

**TROUTMAN
SANDERS LLP**

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of 2002**

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BUSINESS & THE LAW

THE SARBANES-OXLEY ACT OF 2002

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On July 25, 2002, Congress passed the Sarbanes-Oxley Act of 2002. President Bush has already stated that he will sign the Act, which has been called by some commentators the most sweeping securities legislation since the 1930's. The reforms in the Act are ambitious and broad in scope; however, the Act is just one prong of the sweeping reforms proposed in the wake of the growing list of corporate scandals, which include Enron, Adelphia and WorldCom.¹ It will be some time before the collective impact of these reforms can be measured, but the Act will be a significant piece of this puzzle.

This Bulletin does not purport to summarize all of the Act's provisions; rather, we have chosen to highlight those portions of the Act that will have the most direct and immediate effect

on public companies from a disclosure and compliance perspective. It is our hope that this Bulletin will help our clients and friends stay ahead of the curve, as compliance with the Act's various mandates becomes a reality.

Certification

- *CEO and CFO Certification of Financial Statements and Periodic Reports* - Commencing 30 days after the Act becomes law, CEOs and CFOs will be required to certify the accuracy of each quarterly and annual report filed with the SEC, including the financial statements filed therewith. The certification requirement applies to all public companies and is in addition to the certification requirements for CEOs and CFOs of the 945 largest U.S. companies under the SEC's June 27, 2002 order. To meet the certification requirement, the CEOs and CFOs must:
 - Certify that the signing officer has reviewed the report and state, to the officer's best knowledge, it is accurate and does not contain any materially untrue or misleading statements;

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- State that, to the officer's best knowledge, the financial statements and related information fairly present the financial condition and results of operations of the issuer; and
- Make several attestations as to the effectiveness of the company's internal controls, including a statement that the officer has disclosed to the auditors and audit committee (i) any significant deficiencies in the design or operation of the internal controls and (ii) the existence of any fraud, whether material or not, involving management or other employees who have a significant role in the internal control process.

Trading by Officers and Directors

- *Insider Trades Reportable on Second Business Day* - Also commencing 30 days after the Act becomes law, insiders — in particular Section 16 filers of Forms 3, 4 and 5 — will be required to report their transactions in their issuer's securities within two business days of the transaction. (However, in implementing the final rule, the SEC has been granted the discretion to extend the filing requirement upon a finding that the two day deadline is not feasible.) Currently, an insider is generally required to report these transactions no later than 10 days following the end of the month in which the transaction takes place or, in some instances, within 45 days following the end of the issuer's fiscal year. Commencing within one year, all reports will have to be filed

electronically and posted on the Web site of the issuer.

- *Insider Trading Frozen During Benefit Plan Blackouts* - Insiders are prohibited from trading equity securities of the issuer during blackout periods in which employees of the issuer are prohibited from trading issuer securities through their benefit plans.

Audit Committee and Auditors

- *New Standards Relating to Audit Committees* - The Act directs the national securities exchanges to enact a series of audit committee standards to become effective no later than 270 days after the Act becomes law:
 - The Audit Committee must be comprised solely of independent directors. For directors to satisfy the new independence standard, they may not, other than in their capacity as directors, (i) accept any consulting, advisory or compensatory fee from the issuer or (ii) be affiliated with the issuer.
 - The Audit Committee is to be directly responsible for the appointment, compensation and oversight of the issuer's auditors. The Audit Committee is also responsible for resolving any disagreements between the auditors and management.
 - The Audit Committee is required to establish a system for receiving accounting complaints

and concerns, including providing for the confidential, anonymous reporting of problems by employees of the issuer. In a related provision, issuers are prohibited from discriminating against whistleblowers or those who assist in prosecutions against an issuer.

- The Act specifically grants to the Audit Committee the authority to engage independent counsel and other advisors as necessary, which the issuer is required to fund.
- *Auditor Independence and Oversight Board* - The Act contains several provisions concerning new requirements for auditor independence and establishing the Public Company Accounting Oversight Board, which is designed to monitor auditors of public companies.

Securities Fraud

- *Statute of Limitations for Securities Fraud* - The Act extends the statute of limitations for securities fraud to the earlier of two years from the discovery of facts giving rise to a claim for fraud or five years from the date of the fraudulent act or omission. The previous statute of limitations was one and three years, respectively.
- *Debts from Fraud Violations are Non-dischargeable in Bankruptcy* - Debts of individuals from civil and criminal penalties stemming from securities fraud violations are not dischargeable in bankruptcy proceedings.

Penalties

- *Violation of Financial Statements Certification Requirement* - A knowing violation by the CEO or CFO of the Act's financial statements certification requirement is punishable by up to a \$1,000,000 fine and/or up to 10 years in prison. A willful violation is punishable by up to a \$5,000,000 fine and/or up to 20 years in prison.
- *Disgorgement of Bonuses and Profits* - In the event that an issuer is required to prepare an accounting restatement as a result of material noncompliance with the reporting requirements due to misconduct, the CEO and CFO will be required to return to the company any bonuses, other incentive based compensation and profits from the sale of the issuer's stock for the twelve month period following each improper financial report.
- *Officers and Directors May be Barred from Service* - The Act grants to the SEC the authority to prohibit any person who violates the anti-fraud provisions of the securities laws from serving as a director or officer of any issuer if the officer or director is found to be "unfit" for service in a public company.
- *Document Destruction* - Persons who destroy or falsify corporate records in an attempt to impede or obstruct an investigation shall be subject to fines and/or imprisonment of up to 20 years.
- *Securities Fraud* - Persons who commit securities fraud shall be subject to fines and/or imprisonment of up to 25 years.

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Employee Benefits & The Law discusses current developments in the law and current issues in the administration of employee benefits and executive compensation.

Employment & The Law details current federal and state labor issues that impact the relationship between employers and employees.

Environment & The Law tracks developing trends in environmental law, including air and water quality and hazardous substances.

Intellectual Property & The Law covers current issues in intellectual property/ high tech areas, including copyrights, trademarks, patents, trade secrets, employment agreements and tax issues applicable to the development of technology.

International Business & The Law details current issues that impact international business transactions, trade in merchandise and services, and international investment opportunities.

Real Estate & The Law provides up-to-date information on legal developments affecting real estate including opportunities for readers to protect their properties, and provides general insights into related areas of interest.

Transportation & The Law addresses issues of interest to trucking companies, railroads, logistics companies, shippers with transportation needs and others with an interest in transportation issues.

Please contact the Department of Business Development at 404-885-3639 if you would like to receive any of these publications.

Miscellaneous

- *Prohibition on Personal Loans* - An issuer is prohibited from directly or indirectly making a personal loan to any of its directors or executive officers, except for certain loans made in the ordinary course of the issuer's consumer credit business on customary terms.
- *Mandatory Review Every Three Years* - Every public company will have its Exchange Act filings reviewed by the SEC at least once every three years.
- *Rules of Professional Responsibility for Attorneys* - The Act mandates that the SEC adopt rules requiring that outside counsel for public companies report material securities law violations or breaches of fiduciary duty to in-house counsel or the CEO, and if that individual does not appropriately respond to the evidence presented, the attorney is required to report the evidence to the audit committee or another board committee comprised of independent directors.

Conclusion

The Act embodies numerous changes to the existing law, several of which were already in development under the standard SEC rulemaking process (i.e., the certification requirement and new standards relating to audit committees) and which were anticipated to become law. Changes not otherwise anticipated include restrictions on trading by insiders, extended statutes of limitations for securities fraud violations and many of the heightened criminal penalties. It is

important that all public companies fully understand the impact of the Act; in that regard, we will be happy to help you understand and comply with these new requirements. We also stand ready to provide litigation counseling, claim assessment and representation in civil or criminal proceedings before the SEC or in federal and state courts. ♦

(Footnotes)

¹ For example, on June 17, 2002 the SEC proposed to shorten the deadline for filing current reports on Form 8-K and to include additional disclosable events. On June 27, 2002 the SEC ordered that CEOs and CFOs of the 945 largest U.S. companies certify their most recent periodic reports and financial statements filed therewith. Both Nasdaq and the NYSE have independently submitted recommendations to the SEC that would impose heightened corporate governance standards for listed companies.