 904 - Makes 29 U.S.C. § 1131 a felony by increasing penalties for willfully violating reporting and disclosure requirements concerning ERISA employee benefit plans.

- ◆ Increases maximum term of imprisonment from 1 to 10 years
- ◆ Increases maximum fine for an individual from \$100,000 to \$500,000
 - ◆ Because 18 U.S.C. § 3571 is now implicated, individual may be fined \$250,000 or twice amount of gain or loss caused by crime
- ◆ Entities are subject to paying twice the amount of gain or loss

New General Securities Fraud Statute

Title VIII, Section 807 - "Securities Fraud"

Whoever knowingly executes, or attempts to execute, a scheme or artifice-

(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 781) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 781) or that is required to file reports under section 15 (d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); shall be fined under this title, or imprisoned not more than 25 years, or both.

18 U.S.C. § 1348

R
O
S
S
D
I
X
O
N
&
B
E
L
L

New General Securities Fraud Statute

- ◆ Catchall provision modeled on the bank fraud statute, 18 U.S.C. § 1344, and, to a lesser extent, the healthcare fraud statute, 18 U.S.C. § 1347
- ◆ Broader than previous proscriptions on securities fraud under the Exchange Act
 - ◆ No need to prove willful violation - only a knowing intent to defraud - which deprives accused of the argument that no matter how improper his conduct may have been, he did not intentionally violate a known legal duty
 - ◆ No need to prove that the fraud was "in connection with the purchase or sale" of securities
- ◆ Likely to persuade more federal prosecutors to take on securities fraud cases
- ◆ Great scope in time and place
 - ◆ Prosecution for execution of scheme that started before enactment
 - ◆ Prosecution in any federal district in which any part of scheme was executed
 - ◆ Prosecutors are familiar with this type of statute
 - ◆ Expectation that this will now be charged

R
O
S
S

D
I
X
O
N

&

B
E
L
L

Attempt and Conspiracy

Title IX, Section 902 - "Attempt and conspiracy"

Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

18 U.S.C. § 1349

- ◆ **Formally adds an attempt component to wire fraud statute**
- ◆ **Pegs maximum conspiracy sentences to underlying substantive offenses**
 - ◆ **Sentencing Commission failed to enhance Guidelines to reflect Congress' determination that attempts and conspiracies should be punished equal to their objects**

New Certification Requirement

Title IX, Section 906 - "Failure of corporate officers to certify financial reports"

(a) **Certification of Periodic Financial Reports.**-Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

(b) **Content.**-The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

(c) **Criminal Penalties.**-Whoever-

(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$1,000,000 or imprisoned not more than 10 years, or both; or

(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both.

18 U.S.C. § 1350

R
O
S
S

D
I
X

O
N

&

B
E
L
L

New Certification Requirement

- ◆ Prior to enactment of this statute, no federal criminal provision explicitly covered false certifications to the SEC by CEOs or CFOs
- ◆ Serves as both a warning and deterrent to CEOs and CFOs of their affirmative duty to determine the accuracy of financial reports
- ◆ Government need not prove any actual or intended effect on stock prices or any actual or intended pecuniary gain on behalf of a CEO or CFO
- ◆ Accused may defend by arguing that he was misled or deceived by others but this is not likely to succeed given the affirmative duties imposed under Act's separate certification requirement (Section 302)

New Anti-Retaliation Provision

Title XI, Section 1107 - "RETALIATION AGAINST INFORMANTS"

(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.

18 U.S.C. § 1513(e)

R
O
S
S

D
I
X
O
N
&

B
E
L
L

New Anti-Retaliation Provision

- ◆ Broad and powerful prosecutorial tool in that it covers "any [retaliatory] action harmful to any person"
 - ◆ Conceivably covers retaliation against child, spouse, or friend of a whistleblower
- ◆ Two Significant Limitations - criminal liability is based on whistleblower's providing any "truthful" information to "law enforcement officer"
 - ◆ Narrower than § 1513(b)(2) which does not have a "truthful" component
 - ◆ Be aware of interplay with Title VIII, Section 806 which provides civil protection for whistleblower so long as he reasonably believed his information to be accurate or correct
 - ◆ Thus, on civil side you cannot retaliate in every instance where information provided is not truthful
 - ◆ Corporation should not generally be deciding who or what is truthful
 - ◆ Section 806 covers categories broader than law enforcement officers

R
O
S
S
D
I
X
O
N
&
B
E
L
L

Ex Post Facto Considerations

New statutes and enhanced penalties do not apply retroactively to conduct committed before enactment, however:

- ◆ Conspiracies that start before enactment but continue after enactment may be prosecuted
- ◆ Under Section 1348, schemes that extend in execution beyond enactment may be prosecuted
- ◆ For obstruction of justice, key date is when the act constituting obstruction occurred, not the wrongdoing being covered up

Key Points

1. **Statutes themselves are not breathtaking**
2. **All current indictees were charged under pre-existing law**
3. **Intangibles must be taken into account:**
 - A. **Arthur Andersen LLP indictment**
 - B. **Joint Task Forces**
 - C. **Public outcry**
4. **Law of unintended consequences: Creative Prosecution 101**
5. **Civil criminal interplay**

Thank you.

Solomon L. Wisenberg

Ross, Dixon & Bell

(202) 662-2056

swisenberg@rdbl.com