Analysis&Perspective

SARBANES-OXLEY ACT OF 2002

A Litigator's Perspective on Sarbanes-Oxley: An Assessment of Some Key Issues

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On July 30, President Bush signed the hastily-prepared Sarbanes-Oxley bill. This article discusses the impact of the legislation on private civil securities litigation. We address several major topics: the new statute of limitations; the new obligation to make ''real time'' disclosures; the implications of the new responsibilities of audit committee members for their exposure to control person liability; the possible impact of the prohibition of loans by public companies to their senior officers on the power of issuers to advance litigation defense costs; the new criminal penalties for improper document destruction and the possibility of implied private rights of action.

I. The New Statute of Limitations for Fraud-Based Claims

One provision of the Act extended the limitations period for commencing claims for fraud under the securities laws to two years after discovery of the alleged fraud, or five years after the alleged violation, whichever is earlier. Section 804(a) of the Act provides in relevant part:

> [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of
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> (1) 2 years after the discovery of the facts constituting the violation; or
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> (2) 5 years after such violation.

Id. at § 804(a)(2)(b).

The Act further provides that this new statute of limitations is not applicable to actions pending on the date the Act was enacted, but only to new actions commenced on or after that date. Section 804(b) of the Act provides:

> The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of the Act.

Id. at § 804(b).

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The question naturally arises whether the new statute of limitations revives claims that were already time-barred when the statute was enacted. For the reasons that follow, the courts should conclude that the provision is prospective in effect only.

A. The Act Does Not Revive Time-Barred Claims. Under the law in effect prior to the Act, claims under the 1933 and 1934 Acts were time-barred unless asserted within three years of the date on which the security at issue was sold or within one year after the discovery of the alleged fraud, whichever was shorter.[1] A statute of repose such as the three-year limitation for securities claims is an absolute bar that cannot be tolled.[2]

The courts have made it clear that a statute extending a period of limitations will not be deemed to revive claims that were time-barred before the statute was enacted unless the statute expressly states an intent to revive such claims. *See Resolution Trust Corp.* v. *Seale*, 13 F.3d 850, 853 (5th Cir. 1994); *FDIC* v. *Belli*, 981 F.2d 838, 842 (5th Cir. 1993); *Trizec Properties, Inc.* v. *United States Mineral Products Co.*, 974 F.2d 602, 606-08 (5th Cir. 1992). In *Belli*, for example, the court addressed the contention that 12 U.S.C. § 1821(d)(14), part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (''FIRREA''), applied retroactively to revive claims that were time-barred under federal law before FIRREA was enacted. That section of the statute provided that the statute of limitations on a contract claim held by the FDIC as receiver for a federally-insured bank began to run either when the claim accrued or when the FDIC was appointed receiver, whichever was later.[3]

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[1] *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350 (1991) (establishing one-year/three-year limitations period Section 10(b) and Rule 10b-5 claims); *Radford* v. *General Dynamics Corp.*, 151 F.3d 396, 400 (5th Cir. 1998) (citing *Lampf* for the proposition that a provision under the Securities Exchange Act of 1934 was not subject to tolling ''[b]ecause the purpose of the three-year limitation is clearly to serve as a cutoff''); 15 U.S.C.A. *§ 77m (imposing three-year statute of repose for claims under § 13 of the '33 Act)*; *Summer* v. *Land & Leisure, Inc.*, 664 F.2d 965, 967-68 (5th Cir. 1981), *cert. denied*, 458 U.S. 1106 (1982) (three-year statute of repose under '33 Act applies to § 11 claims); *Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981) (three-year statute of repose applies to § 15 claims); *Theoharous* v. *Fong*, 256 F.3d 1219, 1228 n.12 (11th Cir. 2001) (statute of repose for § 10(b) claim applies to § 20(a) claim).

[2] *See Corwin* v. *Marney, Orton Inv.*, 788 F.2d 1063, 1066 (5th Cir. 1986); *Summer*, 664 F.2d at 968.

[3] The statute provided in relevant part: ''Notwithstanding any provision of any contract, the applicable statute of limita-

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The Fifth Circuit rejected the FDIC's contention that the statute revived claims that had expired before FIRREA was enacted. The court noted the general rule that " '[i]n the absence of evidence of a contrary legislative purpose, subsequent extensions of a statutory limitations period will not revive a claim previously barred.' " *Id.* at 842 (quoting *Village of Bellwood* v. *Dwivedi*, 895 F.2d 1521, 1527 (7th Cir. 1990)). The court held that the FIRREA provision before it "lacks a clearly expressed intent" to revive claims that had expired before its effective date, and thus should not be construed to revive such claims. *Id.*

Subsequently, in *Seale*, the Fifth Circuit held that the same provision of FIRREA did not revive claims that were time-barred under state law when FIRREA was enacted. *Seale*, 13 F.3d at 852-54. The court noted that *Belli* accommodates the competing policies at issue "by invoking the doctrine of clear statement—Congress can revive stale claims but must do so clearly." *Id.* at 853. Thus, the court noted, citing *Belli*,

> Subsequent extensions of a limitation period will not revive barred claims in the absence of a clear expression of contrary legislative intent.

Id.

The court held that neither the language nor the legislative history of FIRREA provided such a clear expression of an intent to revive time-barred claims. *Id.* at 853-54.[4]

Cases from other Circuits are in accord. *See Million* v. *Frank*, 47 F.3d 385, 389 (10th Cir. 1995) (section of Civil Rights Act of 1991 extending time limits for federal employees to sue for employment discrimination did not apply to revive time-barred claims); *Chenault* v. *United States Postal Service*, 37 F.3d 535, 539 (9th Cir. 1994) (same); *Kansas Public Employees Retirement Sys.* v. *Reimer & Kroger Assoc.*, 61 F.3d 608, 615 (8th Cir. 1995) (state statute extending limitations period did not revive time-barred claims; although the statute expressly stated that it should be "applied retroactively," it did not expressly state that it revived expired claims); *Resolution Trust Corp.* v. *Artley*, 28 F.3d 1099, 1103 n.6 (11th Cir. 1994) (holding, in reliance on *Seale*, that "FIRREA does not provide a clear enough statement that RTC's appointment permits the bringing of claims which, under analogous state causes of action, would have been barred").

The "clear statement" rule enunciated in these cases applies the more general principle that federal statutes will not be deemed to apply retroactively to increase liability for past conduct or impair rights unless the statute contains an "unambiguous directive" that it be so applied. *INS* v. *St. Cyr*, 533 U.S. 289, 372 (2001); *Landgraf* v. *USI Film Prods.*, 511 U.S. 244, 280 (1994). Thus, such statutes will not be deemed to have a retroactive effect "unless their language requires this result," *St. Cyr*, 533 U.S. at 315-16—*i.e.*, unless the statutory language requiring retroactive application is "so clear that it could sustain only one interpretation." *Id.* at 317. This "clear statement" requirement ensures that Congress has affirmatively considered the potential unfairness of retroactive application and actually decided that it is an acceptable price to pay for the countervailing benefits. *Landgraf*, 511 U.S. at 272-273.[5]

In our view, Section 804(b) of the Act does not contain a "clear statement" that it was intended to revive already time-barred claims. Indeed, the statute says nothing whatsoever about reviving time-barred claims. The language of the statute—stating that the new limitations period applies only to proceedings "commenced on or after" the date the statute was enacted—makes clear that Congress intended only to extend the statute for claims that were timely when the statute was enacted, and did not revive claims that were already barred.

If Congress had intended to revive time-barred securities fraud claims, it could readily have done so, as it has done in other federal statues. *See Nehme* v. *INS*, 252 F.3d 415, 432 (5th Cir. 2001) ("In contrast to § 104, the effective date provisions contained in Title II explicitly provide that the amendments related to voting apply to past conduct and shall be effective as if they had been enacted in 1996. Had Congress intended that the amendments to § 320 of the INA have the broad retroactive effect Nehme advocates, it would have used similar retroactive language in § 104."). *Resolution Trust Corp.* v. *Artley*, 28 F.3d 1099, 1103 n.6 (11th Cir. 1994) ("Congress is clearly aware of its ability to revive stale claims; and, if it wished, Congress could have provided a lengthy limitations period which explicitly revived stale claims . . . .")[6]

Courts have likewise held that state statutes revive previously time-barred claims only when they employ clear language. *E.g.*, *Frazer* v. *Superior Court*, 2001

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tions with regard to any action brought by the Corporation as conservator or receiver shall be—. . .(ii) in the case of any tort claim, the longer of — (I) the 3-year period beginning on the date the claim accrues; or (II) the period applicable under State law. . . .*The date on which the statute of limitations begins to run on any claim described in such paragraph shall be the later of — (i) the date of the appointment of the Corporation as conservator or receiver; or (ii) the date on which the cause of action accrues.*" 12 U.S.C. § 1821(d)(14)(A) & (B) (emphasis added).

[4] *See also Hartford Casualty Ins. Co.* v. *FDIC*, 21 F.3d 696, 702 n.8 (5th Cir. 1994) ("In *Belli*, we stated that we would not revive a stale claim even where a statute of limitations had been extended.").

[5] *See also Vela* v. *City of Houston*, 276 F.3d 659, 674 (5th Cir. 2001) (statute held not to apply retroactively where "neither the language nor the legislative history . . . expressly states that Congress intended it to apply retroactively"); *Nehme* v. *INS*, 252 F.3d 415, 432 (5th Cir. 2001) (same).

[6] Indeed, the history of the FIRREA limitations period shows that Congress is well aware of the "clear statement" requirement for reviving time-barred claims and of the language that can be used to satisfy it. In response to the *Belli* and *Seale* decisions, Congress amended FIRREA to provide expressly that the time-barred claims should be deemed revived. *See Bank and Thrift Statute of Limitations Clarification Act of 1994: Statements on Introduced Bill and Joint Resolution*, 103d Cong., 140 Cong. Rec. 4347 (Comments of Senator Riegle). The statute, as amended, provided in relevant part:

> *Revival* of expired state causes of action. In the case of any tort claim described in subparagraph (A)(ii) for which the *statute of limitation* applicable under State law with respect to such claim has expired not more than 5 years before the appointment of the Corporation as conservator or receiver, the Corporation may bring an action as conservator or receiver on such claim without regard to the expiration of the statute of limitation applicable under State law.

Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, § 201, 108 Stat. 2368 (1994) (emphasis added).

U.S. Dist. LEXIS 18771 (N.D. Cal. Nov. 5, 2001) (state penal code provision held to revive time-barred claims where statute provided that it ''shall revive any cause of action barred'' by previous law); *Speer* v. *Wheelabrator Corp.*, 826 F. Supp. 1264 (D. Kan. 1993) (same holding where statute provided that ''[t]he provisions of this subsection shall revive causes of action''); *cf. Kansas Public Employees*, 61 F.3d at 615 (where state statute did not state that it revived time-barred claims, it did not do so, although statute provided that it should be ''applied retroactively'').

Moreover, interpreting the Act to revive time-barred claims is inconsistent with its express limitation to actions commenced on or after the date of its enactment. Such an interpretation would yield the absurd result that a four-year old claim asserted on July 29, 2002 (the day before the Act was enacted) would be time barred, while the same claim, filed by a more dilatory plaintiff one day *later*, would be deemed timely. This irrational result is readily avoided by enforcing the plain language of the Act, so that it *extends* the limitations period, but does not *revive* claims that were already time-barred when the Act was signed by President Bush. Under this construction, claims that were time-barred under the statute would still be time-barred, and all plaintiffs with claims that were still timely when the Act was enacted would benefit equally from the extension of the limitations period.[7]

B. Legislative History Further Shows That Congress Did Not Intend to Revive Time Barred Claims. Consistent with the language of the statute, the legislative history contains nothing to suggest that Congress intended to revive claims that were already time-barred—much less the requisite unambiguous directive.[8] Nowhere in the Act's legislative history can one find any form of the words ''retroactive,'' ''retrospective,'' or ''revival,'' or any statement whatsoever that the new statute of limitations would revive time-barred claims. We think that a court would find that this fact alone is dispositive, because, as noted, for the Act to revive time-barred claims, Congress must not just vaguely imply such an intent; it must state so expressly. *See Vela*, 276 F.3d at 674.

Indeed, the legislative history expresses Congress' recognition that, even after the Act became law, previously time-barred claims would still be time-barred. For instance, Senator Patrick Leahy (a sponsor of the amendment to the Act that added Section 804(b), and the Chairman of the Senate Judiciary Committee) stated in a Capital Hill hearing held six days before the Act was signed by President Bush, ''[In the Act] we extend the statute of limitations in security-fraud cases—something that *would've helped* so many people who were defrauded by Enron and others.''[9] Senator Leahy also stated that ''In Washington State alone, the short statute of limitations may cost [investors]. . . nearly $50 million in lost Enron investments *which they can never recover*.''[10] These statements reflect the clear understanding that the Act *will not* revive these expired claims.

In stark contrast to the legislative history of the Sarbanes-Oxley Act, in other instances in which Congress has intended by statute to revive time-barred claims, the legislative history has expressly revealed that intent. For example, when Congress amended FIRREA to provide that time-barred claims were revived, it said so clearly:

> The revival of expired claims is an extraordinary remedy because it is a form of the retroactive application of laws which the courts and Congress has generally disfavored. Accordingly, section 201 would limit this extraordinary remedy. . . .[11]

C. Can Plaintiffs in a Case Already Pending on the Date of Enactment Commence a Second Action to Expand the Class Period? If one thing is clear about the new statute of limitations in the Act, it is that it does *not* apply to pending cases. As noted, the Act provides that the longer statute of limitations ''shall apply to all proceedings addressed by this section that are *commenced on or after the date of enactment of this Act*''—*i.e.*, not to actions commenced before that date. *See* Pub. L. No. 107-204 § 804(b) (emphasis added).

We would argue that plaintiffs cannot take advantage of any longer statute of limitations available under the Act merely by filing a purportedly ''new'' case that in reality is simply an amendment to a pending case.

The courts have repeatedly held that a plaintiff with a pending case cannot file a new complaint to accomplish that which it could not do by amending its pending complaint. Thus, ''[p]laintiffs may not file duplicative complaints in order to expand their legal rights.'' *Curtis* v. *Citibank, N.A.*, 226 F.3d 133, 140 (2d Cir. 2000) (affirming district court's dismissal of a second suit based

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[7] *See Atchison* v. *Collins*, 288 F.3d 177, 181 (5th Cir. 2002) (statutes should be construed to avoid irrational consequences); *United States ex. rel. Garibaldi* v. *Orleans Parish Sch. Bd.*, 244 F.3d 486, 493 (5th Cir. 2001) (same); *United States* v. *Female Juvenile*, 103 F.3d 14, 16-17 (5th Cir. 1996) (same).

[8] It should be noted that since *Landgraf*, the Circuits have split on whether or not legislative history alone can ever satisfy the ''clear intent'' requirement. See Hunter *v.* United States, 101 F.3d 1565, 1569 (11th Cir. 1996) (en banc), cert. denied, 520 U.S. 1211, 117 S. Ct. 1695 (1997) (recognizing that ''there appears to be a conflict among the circuits, and even within some circuits, about whether Landgraf's first step can be satisfied by evidence of legislative intent other than in an express statutory command.''), abrogated on other grounds, *Lindh* v. *Murphy*, 521 U.S. 320 (1997).

[9] Federal News Service, *Conference Report on Corporate Responsibility Legislation*, July 24, 2002, available at LEXIS, News Library, Federal News Service file (emphasis added).

[10] Legislative History of Title VIII of HR 2673: The Sarbanes Oxley Act of 2002, 107th Cong., 148 Cong. Rec. 7418 (2002) (emphasis added).

[11] *Conference Report on H.R. 3841 Before the House*, 103d Cong. 140 Cong. Rec. H 6625 (1994) (Statement of Mr. Gonzalez).

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on an amendment which plaintiff feared the court would not allow in his first suit).[12]

More specifically, the Supreme Court has held that a plaintiff with a case pending cannot simply file a new case to take advantage of a change in the law, where Congress has made it clear that the new law was not intended to apply to pending cases. *See Central Trust Co.* v. *Official Creditors' Committee of Geiger Enterprises, Inc.*, 454 U.S. 354, 102 S. Ct. 695 (1982). In *Central Trust*, a debtor filed a Chapter 11 petition under the Bankruptcy Act of 1898 and a few weeks later the Bankruptcy Act of 1978 (the " '78 Act") was passed. The debtor apparently wanted to take advantages of the new act. The language of the '78 Act, however, made it clear that it did not apply to pending cases. Thus, the debtor voluntarily dismissed his action and brought a "new" one. Nonetheless, the Supreme Court found that because the debtor's case was already pending and because the new act applied only to actions commenced after the date of enactment, he could not simply refile it in order to benefit from the changes in the act. *Id.* at 359-60 ("the dismissal was entered solely to permit [the debtor] to file under the New Code, that is, to permit it to avoid the prohibition of § 403(a) [which essentially stated that the New Code did not apply to pending cases]").

D. Has the Statute Adopted a New Standard for Inquiry Notice? One potentially problematic feature of the new statute of limitations provision lies in its choice of language to describe the "inquiry notice" branch of the limitations rule. As noted above, the statute of limitations is five years after the violation or "two years after discovery of the facts constituting the violation." Query whether this language will make it harder for defendants to argue (especially at the pleading stage) that plaintiffs were on inquiry notice.

The law on this subject is in disarray. Thus, in the Second Circuit, "inquiry notice" is triggered upon "*constructive notice* of facts sufficient to create a duty to *inquire further* into the matter." *Dodds* v. *Cigna Securities, Inc.*, 12 F.3d 346, 350-52 (2d Cir. 1993) ("investor does not have to have notice of the entire fraud being perpetrated to be on inquiry notice"). By contrast, in the Seventh Circuit, "inquiry notice" is not triggered until plaintiffs are able, " 'with the exercise of reasonable diligence (whether or not actually exercised), to ascertain the information *needed to file suit*.' " *See, e.g., Abrams* v. *Van Kampen Funds, Inc.*, 2002 WL 1160171 * 9 (N.D. Ill. 2002). *See also Rothman* v. *Gregor*, 220 F.3d 81, 96-97 (2d Cir. 2000) (declining to adopt Seventh Circuit's standard).

In many cases, plaintiffs will plainly have seen "storm warnings" sufficient to cause a reasonable person to consult counsel and take steps to determine whether to pursue a claim. The majority of courts hold that this is enough to start the statute of limitations running and have rejected the argument that plaintiffs must be on notice of all the facts necessary to plead a cause of action. Arguably—and perhaps inadvertently—Congress has changed the rule established by the predominant case law on this subject.

II. Disclosure on a "Rapid and Current Basis"

Section 409 of the Act amends Section 13 of the Securities Exchange Act to require that each issuer reporting under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 disclose to the public on a "rapid and current basis" any additional information concerning material changes in its financial condition or operations, which may include trend and qualitative information, as the SEC determines is necessary and in the public interest. This requirement, which has received little attention from commentators, significantly changes the existing disclosure regime and is likely to give rise to a new genre of securities fraud claim.

Section 409 reads as follows:

> (1) REAL TIME ISSUER DISCLOSURES.— Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, rule, is necessary or useful for the protection of investors and in the public interest.

Although from time to time there has been debate about the merits and practicability of shifting to a "continuous disclosure" regime, with certain specific exceptions that is not the law today. Section 409 promises to modify that regime significantly—with the predictable corollary that there will be litigation over whether newly mandated disclosures were sufficiently "rapid and current."

Issuers ordinarily do not have to disclose operating results as a quarter progresses—for example, declining sales or reverse trends, changes in product mix or margins, delays in new product introductions, etc.—unless it is necessary to correct a prior statement inaccurate at the time it was made. Financial information is normally disclosed quarterly—as is a company's views of known trends and uncertainties—in the MD&A section of its Forms 10-K and 10-Q. No rule requires the routine reporting of mere changes, or anticipated changes, in operating results during a quarter. A number of cases have said that there is no duty to make intraquarter disclosures, even if results are below a company's own, and the market's, expectations.[13]

Strong policy reasons support this rule. It takes time for a company to generate accurate and reliable information regarding current performance, to analyze the information meaningfully. Requiring disclosure of such information is therefore tantamount to requiring disclosure of internal projections that will constantly change as the quarter progresses. That information is inherently transitory and fragmentary, even if it is in some

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[12] *Accord, e.g., Walton* v. *Eaton Corp.*, 563 F.2d 66 (3d Cir. 1977) (filing of a second complaint would not be allowed to result in a greater right to trial by jury, where plaintiff filed the second complaint to evade waiver of jury trial in her first complaint); *Oliney* v. *Gardner*, 771 F.2d 856 (5th Cir. 1985) (dismissing second suit in which plaintiff sought nothing more than to amend allegations in the initial action relating to diversity jurisdiction); *Serlin* v. *Arthur Andersen & Co.*, 3 F.3d 221, 223-224 (7th Cir. 1993) (finding no abuse of discretion in dismissing a second complaint despite the possibility that the first would be dismissed for untimely service.)

[13] *See, e.g.*, Steckman v. Hart Brewing, Inc., No. CIV. 96-1077-K.1996 WL 881659, at *4 (S.D. Cal. Dec. 24, 1996) ("companies have no duty to disclose intraquarter results, even if those results are lower than the company's internal projections"), *aff'd on other grounds*, 143 F.3d 1293 (9th Cir. 1998).

metaphysical sense "current" or "known." As one district court has held, "regardless of whether a public offering occurs seventeen or only two days before the close of a fiscal quarter, data concerning a quarter that is in progress is necessarily incomplete.[14]

The language of Section 409 indicates that there must be SEC rule-making on this subject, but (unlike other sections of the statutes) it does not contain a specific deadline for such rule-making. It is possible, however, that the SEC rules may resemble the SEC's recent proposal regarding Form 8-K disclosure. In June 2002, the SEC proposed rules relating to disclosure of Current Reports on Form 8-K that would add new items and events to be disclosed in Form 8-K reports, and require that Form 8-K reports be filed within two business days instead of the current five to 15 days. The proposed rules were subject to a 60-day comment period. The proposed rules have not yet been adopted.

It is reasonable to assume that the rules ultimately promulgated under Section 409 will cover some of the same subjects that were to be the mandatory subject of 8-K filings. The list is worth contemplating. It includes:

- entry into, or material amendment of, a material agreement not made in the ordinary course of business;
- termination of a material agreement not made in the ordinary course of business;
- termination or reduction of a business relationship with a customer that constitutes more than 10% or more of the company's consolidated revenues;
- creation of a direct or contingent financial obligation that is material;
- events of default or acceleration triggering a direct or contingent financial obligation that is material, including any default or acceleration of an obligation;
- exit activities including any material write-off or restructuring charge;
- any material impairment to one or more assets, including an impairment of securities or goodwill, under GAAP;
- a change in a rating agency decision, issuance of a credit watch or change in a company outlook; and
- notice to the company from its current or previously engaged independent accountant that the independent accountant is withdrawing a previously issued audit report or that the company may not rely on a previously issued audit report.

Many of the items on this list are likely to be unproblematic—that is, unlikely to give rise to a claim that the issuer failed to disclose it promptly enough—because they are objective, one shot events that require little in the way of judgment to decide whether a disclosure obligation has been triggered. Thus, termination of a material agreement or a change in a rating agency decision should be relatively simple to disclose promptly.

But it is likely, given Section 409's explicit mention of "trend and qualitative information," that the rules will encompass more subjective material developments. And that means that this provision will be a subject of substantial litigation. The reports are filled with cases in which plaintiffs assert that a trend, ultimately revealed in disappointing quarterly earnings, was known to the issuer much earlier in time. One time-honored defense to such a claim, normally asserted at the pleading stage, is that there is no duty to disclose such information. Section 409 calls the viability of that defense into serious doubt.

A substantial body of case law from recent years deals with the question of when an issuer has a duty to update prior forward-looking statements. Generally speaking, the judicial consensus had been that the duty to update does not arise whenever a company makes a forward-looking statement or projection that was reasonable at the time but which, because of *subsequent* events, has become untrue. In contrast, however, if a company makes a statement that is revealed by subsequently discovered information to have been inaccurate or unfounded at the time it was made, the company must correct the prior statement within a reasonable period of time. In an often-cited (because clearly reasoned) opinion, the Seventh Circuit held in *Stransky* v. *Cummins Engine Co.* that liability cannot be based on circumstances that arise after the speaker makes the statement, because the securities laws "typically do not act as a Monday Morning Quarterback."

To be sure, the law on the scope of any duty to update is less than crystal clear. A main culprit is a decision by the United States Court of Appeals for the Third Circuit in *Weiner* v. *Quaker Oats Co.*,[15] arising out of Quaker Oats' acquisition of Snapple. The acquisition made Quaker a much more highly leveraged company, raising its total leverage ratio to about eighty percent. Plaintiffs alleged that the company had violated a duty to update its prior disclosures, in which Quaker had advised the market that it had adopted a much lower debt-to-equity "guideline." The complaint depended on the assertion that the projected debt-to-equity ratio—and the failure to correct the guideline when it became inaccurate—had artificially inflated the price of the company's common stock.

The Third Circuit held that it was a question of fact as to whether the market would have expected the company to make another prediction about its leverage guideline if its leverage ratio were going to change significantly by virtue of the anticipated acquisition. The Third Circuit relied heavily on its own earlier decision in *In Re Phillips Petroleum Securities Litigation*,[16] in which the court recognized that the anti-fraud provisions of the securities laws do not impose a general duty to update or correct prior statements that were accurate when made, but that "a duty exists to correct prior statements, if the prior statements were true when made but misleading if left unrevised.[17] Since the *Phillips* case involved a fairly unequivocal statement of intent, rather than a more amorphous projection or guideline, many practitioners had read the *Phillips* case rela-

[14] *Zucker* v. *Quasha*, 891 F. Supp. 1010, 1016 (D.N.J. 1995), *aff'd*, 82 F.2d 408 (3d Cir. 1996) *cert. denied*, 117 S. Ct. 85 (1996); *accord Schoenhaut* v. *America Sensors, Inc.*, No. 95 CIV 1464 (BSJ), 1997 WL 731804 (S.D.N.Y. Nov. 14, 1997). There is one context, however, in which the case law suggests that a company might sometimes be required to make additional intraquarterly disclosures—where the company is effecting a public offering and there is a trend that, if continued through the end of the quarter, is likely to result in an "extreme departure" from the range of results expected by the marketplace based on publicly available information. The precise scope of this duty is not clearly defined. *Compare Shaw* v. *Digital Equipment Corp.*, 82 F.3d 1194, 1211 (1st Cir. 1996) *with Glassman* v. *Computervision Corp.*, 90 F.3d 617 (1st Cir. 1996).

[15] 129 F.3d 310 (3d Cir. 1997).

[16] 881 F.2d 1236 (3d Cir. 1989).

[17] *Id.* at 1245.

tively narrowly and as largely consistent with the general concept that there is no duty to update projections. The *Quaker Oats* decision casts substantial doubt on whether, at least in the Third Circuit, even accurate predictions must be updated if the underlying circumstances change.

The PSLRA was of no help to one in search of illumination on this subject. It appears to have neither expanded nor contracted the prior law. There is a section of the statute called "Duty to Update," which reads in its entirety as follows: "Nothing in this section shall impose upon any person a duty to update a forward-looking statement."[18] The PSLRA Conference Report does not add anything to this statement. Although some have suggested that the intent of the provision is to *eliminate* any duty to update, the more plausible reading is that the Act does not impose any obligation to update that does not already exist.

In the absence of a specific SEC rule proposal in this area, of course, it is hard to predict whether Section 409 creates a significant risk of liability exposure. All one can say with certainty is that requiring "rapid and current" disclosure of trends and other "soft" information will give rise to suits that can only rarely be filed under the current state of the law.

III. Advancement of Litigation Expenses

Section 402 of the Act provides that it shall be unlawful for any issuer, "directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer." The goal of this provision appears to be to prohibit personal loans to directors and executive officers on nonmarket terms, in order to curb perceived abuses of power by executives of public companies that have now suffered catastrophic declines in value. But concerns have been widely expressed that the application of this broadly framed provision may result in a number of unanticipated consequences.

From a litigation perspective, for example, does the statute now prohibit the advancement of litigation expenses to officers and directors for indemnification purposes? Most state corporation laws specifically empower companies to advance the costs and expenses of litigation (including attorney's fees) to its officers and directors, subject to a repayment obligation if certain conditions are met.[19] As a result, almost all public companies have indemnification arrangements that typically provide for the advancement of litigation expenses (including attorneys' fees) to officers and directors.

[18] 15 U.S.C. § 77z-2(d) (Supp. II 1996); *id.* § 78u-5(d).

[19] The advancement of litigation expenses upon the receipt of an undertaking to repay the amounts advanced in certain circumstances is authorized by the corporation laws of (by way of example) California, Delaware, Florida, Illinois, Massachusetts, New Jersey, New York, Ohio and Pennsylvania. Many other states provide for a similar, if not the same, mechanism.

The advancement of litigation expenses is also authorized by the Model Business Corporation Act, which requires that the party requesting the advance also deliver to the company a written affirmation of his or her good faith belief that the proceeding involves conduct for which liability has been eliminated under the company's articles of incorporation.

The advancement of litigation expense provision in the Delaware indemnification statute is illustrative. It provides that:

> Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director of officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section.[20]

Practitioners are concerned that such an advancement of litigation expenses literally falls within the prohibition on extending credit in the form of a personal loan set forth in Section 402. Those who have raised this concern also point out that Section 402 enumerates certain transactions that are exempt from this prohibition—such as loans by financial institutions to their employees—and that indemnification expense advances are *not* included in the list of exempt transactions.

However, we believe that the better view is that Section 402 does *not* prohibit companies from continuing to advance litigation expenses as permitted by state corporation laws. There are three principal arguments in support of this position.

First, the advance is not really a "loan" at all. At the time the advance is made, the corporation is spending funds to advance a corporate purpose—the defense of its own officers and directors in litigation arising out of their conduct as such. Unless the conduct of the officer or director is ultimately determined to require repayment as a matter of public policy—usually because he has been adjudicated to have acted in bad faith or in a manner that was contrary to the company's interest—the "advance" is never repaid; it is conclusively established that it was indeed an appropriate corporate expenditure.

Second, the advance is not a "personal" loan in any meaningful sense. The advance is being made to an officer or a director solely in his or her capacity as an officer or director for a business purpose and not for his personal financial benefit. The advancement of litigation expenses is not a commercial arrangement whereby an officer or director receives money as part of his compensation; the funds that are advanced are used to pay attorneys, experts and the like.

Third, there is a strong, longstanding policy sanctioned by state statute and public policy in favor of indemnification of officers and directors, including a policy favoring corporate power to advance litigation expenses. The state legislatures have generally made the public policy decision that a prohibition on advancing litigation expenses would likely decrease the willingness of qualified people to serve as officers and directors.

There is *zero evidence* that Congress intended to override these state laws or to second-guess this traditional state law corporate governance policy. This conclusion is strongly supported by the legislative history of Section 402, which indicates that Section 402 was enacted in response to particular abuses, such as loans be-

[20] Delaware General Corporation Law § 145(e).

ing made for compensatory purposes.[21] The legislative history makes no mention of any concern about indemnification advances.

The comments made by Senator Schumer in support of his amendment to Section 402 are typical. Senator Schumer made the amendment in response to the President's statement, ''I challenge compensation committees to put an end to all company loans to corporate officers.'' Senator Schumer expressed his concern that ''we didn't learn our lessons during the S&L crisis in the 1980's . . . where transactions were used then to 'cook the books' and our Nation's economy and financial institutions paid the price for it.''[22] He gave examples of two companies that extended significant loans to executives while the companies were facing financial difficulty and asked why rich corporate executives could not go to their local banks for loans like everyone else.[23]

Similarly, at the same hearings, Sarah Teslik, the Executive Director of the Council of Institutional Investors, testified that when chief executive officers get loans, not from banks but from their companies, ''you have to ask yourself what's going on.''[24] She hypothesized that loans are used to cover CEOs' ''dumping stock before a company crashes'' at a time when disclosure of the transaction can be delayed for up to a year.

Finally, reading Section 402 to prohibit the advancement of litigation expenses would mean that Congress had silently preempted an area traditionally reserved to the states: to define the scope and limits of the power of corporations to regulate their internal affairs. The Supreme Court has stated that,

> ''Because the states are dependent sovereigns in our federal system, we have long presumed that Congress does not cavalierly preempt the state law causes of action. In all preemption cases . . . we start with the assumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.''[25]

This strong presumption against preemption must be considered in analyzing Section 402. In light of the presumption against preemption, Congress would surely have explicitly addressed the issue of indemnification advances if it wanted to preempt state indemnification laws. The failure to do so provides strong support that Section 402 was not intended to and should not prohibit indemnification advances currently allowed under state law.

IV. Section 301: Audit Committees

Section 301 of the Sarbanes-Oxley Act expands the role of the audit committee in corporate governance. The SEC is mandated to direct the New York Stock Exchange (NYSE), the Nasdaq Stock Market, and other exchanges and national securities associations to require, through listing standards, that the audit committee of each listed company fulfill certain obligations. These include the duty to:

- appoint, compensate, and oversee the work of any registered public accounting firm employed by that issuer for the purpose of preparing or issuing an audit or related work, which such registered public accounting firm shall report directly to the audit committee;
- be responsible for ''resolution of disagreements between management and the auditor regarding financial reporting'';
- have in place procedures for receiving, retaining, and addressing complaints concerning accounting, internal accounting controls, or auditing matters and procedures for employee whistleblowers to anonymously submit their concerns regarding accounting or auditing issues;
- have authority and appropriate funding to engage independent counsel and other outside advisors, as it determines necessary to carry out its duties; and
- determine the appropriate compensation for auditors and any advisors employed by the audit committee.

Does the assumption of these new statutory duties—largely mirrored in the listing standards that the NYSE and NASDAQ have now proposed—meaningfully change the litigation risks to audit committee members? In particular, will membership on an audit committee now give rise to greater risk of controlling-person liability under § 15 of the Securities Act or § 20 of the Exchange Act? We think not.

Mere membership on an audit committee has long been found to be *insufficient* to create control-person liability. *In re Livent, Inc. Sec. Litig*., 78 F. Supp. 2d 194, 221 (S.D.N.Y. 1999) (''Officer or director status alone does not constitute control'' for purposes of §§ 15 or 20(a); neither ''does membership on a corporation's audit committee''). However, an audit committee member's power to approve financial statements has been held to create an inference of control.[26]

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[21] The limited discussion on the prohibition on loans includes comments by Representative Mink (''the bill prohibits a corporation from providing ''sweetheart'' loans—that is, direct or indirect personal loans— to or for any director of executive officer'') (148 Cong. Rec. at H 5474; Vol. 148, No. 103), Representative Udall (''It also generally bars corporations from providing loans to any of its executive officers'') (148 Cong. Rec. at E 1462; Vol. 148, No. 105) and Representative Bentsen (''[the law provides] bans on egregious practices and corporate loans'') (148 Cong. Rec. at H 5467; Vol. 148, No. 103).

[22] 148 Cong. Rec. at S 6690 (Vol. 148, No. 94).

[23] The Senator further observed: ''Executives of major corporations, including Enron, WorldCom, and Adelphia, collectively received more than $5 billion in company funds in the form of personal loans. For example, Bernard Ebbers, CEO of WorldCom, borrowed a mind-boggling $408 million from the corporation over several years, while receiving a compensation package valued at over $10 million annually, all the while the company was facing massive losses. In the case of Adelphia, the Rigas Family received loans and other financial benefits totaling a staggering $3.1 billion, while the company has also reported huge financial losses.

The question is: Why can't these super rich corporate executives go to the corner bank, the Suntrust's or Bank of America's, like everyone else to take loans?

In the case of WorldCom, Ebbers had funded his personal stock market activities by borrowing on margin. When the value of those investments plunged, Ebbers had to pay up. How did he do it? He borrowed money from his board of directors to pay for the stock he had bought that was now being called in.

This is just wrong, and it must be stopped.''

[24] Federal News Service, March 20, 2002.

[25] *Medtronic Inc*. v. *Lohr*, 518 U.S. 470, 485 (1996) (Justice Stevens opinion), quoting from *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

[26] *See, e.g., Jacobs* v. *Coopers & Lybrand, L.L.P.*, 1999 WL 101772, *18 (S.D.N.Y. 1999) (''It does comport with common sense to presume that a person who signs his name to a report has some measure of control over those who write the re-

In the most recent opinion to deal with this issue, the court held that plaintiffs had sufficiently alleged that audit committee members controlled the company's financial reports because the complaint asserted that, inter alia, the members (a) signed SEC filings; (b) had the ability to retain accounting and legal advisors to investigate improprieties; (c) had the power to discharge senior officers of the company; (d) had access to financial information; (e) met frequently with the auditors; and (f) reviewed drafts of quarterly financials before their release.[27]

If carrying out these quintessential duties of an audit committee are already enough to subject its members to control-person liability under the pre-Sarbanes-Oxley regime, it is difficult to see how Section 301 alters the substantive responsibilities of an audit committee in ways that expand significantly the substantive control-person liability risk of committee members.

This is because most of the tasks for which the audit committee is newly responsible, such as decisions about hiring auditors and setting their compensation, do not give the committee members effective control over the actual content of financial disclosures. Although one could imagine a scenario in which the new audit committee powers could be abused or exercised negligently or imprudently, we think it will be a relatively rare case in which a plaintiff could plausibly allege that statutory delegation of these functions to an audit committee gave its members the sort of ''control'' of a company's affairs that could trigger liability under Section 15 of the Securities Acts or Section 20 of the Exchange Act.

However, if the conduct or transaction under attack is one that was the subject of a disagreement between management and the auditor regarding financial reporting—an enumerated area of audit committee responsibility—the committee member could be vulnerable to a control person claim because he possessed the power to control the specific activity upon which the primary violation is predicated.[28]

Similarly, in cases in which the underlying conduct at issue involves flaws in the issuer's accounting procedures, audit committee members do have additional control-person liability risks, not so much because of Section 301, but because, as discussed above, CEOs and CFOs have a statutory obligation to communicate with the audit committee concerning potential deficiencies in internal controls. The enhanced role of the audit committee may well lead to additional control person claims because, again, audit committee members possess the power to control the specific activity upon which the primary violation is predicated. In those circuits in which culpable participation is a separate element of a control-person claim—which the plaintiff must plead with particularity—a single allegation that the audit committee member failed in his obligation to fulfill his statutory responsibility should be insufficient to state a claim.[29]

V. Prohibition on Destroying Documents

In light of the massive document destruction by Arthur Andersen in the wake of Enron's collapse, Congress determined to send a clear and forceful message concerning the consequences of conduct that obstructs judicial proceedings. That message is conveyed in two different provisions of the Sarbanes-Oxley Act, Sections 802 and 1102.

A. Section 802. Section 802 of the Act creates two new criminal statutes – Sections 1519 and 1520 of the federal Criminal Code. The first prohibits falsification or destruction of documents in governmental or bankruptcy proceedings, and the second requires outside auditors of public companies to retain work papers for five years after the end of an audit.

1. 18 U.S.C. § 1519. Section 1519 provides a 20-year criminal penalty for destruction, alteration or falsification of records in federal investigations and bankruptcies. It reads as follows:

> 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.

A significant issue relating to Section 1519 concerns the ''intent'' the government must prove to establish a violation. It is not entirely clear whether prosecutors will have to establish that a defendant specifically intended to obstruct a federal investigation or bankruptcy to secure a conviction under this new statute, or whether it will be sufficient simply to show that a defendant knew that such obstruction was a foreseeable result of his conduct.

Historically, obstruction of justice statutes required the government to prove that the defendant acted ''corruptly,''[30] and some have suggested that the absence of

port''). But this view is not universal. *See Klein* v. *Goetzmann*, 770 F. Supp. 78, 81 (N.D.N.Y. 1991).

[27] *See In Re Lernout & Houspie Securities Litigation*, 2002 WL 31662595 (D. Mass. Nov. 18, 2002).

[28] *See, e.g., Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir.), *cert. denied*, 474 U.S. 1057 (1986); *Brown v. Enstar Group, Inc.*, 84 F.3d 393, 395 (11th Cir. 1996), *cert. denied*, 117 S.Ct. 950 (1997); *Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873, 881 (7th Cir. 1992), *cert. denied*, 509 U.S. 904 (1993); *Abbot v. Equity Group, Inc.*, 2 F.3d 613, 619-20 (5th Cir. 1993), *cert. denied*, 114 S.Ct. 1219 (1994); *Donohue v. Consolidated Operating and Production Corp.*, 982 F.2d 1130, 1138 (7th Cir. 1992); *Sanders Confectionary Prods., Inc. v. Heller Fin., Inc.*, 973 F.2d 474, 486 (6th Cir. 1992), *cert. denied*, 506 U.S. 1079 (1993) (''Control person liability will attach if such a person possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, even if such power was not exercised'').

[29] *Compare Ganino v. Citizens Utilities Co.*, 228 F.3d 154 (2d Cir. 1996) *with Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990); *see also In re Emex Corp. Sec. Litig.*, 2002 U.S. Dist. LEXIS 17528 (S.D.N.Y. Sept. 17, 2002); David M. Brodsky & Daniel J. Kramer, Federal Securities Litigation: Commentary and Forms 11-5 – 11-7 (1st ed. 1997 & Supp. 2001).

[30] For example, 18 U.S.C. § 1503, which prohibits influencing or injuring a juror or an officer of a United States court, applies to any person who ''corruptly'' ''endeavors to influence, intimidate, or impede'' such persons. Similarly, 18 U.S.C. § 1505, which prohibits obstruction of proceedings before departments or agencies of the United States or committees of either House of Congress, applies to a person who ''corruptly'' ''influences, obstructs, or impedes or endeavors to influence,

that word from new Section 1519, which only requires that the defendant act ''knowingly,'' but not ''corruptly,'' indicates that the government's burden in proving a violation under Section 1519 may be lower than in other, traditional, obstruction statutes. We are not so sure. In fact, there is reason to believe that the scienter requirement under Section 1519 will be more difficult to prove than in other obstruction statutes.

While it is true that as far back as 1893, in *Pettibone v. United States*, the Supreme Court interpreted ''corruptly'' in an obstruction of justice statute to require a level of intent consistent with the mens rea of ''specific intent''—*i.e.,* intent to thwart a specific judicial proceeding —over the years that requirement has been watered down. *See Pettibone v. United States*, 148 U.S. 197, 206-07, 210 (1893) (holding statute required that defendant must ''specifically intend'' to obstruct justice). For example, in 1979, the Fourth Circuit, in *United States v. Neiswender*, found that the ''the defendant's actual design is irrelevant'' and required the government to prove something less than specific intent. *See* 590 F.2d 1269, 1273-74 (4th Cir. 1979). Under the *Neiswender* test, if obstruction is a reasonable foreseeable consequence of defendant's conduct, then the defendant is on notice that his acts could obstruct justice. Once a defendant is deemed to be acting under such notice, a jury may infer the specific intent required for conviction. *Id.* at 1273. Following *Neiswender*, many courts, including circuits ostensibly requiring the government to prove specific intent, have adopted the *Neiswender* ''foreseeability rule'' and have found the intent requirement satisfied if the government shows the defendant knowingly and intentionally undertook an action from which an obstruction of justice was a reasonably foreseeable result. *See United States v. Cueto*, 151 F.3d 620, 630-31 (7th Cir. 1998), *cert. denied*, 526 U.S. 1016 (1999); *United States v. Jespersen*, 65 F.3d 993, 1000-01 (2d Cir. 1995); *United States v. Fleming*, 215 F.3d 930, 938 (9th Cir. 2000); *United States v. Schwartz*, 1999 WL 6365, at *5 (S.D.N.Y. Jan. 7, 1999). Thus, the term ''corruptly'' does not necessarily signal a higher scienter standard than statutes that only use the word ''knowing.''

This, however, is not the end of the analysis with respect to Section 1519, because, even though 1519 does not include the word ''corruptly,'' it does require that defendant act ''with the intent to impede, obstruct, or influence'' any government matter or investigation. To prove this level of intent, it appears that the government will be required to demonstrate more than that the defendant was aware that the probable consequences of his actions would be to ''impede, obstruct, or influence'' any government matter or investigation, and that prosecutors will have to establish that the defendant had the specific intent to thwart such matters or investigations.

In addition, it is not clear what part of the statute the ''intent to . . . influence'' clause modifies. If that clause only modifies the language that it immediately precedes, then the government is required to establish an ''intent to impede, obstruct, or influence'' only with respect to a pending matter or case. But, if the ''intent to . . . influence'' clause also modifies the statute's final clause—''in relation to or contemplation of any such matter or case''— then the government would also be required to prove defendant's ''specific intent'' in prosecutions brought with respect to matters that are contemplated, but not instituted, at the time of the document destruction. Given the structure of Section 1519, we believe that the latter view is the better reading of the statute.

Finally, the ''in . . . contemplation'' clause does not contain a temporal limit. Thus, it appears that the statute could apply to an individual who altered a document many years before any proceedings began.

2. 18 U.S.C. § 1520. Section 802 also creates 18 U.S.C. § 1520, a provision that mandates document retention by accountants who audit public companies. The first part of Section 1520 requires auditors to retain their work papers for five years after the end of the fiscal period in which the audit or review was concluded. *See* 18 U.S.C. § 1520(a)(1). This measure codifies the general practice that currently exists at many accounting firms.

The five-year retention requirement, however, is inconsistent with another section of the Sarbanes-Oxley Act, Section 103(a)(2)(A)(i). That provision instructs the newly formed Public Company Accounting Oversight Board to issue rules governing auditor conduct, and it includes a mandate to require auditors to retain ''audit work papers, and other information related to any audit report'' for seven years.

The second part of Section 1520 directs the SEC to issue new regulations that may require auditors to retain documents that lie outside the traditional understanding of work papers.[31] A Senate Committee Report addressing this part of the provision explains that ''additional records, which contain conclusions, opinions, analysis, and financial data relevant to an audit or review'' must be retained, irrespective of whether these materials support the final conclusions of the auditor. *See* Senate Report 107-146 (2002). If such an expansive rule is promulgated, accounting firms will be forced to make significant changes to their record keeping policies.

B. Section 1102. Section 1102 does not create a new criminal statute, but it does broaden the scope of one of the most important existing obstruction-of-justice statutes, 18 U.S.C. § 1512, which provides comprehensive federal protection to witnesses, victims and informants. Section 1512 accomplishes this in two ways. First, 1512 protects any ''person''—a term courts have construed broadly to include potential witnesses,[32] grand jury witnesses,[33] excused witnesses,[34] and state investigators.[35] Second, as a result of amendment and interpretation,

obstruct, or impede'' such departments, agencies or committees. However, not all obstruction of justice statutes require the government to prove a ''corrupt'' intent. For example, 18 U.S.C. § 1512(b), which provides comprehensive protection to victims, witnesses, and informants, applies to persons who ''knowingly'' intimidate, threaten or deceive another ''with intent to . . . influence, delay, or prevent the testimony of any person . . . .''

[31] *See* Statement on Audit Standards No. 41, *Working Papers; see also*, D. Edward Martin, Attorney's Handbook of Accounting, Auditing and Financial Reporting § 12.03, at 12-48 (4th ed. 1992 & Supp. 2001).

[32] *See United States v. Diaz*, 176 F.3d 52, 62 (2d Cir. 1999).

[33] *See United States v. Schmidt*, 935 F.2d 1440, 1452 (4th Cir. 1991).

[34] *See United States v. Wilson*, 796 F.2d 55, 57 (4th Cir. 1986).

[35] *See United States v. Veal*, 153 F.3d 1233, 1246 (11 Cir. 1998).

   ISSN 0037-0665

Section 1512 applies to both coercive and non-coercive witness tampering.[36]

Section 1102 amends Section 1512 to create primary liability for anyone who ''corruptly'' alters or destroys a document ''with the intent to impair the object's integrity or availability for use in an official proceeding.'' Section 1102 expands the reach of Section 1512, by permitting the government to prosecute an individual who acts alone in destroying evidence. While other obstruction of justice statutes cover such acts, those statutes had been interpreted as applying only where a proceeding is pending, and a subpoena had issued for the evidence, whereas Section 1512 does not have those requirements. [37]

Finally, Congress directed the Sentencing Commission to review and possibly amend the Sentencing Guidelines to ensure that the base offense level and accompanying adjustments for obstruction of justice are severe enough to deter and punish such behavior. To make its intentions clear, Congress included this mandate in two different sections of the Act, Sections 805 and 1104. In January 2003, the Sentencing Commission promulgated emergency amendments to the Sentencing Guidelines. Traditionally, obstruction of justice had a base offense level of 12 which yields a sentence of at least 10-16 months. See 18 U.S.C.S. Appx § 2J1.2(a). There are also specific offense characteristics that can increase the offense level by as many as 8 levels. Id. at § 2J1.2(b). The amendment increases the base offense level from level 12 to level 14. It also adds a new two level enhancement that applies if the offense (1) involved the destruction, alteration, or fabrication of a substantial number of records, documents, or tangible objects; (2) involved the selection of any essential or especially probative record, document, or tangible object to destroy or alter; or (3) was otherwise extensive in scope, planning or preparation. As a result, a defendant who interferes with the administration of justice by shredding a substantial number of documents or especially probative documents will receive a guideline sentencing range of approximately three years' imprisonment (30-37 months).

VI. Private Rights of Action

The Sarbanes-Oxley Act contains several provisions that are to be enforced by the SEC, and creates new criminal statutes that will be prosecuted by the Department of Justice, but it only expressly provides two provisions that may be enforced by private parties in civil litigation. Section 806, which provides whistleblower protection to employees of public companies, states that employees who believe they have been discriminated against in any manner for whistleblowing may initiate an action, and sets out the procedure that a claimant must follow to institute an action, the burden of proof, the statue of limitations, and the permissible damages. Similarly, Section 306, which prohibits insider trading during a blackout period, provides that profits may be recovered by the issuer. If the issuer fails or refuses to bring an action to recover profits, ''the owner of any security of the issuer'' may bring such an action on behalf of the issuer in any court of competent jurisdiction. *See* 15 U.S.C. 7244(a)(2)(B).

Two other sections of the Act contain language that specifically precludes private rights of action. Section 303, which prohibits any agent of an issuer from improperly influencing any auditor of the issuer, grants the SEC exclusive enforcement authority. Similarly, Section 804, which extends the statute of limitations for a securities fraud action under the 1934 Securities Act, states that ''nothing in this section shall create a new, private right of action.'' Evidently, Congress wanted to make it clear that no new securities fraud actions should follow from the enlargement of the limitations period. Finally, one provision, Section 409, which relates to real time issuer disclosure by companies with material developments, initially provided that only the SEC could enforce the provision in a civil action. The Conference Committee chose not to include this provision, but it also did not provide for an express private right of action.

Thus, two sections of the Sarbanes-Oxley Act provide expressly for a private right of action and two sections of the Act clearly prohibit the implication of a private right of action. The question that remains is whether, with respect to any of the other provisions of the Act that are silent on the issue, including the section that dropped a provision that would have permitted only SEC enforcement, a court should imply a private right of action. We believe that the answer is no, based upon the Supreme Court's 1994 decision in *Central Bank*, where the court refused to imply a private right of action for aiding and abetting securities fraud under Section 10(b) of the Securities Exchange Act of 1934. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

In *Central Bank*, the Supreme Court's analysis focused almost exclusively on the text of the statute. After reaching the ''uncontroversial conclusion'' that the statue did not expressly create liability for aiding and abetting a Section 10(b) violation, the Court was unwilling to imply a cause of action for aiding and abetting under the statute. The Court refused to be swayed by legislative history of the Securities Exchange Act or policy arguments, noting that ''policy considerations cannot override our interpretation of the text and structure of the Act.'' *Id.* at 188. Similarly, with respect to the Sarbanes-Oxley Act, courts should not imply private rights of action where they have not explicitly been granted by the Act.

[36] Prior to 1988, non-coercive witness tampering was not prohibited by Section 1512 or any other obstruction of justice statute. In 1988, Congress added the term ''corruptly persuades'' to Section 1512(b), expanding the scope of Section 1512 to cover non-coercive as well as coercive forms of witness tampering. 18 U.S.C. 1512 (2000).

[37] The amended statute retains the traditional mens rea standard of ''corrupt'' behavior and applies only to ''official proceeding[s]'' —defined as judicial, congressional or federal agency proceedings, or a proceeding involving the business of insurance affecting interstate commerce. *See* 18 U.S.C. § 1515(a)(1).